



PENSION
RESERVE TRUST

FIDEICOMISO DE RESERVA DE PENSIONES

**Commonwealth Plan of Adjustment
Pension Reserve Trust**

**Fund Financial Statements
Fiscal Year Ended June 30, 2023
(With Independent Auditors' Report)**

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KPMG LLP
American International Plaza
Suite 1100
250 Muñoz Rivera Avenue
San Juan, PR 00918-1819

Independent Auditors' Report

Board of Trustees
Puerto Rico Pension Reserve Trust:

Opinion

We have audited the fund financial statements of the Puerto Rico Pension Reserve Trust (the Trust) as of June 30, 2023 and for the year ended June 30, 2023, and the related notes to the 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 financial position of the Trust, as of June 30, 2023, and the changes in its financial position for the year then ended in accordance with U.S. generally accepted accounting principles.

Basis for Opinion

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 opinion.

Emphasis of Matter

As discussed in Note 1, the financial statements of the Trust are intended to present the financial position and changes in financial position of only that portion of the general fund of the Commonwealth of Puerto Rico (the Commonwealth) that is attributable to the transactions of the Trust. They do not purport to, and do not, present fairly the financial position of the Commonwealth, as of June 30, 2023, and the changes in its financial position for the period then ended in accordance with U.S. generally accepted accounting principles. Our opinion is not modified with respect to this matter.

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.

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 opinion. 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.

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
February 27, 2024

Stamp No. E556005 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.

Required Supplementary Information –
Management’s Discussion and Analysis

June 30, 2023

(Unaudited)

Overview

This section presents management’s discussion and analysis of the Commonwealth Plan of Adjustment Pension Reserve Trust’s (the “Pension Reserve Trust” or the “Trust”) financial performance for the fiscal year ended June 30, 2023 and should be read in conjunction with the financial statements, which follow this section.

The Pension Reserve Trust is a Puerto Rico irrevocable public trust duly organized due to the execution of that certain Deed of Public Trust (the “Deed of Trust”), effective as of March 14th, 2022, pursuant to the provisions of Chapter III of Act 219 of August 31st, 2012, as amended (the “Trust Act”) to provide financial support for the Government’s pension obligations under the pay-as-you-go pension system (the “PayGo System”) created pursuant to the provisions of Act 106 of August 23, 2017.

The Guidelines for the Governance and Administration of the Puerto Rico Plan of Adjustment Pension Reserve Trust and Monitoring of Plan of Adjustment Pension Benefits (the “Guidelines”) are incorporated into the Deed of Trust. The Trust is overseen by a five-person board of trustees (the “Pension Reserve Board” or the “Board”), which is tasked with providing independent and professional management of the Trust’s assets. As part of the Modified Eighth Amended Title III Joint Plan of Adjustment of the Commonwealth of Puerto Rico (the “Plan”), the Government of Puerto Rico (the “Government”) has agreed to provide contributions to the Trust on a yearly basis through the fiscal year ending June 30, 2031. These contributions will be received in the form of a base contribution, as well as an additional contribution contingent on the economic performance of the Government.

During fiscal year 2023, the Trust moved into its offices and received the first annual contribution from the Government (the “First Annual Contribution”). The first annual contribution was deposited into the selected interim custodian bank, Banco Popular de Puerto Rico. Subsequently, on March 15, 2023, the Pension Reserve Board selected The Northern Trust Company as the long-term Custodian Bank for the Trust. Furthermore, the Pension Reserve Board established the Investment Committee and Audit & Compliance Committee.

The Financial Statements include the balance sheet and the statement of revenues, expenditures, and change in fund balance. They present the financial position of the Trust as of June 30, 2023, and its financial activities for the year then ended. The notes to the financial statements provide further information that is essential to a full understanding of the financial statements. The notes describe the significant accounting policies of the Pension Reserve Trust and provide detailed disclosures on certain account balances.

The financial statements of the Pension Reserve Trust are prepared in conformity with U.S. Generally Accepted Accounting Principles (“GAAP”) for governments as prescribed by the Governmental Accounting Standards Board (“GASB”) and reported using the current financial resources measurement focus and the modified accrual basis of accounting. Further, this complies with Article 5.7 of the Deed of Trust, which requires the Trust to “... keep accurate records and books of account of all transactions affecting assets of the Pension Reserve Trust, following standards that are generally accepted in public pension funds in the United States”.

