JUSTICE WATCH

John Pacenti

UBS in the hot seat amid Puerto Rican bond crisis

Five years after becoming the poster child for the Department of Justice's war on banking secrecy and offshore accounts, Switzerland's UBS AG finds itself in the eye of another potential tempest, this time the Puerto Rican bond crisis.

And to make matters worse, one of its top executives, Raoul Walsh, was arrested in Italy last week. He is awaiting extradition to South Florida to face charges he assisted wealthy Americans hide assets from the Internal Revenue Service.

Attorneys Jeffrey Somn and Jeffrey Erez have spoken to hundreds of families in Puerto Rico in the past few weeks.

ROTHSTEIN FALLOUT

Costs drove decision

Lawsuit against Qtask abruptly dismissed

by Julie Kay
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Four years after a trustee filed a contentious lawsuit against a software company that served the defunct law firm of Rothstein Rosenfeldt Adler, the case is over.

Michael Goldberg, the liquidating trustee in the case, abruptly filed a motion to dismiss the case against Qtask on Oct. 17. On Tuesday, the day the case was set for trial in U.S. Bankruptcy Court in Fort Lauderdale, he also moved to withdraw trustee Herbert Sutzin's motion seeking sanctions against Qtask and its colorful owner, Reichart Von Wolsfeld.

Goldberg's decision to drop all litigation against Von Wolsfeld characterized the decision to end the case against him and his software company as "wise."

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JUDICIARY

Meenu Sasser ranks highest in judicial poll

by Adolfo Pesquera
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Palm Beach Circuit Judge Meenu Sasser rose head and shoulders above most of her colleagues on the bench in a judicial evaluation performed by the Palm Beach County Bar Association.

The evaluation of circuit and county court judges is done biannually by litigation attorneys who appear before each of the judges in the 15th Judicial Circuit.

Association attorneys score judges as excellent, satisfactory or needs improvement in nine categories. Judges are scored for their knowledge of law, impartiality, preparedness, demeanor, control of the courtroom, case management...

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JUDICIAL PROFILE

Broward judge a magnet for newsworthy cases

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JUSTICE WATCH: Lawyers swarm island to interview clients

"In baseball, it’s three strikes and you’re out. UBS seems to have been at the plate for awhile. Whether they’re yet called out is a decision those at the Justice Department have to make," Fort Lauderdale attorney Jeffrey Neiman, a former assistant U.S. attorney, said. While at the U.S. attorney’s office in Miami, he prosecuted former UBS banker and whistleblower Bradley Birkenfeld.

UBS ended up paying an $885 million fine in a deferred prosecution agreement. As part of the deal, it turned over 4,000 customer names to the IRS in a case that ripped a centuries-old lid off banking secrecy in Switzerland that benefited the wealthy.

The most recent of the bank’s concerns, though, is not federal prosecutors but civil litigators. Security lawyers representing Puerto Rican investors are gathering information for complaints to be filed with the Financial Industry Regulatory Authority in connection with the bond crisis in Puerto Rico.

In press releases issued this month, the attorneys assert UBS exposed customers to undue risk when the island’s municipal bond market fell by 19 percent this year and the Commonwealth almost defaulted on its debt.

The bank operated a family of closed-end funds available to Puerto Rican residents that were advertised as safe. Many customers had been leveraged through UBS funds. It’s estimated that more than 75 percent of the municipal bond funds in the U.S. have significant exposure to the Commonwealth’s island debt. Franklin Resources Inc. and Oppenheimer & Co. Inc. operate funds with large concentrations of Puerto Rican bonds. But the UBS arm in the U.S. territory specialized in them.

In the $8.7 trillion municipal-bond market, Puerto Rico and its agencies more than doubled their borrowing since 2004 to $70 billion this year, according to Bloomberg News. Even as the island’s population shrank and the economy contracted 16 percent since 2004, the government kept selling enough bonds to saddlle each man, woman and child with $19,000 in debt, Bloomberg reported. And the Bloomberg story says that Wall Street, not surprisingly, has been feeding this frenzy, finding that Wall Street banks have paid $850 million to manage roughly $120 billion in bond sales since 2000.

An estimated 132 UBS financial advisers on the island are potential targets. What could become a protracted legal fight with local investors who purchased the highly leveraged funds and now want their money back.

