



**EMPLOYEES' RETIREMENT SYSTEM OF THE GOVERNMENT
OF THE COMMONWEALTH OF PUERTO RICO—
"ERS LEGACY TRUST"**

(A Component Unit of the Commonwealth of Puerto Rico)

Basic Financial Statements

June 30, 2022

(With Independent Auditors' Report Thereon)

**EMPLOYEES' RETIREMENT SYSTEM OF THE GOVERNMENT
OF THE COMMONWEALTH OF PUERTO RICO—
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(A Component Unit of the Commonwealth of Puerto Rico)

June 30, 2022

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Independent Auditors' Report

The Retirement Board of
The Government of Puerto Rico Employees' Retirement System of the Government
Of the Commonwealth of Puerto Rico – "ERS Legacy Trust":

Report on the Audit of the Financial Statements

Opinions

We have audited the financial statements of the governmental activities and the general fund of the Employees' Retirement System of the Government of the Commonwealth of Puerto Rico – "ERS Legacy Trust" (the Trust), a component unit of the Commonwealth of Puerto Rico (the Commonwealth), as of and for the year ended June 30, 2022, and the related notes to the financial statements, which collectively comprise the Trust's basic financial statements as listed in the table of contents.

In our opinion, the accompanying financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and the general fund of the Trust as of June 30, 2022, and the respective changes in financial position for the year then ended in accordance with U.S. generally accepted accounting principles.

Basis for Opinions

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditors' Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Trust and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with U.S. generally accepted accounting principles, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Trust's ability to continue as a going concern for twelve months beyond the financial statement date, including any currently known information that may raise substantial doubt shortly thereafter.

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinions. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of



internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Trust's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Trust's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control related matters that we identified during the audit.

Required Supplementary Information

U.S. generally accepted accounting principles require that the management's discussion and analysis be presented to supplement the basic financial statements. Such information is the responsibility of management and, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with GAAS, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

KPMG LLP

San Juan, Puerto Rico
October 20, 2023

Stamp No. E520116 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.

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Management's Discussion and Analysis (Unaudited)

June 30, 2022

Introduction

The following discussion and analysis of the financial performance of the Employees' Retirement System of the Government of the Commonwealth of Puerto Rico — “ERS Legacy Trust” (the “Trust” or “ERS”) provides an overview of its activities for the fiscal year ended June 30, 2022. Its purpose is to provide explanations and insights into the information presented in the basic financial statements and required supplementary information. This discussion and analysis is intended to be read in conjunction with the Trust's financial statements.

Prior to July 1, 2017, the Trust was a pension trust fund created by the Legislature of the Commonwealth of Puerto Rico (the Legislature) by Act No. 447 of May 15, 1951, known as the *Retirement System for Employees of the Government of the Commonwealth of Puerto Rico* (Act No. 447 of 1951), as amended, to provide pension and other benefits to retired employees of the Commonwealth of Puerto Rico (the Commonwealth), its public corporations, and municipalities. The Trust was administered by the Puerto Rico Government Employees and Judiciary Retirement Systems Administration (the ERS and JRS Administration) and governed by a board of trustees (the Board of Trustees). During this time, the Trust administered a cost-sharing, multiemployer, pension plan consisting of three benefit structures: (i) a cost-sharing, multiemployer, defined benefit program (the Defined Benefit Program); (ii) a defined contribution program (the System 2000 Program); and (iii) a contributory hybrid program (the Contributory Hybrid Program).

On August 23, 2017, the Governor of Puerto Rico signed into law Act No. 106 of 2017, known as the *Law to Guarantee the Payment of Our Pensioners and Establish a New Plan of Defined Contributions for Public Servants* (Act 106-2017), which completely transformed the Trust by, among other things, (i) replacing the Trust's Board of Trustees and the governing boards of the Retirement System for the Judiciary of the Commonwealth of Puerto Rico (JRS), and the Puerto Rico System of Annuities and Pensions for Teachers (TRS, and collectively with the Trust and JRS, the Retirement Systems) with a single Retirement Board of the Commonwealth of Puerto Rico (the Retirement Board) and (ii) implementing a pay-as-you-go (PayGo) system in which direct payments to pension beneficiaries are made by the Commonwealth and reimbursed by individual government employers through an applicable PayGo fee. The Trust's assets are being liquidated, and programs and activities were terminated or suspended. Refer to Note 1 to the basic financial statements for further information regarding Act 106-2017.

As of July 1, 2017, Joint Resolution 188 from the Legislature of Puerto Rico and Act 106-2017 together required the Trust to liquidate its assets. Act 106-2017 also mandated the transfer of all of the Trust's existing retirement plans and benefits to a new defined contribution plan (the New Defined Contribution Plan) for existing active members and new employees hired after July 1, 2017. The New Defined Contribution Plan and the individual beneficiary accounts established thereunder were officially launched on June 22, 2020.

The Trust continues to administer postemployment healthcare benefits provided by the Commonwealth to retired plan members (ERS OPEB MIP), an unfunded, cost-sharing, multiemployer defined benefit other postemployment benefit plan. ERS OPEB MIP is also funded through the PayGo System.

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In addition, between May 21, 2017, and March 15, 2022, the Trust operated in a case under Title III of the Puerto Rico Oversight Management and Economic Stability Act (PROMESA) in the United States District Court for the District of Puerto Rico (the Title III Court). On March 15, 2022, the conditions precedent to the effective date of the Plan of Adjustment (as defined in Note 9)—which resolved all obligations against the Commonwealth, the Trust, and the Puerto Rico Public Buildings Authority (PBA)—were satisfied and/or waived by the Financial Oversight and Management Board of Puerto Rico (the Oversight Board), and that plan became effective. Accordingly, the Plan of Adjustment has been confirmed and is currently effective as of the date hereof, and thus the Trust's Title III case has been concluded.

The Trust is considered an integral part of the financial reporting of the Commonwealth. Since Act 106-2017 transferred the primarily responsibility of the payment of the pensions to the general fund and instructed the Trust to liquidate its assets to fund the pension benefits it is determined that Trust's assets and activities should not be reported as a pension trust fiduciary funds. Instead, starting in fiscal year 2018, the Trust is reported as part of the blended component units in the Commonwealth's financial statements. Accordingly, the financial activities of the Trust consist only of governmental activities. For its reporting purposes, the Trust has combined the general fund and government-wide financial statements using a columnar format that reconciles individual line items of fund financial data to government-wide data in a separate column. As of June 30, 2022, the Trust had not completed the transfer of the net assets to the Commonwealth and continues managing the remaining assets as custodian. As in previous years, current year revenues and expenses (expenditures) are limited to the administration of the assets under its custody. Revenues and expenses (expenditures), associated with the assets under the Trust's custody are presented as part of the change in Due to Commonwealth. During year ended June 30, 2022, the Trust, JRS and TRS, also component units of the Commonwealth, began to be administered by the Retirement Board of the Government of Puerto Rico (the Retirement Board), an instrumentality of the Commonwealth of Puerto Rico. During this year, the Retirement Board assumed the responsibility for the general and administrative expenses of all three retirement systems including the Trust.

Financial Highlights

The Trust's total assets as of June 30, 2022 and 2021 amounted to approximately \$399 million and \$980 million, respectively.

As of June 30, 2022, the Trust's total assets consisted of the following:

- \$399 million in Commonwealth's assets in custody of the Trust, which includes:
 - \$117 million of investments in bonds and notes;
 - \$58 million in investments in limited partnerships;
 - \$169 million in member loans and interest receivable;
 - \$52 million in cash and cash equivalents and net receivables; and
 - \$3 million in capital and other assets.

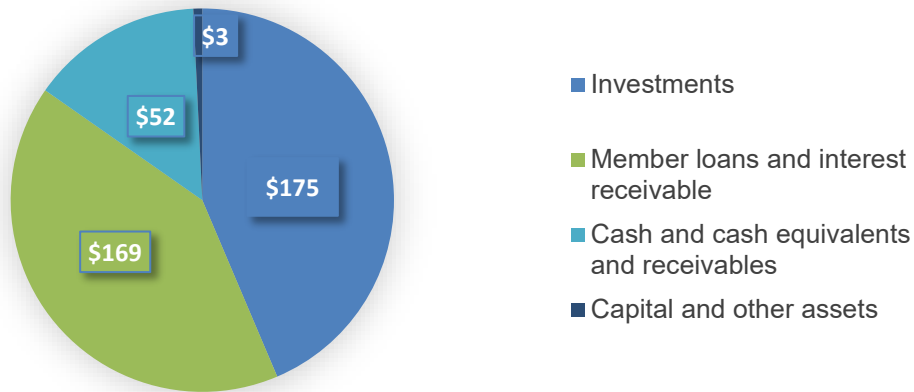
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The Trust's total assets as of June 30, 2022 are presented in the following chart (in millions):



As of June 30, 2021, the Trust's total assets consisted of the following:

- \$95 million in cash and cash equivalents; and
- \$885 million in Commonwealth's assets in custody of the Trust, which includes:
 - \$141 million of investments in bonds and notes;
 - \$73 million in investments in limited partnerships;
 - \$2 million in due from Retirement System for the Judiciary of the Commonwealth of Puerto Rico (JRS);
 - \$189 million in member loans and interest receivable;
 - \$477 million in cash and cash equivalents and net receivables; and
 - \$3 million in capital and other assets.

