

Americas DC Meeting Statement July 21, 2016

DC Issue Number 2016070801

Commonwealth of Puerto Rico

Summary

On July 18, 2016, the Americas DC Resolved that a Failure to Pay Credit Event occurred on July 8, 2016 with respect to the Commonwealth of Puerto Rico (**Puerto Rico**).

The Americas DC determined that the relevant Transaction Type relating to the DC Question is "Standard U.S. Municipal Full Faith and Credit." Therefore, the DC Question relates to Updated 2003 Transactions¹ which incorporate the 2012 ISDA U.S. Municipal Reference Entity Supplement to the 2003 ISDA Credit Derivatives Definitions published by ISDA on March 5, 2012 (the **Muni Supplement**) (such transactions, **Muni Transactions**).

Each capitalized term used but not defined in this Meeting Statement has the meaning given to such term in the Credit Derivatives Determinations Committees Rules (January 20, 2016 version) (including the Updated 2003 Definitions, as defined therein) (the **DC Rules**).

Publicly Available Information

Based on the Publicly Available Information² submitted in connection with the DC Question, the DC Resolved that Puerto Rico failed to make a payment due July 1, 2016 in connection with its \$3,500,000,000 General Obligation Bonds of 2014, Series A (the **Bonds**).

Based on a review of further information released by Puerto Rico after the DC Question was submitted, the DC determined that the relevant payment failure continued until at least July 12, 2016.³

Failure to Pay

The definition of Failure to Pay for purposes of the Updated 2003 Definitions states as follows:

"Failure to Pay" means, after the expiration of any applicable Grace Period (after the satisfaction of any conditions precedent to the commencement of such Grace Period), the failure by a Reference Entity to make, when and where due, any payments in an aggregate amount of not less than the Payment Requirement under one or more Obligations, in accordance with the terms of such Obligations at the time of such failure.

In Resolving that a Failure to Pay occurred, the Americas DC reached the following conclusions:

¹ In accordance with the DC Rules, "Updated 2003 Transaction" means a March 2009 Supplement Transaction or a July 2009 Supplement Transaction (and not a Credit Derivatives Transaction incorporating the 2014 Definitions as a result of the ISDA 2014 Credit Derivatives Definitions Protocol).

² See, e.g. Bloomberg, "Puerto Rico Says \$911 Million in Payments Missed in Default" ("Governor Alejandro Garcia Padilla said during a press conference in San Juan that the biggest missed payment is for \$780 million of general-obligation bonds") (available online at: www.dc.isda.org/commonwealth-of-puerto-rico/).

³ See The Commonwealth of Puerto Rico Event Notice filed with the Municipal Securities Rulemaking Board on July 12, 2016 ("[N]one of the remaining interest or principal outstanding, totaling approximately \$277.4 million and \$241.9 million, respectively, was paid by the Commonwealth") (available online at: <http://emma.msrb.org/ER980533-ER766970-ER1168826.pdf>).

(a) *"expiration of any applicable Grace Period..."*

The General Obligation Bonds (the **Bonds**) described in the Publicly Available Information contain no contractual grace period for payments of principal or interest. Therefore, the Americas DC applied a three Business Day grace period pursuant to the terms of Section 1.12(a)(iii) of the Updated 2003 Definitions. As noted above, the Americas DC determined that the relevant payment failure was continuing at the time of Puerto Rico's July 12 filing with the Municipal Securities Rulemaking Board, and therefore the Failure to Pay occurred immediately prior to midnight on the last day of the deemed three Business Day grace period, as adjusted by reference to Greenwich Mean Time (i.e., on July 8, 2016).

