

GOVERNMENT EMPLOYEES' RETIREMENT SYSTEM
OF THE
VIRGIN ISLANDS

ANNUAL OVERVIEW OF OPERATIONS

FISCAL YEAR

2016



"Contributing today for a better tomorrow"

Presented to
Committee on Finance
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Presented by:
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GOVERNMENT EMPLOYEES' RETIREMENT SYSTEM

Annual Overview of Operations

TABLE OF CONTENTS

Introduction.....	2
Accomplishments for Fiscal Year 2016.....	2
Goals for Fiscal Year 2017	3
Unfunded Liability (Employer's Net Pension Liability)	3
Missing Employee and Employer Contributions.....	5
Central Government	5
Autonomous Agencies	6
Direct Contributions Due from Central Government.....	6
Membership Total Contributions Received vs. Benefit Payments & Expenses.....	6
Annuity Payments.....	7
Assets (Including Investments).....	8
Portfolio Performance	8
Alternative Investment Program.....	9
Actuarial Valuation	10
Annual Financial Audit	11
Summary.....	11

GOVERNMENT EMPLOYEES' RETIREMENT SYSTEM

Annual Overview of Operations

INTRODUCTION

Good morning, Honorable Senator Clifford F. Graham, Chairman of the Committee on Finance, distinguished Committee members, other distinguished senators present in the chambers and good morning to all. I am, Austin L. Nibbs, Administrator/CEO of the Government Employees' Retirement System of the Virgin Islands (GERS). I am pleased to appear before you to present the System's Annual Overview of Operations. Before I begin, I would like to acknowledge members of my senior management team that are joining me today in the chambers.

In an effort to comply with the time limits set for our presentation, we will highlight our major accomplishments for FY 2016 and our major goals for FY 2017, and share the major issues affecting the GERS today.

FISCAL YEAR 2016 ACCOMPLISHMENTS

- We have completed 65 percent of the NOPA Project updates to member records which improved the timely processing of the member's benefits while providing timely and accurate information to our members.
- We have improved customer service and educational awareness to members by 50 percent.
- We have started the implementation of the GERS Strategic Plan for FY 2016 –FY 2020, and the change management process within the organization.
- The annual statement implementation was completed and statements will be issued for calendar year 2015 to approximately 60 percent of Tier I members this summer.
- The Certified Audited Financial Statements for FY 2015 were issued on June 22, 2016.
- The annual Actuarial Valuation Review is 90 percent completed and will be issued by the end of July.

FISCAL YEAR 2017 GOALS

- To reconcile and close the FY 2016 books by December 2016.
- To complete the FY2016 Certified Annual Audit and the FY 2016 Actuarial Valuation by March 2017.
- To reduce outstanding loan delinquencies by 50 percent.
- To reduce backlogged prior service requests by 30 percent.
- To conduct workshops with all human resources government representatives.
- To complete employer service credit evaluations for employer billings.
- To complete the Phase I refurbishment project to improve the appearance of the Havensight Mall.
- To issue the annual statements for Tier I and Tier II members for calendar year 2016 by the 2nd quarter of FY 2017.
- To increase employee engagement and morale.
- To aggressively monitor our international exposure in the portfolio in light of the recent developments in the United Kingdom.

UNFUNDED LIABILITY (EMPLOYER'S NET PENSION LIABILITY)

In our April 2016 newsletter, which is included as part of this presentation, we have outlined in detail the reason for the significant change in the unfunded liability which is now referred to as the ***employer's net pension liability***. The Government Accounting Standard Board (GASB) revised and established new financial reporting requirements for most states and local governments that provide employees with a defined benefit pension plan. GASB 68 mandates that the governments providing defined benefit pensions to recognize their long-term obligations for pension benefits as a liability for the first time on the FY 2015 financial statements of the central government and some autonomous agencies. GASB 68 enhances accountability and transparency. Prior to the implementation of GASB 68, the Fund had an unfunded liability of \$ 2.0 billion. Because of the implementation of GASB 68, the ***employer's net pension liability*** increased to