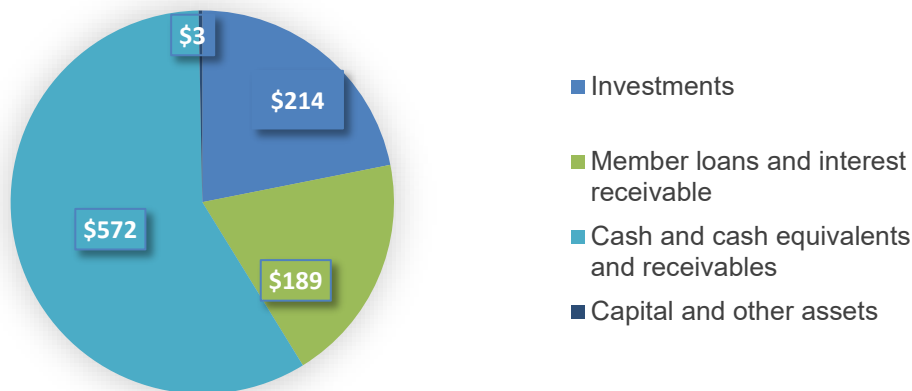
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The Trust's total assets, excluding amounts due from JRS, as of June 30, 2021 are presented in the following chart (in millions):



Although, the Trust had been in a net deficit position since fiscal year 2015, during fiscal year 2022, total assets equaled liabilities as of June 30, 2022, compared with a net deficit position of approximately \$3.713 billion as of June 30, 2021.

Overview of the Basic Financial Statements

This Management's Discussion and Analysis section is intended to serve as an introduction to the Trust's basic financial statements. The Trust's basic financial statements comprise three components: (1) government-wide financial statements on all of the activities of the Trust; (2) fund financial statements; and (3) notes to basic financial statements.

- *Government-wide Financial Statements* – The government-wide financial statements are designed to provide readers with a broad overview of the Trust's financial position, in a manner similar to a private-sector business.

The statement of net position presents information of all of the Trust's assets and deferred outflows of resources and liabilities and deferred inflow of resources, with the difference between the two reported as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the Trust is improving or deteriorating as a result of the year's operations.

The statement of activities presents information showing how the Trust's net position changed during the most recent fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods.

- *Fund Financial Statements* – For accounting purposes, a fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives.

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The governmental fund financial statement focus on near-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating the Authority's near-term financing requirements.

Because the focus of governmental fund financial statements is narrower than that of the government-wide financial statements, it is useful to compare the Trust's information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of financial decisions related to the Trust's governmental activities. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and change in fund balance provide a reconciliation to facilitate this comparison between governmental fund and governmental activities.

- *Notes to the Basic Financial Statements* – Provide additional information that is essential for an understanding of the data provided in the financial statements. The notes present information about the Trust's accounting policies, significant account balances and activities, material risks, obligations, contingencies, and subsequent events, if any.

Financial Analysis of the Governmental Activities

Net Position

The statement of net position serves as an indicator of the Trust's financial position at the end of each fiscal year. As of June 30, 2022, the Trust's net position totaled \$0. The following is condensed summary information for fiscal years ended June 30, 2022 and 2021:

	Condensed summary of net deficit			
	2022	2021	Change	
			Amount	Percentage
	Dollars in thousands			
Assets:				
Trust's assets	\$ —	94,718	(94,718)	(100.00)%
Assets under custody of the Trust	398,898	885,300	(486,402)	(54.94)%
Total assets	<u>398,898</u>	<u>980,018</u>	<u>(581,120)</u>	(59.30)%
Liabilities and net position:				
Other liabilities	2,710	505,344	(502,634)	(99.46)%
Due to Commonwealth	396,188	861,588	(465,400)	(54.02)%
Long-term liabilities	—	3,326,329	(3,326,329)	(100.00)%
Total liabilities	<u>398,898</u>	<u>4,693,261</u>	<u>(4,294,363)</u>	(91.50)%
Net position:				
Net deficit – unrestricted	\$ —	<u>(3,713,243)</u>	<u>3,713,243</u>	(100.00)%

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Decrease in Trust's assets from approximately \$94.7 million in fiscal year 2021 to \$0 in fiscal year 2022 was due to the transfer of approximately \$94.7 million to the Treasury Secure Account (TSA) for the payment to ERS bondholders under the terms of the Plan of Adjustment.

As of June 30, 2022, and 2021, the Trust held under custody approximately \$169 million and \$189 million, respectively, in loans and interest receivable from plan members, which represents 49% and 47%, respectively, of the total investment portfolio, including loans. As of June 30, 2022, member loans and interest receivable consisted of \$131 million in mortgage loans, \$49 million in personal loans, \$5 million in cultural trips loans, and \$11 million in interest receivable, less \$8 million in escrow funds and less \$19 million in the allowance for loan losses. As of June 30, 2021, member loans and interest receivable consisted of \$139 million in mortgage loans, \$65 million in personal loans, \$6 million in cultural trips loans, and \$14 million in interest receivable, less \$11 million in escrow funds and less \$24 million in the allowance for loan losses. As of June 30, 2022 and 2021, the fair value of the Trust's investment in limited partnerships amounted to approximately \$58 million and \$73 million, respectively, which represented approximately 17% and 18% of the investment portfolio, as of June 30, 2022 and 2021, respectively. As of June 30, 2022 and 2021, the fair value of the Trust's investment in bonds and notes amounted to approximately \$117 million and \$141 million, respectively, which represented approximately 34% and 35% of the investment portfolio, as of June 30, 2022 and 2021, respectively.

The decrease in other liabilities from approximately \$505 million in 2021 to \$0 million in 2022 was due to the transfer of such liabilities to the newly created Retirement Board as an instrumentality of the Commonwealth. As part of the commencement of the transition and dissolution of the Trust, in fiscal year 2022 the Retirement Board received appropriations from Commonwealth's General Fund to manage its operations and administer Commonwealth's assets under custody of the Trust. Therefore, as of June 30, 2022, the Trust has no liabilities related to general and administrative matters. Fiscal year 2021 other liabilities amounting to \$12 million were paid in fiscal year 2022 with Trust cash under its custody. Also, the fiscal year 2022 bonds interest payable amounting to \$493 were settled in fiscal year 2022 as part of the of the Plan of Adjustment (refer to Note 3).

As of June 30, 2022, due to Commonwealth balance decreased by approximately \$465 million when compared to fiscal year 2021, mostly due to the cash transferred to the Commonwealth by approximately \$492 million as part of the implementation of the Plan of Adjustment.

Capital Assets

The capital assets under custody of the Trust are those assets that are used in the performance of its functions. During the fiscal year ended June 30, 2022, capital assets decreased by approximately \$103,000.

Capital assets, net decreased primarily due to the net effect of the following:

- Current year's depreciation and amortization of approximately \$98,000.
- The disposition of equipment at a net cost of approximately \$5,000.

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June 30, 2022

Changes in Net Position

The following summary of activities reflects how the Trust's net position changed during the fiscal years ended June 30, 2022 and 2021.

	<u>2022</u>	<u>2021</u>	<u>Change</u>	
			<u>Amount</u>	<u>Percentage</u>
			(Dollars in thousands)	
Additions:				
Revenue from Commonwealth	\$ 438,854	42,872	395,982	924 %
Interest income	99	742	(643)	(87)
Total additions	<u>438,953</u>	<u>43,614</u>	<u>395,339</u>	<u>906</u>
Deductions:				
Interest on bonds payable	148,335	207,615	(59,280)	(29)
General and administrative	—	38,040	(38,040)	(100)
Other expenses	90,055	4,832	85,223	1,764
Total deductions	<u>238,390</u>	<u>250,487</u>	<u>(12,097)</u>	<u>(5)</u>
Extraordinary items:				
Gain on extinguishment of debt	3,512,680	—	3,512,680	100
Total extraordinary items	<u>3,512,680</u>	<u>—</u>	<u>3,512,680</u>	<u>100</u>
Net decrease in net position	3,713,243	(206,873)	3,920,116	(1,895)
Net position (deficit):				
Beginning of year	<u>(3,713,243)</u>	<u>(3,506,370)</u>	<u>(206,873)</u>	<u>6</u>
End of year	<u>\$ —</u>	<u>(3,713,243)</u>	<u>3,713,243</u>	<u>(100)%</u>

Total additions increase of approximately \$396 million in fiscal year 2022 is mostly due to the revenues from the Commonwealth, which represents payment made by the Commonwealth on behalf of the Trust to its bondholders under the terms of the Plan of Adjustment. Also, during fiscal year 2022, the Trust received interest in the amount of \$99,000, which represents a decrease of \$643,000 when compared to fiscal year 2021.

