

ORRIN G. HATCH, UTAH, CHAIRMAN

CHUCK GRASSLEY, IOWA
MIKE CRAPO, IDAHO
PAT ROBERTS, KANSAS
MICHAEL B. ENZI, WYOMING
JOHN CORNYN, TEXAS
JOHN THUNE, SOUTH DAKOTA
RICHARD BARR, NORTH CAROLINA
JOHNNY ISAKSON, GEORGIA
ROB PORTMAN, OHIO
PATRICK J. TOOMEY, PENNSYLVANIA
DANIEL COATS, INDIANA
DEAN HELLER, NEVADA
TIM SCOTT, SOUTH CAROLINA

RON WYDEN, OREGON
CHARLES E. SCHUMER, NEW YORK
DEBBIE STABENOW, MICHIGAN
MARIA CANTWELL, WASHINGTON
BILL NELSON, FLORIDA
ROBERT MENENDEZ, NEW JERSEY
THOMAS R. CARPER, DELAWARE
BENJAMIN L. CARDIN, MARYLAND
SHERROD BROWN, OHIO
MICHAEL F. BENNET, COLORADO
ROBERT P. CASEY, JR., PENNSYLVANIA
MARK R. WARNER, VIRGINIA

United States Senate

COMMITTEE ON FINANCE

WASHINGTON, DC 20510-6200

CHRIS CAMPBELL, STAFF DIRECTOR
JOSHUA SHEINKMAN, DEMOCRATIC STAFF DIRECTOR

June 23, 2016

The Honorable Mary Jo White
Chair
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Dear Chair White:

As Congress considers legislation to address the mounting debt crisis in Puerto Rico, several Senators have asked that the Securities and Exchange Commission (SEC) conduct an investigation to determine if any illegal activity – particularly on the part of brokers, advisers, or underwriters – contributed to the territory’s current difficulties. I am writing to ask that the agency look into other matters as well, including potential wrongdoing on the part of U.S. government officials.

Despite its ongoing lobbying efforts for debt relief and assistance, the government of Puerto Rico has not produced audited financial statements since fiscal year 2013, despite numerous requests from Member of Congress, creditors, and others. Adherence to promises—that the government of Puerto Rico would abide by continuing disclosure requirements—made in bond offering documents have been substantively ignored. There have recently only been disclosures to the Municipal Securities Rulemaking Board’s (MSRB’s) Electronic Municipal Market Access (EMMA) service, on which the government of Puerto Rico essentially identifies that it or one of its component units has not provided sufficient information for an audit. That, substantively, is no different than the government saying that it has decided not to produce updated information.

Instead, Puerto Rico has been selectively releasing small amounts of information about its finances, mostly through reports paid for by the territory itself, by former International Monetary Fund analysts (the so-called June 29, 2015 “Krueger Report” and revised view of September 9, 2015) and Conway MacKenzie (August 2015 Liquidity Update). However, both the Krueger Report and Conway MacKenzie analyses relied on unaudited information.

According to the limited information at our disposal, the government of Puerto Rico has accessed public credit markets by issuing triple-tax-free “municipal” debt in an amount that may exceed \$70 billion. And, by all appearances, the territory has done so while ignoring basic information reporting requirements. At the same time, the government of Puerto Rico has repeatedly failed to follow through on multiple promises to provide audited financial statements. Puerto Rican officials have also issued statements of impending liquidity crises and squeezes as

well as potential runs on cooperativas. Yet, subsequent to these various crisis warnings, Puerto Rico has pooled funds to make a number of curious, if not outright suspicious, preferred payouts, including Christmas bonuses for government employees and financing for a relatively sophisticated lobbying and public relations campaign in favor of federal government assistance to address the crisis. Throughout all of this, Puerto Rico has sent to Congress, in lieu of audited financial data, stale, unusable data that often relies on third-party assessments of debt or liquidity positions. This, to put it bluntly, is very concerning for members of Congress tasked with producing legislation to address the current situation.

No less concerning is the fact that there exist information asymmetries between investor groups, and between investors and government officials, including officials in Puerto Rico and U.S. Treasury officials.

For example, the Puerto Rico Electric Power Authority (PREPA) has, in the recent past, decided in forbearance agreements to disclose certain information to only one segment of its bondholders—those subject to the forbearance agreement. It is not clear, however, whether information provided to the forbearing bondholders is different from that which is publicly available and, if so, whether those bondholders are restricted from trading on privileged information. Given the myriad and complex links that exist between the government of Puerto Rico and among the numerous debtor municipalities, public corporations, and the island's opaque Government Development Bank, it is not clear whether the forbearing bondholders receive better information on the true state of the government's finances than ordinary investors can access by way of the MSRB's EMMA disclosures. It is also not clear whether forbearing bondholders could trade on superior information with other forbearing bondholders, and not be in violation of securities laws.

