



COMPLIANCE AUDIT: APS' 2018 FINANCIAL STATEMENTS



General Audit Chamber
Algemene Rekenkamer



December 2019

This document is an English translation of the original Dutch language report entitled: "Rechtmatigheidsonderzoek: Jaarrekening 2018 van het Algemeen Pensioenfonds Sint Maarten". In the event of textual contradictions or any other differences, the original Dutch text will prevail.

General Audit Chamber, Juancho Yrausquin Bldv 10, Philipsburg, St. Maarten

PREFACE

This is the General Audit Chamber's report containing the results of the audit of the [2018 Financial Statements of the General Pension Fund St. Maarten](#) (APS).

In contrast to previous reports, we have added a digital [glossary](#). This supplement is meant to explain jargon and technical terminology. By clicking on words shown in blue, the reader is automatically redirected to the glossary site. We invite you to use these functionalities.

After eight years reporting on APS' financial statements, we note that our recommendations are being taken seriously, though the Fund's financial position is still not stable. Our report demonstrates the significant role the return on investment on the international portfolio has on the coverage ratio.

CONTENTS

SUMMARY	1
RECOMMENDATIONS	2
1 OUR AUDIT	3
1.1 Basis for the audit.....	3
1.2 The objectives and audit questions	3
1.3 Audit methodology	3
1.4 Reading guide	3
2 THE FINANCIAL STATEMENTS	4
2.1 Claims	4
2.2 Pension obligation provision	4
2.2.1 <i>Accuracy and comprehensiveness of the participant administration</i>	5
2.2.2 <i>Prudential actuarial assumptions</i>	5
2.3 Coverage ratio	6
2.4 2018 Financial results	6
2.5 Comparison of results among regional pension funds	7
2.5.1 <i>Vidanova</i>	7
2.5.2 <i>Pension Fund of the Caribbean Netherlands</i>	7
2.5.3 <i>General Pension Fund Curaçao</i>	8
2.6 Opinion regarding the reliability of the 2018 Financial Statements.....	8
3 COMPLIANCE	9
3.1 Legislation	9
3.2 Opinion on legal compliance	9
4 STATUS AS OF DECEMBER 2019	10
4.1 Pension Reform	10
4.2 Recovery Plan	10
5 REACTION OF APS AND OUR EPILOGUE	11
5.1 Reaction from APS' Board.....	11
5.2 Our epilogue	11

SUMMARY

The General Audit Chamber conducted an audit of APS' 2018 Financial Statements pursuant to article 26 of the National Ordinance for the General Pension Fund St. Maarten.

With this report, we inform the Minister of Finance and Parliament about the reliability of the APS' 2018 Financial Statements as well as their legal compliance. Our report is public so that the Fund's participants can take note of the results of our investigation.

The coverage ratio at the end of 2018 was 97.6% (2017: 103.1%). The Fund's assets are insufficient to cover both general and investment risks.

The reduction of the coverage ratio is primarily caused by the negative yield on the international investment portfolio. Where there was a positive result in 2017 of ANG 22.5 million, fiscal year 2018 produced a loss of ANG 36.9 million. The coverage ratio decreased by 5.5% as compared to 2017.

In our opinion, APS' 2018 Financial Statements provide a true and fair representation of the Fund's financial position as of December 31, 2018, as well as APS' financial result that year, with the following exceptions:

1. There is no agreement with the General Pension Fund of Curaçao regarding the size of the claim of ANG 12.7 million (2016: ANG 12.7 million). In 2018, there is uncertainty about the existence and valuation of the claim;¹
2. There is uncertainty regarding the valuation of an amount of ANG 22.1 million (2017: ANG 23.7 million) against the government of St. Maarten and other participating organizations;

We established that APS is legally compliant. We note that it remains unclear whether a deputy Chairperson was appointed during the period from July 7, 2018 up to and including May 27, 2019.

¹In their reaction of December 2, 2019 (reference: 2019-12/APS-007), APS states that in 2019 the only uncertainty that remains is regarding the valuation and not the existence of the claim.

RECOMMENDATIONS

Based on our findings, we recommend the following:

- Incorporate the prevailing mortality- and marital frequency principles in the administrative system as soon as possible to avoid manual modifications to the system;
- Adjust mortality principles:
 - o Expand the review of mortality principles using quantitative research;
 - o Use a forecast table for longevity rates.
- Continue monitoring the development of interest rates and the policy regarding the rounding off of actuarial rates;
- Continue updating the recovery plan and take the comments detailed in paragraph 4.2 into account;
- Investigate whether there are measures, and if so which, can be taken to reduce, as much as possible, the risks related to the international investment portfolio;
- Carry out an ALM-study. Take into account the various arrangements that can be calculated to determine the suitability of the appropriate financial policy.

