

REPORT OF THE SETTLEMENT TRUSTEE

Civille & Tang PLLC

*Betty Johnson v. Eloy S. Inos, et al., CV 09-0023*

Period Ending December 31, 2013

## I. INTRODUCTION

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Pursuant to an Order dated September 25, 2013, Chief Judge Frances Tydingco-Gatewood appointed Civille & Tang, PLLC, through its principal representative, Joyce C.H. Tang, as the Settlement Trustee. The Settlement Trustee was tasked with managing and overseeing the operations of the Settlement Fund, and performing all acts necessary to carry out and comply with the terms of the Final Amended Stipulation and Agreement of Settlement (the “Settlement Agreement”).

Following the approval of the Settlement Agreement, the Settlement Trustee began the task of transferring assets to the newly created Settlement Fund. This involved the establishment of new accounts, and assignment of existing investment consultant contracts to the Settlement Fund. The NMI Settlement Fund’s website is located at: [www.nmisf.com](http://www.nmisf.com). The website provides general information regarding the composition of the Settlement Fund and other information which may helpful to the retirees, including updates regarding the Settlement Fund, forms, and links to relevant documents and information. The staff of the Settlement Fund is also working on making each retirees’s basic pension account information available to retirees through the website. The status of administrative cases will also be posted on the website.

Under the Settlement Agreement, employees of the NMI Retirement Fund had the option of continuing their status as classified employees of the NMI while at the same time being seconded to the Settlement Agreement. With the exception of one employee, all of the remaining employees elected to be seconded to the Settlement Fund. Governor Inos has approved the secondment of the employees. Under the terms of the Settlement Agreement, the Settlement Fund will reimburse the NMI Retirement Fund for the actual cost of the employees

during the one year secondment, and the employees will retain their status as employees of the NMI Retirement Fund with all of the rights and protections afforded NMI government employees. The transition of the staff to the Settlement Fund was seamless. The Governor and his team were accommodating, responsive and worked with the Settlement Fund to help with the transition.

The Settlement Trustee met with Governor Inos on two occasions, and had regular communications with Ms. Patel, the designated contact person for the NMI Government during the transition period. Ms. Pangelinan, the Settlement Fund Administrator, had daily contact with the Governor and his team as well.

Section 4.0 of the Settlement Agreement requires the NMI Government to make Annual Payments to the Settlement Fund on a quarterly basis. The amount due for FY 2014 is \$25 million, of which \$3,750,000 (15% of \$25,000,000) was due on or before December 31, 2013. The first quarter payment of \$3,750,000 was timely paid. In addition to the Annual Payments, §5.0 of the Settlement Agreement requires the NMI Government to remit the employee and employer contributions (“Additional Contributions”) for Settlement Class members who are employed by the NMI Government or autonomous agencies. As of December 31, 2013, the Settlement Fund received all of the employee contributions, but did not receive all employer contributions. The outstanding employer contributions due from the NMI Government for the pay period October 5, 2013 to January 11, 2014 is \$419,120.19, and an additional amount of \$549,287.56 is due from the autonomous agencies. The combined amount due for employer contributions is \$968,407.75

## II. FINANCIAL REPORT

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### A. Financial Snapshot

For FY 2014, the amount required to cover pension payments and operating expenses of the Settlement Fund is approximately \$51,662,714. Assuming full timely payment of the \$25 million Annual Payment from the NMI Government, after paying pension payments and operation expenses, there will be a shortage of approximately \$26,662,714. In order for the Settlement Fund to meet its monthly financial obligations, the Settlement Fund is drawing down on its investments accounts each month. A snapshot of the monthly inflow and outflow of funds is presented below:

**NMI Settlement Fund FY 2014 Cashflow Schedule**

	Budgeted Operation Expenses	Pension Payments to Retirees	Annual Payments (Monthly)	Minimum Quarterly Payments	Budgeted Monthly Shortfall
October	\$ 215,000	\$ 4,200,000	\$ 4,415,000	\$ -	\$ (4,415,000)
November	\$ 215,000	\$ 4,200,000	\$ 4,415,000	\$ 1,041,000	\$ (3,374,000)
December	\$ 215,000	\$ 4,200,000	\$ 4,415,000	\$ 2,709,000	\$ 3,750,000 \$ (1,706,000)
January	\$ 215,000	\$ 4,200,000	\$ 4,415,000	\$ 2,916,667	\$ (1,498,333)
February	\$ 215,000	\$ 4,200,000	\$ 4,415,000	\$ 2,916,667	\$ (1,498,333)
March	\$ 215,000	\$ 4,200,000	\$ 4,415,000	\$ 2,916,667	\$ 8,750,000 \$ (1,498,333)
April	\$ 215,000	\$ 4,200,000	\$ 4,415,000	\$ 1,666,667	\$ (2,748,333)
May	\$ 215,000	\$ 4,200,000	\$ 4,415,000	\$ 1,666,667	\$ (2,748,333)
June	\$ 215,000	\$ 4,200,000	\$ 4,415,000	\$ 1,666,667	\$ 5,000,000 \$ (2,748,333)
July	\$ 215,000	\$ 4,200,000	\$ 4,415,000	\$ 2,500,000	\$ (1,915,000)
August	\$ 215,000	\$ 4,200,000	\$ 4,415,000	\$ 2,500,000	\$ (1,915,000)
September	\$ 215,000	\$ 4,200,000	\$ 4,415,000	\$ 2,500,000	\$ 7,500,000 \$ (1,915,000)
	\$ 2,580,000	\$ 50,400,000	\$ 52,980,000	\$ 25,000,000	\$ 25,000,000 \$ (27,980,000)

At the beginning of October 2013, the combined Settlement Fund Investment Accounts had a balance of \$128,332,000. *See, Exhibit A (NMI Settlement Fund Wilshire September 2013 Flash Report).* After the disbursement of the PL 17-82 payments in November 2013 totaling

\$40,615,807, the remaining balance in the investment accounts as of December 31, 2013 was \$104,879,000. *See, Exhibit B (NMI Settlement Fund December 2013 Flash Report).*

The Settlement Fund continues to draw down on the Investment Accounts each month to cover the pension payments and operating expenses. The Settlement Fund will continue to draw down on its investment accounts at the rate \$24M to \$27M per year to cover the annual pension payments and operating expenses shortfalls.

The schedule below shows the depletion of the Investment Accounts over the next five (5) years. **Because of the required monthly draw down from the investment accounts, assuming zero investment income from the investment accounts and that the NMI Government will continue to pay the Annual Payments, the investment accounts will be completely depleted by 2019.**

Combined Investment Acct. as of 10/1/13	\$128,322,000
(Less) Final PL17-82 Draw Down	\$ 13,000,000 <sup>1</sup>
Amount Transferred to Settlement Fund 10/1/13	\$113,322,000

	<b>Annual Payment</b>	<b>Annual Shortfall</b>	<b>Declining Investment Account Balance</b>
Year 1 (FY 2014)	\$25M	\$28M	\$85M
Year 2 (FY 2015)	\$27M	\$26M	\$59M
Year 3 (FY 2016)	\$30M	\$23M	\$36M
Year 4 (FY 2017)	\$33M	\$20M	\$16M
Year 5 (FY 2018)	\$45M	\$8M	\$8M
Year 6 (FY 2019)	\$44M	\$9M	(\$1M)

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<sup>1</sup> The Settlement Fund paid out a total of \$40,615,807 for P.L. 17-82 and P.L. 18-02 payments between October – November 2013.

### B. Portfolio Allocation

In order to determine how much risk the portfolio may be able to take, the expected investment horizon is one of the most important consideration. This is because of the fact that risky assets like stocks will reward investors with attractive returns for taking higher risk in the long run, but the return pattern is highly variable. If an investor does not have a long time horizon, the short term volatilities of stock market may deplete the investor's asset base before the market recovery takes place. Generally speaking, "a long time horizon" usually means a ten year investment horizon.