"PUerto Rico has a ring of funds consists of 14 such closed-end funds, sold exclusively through registered representatives and brokers with UBS Financial Services Inc. of Puerto Rico. Anxiety in the broader municipal bond market reached Puerto Rico and eroded the net asset value of the funds because of their heavy allocation to local securities." According to marketing materials, UBS had sold more than $10 billion through the end of 2019.

The island has been in recession since 2006, when a federal tax break for corporate income expired, precipitating many business to leave Puerto Rico’s debt had been a staple of American municipal bond funds because of its high yields and tax-free status, but those bonds took a hit earlier this year with fears that the Commonwealth would default on payments because of its economic woes. A Puerto Rican 20-year bond maturing in 2033 currently yields 10 percent and trades at 46 cents below par, falling precipitously since May.

Promotional literature, plaintiffs assert, touted them as low-risk, income-producing investments.

"We have seen these bond funds used almost exclusively in the portfolios of retired people or people approaching retirement," said attorney Jeffrey Sonn, a partner at Sonn & Erez in Miami. "What customers didn’t understand is that the funds borrowed money so their downside risk was quite high."

His law partner, Jeffrey Erez, said the reason Puerto Rican residents ended up with such high concentrations of the island’s municipal funds is that they were triple tax free. Residents did not have to pay state, federal or inheritance taxes.

Furthermore, UBS brokers encouraged investors to take low-interest loans to put more money in the bond funds, telling them that they could make at least a 4 percent spread buy- ing on margin.

"People’s portfolios are down 60 percent or even more," Erez said.

Sonn & Erez have spoken to hundreds of families in Puerto Rico in the last few weeks. They are not the only lawyers serving the islands. Attorney David R. Chase in Fort Lauderdale, a former attorney with the Securities and Exchange Commission, published a press release on Oct. 10 aimed at UBS Puerto Rico bond fund investors in possible need of legal advice. Attorney Scott L. Silver of the Silver Law Group in Coral Gable, Florida, attorney Adam Rabin, a partner at West Palm Beach’s McCabe Rabin, have also issued statements.

"We are focusing on clients whose mutual funds own these municipal bonds," he said. "We are going back through existing clients’ portfolios, re-evaluating whether they suffered losses as a result of these Puerto Rico funds."

The SEC also has launched a probe of U.S. mutual funds to make sure they don’t implicate if Puerto Rico’s credit rating degrades further. Chase said in his release that reports have indicated investors who borrowed money from credit lines offered by securities firms to purchase the bond funds have seen margin calls and, in some cases, have had their fund shares liquidated.

"Anytime you have an asset class that is quickly depreciating, coupled with leverage, it is a recipe for disaster," Chase said. "That is particularly true for the investors in Puerto Rican bond funds who were over-concentrated."

For UBS, the gathering storm of lawyers is starting to look akin to the Sioux crossing in on Col. George A. Custer’s force.

Local South Florida attorneys who represent the bank said they could not receive immediate approval to discuss any potential exposure UBS may face in the future.

"It’s another black eye for UBS," asserted Miami securities attorney Andrew Hall, a partner at Hall, Lamb & Hall.

Hall said he is not yet involved in the great Puerto Rican bond litigation rush. But he said the stampede of lawyers to the island right now is formidable. He acknowledged a point of attack against UBS is likely to center on suitability — whether the bonds were an appropriate fit for the customers’ financial peril.

"The concentration of Puerto Rican bond funds, in and of itself, will be a real problem for UBS," Hall said. "They are supposed to know their customers."

Neiman, who is not involved in representing any investors, said he predicts UBS will try to blame a few rogue officers.

"This is endemic throughout the entire island," Silver said. "We have spoken to countless retail investors and this was an operational problem, not a situation where there was just a handful of brokers."

And UBS also has to deal with the embarrassment of having to sue its own lawyers.

Well was indicted in November 2008 when he was overseeing about 85 percent of UBS roughly 20,000 American clients who had hidden their identities and bank accounts from the IRS.

"Switzerland makes a point not to extradite its own citizens when its citizens are charged in the United States, but if they get a little adventurous and chose to leave the safety of Switzerland, they will be arrested and extradited," Neiman said.

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