Total deductions decreased by approximately \$12 million in fiscal year 2022, mainly because of the net effect of the decrease of approximately \$59 million in interest on bonds payable, the decrease of approximately \$38 million in general and administrative and an increase of approximately \$85 million in other expenses. General and administrative expenses amounted to approximately \$0 for the fiscal year 2022, as compared to approximately \$38 million for the fiscal year 2021. The decrease in general and administrative expenses is due

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June 30, 2022

to the creation of the Retirement Board as an instrumentality of the Commonwealth assuming all general and administrative expenses and professional services for the Trust, JRS and TRS.

Investment Portfolio

Total investment assets under the custody of the Trust, including member loans, investments in limited partnerships, and bond and notes (investment portfolio, including loans), as of June 30, 2022 totaled approximately \$344 million. Member loans amounted to \$169 million as of June 30, 2022.

Debt Administration

The Trust historical long-term debt obligations include the Trust's senior funding bonds (the ERS bonds) amounting to \$0 million and approximately \$3,314 million as of June 30, 2022 and 2021, respectively. During the fiscal year ended June 30, 2008, the Trust issued three series of revenue bonds designated as "Senior Pension Funding Bonds", the proceeds of which were used mainly to increase the funds currently available to pay pension benefits to certain of its beneficiaries and reduce its unfunded actuarial accrued liability. The Bonds were limited, nonrecourse obligations of the Trust, payable solely from and secured solely by a pledge of employer contributions made after the date of issuance of the first series of Bonds, and from funds held on deposit with the Bank of New York Mellon (the Fiscal Agent). The Bonds were not payable from contributions made to the Trust by participating employees, or from the assets acquired with the proceeds of the Bonds, or from employer contributions released by the Fiscal Agent to the Trust after funding of required reserves, or from any other assets of the Trust. Prior to the Plan of Adjustment's effective date on March 15, 2022, these bonds were rated "C" by Moody's Investors Service and "CC" by Standard & Poor's Ratings Services.

On the Effective Date of the Plan of Adjustment, the ERS Bonds—which were classified as ERS Bond Claims under Class 65— were discharged and all related litigation dismissed in exchange for a 16% recovery consisting of cash and interests in the ERS Private Equity Portfolio (defined below). Specifically holders of the ERS Bonds received (i) \$373 million in cash distributions, with such cash payments being made available from ERS and the Commonwealth from the purchase of ERS assets, and (ii) interests in a trust holding a portfolio of private equity interests held by ERS as of the Effective Date (the ERS Private Equity Portfolio), which assets continue to be managed by ERS up to the date that such assets are purchased by the Commonwealth or holders of the ERS Bonds Claims, pursuant to an election provided in the Plan of Adjustment (the Bondholder Election). In particular, under the Plan of Adjustment, (i) the Commonwealth is granted an option through April 10, 2023 to purchase the ERS Private Equity Portfolio for \$70,750,000, (ii) in the event the Commonwealth declines to exercise such option, pursuant to the Bondholder Election, ERS bondholders have the option to purchase the ERS Private Equity Portfolio for \$70,750,000, plus such amount as may be necessary to reimburse the Commonwealth for any funded shortfall amounts in connection with the ERS Private Equity Portfolio, and (iii) in the event that the Bondholder Election is not exercised, the Commonwealth shall purchase the ERS Private Equity Portfolio for \$70,750,000. On November 18, 2022, the Commonwealth exercised the options and purchased ERS Private Equity Portfolio.

Refer to Note 3 of these financial statements for the financial impact of Plan of Adjustment.

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June 30, 2022

Requests for Information

This financial report is designed to provide a general overview of the Trust's finances, comply with related laws and regulations, and demonstrate commitment to public accountability. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Commonwealth of Puerto Rico Retirement Systems Administration, 235 Ave. Arterial Hostos, Edificio Capital Center Torre Norte, Piso 8, Hato Rey, Puerto Rico 00918.

**EMPLOYEES' RETIREMENT SYSTEM OF THE GOVERNMENT
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General Fund Balance Sheet and Statement of Net Position

June 30, 2022

(In thousands)

Assets	General fund Balance sheet	Adjustments	Statement of net position
Commonwealth's assets in custody of the Trust:			
Cash and cash equivalents:			
Deposits at commercial banks:			
Unrestricted	\$ 3,793	—	3,793
Restricted	21,101	—	21,101
Money market funds	26,629	—	26,629
Other receivables	231	—	231
Investments:			
Bonds and notes	117,405	—	117,405
Limited partnerships	57,712	—	57,712
Member loans and interest receivable – net	169,146	—	169,146
Capital assets – net	—	91	91
Other assets	—	2,790	2,790
Total assets	\$ 396,017	2,881	398,898
Liabilities			
Accounts payable and accrued liabilities	\$ 2,710	—	2,710
Due to Commonwealth of Puerto Rico	393,307	2,881	396,188
Total liabilities	396,017	2,881	398,898
Fund Balance/Net Position			
Fund balance—unrestricted	—	—	—
Total liabilities and fund balance	\$ 396,017		
Net position		\$ —	—

See accompanying notes to basic financial statements.

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Statement of Revenues, Expenditures, and Changes in Fund Balance and Statement of Activities

Year ended June 30, 2022

(In thousands)

	General fund Statement of revenues, expenditures, and changes in fund balance	Adjustments	Statement of activities
Revenues:			
Revenues from Commonwealth	\$ 426,483	—	426,483
Interest income	99	—	99
	426,582	—	426,582
Expenditures/expenses:			
General government:			
Interest on bonds payable	117,945	30,390	148,335
Other expenses	77,684	—	77,684
Total expenditures/expenses	195,629	30,390	226,019
Excess (deficiency) of revenues over expenses	230,953	(30,390)	200,563
Extraordinary item—			
Gain on extinguishment of debt	167,633	3,345,047	3,512,680
Total extraordinary item	167,633	3,345,047	3,512,680
Excess (deficiency) of revenues and extraordinary items over expenditures	398,586	(398,586)	—
Change in net position		3,713,243	3,713,243
Fund balance (deficit)/net position (deficit):			
Beginning of year	(398,586)	(3,314,657)	(3,713,243)
End of year	\$ —	—	—

See accompanying notes to basic financial statements.

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(1) Organization

Prior to July 1, 2017, the Employees' Retirement System of the Government of the Commonwealth of Puerto Rico— “ERS Legacy Trust” (“ERS” or the “Trust”) was a pension trust fund created by the Legislature of Puerto Rico (the Legislature) under Act No. 447, as amended, to provide pension and other benefits to retired employees of the Commonwealth of Puerto Rico (the Commonwealth), its public corporations, and municipalities. The Trust was administered by the Puerto Rico Government Employees and Judiciary Retirement Systems Administration (the ERS and JRS Administration) and governed by a board of trustees (the Board of Trustees). During this time, the Trust administered a cost-sharing, multiemployer, pension plan consisting of three benefit structures: (i) a cost-sharing, multiemployer, defined benefit program (the Defined Benefit Program); (ii) a defined contribution program (the System 2000 Program); and (iii) a contributory hybrid program (the Contributory Hybrid Program).

After the enactment of Act No. 106 of 2017, known as *the Law to Guarantee the Payment to Our Pensioners and Establish a New Plan for Defined Contributions for Public Servants* (Act 106-2017), the Trust's operations are limited to maintain custody of the unliquidated assets that are pending to be transferred to the Commonwealth's General Fund, servicing the bonds payable and administrative services on behalf of the Commonwealth.

Act 106-2017 approved a substantial pension reform for all of the Commonwealth's Retirement Systems, including the Trust. This reform modified most of the Trust's activities, restructured the Trust's operations and created the legal framework so that the Commonwealth can make benefit payments to current pensioners. Effective on July 1, 2017, the Trust's previously existing pension programs under Act No. 447 of 1951 (as amended) were terminated and transitioned to a pay-as-you-go (PayGo) system, in which the Trust stopped receiving contributions from employers or plan participants and is no longer managing contributions on behalf of participants. Under the PayGo system, the Commonwealth's General Fund makes direct pension payments to the pensioners and then gets reimbursed for those payments by the applicable employers. Act 106-2017 also ordered a suspension of the Trust's loan programs and ordered a merger of the administrative structures of the retirement systems.

The Commonwealth's General Fund became the only recipient of the assets maintained under the custody of the Trust. The product of the liquidation of said assets is designated by law to be used by the General Fund to cover pension benefits. Therefore, the basic financial statements of the Trust are blended in the Commonwealth's fund financial statements. The financial activities of the Trust consist only of governmental activities. Refer to Note 2 for basis of presentation.

Between May 21, 2017 and March 15, 2022, the Trust operated in a case under Title III of the Puerto Rico Oversight Management and Economic Stability Act (PROMESA) in the United States District Court for the District of Puerto Rico (the Title III Court). On March 15, 2022, the conditions precedent to the effective date of the Plan of Adjustment (as defined in Note 9)—which resolved all obligations against the Commonwealth, the Trust, and the Puerto Rico Public Buildings Authority (PBA)—were satisfied and/or waived by the Oversight Board, and that plan became effective. Accordingly, the Plan of Adjustment has been confirmed and is currently effective as of the date hereof, and thus the Trust's Title III case has been concluded. Refer to Note 10 to the basic financial statements for a detailed explanation of the Trust's Title

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III case and other activities mandated by the United State District Court for the District of Puerto Rico (the Title III Court).

