Government Employees' Retirement System of the Virgin Islands

Annual Overview of Operations

FISCAL YEAR 2018

"Contributing today for a better tomorrow"

Presented to
Committee on Finance
32nd Legislature of the United States Virgin Islands

Presented by:
Austin L. Nibbs, CPA, CGMA - Administrator

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GOVERNMENT EMPLOYEES' RETIREMENT SYSTEM
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INTRODUCTION

Good morning, Honorable Senator Kurt A. Vialet, Chairman, Committee on Finance, distinguished Committee members, other distinguished senators present in the chambers, and good afternoon 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 this Committee to present the System's Annual Overview of Operations. As you know, The System is not required to submit a budget to the Legislature for approval. The Board of Trustees is responsible for the approval of the annual budget of the GERS. Therefore, our presentation is an overview of the operations of GERS. Before I begin, I would like to acknowledge members of my senior management team that are joining me today in the chambers.

Mr. Chairman, this is my eleventh year presenting before the Committee on Finance as the administrator of GERS. In my first annual presentation before the Committee on Finance in 2008, I presented the caption below "**LOOKING AHEAD TO THE FUTURE".** I have extracted my comments verbatim from the 2008 presentation. As follows:

"LOOKING AHEAD TO THE FUTURE

A great part of the future of the Government Employees' Retirement System will depend on whether the Plan Sponsor fund the contributions to the System based on an "actuarial reserve basis", and/or a combination of floating Pension Obligation Bonds and making substantial lump sum payments to the System."

Also, in my annual presentation before the Committee on Appropriations and Budget, one year later August 5, 2009, I explained in the caption below the "**HEALTH OF THE SYSTEM"** as follows:

"HEALTH OF THE SYSTEM

From 1959 through 1989, there was no substantial payment of annuities because, for the most part, few members were not eligible to retire. There were no deficits, and contributions and investment returns exceeded the benefits paid out.

Since 1996 the GERS has not been in good health and its health continues to deteriorate. This is the year that the System went from a positive net cash flow to a negative net cash flow. Where benefits and expenses exceeded contributions. This trend has continued up to today which results in approximately $60 million negative cash flow annually. Without a significant cash infusion and or increases in the contribution rates, our Actuary has predicted that the System will run out of assets in the next 14-19 years. The Actuary has also predicted that in the next 14-19 years the benefits payments and expenses will exceed 50% of payroll and increasing each year thereafter. What the GERS is experiencing is not unique. This is typical of any "mature system". However, for the plan sponsor to continue to delay addressing the root causes of the problems facing the System will cause the following:

- The unfunded liability to increase.
- Benefits payments to the retirees to continue to exceed the contributions received by approximately $60 million - $80 million annually.
- The actual employer contributions not keeping pace with the annual employer required contributions.
- Actuarially required amounts increasing in future years to make up for current and prior years' contribution deficits.
- The unfunded actuarial liabilities of the plan continuing to increase significantly over time.
- A continual decrease in the "funding ratio", (the amount that measures the progress being made towards the funding of benefits accruing from year to year)."

These statements before the Legislature since 2008, highlight the System's continued efforts to educate and advocate for the solvency of the GERS. Today, once again, I am before the Legislature with the same message, but with greater urgency, as the system with the current funding, will not provide the members with the benefits that were promised in 2023-

2024.

UNFUNDED LIABILITY (EMPLOYER'S NET PENSION LIABILITY) – EXHIBIT A

A synopsis of the unfunded liability for the past four fiscal years as follows:

As of October 1, 2014, GERS reported an Actuarial Accrued Liability (AAL) of $3.1 billion based on a long-term expected annual rate of return of 7.50%. Since the GERS assets as of the same date were $1.1 billion, the Unfunded Actuarial Accrued Liability (UAAL) was $2.0 billion as of October 1, 2014 under the same basis. However, because the GERS is projected to be insolvent some time in 2023-2024, the Governmental Accounting Standards Board (GASB) requires that the AAL and UAAL for GASB 68 reporting purposes be determined based on a blended rate between the expected long-term annual rate of return of 7.50% and the 20-year AA Municipal Bond Index rate of 4.11% as of October 1, 2014. As a result of the initial implementation of GASB 68 in 2014, the UAAL (or sometimes referred to as the ***employer's net pension liability***) was determined based on a GASB blended rate of 4.42% and amounted to $3.1 billion as of October 1, 2014 for GASB 68 reporting purposes. This is $1.1 billion higher than the $2.0 billion UAAL, which was determined based on the presumption that the GERS will remain solvent and continue to be sustainable in the long-term. The lower blended discount rate of 4.42% as compared to the 7.50% resulted in a higher UAAL. The UAAL (or 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. With the October 1, 2015 valuation, the long-term annual rate of return assumption was lowered from 7.50% to 7.00%. The UAAL has since increased by $0.7 billion to $2.7 billion as of October 1, 2016 based on the expected long-term annual rate of return of 7.00%. This is mainly a result of the actual contributions continuing to fall short of the Actuarially Determined Employer Contributions (ADEC) over the last two years. Under GASB 68 reporting, the UAAL or employer's net pension liability has since increased by $1.5 billion to $4.6 billion as of October 1, 2016. This is partly due to the GASB blended discount rate decreasing from 4.42% to 3.20% as of October 1, 2016. Exhibit A is presented to show the estimated UAAL or employer's net pension liability as of October 1, 2017, under both assumptions.

We note that the FY 2017 actuarial valuation will be presented to the board at the annual board retreat next week, and it will be made public shortly thereafter. However, we estimate the unfunded liability under GASB 68 is $4.74 billion as shown in Exhibit A.

TOTAL CONTRIBUTIONS RECEIVED/BENEFIT PAYMENTS & EXPENSES - EXHIBIT B

Contributions are the main driver of a pension system. The pension formula is:

Contributions + Investment Income = Benefit Payments + Administrative Expenses

Beginning in 1996, there was an imbalance between contributions collected and benefit payments and expenses resulting in a deficit of $1.6 million. Each year thereafter, contributions collected have been less than the benefit payments and expenses. In 2017, there was a shortfall of $164 million, and a shortfall of $83.8 million for the 9 months in fiscal year 2018. Annual shortfalls between contributions collected and benefit payments and expenses since 2000 have caused the system to withdraw $1.5 billion from the portfolio to fund the retiree payroll.

ACTUARIALLY DETERMINED EMPLOYER CONTRIBUTIONS (ADEC) DUE – EXHIBIT C

One of the major contributors to the unfunded liability is the failure of the Legislature to adequately fund the System, and identify revenue streams that can contribute to the required ADEC. The ADEC is the amount of contributions that should be appropriated by the Legislature, and paid to the System each year by the plan sponsor to keep the System actuarially sound.

For the past 27 years from 1991-2017, the Plan Sponsor has contributed $1.6 billion less than it should have contributed to the GERS. The amount the plan sponsor should have contributed was $3.2 billion. The actual contributions received were $1.6 billion. In 2017, the ADEC is $250.6 million, which is an increase from $247.2 million in 2016. The actual contributions received in 2017 are $84.8 million, which are slightly less than the $86.3 million received in 2016. The ADEC for 2018 is currently being determined pending the completion of the October 1, 2017 actuarial valuation but due to the continuing shortfalls in actual contributions compared to the ADEC. The 2018 ADEC is expected to increase from the $250.6 million amount in 2017.

Mr. Chairman, this $1.6 billion and growing shortfall in the ADEC must be addressed sooner rather than later to ensure the sustainability of the GERS. The introduction and passing of piecemeal legislation that does not have a significant impact on reducing the unfunded liability, like a significant cash infusion to grow the portfolio, and improve the liquidity of the Fund, will not have a meaningful impact on the sustainability of the Fund.

PRIOR YEARS STATUTORY EMPLOYER CONTRIBUTIONS

In 2011, our actuary estimated that there were $47 million in prior years statutory employer missing contributions. Since 2012 through June 30, 2018, we billed and received $9.8 million, which leaves a balance of $37.2 million as of June 30, 2018. This amount does not include the employee and employer contributions owed by Juan F. Luis Hospital and Medical Center in the amount of $11.2 million.

