General Audit Chamber
Algemene Rekenkamer

Compliance Audit:
APS' 2020 Financial Statements

OCTOBER 2021

October 2021

General Audit Chamber, Juancho Yrausquin Bldv 10, Philipsburg, Sint Maarten

This document is an English translation of the original Dutch language report entitled: "*Rechtmatigheidsonderzoek: Jaarrekening 2020 van het Algemeen Pensioenfonds Sint Maarten*". In the event of textual contradictions or any other differences, the original Dutch text will prevail.

PREFACE

This is the report of the General Audit Chamber, containing the results of the audit of the 2020 Financial Statements of the General Pension Fund Sint Maarten (APS).

In 2020, the focus is on the Corona pandemic. Globally, COVID-19 is negatively impacting economies. So too on St. Maarten. According to figures from the International Monetary Fund (IMF), by 2020 the economy shrunk by 24% and unemployment increased by 19%.

For the stock markets, 2020 was the most remarkable year for global financial markets. After the Covid-19 pandemic caused the worst crash in a generation, unprecedented stimulus measures and vaccine innovations caused stocks to climb back to record highs. That was good news for pension funds, including APS.

This year, 2020, is also distinguished by the introduction of pension reforms. In this report, we outline the changes along with the consequences. Despite the decent investing results and the pension reforms, APS' coverage ratio was lower compared to 2019.

We received the 2020 Financial Statements on June 30, 2021. We compliment APS on the early delivery. Due to recesses at both APS and their accountant, we experienced a delay of approximately one month for the conduct of our audit.

Finally, we take note of the departure of APS' chairman, whose term, in accordance with the law, ended in 2020. We would like to thank him for his cooperation over the last years, and we appreciate APS' cooperation during the development of this report.

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SUMMARY

The APS's coverage ratio at the end of 2020 is 101.9% (2019: 103.8%). This means that, like previous years, their assets are insufficient to cover general and investment risks.

In our opinion, APS' 2020 Financial Statements fairly represent the financial position as of December 31, 2020, as well as the financial result for the year 2020, except for the following: uncertainty exists regarding the valuation of receivables from the Government of St. Maarten, as well for other participating organizations for an amount of ANG 21.9 million (2019: ANG 23.7 million).

We have demonstrated the importance of conducting an Asset Liability Study (ALM study) in several reports. The APS commissioned ALM study of 2020, after the passage of pension reform, was completed in March 2021. The results from the ALM confirm that:

- APS is at serious risk of reducing members' pensions in the near future. The main reason for this is the falling actuarial interest rate;
- The Fund maintains excessive liquid assets. If authorization can be obtained from the Central Bank of Curaçao and Sint Maarten, a portion of the liquid assets could be invested internationally;
- Pension accrual of 2% is unrealistic given the current premium contribution rate of 18%. Increasing the contribution rate to 22% (or more) will impact APS' participants;
- Based on a minimum pension accrual of 1.75%, a 115% coverage ratio is not achievable, resulting in lower pension accrual.

APS prepared a short-term recovery plan in 2018 (updated in 2019), designed to achieve a coverage ratio of at least 105% within 5 years. According to the 2019 update, the Fund could remove the coverage deficit within the prescribed timeframe if the pension plan were adjusted from a final salary scheme to a career salary scheme in 2020. Despite the adjustment of the pension plan in 2020, the coverage ratio is still below 105%, primarily due to the adjustment of the mortality assumptions and the reduction of the actuarial interest rate.

APS' actuary states that the increase in the coverage ratio derived from the change of the retirement age will be borne by the participants. We agree with this conclusion.

In 2020, APS' Board bid farewell to its chair in 2020. The process of appointing a new chairperson is currently underway. Three of the five positions on the Board of APS remain vacant.

RECOMMENDATIONS

Based on our findings, we recommend the following:

- Arrange for the settlement of outstanding claims with the Government of Sint Maarten;
- Expand and update the 2019 recovery plan towards the achievement of the desired coverage level;
- Conduct research into the size of the solvency surcharge needed to break even;
- Review the surcharge required to cover future implementation costs;
- Specify in policy that principles are subject to regular review;
- Implement the ALM study's recommendations;
- Further simplify the international investment portfolio based on the results from the ALM study;
- Update participants with information of relevance to them.