The Retirement Board is currently responsible for governing, the Trust, the Judiciary of the Commonwealth of Puerto Rico (JRS) and the Puerto Rico System of Annuities and Pensions for Teachers (TRS). The Retirement Board is comprised of 13 members, including (i) six ex-officio members (or their designees): (1) the Executive Director of the Puerto Rico Fiscal Agency and Financial Advisory Authority (FAFAA), (2) the Secretary of Treasury of the Commonwealth, (3) the Director of the Office of Management and Budget, (4) the Director of the Office for the Administration and Transformation of Human Resources of the Government of Puerto Rico, (5) the President of the Federation of Mayors, and (6) the President of the Association of Mayors; (ii) three Governor-appointed representatives of the teachers of the Department of Education, the public corporations, and the Judiciary Branch; and (iii) four additional Governor-appointed members as representatives of the public interest.

During year ended June 30, 2022, the Trust, JRS and TRS, also component units of the Commonwealth, began to be administered by the Retirement Board of the Government of Puerto Rico (the Retirement Board), an instrumentality of the Commonwealth of Puerto Rico. During fiscal year 2022, the Retirement Board assumed the responsibility for the general and administrative expenses of all three retirement systems, including the Trust.

(2) Summary of Significant Accounting Policies

The accounting and reporting policies of the Trust conform to accounting principles generally accepted in the United States of America (GAAP), as applicable to governmental entities. The Trust follows governmental accounting standards board (GASB) standards in the preparation of its basic financial statements. The following are the significant accounting policies followed by the Trust in the preparation of its financial statements:

(a) Basis of Presentation

The financial activities of the Trust consist only of governmental activities. For its reporting purposes, the Trust has combined the General Fund and government-wide financial statements using a columnar format that reconciles individual line items of fund financial data to government-wide data in a separate column. A brief description of the Trust's government-wide and fund financial statements is as follows:

Government-wide Financial Statements: The government-wide statement of net position and statement of activities report the overall financial activity of the Trust.

The statement of activities demonstrates the degree to which the direct expenses of a given function (i.e., general government) are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function. The financial activities of the Trust consist only of governmental activities, which are primarily supported by the Trust's revenue from the Commonwealth for the custody and administration services performed by the Trust and the servicing of the bonds payable.

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Fund Financial Statements: The fund financial statements provide information about the Trust's General Fund. The General Fund accounts for all financial resources of the Trust.

(b) Basis of Accounting

The accounting and financial reporting treatment is determined by the applicable measurement focus and basis of accounting. Measurement focus indicates the type of resources being measured such as current financial resources or economic resources. The basis of accounting indicates the timing of transactions or events for recognition in the financial statements.

Government-wide Financial Statements: The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenue is recorded when earned and expenses when a liability is incurred, regardless of the timing of related cash flows.

Fund Financial Statements: The General Fund, as a governmental fund, is reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized when they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. Expenditures generally are recorded when the liability is incurred, as under accrual accounting. However, claims and judgments, and compensated absences are recorded only when payment is due. General capital asset acquisitions are reported as expenditures in governmental funds.

(c) Use of Estimates

The preparation of basic financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of changes in net position (deficit) during the reporting period. Actual results could differ from those estimates.

(d) Cash and Cash Equivalents

Cash equivalents in custody of the Trust include all highly liquid debt instruments with original maturities of three months or less from the date of acquisition and consist of deposits and money market funds.

(e) Investments

Investments are reported at fair value. The fair value of investments is based on quoted prices, if available. The Trust had investments in limited partnerships and the Puerto Rico Sales Tax Financing Corporation (COFINA) bonds of approximately \$58 million and \$117 million, respectively, as of June 30, 2022. Investments in limited partnerships are reported at their Net Asset Value (NAV). The NAV of each fund includes the market value of the investments in the fund plus any receivables, payables, and accrued fund expenses.

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(f) Member Loans

Mortgage, personal, and cultural trip loans to plan members in custody are stated at their outstanding principal balance less an allowance for uncollectible amounts. Loans to plan members mostly are collected through payroll withholdings and secured by mortgage deeds, plan members' contributions, and any unrestricted amount remaining in the escrow funds. Act 106-2017 suspended the issuance of new loans effective on August 23, 2017. The maximum amount that was loaned to plan members for mortgage loans was \$100,000 and \$5,000 for personal, and cultural trip loans.

The allowance for personal and cultural loans is estimated using quantitative methods that consider a variety of factors such as historical loss experience, accumulated contributions, death benefits, and payments in transit. The Trust's allowance for mortgage loan losses is based on ASC 450-20 (General Reserve) and ASC 310-10 (Specific Reserve). The allowance for mortgage loan losses is estimated using quantitative methods that consider a variety of factors such as historical loss experience, accumulated contributions, and loan categories. Accordingly, the mortgage loan portfolio is segmented into three categories: performing loans (PLs), which consist of a homogeneous pool of loans that are deemed not impaired; nonperforming loans (NPLs), which are loans in non-accrual status and in the process of evaluation for foreclosure. Performing loans comprise: (i) loans to active participants or retirees, which are considered collectible since the repayment of the loan is guaranteed through payroll/pension withholdings; (ii) loans to separate employees that are current in their payments. Nonperforming loans represent loans for which members are in default and have not made any scheduled payments of principal or interest for some time (at least 90 days).

The Commonwealth, through the Trust, provides life insurance that guarantees the payment of the outstanding principal balance of loans to plan members in case of death of a plan member. The coverage is paid in its entirety by the plan members who obtain these loans from the Trust. Premiums collected for guarantee insurance and benefits claimed are recorded as additions and deductions of the guarantee insurance reserve, respectively. The guarantee insurance reserve for life insurance on loans to plan members is revised each year and adjusted, accordingly, based on the annual higher claim amount of a five-year period increased by a management determined percentage.

(g) Capital Assets

Capital assets under custody include building, building improvements, and furniture and equipment. Capital assets are defined as assets with an initial individual cost of \$500 or more at the date of acquisition and a useful life equal to or in excess of four years. Capital assets are recorded at historical cost, or their estimated historical cost, if actual historical costs are not available. Donated capital assets are recorded at their estimated fair value at time of donation.

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Capital assets are depreciated on the straight-line method over the assets estimated useful life. There is no depreciation recorded for construction in progress. The estimated useful lives of capital assets are as follows:

	Years
Building	50
Buildings improvements	10
Equipment, furniture, fixtures, and vehicles	5–10

(h) Fund Balance (Deficit)/Net Position (Deficit)

Fund Balance (Deficit)

The fund balance for the General Fund is reported in classifications based on the extent to which the Trust is bound to honor constraints on the specific purposes for which amounts in the fund can be spent.

- Fund balance is reported as non-spendable when the resources cannot be spent because they are either in a non-spendable form or legally or contractually required to be maintained intact. There was no non-spendable fund balance as of June 30, 2022.
- Fund balance is reported as restricted when the constraints placed on the use of resources are either externally imposed by creditors, grantors, contributors, or laws or regulations of other governments; or imposed by law through constitutional provision or by enabling legislation. There was no restricted fund balance as of June 30, 2022.
- The Trust's highest decision-making level of authority rests with the Retirement Board. Fund balance is reported as committed when the Board passes a resolution that places specified constraints on how resources may be used. The Retirement Board can modify or rescind a commitment of resources through passage of a new resolution. There was no committed fund balance as of June 30, 2022.
- Resources that are constrained by the government's intent to use them for a specific purpose but are neither restricted nor committed, are reported as assigned fund balance. Intent may be expressed by the Retirement Board. There was no assigned fund balance as of June 30, 2022.
- Unassigned fund balance represents fund balance that has not been restricted, committed, or assigned and may be utilized by the Trust for any purpose.

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Net Position (Deficit)

Net position represents the difference between assets and liabilities in the government-wide financial statements. Net position is displayed in the following components:

- Net investment in capital assets – This consists of capital assets, less accumulated depreciation and amortization. There was no net investment in capital assets net position as of June 30, 2022.
- Restricted – This consists of net position that is legally restricted by outside parties or by law through constitutional provisions or enabling legislation. When both restricted and unrestricted resources are available for use, generally it is the Trust's policy to use restricted resources first, then unrestricted resources when they are needed. There was no restricted net position as of June 30, 2022.
- Unrestricted – This consists of net position that does not meet the definition of restricted or net investment in capital assets.

