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# Puerto Rico's Faux Pension Reform

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It is official: Puerto Rico has entered into the "Title III" bankruptcy that many feared would be the ultimate outcome of the Puerto Rico Oversight, Management, and Economic Stability Act passed by Congress last summer. This includes the island's largest public pension plan, the Employee Retirement System, for which the Commonwealth commenced bankruptcy proceedings this week.

Some conservatives initially rejoiced upon the passage of PROMESA, believing that it could prove to be a formula to fix the pension problems that plague many of the states, especially my home state of Illinois. That seemed to have been the intent, at least: When Congress passed PROMESA the House leadership made it clear that it hoped to facilitate serious reforms across the Puerto Rican government, including its underfunded pension systems.

PROMESA opens the door to significant pension reform through three provisions. First, the legislation contemplates that the board would engage an independent actuary to analyze funding and the sustainability of existing benefits for any territorial pension plan that is materially underfunded (as are every one of Puerto Rico's pension plans).

Second, PROMESA requires that a fiscal plan only provide "adequate" funding to pensions during the restructuring process (that is, it does not specify that the board achieve "full" funding at or near current benefit levels in perpetuity).

Third, it specifies that the Commonwealth and other covered entities (such as its myriad public corporations) that are participating employers are afforded the authority to restructure their pension obligations as well under Title III.

However, it is important to note that the House Natural Resources Committee responsible for drafting PROMESA clearly indicated in its section-by-section summary of the bill that the bill does not "reprioritize pension liabilities ahead of the lawful priorities or liens of bondholders as established under the territory's constitution, laws, or other agreements."

This provision was included to avoid a repeat of the costly mistakes made in Detroit, where pension reform was shunted aside and the city simply got out of its financial morass by forcing bondholders to take a disproportionate share of the losses, often out of line with the city's legal debt hierarchy. To this day, Detroit cannot access the municipal lending market on traditional terms.

In spite of these explicit provisions, the oversight board approved a fiscal plan that does just the opposite while doing little to reform Puerto Rico's retirement systems.

The oversight board retained Pension Trustee Advisors, a Colorado-based firm, to undertake the required review of funding and the sustainability of the pension system, but this has yet to be done. Given the alacrity by which the island's government embraced bankruptcy, PTA seems to have been retained instead to merely validate a pre-wired, aggregate 10 percent reduction in pension obligations. This matches an arbitrary number publicly proposed by the board in a January letter to the commonwealth.

This is a missed opportunity and is a manifestation of the oversight board's apparent ambivalence toward PROMESA.

The ostensibly independent actuary should have been permitted to analyze the financial situation and offer creative solutions to Puerto Rico's pension problems, where—admittedly—one size does not necessarily fit all. For example, contractually based "basic" benefits earned through years of service should be treated differently than legislatively based "system administered benefits" (which include assorted bonuses and cost-of-living adjustments) that might be taken away by the same legislative pen with which they were bestowed. Likewise, existing retirees should be treated differently than active employees, whose accumulated contributions might be returned and invested in a 401(k) style system in lieu of further accruing pension benefits.

At a minimum, the oversight board could greenlight a reform for the Puerto Rico Teachers Retirement System—struck down in 2014 on a technicality—that would have provided an estimated $3.7 billion of savings. There are myriad other ideas that an engaged actuary and a motivated oversight board could explore to achieve meaningful and sustainable reform for Puerto Rico.

The lack of serious reform is made all the more glaring by a recent government move that served to exacerbate the pension issue. Governor Ricardo Rossello signed into law a single employer legislation, which creates the risk that all employee retirement systems liabilities—including those of the commonwealth's municipalities and public corporations—could be shifted to the commonwealth's general fund. It's problematic because the commonwealth and its central government agencies were responsible for only 60 percent of the unfunded actuarial liability, as just one of many participating employers.

This faux reform will prove a costly mistake for many stakeholders. Unfortunately, it seems that both Judge Laura Taylor Swain, who is overseeing the bankruptcy proceeding, and Governor Rossello may nonetheless support it. The governor has adopted an increasingly populist tone toward protecting the pensions in full since being elected on a platform of working with bondholders. Meanwhile, Judge Swain recently made a point of stating that her vision strived to "safeguard pensions."

If "safeguard" means moving forward without serious reform, then Puerto Rico is on the path to wasting this golden opportunity presented by PROMESA to make significant changes to the government's various retirement systems that would make them solvent over the long term. Any short-run political gain of the sort that seems to preoccupy the current government will only entail a far larger degree of long-run economic and financial pain, as a post-Rossello and post-oversight-board Puerto Rico would be left to grapple with the same spiraling problem down the road with far less leeway to enact unilateral fixes. The unstated purpose of the board—as it has been whenever it's been used—is to take the political heat off of the government and allow it to do economically beneficial but politically unpopular reforms. Puerto Rico's government seems to not recognize this.

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