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ABSOLUTE RETURNS CORRUPT ABSOLUTELY: THE PUERTO RICAN DEBT CRISIS AND THE NEED FOR A FIDUCIARY STANDARD

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I. INTRODUCTION

As a young man, Juan Burgos Rosado moved from Puerto Rico to the Hispanic area of the Bronx. He returned to his homeland fifteen years later with a new understanding of hard work. He had spent years furnishing bodegas as well as repairing and selling used motor vehicles.¹ Upon his return to the island, he renovated real estate properties for rent or resale without having banks finance his business operations.² He successfully ran his business until November 2011, when he took a dangerous fall from a tall ladder.³ Upon the advice of a Union Bank of Switzerland (“UBS”) registered representative, Juan purchased \$1,125,000 in proprietary UBS closed-end funds from December 2011 through January 2013.⁴

At the time of his purchases, Juan did not know that UBS was the sole liquidity provider, market maker, and asset manager of those closed-end funds. In addition, Juan did not know that UBS had earned revenue on these purchases from spreads, commissions, and underwriting fees.⁵ Juan did not know that his life’s earnings were over-concentrated with unsuitable investments.⁶ By March 2015, Juan’s investments had lost \$737,000 in value.⁷ Unfortunately, Juan’s losses were neither unavoidable nor noteworthy. In July 2014, UBS reported that customer complaints and arbitration claims totaled over \$600 million in damages for clients in Puerto Rico who owned closed-end funds.⁸

1. Rosado v. UBS Financial Services, No. 14-00170, 6 (FINRA May 18, 2015), (Putnam, Arb.), http://www.finra.org/sites/default/files/aao_documents/14-00170-Award-All%20Public%20Panel-20150519.pdf.

2. *Id.*

3. *Id.* at 3-4.

4. *Id.* at 5.

5. *Id.*

6. *Id.*

7. *Id.* at 4.

8. Kyle Glazier, *UBS Discloses More Than \$600 Million of Claims Filed By PR Investors*, BOND BUYER (July 29, 2014), <http://www.bondbuyer.com/news/washington-enforcement/ubs-discloses-more-than-600-million-of-claims-filed-by-pr-investors-1064775-1.html>.

In conducting a review of the Great Recession of 2008, federal agencies noted that registered representatives had been acting as financial advisers for some time;⁹ however, financial institutions were not acting in their clients' best interests, nor were they required to. By 2013, that inaction led to a business model that created a conflict of interest for the country of Puerto Rico. If Congress had adopted a "uniform fiduciary standard" as recommended by multiple federal agencies, then this conflicting business model would not have been possible. Furthermore, if Congress continues to fail to take action, more American retail investors will suffer the same inevitable fate. The issues that arose in Puerto Rico provide an example of what will happen to other retail investors if financial companies are allowed to continue to advise and counsel their clients without regard to their fiduciary responsibilities.

This paper will address the need to establish a uniform fiduciary standard in the context of the statutory landscape behind the fiduciary standard, address UBS and its various roles as a financial institution in Puerto Rico, give a brief overview of the Puerto Rican economy, and show how the failure to implement a fiduciary standard left retail investors in Puerto Rico vulnerable to UBS.

II. THE FIDUCIARY STANDARD VS. THE SUITABILITY STANDARD

"Broker-dealers . . . under the Securities Exchange Act of 1934 ("1934 Act") are not required to provide services to their clients under the fiduciary standard of care."¹⁰ Instead, broker-dealers and registered representatives provide services under the "suitability standard of care," "which generally requires only the broker-dealers' reasonable belief that any recommendation is suitable for the client."¹¹ A financial recommendation that is "suitable" for a client may or may not be a financial recommendation that is in the client's best interest.¹²

Registered Investment Advisors are financial planners who must act as fiduciaries, as required by the Investment Advisers Act of 1940 ("1940 Act").¹³ A fiduciary "acts in utmost good faith, in a manner he or she reasonably believes to be in the best interest of the client."¹⁴ The distinc-

9. U.S. SEC. & EXCH. COMM'N, STUDY ON INVESTMENT ADVISERS AND BROKER-DEALERS: AS REQUIRED BY SECTION 913 OF THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT 94-95 (2011) [hereinafter SEC Study], available at <http://sec.gov/news/studies/2011/913studyfinal.pdf>.

10. *Fiduciary Standard of Care*, FIN. PLANNING COAL., <http://financialplanningcoalition.com/issues/fiduciary-standard-of-care/> (last visited Sept. 7, 2016); Securities Exchange Act of 1934 § 15(a)-(b), 15 U.S.C. §§ 78a-78pp (2012).

11. *Fiduciary Standard of Care*, FIN. PLANNING COAL., <http://financialplanningcoalition.com/issues/fiduciary-standard-of-care/> (last visited Sept. 7, 2016).

12. *Id.*

13. Investment Advisers Act of 1940, 15 U.S.C. § 80b (2000).

14. *Terminology*, CERTIFIED PLANNING BD., <http://www.cfp.net/for-cfp-professionals/professional-standards-enforcement/standards-of-professional-conduct/terminology> (last visited Sept. 7, 2016).

tion between the 1934 and 1940 statutes is based on the role of the registered representative. The 1934 Act provided for registered representatives to essentially take instructions from clients and then simply abide by that order.¹⁵ The 1940 Act was designed to alert consumers about the possible conflicts of interest that arise when purchasing mutual funds (then an innovative financial product), and provided for financial advisors to act as individuals in the business of giving advice to clients.¹⁶ The 1940 Act “thus reflects a congressional recognition ‘of the delicate fiduciary nature of an investment advisory relationship’ as well as a congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser — consciously or unconsciously — to render advice which was not disinterested.”¹⁷

“Brokers, technically known as registered representatives, buy and sell securities—stocks, bonds, mutual funds and other investment products—for their customers, including individual investors.”¹⁸ Investment advisors are individuals or companies that provide advice about securities tailored to the needs of their clients.¹⁹ Common names for this type of professional include asset managers, investment counselors, investment managers, portfolio managers and wealth managers.²⁰

To put this into context—for example, a supermarket—the standards are different because a broker only provides the client with access to the supermarket in general, whereas the advisor guides the client through each aisle of the supermarket to make a selection. But as thousands²¹ experienced in Puerto Rico, “the distinctions between investment advisers and broker-dealers have become blurred, and participants had difficulty determining whether a financial professional was an investment adviser or a broker-dealer and instead believed that investment advisers and broker-dealers offered the same services and were subject to the same duties.”²² Essentially, a broker has a fiduciary duty to his client unless “he does nothing more than act as a conduit for the customer’s

15. *Id.*

16. *Id.*

17. *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 191-92 (1963) (citing 2 *Loss, Securities Regulation* (2d ed. 1961), 1412).

18. *See Choosing an Investment Professional*, FINRA, <http://www.finra.org/investors/choosing-investment-professional> (last visited Sept. 7, 2016).

19. *Id.*

20. *Id.*

21. *See* Mason Braswell, *Finra gets arbitration process back on track in Puerto Rico*, INVESTMENTNEWS (Apr. 14, 2014, 2:07 PM), <http://www.investmentnews.com/article/20140414/FREE/140419956/finra-gets-arbitration-process-back-on-track-in-puerto-rico> (After a brief suspension of cases, FINRA, in April 2014, resumed arbitration hearings in Puerto Rico once it found arbitrators from the Southwest United States and Texas to hear the cases); *see also Hearing Location Statistics*, FINRA, <http://www.finra.org/arbitration-and-mediation/dispute-resolution-statistics> (last visited Sept. 7, 2016) (Currently, 700 arbitrators are eligible to hear Puerto Rico cases arising from purchases of closed-end funds and/or revenue bonds sold to Puerto Rico residents. As of 2016, FINRA has 1,009 open cases in Puerto Rico).

