Puerto Rico

Overview

After decades of depressed economic activity and unsuccessful policy initiatives, Puerto Rico's debt levels rose to unsustainable levels, leading the Commonwealth to default on July 1, 2016. In September 2017 – while Puerto Rico was in the midst of restructuring its finances – Hurricane Maria caused widespread destruction and plunged the island into a severe humanitarian and economic crisis.

As Puerto Rico's plight grew, a coalition of activists directed their energy towards Puerto Rico's creditors – in particular, hedge fund managers – calling on them to divest or forgive holdings of Puerto Rican debt. Campus groups at Yale, as well as other state and local organizations, demanded that the University disclose all investments in Puerto Rican bonds, cancel all those held by Yale, and fire investment managers who refuse to sell or forgive the debt. These groups argue that bondholders are profiting from the crisis in Puerto Rico, or even facilitating and furthering the crisis by extracting funds that would otherwise be directed to recovery efforts.

Puerto Rico's Debt

Puerto Rico's financial troubles began well before Hurricane Maria. As early as February 2014, the three bond credit rating agencies (S&P, Moody's, and Fitch) downgraded Puerto Rico's debt to non-investment grade. At the time, Puerto Rico's outstanding debt stood at $70 billion, or nearly 70% of its GDP. By comparison, all 50 states have debt loads under 25% of their respective GDPs.

Concerned that Puerto Rico was near default, the U.S. Congress passed the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA), which President Obama signed into law on June 30, 2016. Through PROMESA, Congress established a Fiscal Control Board to oversee the debt restructuring process, aiming to "increase the economy's resilience, shore up public finances, support long-term durable growth, meet basic needs of the citizenry, and restore opportunity for the people of Puerto Rico." Under PROMESA's protection, Puerto Rico officially defaulted on July 1, 2016 and commenced its restructuring.

As in any restructuring process, the creditors (in this case, the holders of Puerto Rico bonds) understand that the debtor's (Puerto Rico's) repayments are subject to adjustment so that the debtor can emerge from bankruptcy in a sustainable fiscal position. According to Moody's, the amount originally owed to creditors of U.S. municipal bonds that defaulted between 1970 and 2016 was reduced by approximately 50% on a dollar-weighted basis during the bankruptcy process, though the number varies widely depending on individual circumstances.[1] Investors – including Yale's managers – make informed judgments about the size and nature of the debt reductions that will be required during the bankruptcy process. As outlined under PROMESA, the Commonwealth is relieved from making interest and principal payments during the restructuring. Payments will only resume after the process is complete, at what are expected to

[1] "US Municipal Bond Defaults and Recoveries, 1970-2016". *Moody's Investors Service*. Published June 27, 2017.

be significantly diminished levels. At the end of the restructuring, if successful, Puerto Rico's debt will be sustainable over the long term and the Commonwealth will regain access to the capital markets, both necessary steps for the island's recovery and development.

ACIR

When this matter was raised in October 2017, it was referred to the ACIR. The ACIR concluded in January 2018 that divestment from Puerto Rican debt is not warranted when an investor is abiding by the applicable legal framework in a process in which the debtor's interests are appropriately represented. PROMESA has placed the Commonwealth under federal court protection to enable the suspension of payments and a workout with creditors. ACIR Chair Jonathan Macey has pointed out that there have been no allegations of unethical debt collection efforts or practices. He further noted that investment managers have fiduciary duties to their investors that likely preclude them from unilaterally forgiving Puerto Rico's payment obligations.