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COMMONWEALTH OF PENNSYLVANIA
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Via First Class Mail & Electronic Transmission

Douglas L. Peterson
President and Chief Executive Officer
S&P Global
55 Water Street
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Dear Mr. Peterson:

We write to you today to raise our concerns around one of the most pressing issues of our day: criminal and civil justice reform. As investors, policy-makers and advocates, we have a clear obligation to more carefully scrutinize how the widespread use of criminal, traffic, and civil monetary penalties have shaped state and local finances in recent years. We ask you, as a leading rating agency provider, to take further concrete steps to identify the real risks this trend poses to investors by including the extent to which an entity relies on fines and fees in its rating action.

Municipal budgets are increasingly reliant on mandatory costs and traffic, civil, and misdemeanor fines (“fines and fees”) generated by their court systems.¹ These fees are disproportionately extracted from low-to-moderate income families and communities of color.² To some, it may seem that municipal revenue derived from traffic and civil penalties is innocuous or even justified--especially at the individual level--but even the most common citations, such as speeding tickets and housing code violations, can turn abusive if certain groups are unfairly targeted.

Nationally, outstanding criminal justice debt totals \$50 billion with at least 60% of all debts owed by Blacks and Latinos.³ Over the past decade, 48 states have increased or added new criminal and civil court fees, including for services that are constitutionally-required.⁴ Florida

¹ “Addicted to Fines: A Special Report,” *Governing*, August 2019, <https://www.governing.com/topics/finance/fine-fee-revenues-special-report.html>.

² “Targeted Fines and Fees Against Communities of Color,” *U.S. Commission on Civil Rights*, September 2017, https://www.usccr.gov/pubs/2017/Statutory_Enforcement_Report2017.pdf.

³ “Is Charging Inmates to Stay in Prison Smart Policy?” *Brennan Center for Justice*, September 2019, <https://www.brennancenter.org/our-work/research-reports/charging-inmates-stay-prison-smart-policy>.

⁴ “As Court Fees Rise, The Poor Are Paying the Price,” *NPR*, May 2014, <https://www.npr.org/2014/05/19/312158516/increasing-court-fees-punish-the-poor>.

alone has created 20 new types of fines and other costs since 1996.⁵ If unpaid, traffic and criminal justice debt can lead to continued probation, incarceration, loss of driving privileges, and interference with voting rights.⁶ For instance, local jurisdictions across the U.S. have re-incarcerated up to 20% of inmates for failure to pay criminal justice fines and other related costs.⁷ Ultimately, revenues generated through criminal justice fines and fees can cost more than any money raised.⁸ Although S&P's institutional framework scoring methodology assesses the entity's role "in encouraging the transparency and comparability of relevant financial information," the entity's potential reliance on fines and fees and the resulting financial risk to investors is not included.⁹

Not only is this system unfair and inefficient, but localities reliant on fines and fees also generate additional negative consequences.¹⁰ The toxic culture created by fines and fees as fiscal policy fosters conditions that lead to unnecessary, violent police interactions.¹¹ Violent police interactions and misconduct have their own fiscal implications for cities. In 2017 alone, the city of Chicago issued \$225 million in general obligation bonds to cover debt for police misconduct settlements.¹² These bonds accumulate costly Wall Street fees and can exacerbate a city's existing revenue shortages along the way.

Case Study: Ferguson

In the wake of the Great Recession, the burden of economic distress led too many localities to make tradeoffs between equity and financial solvency. Ferguson, a small town with a declining population and unclear economic prospects, chose to engage in for-profit policing to

⁵ "The Hidden Costs of Florida's Criminal Justice Fees," *Fines and Fees Justice Center*, March 2010, <https://finesandfeesjusticecenter.org/articles/hidden-costs-floridas-criminal-justice-fees/>.

⁶ "More than 7 million people may have lost driver's licenses because of traffic debt," *The Washington Post*, May 2018, https://www.washingtonpost.com/local/public-safety/more-than-7-million-people-may-have-lost-drivers-licenses-because-of-traffic-debt/2018/05/19/97678c08-5785-11e8-b656-a5f8c2a9295d_story.html.

⁷ "Fines, Fees, and Bail," *Council of Economic Advisors*, December 2015, https://obamawhitehouse.archives.gov/sites/default/files/page/files/1215_cea_fine_fee_bail_issue_brief.pdf.

⁸ "Bail, Fines and Fees Cost More Than They Bring In, New Study Reveals," *Vera Institute of Justice*, January 2017, <https://www.vera.org/newsroom/bail-fines-and-fees-cost-more-than-they-bring-in-new-study-reveals>.

⁹ "U.S. Local Governments General Obligation Ratings: Methodology And Assumptions," *S&P Global Ratings*, September 2013, <https://www.spratings.com/documents/20184/1282625/USPF+Criteria+Book+-+Oct16+-+Tax/22725e62-301b-4d1f-98e6-11a1436702d0>.