22. SEC Study, *supra* note 9, at 99.

orders.”²³

Under the Employee Retirement Income Security Act of 1974 (“ER-ISA”) and the Internal Revenue Code, a person is a fiduciary to the extent that he or she engages in specified activities, including “investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan.”²⁴ But in 1975, the definition of fiduciary was substantially narrowed by the implementation of a five-part test, where each part must be satisfied before a person can be considered a fiduciary.²⁵ As a result of that implementation, many financial advisors have no obligation to abide by the fiduciary standard, regardless of the role they play.²⁶ Effectively, there was “no national standard . . . requiring brokerage firms to put their clients’ interests first by avoiding making profits from conflicted advice.”²⁷

For this reason, the Dep’t of Labor recently adopted a definition of fiduciary advice for individuals providing advice related to retirement and investments plans. Under the new definition, a person who renders investment advice becomes a fiduciary when:

- (1) providing investment or investment management recommendations or appraisals to an employee benefit plan, a plan fiduciary, participant or beneficiary, or an IRA owner or fiduciary, and (2) either (a) acknowledging the fiduciary nature of the advice, or (b) acting pursuant to an agreement, arrangement, or understanding with the advice recipient that the advice is individualized to, or specifically directed to, the recipient for consideration in making investment or management decisions regarding plan assets.²⁸

Acknowledging that certain recommendations should not fall under the new standard, the new definition includes exceptions for, among other things, arms-length transactions where there is generally no expectation of fiduciary investment advice or those who provide investment or retirement education.²⁹ The Dep’t of Labor met heavy resistance prior to its April 2016 announcement regarding the fiduciary standard.³⁰ Still, requiring certain investment professionals to act under a fiduciary rather

23. See *Greenwood v. Dittmer*, 776 F.2d 785 (8th Cir. 1985) (emphasis added) (citing *Guttman v. Paine Webber Jackson & Curtis, Inc.*, Comm. Fut. L. Rep. (CCH), para. 21,434 at 26,077 (CFTC 1982)); see also *Wheeler v. Investment Managers Commodity Corp.*, Comm. Fut. L. Rep. (CCH), para. 20,867 at 23,552 (CFTC 1979).

24. Definition of the Term “Fiduciary”; Conflict of Interest Rule- Retirement Investment Advice, 80 Fed. Reg. 21928 (proposed Apr. 20, 2015) (to be codified at 29 C.F.R. pt. 2509 and 2510) [hereinafter Dep’t of Labor].

25. *Id.*

26. *Id.*

27. Joseph C. Peiffer & Christine Lazaro, *Major Investor Losses Due to Conflicted Advice: Brokerage Industry Advertising Creates the Illusion of a Fiduciary Duty*, 22 PIABA B.J. 1 (2015).

28. Dep’t of Labor, *supra* note 24, at 21929.

29. *Id.*

30. See Press Release, SIFMA, SIFMA Submits Comments on Department of Labor’s Proposed Retirement Regulation (July 20, 2015) (on file with author).

than suitability standard constituted the first real change since the need was identified in 2010.

III. DODD-FRANK ACT OF 2010

Government leaders determined that a principal cause of the 2008 financial crisis was the broken financial regulatory system.³¹ The system was fragmented, antiquated, and allowed large parts of the financial system to operate with little or no oversight, leading to an economic disaster of a scale and severity not seen since the Great Depression.³² Considered “the most far reaching Wall Street reform in history,” the Wall Street Reform and Consumer Protection Act, more commonly referred to as the Dodd-Frank Act, was aimed to prevent the excessive risk-taking that was indicative of the market and led to the financial crisis.³³ When President Obama signed the Dodd-Frank Act, he stated the legislation was “designed to make sure that everybody follows the same set of rules, so that firms compete on price and quality, not on tricks and not on traps.”³⁴ Unfortunately, firms continued to compete on one trick not implemented under the Dodd-Frank Act.

The Dodd-Frank Act sought, among other things, to create a uniform fiduciary standard that would bridge the gap left between the suitability standard for registered representatives and the fiduciary standard required of registered investment advisors.³⁵ “The standard of conduct for all brokers, dealers, and investment advisers, when providing personalized investment advice about securities to retail customers (and such other customers as the Commission may by rule provide), shall be to act in the best interest of the customer without regard to the financial or other interest of the broker, dealer, or investment adviser providing the advice.”³⁶

Section 913 of the Dodd-Frank Act also required the Securities and Exchange Commission (“SEC”) to conduct a study on investment advisers and broker-dealers to evaluate “the effectiveness of existing legal or regulatory standards of care . . . for providing personalized investment advice and recommendations about securities to retail customers” and whether any gaps should be addressed by rule or statute.³⁷ The SEC findings were clear.

31. See *Wall Street Reform: The Dodd-Frank Act, Jobs & The Economy*, WHITEHOUSE.GOV, <https://www.whitehouse.gov/economy/middle-class/dodd-frank-wall-street-reform> (last visited Sept. 7, 2016).

32. *Id.*

33. *Id.*; The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

34. Jesse Lee, *President Obama Signs Wall Street Reform*, WHITEHOUSE.GOV (July 21, 2010, 2:22 PM), <https://www.whitehouse.gov/blog/2010/07/21/president-obama-signs-wall-street-reform-no-easy-task>.

35. SEC Study, *supra* note 9, at vi.

36. Dodd-Frank Wall Street Reform and Consumer Protection Act § 913(g) (2010).

37. See SEC Study, *supra* note 9, at vi.

Despite the extensive regulation of both investment advisers and broker-dealers, retail customers do not understand and are confused by the roles played by investment advisers and broker-dealers, and more importantly, the standards of care applicable to investment advisers and broker-dealers when providing personalized investment advice and recommendations about securities.³⁸

The Dodd-Frank Act, due to its sweeping nature, would protect all retail investors, including the thousands of investors in Puerto Rico. By creating one standard of care—a fiduciary standard—for all registered representatives and all investment advisers, retail investors are better protected from predatory advisors, regardless of the individual client’s financial literacy. Although the Dodd-Frank Act only safeguards those receiving advice about their retirement portfolios and investments, the Dep’t of Labor decision is the much-needed first-step in a long road to enforcing Section 913 recommendations. Until then, retail investors will be vulnerable to their own advisors’ conflicts of interest.

IV. UNION BANK OF SWITZERLAND (“UBS”)

In an advertisement, UBS emphasized, “until my client knows she comes first. Until I understand what drives her. And what slows her down. Until I know what makes her leap out of bed in the morning. And what keeps her awake at night. Until she understands that I’m always thinking about her investment. (Even if she isn’t.) Not at the office. But at the opera. At a barbecue. In a traffic jam. Until her ambitions feel like my ambitions. Until then. We will not rest. UBS.”³⁹

In 2008, UBS served as an adviser to the commonwealth’s Employees Retirement System (“ERS”) when it underwrote a \$2.9 billion bond issue for the pension agency and proceeded to invest half of those bonds into twenty-three closed-end mutual funds⁴⁰ which sold exclusively to customers on the island.⁴¹ “It collected fees at every step.”⁴² As a result of the hundreds of arbitration claims filed because of UBS’ dealings with its cus-

38. *Id.* at 101.

39. *Peiffer, supra* note 27, at 9 (quoting UBS Advertisement).

40. *See id.* (“A closed-end fund raises a prescribed amount of capital only once through an IPO by issuing a fixed number of shares, which are purchased by investors in the closed-end fund as stock. Unlike regular stocks, closed-end fund stock represents an interest in a specialized portfolio of securities that is actively managed by an investment advisor, and typically concentrates on a specific industry, geographic market or sector. The stock price of a closed-end fund fluctuates according to market forces, such as supply and demand, as well as the changing values of the securities in the fund’s holdings.”); *see also Closed-End Fund*, INVESTOPEDIA, <http://www.investopedia.com/terms/c/closed-endinvestment.asp> (“Significantly, unlike open-end funds, most closed-end funds use leverage in an attempt to magnify gains to investors. Using borrowed money to invest as a tool to potentially produce bigger returns greatly amplifies the risk to the investor.”).