\$3.1billion. This is an increase of \$1.1billion. The reason for this increase is because in the past years, the Plan's long-term expected rate of return was 7.5 percent. Because pension plans are not realizing their expected returns, the Government Accounting Standard Board's interpretation was that pension plans were understating their unfunded liability. To eliminate this distortion and for better transparency, the Plan's long-term expected rate of returns had to be discounted using a 20 year AA Municipal Bond Index. So, GERS's 7.5 percent long-term expected rate of return was discounted to 4.42 percent. The lower the expected rate of return, the higher the employer's net pension liability. The employer's net pension liability occurs when there are more liabilities (debt) than assets. Simply, the monies needed to cover current and future retirements are not readily available.

One of the major contributors to the unfunded liability is the Government of the Virgin Islands (Plan Sponsor) failure to contribute the required Actuarially Determined Contributions (ADC), which is the amount of contributions that should be paid to the fund each year in order to keep the System actuarially sound. For the past 25 years from 1991 – 2015, the Plan Sponsor has contributed \$1.3 billion less than it should have contributed to the GERS. What should have been contributed for the past 25 years was \$2.7 billion. The Plan Sponsor actual contributions were \$1.4 billion. We note that in 2015, the ADC was \$200.1 million and the actual contributions received were \$75.2 million. We are in the process of retrieving from the archives and analyzing the ADC and actual contributions paid prior to 1991.

The question remains, how is the GERS going to collect this shortfall in contributions?

In the board meeting held on May 26, 2016, the Board directed the Administrator to follow the law in Title 3, Chapter 27, Sections 718 and 718(a) and Chapter 28A, Sections 767 and 767(a). Therefore, the GERS has delayed paying benefits to members who participated in the early

retirement program, and who have filed an application to retire under the early retirement program (all hazardous employees, judges and legislators), and who have not received an initial annuity beginning May 26, 2016, until the actuary can provide a methodology to calculate the additional ADC the plan sponsor owes for each retiree. The retiree annuity will be delayed until the plan sponsor has made payment for the additional ADC. Thereafter, we will determine the additional ADC that is due and the System will bill the Plan Sponsor for each retiree who retired and is receiving an annuity under any early retirement program, to include the nine (9) unfunded legislative mandates that were passed by the 15th, 20th, 21st, 23rd and 24th Legislatures.

For all other retirees and active members, the actuary will also determine the additional ADC that is due, and the System will bill the Plan Sponsor.

MISSING EMPLOYER CONTRIBUTIONS-CENTRAL GOVERNMENT

In 2011, the actuary Segal Consulting estimated the employer missing contribution amount to be \$47 million. Since 2012 through June 14, 2016, we have billed and received \$7.6 million. The remaining estimated balance as of June 14, 2016 is \$39.4 million. To date, the amount that was billed and *not received* is \$710,319.40. I would like to note however, that the central government is timely with its FY 2016 bi-weekly contributions. The issue of prior periods missing employer contributions is a legacy issue for the System. With the implementation of the new V3 System in March 2012, the problem surfaced as the new system is programmed to account for both the employee and employer contributions in accordance with the 2005 pension reform legislation. The System will continue to bill the Plan Sponsor prior to the retirement of a member for *missing contributions* not paid by the employer during the career of the member.

MISSING EMPLOYEE AND EMPLOYER CONTRIBUTIONS-AUTONOMOUS AGENCIES

The autonomous agencies are timely with payment of their FY 2016 employee and employer contributions with the exception of Juan F. Luis Hospital and Medical Center (JFLHMC). JFLHMC continues to have a significant outstanding contribution amount due to the System for prior years. In our meeting with JFL officials on May 25, 2016, we presented them with a cumulative billing for outstanding contributions for fiscal years 2012, 2013, 2014, and 2015 in the amount of \$7.1million (employee-\$1.5 million, employer-\$3.5 million, interest & fees-\$2.1 million). They could not assure us that the outstanding contributions will ever be paid nor did they present us with a payment plan. Therefore, the GERS has filed a civil action in the Superior Court.