¹⁰ S&P's general rating criteria for evaluating public finance notes that for governmental entities, quantitative factors that can negatively impact a credit rating generally include budgetary and financial performance and other aspects of creditworthiness such as the payment priority of an obligation following default. "General Criteria: Principles of Credit Ratings," *S&P Global Ratings*, December 22, 2014, <https://www.spratings.com/documents/20184/1282625/USPF+Criteria+Book+-+Oct16+-+General/76e056b4-7175-47e6-ad42-8c1ab7ba228f>.

¹¹ "The Link Between Money and Aggressive Policing," *The New Yorker*, August 2016, <https://www.newyorker.com/news-desk/the-link-between-money-and-aggressive-policing>.

¹² "How Cities Offload the Cost of Police Brutality," *Bloomberg CityLab*, June 2020, <https://www.bloomberg.com/news/articles/2020-06-04/the-financial-toll-of-police-brutality-to-cities>.

offset a declining tax base, producing increased fee income. A report by the U.S. Department of Justice (DOJ), documented instance after instance of written communications from city to police leadership demanding ever more citations and the revenue they generated.¹³ This trickled down to the shift sergeant level and materially affected promotion decisions for rank and file officers. The DOJ concluded that “[c]ity officials have consistently set maximizing revenue as the priority for Ferguson’s law enforcement activity.”¹⁴

Years of fines and fees prioritization from city leadership also changed the very culture of the Ferguson Police to the opposite of our “to serve and protect” ideals. The DOJ found that Ferguson’s emphasis on using policing as a source of revenue “compromised the institutional character of Ferguson’s police department...shaped its municipal court....and as a consequence of City and FPD priorities, many officers appear to see some residents, especially those who live in Ferguson’s predominantly African-American neighborhoods, less as constituents to be protected than as potential offenders and sources of revenue.”¹⁵

By December 2014, over 16,000 people, representing 76% of Ferguson’s population, had outstanding warrants issued by the city. 20% of Ferguson’s 2013 budget was funded through fines and fees.¹⁶ Though serious offenses, as classified by the DOJ, remained constant, overall citations spiked with the majority of Ferguson’s fine revenues (and the associated warrants) borne by its minority and low-to-moderate income population. These citations were often for inherently subjective offenses such as disorderly conduct, unkempt property, wearing “saggy pants,” and overzealous enforcement of often bizarre occupancy certificate rules.¹⁷

Many of us know the rest of the story. In an environment that some experts called a “powder keg,” created by the for-profit culture of the Ferguson Police Department, Michael Brown was shot and killed in 2014 by a police officer and the city erupted into chaos.¹⁸

¹³ “Investigation of the Ferguson Police Department,” *United States Department of Justice Civil Rights Division*, March 2015, https://www.justice.gov/sites/default/files/opa/press-releases/attachments/2015/03/04/ferguson_police_department_report.pdf.

¹⁴ *ibid.*

¹⁵ “The Link Between Money and Aggressive Policing,” *The New Yorker*, August 2016, <https://www.newyorker.com/news/news-desk/the-link-between-money-and-aggressive-policing>.

¹⁶ “How Cities Offload the Cost of Police Brutality,” *Bloomberg CityLab*, June 2020, <https://www.bloomberg.com/news/articles/2020-06-04/the-financial-toll-of-police-brutality-to-cities>.

¹⁷ “How municipalities in St. Louis County, Mo., profit from poverty,” *The Washington Post*, September 2014, <https://www.washingtonpost.com/news/the-watch/wp/2014/09/03/how-st-louis-county-missouri-profits-from-poverty/>.

¹⁸ “The Making of Ferguson: How Decades of Hostile Policy Created a Powder Keg,” *The American Prospect*, October 2014, <https://prospect.org/civil-rights/making-ferguson-decades-hostile-policy-created-powder-keg/>.

Ferguson's lesson for all of us

"Let's not let people get away with putting Ferguson in a special class of dysfunction the way many have with Detroit, San Bernardino, and other places that have hit the wall sooner than others. They are not anomalies; they are canaries in the coal mine" Charles Marohn, Strongtowns.org¹⁹

Ferguson is not unique. In a 2019 *Governing* report, nearly 600 cities nationally were found to derive more than ten percent of total revenues from fines and fees.²⁰ In Missouri alone, dozens of towns more heavily relied on fines and fees than Ferguson with some towns exceeding forty percent of total revenue.²¹