1 OUR AUDIT

1.1 The basis for the audit

We audit APS' Financial Statements based on Article 26 of the National Ordinance General Pension Fund Sint Maarten (hereafter: Lv APS). Based on article 18, the tenth paragraph of the Lv APS we annually send the financial statements after completion of our audit to Parliament and the Minister of Finance, accompanied by our comments. This report contains our findings from our audit of the 2020 Financial Statements of APS.

1.2 The objectives and audit questions

The purpose of this audit is two-fold. First, we want to inform Parliament and the Minister of Finance of our opinion on the reliability and legal compliance of the financial statements.

Secondly, we want to identify for Parliament, the Minister of Finance and APS, the areas where we recommend improvement.

The following audit questions were prepared for this investigation:

1. Do APS' 2020 Financial Statements present a true and fair representation of the financial position as of December 31, 2020, and 2020's financial result?
2. Did APS act in accordance with the APS' National Ordinance in 2020?

1.3 Audit methodology

Based on our audit work, we concluded we can use the results of APS' external auditor who audited the 2020 Financial Statements.

1.4 Reading guide

The topics covered in this report are, in order: our findings on the financial position and APS' financial result (Chapter 2). We cite the findings of our investigation of APS' legal compliance in Chapter 3. In Chapter 4, the consequences of the pension reform are detailed. Chapter 5 presents the most important observations from the ALM study.

We conclude in Chapter 6, with a reaction from the APS Board and our epilogue.

2 THE FINANCIAL STATEMENTS

In this chapter, we present our findings and issue our opinion on the audit question:

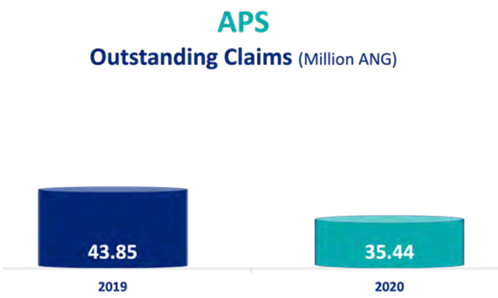
"Do APS' 2020 Financial Statements present a true and fair representation of the financial position as of December 31, 2020, and the 2020 financial result?"

2.1 Claims (receivables)

Total outstanding receivables decreased by ANG 8,41 million in 2020, from ANG 43.85 million to ANG 35.44 million.[1] If and when a portion of the outstanding receivables will be settled, remains uncertain. These uncertainties are:

A lack of settlement for the outstanding claims against the Government and several of the other participating organizations up to an amount of ANG 21.9 million (2019: ANG 23.7 million) [2].

Figure 1: Outstanding claims (receivables)



2.2 Pension Obligation Provision

APS' actuary issued an actuarial opinion for the fiscal year 2020 on June 30, 2021. His opinion on the Pension obligation Provision (VPV) reads: [3]

"The pension obligation provision, in accordance with the described calculation rules and assumptions, in general, has been determined to be adequate."

At the end of 2020, the APS' VPV is ANG 790.3 million (2019: ANG 719.7 million). The total pension assets amount to ANG 805.3 million (2019: ANG 747.1 million). The coverage ratio can then be calculated by using the following formula:

$$\frac{\textbf{Pension Assets (ANG 805.3 million)}}{\textbf{VPV (ANG 790.3 million)}} * 100 = \textbf{Coverage Ratio (101,9\%)}$$

2.2.1 *Accuracy and comprehensiveness of the participant administration*

As in previous years, the auditor included an exception regarding the basic data for 2020. The auditor used a partial sample to establish that an incorrect status was issued to several participants.[4] The APS prepared an additional analysis. According to the actuary, this analysis shows that the provision was prudently established.[5]

The APS's external auditor, based on his audit of the participants' basic data,[6] certified that, except for the limitation noted above, the participants' basic data is accurate, complete, and consistent with the underlying documents in the participants' files.[7]

2.2.2 *Prudential actuarial assumptions*

The actuarial assumptions used by the APS to calculate the VPV are listed in the 2020 Financial Statements. The actuarial interest rate and the assumptions are important in determining the size of the VPV.

