



GOVERNMENT OF PUERTO RICO

Puerto Rico Fiscal Agency and Financial
Advisory Authority

COSSEC Fiscal Plan

Financial Oversight and Management Board for Puerto Rico
9th Open Meeting

Fajardo, Puerto Rico

August 4, 2017



Executive Summary

- COSSEC, though designated as a Covered Entity by the Oversight Board, has not issued public debt, is not a debtor of obligations that require restructuring, has no structural deficit, is able to pay all operational expenses, and is not dependent on central government funds.
- As insurer of deposits and shares in the Cooperatives (Coops), COSSEC faces heightened risks related to claims from insured clients due to (i) potential substantial losses at Coops that invested in bonds issued by the Government of Puerto Rico and its instrumentalities, and/or (ii) run-off of client deposits & shares, due to a perceived lack of confidence in the strength of the Coop system.
- COSSEC has adequate capital to perform its regulatory and insurance duties under ordinary and relatively stressed scenarios.
- Although the Cooperative System’s loan portfolio has been performing adequately, showing great resilience during the economic recession, there is a high degree of concentration in PR Debt among Coops, that could compromise the solvency of some Coops.
- Nonetheless, given enough time, most Coops will be able to absorb investment losses related to PR debt (“special investments”) under regulatory accounting treatment.

COSSEC will collaborate with the Government’s effort to proactively seek to strengthen the system through reforms and other actions, to ensure the continued support of Cooperatives for the economic development of Puerto Rico.



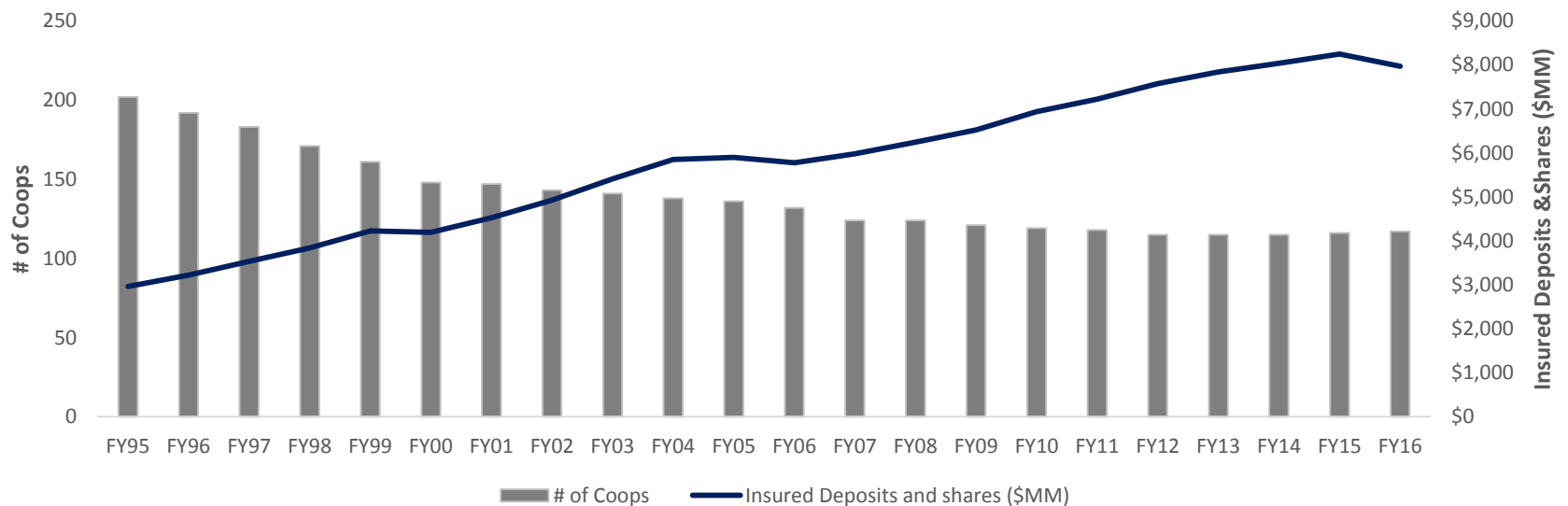
COSSEC's must be distinguished from other Covered Entities who are filing separate Fiscal Plans before the Fiscal Oversight and Management Board ("FOMB")



- COSSEC does not have an structural deficit, and comfortably covers its operating costs including employee benefits
- It is not dependent on General Fund, and generates revenues from premiums paid by member Coops and interest on its investments
- COSSEC's risk is mainly driven by extraneous factors and reputational risks, to wit:
 - Certain Coops have high concentration risk in PR Debt
 - Major cuts as part of restructuring efforts of PR Debt will impact said Coops capital and income