The following is a reconciliation between the General Fund balance sheet and the statement of net position (deficit) at June 30, 2022:

Fund balance:	\$	—
Add capital assets, net of accumulated depreciation, and other assets as they are not financial resources and, therefore, are not reported in the general fund		2,881
Less long-term liabilities are not due and payable in the current period and, therefore, are not reported in the General Fund:		
Due to Commonwealth		(2,881)
Net deficit position	\$	<u>—</u>

The following is a reconciliation of the statement of revenues, expenditures, and changes in fund balances of general fund to the statement of activities for the fiscal year ended June 30, 2022:

Net changes in fund balance:	\$	398,586
Some gains reported in the Statement of Activities do not provide current financial resources and, therefore, are not recognized as gains in governmental funds		3,345,047
Some expenses reported in the Statement of Activities do not require the use of current financial resources and, therefore, are not reported as expenditures in governmental funds		(30,390)
Change in net position	\$	<u>3,713,243</u>

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(i) Recently Issued Accounting Pronouncements

The following new accounting standards have been issued but are not yet effective during the fiscal year ended June 30, 2022:

- GASB Statement No. 96, Subscription-Based Information Technology Arrangements. This Statement provides guidance on the accounting and financial reporting for subscription-based information technology arrangements (“SBITAs”) for government end users (governments). This Statement (1) defines a SBITA; (2) establishes that a SBITA results in a right-to-use subscription asset—an intangible asset—and a corresponding subscription liability; (3) provides the capitalization criteria for outlays other than subscription payments, including implementation costs of a SBITA; and (4) requires note disclosures regarding a SBITA. To the extent relevant, the standards for SBITAs are based on the standards established in GASB Statement No. 87, Leases, as amended. The requirements of this Statement are effective for reporting periods beginning after June 15, 2022.
- GASB Statement No. 99 – Omnibus 2022. The objectives of this Statement are to enhance comparability in accounting and financial reporting and to improve the consistency of authoritative literature by addressing (1) practice issues that have been identified during implementation and application of certain GASB Statements and (2) accounting and financial reporting for financial guarantees.
- GASB Statement No. 100, Accounting Changes and Error Corrections – An Amendment of GASB Statement No.62. This Statement defines accounting changes as changes in accounting principles, changes in accounting estimates, and changes to or within the financial reporting entity and describes the transactions or other events that constitute those changes. As part of those descriptions, for (1) certain changes in accounting principles and (2) certain changes in accounting estimates that result from a change in measurement methodology, a new principle or methodology should be justified on the basis that it is preferable to the principle or methodology used before the change. That preferability should be based on the qualitative characteristics of financial reporting—understandability, reliability, relevance, timeliness, consistency, and comparability. This Statement also addresses corrections of errors in previously issued financial statements. The requirements of this Statement are effective for accounting changes and error corrections made in fiscal years beginning after June 15, 2023, and all reporting periods thereafter.

Management is evaluating the effect that these new statements will have on the Trust’s basic statements.

(3) The Trust Title III Case and Confirmation of Joint Plan of Adjustment

For many years, the Trust suffered a fiscal, economic and liquidity crisis. This crisis caused the Trust to be in a significant deficit net position. In response to that crisis, the Trust has gone through a judicially supervised bankruptcy proceeding under Title III of the Puerto Rico Oversight Management and Economic Stability Act (PROMESA). As result of PROMESA, on May 3, 2017 and May 21, 2017, the Oversight Board, at the request of the Governor, commenced Title III cases for the Commonwealth and the Trust, respectively, by filling petitions for relief under this Title III in the United States District Court for the District

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of Puerto Rico (the Title III Court). By commencing a Title III case, the Trust has benefited from an automatic stay prohibiting creditors from pursuing litigation or collecting any debt payments and had the opportunity to adjust its debts through a plan of adjustment.

On July 30, 2021, the Oversight Board—as representative to the Commonwealth, the Trust, and PBA in their respective Title III cases—filed its *Seventh Amended Title III Joint Plan of Adjustment of the Commonwealth of Puerto Rico, et al.* [ECF No. 17629] (the Seventh Amended Plan) and a corrected disclosure statement related thereto [ECF No. 17628], which was approved by the Title III Court.

On October 26, 2021, the Governor signed into law Act 53, which provided legislative approval for the bond transactions contemplated in the Seventh Amended Plan conditioned on the elimination of its monthly pension cut provisions in an amended version of that plan.

On November 3, 2021, the Oversight Board filed its *Modified Eighth Amended Title III Joint Plan of Adjustment of the Commonwealth of Puerto Rico, et al.* [ECF No. 19053] (the Eighth Amended Plan), which further revised the Seventh Amended Plan to eliminate its monthly pension cut provisions consistent with Act 53, among other things. The hearing to consider confirmation of the Eighth Amended Plan commenced on November 8, 2021 and concluded on November 23, 2021. The final modified version of the Eighth Amended Plan was filed on January 14, 2022 [ECF No. 19813-1] (as confirmed, the Plan of Adjustment).

On January 18, 2022, the Title III Court entered its findings of fact and conclusions of law in connection with the Plan of Adjustment [ECF No. 19812] (the Findings of Fact) and an order confirming the Plan of Adjustment [ECF No. 19813] (the Confirmation Order). In both the Confirmation Order and Findings of Fact, the Title III Court found that Act 53 properly authorized the issuance of new bonds and provided adequate means for implementation of the Plan of Adjustment.

Between January 28, 2022 and February 17, 2022, six appeals of the Confirmation Order were filed in the First Circuit, which have all been dismissed. On March 8, 2022, the First Circuit entered an order dismissing the appeal by the Judge's Association [Case No. 22-1098] following a motion to voluntarily dismiss. By March 11, 2022, the First Circuit denied all parties' motions for a stay pending appeal, which allowed the Commonwealth Plan of Adjustment to become effective despite the appeals. On April 26, 2022, the First Circuit affirmed the Commonwealth Plan of Adjustment with respect to the appeal filed by the teachers' associations. See Case No. 22-1080. The teachers' associations filed a petition for a writ of certiorari, which the U.S. Supreme Court denied on November 21, 2022. On July 18, 2022, the First Circuit affirmed the Title III Court's finding that the Commonwealth Plan of Adjustment could not discharge otherwise valid Fifth Amendment takings claims without payment of just compensation. See Case No. 22-1119. That decision was the subject of petition for a writ of certiorari, which the U.S. Supreme Court denied on February 21, 2023. On October 27, 2022, the First Circuit denied another retiree group's appeal of the Confirmation Order's preemption of Acts 80, 81, and 82 for lack of appellate jurisdiction. See Case No. 22-1120. On November 23, 2022, the First Circuit dismissed the credit unions' appeal as moot after dismissing their underlying adversary proceeding claims. See Case No. 22-1079. On August 22, 2023, the First Circuit dismissed the appeal of a milk producer's takings claim, finding that he only held a contract-based settlement claim that could be impaired in bankruptcy. See Case No. 22-1092.

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On March 15, 2022 (the Effective Date), the conditions precedent to the Effective Date of the Plan of Adjustment were satisfied and/or waived by the Oversight Board, and the plan became effective. Accordingly, the Plan of Adjustment has been confirmed and is currently effective as of the date hereof.

As of the Effective Date, the Plan of Adjustment reduced the Commonwealth's total funded debt obligations from approximately \$34.3 billion of prepetition debt to approximately \$7.4 billion, representing a total debt reduction of 78%. This debt reduction will also reduce the Commonwealth's maximum annual debt service (inclusive of COFINA) from approximately \$4.2 billion to \$1.15 billion, representing a total debt service reduction of 73%. Also as of the Effective Date, all of the legacy Commonwealth general obligation bonds, the Trust's bonds, and PBA bonds were discharged, and all of the Commonwealth, the Trust, and PBA obligations and guarantees related thereto were discharged. In addition, all Commonwealth laws that required the transfer of funds from the Commonwealth to other entities have been deemed preempted, and the Commonwealth has no obligation to transfer additional amounts pursuant to those laws. Importantly, effectuating the Plan of Adjustment provides a path for Puerto Rico to access the credit markets and develop balanced annual budgets.

The Plan of Adjustment classified claims into 69 classes, of which the following classes are related to the Trust's creditors who received the following aggregate recoveries as follows:

- ERS Bond Claims (Class 65): 16% recovery consisting of cash and interests in the ERS Private Equity Portfolio; and
- Various categories of General Unsecured Claims (Classes 13, 58, and 66): 21% recovery in cash.

On the Effective Date of the Plan of Adjustment, the Trust's Bonds—which were classified as ERS Bond Claims under Class 65—were discharged and all related litigation dismissed in exchange for a 16% recovery consisting of cash and interests in the Trust's Private Equity Portfolio (defined below). Specifically holders of the Trust's Bonds received (i) \$373 million in cash distributions, with such cash payments being made available from the Trust and the Commonwealth from the purchase of ERS assets, and (ii) \$74 million in cash distribution, equivalent to an interest in the trust portfolio of private equity interests held by the Trust as of the Effective Date (the ERS Private Equity Portfolio), which assets continued to be managed by the Trust and purchased by the Commonwealth, pursuant to an election provided in the Plan of Adjustment (the Bondholder Election).

The Commonwealth Plan of Adjustment preserves all accrued pension benefits for active and retired public employees under Class 51. However, participants of the Retirement System for the Judiciary of the Commonwealth of Puerto Rico (JRS) and Teachers Retirement System of Puerto Rico (TRS) will be subject to a benefits freeze and the elimination of any cost-of-living adjustments (or COLAs) previously authorized under the JRS and TRS pension plans.