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[1] Balance sheet items: Accounts receivable, Other non-current assets, Accrued interest receivable and Other receivables.
[2] APS states the settlement process is underway and ongoing for some time. A debt settlement agreement was submitted to the Government in September 2020 to which response was received in June 2021. Source: APS' letter to the Audit Chamber dated September 10, 2021.
[3] Certification Report Willis Towers Watson Fiscal Year 2020, Actuarial Statement, opinion on page 10.
[4] "*These participants were part of the 338 participants from the 2020 premium analysis who were determined to have received no premium but were listed as active in the Maia system. The status changes were not made due to the lack of formal notice from the employer.*" Source: Elucidation of the Qualified Opinion from Auditor's Certification Report. Assurance report. Grant Thornton dated June 29, 2021.
[5] Certification Report Willis Towers Watson Fiscal Year 2020, Summary, Comments and Recommendations, page 6.
[6] Date of birth of participant, former participant, pensioner, pensioner's partner, deferred orphans; gender, date of marriage/divorce, date of death, start date of participation, date of retirement, income data (including salary; part-time percentage, disability percentage, income limits).
[7] Assurance report on the basic data. Grant Thornton dated June 29, 2021.

Actuarial interest rate

The board of APS decided to reduce the annual actuarial interest rate by a maximum of 0.25%. At the time of the ALM study, the actuarial rate was calculated by the consulting actuary as 2.45% (rounded to 2.5%).[8] This meant that the actuarial rate of 3.75% used in 2019 was not sufficiently prudent.[9]

At the end of 2020, following APS' principles, the actuarial interest rate was lowered to 3.5% based on the consulting actuary's recommendation.[10] As a result, the coverage ratio decreased by 4.5 percentage points.[11] Each year that the actuarial interest rate is reduced by that percentage, there must be a form of compensation to prevent the coverage ratio from falling by approximately 4 percentage points.[12] One alternative is lowering the accrual rate.

Regarding the actuarial rate, APS' actuary stated: *"We recommend that the fund actively monitors whether the actuarial interest rate used, continues to be sufficiently prudent for the future."* [13]

We support the actuary's recommendation.

Mortality Rates

In 2020, the mortality assumptions were adjusted.[14] The result was:

- reduction of the coverage ratio by 6.3 percentage points;
- when performing individual calculations, the expected improvement is included in a more realistic way;
- using a forecast table, the mortality assumptions are updated annually to reflect the expected increase in life expectancy, which ''automatically'' keeps the mortality assumptions up to date.

In addition, the age brackets were increased from one year to two years for men and from two to three years for women.

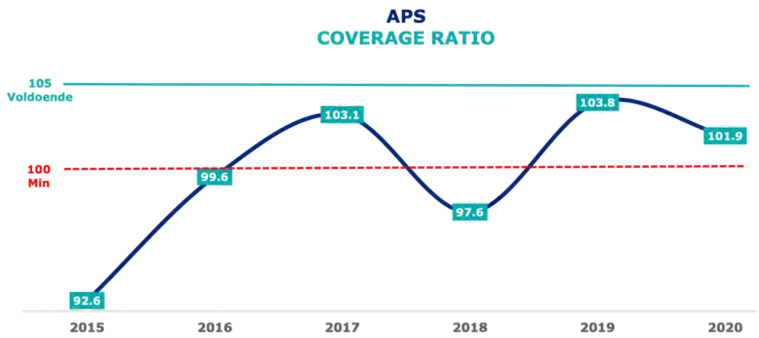
As was the case in 2019, the applicable mortality assumptions were not incorporated into APS' administrative system.[15] We concur with the recommendations from APS' actuary to address the applicable assumptions in the new administrative system, introduced in 2020.[16]

2.3 Coverage ratio

APS' policy assumes a minimum coverage ratio of 105% but strives for a coverage ratio of 115%.

At the end of 2020, APS' coverage ratio was 101.9% (2019: 103.8%). Figure 2 shows the development of the coverage ratio.

