BY ELECTRONIC MAIL

June 27, 2024

The Honorable Pedro R. Pierluisi
Governor of Puerto Rico

The Honorable Rafael Hernández Montañez
Speaker of the House of Representatives of Puerto Rico

The Honorable José L. Dalmau Santiago
President of the Senate of Puerto Rico

Re: Preliminary review of recently enacted legislation with major fiscal impacts in Fiscal Year 2025, including Senate Bill 644, House Bill 2038 and others

Dear Governor Pierluisi, Speaker Hernández Montañez, and President Dalmau Santiago:

The Oversight Board has become aware that, on June 25, 2024, the Legislative Assembly (the "Legislature") overrode Governor Pedro Pierluisi's express veto to Senate Bill 644 ("SB 644") and passed a considerable number of other bills that could have a significant impact on Commonwealth expenditures, budget balancing and, ultimately, on Puerto Rico's path to financial recovery. The scope of these bills includes defined pensions benefits, tax credits and benefits, and many others that were passed with a clear disregard of their estimated costs. Many bills were even passed without any prior assessment regarding their potential impact.

It is the Oversight Board's understanding that the potential aggregate cost of these bills is up to approximately $852 million for FY 25, and at least $6 billion over the next 20 years. Such costs could result in an unbalanced budget for the current and upcoming Commonwealth budgets and compromise the Commonwealth's fiscal stability. If implemented, the following legislation could significantly hinder Puerto Rico's financial recovery and undo the progress we have attained together.

Senate Bill 644

SB 644 seeks to mitigate or provide relief of cooperatives' non-operational risk by disbursing Commonwealth funds to cooperatives via COSSEC.[1] As explained in the Oversight Board's multiple letters,[2] SB 644 is inconsistent with the 2023 Fiscal Plan for COSSEC (the "2023 COSSEC Fiscal Plan") and the Fiscal Plan for Puerto Rico (the "Commonwealth Fiscal Plan," together, the "Fiscal Plans"), and violates PROMESA. Specifically, the government's unverified estimates provided to the Oversight Board indicate the cost of SB 644 range from $300 million to $535 million. This cost is not included as an expense in the Fiscal Plans or in the FY2025 proposed budget currently under negotiation with the Legislature.

The Oversight Board has serious concerns about SB 644's inconsistency with the Fiscal Plans, certified budgets and PROMESA and is currently assessing whether to take additional steps with respect to SB 644.[3]

The Legislature has not explained how the Government would pay this relief for COSSEC.

The government will need to identify a source to fund for this expense and book it consistent with modified accrual accounting standards as required under PROMESA. Unless other FY2025 budgeted expenditures are reduced, adding this incremental expense to the FY2025 budget would significantly increase actual expenses for the year threatens budget balance and undermines the fiscal stability and responsibility the government is working hard to achieve. Additionally, the disbursements of Commonwealth funds to COSSEC and from COSSEC to the cooperatives are not contemplated in either the COSSEC Fiscal Plan or the Commonwealth Fiscal Plan.

Please confirm by **5:00 p.m. AST on June 28, 2024**, in writing, that the Governor, the Secretary of Treasury, and COSSEC agree that a transfer of funds under Section 6 of SB 644 is not permitted without the prior written approval of the Oversight Board, and that the Department of Treasury will not distribute any funds under SB 644 unless the Oversight Board approves such a transfer in writing. Please also be advised that the funds anticipated by SB 644 cannot be reserved in the TSA for the measure's purpose until the Oversight Board provides authorization and a threshold amount is established. Further, we ask COSSEC to confirm by **5:00 p.m. AST on June 28, 2024** that it will not spend any funds to implement SB 644, unless they are provided for in the certified

[1] "Non-operational risk" is defined by SB 644 as the losses suffered by cooperatives other than through "normal operations," including those losses associated with "special investments," as the term is defined in Act 220-2015. *See* SB 644, § 6. This section also provides that any contribution or transfer of funds from the Commonwealth is subject to the approval or authorization of the Oversight Board and further states that no such transfer can be made unless or until the Oversight Board authorizes it. To be clear, the Oversight Board has not authorized any such transfers.

[2] See the Oversight Board's letters dated June 22, 2022, January 24, 2023, May 2, 2023, and December 18, 2023 (available on the Oversight Board's website https://oversightboard.pr.gov/documents/).

[3] Such actions may include nullifying and voiding SB 644 pursuant to Section 11 of the measure.