41. David Evans, *How UBS Spread the Pain of Puerto Rico’s Debt Crisis to Clients*, BLOOMBERG MARKETS (Sept. 21, 2015, 11:01 PM), <http://www.bloomberg.com/news/articles/2015-09-22/how-ubs-spread-the-pain-of-puerto-rico-s-debt-crisis-to-clients>.

42. *Id.*

tomers, UBS closed three out of the five offices it maintained in Puerto Rico, sixty of its 140 financial advisors departed the firm, and the bank's market share fell from forty-eight percent to thirty-three percent since 2010.⁴³

The scheme brought UBS hundreds of millions of dollars in fees and commissions.⁴⁴ The closed-end funds, which had as much as \$8.9 billion in assets in 2009, were used to heavily invest in the Puerto Rico's municipal bonds.⁴⁵ For example, by mid-2013, ERS bonds represented more than half of the net assets in five of the twenty-three funds.⁴⁶ Those bonds lost more than eighty percent of their value from when they were issued in 2008 through August 2015.⁴⁷ On September 10, 2015, "Standard & Poor's predicted with 'virtual certainty' that the bonds [would] default."⁴⁸

Between 2008 and 2013, UBS acted as the de facto market maker, asset manager and retail broker for a family of twenty-three closed-end funds that predominantly held bonds that served as the lead underwriter.⁴⁹ It set prices while recommending to its retail clients that they should purchase more and more of its inventory.⁵⁰ UBS would not reveal the inherent conflicts of interest in these transactions.⁵¹ Simultaneously, UBS pressured its Puerto Rican registered representatives to sell more and more closed-end funds ("CEF"), even if it meant unauthorized trading.⁵² UBS argues that all of the trades during that time were suitable and made in the best interests of their clients.⁵³

V. BROKER-DEALERS AS UNDERWRITERS, ASSET MANAGERS, MARKET MAKERS, AND RETAIL BROKERS

UBS, like many financial institutions, can act in many capacities. Generally, retail investors are not able to discern, and institutions are resis-

43. *Id.*

44. *Id.*

45. *Id.*

46. *Id.*

47. *Id.*

48. *Id.*

49. *UBS Puerto Rico and Puerto Rico Investors Funds Disclosure Brochure*, UBS (2015) [hereinafter *UBS Puerto Rico*], www.ubs.com/us/en/wealth/misc/puertorico/funds/_jcr_content/par/textimage.112314467.file/dGV4dD0vY29udGVudC9kYW0vdWJzX21hbnVhbF9taWcvV01BL2RvY3VtZW50cy9QdWVydG9fUmljb19GdW5kc19FbmcucGRm/Puerto_Rico_Funds_Eng.pdf.

50. *See* Order Instituting Administrative and Cease-And-Desist Proceedings, Securities Act of 1933 Release No. 9318 (May 1, 2012); *see also* Order Instituting Administrative and Cease-And-Desist Proceedings, Securities Act of 1933, Securities Exchange Act of 1934 Release No. 66893 (May 1, 2012).

51. *Id.*

52. *Id.*

53. According to FINRA BrokerCheck, there are approximately 200 active customer complaints against former UBS registered representatives in Puerto Rico related to the sale of closed-end funds and/or Puerto Rico debt instruments. *BrokerCheck*, FINRA, <http://brokercheck.finra.org> (last visited Sept. 12, 2016).

tant to identify, the many hats a financial institution can wear. In Puerto Rico, UBS or an entity within its control acted as underwriter, asset manager, market maker, and retail broker.⁵⁴ As a result, the potential for conflicts of interest grew exponentially. To understand the increasing risk of such conflicts, this section defines the multiple roles UBS played while claiming to provide suitable advice to its Puerto Rican clients.

An underwriter is a financial intermediary.⁵⁵ By underwriting bonds, an investment banker will assume the risk of buying the newly issued bonds from the government entity until they can resell the bonds to the public.⁵⁶ The investment bank earns a profit, also called an underwriting spread, based on the difference between its purchase price from the government and the selling price to the public.⁵⁷ Alternatively, the financial institution can market a new issue of government bonds rather than acting as underwriter.⁵⁸ In that case, the broker earns a commission on the bonds sold after exercising its option to buy only enough bonds to meet buyer demand.⁵⁹

Asset management companies are also intermediaries, not only to governments, but to households and businesses.⁶⁰ Asset managers serve a separate function from the underwriter as they exist to direct the investment decisions for investors who have chosen to have their assets professionally managed.⁶¹ Specifically, the asset manager's role is to reduce risk.⁶² Asset managers can reduce risk by helping individuals diversify among many more assets than an investor could afford to do given transaction costs.⁶³ They also provide a high-level of liquidity to their clients by investing in assets that would be relatively illiquid for an individual retail investor.⁶⁴ Whereas the underwriter earns income from bringing the sale of the bond, the asset manager earns income from the increase in value of assets as a whole.⁶⁵ Whether or not there is actual incremental value in the services provided by asset managers is still open for debate.⁶⁶

The market maker accepts "the risk of holding a certain number of shares of a particular security in order to facilitate trading in that secur-

54. UBS Puerto Rico, *supra* note 49.

55. See *Underwriting Bond Issues, Course 105: The Process of Issuing Bonds, Investment Classroom*, MORNINGSTAR, <http://news.morningstar.com/classroom2/course.asp?docId=5458&page=3&CN=com> (last visited Sept. 8, 2016).

56. *Id.*

57. *Id.*

58. *Id.*

59. *Id.*

60. Bernard Delbecque, *Key functions of asset management*, VOX (Mar. 3, 2012), <http://www.voxeu.org/article/key-functions-asset-management>.

61. *Id.*

62. *Id.*

63. *Id.*

64. *Id.*

65. *Asset Management Company*, INVESTOPEDIA, http://www.investopedia.com/terms/a/asset_management_company.asp (last visited Sept. 11, 2016).

66. See David Teten, *Asset Management is a Bizarre Industry Ripe for Disruption*, FORBES (Nov. 13, 2013, 12:25 PM), <http://www.forbes.com/sites/daviddteten/2013/11/13/asset-management-is-a-baffling-industry/#3dd52415464a>.

ity.”⁶⁷ Thus, a market maker must always be ready for every trading day. This allows the purchase of an investment from an investor, even if the market maker does not have an offsetting purchaser ready to buy those shares.⁶⁸ In that case, the market maker immediately sells from its own inventory. By doing so, the firm is literally ‘making a market’ for the stock. The market maker maintains a spread on each investment covered, thereby earning its income by enabling the transaction.⁶⁹

Ordinarily, unrelated companies play the many roles mentioned above – doing so promotes healthy competition and minimizes the risk of an institution by putting its interests ahead of its customers. On the other hand, a financial institution could maximize its revenues from taking on all of these roles at once. As the underwriter, a company would be in a position to purchase the security from the government entity at the lowest cost. The company could then sell that inventory to an affiliate or subsidiary acting as the market maker while paying another subsidiary to manage the assets. With a sufficient amount of retail investor clients, the institution can then set a higher price that its client will pay for the assets. The asset manager could then charge the retail client for the management of the investment. If a client wishes to sell her shares, the market maker can again set the price that it will purchase back the investment from the client—which may or may not be the same price that client would purchase shares for reinvestment.

In some cases, the market maker may choose not to take on inventory, in which case the retail client is left with an illiquid investment that may remain so indefinitely. While sales advertisements provide that a market maker is not obliged to make a market, the market makers may do so to facilitate short term client liquidity. However, as all these roles merge over time and firm revenues increase, an institution can choose to increase its inventory to a point where a security cannot be sold without it. Upon reaching that point, the market maker eclipses its role as short-term facilitator and becomes the gravitational force compelling the security’s value upwards or downwards. When the financial institution takes on all these roles in the midst of a bear market or recession, and where those instruments are not guaranteed by the full faith and credit of a state or commonwealth, the risk of a conflict of interest is staggering.