In their respective appeals, the teachers' association and judges' association argued that (i) the Commonwealth Plan of Adjustment's freeze of pension accruals and the elimination of COLAs were inconsistent with Act 53 and, therefore, those provisions were unauthorized by the legislature, and (ii) the Commonwealth laws authorizing the continued accruals for the JRS and TRS pension plans were not properly preempted by the Commonwealth Plan of Adjustment. See *In re The Fin. Oversight & Mgmt. Bd.*

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for P.R., Case No. 17-3283-LTS, 2022 WL 620624, at *3-4 (D.P.R. Mar. 3, 2022). The First Circuit rejected these arguments, concluding that the operative provisions of Act 53 conditioned authority to issue securities under the Commonwealth Plan of Adjustment on the elimination of the “Monthly Benefit Modification” in the Seventh Amended Plan, which only concerned accrued pension rights of pension plan participants and retirees, not the defined benefit freeze or elimination of COLAs. See *In re The Fin. Oversight & Mgmt. Bd. for P.R.*, 32 F.4th 67, 81-82 (1st Cir. 2022). In addition, the First Circuit held that PROMESA preempts Commonwealth law—such as the JRS and TRS pension statutes—insofar as those laws purport to dictate contrary to the Commonwealth Plan of Adjustment the Commonwealth’s financial obligations to participants in its pension plans. *Id.* at 78. As a result, the First Circuit affirmed the Title III Court’s Confirmation Order as to the JRS and TRS pension provisions implementing a benefits freeze and the elimination of COLAs.

The completion of the Commonwealth’s restructuring under the PROMESA Title III process and the discharge of claims under the Plan of Adjustment resulted in an aggregate extraordinary gain of approximately \$3.5 billion for fiscal year 2022.

On November 18, 2022, the Commonwealth exercised the options and purchased the Trust’s Private Equity Portfolio. In particular, under the Plan of Adjustment, (i) the Commonwealth was granted an option through April 10, 2023 to purchase the ERS Private Equity Portfolio for \$70,750,000, (ii) in the event the Commonwealth declines to exercise such option, pursuant to the Bondholder Election, ERS bondholders have the option to purchase the ERS Private Equity Portfolio for \$70,750,000, plus such amount as may be necessary to reimburse the Commonwealth for any funded shortfall amounts in connection with the ERS Private Equity Portfolio, and (iii) in the event that the Bondholder Election is not exercised, the Commonwealth shall purchase the ERS Private Equity Portfolio for \$70,750,000.

For general unsecured claims, the Plan of Adjustment provides for separate levels of creditor cash recoveries at each debtor, as applicable. All general unsecured claims against ERS are discharged, and ERS’s general unsecured creditors will receive pro rata cash distributions from a fund established for ERS general unsecured creditors, which consists of \$500,000 plus any net recoveries by the Avoidance Actions Trust allocable to ERS.

For further information, refer to the final versions of the Plan of Adjustment, Findings of Fact, and Confirmation Order, which are available at <https://cases.ra.kroll.com/puertorico/Home-DocketInfo>.

(4) Extraordinary Gain on Extinguishment of Debt

As a result of the Effective Date of the Plan of Adjustment during the fiscal year ended June 30, 2022, an extraordinary gain on extinguishment of debt was recorded in the general fund and in the conversion to full

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accrual of the statement of net deficit as of June 30, 2022. A summary of the extraordinary gain recognized is detailed as follows:

<u>Description</u>	<u>Source</u>	<u>General fund</u>	<u>Accrual basis adjustment</u>	<u>Total extraordinary gain</u>
Accrued interest payable	Discharged	\$ 167,639	443,750	611,389
Bonds payable retired	Discharged	—	2,901,291	2,901,291
Total		<u>\$ 167,639</u>	<u>3,345,041</u>	<u>3,512,680</u>

(5) Deposits and Investments

(a) Deposits

Deposits as of June 30, 2022 consisted of the following (in thousands):

	<u>Carrying amount</u>	<u>Depository bank balance</u>	<u>Amount uninsured and uncollateralized</u>
Deposits in custody of the Trust:			
Deposits with Puerto Rico commercial banks	\$ 24,894	28,120	—
Money market funds	26,629	26,629	—
Total in custody of the Trust	<u>\$ 51,523</u>	<u>54,749</u>	<u>—</u>

Custodial credit risk for deposits is the risk that, in an event of the failure of a depository financial institution, the Trust may not be able to recover deposits or collateral securities that are in the possession of an outside party. The Commonwealth requires that public funds deposited in Puerto Rico commercial banks be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by banks in the Commonwealth's name. Deposits with non-Puerto Rico commercial banks and money market funds are uninsured and uncollateralized, as these entities are exempt from compliance with the collateralization requirement.

(b) COFINA Bonds Restructuring

On February 12, 2019, the *Third Amended Title III Plan of Adjustment of the Puerto Rico Sales Tax Financing Corporation* (the COFINA Plan of Adjustment) was substantially consummated and became effective. As result, COFINA's existing senior and subordinated bondholders, including the Trust, received new senior secured bonds issued by COFINA in accordance with the COFINA Plan of Adjustment. During the year fiscal ended June 30, 2022, COFINA bonds generated unrealized losses of approximately \$23.9 million and is reported as a decrease in due to Commonwealth.

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(c) Fair Value Measurement

The Trust categorizes its fair value measurements within the fair value hierarchy established by GAAP. The hierarchy is based on the inputs used in valuation, gives the highest priority to unadjusted quoted prices in active markets, and requires that observable inputs be used in the valuations when available. The disclosure of fair value estimates in the hierarchy is based on whether the significant inputs into the valuations are observable. In determining the level of the hierarchy in which the estimate is disclosed, the highest level, Level 1, is given to unadjusted quoted prices in active markets and the lowest level, Level 3, to unobservable inputs.

Level 1 – Inputs whose values are based on unadjusted quoted prices for identical instruments in active markets that the Trust has the ability to access.

Level 2 – Inputs whose values are based on quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs are observable.

Level 3 – Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

In instances where inputs used to measure fair value fall into different levels in the fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. The Trust's assessment of the significance of particular inputs to these fair value measurements requires judgment and considers factors specific to each investment. Investments measured at Net Asset Value (NAV) as practical expedient are not subject to level classification.

The table below shows the fair value leveling of the Trust's investments:

<u>Investment type</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Investments measured at fair value:				
COFINA bonds	\$ —	117,405	—	117,405
Investments measured at NAV as practical expedient:				
Investments in limited partnerships				<u>57,712</u>
Total Investments			\$	<u><u>175,117</u></u>

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The Trust's investments are exposed to custodial credit risk, credit risk, concentration of credit risk, foreign currency risk, and interest rate risk. Following is a description of these risks as of June 30, 2022:

(i) *Custodial Credit Risk*

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the Trust may not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. At June 30, 2022, securities investments were registered in the name of the Trust and were held in the possession of the Trust's custodian banks.

(ii) *Credit Risk*

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. COFINA Bonds has not been rated as of June 30, 2022.

(iii) *Concentration of Credit Risk*

Concentration of credit risk is the risk of loss attributed to the magnitude of the Trust's investment in a single issuer. As of June 30, 2022, all investments in COFINA Bonds and in limited partnerships, maintained by the Trust represent 5% or more of the Trust's total investments.

(iv) *Interest Rate Risk*

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment.

The contractual maturity of investments as of June 30, 2022, is summarized below (in thousands). Expected maturities will differ from contractual maturities, because counterparties may have the right to call or prepay obligations with or without call or prepayment penalties.

<u>Investment type</u>	<u>Maturity (in years)</u>				<u>Total</u>
	<u>Within one year</u>	<u>After one to five years</u>	<u>After five to ten years</u>	<u>After ten years</u>	
Bonds and notes:					
COFINA bonds	\$ —	—	—	117,405	<u>117,405</u>
Total investments					<u>\$ 117,405</u>

(v) *Investments in Limited Partnerships*

The fair value of investments in limited partnerships at June 30, 2022, amounted to approximately \$57.7 million and is presented as private equity investments in the statement of net position. The allocations of net gains and losses to limited partners are based on certain percentages, as established in the limited partnership agreements.

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In accordance with the partnership agreements, the Trust's investments can only be redeemed upon distribution from funds managers; usually in the form of a sale of its holdings or dividends distributed. As of June 30, 2022, the Trust does not intend to sell its investments in limited partnerships for an amount different to that presented in the financial statements. Refer to Note 11 to these financial statements for subsequent events on the purchase option exercised by the Commonwealth pursuant to the terms of the Plan of Adjustment.

