DR. RICARDO ROSSELLÓ NEVARES

March 1st, 2016

Chairman Orrin G. Hatch
Committee on Finance
United States Senate
Washington, DC 20510-6200

Dear Chairman Hatch,

I write to you in response to your letter dated February 10, 2016 to Governor Alejandro García Padilla regarding Puerto Rico's economic and fiscal crisis. I am responding to your letter because regardless of the response that you may or may not get from Governor García Padilla, as the leading candidate to become the next Governor of Puerto Rico, Congress should receive a clear message on how we plan on immediately addressing the crisis upon being elected. In your letter you highlight the challenge it has been to obtain recent verifiable financial information about Puerto Rico's financial condition. On behalf of the People of Puerto Rico, we applaud and support your efforts to obtain and disclose this vital information in order for all stakeholders to determine how to best contribute to the resolution of the crisis.

I make reference to my written statements to the Senate Judiciary Committee titled "Diagnosis and Treatment of Puerto Rico's Fiscal Crisis", submitted on December 1st, 2015 and to the House Committee on Natural Resources titled "A Sustainable Solution to Puerto Rico's Fiscal Crisis", submitted on February 2nd, 2016. In these statements we emphasize the urgent need for greater transparency and oversight of the government's finances and propose the establishment of a special permanent Joint Commission and Debt Management Authority with participation of the Federal and Commonwealth governments that would provide a robust and lasting collaboration framework to implement the necessary measures, focusing specifically on the management of the debt.

We also suggest that the imposition of an overarching Federal Fiscal Control Board at this point in time would federalize the crisis and rob the People of Puerto Rico of a legitimate opportunity to assume responsibility and resolve the crisis on their own terms. We believe that the Administration's focus on debt restructuring is a distraction from the urgent need to reduce government expenditures and restore economic growth. In order for a solution to Puerto Rico's fiscal problems to be sustainable, it must integrate the democratic will of the territory's residents and principal stakeholders and it is clear to everyone on the island that the current Administration is no longer representative of the will of the People of Puerto Rico or of their capacity to confront the crisis and take responsibility for its resolution.

As an ordinary citizen, I do not have access to any financial information that has not been publicly disclosed, but I will proceed to provide my policy perspectives on your very poignant questions.

1. **Debt and Puerto Rico's Constitution** – We believe wholeheartedly that Puerto Rico's General Obligation (GO) debt has a clear repayment priority over any other debt repayment and other governmental expenditures. This Constitutional guarantee has been an important factor, relied upon by countless GO creditors over many subsequent issuances, and should

not be retroactively amended by State or Federal statute or it will further erode the credibility and legal predictability of investing in the territory or, for that matter, in any other US state or local bond. In my written statement to the Senate Judiciary Committee, I further developed this point and am including it here for reference:

Paying the Commonwealth's Most Senior Obligations

The incoherence of the Garcia Padilla's Fiscal Adjustment Plan has increased investor confusion and alarm in part because it does not follow any established priority for Commonwealth obligations. If investors cannot rely on the legal framework established when they invested in Commonwealth debt, literally nothing is safe.

A vital first step in restoring investor confidence is to adhere to the rules of engagement established by the Commonwealth's Constitution and the legal contracts the government entered into when it issued debt. Attempts to change these rules after the fact, including by passing its own bankruptcy legislation, the Recovery Act, and by asking Congress to include Puerto Rico in Chapter 9, have obliterated the confidence of investors that is essential to Puerto Rico's achieving access to capital markets at reasonable interest rates.

Puerto Rico's Constitution provides the strongest possible protection for:

- $12.7 billion in outstanding General Obligation Bonds (GOs), and
- $5.6 billion of Public Building Authority Bonds and other bonds that carry a Commonwealth guarantee (Commonwealth Guaranteed Bonds or CGBs).

The Constitution provides that all Commonwealth Revenues (CRs) must be used first to pay these bonds before any other appropriation or contractual obligation, including certain bonds to which CRs have been pledged such as Highways and Transportation Authority Bonds (HTAs), Convention Center Development Authority Bonds (CCDAs) and Infrastructure Authority Bonds backed by the Rum Tax or the Petroleum Products Tax (PRIFAs). HTAs, CCDAs and PRIFAs were sold to investors with explicit provisions that the revenues pledged to these bonds included CRs which are subject to a "Claw Back" in favor of GOs and CGBs.

To ignore or seek to evade this provision of Puerto Rico's Constitution undermines the rule of law and the foundation of Puerto Rico's credit in the capital markets.

