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# United States Senate

COMMITTEE ON FINANCE

WASHINGTON, DC 20510-6200

CHRIS CAMPBELL, STAFF DIRECTOR  
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February 10, 2016

The Honorable Alejandro Javier García Padilla  
Governor  
Commonwealth of Puerto Rico  
La Fortaleza  
San Juan, Puerto Rico

Dear Governor,

As you know, Congress is considering ways to assist Puerto Rico in light of Puerto Rico's economic and financial challenges. Some have proposed construction of a new, broad federal debt restructuring mechanism encompassing Puerto Rico's obligations, many of which were issued to investors across the United States on a triple tax free basis, stemming from municipal debt, General Fund debt, COFINA debt, public pension liabilities, and debts issued from public corporations. All told, debts and unfunded public pension liabilities total \$117 billion or more. A broad restructuring authority for debts associated with municipalities encompassing such a large amount of total liabilities would be unprecedented in the history of bankruptcy proceedings applied to municipalities.

Unfortunately, it has been challenging to acquire recent verifiable financial information about Puerto Rico's financial condition. In addition, given what appears to be a large stock of severely underfunded public pension promises in Puerto Rico, I wish to clarify the nature of the pension systems. Consequently, I am writing to obtain information that will prove useful to Congress and other stakeholders as we continue to work to find measures to assist the people of Puerto Rico as the government of Puerto Rico continues to face financial and transparency challenges.

Please respond to the questions and requests for updated, verifiable information below, not later than March 1, 2015.

- 1. Debt and Puerto Rico's Constitution:** As I understand it, general obligation (GO) debt issued by Puerto Rico is secured by the "good faith and credit" of the central government, and in Puerto Rico it is also backed by a constitutional promise to pay such bonds before any other expenditure. Recent offering documents associated with GO bonds identified that: "The Bonds are general obligation bonds of the Commonwealth of Puerto Rico (the 'Commonwealth'). The good faith, credit and taxing power of the Commonwealth are irrevocably pledged for the prompt payment of the principal of and interest on the Bonds. The Constitution of Puerto Rico provides that public debt of the Commonwealth, which includes the Bonds, constitutes a first claim on available resources. The Constitution of Puerto Rico empowers a holder of bonds and notes evidencing public debt, including the Bonds, to bring suit against the Secretary of the Treasury to require application of

available Commonwealth resources to the payment of principal of, and interest on, public debt when due.”

- a. Do you agree that Puerto Rico’s GO debt, according to Puerto Rico’s Constitution, has repayment priority over any other debt repayment and any other debts of Puerto Rico?

**2. Financial Statements:**

- a. Please provide updated audited financial statements for Puerto Rico, including the Commonwealth’s Comprehensive Annual Financial Report (CAFR) with a clean opinion from the Commonwealth’s auditors and statements of each of the three major public pension systems of Puerto Rico with clean opinions from actuaries and auditors.
- b. In a recent disclosure to the MSRB dated October 30, 2015, the Commonwealth of Puerto Rico’s Government Development Bank stated in a “Notice of Failure to File Annual Report” that the Commonwealth would not file its audited financial statements for fiscal year **2014** by October 31, 2015, as the Commonwealth had previously announced, stating that: “The Commonwealth cannot provide an estimate at this time of when it will be able to complete and file its audited financial statements.” In turn, the stated inability to file those statements was “principally due to the delay of certain component units and fiduciary units in completing their financial statements and the independent auditor’s decision to conduct additional audit procedures given the liquidity risk and uncertainties affecting the Commonwealth and such units and funds.” Among “the component units and fiduciary funds that have not issued their audited financial statements” as of October 30, 2015 were the three retirement systems of the Commonwealth.
- c. Please provide copies of all reportable event notices provided to the Municipal Securities Rulemaking Board (MSRB) over the past three years in connection with the Commonwealth’s disclosure obligations, including the continuing disclosure obligations imposed on issuers of municipal securities by Rule 15c2-12 of the Securities Exchange Act of 1934 and municipal secondary market disclosures.