1 OUR AUDIT

1.1 Basis for the audit

APS is subject audit by us pursuant to article 26 of the [National Ordinance for the General Pension Fund](#) (hereafter Lv APS). In keeping with article 18, paragraph ten of the Lv APS, we submit the audited financial statements along with our comments to Parliament and the Minister of Finance each year. The report contains our findings from our audit of APS' 2018 Financial Statements.

1.2 The objectives and audit questions

There is a dual purpose to this investigation. One is to inform both Parliament and the Minister of Finance of our opinion regarding the reliability of the financial statements and legal compliance.

Secondly, we wish to advise Parliament and the Minister of Finance, of the areas that require improvement.

The following audit questions were formulated:

1. Does APS' 2018 Financial Statements provide a true and fair representation of the financial position as of December 31, 2018, as well as the financial results for the fiscal year?
2. Did APS comply with the National Ordinance for the General Pension Fund of St. Maarten?

1.3 Audit methodology

APS' 2018 Financial Statements were audited by an external accountant. To avoid repetition of audit work on the Financial Statements, we examined, in consideration of efficiency, the extent to which we could use results of the external accountant's work. As such, we reviewed the audit dossier and spoke to the external accountant. Additionally, we investigated the 2018 Financial Statement as follows:

- Numerically analyzed the Financial Statements;
- Requested and evaluated documents of APS;

For aspects related to actuarial assumptions for determining the for the pension obligation provision (hereafter: VPV), we were assisted by an external actuary.

1.4 Reading guide

The following topics are addressed in this report: our findings about APS' financial position and the financial result (Chapter 2). We mention the results of the review of APS' legal compliance in Chapter 3. In Chapter 4, we address the current situation in 2019 where we give brief attention to the planned pension reform as well as APS' recovery plan.

We conclude our report with the APS' reaction and our epilogue (Chapter 5).

2 THE FINANCIAL STATEMENTS

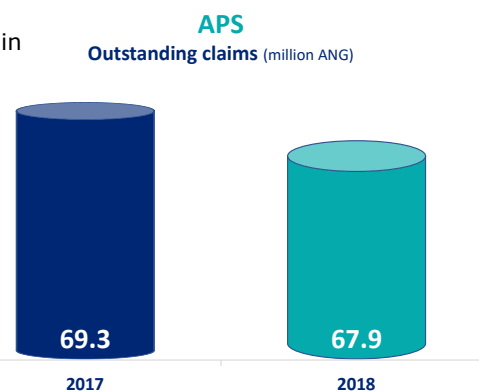
In this chapter, we present our results and provide our opinion regarding the audit question:

“Does APS' 2018 Financial Statements provide a true and fair representation of the financial position and their results as of December 31, 2018?”

2.1 Claims

The total outstanding claims (receivables) declined in 2018 by ANG 1.4 million, namely from ANG 69.3 million to NAf 67.9 million.² For a portion of the outstanding claims, there is uncertainty about if or when they will be settled. These uncertainties are:

1. Uncertainty in 2018 regarding the existence and the valuation of the claim against the General Pension Fund of Curaçao of ANG 12.7 million (2017: ANG 12.7 million)³;
2. Uncertainty about the valuation of claims against the Government of St. Maarten and other participating organizations of ANG 22.1 million (2017: ANG 23.7 million);



In our report regarding APS' 2017 Financial Statement we state that an outstanding claim of ANG 20.2 million existed for which there is uncertainty about the timing of settlement by Government (as part of the remaining debt settlement agreement).⁴ APS received this amount in June 2019.⁵

2.2 Pension obligation provision

APS' actuary issue dan opinion on August 29, 2019 regarding fiscal year 2018. The opinion regarding the VPV is as follows⁶:

“The pension obligation provision is, in accordance with the rules and principles used for calculation, generally, sufficient.”

At the end of 2018, APS' VPV is ANG 696.4 million (2017: ANG 653.6 million). Total pension assets amount to ANG 679.4 million (2017: ANG 673.5 million). The coverage ratio is calculated using the following equation:

$$\frac{\text{Pension assets (ANG 679.4 million)}}{\text{VPV (ANG 696.4 million)}} * 100 = \text{Coverage ratio (97.6\%)}$$

² Balance sheet items: Other non-current assets, Accounts receivable, Other receivable and Accrued interest receivable.