Required Supplementary Information –
Management’s Discussion and Analysis

June 30, 2023

(Unaudited)

Investment Strategy

As part of the investment objectives embedded in the Deed of Trust and the Guidelines, the objective of the Trust’s investment program is to generate returns within an appropriately risk-constrained framework, net of reasonable investment fees and expenses, that must serve the intended purposes of the Pension Reserve Trust under the Plan. The above will be achieved by means of a carefully planned and executed long-term investment program as developed and adopted by the Pension Reserve Board (the “Investment Policy Statement”) with expert assistance from its investment advisors. As of June 30, 2023, the investment advisors of the Trust were NEPC.

On May 5, 2023, the Board adopted the Investment Policy Statement. The Pension Reserve Board adopted an investment strategy with the goal of generating enough monies to support pension obligations by investing contributions received from the Government in line with these objectives. The Investment Policy Statement is intended to assist the Pension Reserve Board in carrying out its fiduciary responsibilities for the prudent investment of the assets of the Trust and is designed to set forth the goals, objectives, and risk tolerances of the Pension Reserve Trust’s investment program. The Investment Policy Statement includes the mechanism to effectively supervise, monitor, and evaluate the investment of the assets of the Trust, all in furtherance of the investment objective defined in Section 8.1D of the Guidelines. The objectives of the Investment Policy Statement are based on currently available information, including but not limited to the Government’s Certified Fiscal Plan. If there is a material change in relevant forecasts and projections, the Board could reevaluate the investment strategy and objectives set forth in the Investment Policy Statement.

The Board’s asset allocation plan embodies its decisions to invest portions of the Trust in high-quality fixed income securities (US Treasury Bills, Bonds & Notes, discount notes, investment grade corporate bonds, etc.), equity securities, global fixed income securities, below investment grade corporate bonds, private credit, public market real assets and real estate. As such, the Pension Reserve Board will implement an investment strategy with a flexible approach using target allocations and ranges.

At June 30, 2023, the Trust held investments consisting of short-term U.S. Government Agency obligations in the amount of \$1.466 billion.

All Annual Contributions received from the Government are deposited into the Custodian Bank account and invested in accordance with the Investment Policy Statement approved by the Pension Reserve Board. No material or relevant changes were experienced in the forecast and/or projections as considered in the Investment Policy Statement.

In the instances of additional government contributions, the Board may use a short-term dollar-cost averaging approach. During this period, the PRT will invest the cash proceeds in either the default cash option or an equivalent set of holdings (e.g., treasuries, discount notes, or other government securities).

Required Supplementary Information –
Management’s Discussion and Analysis

June 30, 2023

(Unaudited)

Financial Highlights

- The fund balance of the Pension Reserve Trust increased \$1.5 billion during the year ended June 30, 2023. Total fund balance was \$1.47 billion at June 30, 2023, compared to \$4.4 million at June 30, 2022.
- Net investment income for 2023 was \$45.6 million. As there were no investments held during the year ended June 30, 2022, no investment income was reported.
- Transfers in from the Commonwealth to the Pension Reserve Trust totaled \$1.4 billion during the year ended June 30, 2023, compared to \$5 million during the period ended June 30, 2022.
- Transfers out to the Pension Benefits Council totaled \$578 thousand during the year ended June 30, 2023, compared to \$550 thousand during the period ended June 30, 2022.

Required Supplementary Information –
Management’s Discussion and Analysis

June 30, 2023

(Unaudited)

Condensed Financial Information

Summary balances and activities of the Pension Reserve Trust as of and for the year ended June 30, 2023, and as of and for the period ended June 30, 2022, are presented below:

Summary of fund balance:

	<u>June 30, 2023</u> (In thousands)	<u>June 30, 2022</u> (In thousands)
Assets:		
Cash	\$ 2,022	4,451
Investments at fair value	1,466,491	-
Operating lease right-of-use asset	234	-
Property, plant & equipment – net	16	-
Other assets	63	-
Total assets	<u>1,468,826</u>	<u>4,451</u>
Liabilities:		
Accounts payable	165	-
Accrued expenses	245	18
Personnel related payable	14	-
Operating lease liability	234	-
Withholding taxes	7	-
Total liabilities	<u>665</u>	<u>18</u>
Fund balance – restricted	<u>\$ 1,468,161</u>	<u>4,433</u>