**3. Total Amount of Debt Outstanding, and Sources of the Debt:**

- a. According to “An Update on the Competitiveness of Puerto Rico’s Economy,” (July 31, 2014, Federal Reserve Bank of New York): “Puerto Rico’s total public debt (as of December 2013) is comprised of five major components: 1. General obligation and/or full faith and credit debt (\$15.8 billion, or 21.9 percent of \$71.9 billion outstanding) 2. COFINA (\$15.6 billion, or 21.7 percent) 3. Municipalities and other (\$13.2 billion, or 18.4 percent) 4. Tax revenue anticipation notes (\$1.1 billion, or 1.4 percent) 5. Public corporations and agencies (\$26.2 billion, or 36.4 percent).” Please provide updated data.
- b. How many units associated with the government of Puerto Rico have authority to issue debt sold to investors on a tax free basis (free of Federal, U.S. State, and/or Puerto Rico income taxes)?
- c. Please name those units.
- d. What is the amount of the annual debt service payable by each of those units, listed individually?
- e. Please indicate which items of debt service are either subject to the full faith and credit of the Commonwealth of Puerto Rico or guaranteed by the Commonwealth.

**4. Expenditures:**

- a. In each of the past five fiscal years, how much of the general fund has been used for expenditures on: **health** (including: Environmental Quality Board; Department of Health; Puerto Rico Medical Services Administration; Puerto Rico Solid Waste Authority; Puerto Rico Health Insurance Administration; Medical Services Administration; and the University of Puerto Rico Comprehensive Cancer Center); **public housing and welfare** (including: Office of Youth Affairs; New Business Training Administration; Department of Labor and Human Resources; Labor Relations Board; Department of Housing; Department of Recreation and Sports; Administration for the Horse Racing Sport and Industry; Women’s Affairs Commission; Public Housing Administration; Office of the Veteran’s Ombudsman; Department of Family; Family and Children Administration; Minors Support Administration; Vocational Rehabilitation Administration; Social Economic Development Administration; Office of the Disabled Persons Ombudsman; Office for Elderly Affairs; Right to Employment Administration; Company for the Integral Development of the Peninsula de Cantera; Industries for the Blind and Other Disabled Persons of Puerto Rico; Patient Ombudsman; Administration for the Care and Development of Children; Special Communities Trust; and the Puerto Rico Public Finance Authority); **education** (including: Department of Education; Institute of Puerto Rican Culture; Puerto Rico School of Plastics Art; State Office for Historic Preservation; University of Puerto Rico; Musical Arts Corporation; Fine Arts Center Corporation; Puerto Rico Public Broadcasting Corporation; Athenaeum of Puerto Rico; Puerto Rico Conservatory of Music Corporation; Puerto Rico Council on Education); and **interest**.
- b. In a June 30, 2013 report: “Commonwealth of Puerto Rico: Basic Financial Statements and Required Supplemental Information” (hereafter, “the June 30 Report”) prepared by the Puerto Rico Department of the Treasury, government activities for 2013 involved expenses of \$21,513 million, of which 15.18% were for general government, 15.09% were for health, 17.35% were for housing and welfare, 22.74% were for education, and 9.76% were for interest. By far the highest expense was labeled “education.” In recent offering documents associated with General Obligation Bonds issued by Puerto Rico, it was written that: “The budget appropriation for the Commonwealth’s Department of Education represents 25% of the total General Fund budget for fiscal year 2014. Historically, the Department of Education has experienced inadequate cost control mechanisms and produced annual operating expense overruns. Due to the considerable size of the Department of Education budget, the Commonwealth’s ability to achieve a balanced General Fund budget depends on its ability to continue to monitor and control Department of Education Expenditures. The Commonwealth’s accounting, payroll and fiscal oversight information systems have deficiencies that have significantly affected its ability to control Department of Education expenditures. There is no assurance that the Department of Education budget estimates for fiscal year 2014 will be achieved or that the Commonwealth will be able to implement sufficient cost and expenditure controls at the Department of Education in order to prevent future budget overruns.”
- i. Have cost and expenditure controls been improved recently?
  - ii. Have representatives of the U.S. Treasury, who have been given authority by Congress to provide technical assistance to Puerto Rico, been able to provide any help along this dimension?
  - iii. If so, what have they done?