In addition, bonds issued by the Sales Tax Financing Corporation (COFINAs using its Spanish acronym), which are backed by a portion of the Sales and Use Tax (SUT) were sold to investors with the promise that these bonds are not subject to the Claw Back.

If Puerto Rico is to regain credibility with investors, it must first honor its obligation to pay debt service on GOs, CGBs and COFINAs above all else. This responsibility is far less onerous than the Garcia Padilla Administration and its army of lawyers and designed to maximize drama so as to justify the exorbitant fees being paid to this large group of debt restructuring consultants and lawyers.

2. **Financial Statements** – Much has been debated in recent weeks about the reasons for the Commonwealth's astounding delay in issuing audited financial statements for fiscal year 2014. The Administration would have us believe that this is a historical problem and one that should not be used as a valid reason to withhold judgement on the course of action to be taken to address Puerto Rico's problems. However, if we look at the historical data below, we can see that the last three Administrations have managed to issue half of their audited financial statements prior to the filing deadline and none have been remotely as late as this one, who at the time of this letter is over 300 days past-due.

Fiscal Year	Close	Deadline	Publish	Delay	Total	Auditor
2014	6/30/2014	5/1/2015		305	610	KPMG
2013	6/30/2013	5/1/2014	6/30/2014	60	365	KPMG
2012	6/30/2012	5/1/2013	9/16/2013	138	443	Deloitte
2011	6/30/2011	5/1/2012	4/27/2012	(4)	302	Deloitte
2010	6/30/2010	5/1/2011	4/27/2011	(4)	301	Deloitte
2009	6/30/2009	5/1/2010	10/22/2010	174	479	Deloitte
2008	6/30/2008	5/1/2009	8/12/2009	103	408	KPMG
2007	6/30/2007	5/1/2008	6/15/2008	45	351	KPMG
2006	6/30/2006	5/1/2007	8/1/2007	92	397	KPMG
2005	6/30/2005	5/1/2006	3/30/2006	(32)	273	KPMG
2004	6/30/2004	5/1/2005	4/8/2005	(23)	282	KPMG
2003	6/30/2003	5/1/2004	6/9/2004	39	345	KPMG
2002	6/30/2002	5/1/2003	5/30/2003	29	334	KPMG
2001	6/30/2001	5/1/2002	2/28/2002	(62)	243	KPMG
2000	6/30/2000	5/1/2001	12/29/2000	(123)	182	Deloitte

It is precisely in a time of crisis that greater transparency, discipline, and independent analysis are required in order to properly diagnose the problems and produce sustainable solutions. Regardless of the timing of the publication of the audited financial statements and the provision of additional unaudited financial disclosures by the Administration, we propose that the Joint Commission's first order of business should be to perform a comprehensive and independent audit of the debt and the Commonwealth's financial processes and condition, prior to prescribing measures that will impact stakeholder's rights beyond the enforcement of the pre-established payment priorities and contractual obligations.

3. **Total Amount of Debt Outstanding, and Sources of the Debt** – In July of 2015 the Administration approved Act 97-2015 to create an independent board to audit Puerto Rico's debt and in December of 2015 the Administration approved Act 208-2015 to create a local Fiscal Oversight Board, both of which have been virtually ignored by the investor community, the Federal Government, and the Administration itself, demonstrating a clear unwillingness or incapacity to act responsibly towards a sustainable solution and further

making the case that independent oversight and review should be the initial step to be taken by Congress.

Throughout the fiscal crisis, there has been relatively little discussion of the Government Development Bank (GDB) and its role at the center of the Commonwealth's debt expansion. Over many decades, Puerto Rico proliferated an array of financing structures and dedicated revenue streams that allowed it to grow debt beyond the Constitutional limits on GOs. The myriad of financing arrangements with the GDB and its subsidiaries are difficult to analyze and have contributed to the market's confusion over the sustainability of Puerto Rico's debt. Furthermore, the deliberate conflation of GDB's debts with those of the Commonwealth is aggravating this confusion.

Some analysts have highlighted the inherent conflict of interest that plainly exists in having the GDB, an independent issuer and the holder of some of Puerto Rico's most impaired debts, leading the strategy and the negotiations with bondholders on behalf of the entire Commonwealth and its various issuers. The Commonwealth and its other agencies have an under-appreciated exposure to the GDB's insolvency as billions of the Commonwealth's deposits that have been placed at the GDB to shore up the GDB's liquidity position have been exhausted and will likely not be replenished given the quality of the credit portfolio held by the bank. If Commonwealth officials were acting independently, protecting the interests of the Central Government and attempting to implement the payment priorities established by the Constitution, they should demand the immediate withdrawal of the remaining cash held at the GDB and allow the insolvent institution to pursue its own path forward.