VI. BRIEF OVERVIEW OF THE PUERTO RICAN DEBT CRISIS

On June 2, 2015, Governor Alejandro García Padilla signed “a law establishing a de facto bankruptcy regime for state-owned enterprises.”⁷⁰ “Likening the island’s economic trajectory to a ‘death spiral,’” the Gov-

67. *Market Maker*, INVESTOPEDIA, <http://www.investopedia.com/terms/m/marketmaker.asp> (last visited Sept. 10, 2016).

68. *Id.*

69. *Market-Maker Spread*, INVESTOPEDIA, <http://www.investopedia.com/terms/m/marketmakerspread.asp> (last visited Sept. 18, 2016).

70. *Puerto Rico’s Debt Crisis: Neither a state nor independent*, ECONOMIST (July 5, 2014) [hereinafter *Puerto Rico Debt Crisis*], <http://www.economist.com/news/>

ernor “concluded that Puerto Rico’s creditors must” be a “part of the island’s attempt to rid itself of its debt problem.”⁷¹ Puerto Rico’s economic issues resulted from a fusion “of structural weaknesses, external shocks, and self-inflicted wounds.”⁷²

Poverty levels, unemployment levels, a corresponding fall in GDP, an underfunded retirement system, a decline in population and the island’s skyrocketing debt all played a part in the current debt crisis. Between 2010 and 2014, forty-five percent of Puerto Ricans lived below the poverty line and nearly thirty-five percent of the population received food stamps.⁷³ By comparison, in 2014 the U.S. rates were approximately fifteen percent and fifteen percent, respectively.⁷⁴ Puerto Rico had a per capita income of \$15,203, which is less than Mississippi, the poorest state in the United States.⁷⁵

Furthermore, Puerto Rico has struggled with a high unemployment rate for decades—registering almost non-stop double digit unemployment rates every month since January 1995.⁷⁶ Prior to the economic collapse in 2013, Puerto Rico’s official unemployment rate in December 2012 was 15.4 percent.⁷⁷ The Puerto Rican Employees Retirement System’s funded ratio is far worse than almost any of the fifty states.⁷⁸ A 2010 study, paid for by the Commonwealth, noted the fund had a funded ratio of just 6.8 percent, well below the average in the U.S.; Puerto Rico’s declining workforce also contributes to the problem.⁷⁹ As the ratio of workers to pensioners falls, fewer workers are left supporting the many pensioners, creating a system where funds are extracted from the pension at a faster rate than can be replaced.

united-states/21606319-how-territory-falls-between-bankruptcy-regimes-neither-state-nor-independent.

71. Chandler Foust, *Capital Over People? Puerto Rican Debt Crisis Explained*, COUNCIL ON HEMISPHERIC AFFAIRS (Aug. 3, 2015), <http://www.coha.org/capital-over-people-puerto-rican-debt-crisis-explained/>.

72. *Puerto Rico Debt Crisis*, *supra* note 70.

73. Schiffgold, *How Socialism Destroyed Puerto Rico, and How Capitalism Can Save It*, SCHIFFGOLD (July 17, 2015), <http://schiffgold.com/commentaries/socialism-destroyed-puerto-rico-capitalism-can-save-it/>.

74. Ali Meyer, *Food Stamp Beneficiaries Exceed 46,000,000 for 38 Straight Months*, CNSNEWS (Jan. 13, 2015, 9:24 AM), <http://www.cnsnews.com/news/article/ali-meyer/food-stamp-beneficiaries-exceed-46000000-38-straight-months>.

75. Sarah Pringle, *Puerto Rico’s Statehood Bid Complicated by a Struggling Economy*, WALTER CRONKITE SCH. OF JOURNALISM AND MASS COMM’N AT ARIZ. STATE UNIV. (Oct. 29, 2012), <http://cronkite.asu.edu/buffett/puertorico/economy.html>.

76. Bureau of Labor Statistics, *Puerto Rico Unemployment Statistics*, DEP’T OF LABOR (July 2016) <http://www.bls.gov/eag/eag.pr.htm>.

77. *Id.*

78. Taylor Riggs, *How Puerto Rico’s Debt Levels Compare With Those of U.S. States*, BLOOMBERG (July 9, 2015, 12:35 PM CDT), <http://www.bloomberg.com/news/articles/2015-07-09/how-puerto-rico-s-debt-levels-compare-with-those-of-u-s-states>.

79. CONWAY MACKENZIE, INC., *Review of the Events and Decisions That Have Led to the Current Financial Crisis of the Employees Retirement System of the Government of Puerto Rico*, SENADO DE PUERTO RICO, (October 2010) <http://www.slcg.com/blog/13409.pdf>.

For several years, Puerto Rico has suffered from a long-term decrease in its population. "From 2000 to 2010, a net 288,000 people left for the U.S. mainland, according to the Puerto Rico Institute of Statistics."⁸⁰ As the economic situation worsened, the population listed "a net loss of 54,000 residents per year in 2011 and 2012, on an island of just over 3.6 million people."⁸¹ This exodus shrinks the island's tax base, lowers the demand for goods and services, and leaves housing units vacant.⁸² Intuitively, as the size of the workforce shrinks, the long-term potential output of that economy decreases. Coinciding with Puerto Rico's economic recession, its issuance of municipal debt skyrocketed.⁸³ Estimates of Puerto Rico's public debt range from seventy percent to 100 percent of GDP.⁸⁴ The island's current debt, \$70 billion, is the highest per capita out of all U.S. states.⁸⁵

While these internal issues have hurt the island, Washington, D.C. decision-making has further fueled the issues. As an overseas American territory, the Commonwealth of Puerto Rico uses the dollar and the national minimum wage.⁸⁶ That makes the island's labor costly and its exports uncompetitive.⁸⁷ In saying so, from 1976-2006, firms on the island were exempt from federal tax on their local profits.⁸⁸ Because of that tax break, in effect from 1976 through its phase out in 1996, "Puerto Rico became, by a wide margin, the most attractive locale in the world for American companies to operate in."⁸⁹

Once the loophole closed, the economy fell into a recession.⁹⁰ Puerto Rico's high corporate taxes on domestic corporations, along with low taxes on subsidiaries from the U.S. mainland, "skewed the Puerto Rican economy toward foreign investment from the U.S."⁹¹ Once the tax break was gone, however, "foreign investment began to flee."⁹² "Without a strong domestic corporate presence to fill the void" left by the new statutory framework, "the economy began to contract, along with tax revenues."⁹³

80. Arian Campo-Flores, *Puerto Ricans Flock North Away From Battered Economy*, WALL ST. J. (Jan. 6, 2014), <http://www.wsj.com/articles/SB10001424052702304173704579262390542968318>.

81. *Id.*

82. *Id.*

83. Riggs, *supra* note 78.

84. *Puerto Rico: Greece in the Caribbean*, ECONOMIST (Oct. 26, 2013), available at <http://www.economist.com/news/leaders/21588374-stuck-real-debt-crisis-its-back-yard-america-can-learn-europes-aegean>.

85. *Id.*

86. Foust, *supra* note 71.

87. *Id.*

88. *Id.*

89. James Surowiecki, *The Puerto Rican Problem*, NEW YORKER (Apr. 6, 2015), <http://www.newyorker.com/magazine/2015/04/06/the-puerto-rican-problem>.

90. Foust, *supra* note 71.

91. Scott Greenberg & Gavin Ekins, *Tax Policy Helped Create Puerto Rico's Fiscal Crisis*, TAX FOUNDATION: THE TAX POLICY BLOG (June 30, 2015), <http://taxfoundation.org/blog/tax-policy-helped-create-puerto-rico-s-fiscal-crisis>.

