

WRITTEN TESTIMONY OF
NATALIE JARESKO, EXECUTIVE DIRECTOR,
FINANCIAL OVERSIGHT and MANAGEMENT BOARD FOR PUERTO RICO

before the

House Committee on Natural Resources

“The Status of the Puerto Rico Oversight, Management, and Economic Stability Act
(PROMESA): Lessons Learned Three Years Later”

May 2, 2019

Chairman Grijalva, Ranking Member Bishop, and Members of the Committee, I am Natalie Jaresko, Executive Director of the Puerto Rico Financial Oversight and Management Board (the “Board” or “Oversight Board”). Thank you for this opportunity to update the Committee on the work the Board has done for the benefit of the people of Puerto Rico and its substantial progress towards achieving the Board’s mandate under PROMESA. We have been working diligently to put in place the critical fiscal building blocks for Puerto Rico’s economic success: ensuring the Government’s fiscal responsibility, securing a fair and sustainable exit from bankruptcy, and restoring access to the capital markets.

I. Introduction

When the Board began its work, Puerto Rico faced an unsustainable burden of more than \$70 billion in debt and \$60 billion in unfunded pension liabilities, exacerbated by a decade of economic decline and significant outmigration. To put it in context, when Congress mandated the establishment of the Oversight Board, Puerto Rico’s largest pension system was about 1% funded, whereas states like New Jersey and Illinois, two of the states with the lowest funded ratios, are in the 30% range. By then, the sitting Governor had already declared the debt was unsustainable and could not be paid, and more than 300,000 people, 10 percent of the population, had already left the Island. Despite that reality, Government spending remained bloated, government services were inefficient, liquidity shortfalls impaired strategic decision making, and no multi-year, coordinated strategy existed to restore growth and opportunity to the U.S. citizens living and working on the Island. Congress and PROMESA provided a way forward for Puerto Rico.

Mindful of the severe challenges faced by many of the Island’s residents, the Oversight Board began exercising its authority under PROMESA to change the fiscal culture of the Government of Puerto Rico, instituting long term fiscal planning and balanced budgeting. As those efforts were underway, Hurricanes Irma and María inflicted the most horrific natural disaster devastation to strike the U.S. in 100 years. The tragic, unimaginable damage to the Island and its people compounded this financial distress.

My testimony before this Committee on November 7, 2017, detailed the extensive joint post-hurricane efforts of the Board and the Government, including the singular importance of restoring electricity and transforming the power sector to be more reliable, resilient, and cost effective.

Today, the Board is responsible for administering the largest public entity restructuring in U.S. history and is party to hundreds of lawsuits, many in opposition to the Board-formulated debt restructuring, others by parties opposed to PROMESA, and inevitably actions by the Board implementing PROMESA. Moreover, the Board is monitoring more than 120 reform implementation plans across the Government, which requires a significant amount of resources and expertise. These plans translate into thousands of individual reform milestones that need to be monitored and tracked. Since the inception of the Board, we have held hundreds of working meetings with the Government and Legislature, organized many diligence sessions with creditors, and held numerous public hearings on issues of keen interest to stakeholders.

The Oversight Board has also improved financial transparency of the Commonwealth so that residents have full access to the way their taxpayer dollars are spent, as well as accountability from their Government. This includes public records, available online, of budgeted versus actual spending, cash and bank balances, submission of reform implementation plans for all agencies, and mandated oversight over all outside contracting and new debt issuance. All of the Board-approved budgets of the Commonwealth and its instrumentalities are also accessible online, as are the financial records of the Board itself. Board meetings are open to the public, webcast, and posted to the Board's website. Many of these documents are available in English and Spanish to ensure as many people as possible have access to complete information regarding the Board's efforts.

The Board is also committed to responsible stewardship and transparency in its operations but there is always room for improvement. Representatives Velázquez and Bishop have filed a bill to strengthen the legislated disclosure requirements of third parties hired by the Board, and the Board supports steps towards greater transparency.

I will now walk you through the Oversight Board's main accomplishments in the areas of fiscal plan implementation, fiscal responsibility and debt restructuring.

II. Fiscal Plan Implementation

As you know, the Board's authorities under PROMESA center around the development and certification of multi-year fiscal plans. These fiscal plans must balance competing priorities enumerated in the law. Prior to and since the hurricanes, the Board certified fiscal plans successfully balancing those interests and delineating a path forward for the Island.