4. **Expenditures** – In my written statement to the Senate Judiciary Committee, I emphasized the need to look beyond the current fiscal crisis, which is primarily a liquidity crisis brought about by rising debt levels, low (but positive) nominal GDP growth, and a loss of investor confidence in the government's policies and actions, and begin addressing the structural mismatch between recurring revenues and expenses throughout the government and its instrumentalities:

> **Looking Beyond the Current Fiscal Year**
>
> It is time for Puerto Rico's leaders to stop improvising and managing finances on a year-to-year basis and to start addressing the long-term imbalance between spending and revenues. Eliminating all of the debt service on all of the Commonwealth's bonds would still leave a significant budget deficit, and the challenge of unfunded pension liabilities will swamp any other debt service obligations. We need to look ahead and anticipate these challenges instead of simply careening from one crisis to the next.
>
> The resolutions of municipal fiscal crises in the US and emerging market sovereign debt crises have followed very different paths. The Garcia Padilla Administration's decision to retain experts in sovereign restructurings with little

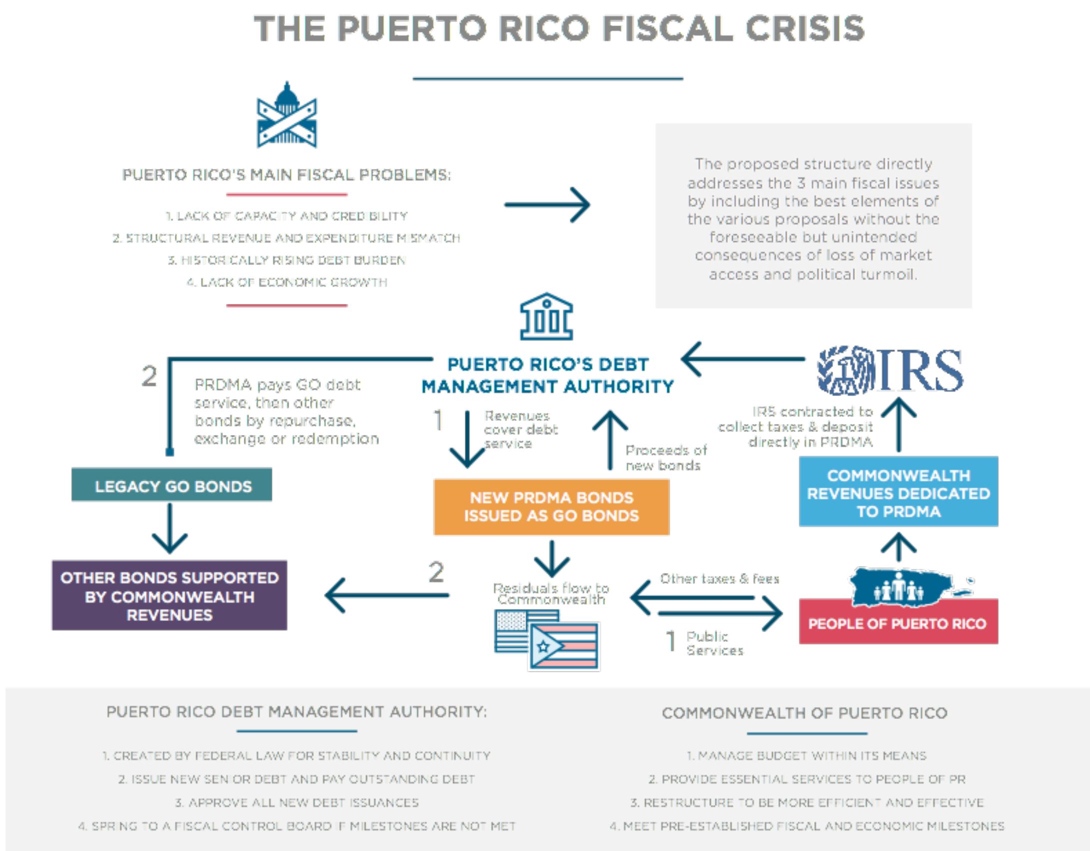
experience in US municipal finance seems to be going down a path that is more appropriate for Argentina, Ecuador or Venezuela than for an issuer which has historically borrowed at very low interest rates.

