

Puerto Rico Employees Retirement System Outlook Revised To Negative From Stable Based On Budget And Pension Challenges

Publication date: 26-Jul-2012 14:19:01 EST

 [View Analyst Contact Information](#)

Contact Client Services
1-877-SPCLIENT
1-877-772-5436
Call Tree Options
Contact Us

DALLAS (Standard & Poor's) July 26, 2012--Standard & Poor's Ratings Services revised its outlook on the Employees Retirement System (ERS) of the Government of the Commonwealth of Puerto Rico's \$2.9 billion in senior pension funding bonds, series A, B, and C to negative from stable based on our opinion of the ability of the leading participating employers including, but not limited to the commonwealth, to continue to make their required contributions to the system in full and on a timely basis. At the same time, Standard & Poor's affirmed its 'BBB-' rating on the bonds.

Our current rating and outlook on the ERS bonds mirror our rating and outlook on Puerto Rico's (BBB/Negative) appropriation debt. "However, we believe that the commonwealth's fiscal and budgetary challenges, including the independent actuary's projected depletion of the retirement fund's gross assets by fiscal 2019, could limit the commonwealth's ability and willingness to provide the timely contributions that will be required to maintain an adequate debt service coverage on the ERS bonds," said Standard & Poor's credit analyst Horacio Aldrete-Sanchez. Puerto Rico's failure to adopt comprehensive measures to address its unfunded pension liability within the next year could result in a downgrade on the ERS bonds even without a corresponding downgrade on the commonwealth appropriation rating. While we recognize that the adopted multiyear increases to the employers' required contribution could result in higher annual debt service coverage on the bonds, we believe that the timely adoption of these increases will remain uncertain due to the commonwealth's fiscal and budgetary challenges.

Other factors that support our ratings include the system's:

- Large pool of participating employers, including government agencies, most public corporations, and municipalities;
- Long track record of receiving employer contributions at a rate that has not been reduced since 1960;
- Statutory mandate by employers to appropriate the 11.275% contribution rate. These contributions, however, are subject to appropriation by the participating employers; and
- Adequate annual debt service coverage through fiscal 2027, which we believe could increase as a result of the passage of Law 116 of 2011, which requires annual increases of 1% to the employer contribution starting in fiscal 2012 through fiscal 2016, with additional annual increases of 1.25% until employer contributions reach 20.5% of payroll in fiscal 2021.

Factors that preclude a higher rating include:

- The credit quality of the leading contributors to the ERS, particularly Puerto Rico and its agencies;
- The subordinate nature of the commonwealth's employer contributions to payments on its GO debt, which effectively makes a portion of the pledged revenues subject to Puerto Rico's "clawback" provision;
- Legal precedent that precludes the legislature from making amendments to employer contributions that hinder the actuarial solvency of the system. This legal protection, however, does not apply to the legislature's ability to amend employer contributions if it affects bondholders; and
- The extended maturity of the bonds, which increases the risk of significant variations in the contributions securing the bonds.

The bonds are limited, nonrecourse obligations of the ERS, secured solely by a pledge of participating employer contributions, currently paid at a rate of

pledge of participating employer contributions, currently paid at a rate of 11.275% of payroll.

The negative outlook is based on our opinion of the ability of the leading participating employers including, but not limited to the commonwealth, to continue to make their required contributions to the system in full and on a timely basis. Our outlook on the ERS bonds mirrors our outlook on the commonwealth's appropriation debt. However, we believe that the commonwealth's fiscal and budgetary challenges, coupled with the independent actuary's projected depletion of the retirement fund's gross assets by fiscal 2019, could limit the commonwealth's ability and willingness to provide the timely contributions that will be required to maintain an adequate debt service coverage on the ERS bonds. Although the ERS rating could be affected by any change in the commonwealth's GO or appropriation ratings, the failure by the commonwealth to adopt comprehensive measures to address its unfunded pension liability within the next year could result in a downgrade on the ERS bonds even without a corresponding downgrade on other commonwealth debt. While we recognize that the adopted multiyear increases to the employers' required contribution could result in higher annual debt service coverage on the bonds, we believe that the timely adoption of these increases will remain uncertain due to the commonwealth's fiscal and budgetary challenges.

RELATED CRITERIA AND RESEARCH

- USPF Criteria: [Special Tax Bonds](#), June 13, 2007
- USPF Criteria: [State Ratings Methodology](#), Jan. 3, 2011
- USPF Criteria: [Appropriation-Backed Obligations](#), June 13, 2007

Complete ratings information is available to subscribers of RatingsDirect on the Global Credit Portal at www.globalcreditportal.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.

Primary Credit Analyst: Horacio Aldrete-Sanchez, Dallas (1) 214-871-1426;
horacio_aldrete@standardandpoors.com

Secondary Contact: Dave G Hitchcock, New York (1) 212-438-2022;
david_hitchcock@standardandpoors.com

No content (including ratings, credit-related analyses and data, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of S&P. The Content shall not be used for any unlawful or unauthorized purposes. S&P, its affiliates, and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions, regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact or recommendations to purchase, hold, or sell any securities or to make any investment decisions. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P's opinions and analyses do not address the suitability of any security. S&P does not act as a fiduciary or an investment advisor. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain credit-related analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com and www.globalcreditportal.com (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

Any Passwords/user IDs issued by S&P to users are single user-dedicated and may ONLY be used by the

Any Passwords/user IDs issued by S&P to users are single user-dedicated and may ONLY be used by the individual to whom they have been assigned. No sharing of passwords/user IDs and no simultaneous access via the same password/user ID is permitted. To reprint, translate, or use the data or information other than as provided herein, contact Client Services, 55 Water Street, New York, NY 10041; (1) 212-438-7280 or by e-mail to: research_request@standardandpoors.com.

[Regulatory Affairs and Disclaimers](#) | [Terms of Use](#) | [Privacy Notice](#) | [Contact Us](#)

Copyright © 2012 Standard & Poor's Financial Services LLC, a subsidiary of The McGraw-Hill Companies, Inc. All rights reserved.