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August 5, 2016

U.S. Senator Orrin Hatch
Senate Finance Committee, Chairman
104 Hart Office Building
Washington, DC 20510

Dear Senator Hatch:

I am pleased to submit to the Special Task Force established by Section 409 of the Puerto Rico Oversight, Management and Economic Stability Act (PROMESA) Public Law 114-87, the following idea which in my opinion could help Puerto Rico to get its fiscal house in order while strengthening economic growth.

The cost of my proposal would be born completely by the private sector, protect the interest of the bondholders, help to fund the actuarial deficit of the public employee pensions and jump start the Puerto Rico economy.

It is my understanding that Controlled Foreign Corporation (CFC's) operating in Puerto Rico contribute approximately \$1.8 billion dollars to the tax receipts of the Commonwealth from the 4% special tax on its earnings. This means that CFC's operating in Puerto Rico are earning approximately \$45 billion per year and therefore the accumulated earnings from 2006 to 2016 should be around \$450 billion dollars. These funds cannot be repatriated tax free to the U.S. as a result of the elimination of the tax free repatriation of earnings by the CFC's which previously operated as Section 936 companies.

On the other hand, the actuarial deficit of the public employee pension program is around \$50 billion dollars. The Government of Puerto Rico has failed to make the required contribution during the last three fiscal years and has been paying the pensions by liquidating the assets of the teachers, public employees, policemen and judicial branches employees. In addition, the Government used the assets of the deferred contribution program for public employees entering public service after the year 2000 to pay benefits to retired employees of the defined contribution program for employees who entered public service before the year 2000.

My idea is to grant a one time incentive to the CFCs whereby they can invest an amount equal to between \$45 and \$70 billion dollars in PR Pension Benefit and PR Economic Development Bonds which would have a yield (coupon) of 1% with a maturity of at least 10 years (due July 1, 2026). For every \$1.00 invested in these bonds the CFC would be permitted to repatriate ten times the face amount to the U.S. The proceeds from these bonds can only be used for:

- (1) Funding the actuarial deficits of the Retirement System of the Commonwealth of Puerto Rico (ELA, Teachers, Policemen and Judiciary).
- (2) Providing guarantee or Funding for Loans required to promote economic development in Puerto Rico such as Roads, Infrastructure Development (capital investment for water and power generation projects), health or low income housing.

The Executive Director of PROMESA should implement the required mechanism to assure that the proceeds are used for the intended purpose. Enclosed herewith as an **Exhibit** is an illustration of the Proposed IDEA. The retirement systems would issue sufficient bonds to be approximately 80% funded. To the extent possible the retirement systems could purchase a prudent amount to avoid over concentration of any PR Agency bonds which are currently yielding more than 15% in the market with maturities longer than 10 years to lock in these higher rates.

Effectively by paying 100% of its Constitutional Debt and 100% of the Debt that is not General Obligation Debt the Government of PR would benefit from the reduction of its actuarial deficit resulting from the arbitrage between the yield of the bonds issued at 1% yield and the current yield of its general obligation debt and other agency debt.

Instead of negotiating a cramp down and forcing U.S. bondholders, pension funds and mutual funds to realize a substantial loss of its investments the costs would be indirectly born by the same entities which benefited the most from the local tax incentives offered by the PR Government. This would also inject 10 times that amount into the US economy thereby stimulating investment in the U.S. economy and helping the trade deficit from the repatriation of these funds.

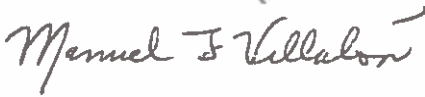
I hope this proposal assists your quest to address this particular matter, which aside from its effect on Puerto Rico's finances, bears very negatively on the most vulnerable of our citizens: the old aged.

U.S. Senator Orrin Hatch
August 5, 2016
Page 2

Finally I want to make myself available to you and your staff to further discuss or develop this proposal.

Thank you very much for your attention and interest to this and other matters related to Puerto Rico.

Sincerely yours,

A handwritten signature in dark ink, reading "Manuel F. Villalón". The signature is written in a cursive style with a prominent flourish at the end of the last name.

Manuel F. Villalón

Enclosure

EXHIBIT

Manuel F. Villalón
Letter dated August 5, 2016