The Administration's advisors have seemingly ignored the protections afforded to US municipal finance in the US Constitution and replicated in the Puerto Rico Constitution, including the non-impairment of contracts and the anti-fraud and timely disclosure statutes of the securities laws under the Securities and Exchange Commission (SEC). Unlike those foreign countries, NYC, Philadelphia, Yonkers, Bridgeport, and many others had successful resolutions to their debt crisis without bankruptcy, the cramming down on debt holders, or repudiating contracts, thereby assuring the rapid reopening of market access. It is the success of those precedents that I urge review because they should provide confidence in permitting the People of Puerto Rico to resolve this crisis in collaboration with the Federal government, but on our own terms.

As a mechanism to both restore investor confidence and provide the Government of Puerto Rico an opportunity to reinvent itself and balance its budget, I formally proposed the creation of a Joint Commission and the Puerto Rico Debt Management Authority (PRDMA) through Federal and Commonwealth legislation. The PRDMA would contract with the IRS to oversee the collection of certain Commonwealth revenues including certain income, excise, and other taxes and these revenues would be pledged to issue new bonds that would then enable the PRDMA to retire Commonwealth obligations through open market purchases, tenders, exercise of rights of redemption, exchanges, or any such other means as the PRDMA shall determine through negotiation with bondholders. The means and order of retirement shall be established to produce the lowest aggregate expected debt service cost to PRDMA and the Commonwealth.

In turn, the Commonwealth government will continue to provide public services to residents based on the residual revenues distributed to it by the PRDMA as well as through the revenues it continues to collect directly which do not flow through the PRDMA. The government will design and implement a comprehensive reorganization process in order to be more efficient and effective. The PRDMA would spring to a full Federal Fiscal Control Board if certain triggering events, as determined by the Joint Commission were to occur, including the violation of any bond covenant or payment default on any obligation unless waived by the creditors and a failure to approve and implement a government-wide balanced budget based on recurring revenues, expenses, and any PRDMA bond proceeds allocated as bridge financing during the first two (2) years of operation.

Below is a conceptual diagram of the PRDMA and the flow of funds between the entities.



I have consistently proposed the need for creating a new government structure in Puerto Rico that significantly reduces its cost and enhances its function. The current structure allows for the existence of 118 agencies in the executive branch, at a price tag of $21.8 billion per year. All of the services provided by these agencies, 340 in total, must be reassessed to determine if some of them can be consolidated, delegated to the private sector or to non-for-profit organizations, and which ones are simply not necessary. The strategy could provide for a dramatic reduction in the government's sprawling administrative structure. We can achieve this through a few key steps. First, making the government a single employer, so that it can allocate human resources where they are most needed and avoiding layoffs. Second, implementing a zero-based budgeting approach, where all government expenses have to be justified to show that they are truly necessary and meet the needs of the citizens and where expenditures are strictly scrutinized to avoid waste. Third, using technology to transform the government's processes to be efficient and transparent in order to ensure accountability and continuous improvement. We also propose that Public-Private Partnerships (P3s) can play a key role in providing the long-term repayment guarantees to bondholders and most importantly, the much needed reduction in the cost and improvement in the quality and accessibility of basic infrastructure services to the island's residents and businesses. These common-sense measures to control and reduce government expenditures that are long overdue will become the basis upon which we will restore investor confidence, organize a sustainable government structure, and consequently turnaround Puerto Rico's economy.

5. **Public Pensions** – In your letter you rightfully emphasize the need for greater transparency and detailed information regarding the state of the public pension systems. Perhaps the most troubling issue with this large unfunded liability is the fact that funds that have been contributed to the Employee Retirement System (ERS) under the System 2000 defined contribution plan are commingled with the small remaining assets of the traditional defined benefits plans. The sheer scale and long-term actuarial projections of the pension system liability further validate that the number one priority for the Commonwealth government should be to balance the budget and that debt-restructuring alone will not resolve the crisis. Additionally, if court-imposed restructuring were to be authorized and pursued, it would seem that prioritizing the largest creditor class above all other creditors, in violation of the established Constitutional priorities, would dramatically limit the effectiveness of such a restructuring to achieve meaningful debt relief. We look forward to the García Padilla Administration's response to this question and to the increased consideration of this issue in the articulation of a sustainable solution.