Figure 2: Developments of APS' coverage ratio



The pension reform (including the increase of the retirement age) together with inflation positively affected the coverage ratio. However, the reduction of the actuarial interest rate and the adjustment of the mortality assumptions resulted in a lower coverage ratio (higher VPV).

[8] ALM study, final results, pages 46 and 91.
[9] Actuarial Advisory Report Willis Towers Watson Fiscal Year 2020, Actuarial Rate, page 12.
[10] Actuarial Advisory Report Willis Towers Watson Fiscal Year 2020, Actuarial Rate, page 12.
[11] Certification Report Willis Towers Watson Fiscal Year 2020, page 6, Summary, Comments and Recommendations.
[12] See also: AB 2020, no. 34, Explanatory Memorandum, paragraph 4.1 penultimate paragraph.
[13] Certification Report Willis Towers Watson Fiscal Year 2020, page 16, Financial Position.
[14] Association of Actuaries, Mortality and life expectancy, page 10: Mortality assumptions, also known as mortality principles, are the set of assumptions about the mortality of a particular insurance contract, portfolio of insurance, or reporting group.
[15] Certification Report Willis Towers Watson Fiscal Year 2020, page 14, Financial Position, Actuarial Analysis of Earnings.
[16] Certification Report Willis Towers Watson Fiscal Year 2020 WTW, page 14, Financial Position, Actuarial Analysis of Earnings.

A coverage ratio of 101.9% means that at the end of 2020, the pension liabilities were covered by the available assets. However, the assets are insufficient to cover general and investment risks.

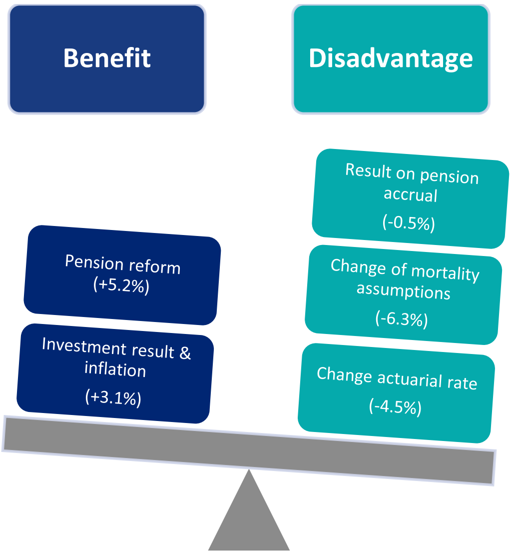
Recovery Plan

In 2018, the level of the coverage ratio triggered APS to prepare a short-term Recovery Plan. This plan was updated in 2019. According to the plan, the Fund would eliminate its coverage deficit within the prescribed timeframe if the pension plan were adjusted from a final salary scheme to a career salary scheme, and if the retirement age was increased from 62 to 65.[17] On June 3, 2020, pension reform was approved by Parliament. According to the amended law, APS has additional options to achieve a coverage ratio of at least 105% within 5 years.

2.4 2020 Financial Results

The 2020 Financial Statements close with an unfavorable (negative) result of ANG 12.2 million (2019: ANG 44.3 million positive).[18] The drop was mainly caused by an increased Pension Obligation Provision (VPV). Figure 3 shows the increased VPV's causal factors.

Figure 3: Description of the increase in the Pension Obligation Provision (VPV)



Premium Income

In 2020, premium income was ANG 2.0 million less than the total actuarial cost (in 2019 ANG 7.3 higher).[19] In other words, the premium will not contribute to the maintenance of equity capital or contribute towards achieving a 115% coverage ratio. The adjustment of the pension scheme was expected to result in a break-even premium for 2021, including a solvency surcharge.[20] We note that if the contribution does not break even, the participant's accrual under the new pension scheme will be reduced to 1.75%.[21] Commenting on this report, APS notes that consistent with the law, the accrual rate was reduced to 1.75%.[22]