92. *Id.*

93. *Id.*

The Puerto Rican government implemented massive reforms, yet has had little to show for it.⁹⁴ “Cuts in government spending and increases in taxes have further constricted the Puerto Rican economy, making it increasingly difficult for the island to pay off its outstanding debt.”⁹⁵ Moreover, after the Detroit bankruptcy in July 2013, “investors fled risky municipal bonds,” which also “raised Puerto Rico’s financing costs.”⁹⁶

The government has spent too little on infrastructure and too much on pensions. For example, the Puerto Rican Electric Power Authority still generates sixty-five percent of its power using expensive fuel oil, which in turn acts as a tax on economic activity.⁹⁷ Simply put, “Puerto Rico is in a debt crisis because the government has [grossly] overspent for years while the island’s economy was shrinking.”⁹⁸ As a result, “Puerto Rico has been in and out of recession since 2006.”⁹⁹ Puerto Rico’s “unemployment rate is around fourteen percent, forty-five percent of the population lives below the federal poverty line, and there’s a fiscal crisis—a scramble to restructure debts of \$73 million dollars.”¹⁰⁰

Unfortunately, Puerto Rico’s growth was wholly dependent on the tax break. Between 1996 and 2014, Puerto Rico fell off the map as “the number of manufacturing jobs on the island fell by almost half.”¹⁰¹ On August 3, 2015, Puerto Rico defaulted to creditors of its Public Finance Corporation when “it paid a mere \$628,000 dollars toward a \$58 million dollar debt.”¹⁰² This did not surprise anyone. Moody’s, a credit ratings company, had long since downgraded Puerto Rico’s general obligation debt.¹⁰³ Moody’s cited, among other credit challenges, the island’s: (1) “[v]ery large unfunded pension liability relative to revenues;” (2) “[v]ery high and growing government debt relative to the size of the economy;” (3) “[h]igh unemployment, low workforce participation, and high poverty levels compared to the U.S.,” and (4) “[m]ulti-year trend of large General Fund operating deficits.”¹⁰⁴ Because “the debt is mostly owned by ordinary Puerto Ricans through their credit unions,” the default mostly in-

94. Foust, *supra* note 71.

95. *Id.*

96. *Puerto Rico Debt Crisis*, *supra* note 70.

97. *Id.*

98. Patrick Gillespie & Heather Long, *Puerto Rico’s Crisis . . . in 2 Minutes*, CNN MONEY (Aug. 4, 2015, 9:14 AM), <http://money.cnn.com/2015/08/03/investing/puerto-rico-crisis-in-2-minutes/>.

99. Surowiecki, *supra*, note 89.

100. *Id.*

101. *Id.*

102. Patrick Gillespie, *Puerto Rico Just Defaulted for the First Time*, CNN MONEY (Aug. 3, 2015, 5:36 PM), <http://money.cnn.com/2015/08/03/investing/puerto-rico-default/index.html?iid=EL>.

103. Global Credit Research, *Moody’s Downgrades Puerto Rico General Obligation and Related Bonds to Baa3 from Baa1 and Certain Notched Bonds to Ba1*, MOODY’S INVESTORS SERVICE (Dec. 13, 2012), https://www.moodys.com/research/Moodys-downgrades-Puerto-Rico-general-obligation-and-related-bonds-to-PR_262231.

104. *Id.*

juries “the island’s residents, [and] not Wall Street.”¹⁰⁵

VII. THE EFFECT OF KEEPING THE STATUS QUO

With the governor’s announcement that Puerto Rico’s December 2015 debt payments would be “likely among the last Puerto Rico will make in coming months,”¹⁰⁶ there is little to suggest that the island is capable of overcoming its financial difficulties without external aid. Currently, “close to half of the budget goes to debt service and this is just an unsustainable situation.”¹⁰⁷ In addition to the “need for structural reform of the Island’s economy,” Congress must allow Puerto Rico to declare Chapter 9 bankruptcy.¹⁰⁸

Since 1984, Puerto Rican municipalities and public corporations have not been able to declare bankruptcy because, in that year, Congress changed the law affecting Puerto Rican public institutions.¹⁰⁹ Chapter 9 bankruptcy would allow Puerto Rico to reorganize its debt through “extending debt maturities, reducing the amount of principal or interest,” or taking on a new loan to refinance the debt.¹¹⁰ But without a change in federal law, or making Puerto Rico the fifty-first state, the island will remain in an endless loop of paying down debt simply to take on more.

After over two years of having Puerto Rican debt instruments being rated as junk, Governor Padilla made a long awaited announcement. Following two defaults for debt owed by small government agencies and facing a \$422 million dollar payment due May 1, 2016, the Governor signed legislation enabling an immediate moratorium on non-constitutionally guaranteed bond re-payments, to become effective on July 1, 2016.¹¹¹ Furthermore, “Puerto Rico’s problems stopped being legal problems and they have started being a math problem. . . at the end of the day Puerto Rico cannot pay.”¹¹²

Because investments in Puerto Rican debt were made based on the safety of the clients’ principal, despite the known problems of the Puerto Rican economy, this act effectively rendered any promise of suitability by

105. Gillespie, *supra* note 98.

106. Aaron Kuriloff, *Puerto Rico to Make Most Crucial of Debt Payments on Jan. 1*, WALL ST. J., Dec. 30, 2015, 5:02 PM, available at <http://www.wsj.com/articles/puerto-rico-will-make-most-debt-payments-due-jan-1-1451500478>.

107. Interview with Michael Fletcher, *Everything You Should Know About Puerto Rico’s Debt Crisis*, PBS NEWS HOUR (July 11, 2015, 6:04 PM), <http://www.pbs.org/newshour/bb/everything-know-puerto-ricos-debt-crisis/>.

108. Foust, *supra* note 71.

109. *Id.*

110. *Chapter 9 – Bankruptcy Basics, in Service & Forms*, ADMIN. OFFICE OF THE U.S. COURTS, <http://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-9-bankruptcy-basics> (last visited Sept. 16, 2016).

111. Nick Brown, *Puerto Rico Enacts Emergency Debt Moratorium Bill*, REUTERS (Apr. 6, 2016, 9:21 PM), <http://www.reuters.com/article/us-puertorico-debt-legislation-idUSKCN0X31GJ>.

112. *Id.*

financial advisors to their clients to be meaningless.¹¹³ It is therefore binding on broker-dealers to do more than make transactions on behalf of their clients. Given the myriad of factors likely to be unknown by their clients, broker-dealers must make recommendations that are in their clients' best interests.¹¹⁴ This can be difficult in straight forward relationships between clients and their advisors. Thus, this is impossible when a broker-dealer is responsible for more than just selling a stock or a bond.

VIII. UBS SUCCUMBS TO TEMPTATION

Since its inception in 1951, the Employee Retirement System ("ERS") of the Government of Puerto Rico has been chronically underfunded.¹¹⁵ Puerto Rico's funding ratio prior to 2008 was approximately twenty percent and then dropped even more due to the recession.¹¹⁶ By comparison, "the three next worst average funding ratios from 2007 to 2011 were Illinois (fifty-one percent), Connecticut (fifty-eight percent), and Kentucky (fifty-nine percent)."¹¹⁷ Indeed, when UBS attempted to sell ERS bonds outside of Puerto Rico, it found no investor appetite whatsoever.¹¹⁸

Still, even after Merrill Lynch had failed to find any market for the same bonds, UBS led the underwriting for three separate ERS bond issues in 2008.¹¹⁹ In January 2008, UBS offered almost \$1.6 billion dollars in Series A ERS bonds.¹²⁰ In May 2008, UBS offered over \$1 billion dollars in Series B ERS bonds.¹²¹ UBS added \$300 million dollars in Series C bonds to the market one month later.¹²² In total, UBS acquired \$1.3 billion dollars in the sale to investors through its family of closed-end

113. See Michael Finke & Thomas Langdon, *The Impact of the Broker-Dealer Fiduciary Standard on Financial Advice*, FPA, available at <https://www.onefpa.org/journal/Pages/The%20Impact%20of%20the%20Broker-Dealer%20Fiduciary%20Standard%20on%20Financial%20Advice.aspx> (last visited Sept. 19, 2016).