Summary of revenues, expenditures, and change in fund balance:

	<u>June 30, 2023</u> (In thousands)	<u>June 30, 2022</u> (In thousands)
Revenues:		
Interest Income	\$ 45,630	1
Expenditures:		
General government expenditures	1,702	18
Investment expenditures	558	-
Total expenditures	<u>2,260</u>	<u>18</u>
Other financing sources (uses):		
Transfer in - Commonwealth	1,420,936	5,000
Transfer out – Pension Benefits Council (“PBC”)	(578)	(550)
Total other financing sources	<u>1,420,358</u>	<u>4,450</u>
Change in fund balance	1,463,728	4,433
Fund balance, beginning of year – restricted	4,433	-
Fund balance, end of year – restricted	<u>\$ 1,468,161</u>	<u>4,433</u>

Required Supplementary Information –
Management’s Discussion and Analysis

June 30, 2023

(Unaudited)

Pension Reserve Trust Performance for Fiscal Year Ending June 30, 2023

The Trust took receipt of an initial cash contribution of \$1.421 billion on October 1, 2022. From there the Board invested the capital in various cash equivalent assets such as treasury bills, discount notes, and money market funds. For the year ending June 30, 2023, the Pension Reserve Trust portfolio earned 3.0%, net of fees. This rate was in line with a comparable return of 3.1% on the 90-Day US Treasury Bill Index.

The Trust ended the fiscal year with \$1.466 billion in assets, adding over \$45.5 million in earnings. As of June 30, the ending assets were invested almost evenly among US Treasury Bills Due on August 1 and August 29, and a Money Market Treasury Fund with Northern Trust, the Pension Reserve Trust’s custodian bank. As a result, the Trust’s financial position has improved when compared with the period ended June 30, 2022, when the Trustees composing the Pension Reserve Board had only recently been appointed, the \$4.45M initial funding contribution transferred from the Commonwealth had been received, and the process to hire the Trust’s staff had not commenced.

In April 2023, the Board approved a new investment policy statement and a long-term asset allocation strategy, with the stated goal of initiating the new asset allocation policy in early July 2023. The asset allocation policy is as follows: High Quality Fixed Income 55%, Equity 25%, Credit 10%, and Diversification 10%. The policy defines these as follows:

HIGH QUALITY FIXED INCOME: US treasury bills, bonds, & notes, federal agency debt, discount notes, money market funds and other similar instruments, investment grade US dollar denominated corporate bonds.

EQUITY: investments include public market stocks.

CREDIT: Investments include global fixed income, below investment grade corporate bonds, and private credit.

DIVERSIFICATION: Investments include public market real assets, private real estate, and tactical asset allocation strategies.

Other Information

This financial report is designed to provide a general overview of the PRT’s financial results. Additional information can be found on the PRT Board’s website at www.prtpr.org. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Pension Reserve Trust Board via e-mail through comments@prtpr.org or by mail to B5 Tabonuco Street, Suite 216, PMB 355, Guaynabo, Puerto Rico 00968.

Balance Sheet
June 30, 2023
(Dollars in thousands)

	2023
Assets:	
Current assets	
Cash	\$ 2,022
Investments at fair value	
Short-term	1,466,491
Other current assets	63
Total current assets	1,468,576
Noncurrent assets	
Property, plant & equipment – net	16
Operating lease right-of-use asset	234
Total assets	1,468,826
Liabilities:	
Current liabilities:	
Accounts payable	165
Accrued expenses	245
Personnel related payable	14
Current portion of operating lease liability	23
Withholding taxes	7
Total current liabilities	454
Operating lease liability	211
Total liabilities	665
Fund balance – restricted	\$ 1,468,161

The accompanying notes are an integral part of these financial statements.

