

FINANCIAL OVERSIGHT AND MANAGEMENT BOARD FOR PUERTO RICO



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Natalie A. Jaresko
Executive Director

BY ELECTRONIC MAIL

September 20, 2019

The Honorable Wanda Vázquez Garced
Governor of Puerto Rico
La Fortaleza
PO Box 9020082
San Juan, PR 00902-0082

Dear Governor Vázquez Garced:

As we each have reiterated publicly multiple times, we share a common view that the pensions of Puerto Rico's public workers should be, must be a priority for the Government. Congress made clear that it too agrees, directing that fiscal plans "provide adequate funding for public pension systems"¹ in recognition of the utmost importance that the Government make good on its past pension promises.

Unfortunately, it appears that the University of Puerto Rico ("UPR") is not acting in accordance with this priority. UPR recently announced that it is contributing less than half the actuarially required pension contribution to the University of Puerto Rico Retirement Plan ("UPRRP") for FY2020. This conscious decision by UPR to undermine its pension obligations and to put the pensions of its faculty and staff at risk is grossly irresponsible, contrary to the Government's public policy of prioritizing pensions, and violative of PROMESA.

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The Oversight Board certified a fiscal plan on June 5, 2019 for UPR (the "Certified Fiscal Plan"). An essential element of the Certified Fiscal Plan was addressing the UPRRP. According to the Oversight Board's recent actuarial analysis, if UPR makes no changes to the pension benefit structure or its funding policy, its pension plan could be insolvent by 2031.² That means the

¹ Section 201(b)(1)(C) of PROMESA.

² The Oversight Board's analysis was based on the Pub2010 Teachers Below Median mortality table projected five years beyond the valuation date using scale MP-2018. Cavanaugh Macdonald's proposed assumption was RP-2014 White Collar Headcount-weighted projected generationally with Scale MP-2017 with rates adjusted by 103.8% for males and 98.2% for females. UPR's current funding policy is 14.57% of payroll.

UPRRP would not have sufficient funds to pay pension benefits after 2031. Rather than accepting that UPR may repeat the mistakes of ERS, JRS, and TRS at the Commonwealth, which became insolvent because their funding was far too low relative to the benefits they offered, the Certified Fiscal Plan outlined three options that UPR could take to adequately fund the UPRRP:

- Option 1 – Baseline benefits scenario: Under this option, UPR makes no changes to the current defined benefit plan. Therefore, UPR must make a contribution of roughly \$161 million per year, which is what our recent actuarial analysis indicates is the actuarially required amount. Relative to what the Certified Fiscal Plan projects, this option requires UPR to save an additional \$60 million per year within its budget in order to afford the \$161 million contribution to UPRRP (in addition to an extra \$80 million in FY2020 to make up for the deficient contribution UPR has already announced).
- Option 2 – Freeze defined benefit plan in 2020 and move to a defined contribution plan: Under this option, UPR freezes the pension plan in FY2020 and establishes a new defined contribution plan. Because freezing the defined benefit plan reduces the cost of the UPRRP benefits, UPR can make lower contributions to the UPRRP. Our recent actuarial analysis indicates the actuarially required amount is \$161 million in FY2020, followed by approximately \$140 million per year afterwards. Relative to what the Certified Fiscal Plan projects, this option requires UPR to save an additional \$40 million per year within its budget in order to afford the \$140 million contribution to UPRRP (in addition to an extra \$80 million in FY2020 to make up for the deficient contribution UPR has already announced).
- Option 3 – Reduce accrued benefits, freeze defined benefit plan in 2020 and move to a defined contribution plan: Under this option, UPR freezes the pension plan in FY2020, reduces accrued benefits and eliminates bonuses in a manner similar to ERS and TRS, and establishes a new defined contribution plan. Our recent actuarial analysis indicates the actuarially required amount is \$161 million in FY2020, followed by approximately \$100 million per year afterwards. Relative to what the Certified Fiscal Plan projects, this option does not require UPR to save any additional amount in order to afford the \$100 million contribution to UPRRP (except for an extra \$80 million in FY2020 to make up for the deficient contribution UPR has already announced).

Each of these scenarios requires UPR to make the full actuarially required contribution. For each scenario, that amount is a \$161 million contribution to UPRRP in FY2020. However, since the certification of the Certified Fiscal Plan, not only has UPR failed to implement any of the options presented, but it has announced it will make only an \$80 million contribution to UPRRP in FY2020 – less than half of the actuarially required amount.

UPR's own advisors agree with us. On August 29, 2019, UPR submitted updated actuarial reports, which included a pension valuation report from Cavanaugh Macdonald and a report on the status of UPRRP from BDO. The Cavanaugh Macdonald report presented different suggested contributions to address the "poor funded status of the [UPR Retirement] System" based on various assumptions, one of which required a contribution of \$154 million for FY2020. This amount

Honorable Wanda Vázquez Garced

September 20, 2019

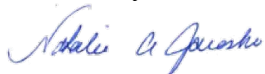
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closely matches the Oversight Board's required contribution amount of \$161 million (the difference comes from different mortality assumptions) and is far higher than UPR's proposed contribution of only \$80 million. Moreover, BDO's report for UPR states that "a wake-up call into urgency is predicated in the results of the underlying studies that show it is very likely that the true net pension liability is twice the size originally considered," which under the Cavanaugh MacDonald assumptions implies the UPRRP will run out of money in 2032. Again, this corroborates the Oversight Board's projection that the UPRRP could become insolvent by 2031 if UPR fails to take immediate, drastic action.

* * *

UPR is knowingly defunding the UPRRP, putting the pensions of its faculty and staff at risk rather than heeding the advice of its actuaries, the Certified Fiscal Plan for UPR, or the learned experience from the Commonwealth. We write now to ask for your commitment and support to stave off a looming pension crisis at UPR. The first step is getting UPR to make the full \$161 million contribution to the UPRRP this year. Once that happens, UPR may choose the pension benefit and funding approach that it believes best services its interests. But whatever UPR chooses, it must not put the UPRRP or pensions of faculty and staff at risk.

Sincerely,



Natalie A. Jaresko

Andrew G. Biggs
José B. Carrión
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José R. González
Ana J. Matosantos
David A. Skeel, Jr.

CC: Mr. Omar Marrero Díaz
Mr. Elí Díaz Atienza
UPR Governing Board
Mr. Walter Alomar Jiménez
Mr. Jorge Haddock Acevedo

Appendix A: Pension Reform Options from the UPR Certified Fiscal Plan

EXHIBIT 24: PENSION REFORM OPTIONS

Impact of UPR pension policy options, \$ 000s

\$ Savings achieved, \$ 000s