³ In their response (ref: 2019-12/APS-007), APS indicates that in 2019 there is only uncertainty about the amount of valuation and not about its existence. We will continue to monitor the progress of this matter.

⁴ Paragraph 2.1 of our report: Compliance audit: APS' 2017 Financial Statements

⁵ Paragraph 3.16 of APS' 2018 Financial Statements.

⁶ Certification report Fiscal Year 2018, Actuarial Statement, opinion on page 11.

2.2.1 Accuracy and comprehensiveness of the participant administration

Based on the audit of the participant's basic data⁷, APS' external accountants' opinion is that the participant administration is accurate, complete and in accordance with underlying documentation in the participant files, with one exception.⁸ The restriction reported in 2018, concerned errors in the pension administration (252 participants had an incorrect status due to the absence of formal notification from the employer).

2.2.2 Prudential actuarial assumptions

The actuarial principles APS used to calculate the VPV are listed in the [2018 Financial Statements](#). Two of the fundamental principles that are important for setting the level of the [VPV](#) are the [actuarial interest rate](#) and the [mortality rate](#).

Actuarial rate

In 2018, the actuarial interest rate is set at 3.75%. APS' certifying actuary stated the following regarding the actuarial rate: "*The actuarial rate used is 3.75%. We recommend that the Fund actively monitors the actuarial rate to ensure it remains sufficiently prudent in the future, given the observation that the average unadjusted (not rounded) interest declined over the fiscal year.*"⁹ We support this recommendation.

Mortality rates

In 2018, APS, after conducting research, decided to use an adjusted GBM/V 2005-2010 period table for calculating the VPV. Previously, the GBM/V 2000-2005 table was used. Because the research was primarily qualitative, we agree with the recommendation issued by APS' actuary to conduct further quantitative research using mortality results of recent years.¹⁰

The prevailing mortality principles are not processed in the administrative system.¹¹ We concur with the recommendation of the APS' actuary for this to be accomplished soon as possible.¹²

Marital Status

Marital status or frequency rates were amended by the Fund from 100% married for both men and women to 90% for men and 75% for women. This adjustment lowered the VPV by approximately 1.1%.

The prevailing rate for marital status were not incorporated into the administrative system.¹³ We are in agreement with the recommendation issued by APS' actuary to have this corrected as soon as possible.¹⁴

⁷ Participant date of birth, former participant, participant eligible for pension, partner of eligible participant, latent orphans; gender, date marriage/divorce, date of death, start date participation, date of pension, income data (among which salary; part-time percentage, disability percentage, income limits).

⁸ Assurance report regarding the basic data. Grant Thornton August 28, 2019.

⁹ Certification report Fiscal Year 2018, Actuarial Statement, Summary, conclusion and recommendations and page 16, Financial Position.

¹⁰ Page 7 of the WTW Actuarial Statement for fiscal year 2018, WTW, August 29, 2019.

¹¹ In their reaction of December 2, 2019 (reference: 2019-12/APS-007), APS states that the current mortality rates have been included 'off-balance-sheet', though not yet incorporated in the administrative system because of the timing and completion of the analysis.

¹² Page 7 of the WTW Actuarial Statement for fiscal year 2018, WTW, August 29, 2019.

¹³ In their reaction of December 2, 2019 (reference: 2019-12/APS-007), APS states that the current mortality rates have been included 'off-balance-sheet', though not yet incorporated in the administrative system because of the timing and completion of the analysis.

¹⁴ Page 7 of the WTW Actuarial Statement for fiscal year 2018, WTW, August 29, 2019.