- c. In the June 30 Report, the basis financial statements of the Commonwealth include financial statements of many ‘component units,’” including (using titles given in that report): Public Buildings Authority; Puerto Rico Infrastructure Financing Authority; Puerto Rico Maritime Shipping Authority Puerto Rico Medical Services Administration; Special Communities Perpetual Trust; The Children’s Fund; Agricultural Enterprises Development Administration; Automobile Accidents Compensation Administration; Cardiovascular Center Corporation of Puerto Rico and the Caribbean; Company for the Integral Development of the “Península de Cantera;” Corporation for the “Caño Martín Peña” ENLACE Project; Corporation for the Development of the Arts, Science and Film Industry of Puerto Rico; Corporation of Industries for the Blind and Mentally Retarded and Incapacitated Persons of Puerto Rico; Culebra Conservation and Development Authority; Employment and Training Enterprises Corporation; Farm Insurance Corporation of Puerto Rico; Fine Arts Center Corporation; Institute of Puerto Rican Culture; Institutional Trust of the National Guard of Puerto Rico; Land Authority of Puerto Rico; Local Redevelopment Authority for Roosevelt Roads; Puerto Rico Musical Arts Corporation; National Parks Company of Puerto Rico; Port of the Americas Authority; Public Corporation for the Supervision and Deposit Insurance of Puerto Rico Cooperatives; Puerto Rico Aqueduct and Sewer Authority; Puerto Rico Conservatory of Music Corporation; Puerto Rico Convention Center District Authority; Puerto Rico Council on Education; Puerto Rico Electric Power Authority; Puerto Rico Health Insurance Administration; Puerto Rico Highways and Transportation Authority; Puerto Rico Industrial Development Company; Puerto Rico Industrial, Tourist, Educational, Medical and Environmental, Control Facilities; Financing Authority; Puerto Rico Land Administration; Puerto Rico and Municipal Islands Maritime Transport Authority; Puerto Rico Metropolitan Bus Authority; Puerto Rico Municipal Finance Agency; Puerto Rico Ports Authority; Puerto Rico Public Broadcasting Corporation; Puerto Rico Public Private Partnerships Authority; Puerto Rico School of Plastic Arts; Puerto Rico Telephone Authority; Puerto Rico Trade and Export Company; Solid Waste Authority; State Insurance Fund Corporation; University of Puerto Rico; University of Puerto Rico Comprehensive Cancer Center.
- i. Is that a complete list of the component units whose statements give rise to the overall financial statement of the Commonwealth?
  - ii. Which, if any, of the component units have not provided statements necessary for Puerto Rico to fulfill its obligation to provide audited financial statements for recent fiscal years?
- d. According to the June 29, 2015 report titled “Puerto Rico – A Way Forward,” by Anne O. Krueger, Ranjit Teja, and Andrew Wolfe, a study that “was prepared at the request of legal counsel”: “Puerto Rico currently has 40% fewer students but 10% more teachers than a decade ago.” Are those statistics accurate?
- e. The so-called Krueger Report, referred to above, identifies that, in Puerto Rico: “Workers are disinclined to take up jobs because the welfare system provides generous benefits that often exceed what minimum wage employment yields; one estimate shows that a household of three eligible for food stamps, AFDC, Medicaid and utilities subsidies could receive \$1,743 per month—as compared to a minimum wage earner’s take-home earnings of \$1,159.” A June, 2012 report on the competitiveness of Puerto Rico’s economy, produced by the Federal Reserve Bank of New York, identifies that: “A wider reexamination of the application of the federal minimum wage and the design of entitlement programs may also be warranted in order to improve incentives to seek employment and increase the number of jobs available for workers on the Island.” What do you support in terms of alterations, if any, to the application of the federal minimum

wage to Puerto Rico as well as alterations, if any, to implementation of rules governing food stamps, AFDC, Medicaid, and utilities subsidies?

