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*Consummate Professionals - Four Decades of Success*

October 14, 2016

**Executive Brief**

Hon. Pedro Pierluisi  
The Puerto Rico Congressional Task Force

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**Re: Recommendations for the economic recovery of Puerto Rico as proposed by the Puerto Rican Cooperative Industry and State Chartered Credit Unions<sup>1</sup>.**

We respectfully submit to your consideration our suggestions of how to facilitate the insertion of the Puerto Rico Cooperative Sector in the revitalization of the Puerto Rico's economy. We acknowledge that there are other members of the Cooperative Sector such as Puerto Rico Credit Unions and Banco Cooperativo (Cooperative Bank), that could be submitting recommendations about ways the Cooperative Sector can help the Puerto Rico's economy. We come forward with a series of recommendations with the following primary purpose:

1. Ensure State Chartered Credit Unions liquidity in order to maintain financial and economic stability, continued community lending and stir local entrepreneurship.
2. Create a strategic alliance among the Cooperative Sector, State Chartered Credit Unions and the United States Federal government and its agencies pursuing economic development.
3. Play a participative active role in the future well-being of our community.

Please be assured that the recommendations below have as main objective to insert the Puerto Rico Cooperative Sector as a key player in the economic development of Puerto Rico.

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<sup>1</sup> Non-Profit financial savings and lending cooperatives whose members are also part owners, under the regulatory authority of the "Corporación para la Supervisión y Seguros de Cooperativa" (COSSEC), the local Puerto Rico Credit Union regulator and insurer.

Recommendations:

1. Improve the Liquidity of State Chartered Credit Unions in order to stabilize the industry and thus stimulate sound lending for Individuals and Small Business.

Federal Assisted Liquidity programs for State Chartered Credit Unions under one or more of the following proposed programs:

- a. The issuance of Federal Government guaranteed equity instruments for an amount to be determined ensuring sufficient liquidity for State Chartered Credit Unions under specific monitoring and financial terms of reference. The plan would be to stabilize the local credit union system and provide the necessary resources to allow the Puerto Rico Cooperative sector to support the Puerto Rico economic development. This would be similar to the National Credit Union Administration's<sup>2</sup>, corporate resolution program of September/ 2010. As part of that resolution plan it created a guaranteed note program to stabilize the U.S. credit unions, protect the National Credit Union Share Insurance Fund<sup>3</sup> ("NCUSIF"), and provide long term funding for distressed investment securities from failed credit unions
- b. The investment by the US Treasury Department directly in equity securities issued by COSSEC. This would be a more expedite alternative than (a) above for providing the necessary liquidity to Puerto Rico Credit Unions, and allow them to continue lending and promoting economic development.
- c. Federal Guarantee of Credit Lines with Credit Union Service Organizations<sup>4</sup> ("CUSO"). The Federal government could provide limited or unlimited guarantees, dependent on the financial strength of the requesting State Chartered Credit Union, to CUSO's so they may provide either Revolving or Non-Revolving Lines of Credit and/ or undertake deposits. Currently either of these is placed solely with cash collateral requirements due to the contagion country risk. These Federal Guarantees could also mandate standard collateral options traditionally typical for these transactions that currently are not available to local sources. The possibility of obtaining this additional financing or

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<sup>2</sup> The National Credit Union Administration ("NCUA") is the independent federal agency created by the United States Congress to regulate charter and supervise federal credit unions. With the backing and the full faith and credit of the U.S. government, NCUA operates and manages an insurance fund in all federal credit unions and an overwhelming majority of state- chartered credit unions in the United States.

<sup>3</sup> The National Credit Union Share Insurance Fund is administered by the NCUA for the purpose of providing deposit insurance to protect the deposits of credit union members. The NCUSIF is funded by participating credit unions.

<sup>4</sup> Credit Union Service Organizations ("CUSO") are corporate entities owned by federally chartered or insured state chartered credit unions. CUSO's typically serve credit unions and credit union members performing permitted services. For example not all credit unions have the capital to gain the expertise to originate business loans. But if several credit unions pool their resources they can afford to hire the right individuals and in turn provide such service to its members.



deposit placement opportunity for State Chartered Credit Unions will also increase liquidity options.

Any of the recommended Federal Liquidity Programs could be issued and managed by COSSEC, now under the oversight of the newly constituted Puerto Rico Fiscal Control Board. The source of repayment will come from the premiums collected by COSSEC. These funds will primarily be utilized to provide liquidity to State Chartered Credit Unions to promote lending activity helping in turn to increase economic activity. In addition, in case it is deemed necessary COSSEC will have the resources to help in the potential consolidation process amongst State Chartered Credit Unions that combined are deemed viable and require such transition funding.

The recommended timeline for this initiative given its urgent nature should be no later than the first quarter of 2017 while providing time for delineated Guaranty approval, emission details, monitoring, placement and messaging. The later considered of importance as it provides a balancing economic stimulant while other related or unrelated economic measures are concurrently enacted.