Statement of Revenues, Expenditures, and Change in Fund Balance

For the Fiscal Year Ended June 30, 2023

(Dollars in thousands)

	<u>2023</u>
Revenues:	
Interest Income	\$ 45,887
Net change in unrealized depreciation on investments	(257)
Total revenues	<u>45,630</u>
Expenditures:	
General government	
Personnel related	360
Trustees	266
Legal counsel	108
Accounting and audit	74
Other professionals	32
Administrative	47
Travel & other reimbursable expenses	46
Start-up costs	769
Total general government expenditures	<u>1,702</u>
Investment expenditures	
Interim custodian	74
Custodian	60
D&O insurance policy	38
Investment consultant & OCIO	386
Total investment expenditures	<u>558</u>
Total expenditures	<u>2,260</u>
Other financing sources (uses):	
Transfer in - Commonwealth	1,420,936
Transfer out – Pension Benefits Council (“PBC”)	(578)
Total other financing sources	<u>1,420,358</u>
Change in fund balance	1,463,728
Fund balance, beginning of year – restricted	4,433
Fund balance, end of year – restricted	<u>\$ 1,468,161</u>

The accompanying notes are an integral part of these financial statements.

Notes to the Fund Financial Statements

June 30, 2023

(Dollars in thousands)

(1) Description of the Pension Reserve Trust

Pursuant to the Modified Eighth Amended Title III Joint Plan of Adjustment of the Commonwealth of Puerto Rico (the "Plan"), the Government of Puerto Rico (the "Government"), and the Financial Oversight and Management Board for Puerto Rico ("FOMB") have established the Commonwealth Plan of Adjustment Pension Reserve Trust (the "Pension Reserve Trust" or the "Trust") to provide financial support for the Government's pension obligations under the pay-as-you-go pension system (the "PayGo System") created pursuant to the provisions of Act 106 of August 23, 2017. The Pension Reserve Trust is a Puerto Rico irrevocable public trust duly organized due to the execution of that certain Deed of Public Trust (the "Deed of Trust"), effective as of March 14th, 2022, pursuant to the provisions of Chapter III of Act 219 of August 31st, 2012, as amended (the "Trust Act").

As outlined in the Deed of Trust and the Guidelines, the Pension Reserve Trust is an independent and separate legal entity from the Government. The Government has the obligation to provide the Trust with initial funding, an annual base contribution (the "Annual Contribution"), and an additional contribution based on the Government surplus (the "Additional Contribution") while remaining responsible for all pension payments, current and future. The Trust is overseen by a five-person board of trustees (the "Pension Reserve Board" or the "Board"), which is tasked with providing independent and professional management of the Trust's assets. Assets under the Trust are irrevocably held by the Board for the exclusive purposes of: (i) paying the operating and administrative expenses of the Trust and the Pension Benefits Council, and (ii) making disbursements to the Government as the Trust's sole beneficiary pursuant to the Guidelines.

An additional entity composed of nine members appointed by different key stakeholders, and some elected by eligible retirees (the "Pension Benefits Council" or the "Council") was established for the purpose of ensuring the Government's compliance with the Plan of Adjustment and the Guidelines in funding the Pension Reserve Trust through annual contributions and shall, along with the Pension Reserve Board, administer requests by the Commonwealth to withdraw funds from the Trust.

Over the next decade, after the close of each fiscal year, the Commonwealth must make deposits to the Pension Reserve Trust based on the annual surplus from the most recent fiscal year. The Annual Contributions are expected for a duration of ten (10) fiscal years, with the final payment anticipated to occur based on the fiscal year ending on June 30, 2031. Most of the deposits are expected to be received as a base contribution by October 1 of each year, although the Additional Contribution is contingent on the economic performance of Commonwealth and may not be known until November of each year. The Trust will commence transferring funds back to the Commonwealth no earlier than 2032, as required to assist the Commonwealth in meeting its pension obligations.

Notes to the Fund Financial Statements

June 30, 2023

(Dollars in thousands)

(2) Summary of Significant Accounting Policies**(a) Basis of Accounting and Financial Statement Presentation**

The preparation of these financial statements is in conformity with generally accepted accounting principles in the United States of America as promulgated for governmental funds by the Governmental Accounting Standards Board. The financial activities of the Pension Reserve Trust are reported as part of the Commonwealth's general fund in the Commonwealth's financial statements. For its reporting purposes, the Trust has presented only governmental fund financial statements, which are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenue is recognized as soon as it is both measurable and available, and net of amounts considered not collectible. Revenue is considered to be available when it is collectible within the current period or soon enough thereafter to pay liabilities of the current period.