- f. The Krueger Report also identifies that: “Welfare needs to be made consistent with local labor market conditions rather than with US mainland conditions. The federal government should give the Commonwealth more latitude to adjust welfare requirements and benefits—e.g., to continue food stamps for a while even after a person returns to work; or to provide lower housing benefits to more people rather than higher benefits to a few (the Commonwealth block grant is capped and insufficient for all those who qualify). Puerto Rico too can act here, cutting back the Medicaid benefits it pays out over and above the Federal minimum standard (this saving some \$150 million per year).” Do you agree with those recommendations?

5. **Public Pensions:** As with Puerto Rico, many State and local public pension plans are critically underfunded: aggregate estimates of underfunding range from around \$1.3 trillion to over \$4.0 trillion, with differences accounted for by varying assumptions. Moreover, underfunded public pension plans have factored into resolutions of a number of recent, large municipal bankruptcies, and it is likely that future municipal bankruptcies will also involve, in one way or another, underfunded pension plans.

In the case of Puerto Rico public pensions, I understand that there are significant unfunded actuarial accrued liabilities (UAALs), high UAALs as a percentage of covered payrolls, and low funded ratios (ratios of pension assets to liabilities). Although the Commonwealth enacted legislation in 2013 and 2014 to reform the pension systems, those reforms were designed to address the Commonwealth’s cash flow needs and “pay-as-you-go” requirements, and the retirement systems will continue to have large UAALs and low funded ratios. Public pension funding requirements place demands on the Commonwealth’s General Fund (since the Commonwealth sponsors pension plans and is obligated to make contributions to the trust funds of the plans); not all of the enacted reforms survived challenges that were adjudicated at the level of Puerto Rico’s Supreme Court; and of the reforms that survived, some of the additional annual pension contributions required by the reforms have not been made.

As I understand it, there are three major public pensions in Puerto Rico: the Puerto Rico Government Employees Retirement System (ERS for short); the Puerto Rico Teachers Retirement System (TRS); and the Puerto Rico Judiciary Retirement System (JRS). Collectively, I will refer to the three as the Public Retirement Systems, and the “trust funds” underlying the collective system as the Pension Trust Funds. Collectively, as I understand it, those the systems have, around \$44 billion in net pension liabilities, a funded ratio (ratio of pension assets to liabilities) of around 4%, and significant UAALs. And the largest plan, ERS, representing approximately \$30 billion of the \$44 billion in net pension liabilities, appears to have exhausted its assets entirely and may be in “pay-as-you-go” status, saddling the Commonwealth with what are essentially additional debt service obligations.

Adding the \$44 or so billion in net pension liabilities to the \$73 billion or so of outstanding debt that is backed in one way or another by governments in Puerto Rico, and

the size of a “broad, comprehensive” restructuring authority, which I understand is backed by you and some other officials in Puerto Rico, may involve \$117 billion or more of liabilities. That amount would be, by many multiples, the largest ever contemplated for Chapter 9-like bankruptcy procedures in the history of the country.

As you are aware, U.S. Treasury officials have discussed with stakeholders a proposal for broad, comprehensive debt restructuring authority based on creation of new federal law, under which public pension obligations of Puerto Rico would enjoy explicit preference over similarly situated unsecured obligees, including GO bondholders. Do you support such a structure? Do you believe that such a structure, by placing GO bondholders in an unsecured creditor class with public pension obligations that could receive priority over GO bondholders, would be inconsistent with Puerto Rico’s Constitution?