(b) *"payments in an aggregate amount of not less than the Payment Requirement..."*

Based on Puerto Rico's filings with the Municipal Securities Rulemaking Board, the Americas DC determined that the relevant payment failure exceeded the Payment Requirement of USD 1,000,000.⁴

(c) *"under one or more Obligations"*

The Americas DC noted that for purposes of a Muni Transaction, an "Obligation" is defined as an obligation of the Reference Entity "determined pursuant to the method described in Section 2.19 [of the Updated 2003 Definitions]." Section 2.19 of the Updated 2003 Definitions, in turn, provides that an "Obligation" must satisfy the relevant "Obligation Category" and have each of the "Obligation Characteristics" specified in the related Confirmation.

The "Standard U.S. Municipal Full Faith and Credit" Transaction Type applicable to Muni Transactions specifies that the relevant "Obligation Category" is "Borrowed Money." The Americas DC determined that the Bonds satisfy the "Borrowed Money" Obligation Category.

The "Standard U.S. Municipal Full Faith and Credit" Transaction Type applicable to Muni Transactions specifies the following two Obligation Characteristics.

(i) Not Subordinated

In relevant part, the definition of "Not Subordinated" in the Updated 2003 Definitions (as supplemented by the Muni Supplement) provides that an obligation is "Not Subordinated" if that obligation is not "Subordinated" to "any unsubordinated Borrowed Money obligation of the Reference Entity."

The Muni Supplement further amends Section 2.19(b)(i)(B) of the Updated 2003 Definitions by adding the following sentence:

"Notwithstanding the foregoing, a Full Faith and Credit Obligation Liability of a Reference Entity that is payable, in whole or in part, from ad valorem taxes (where the amount of such taxes that may be levied is subject to applicable constitutional, statutory and other legal limits) shall be deemed to be Subordinated to any Full Faith and Credit Obligation Liability of such Reference Entity that is payable, in whole in part, from ad valorem taxes that are not so limited."

⁴ See FN 3 above.

The cover page of the Official Statement for the Bonds⁵ provides that the "public debt of the Commonwealth, which includes the Bonds, constitutes a first claim on available Commonwealth resources." As a result, the Americas DC determined that the Bonds would not be "Subordinated" (as defined in the Updated 2003 Definitions, as supplemented by the Muni Supplement) to any unsubordinated Borrowed Money obligation of Puerto Rico.

With respect to the amendment to Section 2.19 set forth in the Muni Supplement, the Americas DC determined that the General Obligation Bonds are in fact payable, in whole or in part, from ad valorem taxes.⁶ The Americas DC received legal advice from counsel in Puerto Rico confirming that the amount of such ad valorem taxes that may be levied is not subject to constitutional, statutory or other legal limits.

On the basis of the above, the Americas DC concluded that the Not Subordinated Obligation Characteristic was satisfied.

(ii) Full Faith and Credit Obligation Liability

In relevant part, the definition of "Full Faith and Credit Obligation Liability" in the Muni Supplement includes "any liability of the Reference Entity [...] the payment of which in accordance with its terms or applicable law is backed by the "full faith and credit" (or similar language) of the Reference Entity."

The cover page of the Official Statement of the Bonds provides that the "good faith, credit and taxing power of the Commonwealth are irrevocably pledged for the prompt payment of the principal of, and interest on, the Bonds." The Americas DC therefore determined that the Bonds satisfy the definition of Full Faith and Credit Obligation Liability.

Accordingly, the Americas DC Resolved that a Failure to Pay occurred on July 8, 2016 with respect to the Reference Entity in relation to Muni Transactions.

⁵ Filed March 11, 2014 (available online at: <http://emma.msrb.org/ER892398-ER588507-ER990528.pdf>) (the **Official Statement**).

⁶ "Ad valorem taxes" are generally defined to include taxes based on the assessed value of real estate, personal property and/or the duty levied on imported items. Among other sources of revenue, the Bonds are payable from certain excise taxes (see, e.g., the discussion of excise tax imposed by Act 154-2010 at p 12 of the Official Statement), sales tax (see p 19 of the Official Statement) and an annual special tax of 1.03% on real and personal property established by Act No. 83-1991 (see p 30 of the Official Statement).