Result on investments

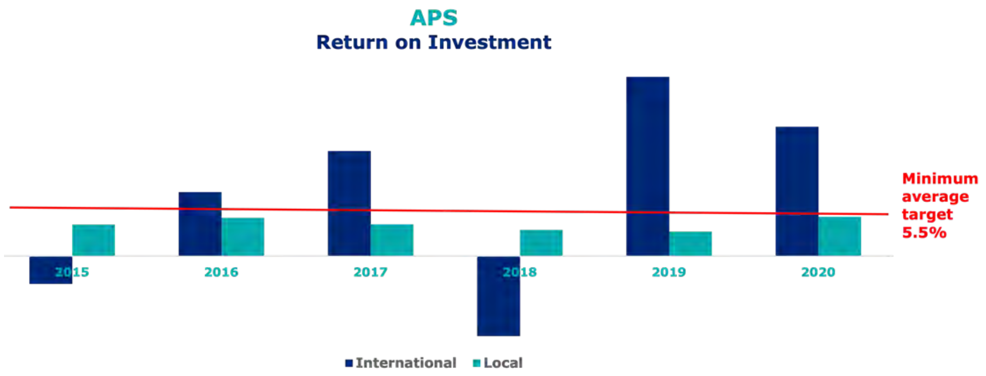
Despite the pandemic, 2020 has resulted in positive returns on all investments. Compared to the previous year, the return on the international portfolio is lower,[23] but returns on the domestic investments are higher.[24] The total return is 7.03% (2019: 9.54%), which exceeds the investment target of 5.5%.

[17] Certification Report Willis Towers Watson Fiscal Year 2020, Financial Position, Recovery Plan, page 13 and Short-Term Recovery Plan dated October 4, 2019, page 5.
[18] Section 3.2 of APS' 2020 Financial Statements.
[19] Certification Report Willis Towers Watson Fiscal Year 2020, Key Figures, page 9.
[20] Willis Towers Watson Certification Report, Financial Position, Premium Paid versus Actuarial Cost, page 18.
[21] Article 28b of the Civil Servants Pension Ordinance.
[22] APS' letter to the Audit Chamber reacting to the Memorandum of Findings on the 2021 Financial Statements, dated September 10, 2021, Ref. 2021-09/APS-028.
[23] The return on investment (ROI) for international investments in 2020 is 14.56% compared to 20.17% in 2019.
[24] Local ROI in 2020 is 4.46% compared to 2.77% in 2019.

An investment plan was not established for 2020. APS reports that the Fund operated under the 2018 investment plan with adjustments to the MIPS. Figure 3 presents the progression of the return on investments starting in 2015.

The ALM study recommended a simplification of the international investment portfolio.[25] We support this recommendation, which we have issued in previous reports.[26]

Figure 3: Return on domestic and international investments



2.5 Opinion on the Reliability of the 2020 Financial Statements

Based on our review, we believe that, except for the potential impact of the issue described below, APS' 2020 Financial Statements provide a fair representation of the financial position of the Fund as of December 31, 2020, as well as of the financial results from its operations for 2020.

The issue, and its possible effect, relate to the lack of a settlement for outstanding claims against the Government of St. Maarten and other participating organizations totaling ANG 21.9 million (2019: ANG 23.7 million). The valuation of these receivables is therefore uncertain.

[25] ALM study, page 19.

[26] See, for example: *Audit of APS' Investment Process* (2019), Chapter 4: Opinion and Recommendations. In its response dated October 4, 2021, APS states that the international portfolio was simplified in 2016 and that further simplification of the portfolio is expected in the fourth quarter of 2021, as recommended by the ALM study and updated investment beliefs.

3 LEGAL COMPLIANCE

In this chapter, we answer the following audit question, "Has APS complied with the National Ordinance General Pension Fund Sint Maarten in 2020"?

3.1 Legislation

APS is not operating with a full complement of members for its Board. Of the five board positions, three are currently vacant. One vacancy has been filled, but the required national decree remains outstanding.[27] As a result, board regulations were not adopted by the current board.

APS, with the exception of the following two stipulations, complied with all the legal requirements of the Lvo APS in 2020:

- Article 5, first paragraph: the board does not consist of a chairman and four members; there were three vacancies at the end of 2020;
- Article 15, first paragraph: investment plan for 2020 was not adopted by the board.