The Trust's assets are restricted assets of the Commonwealth and represent only the portion of the Commonwealth's General Fund related to the Trust; therefore, the basic financial statements of the Trust are not intended to present the financial position or changes in financial position of the Commonwealth as a whole in conformity with U.S. generally accepted accounting principles.

(b) Cash and Cash Equivalents

Cash and cash equivalents include deposits and short-term investments held in the Trust's operating bank accounts and custodian bank. Short-term investments include cash held in short-term investment funds and other highly liquid investments. Short-term investments considered cash are recorded at cost, which approximates fair value.

(c) Transfers from the Commonwealth of Puerto Rico

The Commonwealth's Annual Contributions to the Trust are recognized as an other financing source when received.

(d) Transfers to the Pension Benefits Council

Funding of the Council's administrative and operating budget by the Trust is recognized as an other finance use when paid.

(e) Investments

Investment securities are carried at fair value, except for money market investments, which are carried at cost. Fair value is determined based on quoted market prices and quotations received from independent broker/dealers or pricing service organizations. Such quoted market prices are obtained from independent sources.

Notes to the Fund Financial Statements

June 30, 2023

(Dollars in thousands)

Security transactions are recorded on the date the securities are purchased or sold. The cost of a security is the purchase price. The calculation of realized gains (losses) is independent of the calculation of the net change in unrealized appreciation (depreciation) on investments. Realized gains and losses on investments sold in the current year include previously recorded unrealized amounts and are included in net realized gain on investments within the financial statements.

(f) Prepaid Expenses

Expense items of a nature which will benefit future periods are charged to the prepaid expense accounts and are amortized over the term of the expenditure.

(g) Property and Equipment

Property and equipment are stated at cost. Expenditures for repairs and maintenance are charged to operations as incurred, whereas major betterment are capitalized. Depreciation and amortization are computed by the straight-line method based on the estimated useful life of the equipment, but not exceeding the allowed depreciation for tax purposes. They are tested for recoverability whenever events or circumstances indicate that the carrying amount of the asset group may not be recoverable. If the asset group is not recoverable, its carrying amount is reduced to its fair value.

(h) Investment Income

Interest income is recognized based on the coupon rate. Gains and losses on the sale of investment securities are recorded on the trade date and determined using the specific identification method.

(i) Use of Estimates

The preparation of the basic financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the basic financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

(j) Fund Balance

Fund balance is reported as restricted when 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 provisions or by enabling legislation. As the assets held by the Trust are restricted to provide financial support for the Government's pension obligations under the PayGo System in accordance with the Guidelines, and to pay the expenses of the Pension Reserve Board and the Pension Benefits Council, the Trust classifies fund balance as restricted.

Notes to the Fund Financial Statements

June 30, 2023

(Dollars in thousands)

(k) Adoption of New Accounting Pronouncement

Effective February 2023, the PRT adopted GASB Statement No. 87, *Leases*, (GASB No. 87). PRT determines if an arrangement contains a lease at inception based on whether the PRT has the right to control the asset during the contract period and other facts and circumstances. The PRT elected the package of practical expedients permitted under the transition guidance within the new standard, which among other things, allowed it to carry forward the historical lease classification.

The adoption of GASB No. 87 resulted in the recognition of right-of-use-assets and operating lease liabilities of \$241,665 as of March 1, 2023. Results for periods beginning prior to March 1, 2023 continue to be reported in accordance with our historical accounting treatment. The adoption of GASB 87 did not have a material impact on the PRT's results of operations, cash flows or debt covenants. Refer to Note 7 for Description of Leasing Arrangements.

(3) Fair Value Measurements of Investments

GASB Statement No. 72, *Fair Value Measurement and Application*, (GASB No. 72), defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This statement establishes a hierarchy of valuation inputs based on the extent to which the inputs are observable in the marketplace. Inputs are used in applying the various valuation techniques and consider the assumptions that market participants use to make valuation decisions. Inputs may include price information, credit data, interest and yield curve data, and other factors specific to the financial instrument. Observable inputs reflect market data obtained from independent sources. By contrast, unobservable inputs reflect the entity's assumptions about how market participants would value the financial instrument.