To date, the Oversight Board has successfully certified more than a dozen transformative fiscal plans with multi-year forecasts for the Commonwealth and several of its instrumentalities. These fiscal plans are specifically designed to guide long-term planning and promote the Island's transformation and fiscal recovery. They are based on collaborative efforts with the Government

and extensive stakeholder input, including listening sessions with major sectors of Puerto Rico's economy.

One of the most important components of the certified fiscal plans are the series of structural reforms that enhance Puerto Rico's ability to compete and create quality jobs, including reforms to increase Puerto Rico's labor force participation rate of 40%. They also seek to improve educational outcomes, enhance the business climate, and transform the energy sector. In addition, the fiscal plans must transform the Government to reflect changed demographics and the fact that Puerto Rico is in financial distress. Embracing the reforms in the fiscal plan will undoubtedly lead Puerto Rico out of its financial and economic crisis.

The fiscal plans include overdue right-sizing by the Government while improving the delivery of services to residents. The Government's proposal and implementation of around 250 school closures is a direct response to these changing demographics and the desire to provide a better education to all students by focusing limited resources in the remaining schools. Spending over the past several decades without limits has not produced better healthcare or educational outcomes or a safer Island for its people. Thus, the focus of the right-sizing in the fiscal plans is on improving these outcomes, while reducing spending.

The efficiency and quality of government services on the Island remain a challenge:

- Residents of Puerto Rico do not receive the same speed of police and emergency response as their U.S. mainland counterparts;
- The Government has not properly maintained transportation and infrastructure on the island, resulting in extreme congestion and a higher vehicle death rate;
- The Government lags behind the mainland when it comes to simplifying the process of starting and running a business;
- The Government has struggled to provide the level of education necessary for its residents to compete with peers on the mainland and achieve job security on the Island; and
- Puerto Rico struggles to provide high quality government services despite having higher spending and personnel in many parts of the government.

Unfortunately, three years later, the Government has not yet implemented many of the fiscal plan's most critical reforms. As an example, just this week, the Governor announced he no longer intends to enact the healthcare reforms he proposed in the fiscal plan. This is, however, just the latest example of the Government's failure to act. The fiscal plans are not a selective menu from which options can be selected, rejected, or ignored. It is a rigorous, multi-year, ambitious transformation plan that must be proactively managed and enacted over time.

III. Accomplishments to Date: Fiscal Responsibility

The Oversight Board has successfully implemented fiscal discipline and controls over the past three years. These are some of the main accomplishments to date:

Moved to a Pay as you Go pension system: This allowed retirees to receive their pensions without interruption, despite the fact that Puerto Rico's pension funds did not have enough assets to sustain paying pensions for more than a few more months. Now the Board ensured over \$2 billion per year is budgeted out of the Government's general operating fund to meet current pension payments, while pressing for the establishment of independently-managed and transparent Defined Contribution plans. In handling the claims of the retirees in the Title III process, the Board developed a pension policy that ensures adequate funding for pensions and guarantees that those with the lowest pensions are protected from any cut, while ensuring a 10% savings of total pension costs. Teachers and police officers will also be enrolled in Social Security to increase their security and retirement benefits.

Created more transparency and visibility into Puerto Rico's complex financial situation: The Oversight Board's efforts led to improved transparency and visibility into Puerto Rico's liquidity, budgets, special revenue funds, public corporations, and other sources of intergovernmental spending, notwithstanding the Government's continued delays in completing its overdue audited financial statements. The Board also reviews major contracts before they can be ratified to foster accountability and discourage unnecessary and/or unavailable spending.

Prioritized critical spending: The Board-certified budgets carefully balance the need to maintain funding for critical services commensurate with the size of the population and prioritize critical services such as education, public safety, and healthcare. Specific reinvestments in the current budget include:

- Allocated funds over a three-year period to pay ten years' worth of debts owed to police officers for back pay;
- Enabled reapportionments to ensure badly needed funding to improve the operations of the Island's Forensic Science Bureau, including funds for safe kits, many decades old, to insure proper forensic analysis and long-awaited justice for both the victims and the accused;
- Allocated appropriations for expenses important to the people of Puerto Rico not previously funded, such as pay increases for teachers and police, which begins the process of restoring competitive compensation packages with the mainland;
- Approved new spending of more than \$200 million for an Earned Income Tax Credit to support labor participation on the Island;

- Ensured the creation of a reserve account to ensure liquidity on an ongoing basis in case of an emergency in the future;
- Ensured funds are budgeted to cover any cost-share for federal disaster funding, such that the Island would be able to access the FEMA public assistance funds; and
- Budgeted \$400 million a year in capital expenditures at the Commonwealth level to improve systems and assure appropriate maintenance of infrastructure, necessary to avoid the significantly underinvested situation in which Puerto Rico found itself at the time of the hurricanes.