In their response, the APS cautions that the term of the Acting Chairman of the Board is set to expire on December 28, 2021. If this member is not reappointed, the Fund will be left with a single board member as of December 29. APS states it is awaiting a response from the Minister of Finance.[28]

3.2 Opinion on Legal Compliance

Based on the above, we believe that APS was legally compliant with the relevant legal requirements in 2020, with exception of the previously mentioned issues.

[27] APS' 2020 Financial Statements, Chapter 1.3 Governance.
[28] APS' letter to the Audit Chamber in response to the Memorandum of Findings for the 2021 Financial Statements, dated September 10, 2021, Ref. 2021-09/APS-028.

4 THE IMPACT OF PENSION REFORMS

4.1 What changed for the participant?

Figure 4 illustrates the changes affecting the participant.

Figure 4: Changes affecting the participant due to the 2020 pension reform

Amendment	New law	Old law
Age of retirement Art. 12	65 years	62 years
Pension accrual from Art. 17	18 years	25 years
Pension calculation Art. 27	Average career salary	Final career salary
Indexation Art. 30	Not automatic	Automatic
Pension premium Art. 58	18%	25%
Cost-of-living for participants prior to 1998 Art. 101	Dropped	Valid

Amendment	New law	Old law
Adjustment % orphan's pension Art. 47	Adjustable by LBham but continues according to the old law for now.	14% of the pension
Eligibility for orphan's pension up to Art. 33	18 years	25 years
Eligibility for Disability Pension Art. 28	Yes, reassessed after five (5) years.	No re-assessment after disability pay
Term and size of disability pensions Art. 14 and 16	Applicable	N/A
Right to special survivor's pension Art. 32	Dropped	Valid
Survivor's pension Art. 35 and 51a	Adjustable by LBham but continues according to old law for now.	70% of pension and can be lowered in the interim.

Amendment	New law	Old law
Accrual percentage Art. 27 and 89	2,00% (At required contribution of < 18%) 1,75% (At required contribution of > 18%)	N/A

The actuary stated that the increase in the coverage ratio resulting from the change to the age for retirement will be borne by the participants. We agree with this conclusion.[29]

Given the falling actuarial interest rate and APS' limited influence on the investment results, the coverage ratio will come under pressure in the future. For the active and former participants, this means that it is increasingly uncertain whether the pledged pension benefits will be realized.

As part of the Dutch liquidity support for the Government, the Country Package (section E.5) established that the retirement age would be increased to 66 in 2023 and 67 in 2025. We believe that before the implementation of this measure, stakeholders should conduct proper research into its (social) consequences, including consideration for certain "heavy" professions, for which earlier retirement could be feasible.

[29] Willis Towers Watson Certification Report, Pension Obligation Provision, page 16.

5. RESULTS OF THE ALM-STUDY

5.1 What are the major results of the ALM study?

An Asset and Liability Management Study (abbreviated as ALM study) is conducted to provide insight into the relationship between expected investment returns and the associated risks. The study can be used to recommend changes that could lead to improvements in the coverage ratio. In 2020, APS commissioned an ALM study.[30]

The results from the ALM study indicate that:

- APS is at serious risk of reducing members' pensions in the near future. The main reason for this is the falling actuarial interest rate;
- The Fund maintains excessive liquid assets;[31]
- If authorization can be obtained from the Central Bank of Curaçao and Sint Maarten, a portion of the liquid assets could be invested internationally;[32]
- The current international investment portfolio is complex and contains investments that are not in line with APS principles;
- Pension accrual of 2% is unrealistic given the current premium contribution rate of 18%;
- Increasing the contribution rate to 22% (or more) will impact APS' participants;[33]
- Based on a minimum pension accrual of 1.75%, a 115% coverage ratio is not achievable.[34] This may lead to a lower pension accrual.

If a break-even premium exceeds 18%, this will initially require a reduction in pension accrual from 2% to 1.75%.[35] During 2020, the pension premium failed to cover costs.[36] As a result, the accrual rate will be reduced from 2% to 1.75%.[37]

We contend that APS could have explained the ALM-study results more extensively in the 2020 Financial Statements, given that the decisions taken because of the ALM study may materially affect the Fund and the participant's position.