*Situational Credit Union Liquidity background noted in Appendix 1.*

2. Strategic Alliances with several Federal Agencies in order to properly channel and transfer information related to economic development.
  - a. HUD (Housing Urban Development). Puerto Rico has a pent up demand for low cost housing in both urban and rural sectors. Credit Unions given their community outreach can play a pivotal role in obtaining much needed investments for either for-purchase or for-lease of affordable housing (i.e. Low Income Tax Credit – PR Housing IRC Section 42). The programs to be contemplated are new construction as well as remodeling and/ or those repopulating City or Town centers.
  - b. Expand funding for Small Business Administration (“SBA”) and United States Department of Agriculture (“USDA”) programs including State Chartered Credit Unions as eligible participants. Again these programs provide good opportunities for business ventures in start- up or leveraged ventures.
  - c. Launch locally the Community Development Financial Institutions Fund<sup>5</sup> (“CDFIIF”) by way of pilot programs with selected State Chartered Credit Unions. CDFIIF is previewed as innovative funding source that may generate creative entrepreneur incubators which is sorely lacking in our economy.

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<sup>5</sup> CDFIIF is an impact investor and a non-profit Investment fund. Its mission is to increase access to low income and underperformed communities by serving as a catalytic agent by investing capital, facilitating financing, and creating innovative business opportunities. They are known for their business modeling and social performance metrics.

How these alliances may be extended is by the transferring of knowledge in the recommended following manner:

- a. Access to agency Spanish speaking staff and documentation so as to accommodate these demographics.
- b. Explore the possibility of establishing a development specific provisional office in Puerto Rico that will serve as a one stop center for Lenders. These offices could be temporary development centers due to our government fiscal crisis, on-going recession and demographic drain. They should be measured by successful development metrics, so as to jump start the programs, ensure governance and adequate monitoring and obtain long awaited positive economic results.

Summary:

The role of the Credit Unions is best defined by its numbers. As of December 31, 2015 they represented \$8.5B in assets with loans extended of \$4.6B (both represent approximately 9% of total financial industry assets and loans). With a 223 branch network , 3,420 employees, 975,000 stakeholders (approximately 30% of the total population), 331,500 non-member deposit holders they have grown in stature filling the void left by the closure of commercial banks especially in small towns. It is estimated that their market penetration rate is of 24% of the population. Credit unions can serve to be one of the components of the economic recovery. Not only be providing financial guidance but also in the concept of entrepreneurship; as a member you are stakeholder for a collective purpose and need. It is participative in nature and provides even the skills and knowledge for individuals to branch out in other fields.

Credit Unions will also serve the next generation with focuses on agriculture and technology. This will also be an essential component of their strategic plan in order to grow its small business lending above its 6% of total loans average.

The Industry accordingly wants to be a strong and active player in the new dynamics of our island's economic situation. We have ample evidence available supporting an in-depth analysis of the importance of the Cooperative Sector on the island economy that can be provided to you on short notice.

These recommendations address our needs from both a financial and market perspective. We are available to discuss these and others for the greater benefit of this community.

## Appendix 1

### Credit Union Liquidity Causes and Effects

From 2009 to 2012 Puerto Rico Credit Unions grew its deposit base (average 5-7%, year- over -year) given the closure of three local financial institutions and the uncertainty created by the recessionary cycle. While liabilities increased assets (lending activity) grew at a slower pace during this period growing 2-2.5%, a result of the recession and lack of credit opportunities. This caused many Credit Unions to invest their liquidity in either local Government bonds or in Certificates of Deposit from other Credit Unions.

Regulation 7051 (proceeding from Law 255 dated 2002) regulates Credit Union investments. Subsequently in 2009 by way of Circulatory Letter (09-03) COSSEC permits investments particularly in those emitted by the Puerto Rico Government Development Bank ("GDB"). In addition, in the same communication was stated that if these investments were to diminish in value this would not be a violation of the conditions set in Regulation 7051; this last point could have motivated the management of some Puerto Rico Credit Unions to increase its holdings of Puerto Rico bonds . During 2012 COSSEC by way of Circulatory Letter (12-02) increases the permitted percentage of these government emitted investments held from 25% to 30%.

The result of these policies, the implicit or assumed Government and constitutional payment guarantees and the excellent offered yields had the effect of quadrupling Credit Union investments of these instruments in a four year period. These increased from \$400MM in 2009 to \$1.6B in 2012 with 60% consisting of GDB notes. Credit Unions did not diversify their investment portfolio but actually concentrated it politically and geographically.

Commencing in 2013 and as a result of the Government debt downgrades the Credit unions begin to incur in investment portfolio non realized losses. During 2015 many of the Bonds default and do pay neither stipulated principal nor interest. This begins to stress Credit Union projected liquidity. This fact along with attempts to solve the liquidity crisis have generated that approximately \$500MM in deposits have been withdrawn from the Credit Unions in a 12 month period comparatively 2015 to 2016.

Currently Investment portfolios average 40% to 45% market loss of value compared to cost. These investments currently have little or extremely discounted market resale acceptance.

Given the limited lending activities (flat during 2<sup>nd</sup> quarter 2016), non-payment of stipulated principal and interest of the Government held investments and deposit withdrawals from both individual and other Credit Unions, many Credit Unions are at the risk of becoming illiquid.

Many of these Credit Unions have been requesting financing from Banco Cooperativo de Puerto Rico whose primary liquidity forth comes from Credit Union deposits. This makes them all further vulnerable to a systematic industry liquidity risk.

Some Credit Unions have attempted to establish relationships for deposits or financing with United States Cooperate CUSOs (Credit Union Service Organizations). This has not been successful due to Puerto Rico risk and any facility would require cash collateral at a mandated coverage possibly over 1x.