DIRECT CONTRIBUTIONS DUE FROM CENTRAL GOVERNMENT

Act No. 7261 calls for *appropriating in fiscal year ending September 30, 2013, and all subsequent fiscal years*, the sum of \$7,000,000 from the Internal Revenue Matching Fund to the GERS as a direct contribution. We are happy to report that on May 31, 2016, we received a check in the amount of \$7 million from the central government as a payment on the \$28 million that was due since FY 2013. The balance outstanding is \$21 million.

MEMBERSHIP/TOTAL CONTRIBUTIONS VS. BENEFIT PAYMENTS & EXPENSE

The gap between the active members and the retirees and beneficiaries has decreased from a 1.09 to 1 ratio in Fiscal Year 2014 to a 1.07 to 1 ratio in Fiscal Year 2015. The active members increased by 141 between September 30, 2014 and September 30, 2015, and the retirees and beneficiaries increased by 296 for the same period. Based on the most current numbers for FY 2016 (October 1, 2015 – June 15, 2016), we estimated the ratio to be 1.07 to 1 (active members 9,200/retirees 8,553), which is about the same as in FY 2015, down from 2.58 to 1 in 1996.

We note that the deficit between total contributions and benefit payments and expenses decreased from \$163.6 million in FY 2014 to \$158.0 million in FY 2015. The reduction in the deficit was due mainly to the increase in the employees' contribution rates. The trend appears to be the same in FY 2016 as in FY 2015. As of May 2016 year-to-date, total contributions received were \$73.5 million and contributions and benefit payments and expenses were \$170.1 million, for a deficit of \$96.6 million for the eight (8) months of FY 2016.

ANNUITY PAYMENTS (CENTRAL GOVERNMENT AND AUTONOMOUS)

The total annuity payments from October 1, 2015– June 15, 2016 was \$170.3 million for 8,533 retirees. The gross retiree payroll for pay date June 15, 2016 was \$10.1 million. For the period October 1, 2015 – June 15, 2016, 249 retirees were placed on the payroll. During the same period, 184 retirees were removed from the payroll because of deaths.

There were 299 (St. Croix-150 /St. Thomas-149) retiree applications filed in calendar year 2015. Of the 299 applications received, to date 233 retirees have received their initial retirement annuity payment. From January 1, 2016 to June 15, 2016, 78 (St. Croix-31 / St. Thomas-47) retiree applications were received. Of the 78 applications received in 2016, to date, 4 retirees have received their initial retirement annuity payment. The number reflected is not higher for one or more of the following reasons:

- Missing employer contributions billed and not received
- Retirement NOPA not received
- Missing NOPAs
- Contribution Postings for the GVI are not up to date due to errors in the file. Finalizing cases up to March 31, 2016.
- Corrections and final review
- Mandate from the GERS Board to discontinue paying Special Pensions until review is done by the actuary

ASSETS

The assets of the GERS include the investment portfolios, which include cash and cash equivalents, stocks and bonds, private equity and other alternative investments, such as real estate and local investments and member loans.

Portfolio Performance

The System will continue its commitment to a disciplined investment strategy that focuses on long-term results. Its investment portfolio is managed by 13 investment managers (9 equity – domestic & international), 2 fixed income (bonds), 1 private equity (non-local), and 1 life settlement.

At May 31, 2016, the market value of the portfolio was \$755.2 million which represents a decrease from \$825.9 million for the same period one year ago. (See investment performance handout). To meet obligations, \$58.5 million was withdrawn from the Fund. The Fund earned income of \$12.9 million and had a loss in the portfolio of \$25.2 million.

We are monitoring the portfolio to assess the impact the United Kingdom's referendum to break away from the European Union has on the portfolio. The portfolio consists of 14% - International Equity and 14.2% - International Fixed Income.

The System's aggregate assets performance at May 31, 2016 year-to-date is 2.7 percent. The total plan returned -0.1 percent for the month of May 2016. Since 1981 when the portfolio was invested in the market, the total plan has returned 9 percent. Since 1981, Total Equity has returned 12.8 percent, Total Fixed Income (bonds) has returned 7.6 percent, and Total Alternatives has returned -1.4 percent.