PAST DUE STATUTORY BI-WEEKLY EMPLOYEE CONTRIBUTION DEDUCTIONS / LOANS DEDUCTIONS / EMPLOYER CONTRIBUTIONS

We have received all past due employee and employer contributions and loan deductions from the central government through December 31, 2017. The untimely payments of employee and employer contributions have caused delays in retirees receiving their initial annuities for up to 9 months after their retirement date, which created financial hardships to many, especially after experiencing two natural disasters. The untimely receipt of loan deductions has caused member's accounts to become delinquent.

Mr. Chairman, the V.I.C. calls for statutory contributions that are deducted from employee's pay checks to be remitted to the GERS 10 days after the pay date. To divert statutory contributions and loan deductions from employee's pay checks to fund ***"other priorities"*** using the term "good fiscal management" is fraud. This practice not only affected the retirees waiting to receive their initial annuities, it also affected the Fund. From July 2017 through January 2018, a total of $103 million, was withdrawn from the already dwindling portfolio to make payment to the retirees. This amount included in excess of $40 million for past due payments from July 2017 through January 2018.

DIRECT CONTRIBUTION DUE FROM CENTRAL GOVERNMENT (ACT NO. 7261) – EXHIBIT D

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. As of September 30, 2018, the accumulated amounts owed to the GERS from 2013 – 2018 from the Internal Revenue Matching Fund under Act No. 7261 is $42 million. We have received $24 million. The balance due through September 30, 2018 is $14 million.

MEMBERSHIP AND ANNUITY PAYMENTS

The number of retirees on the payroll as of June 20, 2018 was 8,493. The total annuity payments from October 1, 2017–June 30, 2018 was $183,433,501.29. The bi-weekly payroll for the June 30, 2018 payment was $10,216,910.80. The current ratio of active members (8,669) to retirees (8,493) is 1.02 to 1.

ASSETS (INCLUDING INVESTMENTS)

ASSETS

The assets of the GERS include the investment portfolio, which is comprised of cash and cash equivalents, equity, fixed income, private equity and other alternative investments, such as real estate, local investments and member loans.

Portfolio Performance

The System terminated all its active equity (stock) managers and continues its commitment to a disciplined investment strategy using the Dynamic Asset Allocation investment strategy. Its investment portfolio is now managed by 2 active fixed income (bonds) managers, 1 index (equity and fixed income) manager, and 1 private equity (non-local) manager.

The latest market value of the portfolio is as of May 31, 2018. The market value for this period was $672 million which represents a decrease from $722 million for the same period one year ago. To meet obligations, $96 million was withdrawn from the Fund. The Fund earned income of $7.4 million and had a gain of $34 million. Note that the May 31, 2018 market value of $672 million excludes member loan program market value of $101 million, the St. Thomas office complex market value of $7.6 million, and the St. Croix office complex market value of $3.1 million. Therefore, the *total* market value of the System's assets as of May 31, 2018 is $783.6 million.

The System's aggregate assets performance as of May 31, 2018 year-to-date was 1.5 percent. The total plan returned 0.9 percent for the month of May 2018, and over the one-year period was 6.1 percent. Since inception, the Total plan has returned 8.8 percent, Total Equity has returned 11.7 percent, Total Fixed Income (bonds) has returned 7.3 percent, and Total Alternatives has returned -2.3 percent.

Alternative Investment Program

Title 3, Section 12, Chapter 27of the Virgin Islands Code gives the Board of Trustees the authorization to invest in an Alternative Investment Program (AIP). 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 AIP 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 7.0 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. Shortly thereafter, the Board suspended the AIP. 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

Mesirow Financial Private Equity Fund (Limited Partnership)

Real Estate

1. GERS Complexes on 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 (Local Investments)

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 (Suspended on November 19, 2015)

ACTUARIAL VALUATION

Title 3, Chapter 27, Section 718 (a) of the Virgin Islands Code mandates that the Government Employees' Retirement System of the Virgin Islands be financed on an "actuarial reserve basis". An **"actuarial reserve basis"** generally means that the retirement benefits are funded during employee's 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. An actuarial valuation is performed to calculate the ADEC and is based on the assumptions and methods adopted by the Board. For many years, the actual amounts contributed by the plan sponsors have not been based on the required ADEC amounts. The amounts that were contributed by the Plan Sponsor have been significantly less than the required ADEC. We note that although the employer contribution rate is currently 20.5 percent of payroll, the ADEC rate has increased from 35 percent of payroll in 2006 to 64 percent of payroll as of October 1, 2016. The actuarial valuation for October 1, 2017 will be presented and approved at the 2018 board retreat at the end of July and made public shortly thereafter.