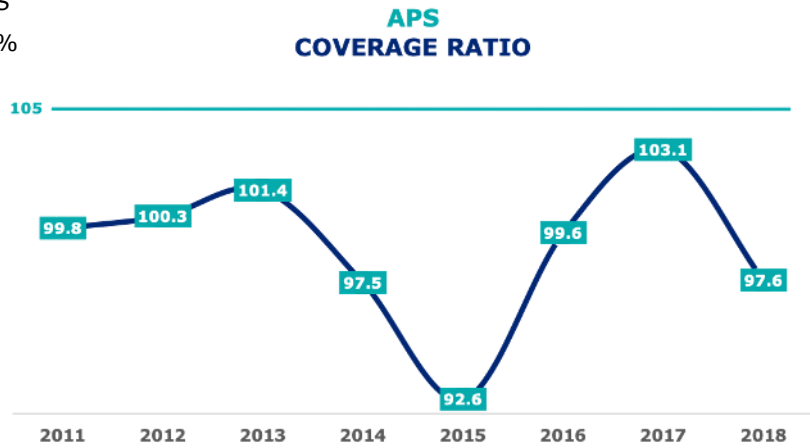
2.3 Coverage ratio

A 100% coverage ratio means that the fund can exactly cover future pension obligations. With a coverage ratio of 100%, the pension fund is not resistant to general and financial risks. Maintaining a minimum coverage ratio is a way to prevent this. APS' policy assumes a minimum coverage ratio of 105%.

Figure 1: APS' coverage ratio over time

At the end of 2018, APS' coverage ratio was 97.6% (2017: 103.1%).

The 5.5% decline of the coverage ratio is primarily due to disappointing returns on investment and inflation (ANG -35.6 million).¹⁵ Adjustments to pension principles also had a negative effect on the coverage ratio of approximately 2.0%.

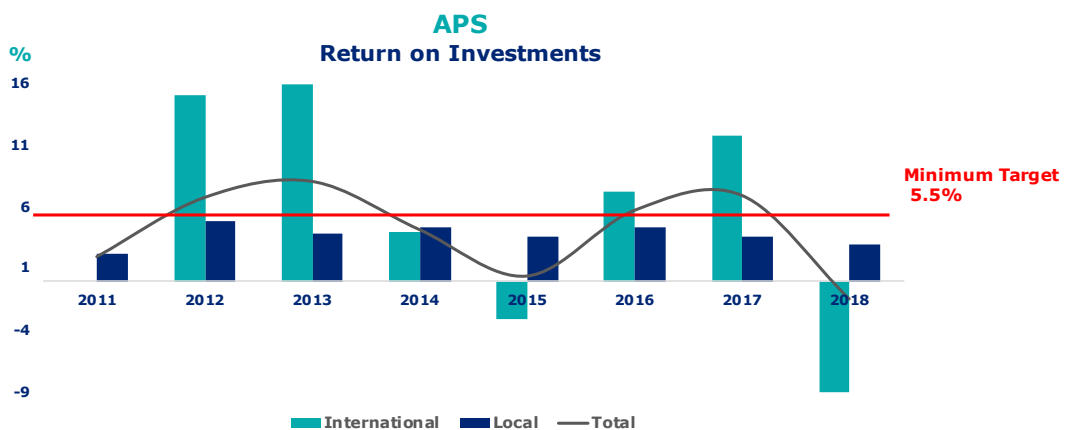


Worthy of note is that the increase in the coverage ratio in 2016, is primarily due to the increase of the retirement age from 60 to 62. At the end of 2018, the available assets were insufficient to cover general and investment risks.¹⁶

2.4 2018 Financial results

The 2018 Financial Statement shows a negative financial result of ANG -36.9 million. In 2017, APS ended the fiscal year with a profit of ANG 2 2.5 million. The decline is primarily due to the result of the investment portfolio that declined as compared to the previous year. Figure 2 presents the return on investment from 2011 onwards.

Figure 2: Return on local and international investments



¹⁵ Actuarial report, APS fiscal year 2018, WTW, August 29, annex E, page 28.

¹⁶ Financial position, Actuarial report, fiscal year 2018, August 29, 2019.

The data used in Figure 2 are derived from APS' financial statements. When Figure 1 and 2 are compared, a link can be made between return on investment on (in particular) the international investments and the coverage ratio. For example, in 2012, 2013 and 2017, the return on the international portfolio was high. In those same years, the coverage ratio was above 100%. In 2015 and 2018, the international investments show a negative return. The coverage ratio was below 100% in those years.

Figure 2 further shows that the result on the international investments varies. In some years there are high yields (example 2012, 2013 and 2017), while in the subsequent years (2014, 2015 and 2018) the return is less or even negative.

2.5 Comparison of results among regional pension funds

Funds will always have to consider the volatility of international markets.¹⁷ While 2017 was a great year for investment, 2018 proved to be a bad investment year for the pension funds we analyzed.