Given the sustained high rates of cash outflow, short expected life and uncertainty whether the NMI Government will continue to meet its annual payment obligations, the Settlement Fund does not have the ability to take on much investment risk in the financial markets. Although a new asset allocation glidepath is being analyzed and considered, it is clear that the portfolio will still be predominantly fixed income based. This means that the expected return for the Settlement Fund will be significantly below an average pension plan's expected return. The combination of continued high outflow of funds coupled with low returns seriously limits the options for earning investment income.

The results of the first quarter FY2014 (period ending on December 31, 2013) are summarized below (*see, Exhibit B, NMI Settlement Fund December 2013 Flash Report, p. 4*):

#### Investments Balances as of 12/31/13

	Ending Balance	Beginning Balance
1. Blackrock	\$ 3,138,000	\$ 3,084,000
2. JP Morgan	\$ 959,000	\$ 959,000
3. Mutual Fund Cash	\$ 721,000	\$ 721,000
4. PIMCO/Richmond Capital	<u>\$ 100,059,000</u>	<u>\$ 100,757,000</u>
	<b>Loss</b>	<b>(644,000)</b>

A WebEx audio presentation updating the financial investments as of December 3, 2013, prepared by the Settlement Fund's investment consultant, Maggie Ralbolvsky of Wilshire Consulting, can be accessed and viewed on the Settlement Fund's website at: <http://www.nmisf.com/documents/>. The presentation materials can be downloaded from the Settlement Fund website as well.

### C. The Settlement Fund Budget

The Settlement Fund's fiscal year begins on October 1, and ends on September 30, the following year. The FY 2014 Budget was developed based on the three months actual expenses incurred from October 1, 2013 to December 31, 2013. See, **Exhibit C** (*NMI Settlement Fund Operating Budget*).

The expenses of the Settlement Fund is broken down into 5 categories:

	Budgeted 2014	Actual 2013	Actual 2012
• Pension and Disability Payments	\$ 49,425,149	\$72,545,613	\$78,491,830
• Wages, Salaries & Employer Expenses	\$ 898,082	\$ 757,074	\$1,087,106
• Consultant and Professional Fees	\$ 822,670	\$ 1,347,241 <sup>2</sup>	\$1,553,630
• General Administrative Expenses	\$ 226,600	\$ 266,076	\$ 321,672
• Other Expenses <sup>3</sup>	\$ 215,000	\$ -0-	\$ -0- -
<b>Total</b>	<b>\$ 51,587,501</b>	<b>\$74,916,004</b>	<b>\$81,454,238</b>

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<sup>2</sup> Approximately \$640,000 of the Professional Fees were paid to the attorneys for the Fund and the Trustee Ad Litem ("TAL"). All payments to attorneys and the TAL were previously approved by the Court. The \$640,000 is an obligation of the NMI Government. Pursuant to the Orders approving the TAL's and attorneys' fees, these amounts are to be reimbursed to the Settlement Fund.

<sup>3</sup> In 2014, the Settlement Fund will be upgrading the computer systems (\$30,000) and acquiring a Benefits Calculation and Audit Software program including travel and training budgeted for \$215,000. This is not a recurring expense.

Beginning on October 1, 2013, pension and disability payments were reduced by 25%. Except for one employee, all of the employees of the NMI Retirement Fund transferred to the Settlement Fund.

Consultant fees and Professional fees include fees for the investment advisor, actuary, auditor, attorneys, the Trustee Ad Litem, and the Settlement Fund Trustee. Maggie Rabolovsky, managing director of Wilshire Consulting, was the NMI Retirement Fund's investment consultant, and she is the Settlement Fund's investment consultant for FY2014. The basic fee charged by Wilshire under its contract with the NMI Retirement Fund in 2013 was \$165,000. In response to an RFP, Wilshire submitted a proposal which offered a reduced basic fee of \$145,000.

Bank of Hawaii is the Custodial Agent and provides all banking services for the Settlement Fund. All bank accounts with the Bank of Guam were closed and new accounts opened at the Bank of Hawaii. This was done to avoid any potential conflicts given that the NMI Government's General Fund is with the Bank of Guam.