In addition, we currently have no way of knowing whether ordinary investors are privy to the same information on Puerto Rico's finances possessed by government officials, including officials of the Federal government. As you know, in 2014, the U.S. Treasury Department created a new Office of State and Local Finance to, among other things "serve as Treasury's liaison to state and municipal officials and associations, monitor developments in municipal bond markets, support policies to improve the management of public pensions and other liabilities, and develop potential federal policy responses to issues that emerge in municipal financing markets."

Since at least March 2015, U.S. Treasury officials have had confidentiality agreements with component units of the Puerto Rico government, such as PREPA. According to the confidentiality agreement that U.S. Treasury officials have with PREPA, for example, confidential information includes the following:

"The term "Confidential Information" shall mean all documents, information, discussions, and other material about the Company, present or future laws, regulations and proceedings applicable to the Company that is non-public, confidential, or proprietary in nature, and that is voluntarily furnished orally or in writing hereunder by a Disclosing Party to the Recipient or to the Recipient's Representative(s) (as defined below) on or after the date of this Agreement.

Confidential Information includes, without limitation, (i) accounting, financial, tax, legal, or operational documents that are non-public, confidential, or proprietary or (ii) non-public, confidential, or proprietary oral, written or electronic communications, confidential memoranda, and presentations prepared by the Company or any of its affiliates related to a potential operational or financial restructuring of the Company.”

“In regards to the Company, the term “affiliate” includes the Government Development Bank for Puerto Rico...”

This, of course, means that Treasury officials can receive superior information relative to that held by public investors, the SEC, and Congress about the true state of Puerto Rico’s finances. Confidential information about the state of the Government Development Bank, which is a major financial center of the government of Puerto Rico, would almost surely provide an informational advantage relative to investors who have no access to such information.

The confidentiality agreement between PREPA and U.S. Treasury officials also indicates that, as a permitted disclosure, the Treasury officials to whom the confidentiality agreement applies:

“may disclose extracts of Confidential Information to other offices and employees within the Executive Branch having a need to know for purposes of policy formulation on State and local government financing issues.”

Since autumn of last year, U.S. Treasury officials have pursued a specific strategy in order to facilitate the passage of federal legislation allowing for “broad” and “comprehensive” debt resolution authorities for Puerto Rico. The legislative strategy has apparently been in concert with government officials in Puerto Rico and their agents, such as ex-U.S. Treasury official James Millstein, an official and paid restructuring advisor to Puerto Rico. Disturbingly, there have been reports, including comments by Puerto Rico government officials, suggesting that U.S. Treasury officials may have interfered with or impeded debt resolution negotiations between private sector creditors and the Commonwealth of Puerto Rico or component units, in an effort to strengthen chances that pressure would mount on Congress to legislate broad debt resolution authorities. A report in Reorg Research, for example, identified that: “Some of the sources have reiterated complaints that U.S. Treasury Department officials, such as Antonio Weiss, a counsel to Secretary Jacob Lew, have discouraged Puerto Rico officials from meeting with creditors to increase pressure on Congress to enact legislation to establish a federal oversight board that would have the power to restructure commonwealth debt and oversee the development and implementation of a long-term fiscal adjustment plan.”

Given these reports, I respectfully ask that, in addition to any investigation the SEC undertakes regarding the conditions of debt instruments issued by the government of Puerto Rico and risks to the general market for municipal debt from lack of adherence to information reporting requirements, the SEC also investigate whether information asymmetries, including asymmetries between public investors and government officials Puerto Rico and the U.S.

Government, have led to acts, actions, and activities in violation of laws designed to protect investors and the integrity of the municipal debt market.

As the SEC's July 31, 2012 "Report on the Municipal Securities Market" identifies: "Congress did *not* exempt transactions in municipal securities from the coverage of antifraud provisions of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 promulgated thereunder...Municipal issuer disclosures, such as disclosures in official statements and ongoing annual, periodic and event-related disclosure, are subject to these prohibitions. In addition...municipal advisors are subject to regulations adopted by the Commission, including those regulations adopted to define and prevent fraud."

During the course of any SEC investigation into these developments, it would be prudent to include a careful look at statements and disclosures made by municipal advisors, including U.S. Treasury officials, and by officials in Puerto Rico. In my assessment, the integrity of the municipal debt market, in which Federal-tax subsidies apply to debt instruments, is threatened when a borrower runs up roughly \$70 billion of debt and decides not to continue to provide updated, accurate, and audited financial statements for years. Integrity would be further threatened if issuing governments begin to adopt strategies for debt repudiation based on information withholding and impediments to good-faith restructuring negotiation. Investors need assurance that government disclosures and statements are accurate, information is symmetric across stakeholders, and debt resolutions do not unfairly involve information asymmetries between borrowing government entities, their advisors, and their investors.

Thank you for your attention regarding this matter.

Sincerely,

A handwritten signature in blue ink, appearing to read "Orrin Hatch", written over a large blue circular scribble.

Orrin G. Hatch
Chairman
Senate Committee on Finance