In the wake of the shooting, Ferguson's real estate property sales and values sharply declined. According to Zillow.com and real estate trade reports, home sales dropped by one-third and median sales prices fell by two-thirds by the end of 2014. Since the majority of cities receive a high percentage of their income from property tax, investors took notice. The bond rating agency had rated Ferguson "AAA" or perfect/near perfect until September 2015 when Moody's downgraded Ferguson from AAA to junk bond status. This downgrade, Moody's noted, "reflects severe and rapid deterioration of the city's financial position, possible depletion of fund balances in the near term, and limited options for restoring fiscal stability. Key drivers of this precipitous drop are declining key revenues, unbudgeted expenditures, and escalating expenses related to ongoing litigation and the Department of Justice consent decree currently under negotiation."²²

The story of Ferguson suggests investors and other financial market players, not simply researchers and advocates for criminal justice reform, have a vested interest in more carefully measuring and scrutinizing municipal budgetary reliance on fines and fees. While S&P's general criteria article on the principles of credit ratings emphasizes its analysis of "the transparency of processes and data and the accountability of institutions" of a governmental entity, reliance on fines and fees continues to remain unmeasured.²³ The same economic conditions and racial inequities that made Ferguson possible are with us today. Like the Great Recession, the economic effects of COVID-19 have put enormous strains on state and local budgets. The Center on Budget and Policy Priorities projects state budget shortfalls will total \$555 billion between

¹⁹ "Ferguson Junk," *Strong Towns*, October 2015, <https://www.strongtowns.org/journal/2015/10/1/ferguson-junk>.

²⁰ "Addicted to Fines: A Special Report," *Governing*, August 2019, <https://www.governing.com/topics/finance/fine-fee-revenues-special-report.html>.

²¹ "Municipal Courts White Paper," *ArchCity Defenders*, 2014, <https://www.archcitydefenders.org/wp-content/uploads/2019/03/ArchCity-Defenders-Municipal-Courts-Whitepaper.pdf> ;

²² "Rating Action: Moody's downgrades Ferguson, MO's GO rating to Ba1 from Aa3 and lease revenue ratings to Ba2 and Ba3 from A1 and A2," *Moody's Investors Service*, September 2015, https://www.moodys.com/research/Moodys-downgrades-Ferguson-MOs-GO-rating-to-Ba1-from-Aa3--PR_334856.

²³ "General Criteria: Principles of Credit Ratings," *S&P Global Ratings*, February 2011, https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/6485398.

2020-2022.²⁴ Since April, state and local governments have already laid off twice as many workers as in all of the Great Recession. Overall, unemployment during the COVID-19 era has swelled from 3% in February to a peak of 13% in May, a substantially greater increase than the Great Recession.²⁵

The political expediencies that led Ferguson to pursue taxation by citation are also painfully still with us. Recent research reveals fine revenue is not heavily correlated with income levels; a mix of rich and poor cities use fines for revenue. “The best indicator that a government will levy an excessive amount of fines is if its citizens are Black.”²⁶ This provides a reminder that the strained police-community relationship is not just a result of high-profile police shootings. The exploitation of fines and fees for government revenue is systemic and racist.

Investor Best Practices

We believe this body of evidence means the time for additional study is over and we are compelled to act. We are not alone: nonpartisan institutions such as the American Bar Association²⁷, Government Finance Officers Association²⁸, and the National Center for State Courts²⁹ have all issued statements or white papers detailing governance and policy reforms to address this issue. From this expertise, and our own analysis, a responsible investor in municipal bonds should expect the following as part of their due diligence:

Transparency. All localities, including courts, should track and make publicly available the total amount of fines, fees, costs, surcharges, and restitution imposed and collected annually. The reporting of these legal financial obligations should be done in a manner to promote transparency and public comprehension and should include fees assessed by third-party entities that handle system-relation functions, e.g. private debt collectors and probation companies. This report should also include policies on how localities assess an individual’s inability to repay. A defendant has a constitutionally protected right to an ability to repay assessment if fines and fees are being imposed, and “to do otherwise would deprive the [defendant] of his conditional

²⁴ “States Continue to Face Large Shortfalls Due to COVID-19 Effects,” *Center on Budget and Policy Priorities*, July 2020, <https://www.cbpp.org/research/state-budget-and-tax/states-continue-to-face-large-shortfalls-due-to-covid-19-effects>.

²⁵ “Unemployment rose higher in three months of COVID-19 than it did in two years of the Great Recession,” *Pew Research Center*, June 2020, <https://www.pewresearch.org/fact-tank/2020/06/11/unemployment-rose-higher-in-three-months-of-covid-19-than-it-did-in-two-years-of-the-great-recession/>.

²⁶ “The Fining of Black America” *Priceonomics*, June 2016, <https://priceonomics.com/the-fining-of-black-america/>.

²⁷ “Ten Guidelines on Court Fines and Fees,” *American Bar Association*, August 2018, https://www.americanbar.org/content/dam/aba/administrative/government_affairs_office/aba-ten-guidelines_.pdf?logActivity=true.