The Cooperative system is a pillar of the PR economy, serving as the main alternative to the commercial banking sector

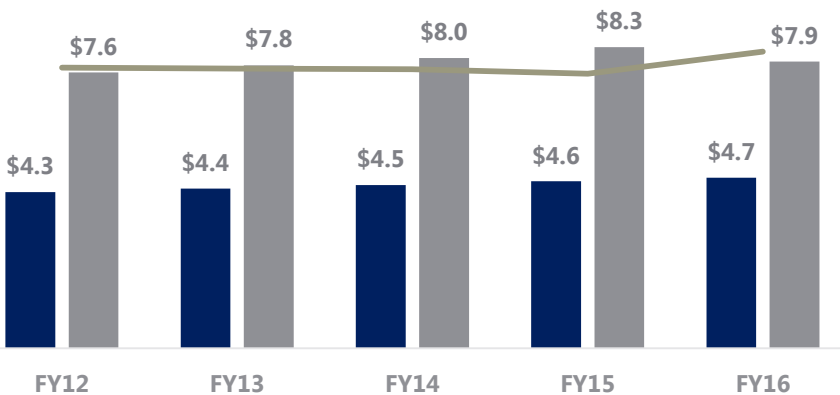
- The Cooperative movement has a strong following in Puerto Rico with 116 savings and loans Coops holding \$7.9bn of deposits & shares for nearly 1 million customers (this compares to approximately \$45bn of deposits held by banks operating in Puerto Rico)
 - Coops have gained popularity in Puerto Rico as customers feel a greater sense of loyalty to their local institution, especially given that the Coops are owned by their shareholders rather than stockholders.
- The individual Coops are significantly smaller than the Puerto Rican banks and often offer a more personalized banking experience; the Coops are viewed as an important institution in many Puerto Rican municipalities, with the president of the local Coop often serving as one of the leading figures in the community
- While the number of individual Coops was falling in the years leading up the financial crisis, the number has remained fairly stable since then as the Coops have taken market share from the banks. Over the same time period, the amount of insured deposits and shares at the Coops has increased nearly 170%, suggesting the migration of customers from banks to Coops



While its funding sources have remained stable over the years, the Coops have been able to grow their asset base

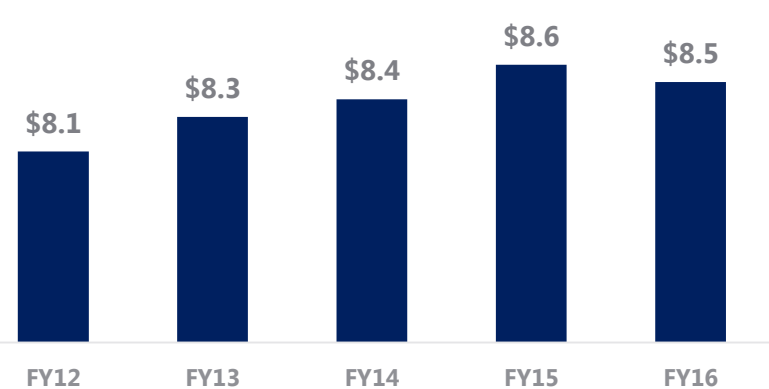
- System assets experienced 5% growth between FY12 and FY16 (1.2% CAGR); this was primarily due to a \$400MM increase in loan balances while cash and other assets remained flat
- This growth in loans was primarily funded via an increase in shares and deposits which accounted for \$350MM of the increase
- Over the 5 year period the ratio of loans / shares & deposits remained fairly constant in the 57-59% range
- The loan / shares & deposit ratio is well within the range targeted by many banks
- At less than 100%, this means that the Coops are able to fund all of their existing loans from member deposits and shares and are not forced to borrow short term funds to make loans. In addition, there is ample liquidity to satisfy deposit redemptions under normal circumstances and relatively stressed scenarios.
- By avoiding the timing mismatch between borrowing short term in the market to make longer term loans, the Coops are able to insulate themselves from a liquidity shock due to a loss of market access

Loans and Shares & Deposits (\$MM)



Loans Shares & Deposits (\$bn) Loans/Shares & Deposits

Total Assets (\$MM)



The Coops are heavily invested in securities issued by the Puerto Rican government and its instrumentalities