114. *Id.*

115. CONWAY MACKENZIE, INC., *supra* note 79, at 3.

116. Craig McCann & Edward O'Neal, Sec. Litig. & Consulting Grp., *UBS Succumbed to Conflicts and Purchased \$1.7 Billion of Employee Retirement System Bonds Into Its Puerto Rican Municipal Bond Funds in 2008*, SLCG BLOG (Nov. 6, 2014), <http://blog.slcg.com/2014/11/ubs-succumbed-to-conflicts-and.html>.

117. *Id.*

118. *Id.*

119. UBS FINANCIAL SERVICES, EMPLOYEE RETIREMENT SYSTEM OF THE GOVERNMENT OF THE COMMONWEALTH OF PUERTO RICO SENIOR PENSION FUNDING BONDS, SERIES A (Jan. 29, 2008), available at http://www.gdb-pur.com/pdfs/public_corp/PensionBondsOS-Jan08-final.pdf.

120. *Id.*

121. UBS FINANCIAL SERVICES, EMPLOYEE RETIREMENT SYSTEM OF THE GOVERNMENT OF THE COMMONWEALTH OF PUERTO RICO SENIOR PENSION FUNDING BONDS, SERIES B (May 28, 2008), available at http://www.gdb-pur.com/investors_resources/documents/2012-04-09-FinalOS-POBSeriesB.pdf.

122. UBS FINANCIAL SERVICES, EMPLOYEE RETIREMENT SYSTEM OF THE GOVERNMENT OF THE COMMONWEALTH OF PUERTO RICO SENIOR PENSION FUNDING BONDS, SERIES C (June 16, 2008), available at http://www.gdb-pur.com/investors_resources/documents/ERSSeniorPensionFundingBonds-SeriesC_000.pdf.

mutual funds.¹²³ “Merrill Lynch’s plan to issue \$7 billion dollars in” ERS bonds “to investors off the island transformed into . . . UBS’s plan to sell \$2.94 billion dollars on the island, of which \$1.7 billion dollars had to be bought by the UBS Funds.”¹²⁴

These bonds would eventually concentrate within the closed-end funds, which would be “sold at a time when there were already fears about the size of Puerto Rico’s debt burden and the weakness of its economy.”¹²⁵ As UBS Puerto Rico President Miguel Ferrer stated in a June 2011 sales meetings with registered representatives weary of the timing of these investments, “[w]e have in your accounts almost one billion dollars in cash that does not generate commissions . . . [y]ou have current yield, and you have a history of good performance. What the f[]ck do you want?”¹²⁶

In addition to the unmarketable ERS bonds, UBS underwrote “\$1.35 billion dollars of COFINA bonds (Puerto Rico Sales Tax Revenue bonds) and bought them into the UBS Puerto Rican Funds in 2007 and 2008.”¹²⁷ Because there was no other market for these bonds, UBS sold \$3 billion dollars of bonds it did not underwrite to make room for the ERS and COFINA bonds within its closed-end funds.¹²⁸ UBS registered representatives would also be able to buy and sell different securities from within its own family of closed-end funds, charging arbitrary and excessive mark ups as they did.¹²⁹ While the average underwriting spread for municipal bonds is 0.8 percent, UBS charged its own clients 1.05 percent for no apparent reason.¹³⁰

By 2013, the UBS underwritten ERS and COFINA bonds lost \$464 million dollars.¹³¹ The disastrous losses suffered by Juan Burgos and other investors in the UBS Puerto Rican Funds in 2013 were “directly traceable to UBS putting its interests ahead of its clients in 2008.”¹³² In all, UBS was the lead or participating underwriter in several revenue

123. McCann, *supra* note 116.

124. Craig McCann, Sec. Litig. & Consulting Grp., *15 Days in Puerto Rico Cost UBS Clients Over \$1 Billion*, SLCG BLOG (Dec. 4, 2014), <http://blog.slcg.com/2014/12/15-days-in-puerto-rico-cost-ubs-clients.html> [hereinafter *15 Days in Puerto Rico*].

125. Suzanne Barlyn, *Exclusive: Recording Shows How UBS Drove Reluctant Brokers to Sell High-risk Puerto Rico Funds*, REUTERS (Feb. 6, 2015, 3:51 PM), <http://www.reuters.com/article/us-ubs-puertorico-tactics-idUSKBN0LA0FN20150206?irpc=932>.

126. Evans, *supra* note 41.

127. Craig McCann & Edward O’Neal, Sec. Litig. & Consulting Grp., *What Hell Hath UBS Puerto Rico Wrought*, SLCG BLOG (Nov. 13, 2014 <http://blog.slcg.com/2014/11/what-hell-hath-ubs-puerto-rico-wrought.html>) [hereinafter *What Hell Hath UBS Puerto Rico Wrought*].

128. *Id.*

129. Geng Deng et al., Sec. Litig. & Consulting Grp., *Did UBS Charge its Proprietary Puerto Rico Bond Funds Excessive Markups?*, SLCG BLOG (Dec. 18, 2013), <http://blog.slcg.com/2013/12/did-ubs-charge-its-proprietary-puerto.html>.

130. Craig McCann, Sec. Litig. & Consulting Grp., *Did UBS Charge its Proprietary Puerto Rico Bond Funds Excessive Markups? Part II*, SLCG BLOG (Jan. 6, 2014), <http://blog.slcg.com/2014/01/did-ubs-charge-its-proprietary-puerto.html> [hereinafter *Part II*].

131. *What Hell Hath UBS Puerto Rico Wrought*, *supra* note 125.

132. *Id.*

bonds issued by agencies of the Commonwealth of Puerto Rico, including: Government Development Bank of Puerto Rico (“GDB”), Puerto Rico Aqueduct and Sewer Authority (“PRASA”), and GDB “Build America Bonds.”¹³³

Between December 2012 and March 2013, many of these bonds, which were also underlying holdings within the CEFs peddled by UBS, were downgraded to near “junk status.”¹³⁴ By early 2014, Moody’s, Standard & Poor (“S&P”), and Fitch rated Puerto Rico’s general obligation bonds as non-investment grade securities.¹³⁵ Still, UBS continued to sell these securities, even to retirees who required the income in order to maintain themselves.¹³⁶ Investors complained that not only were they unaware about these conflicts of interest, they were also repeatedly told these investments were guaranteed and safe.¹³⁷ Because these advisors failed to put the interests of their clients ahead of their own, the losses have been severe.

In fact, the egregious manner in which some advisors violated the fiduciary standard magnified the losses. Even though the closed-end funds were already highly leveraged, UBS clients “were encouraged by [their] brokers to borrow even more money to invest in those funds.”¹³⁸ In 2013, the Tax Free Puerto Rico Fund II had a leverage ratio of fifty-three percent, “meaning for every dollar of customer assets it holds, it has roughly another dollar of assets bought with borrowed money.”¹³⁹ Furthermore, “the Puerto Rico Fixed Income Fund could issue debt securities worth up to fifty percent of its total assets.”¹⁴⁰

While the closed-end funds leveraged their portfolio by financing about half of the assets, “[r]egistered representatives of UBS . . . offered clients loans secured by shares they already owned,” and used the proceeds of

133. Brian Chappatta, *Which Puerto Rico Bond Defaults Next? A 1600% Yield Says It All*, BLOOMBERG (Apr. 29, 2016), <http://www.bloomberg.com/news/articles/2016-04-29/which-puerto-rico-bond-defaults-next-a-1-600-yield-says-it-all>.