2.5.1 Vidanova

In their [2018 annual report](#), Vidanova states the following regarding the international market:¹⁸

"The year 2018 was very tough for global equity markets as well, as almost every major market ended the year in firmly negative territory. Even fixed income markets were tumultuous given apprehension overgrowth and the direction of future central bank action. As the Fund invests internationally it was also affected by these trends. The investment portfolio generated negative returns, though its conservative positioning helped mitigate losses."

And continues:

"We are aware of the fact that we are long term investors and that a negative result during one year is not uncommon in the investment world. However, considering the changing environment on the pension side (switch [from Defined Benefit to Defined Contribution](#)) and the distressed markets on the investment sides, without losing focus of our long term horizon, the Fund has decided to conduct a new Asset and Liability Matching ("ALM") study in 2019. Based on this ALM study the way ahead for the Fund will be determined."

Vidanova proactively took internal measures because of negative results.

2.5.2 Pension Fund of the Caribbean Netherlands

The Pension Fund of the Caribbean Netherlands (*Pensioenfondsen Caribisch Nederland - PCN*) states the following regarding international investment in its [2018 annual report](#):¹⁹

"In 2018, the asset manager Stone Harbor (EMD LC), once again under performs. In November 2018 it was decided, on the advice of BlackRock [fiduciary manager], to review this case in the

¹⁷ In relation to their own investment beliefs, risk appetite, actuarial principles and relevant regulations.

¹⁸ 2018 Annual Report, Vidanova, page 5.

¹⁹ 2018 Annual Report Pension Fund of the Dutch Caribbean, paragraph 6.3.3.

first quarter of 2019. At the start of 2019, the board decided to end the relationship and to fill this category passively going forward."

2.5.3 General Pension Fund Curaçao

In terms of the General Pension Fund Curaçao (*Algemeen Pensioenfonds Curaçao - APC*), we note that they also report a negative result on the international investments of -6.3%. We are unaware of measures APC has taken as a result of the negative result in 2018.

Taking measures is healthy for performance in our opinion. We refer to our report on [APS' investment process](#) in which we report that APS follows the investment cycle. However, our report recommends that APS conduct an ALM study (step 3 of the cycle), in consideration of the current pension system as well as the proposed amendments.²⁰ Based on the ALM-study, the need for adjustments to the strategic investment policy (step 4 of the cycle) can be analyzed. We also noted that APS' policy is excessively complicated and therefore costly, a statement that is supported by APS' certifying actuary.²¹

In their response, APS states that they will carry out an ALM-study after pension reform is implemented. They further state that a *risk budgeting study* is currently underway.²² We believe that the execution of such a study is a positive development, however, we wish to point out that a *risk budgeting study* is not a part of their investment cycle. 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. Finally, we believe that it should not be the case that the implementation of an ALM study is made dependent on external events or actions (in this case pension reform), particularly given the current uncertainty.

2.6 Opinion regarding the reliability of the 2018 Financial Statements

Based on our audit we believe that APS' 2018 Financial Statements, with the exception of possible impacts of items described below, provides a true and fair representation of asset size and composition, as well as the financial result as of December 31, 2018.

The items and potential impacts are:

1. There is no agreement with the General Pension Fund of Curaçao regarding the size of the claim of ANG 12.7 million (2017: ANG 12.7 million). In 2018, there is uncertainty regarding the existence and value of the claim;
2. Uncertainty exists regarding the valuation of the claim of ANG 22.1 million (2017: ANG 23.7 million) against the Government of St. Maarten and related participating organizations.

²⁰ APS' policy requires that an ALM-study or continuity analysis is carried out every 3 years. The last ALM-study dates back to 2014. (Source: Actuarial and technical memorandum of September 28, 2016).

²¹ Risk Budgeting, - Results, Willis Towers Watson, September 14, 2016.

²² Reaction of APS dated December 2, 2019 (reference: 2019-12/APS-007).

3 COMPLIANCE

In this chapter, we answer the following audit question:

“Did APS comply with the National Ordinance for the General Pension Fund of St. Maarten in 2018?”

3.1 Legislation

APS complied with all regulatory provisions of the Lv APS in 2018. However, we note that:

- the position of a board member that became vacant on December 31, 2018 for which the Minister of Finance provides a nomination, remains vacant at the time of this report. APS states in their reaction that they have repeatedly requested the urgent attention of the Minister regarding the nomination;²³
- we are not aware whether a deputy chairperson was appointed for the period July 7, 2018 up to and including May 27, 2019. The deputy chairperson was namely appointed for a year effective July 7, 2017. In their reaction, APS states that a deputy chairperson was appointed for one year, effective May 28, 2019.;²⁴
- the existing vacancy for the function of deputy director was filled in 2019.