APS states in its response dated October 4, 2021, that the ALM study does not provide information about the Fund's actual financial situation as of December 31, 2020, for purposes of the Financial Statements. The study was completed on March 3, 2021 and is therefore a post-balance sheet item. The possible effects of the results of the ALM study on the Fund's future financial position depend on the strategic decisions taken for the Fund as a consequence of this ALM study. No such decisions had been made at the time the Financial Statements were finalized. APS indicates that a phased plan is now being followed which involves acting on several recommendations. Therefore, APS states, it was not appropriate to publicly disclose any more details.[38]

5.2 What are the main potential implications of the ALM study?

According to APS' internal policy, an ALM study should be conducted every 3 years.[39] The last ALM study (before the 2020 study) dates to 2014. Therefore, an ALM study should have been carried out in 2017.

[30] Asset & Liability Management Study. Ortec Finance dated March 3, 2021.
[31] By 2020, the percentage of liquid assets as a proportion of total invested assets decreased to 20.9%. This percentage is still much higher than the 1% strategy target. Source: Willis Towers Watson, Fiscal Year 2020 Report, page 7.
[32] In their reaction dated October 4, 2021, APS states that there were restrictions imposed by CBCS on international transactions since March 2020 to date which prevented APS from implementing this contingency. At the time of publication of this report, a media report indicates that the restrictions have been lifted retroactively as of October 1, 2021 (The Daily Herald, October 6, 2021, "*CBCS eases suspension for granting foreign exchange licenses for transfers*").
[33] According to APS, raising the contribution rate to 22% or more, would impact participants as well as increase the likelihood of indexation. APS' letter to the Audit Chamber in response to the Memorandum of Findings, dated September 10, 2021, Ref. 2021-09/APS-028.
[34] Solvency is expressed as a coverage ratio that indicates whether the fund has an adequate financial position.
[35] AB 2020, no. 34, Explanatory Memorandum, section 4.1 end of third paragraph and article 28b (1).
[36] Notes from the Actuarial Statement, page 18.
[37] AB 2020, no. 34, Explanatory Memorandum, section 4.1 end of third paragraph and article 28b (1).
[38] APS' response to the draft report dated October 4th, 2021.
[39] APS maintains the policy to conduct an ALM study or continuity analysis every three years (source: Actuarial and Operations Memorandum, dated September 28, 2016).

APS chose to wait on the ALM study until after pension reform. In several reports, we have indicated that APS should not continue waiting, in any case not until after pension reform was enacted. For example, in our 2019 report on APS' 2018 Financial Statements, we stated the following:[40]

"We maintain our opinion that, despite the cost, APS cannot continue to delay an ALM study. There are various regulations that can be calculated to determine which financial policy is appropriate, i.e. the old pension scheme and the expected new arrangement after reform. In our opinion, it is crucial to carefully establish the data to be used, while taking the predicted reduced return on investments into account."

In our report on APS's Investment Process, we advised similarly.[41]

Now that the results from the ALM study are known, we conclude that such a study prior to the reform, could have provided more insight.[42] For example, it now appears that with a pension premium of 18%, a 2% pension accrual is not realistic.[43] At the time of this audit, APS informed us that they intend to issue a request to the Minister of Finance for an increase of the premium percentage in the near term.[44]

It is not clear to us who bears this additional cost that will be incurred, the Government or the participant.

5.3 What are the possible measures?

One year after the pension reform, based on the ALM study we conclude that several measures may be necessary to structurally improve the Fund's financial position. These measures include:
- Raising the retirement age;
- Increasing pension contribution (increase premium rate);
- Reducing the pension

These measures are distinct from the legal measures of refraining from the 2% pension indexation and reducing the pension accrual from 2% to 1.75%.[45]

A comparison should be made between APS' statement contained in a press release[46] announcing that the Fund is robust and *future-ready,* to the results of the ALM study and a likely premium increase, a year after reforms were enacted.[47]