ANNUAL FINANCIAL AUDIT

The results of the fiscal year 2017 audit will be presented at the board retreat at the end of July. The System's certified financial statements for fiscal year ending September 30, 2017 will be issued shortly thereafter.

ACCOMPLISHMENTS FOR FISCAL YEAR 2018

Organizational Development

- Completed agency re-organization to improve efficiency.

Stakeholder Engagement

- Hosted two (2) town hall meetings in February one in each district to educate members and the public on the challenges facing the System and provide viable solutions.

- Completed the annual benefit statements through December 31, 2017 for Tier I members only. Access is available on the GERS Member Self-Service (MSS).

Technological and Infrastructure Advancement

- Upgraded and improved 66% of our Network and Technological Infrastructure.
- Disposed of E-Waste realizing a savings of $15,000 from prior years.

Financial / Fiscal Sustainability and Growth

- Obtained legislative approval to reduce re-entry into workplace.
- Provided information to agency heads and HR personnel on the legislation.

Operational Efficiency and Excellence.

- Continue to issue timely retiree payrolls.
- Initiated a direct deposit campaign for retirees still receiving paper checks with 58 percent compliance to date.
- Reviewed and revised job descriptions.
- Considerable progress on the implementation of the Strategic Plan.

GOALS FOR FISCAL YEAR 2019

- To implement the New Customer Service Center under Communication and Member Education to provide prompt and courteous service to our members.
- To streamline current processes and services in various units to increase efficiency and responsiveness.
- To continue educational town hall meetings.
- To complete repairs/renovations to the Havensight Mall infrastructure due to Hurricanes Irma and Maria.
- To complete major capital projects for St. Thomas building (exterior skin, roof replacement, and air conditioning replacement).
- To make available the annual benefit statements through December 31, 2018 for Tier I and Tier II members.
- To continue to increase employee engagement and morale.

GERS FORUM

Earlier this year, the chairman of the board and senior executive leadership of the GERS met with the National Conference on Public Employee Retirement Systems (NCPERS) in Washington, D.C., to brainstorm about viable alternative solutions to the impending insolvency of the GERS. Also discussed were lesson s learned from other similar solvency initiatives throughout the nation. Aware of our challenging, but not unique situation, the GERS and NCPERS will present a Public Pension Forum in the Virgin Islands, on Wednesday, August 29th, and Thursday, August 30th at the Renaissance St. Croix Carambola Beach Resort & Spa. Plan sponsors, stakeholders, and critical community groups will hear about solvency initiatives other public pension systems have implemented and discuss viable solutions to sustaining the solvency of the GERS. Other presenters are the National Association of State Retirement Administrators, "NASRA", the National Institute on Retirement Security, "NIRS", the National Public Pension Coalition, "NPPC", and our actuary the Segal Company. Members of the Legislature will be receiving a formal invitation to attend.

CONCLUSION

Mr. Chairman, the past ten months have been very challenging for the System. The natural disasters crippled all our major operating systems and our communication components, making it impossible to provide quality services to our members. We were unable to return to normalcy until after the new year. However, we did not miss making the annuity payments to our retirees. I must commend our employees for their dedication and commitment during this period, in doing whatever had to be done to accommodate and provide services to our members.