Given that legislative specifications of a discussion draft of the Obama Administration’s proposal, which I understand you have seen, would instruct bankruptcy adjudicators to favor public pension obligations over similarly situated obligations of Puerto Rico, including GO debt, I respectfully request information about the status of the Public Retirement Systems, each of the three major components, and the Pension Trust Funds, along with each of the components. Please provide responses to the following, including the most recent verifiable data where data are requested:

- a. How much in assets were held by the trust fund of each of the systems: the ERS; the TRS; and the JRS in each of the past five fiscal years, including the fiscal year ending June 30, 2015?<sup>1</sup>
- b. What is the composition of those assets?
- c. What is the projected date of asset depletion in each of the three systems, according to the most recent verifiable estimates of the plans’ actuaries?
- d. According to the June 30 Report referenced above: “Loans receivable from plan members are guaranteed by the contributions of plan members and by other sources, including mortgage deeds and any unrestricted amount remaining in the escrow funds. In addition, collections on loans receivable are received through payroll withholdings. For the year ended June 30, 2013, the maximum amount of loans to plan members for mortgage loans was \$100,000, and \$5,000 for personal and cultural trip loans.” Also, according to the report, loans and interest receivable from plan members, after allowance for adjustments and losses in realizations, was \$1.2 billion, including \$1.1 billion for personal and mortgage loans and \$70 million for “cultural trips” loans. As I understand it, “cultural trips” or “educational tour loans have been made to public retirement system members, where the Government of the Commonwealth of Puerto Rico pays 50% of the interest on the loan made to a public employee or pensioner, as the case may be, to “participate in such tours.” Moreover, as I understand it, such loans may be used for trips or excursions organized or approved by the Administrator for the Employees Retirement System of the Government of Puerto Rico and its Instrumentalities, or the Teachers Retirement Board,

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<sup>1</sup> If information relating to the fiscal year ending June 30, 2015, is not available, please provide information for the five most recent fiscal years that is available and send the 2015 fiscal year information as soon as it becomes available.

on behalf of public employees and pensioners “so that they may travel to foreign countries for rest, recreation or educational pursuits.”

- i. How much, in terms of asset value, and what share of overall trust fund asset value, is held in the form of loans receivable from plan members in each of the three systems?
  - ii. Are subsidized loans to plan participants (actively employed currently contributing members as well as current beneficiaries) for personal loans, for mortgage loans, and for cultural trips still available? If so, please provide the terms of such loans currently under offer.
- e. According to the June 30 Report referenced above, the three main retirement systems are omitted from government financial statements “as their resources are not available to fund operations of the Commonwealth.” It is also made clear that those systems “are excluded from the provisions of the Employee Retirement Income Security Act of 1974 (ERISA).” As I understand it, reforms were recently made to the ERS which converted some system members from a “defined benefit” to a “defined contribution” system, according to statements from Puerto Rico officials.
  - i. For those beneficiaries for whom a defined contribution is in place, and given that resources of the retirement systems “are not available to fund operations of the Commonwealth,” is it the case that all funds placed into the ERS system by those operating as defined contribution participants, including funds required from employers, are held in the form of system assets?
  - ii. Is that also true for the TRS and the JRS?
  - iii. If so, please provide evidence of the existence of the assets and of what must have been growth in those assets given contributions that have been made since the inception of the defined contribution part of the system.
  - iv. Have any defined contribution system assets been used, directly or indirectly, to fund the operations of the Commonwealth or any political subdivision or public corporation of the Commonwealth? If yes, how much has been used and for which governmental entity or entities?
- f. How much is necessary, in terms of expected average recurring outlays from the General Fund throughout each of the next five years, for the three funds to maintain solvency?
- g. Puerto Rico Government Employees Retirement System (ERS), provides benefits to members, or their beneficiaries, upon: retirement; disability; vested withdrawal; death; and non-vested withdrawal. Members also receive “bonuses.” Benefits that have been granted under a series of special laws, which are administered by the ERS include: minimum pension benefits; additional minimum death benefits; ad-hoc cost-of-living adjustments; medical insurance plan contribution; Summer bonus (an “annual bonus paid in July” by the General Fund of Puerto Rico); Medication bonus (an “annual bonus to cover health costs paid in July by the General Fund of Puerto Rico); Christmas bonus (an “annual bonus paid in December” by the General Fund of Puerto Rico). Recent changes to benefit promises to some currently active system participants have reduced or eliminated some of the bonuses and may have provided early retirement incentives, some of which may be payable from the Puerto Rico General Fund. Please identify what bonuses (Summer bonus; Medication bonus; Christmas bonus) are currently promised to active plan members and existing beneficiaries under each of the three plans (ERS, TRS, JRS), and identify what changes have been made over the past three years.