In their response dated October 4, 2021, APS wishes to explicitly state that the media message/article which reports that APS is "robust and future ready", cannot and should not be compared to the results of the ALM study. According to APS, the headline is subjective and is not a value judgment. The article merely speaks to APS' results for the year 2020. The issue that APS is referring to when it claims that the Fund is robust is the fact that the Fund faced difficult choices and tough decisions were possible due to the positive investment results in 2020.[48]

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[40] *Compliance Audit: 2018 APS Financial Statements*, paragraph 2.5.3.
[41] *Auditing the investment process of APS*, 2019, Chapter 4.
[42] In their response dated October 4, 2021, APS states the results would not have been different if the ALM study had been conducted earlier, nor would different principles have been used in the legislation. Moreover, no one could have foreseen when pension reform would be implemented considering the trajectory was ongoing for quite some time (since 2014) with no visible signs of conclusion until the corona pandemic occurred and pension reform became a condition for liquidity support. APS contends that it is in fact good that we now recognize that the pension reform is not yielding the desired results or prognoses because this demonstrates that APS' advice to the Government then, to, among others, not lower the premium to 18%, was correct.
[43] Asset & Liability Management Study. Ortec Finance dated March 3rd, 2021.
[44] Email correspondence with APS management, dated August 16, 2021.
[45] Pursuant to Article 28, paragraph 2, of the National Ordinance Civil Servants Pensions, the actuarial expert must annually advise APS' Board by November 1 regarding the basis for pensionable base for the following year.
[46] *The Daily Herald*, July 18th, 2021.
[47] The press release can also be found under 'annual report shows a robust and future ready pension fund' on APS' website.
[48] Response of the APS Board dated October 4, 2021, in response to their rebuttal to the draft report.

5.4 Deviation in actuarial interest rate contained in the Explanatory Memorandum

With the reform measures, the coverage ratio was initially expected to reach 104%. In the years thereafter, the projection is that the coverage ratio would improve by 1 percentage point annually. The explanatory memorandum to the National Ordinance for Civil Servants Pension states that these projections were based on an (unchanged) actuarial interest rate of 4%.

It further states that a quarter percent reduction influences the coverage ratio by approximately -4%.[49] We note that the actuarial rate in 2019 (and previous years) was 3.75%.[50]

However, the explanatory memorandum mentions am actuarial interest rate of 4%. At the end of 2020, the actuarial interest rate was determined to be 3.5%. We were unable to determine what the 4% in the memorandum is based on. The financial impact of a quarter percent reduction in the actuarial rate is significant; the coverage ratio is projected to decline by approximately 4 percentage points.[51]

It is expected that the actuarial interest rate will be adjusted further downwards in the coming years. According to the ALM study, the actuarial interest rate is currently 2.5%.[52]

[49] AB 2020, no. 34, Explanatory Memorandum, section 4.1 penultimate paragraph.
[50] Notes on the actuarial statement, page 16, under discount rate: the discount rate is 3.75%. As of December 31, 2020, it has been changed to 3.5%.
[51] AB 2020, no. 34, Explanatory Memorandum, section 4.1.
[52] ALM study, page 46.

6 EPILOGUE

On September 20, 2021, in accordance with our audit protocol, we submitted the draft report to APS's board for review. Due to the work on APS' budget for 2022, we granted an extension to respond until October 4, 2021. We received a response to the draft report from the Board on October 4. We thank APS for its response.

6.1 Reaction from APS' Board

The Board reported that they are pleased to disclose that of the 8 recommendations, they have now started work on 6. APS presented a draft payment plan to the Government in September 2020 to address the outstanding claims. In the meantime, according to APS, the Government reacted, and they assert that they are in the middle of the negotiation process to come to an agreement.

Discussions with the actuary regarding the expansion of the recovery plan are ongoing and APS stated it expects to have the recovery plan ready by the end of October 2021. In addition, APS mentions that they are in discussion with the actuary about the break-even study to determine the solvency premium.

Implementation of the recommendations arising from the ALM study, including simplification of the international investment portfolio, has already begun, according to APS. Further, APS reports that it seeks to have the implementation of the recommendations from the ALM study completed before the financial statements for 2021 are finalized (July 2022).

We wish to thank APS for its cooperation during this audit and look forward to similar collaboration during the next project.

General Audit Chamber
Algemene Rekenkamer