Alternative Investment Program

Title 3, Section 12, Chapter 27 of the Virgin Islands Code gives the Board of Trustees the authorization to invest in an Alternative Investment Program. Alternative investments are private market (non-publicly traded) investments in domestic and international venture capital and special equity; simply any investments other than the traditional equity and bonds.

The Alternative Investment Program is designed to enhance the total Fund performance by generating a long-term rate of return greater than the Fund's assumed actuarial rate of 7.5 percent. On January 23, 2014, the Board approved a rate of no less than 10 percent effective January 1, 2014 for all alternative *local* investments. To date, GERS has invested in three types of alternative investments, private equity, real estate, special situations (local investments), and member loans.

The portfolio for Alternative Investment consists of:

Private Equity

1. Mesirow Financial Private Equity Fund (Limited Partnership)

Real Estate

1. GERS Complexes in St. Thomas and St. Croix
2. Undeveloped Land (Estates Hoffman and Nullyberg-St. Thomas and Estate Coakley Bay – St. Croix
3. Havensight Shopping Mall – St. Thomas

Special Situations

1. Renaissance Carambola Beach Resorts and Spa – St. Croix
2. V.I. Property Tax Revenue Anticipation Note – Territory-wide
3. Kazi Foods Virgin Islands – St. Thomas and St. Croix
4. V.I. Finest Foods LLC – St. Thomas

Life Settlements

The Attilanus Fund I, L.P. – Outside the Territory

Member Loans – Territory-wide

On November 19, 2015, the Board voted unanimously to *indefinitely* suspend the granting of any new member loans because of liquidity issues and the volatility in the market. At May 31, 2016, there were 8,090 units in the member loans portfolio with a total value of \$138.3 million, down from 8,716 units with a total value of \$156.9 million on August 31, 2015.

On May 9, 2016, the 31st Legislature passed Bill No. 31-0289 which was signed into law by the Governor as Act No. 7880 on May 27, 2016. After reviewing the information presented that was presented during the Administrator's presentation to the Committee on Finance on March 21, 2016 on Bill No. 31-0289, and updates by the Investment Officer, and the performance of the System's portfolio and market conditions and the System's liquidity challenges, on June 16, 2016, the Board voted unanimously *not to reinstate* the member loan program at this time.

ACTUARIAL VALUATION INFORMATION

Title 3, Chapter 27, Section 718 (a) of the Virgin Islands Code mandates that the Employees' Retirement System of the Government of the Virgin Islands be financed on an "actuarial reserve basis". An "**actuarial reserve basis**" generally means that the retirement benefits are funded during employees active years of employment so that by the time they retire, the benefits would have been fully funded in advance of their retirement date. The actuarial valuation, which is conducted by the System's Actuary, determines the contribution rate necessary to meet the cost of benefits being accrued and a corresponding amount to pay down a portion of the unfunded liabilities. The latest actuarial valuation was conducted for FY 2014 and is available on our Website.

The actuary is presently conducting the FY 2015 actuarial valuation and simultaneously conducting an experience study of the assumptions that were made in prior years. The actuary will make his presentation to the Board at the board retreat in July.

ANNUAL FINANCIAL AUDIT

The System's most recent certified financial statements are as of September 30, 2015. The results of the audit were presented to the Board on June 16th. The report is in the process of being issued.

SUMMARY

I would like to thank the employees of the GERS for their hard work and commitment to providing quality service to our members. We are not perfect but our employees are dedicated to perfecting what we do. The employees of the GERS are also members of the Fund. They experience the same anxieties and uncertainties of their future as their fellow members, while continuing to provide the level of services that is expected. As other members who have not vested, because of the uncertainty of the survivability of the Fund, a few of our employees have exited the System, and relocated to the mainland or have entered the private sector. I extend my gratitude to those who remain, and still have confidence in the System

I end with a quote from a famous artist. *"The world today doesn't make sense, so why should I paint pictures that do?"* Pablo Picasso.

Mr. Chairman, this concludes our written presentation. We are prepared to respond to any questions the Committee may have on the operations of the GERS.

Thank you.