- h. Your administration faced pension systems facing near-term insolvency resulting from long periods of underfunding, poor oversight, and neglect. As part of recent pension reforms, additional contributions from the commonwealth and other participating employers in the ERS were called for, but were not made. While fiscal pressures on the commonwealth coincide with the pullback in contributions, contribution shortfalls today increase required future contributions. While the Commonwealth enacted reforms to strengthen the ERS, its efforts to change its other pension plans have been struck down in part by the Puerto Rico Supreme Court in 2014.
  - i. What reforms since the decisions to strike down earlier reform efforts aimed at the TRS system have been made to the ERS, TRS, and JRS?
  - ii. What legislation has been put forward aimed at reforms to the TRS since the decision of the Puerto Rico Supreme Court?
  - iii. Absent further reforms, are the finances of the TRS sustainable?
  - iv. Absent further reforms, are the finances of the ERS sustainable?
  - v. Absent further reforms, are the finances of the JRS sustainable?
- i. Regarding the current financial status of each of the three major public pension plans in Puerto Rico:
  - i. Are any of the ERS, TRS, or JRS operating on a pay-as-you-go basis?
  - ii. If yes, which system and when did it become a pay-as-you-go system?
  - iii. If not, how close is each system to pay-as-you-go pension funding, which will continue to drain general fund resources?
  - iv. In conformance with generally accepted actuarial principles and practices which are consistent with the Actuarial Standards of Practice promulgated by the Actuarial Standards board and the applicable Guides to Professional Conduct, amplifying Opinions, and supporting recommendations of the American Academy of Actuaries and consistent with the application of Government Accounting Standards Board Statements, for each of the ERS, TRS, and JRS, please provide, using the most recent audited retirement system data, the actuarial valuation report, annual required contribution, annual pension cost, and annual other postemployment benefit (OPEB) cost for the fiscal year ending June 30, 2014 and the fiscal year ending June 30, 2015 based on relevant Statements of the Government Accounting Standards Board.
  - v. For the fiscal year ending June 30, 2014 and the fiscal year ending June 30, 2015, please provide the aggregate annual outlays for each year for all benefits and expenses of each system.
  - vi. Is the Commonwealth of Puerto Rico, or any political subdivision or public corporation of the Commonwealth, obligated to fund the pension plan of the University of Puerto Rico?
  - vii. Are there any other public pension plans operating in the Commonwealth of Puerto Rico not been mentioned above? If yes, please list the plan and identify the plan sponsor.

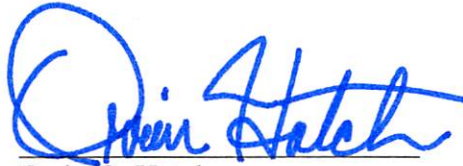
**6. Technical Assistance from U.S. Treasury Employees:**

- a. Please summarize what assistance, to date, the government of Puerto Rico has received from U.S. Treasury employees, technical or otherwise.



- b. Does the government of Puerto Rico, or any of its component units, have a confidentiality agreement with any employee of the U.S. federal government? If so, please identify the parties to the agreement.

Sincerely,

A handwritten signature in blue ink that reads "Orrin Hatch". The signature is written in a cursive style with a large, circular initial "O".

Orrin G. Hatch  
Chairman  
Senate Committee on Finance