Implemented much tighter budgetary controls: The Board imposed significant constraints on governmental spending. Reapportionments within the budget must now be approved by the Board. Multi-year appropriations from previous fiscal years are suspended in light of the absence of audited financial statements and uncertainty of past practices, and, with only a few exceptions, no new multi-year appropriations are permitted. The Board also initiated the first comprehensive review and certification of Puerto Rico’s overall total spending; historically, this detailed reviewed was only conducted on General Fund spending, which represents less than 40% of total spending.

Imposed fiscal discipline: The Board is employing strict discipline to oversee government fiscal reform efforts. All tax initiatives must now be at least budget neutral and projected in a fiscally conservative manner to not overestimate revenues during a very uncertain time. Revenues from new initiatives cannot be counted until realized, and expense reductions must be documented, justified, and proven before being certified.

Required the transformation of the Island’s power sector: Within the Puerto Rico Electric Power Authority (PREPA) Certified Fiscal Plan and budget, the Board required and supported the transformation of PREPA to ensure reliable energy for the residents, more effective and efficient management, as well as lower fuel costs. The Government has aligned with the Board in concluding that private generation and private management of the transmission and distribution system are key to these improvements. The goal is to achieve affordable, resilient, and reliable power that is environmentally compliant and that serves as a driver of economic growth, fully leveraging private market enterprise, and investment; and establishing an independent, well-funded energy regulator.

Supported clean and safe water for the residents of Puerto Rico: Within the Puerto Rico Aqueduct and Sewer Authority (PRASA) Certified Fiscal Plan and budget, the Board supported funds for the Puerto Rico Clean Water and Drinking Water State Revolving Fund for personnel and capital expenditures that will enable critical work on the water system. The fiscal plan for the water utility requires a \$2 billion capital program of local and federal funds over the next six years with roughly \$1 billion focused on investment in projects to improve water quality and reliability through upgraded filtration plants, new transmission and distribution pipelines, upgraded wastewater treatment plants, and more sanitary truck sewers and collection systems.

IV. Accomplishments to Date: Debt Restructuring

On the debt side, the Oversight Board began restructuring Puerto Rico's crushing debt burden. The Board completed the restructuring of approximately 30% of Puerto Rico's debt, primarily based on consensual deals using both Title III (for COFINA) and Title VI (for GDB). The main accomplishments to date are:

Stay on debt service: The automatic stay imposed upon enactment of PROMESA together with the stays provided by the Board's various Title III filings, provided Puerto Rico much-needed breathing room to allow it to work towards a plan to get its fiscal house in order. Without the actions of the Oversight Board, Puerto Rico would have been required to impose draconian cuts to essential services in order to pay the otherwise due debt service.

Approved the first PROMESA Title VI consensual agreement: The Board approved a restructuring to resolve the Government Development Bank's (GDB) over \$4 billion in legacy bond debt and approximately \$8 billion in liabilities. GDB's legacy creditors agreed to a 45% reduction in the face amount of their claim, and municipalities were allowed to offset their GDB loans by the full amount of their deposits.

Confirmed the first PROMESA Title III plan of adjustment, saving billions of dollars for the residents of Puerto Rico: The Board restructured COFINA's \$18 billion debt. The plan of adjustment, approved by the Title III court in February 2019, reduces the par amount of COFINA bonds by \$6 billion. The agreement reduced total debt service by 32%, saving approximately \$17.5 billion over 40 years. On an annual basis, the settlement will reduce the maximum annual debt service from \$1.85 billion to \$992 million and allow the Government to spend the difference on general expenses.