6. **Technical Assistance from U.S. Treasury Employees** – We understand by the expressions made to the press and to Congress by White House and US Treasury officials, that there is meaningful collaboration underway between the Federal and Commonwealth governments, however we have few details on the results of this collaboration other than the visible lobbying efforts we have seen for Congressional action. We believe that the executive branch of the Government of the United States can and should be much more proactive in providing direct support and implementing measures to help manage the territory's fiscal crisis and to stimulate its economic development. On January 19th of 2016, I wrote a letter to Treasury Secretary Jacob Lew where I mentioned three specific measures that the executive branch could pursue that would have an immediate impact on Puerto Rico's economy, please see below:

> The people of Puerto Rico are not seeking any special treatment, but rather equal treatment as the 50 states in Federal programs and regulations. Along those lines, I would like to bring to your attention three situations, which if resolved by providing Puerto Rico equal treatment, could have a meaningful impact on Puerto Rico's economic recovery and create the conditions for a more sustainable management of the Island's debt burden. The first is the elimination of the Electronic Exchange Information (EEI) requirement for shipments between the mainland United States and Puerto Rico. The requirement of EEI filings for shipments perpetuates the mischaracterization of Puerto Rico as a foreign country, imposes an unnecessary cost and administrative burden on interstate commerce, increases the cost of living on the island, and hinders economic development. Eliminating this requirement will not only finally make trade between the island and the mainland truly domestic, but it will also require American companies to treat Puerto Rican consumers equally as those on the

mainland United States when it comes to product availability, price, and service levels.

The second issue that can be quickly resolved is the exclusion of Puerto Rico under the updated Income Tax Convention with Spain for the Avoidance of Double Taxation. Spain is a natural source of foreign direct investment for Puerto Rico and the island is a hub for economic activity between Spain, Latin America, and the US, yet the provisions of this important agreement between the US and Spain do not extend to Puerto Rico and place an additional burden on Spanish companies operating on the island.

The third opportunity lies in the increase of the direct commerce between the Federal Government and companies based in Puerto Rico. Puerto Rican based companies offer a win-win value proposition to the Federal government with operating costs below than those on the mainland, a highly skilled technical workforce, and compliance with all of the legal and regulatory provisions that apply to Federal contractors, however Puerto Rico's share of Federal contracts ranges around 0.20%, which is well below what it could and should be. We recognize the challenges that not having full congressional representation pose for Puerto Rican companies competing with those on the mainland for Federal contracts, which is why we need the executive branch's full support in ensuring that the Puerto Rican companies are always fairly considered.

In addition to these measures that can be implemented almost immediately, the US Treasury can help the Commonwealth government obtain a modest amount of interim financing as it did to General Motors and Chrysler during the 2008 financial crisis and, more applicably, to Washington DC during its fiscal crisis. This interim financing, combined with a clear commitment that both the Federal and Commonwealth governments will follow the rule of law, would allow the Commonwealth to pay its near-term obligations, avoid the expense of complicated litigation, and provide a bridge to the election and inauguration of a new Administration that is committed to transforming the government and honoring its obligations to creditors. In fact, such a clear message regarding the rule of law, would likely create opportunities to obtain interim financing from current Commonwealth creditors.

The Federal government can also instruct the Federal Deposit Insurance Corporation (FDIC) to directly assist in the audit of the GDB in order to identify the most equitable path forward for its multiple stakeholders. The FDIC already has a meaningful presence and experience in Puerto Rico following the orderly resolution of 4 commercial banks in the last 6 years and be instrumental in assessing the GDB's solvency and sustainability.

Finally, there is no doubt that achieving parity in Federal programs such as the Earned Income Tax Credit (EITC) and Medicaid funding, among others, would help ease the strain on the Commonwealth government of maintaining certain programs and stimulating the economy. Remember that the US citizens residing in Puerto Rico voted in 2012 that they no longer consented to the current territorial relationship between Puerto Rico and the United

States and that Statehood was the broadly favored non-territorial preference. As such, any new arrangement with the Federal government or the selective application of Federal laws should be consistent with a clear path towards Statehood. While Puerto Rico's political status remains unresolved, voters will continue to vote with their feet and move to the mainland in search of equal treatment, greater economic opportunities, and improved quality of life.

As part of my bid to become Puerto Rico's next governor, my team and I have further developed these and many other initiative that will help address the current fiscal crisis and put Puerto Rico on a path towards sustainable growth and prosperity. We look forward to an opportunity to collaborate with you and the entire Congress of the United States to define and implement this new path forward.

Sincerely,

Ricardo Rosselló

Ricardo Rosselló Nevares, PhD
Candidate for Governor of Puerto Rico
New Progressive Party