In accordance with GASB No. 72, the Trust categorizes the fair value measurements of its investments within the fair value hierarchy established by generally accepted accounting principles. The fair value hierarchy categorizes the inputs to valuation techniques used for fair value measurement into three levels as follows:

- Level 1 – Inputs that reflect quoted prices (unadjusted) in active markets for identical assets or liabilities that the fund can access at the measurement date. An active market is one in which transactions for the assets occur with sufficient frequency and volume to provide pricing information on an ongoing basis.
- Level 2 – Inputs other than quoted prices that are observable for an asset or liability either directly or indirectly, including inputs in markets that are not considered to be active. Fair values are primarily obtained from third-party pricing services for identical or comparable assets or liabilities, such as interest rates, foreign exchange rates, and yield curves that are observable at commonly quoted intervals.

Notes to the Fund Financial Statements

June 30, 2023

(Dollars in thousands)

- Level 3 – Significant unobservable inputs, for example, inputs derived through extrapolation that cannot be corroborated by observable market data. These will be developed based on the best information available in the circumstances. Level 3 inputs will consider the assumptions that market participants would use in pricing the asset, including assumptions about risk (e.g., credit risk, model risk, etc.)

The fair value hierarchy gives the highest priority to Level 1 inputs and the lowest priority to Level 3 inputs. In certain instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

The estimated fair value may be subjective in nature and may involve uncertainties and matters of significant judgment for certain financial instruments. Changes in the underlying assumptions used in calculating fair value could significantly affect the results. Therefore, the estimated fair value may materially differ from the value that could be realized on sale.

The inputs and methodology used for valuing securities or level assigned are not necessarily an indication of the risk associated with investing in those securities.

The following is a summary of the portfolio by inputs used as of June 30, 2023, in valuing Pension Reserve Trust's investments carried at fair value:

		2023		
		Fair value measurements using		
Investments at fair value	Total	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs or not redeemable (Level 3)
Short-Term:				
US Government & Agency Obligations	\$ 1,466,491	-	1,466,491	-
Total Investments	\$ 1,466,491	-	1,466,491	-

Notes to the Fund Financial Statements

June 30, 2023

(Dollars in thousands)

(4) Deposits and Investments Risks**(a) Credit Risk**

Custodial credit risk is the risk that in the event of bank failure, the Pension Reserve Trust's deposits may not be returned. The Trust maintains cash with Banco Popular de Puerto Rico, a major financial institution in Puerto Rico. The combined account balances at a specific financial institution may periodically exceed federally insured limits. The Trust does not have a deposit policy for custodial credit risk. As of June 30, 2022, the Trust's bank balance was \$2,022, and \$1,772 of that amount was exposed to custodial credit risk because it was uninsured and uncollateralized. The Trust, through its consultants, monitors the credit quality of the financial institutions and does not anticipate its nonperformance.

For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Trust will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Trust maintains its investments with Northern Trust, which employs a Global Enterprise Risk Committee to provide oversight and guidance related to risk management strategies, policies, and tolerance levels, including those for credit risk. The Trust does not have a formal custodial credit risk policy.

(b) Market Risk

Since the purpose of the Trust is to provide funds as necessary beginning FY 2032, the initial time horizon for investments is long-term, and investments will be made with the goal of meeting those needs when they ultimately occur. Capital values fluctuate. The Board recognizes that the risk of capital loss is inherent in any investment program seeking an investment return and that investment losses will occur from time to time. To minimize the risk that these fluctuations prevent the Trust from meeting its ultimate objectives, fund assets will be invested in a prudent manner to ensure diversification of investment risks and opportunities.

The Board recognizes that risk must be assumed to achieve the Trust's long-term investment objectives. The Board also understands that the nature of financial instruments and the markets in which it invests involve fluctuations in market value and rates of return. The Board will aim to meet these objectives and limit risk by its asset allocation, and by diversifying assets across asset classes and investment managers. The Board's current risk tolerance is conservative to moderate, which typically means an allocation to equity or other growth-type assets in the range from 20%-45%.

(c) Concentration of Credit Risk

The Board, with the assistance of its investment advisor, manages the Trust's exposure to concentration of credit risk by establishing guidelines that limit the percentage of investment in any single issue or issuer. The Trust has no investments, at fair value, that exceed 5% of the Trust's total investments as of June 30, 2023.