134. Mary Williams Walsh, *S.&P. Lowers Puerto Rico Debt to Junk Status*, DEAL BOOK N.Y. TIMES (Feb. 4, 2014, 8:35 PM), http://dealbook.nytimes.com/2014/02/04/s-p-lowers-puerto-rico-debt-to-junk-status/?_r=0.

135. *Id.*

136. Evans, *supra* note 41.

137. According to the Financial Industry Regulatory Authority (FINRA) statistics, there are currently 1,022 active customer complaints in Puerto Rico. The total number of Puerto Rico disputes is likely higher since the sheer amount of complaints required moving cases to South Florida, where currently over 300 disputes are active in Miami and Boca Raton. For reference, FINRA has reported 4,592 active customer complaints nationwide in 2016. See *Dispute Resolution Statistics*, in *Arbitration and Mediation*, FINRA, available at <https://www.finra.org/arbitration-and-mediation/dispute-resolution-statistics> (last visited Sept. 19, 2016).

138. Susanne Craig, *UBS Brokers in Puerto Rico Create Headache for the Bank*, N.Y. TIMES, (Oct. 2, 2013, 8:57 PM), http://dealbook.nytimes.com/2013/10/02/ubs-brokers-in-puerto-rico-create-headache-for-the-bank/?_r=0&pagewanted=print.

139. *Id.*

140. Tim Dulaney & Carmen Taveras, Sec. Litig. & Consulting Grp., *Trouble in Paradise: UBS Puerto Rico Bond Fund Investors Hit Hard*, SLCG BLOG (Oct. 7, 2013), <http://blog.slcg.com/2013/10/trouble-in-paradise-ubs-puerto-rico.html>.

the loans to buy more shares in the closed-end funds.¹⁴¹ “Typically, customers use margin loans to buy securities on borrowed funds,” which are governed by regulators to “limit the amount of risk a customer can take on.”¹⁴² For the UBS Puerto Rican clients, “many fund investors also used leverage to buy shares of the fund and were especially hard hit.”¹⁴³ Investors, required to meet margin calls at depressed prices, were “forced to liquidate hundreds of millions of dollars in holdings in these funds.”¹⁴⁴

IX. THE MOST VULNERABLE AMONG US

In 2012, the SEC enabled an Investor Advisory Committee (“IAC”) to study the impact of broker-dealer fiduciary duty on the most imperiled stakeholder of all — the retail investor. Among its 2013 findings, the IAC discovered that:

- (1) “Over the last several decades, however, the roles of some broker-dealers and investment advisers have converged.”¹⁴⁵
- (2) “Because federal regulations have not kept pace with changes in business practice, broker-dealers and investment advisers are subject to different legal standards when they offer advisory services.”¹⁴⁶
- (3) “Those legal standards—a suitability standard for broker-dealers and a fiduciary duty for investment advisers—afford different levels of protection to the investors who rely on those services.”¹⁴⁷
- (4) “[I]nvestors generally treat their relationships with both broker-dealers and investment advisers as relationships of trust and expect that the recommendations they receive will be in their best interests.”¹⁴⁸
- (5) “Investors may be harmed if they choose a financial adviser under a mistaken belief that the financial adviser is required to act in their best interest when that is not the case.”
- (6) “These types of harm can nonetheless have a significant impact on investors’ financial well-being.”¹⁴⁹

141. Laura Marcinek, *UBS Employee Takes Leave Amid Review of Puerto Rico Loans*, BLOOMBERG (Oct. 4, 2013), <http://www.bloomberg.com/news/print/2013-10-04/ubs-employee-takes-leave-amid-review-of-puerto-rico-loans.html>.

142. Craig, *supra* note 138.

143. *Puerto Rico’s Bond Losses Hit Local Investors*, in *Funds News*, REUTERS (Sept. 29, 2013, 7:59 AM), <http://www.reuters.com/article/puertorico-bonds-locals-idUSL2N0HM26D20130929>.

144. Craig, *supra* note 138.

145. *Recommendation of the Investor Advisory Committee: Broker-Dealer Fiduciary Duty*, SEC (last visited Sept. 19, 2016), available at <https://www.sec.gov/spotlight/investor-advisory-committee-2012/fiduciary-duty-recommendation-2013.pdf>.

146. *Id.*

147. *Id.*

148. *Id.*

149. *Id.*

Based on these findings, the IAC made two recommendations. First, "[t]he Commission should conduct a rulemaking to impose a fiduciary duty on broker-dealers when they provide personalized investment advice to retail investors."¹⁵⁰ Additionally, in implementing the new rule, the SEC should create "a uniform, plain English disclosure document to be provided to customers and potential customers of broker-dealers and investment advisers at the start of the engagement, and periodically thereafter, that covers basic information about the nature of services offered, fees and compensation, conflicts of interest, and disciplinary record."¹⁵¹

The IAC noted two historical objections to this rule making approach. The first objection is based on the idea that broker-dealers are already heavily regulated. This argument is irrelevant because "the question is not whether broker-dealers are adequately regulated when they act as [broker-dealers] but whether they are adequately regulated" when giving advice, *i.e.* acting as advisers.¹⁵²

The second objection is that regulation is not needed because "investors are capable of choosing for themselves whether they prefer to work with a broker-dealer operating under a suitability standard or an investment adviser who is a fiduciary."¹⁵³ The IAC cited to numerous studies that found conclusively that:

[I]nvestors today do not have the tools to make an informed choice. Specifically, investors do not distinguish between broker-dealers and investment advisers, do not know that broker-dealers and investment advisers are subject to different legal standards, do not understand the differences between a suitability standard and a fiduciary duty, and expect broker-dealers and investment advisers alike to act in their best interests when giving advice and making recommendations. This is the natural result of regulatory policy that has allowed brokers to rebrand themselves as advisers without being regulated as advisers.¹⁵⁴

While "the lack of [a fiduciary] standard has real-world implications for investors,"¹⁵⁵ financial institutions may rely on case law that is far removed from a typical customer's awareness. For example, "no fiduciary duty arises between a broker and his client in relation to a non-discretionary commodity trading account."¹⁵⁶ In *Greenwood v. Dittmer* ("*Greenwood*"), a case applying Arkansas law and arising over the sale of commodities in feeder cattle, the central issue in determining that the fiduciary standard did not apply was not whether the client received ad-

150. *Id.*

151. *Id.*

152. *Id.*

153. *Id.*

154. *Id.*

155. Peiffer, *supra* note 27, at 3.

156. *Greenwood v. Dittmer*, 776 F.2d 785, 788 (8th Cir. 1985).

vice and information from the broker.¹⁵⁷ Rather, the *Greenwood* court based its decision on the account status being listed as “non-discretionary.”¹⁵⁸

Still, the Eighth Circuit would later decline to expand the *Greenwood* standard beyond the state of Arkansas. Instead, in *Davis v. Merrill Lynch* (“*Davis*”), the Eighth Circuit noted that it was neither bound nor persuaded by *Greenwood*, and declined to apply its holding to overrule the well-supported judgment of the district court that a fiduciary duty exists between licensed securities brokers and their customers under South Dakota law.¹⁵⁹ The *Davis* court also noted that both the status of the account and who actually exercised control is to be examined in determining whether a fiduciary duty exists.¹⁶⁰ Many jurisdictions have similarly promoted substance over form when determining that a fiduciary standard is appropriate.¹⁶¹ Therefore, it would seem that common law is in line with current thinking in a post-Dodd-Frank landscape.

But policy groups, including the largest group representing the United States securities industry, its broker-dealers, banks and asset managers, advocate against the uniform fiduciary standard.¹⁶² By extension, these groups advocate for a status quo that promotes the fallacy that broker-dealers generally operate in the best interests of their retail investors. These policy groups generally argue that a change to the current requirement will restrict access to financial advice and raise the cost of saving for investors.¹⁶³ In a 2014 op-ed, the President and CEO of SIFMA asserted that:

[I]nvestors can choose the type of investment professionals and services they want and the manner in which they prefer to pay for these services. Those with greater needs may choose to work with an in-

157. *Id.* at 786-788.