Reached an agreement with groups of PREPA bondholders to reduce the burden on customers: The Board negotiated a preliminary agreement with PREPA Ad Hoc creditors and a bond insurer, which reduces PREPA's debt by over 30% and protects consumers from uncapped debt-related charges. This agreement is an essential step toward executing the previously described transformation and modernization of Puerto Rico's energy system. Relative to the prior Restructuring Support Agreement that the Board rejected in 2017, the current agreement would save PREPA and the Puerto Rican residents who depend on its electricity supply about \$3 billion in debt service payments over the next 10 years alone. The agreement includes a fixed transition charge as a measure for protecting PREPA's customers from potentially larger rate increases in the future based on a lower demand forecast.

Undertook an independent investigation of the debt and is analyzing potential claims: The Board conducted an independent investigation of Puerto Rico's debt, which led the Oversight Board's Special Claims Committee to file an objection in court contesting the validity of more than \$6 billion in General Obligation bonds. The Oversight Board, through its Special Claims Committee, does plan to commence adversary proceedings covering claims against dozens of

parties, including underwriters, law firms, tax counsel, swap counterparties, and remarketing agents.

Ensured protection for other entities with unsustainable debts: The Board provided Title III protection for the Highways and Transportation Authority (HTA), and the Employees Retirement System (ERS).

Sought forbearance agreements for certain public entities: The Board supported forbearance agreements with regard to outstanding debt of the University of Puerto Rico and the PRASA, in order to allow more opportunity to negotiate sustainable debt restructurings within Title VI.

Continue to engage in good-faith negotiations with all parties: The Board continues to negotiate with other creditors to reach a plan of adjustment for the Commonwealth debt. The Board hopes to be able to reach a court approved deal by the end of this calendar year.

V. Fiscal Plan for the University of Puerto Rico

The University of Puerto Rico (UPR) is an excellent university; Puerto Rico's crown jewel. It is key to a safe and peaceful society. In many ways, the future of Puerto Rico depends on a vibrant and sustainable UPR. Targeted measures to increase revenues and reduce expenditures will allow UPR to operate sustainably and ensure this jewel remains at the center of Puerto Rico's successful economic development.

The reforms are focused on maintaining the ability of all students to access and benefit from an improved university system. The Government has been subsidizing UPR at a rate far exceeding mainland U.S. states — roughly 70% instead of 20-30% — and at a time when it can no longer afford these subsidies in light of its own financial pressures.

The UPR Certified Fiscal Plan focused on creating savings by consolidating back-office functions across UPR's eleven campuses and improving procurement processes. Eleven campuses do not require eleven duplicative administrations. No cuts to faculty or student services are, or have ever been, planned, or are they necessary, if certain administrative savings and a new focus on improving revenues are implemented.

Revenues are depressed and insufficient at UPR due to extremely low tuition levels for all regardless of ability to pay, few "out of state" students, little success in attracting federal grants, and no active development of its superb alumni. The fiscal plan does require increased tuition, but has ensured several safeguards to protect the most vulnerable. The maximum annual tuition (\$5,090 in FY23) will remain below current Federal Pell Grant award levels (\$6,095), meaning all Pell Grant eligible students will be able to cover both tuition and some living expenses. The fiscal plan not only protects, but expands to \$44 million this year, UPR's needs-based scholarship programs such that everyone should be able to attend regardless of income level.

VI. Relationship with the Elected Government of Puerto Rico

Governor Ricardo Rosselló did not create the fiscal and economic crisis. We trust that he and his team are working in the best interest of the people of Puerto Rico to turn the Island around. With one of the largest natural disasters and the largest insolvency proceeding in the U.S., we recognize it is not easy. In many areas, the Government and the Oversight Board are aligned in the transformation that is needed – the PREPA transformation, the move to Defined Contribution pensions, and the implementation of a local EITC, are just a few examples.

In other areas, however, we have found it more complicated to work together. The Legislature, for example, refused to approve a package of labor reforms that would have made it easier for people to find jobs and reduce the administrative burden of formal employment in the market. Converting Puerto Rico into an employment-at-will jurisdiction – like 49 of the 50 states – was a battle we lost. We removed this structural reform from the Certified Fiscal Plan in light of the Legislature’s refusal, and the corresponding economic growth we projected. As a result, without further incremental structural reforms, the Island’s economy will return to an anemic pace of growth, a level unable to sustain the long-term budgetary needs of the people of Puerto Rico.

The creation of a budget inherently includes difficult decisions. Spending a dollar on police salaries instead of professional services contracts or particular industry tax credits is a critical decision. I think that we can all agree that the people of Puerto Rico want their public funds to be better allocated to the services that are most critical to their lives on the Island.