COSSEC budget or unless and until a reprogramming is approved by the Oversight Board in accordance with PROMESA Section 204(c).

House Bill 2038

In a similar disregard for financial responsibility, both chambers of the Legislature voted to pass House Bill ("HB 2038"), which seeks to increase all pension payments made by the Commonwealth by 10%, up to $3,000 per participant effective July 1, 2024.[4] In addition, HB 2038 establishes an annual cost-of-living adjustment ("COLA") beginning July 1, 2025.

The Legislature has not explained how the Government would pay the increased pension payments.

The bill is inconsistent with the Commonwealth Fiscal Plan because it increases expenditures but does not provide for the collection of additional revenue sources nor any cuts to expenditures. After analyzing HB 2038, the Oversight Board estimated that it would increase expenditures by approximately $217.5 million in FY2025.[5] Over five years, HB 2038 would require an additional $1.6 billion in additional unbudgeted spending and $4.3 billion over the next 20 years.

In addition, HB 2038 violates the Plan of Adjustment ("POA") by (i) establishing a new guaranteed defined benefit for certain retirees, (ii) undoing the POA's cost-of-living adjustment freeze by imposing an uncertain annual formulaic COLA based on determinations by the federal Social Security Administration, and (iii) increasing expenditures, rolling back pension reforms, directly contravening the terms of the POA, and jeopardizing the Commonwealth's ability to fulfill its obligations under the POA.

House Bill 1747

House Bill 1747 ("HB 1747") seeks to amend Section 1033.18 of the Internal Revenue Code of 2011 to grant an income tax exemption on the full amount of military pension payments received by veterans and retirees of the United States Armed Forces who reside in Puerto Rico. This tax exemption would replace the current exemption of $15,000 for veterans 60 years of age or older, and $11,000 for veterans under 60 years of age.

[4] AAFAF, the Department of Treasury, and the Retirement Board submitted statements to House Committee explaining that the Bill directly violates the Plan of Adjustment. *See* Report of the House Committee on Labor Affairs and Transformation of the Pension System for a Dignified Retirement of the House of Representatives of Puerto Rico regarding House Bill 2038 at 9-12. Nevertheless, the House Committee recommended passage of the Bill.

[5] The Budget Office of the Legislative Assembly ("OPAL," for its Spanish acronym) estimated that HB 2038 could cost $194.8 million in FY2025, with additional expenditures in subsequent fiscal years. *See* OPAL Report 2024-133 at 1. The Legislature passed HB 2038 notwithstanding OPAL's estimate.

OPAL estimated that HB 1747 would cost $10.1 million in the current tax year 2024, with similar tax revenue losses each year thereafter.[6]

The Legislature has not explained how the Government would pay for the expanded tax exemption established in the Bill.

Senate Bill 1308

House Bill 1308 ("HB 1308") amends the Commonwealth of Puerto Rico Employee Retirement System Act (Act 447-1951) by adding court marshals to the group of high-risk workers and reducing the burden of multiple waiver applications to request an extended retirement date.

The Legislature has not explained how the Government would pay for the additional retirement costs.

OPAL estimated the cost of this Bill at $4.5 million for FY2024. The Oversight Board estimates that, over 20 years, the cost of SB 1308 will amount to $11.97 million.

Senate Bill 1453

Senate Bill 1453 ("SB 1453") proposes to increase a refundable tax credit for certain older, low-income taxpayers. For individuals aged 65 or older whose gross annual income does not exceed $15,000, the tax credit would increase from $400 to $500. For pensioners whose source of income is a pension that does not exceed $4,800 annually, the tax credit would increase from $300 to $400.

Supporting older Puerto Ricans depending on low pensions has merit, but the Legislature has not included such an increased tax credit into the budget and failed to explain how the Government would pay for it.

SB 1453 could have an estimated cost as high as $24 million for FY25, and $118 million over the next five years, HB 1988 is estimated to have an incremental impact of $106.4 million across five fiscal years. OPAL reached a similar conclusion, which was entirely disregarded by the Legislature.[7] Therefore, SB 1453' increased expenditures without the collection of additional revenue nor any reduction in expenditures is inconsistent with the Commonwealth Fiscal Plan.

House Bill 1915

House Bill 1915 ("HB 1915") proposes to exempt certain businesses from obtaining a certificate of compliance proving they meet the criteria to obtain a tax exemption decree under Act 60-2019.

[6] *See* OPAL Report 2024-015 at 9.

