

The Virgin Islands Consortium

Damning Inspector General Audit Finds G.E.R.S. Made Illegal Investment With Taxpayers Pension Fund; Could Lose Over \$40 Million On Speculative Deal

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ST. THOMAS -- An audit performed by the Office of the Inspector General (O.I.G.) on the Government Employees' Retirement System (G.E.R.S.), found that the system's Board of Trustees continues to mishandle tens of millions of dollars of government employees pension monies, through ill-advised and an abundance of risky investments.

The audit, seen [here](#), and made available by the O.I.G., specifically targets G.E.R.S.'s Alternative Investment Program (A.I.P.), which was established as law on November 2, 2005, as Act 6794, and is described as "investment opportunities that have not been

identified by the traditional public equity or fixed income capital markets."

Categories of A.I.P include private equity, natural resources, managed futures and commodities, hedge funds and portfolio overlay and real estate. The intent of the program was to increase income for G.E.R.S. by allowing more risky investments with higher rates of return. And while the original Act allowed for only 5 percent of the total amount of the available portfolio to be used on the program, in 2010, Act 7233 increased the investment to a 10 percent limit.

Act 6794 also allowed G.E.R.S. to invest in another type of non-traditional investment called viatical senior and/or life settlements, which allows G.E.R.S. to purchase life insurance policies at a discount from licensed insurers, while annual policy premiums would continue to be paid by G.E.R.S. The idea is that when the insured dies, G.E.R.S. would collect the proceeds of the acquired policies. The Act limited investments in these policies to not more than 20 percent of the total investments of the system.

According to the audit, G.E.R.S. entered into loan agreements which were not authorized under the A.I.P. or any other authority as defined by the law. It says six A.I.P. investments were actually commercial loans to businesses, and one was a loan to the Government of the Virgin Islands. The total value of these seven loans was at least \$77.1 million, and the interest rate charged for four of the loans was below the rate charged members, and the industry-desired investment rate of return of 7 to 8 percent.

The audit found that the program was not meeting its intended purpose of being a safe return on investments, and that the law, as it currently exists, does not provide adequate controls and protection against the risk of loss of the pension funds entrusted to G.E.R.S. It says that "some investments that meet the industry definition of alternative investments are not included in the alternative investments sections of the Code," and "current non-traditional investments have limits and practices which expose a high percentage of G.E.R.S.'s investment portfolio to highly volatile and risky alternative investments.

"We found that of the twelve non-traditional investments, six were actually commercial loans to new, expanding or financially struggling businesses. In addition, one was a loan to the government secured by property tax revenues. The total G.E.R.S. funds committed as of June 30, 2015, was \$77,093,374. The other five non-traditional investments consisted of three real estate acquisitions totaling \$60,119,234, one venture capital investment totaling \$25 million and one viatical investment totaling \$50 million," reads the audit.

The report says the law, as currently written, allows G.E.R.S. to invest up to 30 percent of its investment portfolio in these highly volatile and risky non-traditional investments. This amount far exceeds the industry average of investment in the risky alternative markets, which is 15 percent, according to the audit.

It also found that G.E.R.S. entered into an extremely risky and questionable viatical investment that jeopardized about \$42 million of its investment portfolio. This was done without performing the necessary due diligence and obtaining the necessary expert advice before exposing the pension fund to this high-risk investment, according to the audit. As a result, G.E.R.S. has already written off 20 percent or \$8.4 million of the remaining value. In addition, G.E.R.S. also granted a \$10 million line of credit to the

same partnership that is handling the viatical. The majority of the proceeds were to pay past due and near term premiums for the policies.

The Board of Trustees responded by denying or disputing most of the audit's findings, only to be rebutted by the Inspector General, Steven van Beverhoudt.

The audit resulted in the following conclusions:

- Viatical and some real estate investments considered by the industry as alternative investments are not included in the alternative investments sections of the Code;
- G.E.R.S.'s current non-traditional investments limit is higher than the industry standards;
- In the 2005 revisions to the Code, there are two sections dealing with alternative investments and one section dealing with viatical; ? a 2015 revision to the Code added five additional categories of alternative investments;
- G.E.R.S. entered into loan agreements that were not authorized under the Alternative Investment Program or any other authority as defined by the Code;
- The interest rate charged for four of the loans was below the rate charged to G.E.R.S. members and the industry desired investment rate of return;
- G.E.R.S. entered into an extremely risky and questionable viatical investment;
- G.E.R.S. also granted a \$10 million line of credit to the same partnership that is handling the viatical investment;
- G.E.R.S. entered into numerous agreements and investments without performing the necessary due diligence evaluation to ensure limited risk and a reasonable rate of return on the funds used;
- G.E.R.S. did not conduct efficient monitoring and oversight activities of investments under the Alternative Investment Program to protect GERS' interest; and,
- G.E.R.S. did not establish any procedures, policies, or benchmarks to ensure that funds were being utilized for the requested purpose of the investments. 5 As a result:
- The law as it now exists does not provide adequate controls to protect against the risk of losing pension funds;
- A high percentage of GERS' investment portfolio is exposed to highly volatile and risky alternative investments;
- Duplications in the Code creates confusing and unmanageable requirements when dealing with non-traditional investments;
- The 2015 revisions to the Code allowed the entire investment portfolio of GERS to be invested in the five risky alternative investments;
- At least \$77.1 million of the investment portfolio was used to fund seven unauthorized loans;
- Potential interest earned on the loans did not justify the high risk taken or meet the desired 7 to 8% rate of return established by the Board of Trustees;
- G.E.R.S. has already written-off \$8.4 million of its investment portfolio, with about \$42 million in additional investment funds in jeopardy of being lost due to an ill-advised viatical investment;
- In addition to being illegal, an additional \$10 million line of credit to the same viatical is also in jeopardy of being lost;
- There was no assurance that funds disbursed in non-traditional investments will produce the desired rate of return, or even if the funds disbursed will be recovered;

and,

- Funds may have been used for purposes not agreed to or authorized by G.E.R.S.

It also recommended that the Board of Trustees make a request to the Legislature to amend the law to include all non-traditional investments in the definition of alternative investments; amend the law to ensure that the limit on investing in the high-risk alternative investment market is within the industry standard; and revise the entire G.E.R.S. statute to ensure that the sections of the law are organized in a consistent and logical manner.