It is unrealistic to believe that the elected Government and the Oversight Board would be one-hundred percent aligned in every aspect. Some tension between the elected Government and the Oversight Board must be expected in a situation like this. We do, however, make every effort to consult, to advise, to offer perspective throughout the process, and work towards full implementation together.

VII. First Circuit Decision on the Unconstitutionality of the Board

On February 15, the First Circuit concluded that the Appointments Clause applies to laws enacted under the Territories Clause, that the members of the Oversight Board are federal officials not territorial officials, and that the members of the Oversight Board are principal officers. It is our belief that the members of the Oversight Board are territorial officers, not federal officers, and that the Appointments Clause does not apply to laws enacted pursuant to Congress’s power under the Territories Clause.

The implications of the First Circuit decision are immense. With respect to the Oversight Board, if a stay is not granted by May 16, then the Oversight Board would cease to function and the Title III cases could be dismissed, leading to chaos in the courts and on the Island.

Late in April, the Oversight Board filed a petition with the U.S. Supreme Court to review the decision by the U.S. Court of Appeals for the First Circuit that declared the appointment of the Members of the Oversight Board unconstitutional and requested that the First Circuit extend the stay of its February 15 ruling pending the Supreme Court’s final disposition of the case.

On April 29, 2019, President Donald J. Trump announced his intent to nominate the current Board Members to undergo U.S. Senate confirmation to serve out the remainder of their terms. We encourage the U.S. Senate to review the nominations as quickly as possible.

VIII. Potential Federal Actions to Continue Supporting Puerto Rico

The Board supports the important efforts of Chairman Grijalva, Ranking Member Bishop, Puerto Rico Resident Commissioner González-Colón, Representative Velázquez, Representative Soto, and many Members of this Committee and throughout Congress advocating for fairness for Puerto Rico in the distribution of federal funding and other federal programs essential to the prosperity of Puerto Rico and the well-being of its people.

Critically, the Oversight Board supports the Government's request to receive equitable treatment in Medicaid and Medicare. Without a permanent solution to the Medicaid cliff, Puerto Rico would need to spend around 25% of its General Fund, and more over time, to fund healthcare for the people of Puerto Rico. In addition, in the key area of healthcare, the Board supports fair treatment in Medicare programs, where residents of Puerto Rico pay the same level of Medicare taxes as mainland residents, but the Island receives substantially lower payments in Medicare programs. These are critical policies that will affect the entire Island's healthcare and economic development.

Finally, PROMESA required the establishment of a Congressional Task Force to provide recommendations to help Puerto Rico's economic and fiscal turnaround. While the Federal Government has supported Puerto Rico in light of the hurricanes, many of the recommendations outlined in the Task Force report have yet to be addressed.

IX. Conclusion

PROMESA is a set of compromises. When PROMESA was passed, there were different expectations from all sides as to the role of the Oversight Board. The reality is that this has been a balancing act, with a balanced Board thanks to the law's bipartisan appointment system.

Some creditors expected to be repaid in full, while others expected the debt to be wiped out. The reality is that Puerto Rico's debt is unsustainable and cannot be repaid in full. But the reality also is that Puerto Rico's restructuring, as decided by Congress, is being done under an orderly bankruptcy process, which requires equitable treatment of creditors.

I understand that many in Congress expected Puerto Rico's mismanagement to be fixed and the Island to be turned around immediately, but 40 years of fiscal mismanagement cannot be fixed in three years. In Washington, DC, New York City, and Detroit, it took years before the jurisdictions began to see progress.

The Oversight Board continues to implement its mandate to bring Puerto Rico back to fiscal responsibility, ensure adequate funding for pensions, and restore access to the capital markets. The law is clear as to the work that we need to do – and for how long.

While the Board has the power to certify the budget and restructure the debt, much of Puerto Rico's economic future and sustainability is in the hands of the elected Government. Puerto Rico's future depends on a strong commitment to implement structural reforms that change the Island's underlying economic model. Restructuring and reform go hand in hand. The Government needs to use the economic boost and cushion of time provided by the stay, by the completed debt restructuring, and by federal disaster funds to make fundamental changes now, in order to sustain economic growth, attract investments, create jobs, and avoid repeating the mistakes of the past.

Difficulties aside, I am optimistic and confident that we can all work together to ensure Puerto Rico's economic future is brighter than ever and that Congress finds confidence that Puerto Rico's problems can and will be solved.