- PR Government securities (\$976 MM) account for approximately 65% of the Coops total investment portfolio (\$1.5bn)
- The majority of Coops purchased PR government bonds at issuance and, due to regulatory accounting treatment, carry all of these “special investments” on their books at par value, even those bonds that trade well below par value
- GDB’s bonds, which comprise approximately 44% of Coop exposure to government securities, trade at a roughly 84% discount to par value; GO bonds, the Coops’ second largest governmental exposure, are trading at a roughly 41% discount
- Taken as a whole, the aggregate Coop investment in government bonds has a market value roughly 49% below the par
- Regulatory accounting treatment allows the Coops to amortize losses on special investments over a 15 year period; however, this will only benefit the Coops from an accounting standpoint as they will still suffer reductions in cash flow due to the likely restructuring of Government debt

Coops Investment in Government Securities (\$MM) as of April 2017

Issuer	Instruments	% of Portfolio	Amortized Cost	Market Value as of April 2017	Market Value/Amortized Cost
GDB	640	44%	\$459,297	\$75,703	16% ⁽¹⁾
GO	208	14%	114,712	67,380	59%
PRASA	112	8%	60,403	42,124	70%
PFC	106	7%	80,622	4,419	5%
COFINA	103	7%	88,909	40,009	45%
PREPA	100	7%	71,112	48,092	68%
PBA	80	5%	52,763	32,754	62%
HTA	29	2%	5,783	4,266	74%
ERS	27	2%	18,480	7,559	41%
Others	55	4%	24,210	12,518	52%
Total	1460	100%	\$976,291	\$334,823	49.2%

(1) On May 15, 2017 GDB signed an RSA with stakeholders detailing three possible recovery rates: Tranche A (55%), Tranche B (60%) and Tranche C (75%).



All Coop system stress scenarios have been completed in accordance with the guidelines set by the FOMB

1 Capital Reserve Report (amortization for losses assumed)

Capital Reserve Report is the actuarial report that measures the sustainability of Coops based on the ability to amortize the Government Securities losses over time by projecting historical ROA. During the second half of FY17, COSSEC's management requested to the actuaries an updated version of this report with 2016-Q4 financial data and the market value of its investments as of April, 2017.

2 Capital Reserve Report (no amortization for losses)

Based on the same report, net reserves (reserves plus accumulated earnings or losses) were impacted by subtracting total PR debt losses instead of its amortized amount under regulatory accounting treatment.

3 Liquidity Report (deposit run-offs)

Short term liquidity analysis stressing the cash and equivalent items available to Coops (subtracting cross deposits among Coops) under different deposit run-off scenarios in order to project possible individual needs.

4 NCUA Report

NCUA performed an analysis of the Puerto Rico Cooperative System in March, 2016. COSSEC has updated the report to include market value of PR Government Securities as of April 2017 and the most recent data available for all insured Coops (2017-Q1).

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COOP-SELF (the “Program”) will provide depositor confidence and ensure the long term sustainability of the Coop System and the Corporation

- The Program is designed to aggregate and organize system-wide resources to be deployed to strengthen the capital base of individual Coops and provide additional liquidity.
- **The initial proposal totaling \$533 MM in combined commitments, is comprised of approximately \$383 MM available for capital injections and an additional \$150 MM for liquidity in exchange for loan assets.**
- The Program will also aim to steer the system towards a path of long term sustainability.
- The oversight and implementation of the Program will be administered by the *Cooperative Technical Financial Task Force*, as per an Memorandum of Understanding (“MOU”).
- Under the MOU the parties will exchange information and provide assistance in connection with the monitoring of the financial situation, crisis management, recovery and mitigation.



NEW Governance Reform

- A new Committee must be created to assume the governance of COSSEC while its Fiscal Plan is in effect and being implemented.
- This Committee shall exercise, exclusively, all powers granted to the COSSEC's Board of Directors.
- The Committee shall adopt by-laws for the administration of its internal affairs and may also adopt such standards, rules and regulations as may be necessary or convenient for the successful implementation of the Fiscal Plan.
- The Committee shall be the operating arm spearheading reforms and other actions, to further strengthen the Cooperative system and the Corporation, and insure a effective execution of the Fiscal Plan.



Concluding Remarks

We are certain that the COSSEC Fiscal Plan addresses all possible system weaknesses with the utmost responsibility and aims at maintaining the cooperative system as one of the main pillars of the local economy.

In summary, the Plan:

1. Confirms COSSECs capacity to perform its regulatory and insurance duties with adequate capital to support the system under ordinary and relatively stressed scenarios.
 2. Implements the right Governance structure to steer COSSEC through the current challenges and implementation of necessary reforms.
 3. Establishes a coordinated liquidity and capital response through the COOP-Self initiative, with system wide resources.
- The Administration strongly believes that the measures set forth for the consideration and approval of the Board, will comply with the requirements set forth in PROMESA, while improving COSSEC's role through enhanced oversight and stronger governance structure.