²⁸ “Financial Policies for Imposed Fees, Fines, and Asset Forfeitures.” *Government Finance Officers Association*, 2020, https://gfoaorg.cdn.prismic.io/gfoaorg/2e311329-a26d-4d75-9330-7d59964820e6_FeesFinesAssetForfeitures_R3.pdf.

²⁹ “Assessing Fines and Fees in the Criminal Justice System,” *National Conference of State Legislatures*, January 2020, https://www.ncsl.org/Portals/1/Documents/cj/Fines%20and%20Fees_v02.pdf.

freedom simply because, through no fault of his own, he cannot pay the fine.”³⁰ The reporting of this information should be in addition to any requirements established by existing law.

Governance. All states and localities should have a defined and transparent mechanism for establishing, increasing, and administering the imposition and collection of criminal and civil fines and fees. The resulting schedule of potential fines and fees should be publicly available. States and localities should have clear policies in place to assess an individual’s ability to pay fines and fees; when and how waivers or reduction in total payment are warranted; and alternatives to payment, e.g. community service. Ratings’ normal scrutiny of the problematic practice of “cross-subsidization” is also necessary. Using fee revenue from one service to fund a different service distorts policy-making and often favors political expediency as in the case of Ferguson.³¹ Finally, fines and fees should never prevent access to critical due process rights such as a public defender or court discovery.

Red Flag Mechanism. As previously discussed, Ferguson’s police department deliberately engaged in a policy of cross-subsidization and increasing revenue by aggressively pursuing fines and fees. In all, fines and fees revenue increased by 54 percent in just two years, ultimately accounting for 20 percent of the city’s \$12.7 million operating revenue in fiscal year 2013. As one observer noted, “[w]hile the events of August 2014 certainly precipitated a sharp deterioration in finances, the financial situation in Ferguson has been precarious for some time. The city is well into...[a] Ponzi Scheme having, after a generation of unproductive growth, taking on enormous levels of debt in an attempt to keep everything going.”³² We believe that any responsible investor should monitor and flag, for additional scrutiny, these types of rapid increases in fines and fees reliance using empirically-based benchmarks. At a minimum, this type of volatility in a locality’s revenue suggests financial distress, e.g. a significant decline in other types of revenue.³³

³⁰ “Bearden v. Georgia,” *Fines and Fees Justice Center*, 2018, <https://finesandfeesjusticecenter.org/articles/bearden-v-georgia/>.

³¹ The power to modify fines and fees and set broader criminal justice policy is typically held by both local government and the courts, as well as other actors, e.g. state government. Accountability and the direct costs of those decisions are often misaligned and diffuse. For example, “[p]rosecutors (paid for by the county) have a motivation to convict people of felonies (which result in state-funded prison sentences) instead of misdemeanors (which result in county-funded jail or probation terms).” In other words, in some instances, it’s cheaper for decision-makers to impose the more expensive policy, because the costs are borne by another party. “Cory Booker has a plan to “reverse” mass incarceration. It won’t work,” *Vox*, September 2017, <https://www.vox.com/the-big-idea/2017/9/26/16363230/mass-incarceration-cory-booker-reverse-bill>.

³² “Ferguson Junk,” *Strong Towns*, October 2015, <https://www.strongtowns.org/journal/2015/10/1/ferguson-junk>.

³³ Fitch’s master criteria for evaluating public finance notes that non-recurring, unsustainable revenue should be treated differently than general revenue and further notes that asymmetrical risks such as litigation, e.g. brutality bonds, are negative credit rating factors. “U.S. Public Finance: Tax-Supported Rating Criteria,” *Fitch Ratings*, March 2020, <https://www.fitchratings.com/research/us-public-finance/us-public-finance-tax-supported-rating-criteria-27-03-2020>.

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Conclusion

For-profit policing is inefficient, short-sighted, and undermines rational policymaking. While the aggressive collection of fines and fees may provide temporary fiscal relief to localities, it is ultimately counter-productive by establishing perverse financial incentives that ripple through the criminal justice system and generate a slew of negative outcomes. These outcomes unnecessarily harm individuals and police-community relations, creating the potential for violent interactions, fatalities, and civil unrest. Consequently, we request that S&P explicitly evaluate new issues for reliance on fines and fees revenue, in order to assess the true risk to investors in the country's \$4 trillion municipal bond market and encourage greater transparency.

Thank you for your consideration of this important issue. Please advise our offices of the policies you have in place, or will implement, to address these issues.

Very truly yours,

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Rebecca Rhynhart
City Controller of Philadelphia

Donna Bullock, Pennsylvania State Representative
Chairwoman, Pennsylvania Legislative Black Caucus

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The Public Interest Law Center