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

EXHIBIT A

Unfunded Liability

Long Term Funding vs. Accounting Liabilities as of October 1, 2017 *(estimated)*

	7.00% Discount Rate	GASB Blended Rate of 3.20%
Actuarial Accrued Liability	$3.62 Billion	$5.54 Billion
Actuarial Value of Assets (AVA)	$0.80 Billion	$0.80 Billion
Unfunded Accrued Liability (based on AVA)	$2.82 Billion	$4.74 Billion
Funded Percentage	22.7%	14.5%

EXHIBIT B

CONTRIBUTIONS VS BENEFITS PAYMENTS & EXPENSES

Fiscal Year		Total Contributions *	Benefits Payments & Expenses	Surplus/Deficit
1994		61.7	46.7	15.0
1995		74.9	64.6	10.3
1996		71.7	73.3	(1.6)
1997		74.3	80.0	(5.7)
1998		71.9	91.6	(19.7)
1999		71.7	95.4	(23.7)
2000		70.2	103.7	(33.5)
2001		69.1	121.2	(52.1)
2002		80.1	133.0	(52.9)
2003		82.1	138.0	(55.9)
2004		84.9	142.6	(57.7)
2005		81.9	153.0	(71.1)
2006		99.3	161.0	(61.7)
2007		96.6	170.5	(73.9)
2008		112.8	184.7	(71.9)
2009		120.3	193.9	(73.6)
2010		117.1	208.3	(91.2)
2011		123.8	223.0	(99.2)
2012		104.4	251.5	(147.1)
2013		98.5	260.1	(161.6)
2014		102.3	265.9	(163.6)
2015		108.5	266.5	(158.0)
2016		127.8	274.2	(146.4)
2017	**Unaudited**	105.5	269.5	(164.0)
2018	**Unaudited – 9 mos.**	111.2	195.6	(84.4)

(numbers in millions)
**** Statutory contributions received***

EXHIBIT C

Actuarially Determined Employer Contributions (ADEC)

Audited Plan Year Ended September 30,	Actuarially Determined Contributions	Contributions Received	Contributions Due	% Contributed
1991	48,659,324	38,169,889	10,489,435	78.44%
1992	48,123,177	34,850,312	13,272,865	72.42%
1993	47,181,730	38,632,619	8,549,111	81.88%
1994	46,856,812	39,353,600	7,503,212	83.99%
1995	55,089,820	50,944,748	4,145,072	92.48%
1996	58,128,608	46,075,378	12,053,230	79.26%
1997	58,251,171	47,703,717	10,547,454	81.89%
1998	62,578,121	45,984,661	16,593,460	73.48%
1999	62,237,129	45,148,387	17,088,742	72.54%
2000	64,992,493	44,078,554	20,913,939	67.82%
2001	64,179,332	43,387,158	20,792,174	67.60%
2002	95,186,021	50,594,531	44,591,490	53.15%
2003	117,124,599	51,588,235	65,536,364	44.05%
2004	108,358,399	54,084,454	54,273,945	49.91%
2005	120,184,848	51,542,030	68,642,818	42.89%
2006	131,059,471	65,061,430	65,998,041	49.64%
2007	137,797,268	60,778,382	77,018,886	44.11%
2008	138,488,871	75,871,146	62,617,725	54.79%
2009	147,490,851	80,177,004	67,313,847	54.36%
2010	157,817,709	77,004,630	80,813,079	48.79%
2011	162,841,336	80,849,762	81,991,574	49.65%
2012	178,644,349	66,677,155	111,967,194	37.32%
2013	172,439,842	64,431,322	108,008,520	37.36%
2014	189,715,251	68,298,617	121,416,634	36.00%
2015	200,089,791	72,287,934	127,801,857	36.13%
2016	247,158,137	86,346,838	160,811,299	34.94%
2017	Unaudited 250,574,023	84,802,335	165,771,688	33.84%
Totals	$ 3,171,248,483	$ 1,564,724,828	$ 1,606,523,655	
		6% Lost Investments	$ 96,391,419	
		Balance Due	$ 1,702,915,074	

EXHIBIT D

Government Employees Retirement System
Schedule of Direct Contributions from the Internal Revenue Matching Fund
Under Act No. 7261

Fiscal Year Ended Sept 30	Amount Required	Advance Received	Date Received	Balance Due
2013	7,000,000	7,000,000	5/24/16	-
2014	7,000,000	1,800,000	5/9/17	4,500,000
		700,000	4/17/18	
2015	7,000,000	7,000,000	4/23/18	-
2016	7,000,000	7,000,000	1/03/18	-
2017	7,000,000	4,500,000	4/23/18	2,500,000
2018	7,000,000	-		7,000,000
Total	**$ 42,000,000**	**$ 28,000,000**		**$ 14,000,000**