Notes to the Fund Financial Statements

June 30, 2023

(Dollars in thousands)

(5) Property, Plant & Equipment

As of June 30, 2023, net property, plant, and equipment balances are as follows:

Furniture and Equipment	\$ 18
Less: Accumulated Depreciation	<u>2</u>
Net property, plant and equipment	\$ 16

(6) Investment Management and Other Management Fees

Expenses incurred in managing the Trust are charged to the Pension Reserve Trust. These expenses consist of investment advisory fees, custodian fees, council fees, and professional fees, as well as staff salaries and other administrative expenses of the Board.

(a) Investment Advisory Fees

NEPC, LLC ("NEPC") served as the Board's principal investment advisor and Outsourced Chief Investment Officer ("OCIO") in fiscal year 2023. The investment advisors provided the Board with comprehensive investment advisory services, including recommendations on asset allocation, selection of investment managers, and the monitoring of performance of the Pension Reserve Trust.

For the year ended June 30, 2023, investment advisory fees were \$386, which are included in investment consultant fees and investment consultant & OCIO annual fee in the accompanying Statement of Revenues, Expenditures, and Change in Fund Balance.

(b) Custodian Fees

Popular Fiduciary Services, a division of Banco Popular de Puerto Rico, served as Pension Reserve Trust's investment custodian through April 2, 2023. Northern Trust has served as the investment custodian for the Trust since April 3, 2023. During this time, Popular Fiduciary Services and Northern Trust performed all daily transactions, including investment purchases and sales, investment income and expenses for the Trust.

For the year ended June 30, 2023, interim custodian and custodian fees were \$134, and are included in investment interim custodian and custodian in the accompanying Statement of Revenues, Expenditures, and Change in Fund Balance.

(c) Pension Benefit Council Expenses

As provided in Section 1.7 of the Guidelines, the Pension Reserve Board shall promptly transfer appropriate sums into the account for administrative and operating expenses of the Pension Benefits Council for the payment of the Pension Benefits Council's expenses. For the year ended June 30, 2023, the Pension Benefit Council's expenses amounted to \$578 and are included as "Transfer out - Pension Benefits Council ("PBC")" in the accompanying Statement of Revenues, Expenditures, and Change in Fund Balance.

Notes to the Fund Financial Statements

June 30, 2023

(Dollars in thousands)

(d) Other Administrative Fees

For the year ended June 30, 2023, other administrative expenses of the Board, including employee compensation, trustee compensation, legal and other professional fees totaled \$1,702, and are included in the accompanying Statement of Revenues, Expenditures, and Change in Fund Balance.

(7) Description of Leasing Arrangements

The Trust leases an office under an operating lease with 10-year initial terms. While the agreement provides for minimum lease payments, it includes payments adjusted for inflation or for variable payments regarding proportional share of insurance and other common expenses. Variable payments are not determinable at the lease commencement and are not included in the measurement of the lease assets and liabilities. The lease agreement does not include any material residual value guarantees or restrictive covenants.

The following summarizes the line items in the balance sheet, which include amounts for operating leases, as of June 30, 2023:

Operating lease right-of-use assets	\$	234
Current portion of long-term debt of operating lease liabilities		23
Operating lease liabilities		211
Total operating lease liabilities	\$	<u>234</u>

The components of operating lease expenses that are included in "Administrative" in the Statement of Revenues, Expenditures and Change in Fund Balance for the year ended June 30, 2023, were as follows:

Operating lease cost	\$	9
Variable lease cost	\$	8

The maturities of operating lease liabilities as of June 30, 2023, were as follows:

Year ending June 30,		
2024	\$	23
2025		23
2026		23
2027		23
2028		23
Thereafter		119
Total	\$	<u>234</u>

Notes to the Fund Financial Statements

June 30, 2023

(Dollars in thousands)

(8) Subsequent Events

On September 30, 2023, the Pension Reserve Trust received the Annual Contribution for fiscal year 2024 due from the Government in the amount of \$1,003,529.

On October 31, 2023, the Pension Reserve Trust received the Additional Contribution for fiscal year 2024 due from the Government in the amount of \$87,818.