158. *Id.* at 788.

159. *See Davis v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 906 F.2d 1206, 1216-17 (8th Cir. 1990) (“*Davis*”).

160. *Id.* at 1217.

161. *See Leboce, S.A. v. Merrill-Lynch, Pierce, Fenner & Smith, Inc.*, 709 F.2d 605, 607 (9th Cir. 1983) (held California law imposes fiduciary obligations “where the agent ‘for all practical purposes’ controls the account”); *see also Miley v. Oppenheimer & Co.*, 637 F.2d 318, 324-25 (5th Cir. 1981) (finding a fiduciary relationship exists without placing undue emphasis on the nature of an account); *see also Mihara v. Dean Witter & Co.*, 619 F.2d 814, 821 (9th Cir. 1980) (showing in the context of churning, “the requisite degree of control is met when the client routinely follows the recommendations of the broker” such that “a pattern of de facto control by the broker” develops); *see also Corbey v. Grace*, 605 F. Supp. 247, 253 (D. Minn. 1985) (noting that a plaintiff seeking to establish a fiduciary relationship with a broker had to specify the content of a special agreement); *see also Moore v. Turner*, 71 S.E.2d 342, 349 (1952) (quoting 8 Am. Jur., Brokers, § 86 that a “broker [employed to sell coal property] is a fiduciary required to exercise fidelity and good faith toward his principal in all matters within the scope of his employment.”).

162. *Position*, in *Fiduciary Standard Resource Center*, SIFMA, <http://www.sifma.org/issues/private-client/fiduciary-standard/position/> (last visited Sept. 19, 2016).

163. Carol Danko, *SIFMA Statement on DOL Fiduciary Rule, Omnibus Appropriations Act*, in *Newsroom*, SIFMA (Dec. 16, 2015), http://www.sifma.org/newsroom/2015/sifma_statement_on_dol_fiduciary_rule_omnibus_appropriations_act/.

vestment adviser who provides individualized investment advice for an asset-based advisory fee, hourly fee or annual retainer.¹⁶⁴

His words artfully dodge the thorough history at the heart of the SEC findings and the Dep't of Labor's current path. At the June 2011 UBS sales meeting, despite UBS advisors' trepidation in selling CEFs they thought to be unsuitable for a list of twenty-two problems, then CEO, Ferrer, pressured his employees into selling the CEFs to their retail clients by saying:

I am going to read it to you, there are twenty-two (22) [items]. I think we could come up with fifty (50) or one hundred (100) if we wanted to . . . Poor liquidity; Excessive leverage; An increase in interest; Security; Instability; Excessive Offer; Bad reputation; Spread pressure; Geographic Concentration; Lending Capability; Lack of Information; UBS Commitment; Trust of Brokers; Charity; Rating versus one-o-three (103); Lack of correlation; Size of Interest Lines; Form of Sales; Lack of Publicity; Stable Reporting; Management Costs; No trail. We are f-cked. So, we either do something or we end this meeting, have a cup of coffee and go home. Because if we do not have that product, which is the only thing that is available right now, you have nothing to do. I guess you should look for another job. If you want to earn gross, then we have to take this and make a list of three or four positive things that you have.¹⁶⁵

Investor-focused trade associations "have sought to ensure that any rules adopted provide sufficient clarity regarding their regulatory obligations and continue to permit them to offer traditional, transaction-based brokerage services."¹⁶⁶ Groups like the Public Investors Arbitration Bar Association ("PIABA") work to translate the positions of industry groups who only pay lip service to protect investor rights. Noting that the National Association of Plan Advisors ("NAPA") equates a rule governing conflicts of interest with a rule creating a barrier to investment advice, PIABA explains that NAPA is really arguing that "prohibiting conflicts of interests would block Americans from working with the financial advisors and investment providers they trust simply because they offer different financial products like annuities and mutual funds – with different fees."¹⁶⁷ NAPA's logic fails an intuitive, much less rationale, analysis. In fact, "[a]ctual data, as opposed to the rhetoric and hyperbole, demonstrates that the imposition of a fiduciary duty upon brokers has no meaningful impact on cost to investors or access to investment advice."¹⁶⁸

164. Kenneth E. Bentsen, Jr., *Helping American Investors Save for Retirement*, in *Pennsylvania + Wall*, SIFMA (May 9, 2014), <http://www.sifma.org/blog/helping-american-investors-save-for-retirement/>.

165. Audio tape: Miguel Ferrer's address, <http://mediacdn.reuters.com/media/us/editorial/assets/FERRER.mp4> (approx. at 3:40) (link also available at Barlyn, *supra* note 125) (last visited Sept. 19, 2016).

166. *Recommendation of the Investor Advisory Committee: Broker-Dealer Fiduciary Duty*, *supra* note 145.

167. Peiffer, *supra* note 27, at 16-17.

168. *Id.* (citing Finke, *supra* note 113).

One thing is clear, though – the path towards establishing a uniform fiduciary standard for brokers who make investment recommendations is not as straightforward as it would seem. Since 2010, when the Dodd-Frank Act was enforced through the recent decision made by the Dep’t of Labor in 2016, a disheartening trend has developed. In response to the recession of 2008, the Dodd-Frank Act sought to protect all investors from Wall Street predators. In 2012, the IAC recommended the uniform fiduciary standard to protect retail investors.¹⁶⁹ By 2016, after significant securities industry pushback, the Dep’t of Labor plan only provides aid to individuals with retirement plans.¹⁷⁰ While studies clearly show that Americans outside the “one percent” need the protections afforded by a fiduciary standard, Wall Street proponents have successfully narrowed the number of Americans that could potentially seek a safe harbor within its shores. Even so, the Dep’t of Labor decision to require a fiduciary standard for those providing retirement plan advice does generate a flicker of hope for retail investors nationwide.

X. CONCLUSION

For retail investors like those in Puerto Rico, or anywhere within the United States, the SEC must require a uniform fiduciary standard for all investment advisers and broker-dealers that is no less stringent than the existing fiduciary standard for investment advisers. Had the recommendations of the Dodd-Frank Act been adopted in 2010, or any time before the collapse of the Puerto Rico bond market in 2013, UBS and other financial institutions would have been required to act in the best interests of Juan Burgos and thousands of other Puerto Rican clients.

While UBS Puerto Rico admitted no wrongdoing when it settled with the SEC for \$26.6 million dollars, an SEC statement noted that “UBS Puerto Rico denied its closed-end fund customers what they were entitled to under the law – accurate price and liquidity information, and a trading desk that did not advantage UBS’s trades over those of its customers.”¹⁷¹ According to the securities industry, “broker-dealers act in their client’s best interests because they know their clients expect them to do so and clients can always take their business elsewhere.”¹⁷² Puerto Rican investors experienced otherwise. Until the federal government requires adop-

169. See SEC’s Investor Advisory Committee Recommends Framework for Uniform Fiduciary Duty Governing Broker-Dealers and Investment Advisors, MORGAN LEWIS, <https://www.morganlewis.com/pubs/secs-investor-advisory-committee> (last visited Dec. 11, 2013).

170. Liz Skinner, *The DOL fiduciary rule will forever change financial advice, and the industry has to adapt*, INV. NEWS (May 9, 2016), <http://www.investmentnews.com/article/20160509/FEATURE/160509939/the-dol-fiduciary-rule-will-forever-change-financial-advice-and-the>.

171. Press Release, SEC Charges UBS Puerto Rico & Two Executives with Defrauding Fund Customers, Wash. D.C. (May 1, 2012) (on file with author), available at <https://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171488798>.

172. See Bentsen, *supra* note 164.

tion of a fiduciary standard for all investment recommendations, history warns us that millions will continue to lose billions.