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Ordinary Investors Could Lose if Puerto Rico Goes Bankrupt.

Average, passive small investors throughout the United States may not realize it, but some of their money, too, may be at risk as Puerto Rico struggles with its debt crisis.

A select group of municipal bond funds have increased their shares in Puerto Rico despite the continuing battle in Congress over how to help the strapped commonwealth pay its $72 billion debt.

Municipal-bond mutual funds run by OppenheimerFunds and Franklin Resources' Franklin Templeton Investments have the highest exposure to Puerto Rico's debt, according to data from Morningstar.

Oppenheimer and Franklin are global investment firms that manage assets and provide investment advice for investors large and small. Both offer funds, or groupings of investments, to investors.

As of last week, 44 percent, or 259, of 588 traditional municipal bond funds in the U.S. have exposure to Puerto Rico. Which means some hands-off investors, including those whose financial matters are handled by a broker, have a vested interest in what happens to Puerto Rico.

While there are no figures to ascertain who invests in these bond funds, they are considered lower-risk and are often used by older investors seeking a relatively safe place for money – although the primary risk is the default of the bond holder, which is relatively rare.

Both Oppenheimer and Franklin have slightly increased their Puerto Rican holdings since August. Both remain optimistic that despite the economic woes, Puerto Rico will make good on its bond obligations.

In a February press release, Oppenheimer said Puerto Rico needs to adopt a process under which its sales tax revenue is securitized, or packaged, and sold to investors. "At OppenheimerFunds, we have invested in Puerto Rico and its bonds for decades," the statement said. "We have a broad vision and long-term horizon and want to help Puerto Rico's economy grow. We welcome the opportunity to work with Puerto Rico to advance our common cause of finding solutions that will aid the long-term economic growth, well-being and investment in Puerto Rico."

Franklin, also in February, told investors that it was "considering our legal actions" with regard to its holdings in Puerto Rico.

The Puerto Rican government is seeking to file for bankruptcy, a move supported by the Obama administration.

But foes of that strategy say federal code does not permit that. As a U.S. territory rather than a municipality such as Detroit, Puerto Rico is not allowed to file for bankruptcy unless Congress amends current law. Instead, those opponents are seeking a restructuring with oversight protections, which could allow Puerto Rico to skirt some repayment rules.

The Wall Street Journal this week reported that Oppenheimer and Franklin, along with some bond insurers, met with congressional staffers involved in crafting legislation concerning Puerto Rico's debt.

Critics claim anything dealing with Puerto Rico comes with trouble, including investments.

"I think the investments are toxic," said Jake Zamansky, a New York lawyer who is handling the claims of investors who said they were led into sinking their money into Puerto Rico funds that were risky. They subsequently endured losses of much of their estate in some cases. In September, UBS AG's wealth-management unit was ordered to pay investors from a $2.9 million fund for losses linked to Puerto Rico's municipal bonds.

"I don't see any way that Puerto Rico can get out of this," Zamansky said. "It can't go bankrupt and it will be litigating with its creditors for years. And it's become a political issue in the U.S. now."

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by Steve Miller

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