As of June 30, 2022, the date of commitment, total commitment, 2022 contributions, contributions to date at cost, and estimated fair value of investments in limited partnerships are as follows (in thousands):

	<u>Date of commitment</u>	<u>Total commitment</u>	<u>2022 Contributions</u>	<u>Unfunded commitments</u>	<u>Estimated fair value</u>
Grupo Guayacán, Inc.:					
Guayacán Fund of Funds II, LP	September 1999	\$ 25,000	—	1,319	305
Advent-Morro Equity Partner, Inc.:					
Guayacán Private Equity Fund, LP	February 1997	5,000	—	355	5,086
Guayacán Private Equity Fund II, LP	April 2007	25,000	—	453	9,770
Venture Capital Fund, Inc.	October 1995	800	—	—	910
GF Capital Management and Advisors, LLC – GF Capital Private Equity Fund LP	December 2006	25,000	—	7	14,802
MCOY Investments	December 2016	10,000	—	—	22,947
Phoenix	July 2016	10,000	—	—	—
Terracap	July 2016	6,829	—	—	3,993
Total		<u>\$ 107,629</u>	<u>—</u>	<u>2,134</u>	<u>57,813</u>

(vi) *Net Appreciation/(Depreciation) in Fair Value of Investments*

For the year ended June 30, 2022, the net appreciation in fair value of investments amounted to approximately \$58.6 million and was recorded as an increase in due to Commonwealth. The segregated net appreciation in fair value is as follows (in thousands):

<u>Investment type</u>	<u>Realized gain/(loss)</u>	<u>Unrealized gain/(loss)</u>	<u>Net appreciation/ (depreciation) in fair value of investments</u>
Bonds and notes	\$ —	(23,942)	(23,942)
Investments in limited partnerships	3,864	3,679	7,543
Total investments	<u>\$ 3,864</u>	<u>(20,263)</u>	<u>(16,399)</u>

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(6) Claim Receivable from Public Entity Trust

On November 29, 2018, the Government Development Bank for Puerto Rico (GDB) completed a restructuring of certain of its indebtedness pursuant to a Qualifying Modification under Title VI of PROMESA (the GDB Qualifying Modification). Under the GDB Qualifying Modification, and pursuant to Act No. 109 of 2017, also known as the Government Development Bank for Puerto Rico Debt Restructuring Act (the GDB Restructuring Act), the balance of liabilities owed between the Commonwealth and its agents, instrumentalities and affiliates, including the Trust (each a Non-Municipal Government Entity) and GDB were determined by applying the outstanding balance of any deposits held at GDB in a Non-Municipal Government Entity's name against the outstanding balance of any loan of such Non-Municipal Government Entity owed to GDB or of any bond or note of such Non-municipal Government Entity held by GDB as of such date. Those Non-Municipal Government Entities having net claims against GDB after giving effect to the foregoing adjustment, including the Trust, received their pro rata share of interests in a newly formed trust created by the GDB Restructuring Act, the Public Entity Trust (the PET) (which included a total PET Claim of approximately \$32.9 million). The interests received against the PET was deemed to be in full satisfaction of any and all claims the Authority may have against GDB and the Trust.

Prior to the closing of the Qualifying Modification, on October 5, 2018, GDB, the Puerto Rico Fiscal Agency and Financial Advisory Authority, the Financial Oversight and Management Board for Puerto Rico and the Official Committee of Unsecured Creditors of All Title III Debtors (Other Than COFINA) (the "Committee") entered a stipulation (the "Stipulation") resolving certain litigation that had been commenced by the Committee challenging the GDB Qualifying Modification. The U.S. District Court for the District of Puerto Rico entered an order on the Stipulation on October 9, 2018.

Under the Stipulation, GDB agreed to transfer to the PET any cash that remained at GDB after satisfaction of the obligations pursuant to certain cash adjustments for which such cash was retained under the GDB Restructuring in an aggregate amount up to \$10 million (the "Contingent Settlement Cash"). The Contingent Settlement Cash, if any, would be applied as partial payment of the remaining claims that the Puerto Rico Electric Power Authority ("PREPA") and the Trust have against the PET.

On February 2, 2022, the PET transferred \$905,000 to the Trust in partial satisfaction of the Contingent Settlement Cash, pursuant to the terms of the Stipulation.

The remaining assets of the PET consist of, among other items, an unsecured claim of \$578 million against the Commonwealth, which is the subject of a proof of claim filed in the Commonwealth's Title III case (the PET Claim). Non-Municipal Government Entities' recoveries on account of their interests in the PET will depend upon the recovery ultimately received by the PET on account of the PET Claim and other PET Assets. As discussed in Note 3, the Commonwealth Plan of Adjustment discharges any claim related to budgetary appropriations, including appropriations for the repayment of certain loans held by the PET. As

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of the date hereof, the Court has not determined if the PET Claim is an allowed claim that will be entitled to a distribution. As a result, units received from the PET were accounted for with a carrying value of zero:

	Pro rata share of interest in the PET		
	Balance	Allowance	Book balance
Claim receivable	\$ 27,606,953	(27,606,953)	—

During the year ended June 30, 2022, no partial payments were received.

(7) Member Loans and Interest Receivable

As of June 30, 2022, the composition of loans and interest receivable from plan members is summarized as follows (in thousands):

Loans receivable:		
Personal	\$	48,993
Mortgage		131,425
Cultural trips		5,012
Total loans to plan members		185,430
Accrued interest receivable		11,109
Less:		
Escrow funds of mortgage loans and guarantee insurance reserve		(8,126)
Allowance for loan losses, including interest		(19,267)
Total loans and interest receivable from plan members – net	\$	169,146

The originations of mortgage loans were frozen in December 2013 and those related to personal and cultural loans were frozen in November 2016.

The allowance for loan losses is considered a general allowance for all categories of loans and interest receivable, except for mortgage loans. For personal and cultural loans, the allowance for loan losses (ALLL) is determined using the specific allowance for loans losses methodology. The ALLL for personal and cultural loans consider all loans categories, including interest receivable. Mortgage loans portfolio is segregated into two categories to determine the ALLL: (i) loans subject to specific reserve; and (ii) loans subject to general reserve.

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(8) Capital Assets

Capital assets in custody of the Trust's activity for the year ended June 30, 2022 was as follows:

	Beginning balance	Increases	Decreases	Ending balance
Capital assets depreciable:				
Equipment	\$ 2,443	—	(49)	2,394
Office furniture	2,663	—	(105)	2,558
Vehicles	82	—	—	82
Total capital asset, depreciable	5,188	—	(154)	5,034
	Beginning balance	Increases	Decreases	Ending balance
Less accumulated depreciation and amortization for:				
Equipment	\$ 2,387	26	(49)	2,364
Office furniture	2,525	72	(100)	2,497
Vehicles	82	—	—	82
Total accumulated depreciation and amortization	4,994	98	(149)	4,943
Total capital asset depreciable	194	(98)	(5)	91
Capital assets, net	\$ 194	(98)	(5)	91

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(9) Bonds Payable

Bonds payable activity for the year ended June 30, 2022 is as follows (in thousands):

	<u>Balance at June 30, 2021</u>	<u>Accretion</u>	<u>Debt Retired</u>	<u>Balance at June 30, 2022</u>
5.85% to 6.45% Term and Capital Appreciation Bonds Series A	\$ 1,645,965	4,556	(1,650,521)	—
6.25% to 6.55% Term and Capital Appreciation Bonds Series B	1,370,520	25,596	(1,396,116)	—
6.15% to 6.50% Term and Capital Appreciation Bonds Series C	303,061	237	(303,298)	—
Unamortized Bond discounts	<u>(5,047)</u>	<u>153</u>	<u>4,894</u>	<u>—</u>
Total	<u>\$ 3,314,499</u>	<u>30,542</u>	<u>(3,345,041)</u>	<u>—</u>

As discussed in Note 3 to these financial statements, on January 18, 2022, the Title III Court confirmed the Plan of Adjustment for the Commonwealth, PBA, and the Trust. The Plan of Adjustment became effective on March 15, 2022. On this Effective Date, all of the Trust's Bond Claims (Class 65) were discharged and all related litigation dismissed in exchange for a 16% recovery consisting of cash and interests in the Trust's Private Equity Portfolio.

Specifically holders of the Trust's bonds received (i) \$373,000,000 in cash distributions, with such cash payments being made available from the Trust and the Commonwealth from the purchase of the Trust's assets, and (ii) interest in a trust holding a portfolio of private equity interests held by the Trust as of the Effective Date (the ERS Private Equity Portfolio), which assets continue to be managed by the Trust up to the date that such assets are purchased by the Commonwealth or holders of the Trust's Bonds Claims, pursuant to an election provided in the Plan (the Bondholder Election). In particular, under the Plan, (i) the Commonwealth is granted an option through April 10, 2023 to purchase the ERS Private Equity Portfolio for \$70,750,000, (ii) in the event the Commonwealth declines to exercise such option, pursuant to the Bondholder Election, the Trust's bondholders have the option to purchase the ERS Private Equity Portfolio for \$70,750,000, plus such amount as may be necessary to reimburse the Commonwealth for any funded shortfall amounts in connection with the ERS Private Equity Portfolio, and (iii) in the event that the Bondholder Election is not exercised, the Commonwealth shall purchase the ERS Private Equity Portfolio for \$70,750,000. On November 18, 2022, the Commonwealth exercised the options and purchased the ERS Private Equity Portfolio. Refer to Note 3 to these financial statements for additional details on the confirmed Plan of Adjustment.

