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Puerto Rico's bond losses hit local investors

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Sept 29 (Reuters) - The steep decline in prices of Puerto Rican bonds on the American municipal bond market is taking a heavy toll at home, where local institutions and individuals own an estimated 30 percent of the \$70 billion of outstanding bonds.

Heightening worries in recent months about Puerto Rico's shrinking economy, double-digit jobless rate and per capita debts far higher than in any U.S. state touched off a wave of selling and briefly pushed some Puerto Rico yields to over 10 percent.

The yield on Puerto Rico's general obligation 30-year bond hit a recent peak of 8.58 percent, up from 5.49 percent on June 30. The steep drop in prices, which move inversely to yields, has hit local banks and closed-end and mutual funds marketed to bond buyers in Puerto Rico. Some of the Caribbean island's bonds fell to as low as 60 cents on the dollar.

Attorneys specializing in securities industry cases estimate losses tied to the sell-off of as much as hundreds of millions of dollars for the year, though Financial Institutions Commissioner Rafael Blanco said it was "impossible" to accurately tally the damage.

The Financial Institutions Commissioner does not track the substantial investments made by island residents through state-side brokerages, nor the holdings of insurers or pension funds.

Local attorney Harold Vicente, who said he is preparing arbitration action against UBS Puerto Rico on behalf of 15 or more clients, said an initial review showed losses among his clients of "tens of millions of dollars." Some retirees, he said, were "totally wiped out."

UBS Puerto Rico is the island's market leader in closed-end funds, operating more than a dozen. Its Tax-Free Puerto Rico Fund Inc. had a net asset value of \$5.242 on Sept. 18, down from \$6.73 on Sept. 4 and \$9.55 on Jan. 31.

Santander Securities and Popular Securities also run closed-end funds with Puerto Rico bond holdings that suffered losses.

Many Puerto Ricans invest in the island's debt through closed-end mutual funds, which in several cases held more than 70 percent of assets in Puerto Rico bonds and employed leverage that magnified this month's losses.

Vicente said he would file cases on behalf of the investors with the arbitration unit of the Financial Industry Regulatory Authority, Wall Street's industry-funded watchdog, where investors must typically resolve disputes with their brokerages.

Vicente said the cases would allege that the amount of leverage involved was clearly "an unsuitable investment strategy" for his clients.

Brokers must recommend investments that are suitable based on age, risk tolerance and other factors.

UBS spokeswoman Karina Byrne said investors in the UBS funds were regularly apprised of the financial risks through periodic statements.

In addition, she said, Puerto Rico government rules require that two-thirds of the securities in its local tax-free funds be Puerto Rico securities in order for an investor to earn a local tax exemption.

"General weakness in municipal markets across the U.S. and Puerto Rico, and apprehension about the direction of interest rates, have led to steep declines in Puerto Rico municipal bond and closed-end fund prices and a lack of liquidity for these securities," Byrne said.

Byrne said the recent volatility of the municipal bond market caused both "losses and unrealized losses" among closed-end mutual fund investors, but would not provide estimates because the firm was still gathering information.

Attorney Jeffrey Erez, who estimated losses at "hundreds of millions of dollars," said many fund investors also used leverage to buy shares of the fund and were especially hard hit.

Shares in the funds have become illiquid, said Erez, whose firm Miami-based firm Sonn-Erez has teamed up with island firm Aldarondo & López Bras to advise investors on potential legal remedies.

Banks in Puerto Rico reported \$533 million in Puerto Rico government bond holdings as of Aug. 31, according to the Office of the Financial Institutions Commissioner. Puerto Rico assets, including sizeable holdings of Puerto Rico bonds, held by

mutual funds were \$9.2 billion on Aug. 31, down from \$11.4 billion a year earlier, according to the commissioner's office.

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