[7] *See* OPAL Report 2024-138 at 5.

The Oversight Board's estimates show that the HB 1915 would result in an estimated impact of $61 million for FY 2025 with an incremental impact of $324 million over the next five fiscal years. Further, it could raise the amount of fraudulent decree applications, in which case the fiscal impact could be as high as $458 million.

The Legislature has not explained how the Government would offset the impact to the budget.

House Bill 1988

House Bill 1988 ("HB 1988") proposes to pay every retired teacher an annual Christmas bonus of $600, at an estimated cost of $22 million per fiscal year, and an incremental impact of $106.4 million across five fiscal years.[8]

The Legislature has not explained how the Government would pay for the bonus.

HB 1988 is inconsistent with the Commonwealth Fiscal Plan because it increases expenditures without providing offsetting measures, such as the collection of additional tax revenue sources or cuts to expenditures.

House Bill 2071

House Bill 2071 proposes the creation of the "Firefighters Retirement Reasonable Adjustment Act," by amending the Firefighters Bureau Billing and Collection Regulation, imposing a surcharge on short-term rentals for a fire prevention certification, and creating a firefighter's pension trust to guarantee a pension of 50% of their salary upon retirement.

The Legislature did not consider the cost of the bill through any economic or fiscal impact analysis.[9]

* * *

The Oversight Board is concerned that the Legislature's actions during the final hours of this term's last ordinary session, including the enactment of SB 644 notwithstanding the Governor's express veto, and the approval of measures such as Senate Bills 1308, 1453 and House Bills 1747, 1988, 2071, 2038, and 1915 may interfere with the ongoing process to enact a jointly developed FY2025 Commonwealth Budget, while also unbalancing FY2024 Commonwealth Budget in its final days.

[8] HB 1988 would also violate Paragraph 62 of the Confirmation Order of the POA. Crucially, this paragraph bars the Government from implementing existing legislation or enacting new legislation "to create or increase any defined benefit pension payment or obligation to current or future retirees from or related to any defined benefit plans over the benefits provided by the Plan, regardless of funding source."

[9] HB 2071 is clearly contrary to paragraphs 25 and 62 of the Confirmation Order, and to Section 83.4 of the Commonwealth Plan of Adjustment. As such, this legislative action clearly disregards the rule of law by ignoring that the Confirmation Order is a federal court order, binding on the Government.

This pattern of spending outside the budget process returns Puerto Rico to the spending practices that led to bankruptcy and the enactment of PROMESA. The Oversight Board is concerned that the current formal process to develop the Commonwealth and other budgets is broken and lacks a disciplined procedure to enable fiscal responsibility.

The Oversight Board reserves all of its rights to take such actions as it deems necessary, consistent with PROMESA §§ 104(k), 108(a), and 204, with regard to the bills referenced within this letter, and any others that could potentially frustrate the purposes of or violate PROMESA. We hope such actions will be unnecessary.[10]

We look forward to discussing with the Governor and the Legislative Presidents alternatives to addressing the fiscal impact of these bills, and, going forward, to agreeing on permanent reforms to the budget process to ensure the integrity of the Commonwealth budget, to ultimately ensure fiscal responsibility and budget balance.

As always, I look forward to continuing working together for the benefit of the people of Puerto Rico, including by certifying a jointly developed FY2025 Commonwealth Budget in the upcoming days.

Sincerely,

Robert F. Mujica, Jr.
Executive Director

CC: Hon. Omar J. Marrero Díaz
Mr. Nelson Pérez Méndez
Ms. Mabel Jiménez Miranda

[10] Enacting laws that are in clear violation of the Plan of Adjustment and the Confirmation Order exposes the Commonwealth to unnecessary and costly litigation risk. In the past and as a last resort, the Oversight Board has initiated litigation to nullify or eliminate laws that violate PROMESA from adversely impacting the Commonwealth's ability to comply with PROMESA or the Plan of Adjustment. The Confirmation Order, among other things, bars all entities of the Government and their representatives from enacting or adopting any law, rule, resolution, or policy, directly or indirectly, imposing liabilities released by the Plan of Adjustment. Violations of the Plan of Adjustment and the Confirmation Order also carry the risk of other forms of civil litigation within the Commonwealth's Title III case, including motions to enforce the Confirmation Order and motions to hold in contempt of court persons and entities responsible for direct or indirect violations and for damages and other remedies from such persons and entities held responsible.