3.2 Opinion on legal compliance

Based on the aforementioned, we believe that in 2018, APS is legally compliant. However, it is not clear to us whether a deputy chairperson was appointed for the period July 7, 2018 up to and including May 27, 2019.

²³ Reaction of APS dated December 2, 2019 (reference: 2019-12/APS-007).

²⁴ Idem.

4 STATUS AS OF DECEMBER 2019

4.1 Pension Reform

Government intends to amend the pension system in the near term. Looking at the costs of the current pension system, a trend can be seen that it is not sustainable.²⁵

The intention to increase the retirement age to 65 years will positively impact on the coverage ratio. APS expects the coverage ratio to increase by approximately 5%. APS' goal is to achieve a structural coverage ratio of at least 105%. In light of current political developments, there is added uncertainty regarding the date of the realization of pension reform. We advise APS to take this into account.²⁶

4.2 Recovery Plan

APS drafted a recovery plan in December 2018. We had the recovery plan examined by an external actuary. Via the actuary we were informed that APS updated their recovery plan in October 2019. We received the updated recovery plan, on our request, on November 14, 2019, during the completion phase of our audit. APS informed us that they would provide us with the updated recovery plan after the next update in mid-January 2020.²⁷

For the purpose of audits, we request that APS proactively provide us with recently updated and/or formally approved information/documentation.²⁸

We did compare the actuary's analysis of the previous recovery plan with the updated version and found the following:

- There are a limited number of scenarios on which the Board has little influence (specifically legislative amendments). The focus of the recovery plan is primarily related to the changes to the pension system.
- In principle, a recovery plan is aimed at showing the development of the coverage ratio. The recovery plan presents the development; however, no recommendations are made about how to achieve the desired coverage ratio. The focus is almost entirely on pension reform.

²⁵ Explanatory memorandum of the draft national ordinance amending the National Ordinance Pension for public servants.

²⁶ We stated in our audit report regarding APS' investment process that in accordance with internal policy, an ALM-study needs to be conducted, and a passive approach awaiting approval of pension reform is not desirable.

²⁷ Email correspondence with the Deputy Director dated November 14 and November 18, 2019.

²⁸ We issued a similar request in our report: *Auditing the Investment Process of the General Pension Fund*.

5 REACTION OF APS AND OUR EPILOGUE

5.1 Reaction from APS' Board

APS's Board provided a reaction to our draft report on December 13th, 2019.

In their response, the Board states that improving the cooperation with supervisors and jointly working on the quality desired by APS' participants and retirees is explicitly included in the Fund's Strategic Agenda 2019-2022. The supervisors are important guardians of the desired quality and play an important role in the further development of the Fund. To clarify its position, APS has formulated core values and qualities as part of the Strategic Agenda 2019-2022, which also includes transparency. As such, the Fund's objective is to proactively inform the General Audit Chamber of any progress that is made based on the recommendations and also provide both solicited and unsolicited information relevant to the execution of the General Audit Chamber's supervisory task.

The Board will also provide updates regarding recommendations issued in the past. We will continue to monitor their progress.

5.2 Our epilogue

The statements made by APS' Board in their reaction are, in our opinion, very positive. For our audit of the [APS' 2017 Financial Statements](#) (first version of the recovery plan), [APS' investment process](#) (amended investment policy) and also for this audit (amended recovery plan), receiving updated documents for the respective investigations would have been valuable. With the latest information, we not only intend to be as accurate and up to date as possible, but also to demonstrate that APS has taken steps with the objective of improving an "outdated" situation.

We would like to thank both the board and management for their cooperation during the conduct of this investigation and look forward to a continued cooperation.



SP-W.	SP-W.	Volatilität	Ums. St.	Ums. Mio. €	Schluss Parkett 29.11.
11,5	11,5	102,71	11334	118,65	4162,11
12	20,5	186	22,2	95,12	
21,6		3350	320,6	41,92	
12		346	14,5	11,05	
2952		152,5			
4870		118,4			

TecDax

Dividende 2008/09	Markt	Ums.
0,00/11,05/09	1000	29,52
0,29/05,07/09	1000	1,00
1,00/28,79/09	1000	1,00

Deutsche Post	8197,7
2951,8	
1168,6	
2217,4	
5650,4	
4015,1	
1885,2	
4045	
11,90	



General Audit Chamber
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