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(10) Related Parties' Transactions

(a) Commonwealth of Puerto Rico

The Trust pays death benefits and refunds of contributions to beneficiaries and terminated members on behalf of the Commonwealth and provides the servicing to loans to participants portfolio, as well as membership services. During the year ended June 30, 2022, the Trust paid on behalf of the Commonwealth approximately \$24.4 million in death benefits and refunds of contributions. Interest income resulting from the loan portfolio servicing amounted to \$9.3 million. These activities were recorded as part of the change in Due to Commonwealth.

During the year ended June 30, 2022, Commonwealth's Treasury Department issued a Circular Letter No. 2022-01 asking the governmental entities to transfer excess of cash identified to the Treasury Secure Account (TSA). Accordingly, the Trust transferred to the TSA account approximately \$587 million, of which approximately \$94.6 million was part of the restricted cash of the Trust and the remaining balance was Commonwealth's cash under custody of the Trust. Therefore, the Trust cash for approximately \$94.6 million was considered as part of the extinguishment of debt transaction of the Trust and the remaining \$492 million was recorded as a reduction of Due to Commonwealth.

(b) Retirement Board of the Government of Puerto Rico

During the year ended June 30, 2022, the Retirement Board began operations as an instrumentality of the Commonwealth and assumed responsibility for the administrative and general expenses of the Trust, JRS, and TRS. Also, the Retirement Board received appropriations from Commonwealths' General Fund for the pension benefits managed by the Trust. Accordingly, during the year ended June 30, 2022, the Trust received transfers of cash from the Retirement Board of approximately \$15.6 million for the payment of refunds of contributions and death benefits to inactive members on behalf of the Commonwealth. The transfer of funds from the Retirement board and the benefits payment to the Trust membership were recorded as a change in Due to Commonwealth.

(11) Contingencies

(a) Litigation Filed by Creditors Against the Trust Before Commencement of the Title III Case

Administración de los Sistemas de Retiro de los Empleados del Gobierno y la Judicatura de Puerto Rico, et. al v. UBS Fin. Servs. Inc. of Puerto Rico, et al., Civ. No. KAC-2011-1067 (803) (P.R. Ct. of First Instance Sept. 29, 2011)

On September 29, 2011, two beneficiaries commenced a derivative suit in the Commonwealth of Puerto Rico Court of First Instance, San Juan Part (the Commonwealth Court), alleging breach of fiduciary duties and breach of contract against the underwriters in the issuance and underwriting of \$3 billion of the Trust bonds in 2008 (the UBS Action). On December 7, 2016, the Commonwealth Court allowed the Trust to intervene and ordered the plaintiffs, which now include the Trust and seven individual plaintiffs (collectively, the Plaintiffs), to file a third amended complaint against the underwriters, including UBS Financial Services Inc. of Puerto Rico (UBS), and related entities (collectively, the UBS Defendants). UBS had served as the lead underwriter of the 2008 ERS bonds.

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Among other things, Plaintiffs allege that by participating as the lead underwriter of the 2008 ERS bonds, UBS violated its contractual, noncontractual and fiduciary obligations to the Trust. The Plaintiffs seek a ruling that UBS is liable to the Trust for over \$800 million for underwriting the 2008 ERS bonds.

On March 6, 2019, Plaintiffs filed the Fourth Amended Complaint against the UBS Defendants, which was accepted by the Commonwealth Court on April 15, 2019. On April 29, 2019, UBS filed its answer and an informative motion regarding its intent to file a counterclaim if the Trust's Title III automatic stay were to be lifted. The proposed counterclaim attached to the informative motion alleges breach of contract and indemnification arising out of the Trust's issuance of the 2008 ERS bonds.

On June 25, 2019, the Oversight Board filed a motion to stay certain contested matters pending confirmation of a proposed plan of adjustment for the Commonwealth. On July 24, 2019, the Title III Court entered an order staying until November 30, 2019, various adversary proceedings and claims objections before it with overlapping issues, including those involving the validity of the Trust bond issuances. UBS contends that the UBS Action in the Commonwealth Court should be stayed pending the Title III Court's resolution of alleged common legal issues.

On October 8, 2019, UBS filed a motion for relief from the automatic stay in order to assert counterclaims in the Commonwealth Court for breach of contract and indemnification against the Trust in the UBS Action. UBS asserted that the Trust represented in the 2008 Bond Offering Statements that it was issuing the 2008 ERS bonds in accordance with the authority provided under the Retirement Act, and that the 2008 ERS bonds would be legally binding special obligations of the Trust. UBS also argued that the Trust represented in the purchase contracts entered into with UBS that the Trust had full right, power and legal authority to issue the bonds, and it was not in violation of any law. On December 11, 2019, the Title III Court held a hearing on UBS's stay relief motion. On December 16, 2019, the Title III Court granted UBS limited relief from the stay solely to allow UBS to present its proposed counterclaims in the Commonwealth Court. On February 4, 2020, UBS submitted its counterclaims in the Commonwealth Court. On March 9, 2020, the Oversight Board filed its objections to the counterclaims. On March 30, 2020, UBS renewed its stay relief motion, arguing that the Oversight Board's objection to the counterclaims violated the December limited lift-stay order and the Commonwealth Court should now be free to hear the Oversight Board's objections. On April 22, 2020, the Title III Court denied the motion. The case remains pending in the Commonwealth Court and is currently in discovery.

UBS has also filed two proofs of claim against the Trust related to the UBS Action, as well as two proofs of claim related to *Casasnovas Balado v. UBS Fin. Servs., Inc.*, No. K AC-2014-0072 (905) (P.R. Ct. of First Instance Jan. 29, 2016), an action filed by a group of individual plaintiffs arising from the Trust bond issuances.

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(b) Litigation Filed by Creditors Against the Trust After Commencement of the Title III Case

La Liga de Ciudades de P.R. v. The Fin. Oversight & Mgmt. Bd. for P.R., Adv. Pro. No. 21-00026-LTS (D.P.R. March 14, 2021)

On March 14, 2021, La Liga de Ciudades de Puerto Rico (La Liga), a non-profit corporation claiming to have as members mayors of Puerto Rico's municipalities, filed a complaint against the Oversight Board, FAFAA, the Municipal Revenues Collection Center (CRIM), the Puerto Rico Health Insurance Administration (ASES), and Luis M. Collazo Rodríguez, in his capacity as administrator of the System (collectively, Defendants). The complaint alleges that CRIM, ASES, and the System are collecting and withholding money from Puerto Rico's municipalities based on an incorrect interpretation of an order entered in the Act 29 Litigation (discussed above), in which the Title III Court declared Act 29 “unenforceable and of no effect.”

After the order in the Act 29 Litigation went into effect, CRIM held back funds that otherwise would have been disbursed to the municipalities in order to pay ASES and the System the health care and retirement contributions that, but for Act 29, would have been made during the period prior to the effective date of the Act 29 Litigation order. La Liga contends those debts are “inexistent,” because the order did not apply retroactively. Accordingly, La Liga seeks (i) a declaratory judgment “decreeing that the debts claimed by CRIM, ASES and [the System] ... are “inexistent” and that the withholdings made by CRIM to purportedly offset those inexistent debts are “illegal”, (ii) an injunction “prohibiting Defendants from collecting from the municipalities any of the monies that Law 29 exempted them” from paying prior to the effective date of the order, (iii) an order requiring CRIM to immediately disburse any funds withheld to pay for the Act 29-related debts, and (iv) an order requiring the System and ASES to return to CRIM “any and all monies” received to pay the purported debts.

On *May* 14, 2021, the Oversight Board and FAFAA (on behalf of the other government defendants) filed separate motions to dismiss. All briefing on the motions to dismiss was completed on *July* 14, 2021. On *November* 2, 2021, certain members of the *U.S.* House of Representatives filed a motion for leave to participate in this case with amicus curiae “plus” status, which would grant the *U.S.* House members full participation rights in the La Liga litigation. On *November* 15, 2021, the Oversight Board filed its response in which it did not object to the Title III Court accepting the amicus brief but objected to *U.S.* House members’ “plus” status in this case. The *U.S.* House members filed a reply on *November* 22, 2021.

On January 4, 2022, the Title III Court entered an order granting the motions to dismiss. On January 18, 2022, La Liga filed a notice of appeal in the First Circuit under Case No. 22-1062. Briefing was completed on November 10, 2022 and oral argument was held on December 6, 2022. As of the date hereof, the First Circuit has not issued a decision.

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(12) Subsequent Events

Subsequent events were evaluated through October 20, 2023, the date the financial statements were available to be issued, to determine if such events should be recognized or disclosed in the 2022 financial statements. The subsequent events disclosed below are principally those related to debt activities, including fiscal events and related legislation, both local and federal, that management believes are of public interest for disclosure.

On November 18, 2022, the Commonwealth exercised the option granted by the confirmed Joint Plan of Adjustment in regard to the Trust Private Equity Portfolio.

On February 24, 2023, the PET transferred approximately \$1.3 million to the Trust, representing its pro rata share of the remaining Contingent Settlement Cash. Upon transfer of approximately \$1.3 million to the Trust, the remaining claims of ERS against the PET were reduced to \$26.3 million.