The Settlement Agreement provides for Arbitration as the dispute resolution process for the administrative cases. Retired Guam Supreme Court Justice, B.J. Cruz, has agreed to act as the arbitrator for the Settlement Fund. Mr. Robert Torres has agreed to act as conflict arbitrator. The previous Administrative Hearing Officers are Retired Judge, Edward Manibusan, and Attorney Jerry Cody. Subject to Court approval, they will continue to act as Administrative Hearing Officers for the Settlement Fund. The budget for the payment of arbitrator fees and Administrative Hearing Officers is \$100,000.

The budget for the Settlement Fund Trustee's fees is \$180,000. Barring extraordinary circumstances, this amount should be sufficient to cover the trustee's fees.

The Settlement Fund has commissioned the development of a Benefits Calculation and Audit Software program from Wilshire. The software program will be able to calculate and audit member's benefits. The one-time development cost of the software program is \$150,000. An additional \$30,000 was budgeted for training expenses, which includes travel expenses and out of pocket expenses. The software is priced significantly less than the previous software systems quoted or purchased by the Retirement Fund. Previously, the Retirement Fund paid over \$400,000 for a software that was not delivered. In 2013, Buck Consulting, the actuary for the Retirement Fund, quoted \$250,000 to develop a similar software system for the Retirement Fund. The \$150,000 development cost is very reasonable. After the first year, there will be no other changes except a maintenance and licensing fee of \$1,000 per month.

### III. MANAGEMENT REPORT

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#### A. Transfer of Programs

Under the Settlement Agreement, the Health and Life Insurance Program and the Home Mortgage and Credit Program are supposed to be transferred to the NMI Government. In earlier meetings with the Government, there were discussions regarding transferring these programs to a Government agency. The Settlement Trustee will work with the Government to transfer these programs by the end of the second quarter.

#### B. Health and Life Insurance Program

The Aetna Health Insurance Plan expired on December 31, 2013. The Plan was extended for an additional two month period at an increased rate to allow the Government to negotiate with Aetna. Under the 2013 government sponsored health plan, the total premiums paid was \$18 million, of which 50% was paid by the Government and 50% was paid by the employee and retiree. *See, “Gov’t health, life insurance with Aetna expiring”*, Marianas Variety Article dated 12/4/2013. Of the \$9 million paid by the Government, approximately 78% (\$7 million) was for retiree coverage, and 22% (\$2 million) was for active employees’ coverage. *Id.*

The Government finalized its negotiations with Aetna in February 2014. Under the 2014 plan, two health plans will be offered: (1) the Low Option Plan; and (2) the High Option Plan. The main differences between the two plans are the premiums charged and whether provider coverage in U.S. is included in the plan. The Low Option Plan does not include U.S. providers in its network, and the premiums are approximately 20% - 21% less than the High Option Plan.

Retirees who are currently enrolled can choose between the two plans. Retirees who opted out cannot re-enroll as they are prohibited under NMI law. The Settlement Trustee has received inquiries from several Retirees living in the mainland U.S. who previously opted out of

the NMI Government Health Insurance Program asking to re-enroll. They were informed that without a change the law, a Retiree will not be allowed to re-enroll in the Government Health Plan after opting out.

The deductibles for the Low Option and High Option Plans were increased. The deductible amounts under the old plan were \$300 (Single), \$600 (Couple), and \$900 (Family). The new plan increased the deductibles as follows: \$500 (Single), \$1,000 (Couple), and \$1,500 (Family). The increase of deductibles combined with other plan changes such as excluding U.S. in the network of providers, allows the Government to offer a more affordable rate to attract active employees to stay in the plan.

The government sponsored life insurance program will be renewed this year. The rates increased by 11.1% percent across the board. The coverage limit for active employees is limited to 1.8 times the employee's annual salary. The coverage limit for retirees is 1.8 times the reduced pension payments. The maximum coverage for both active employees and retirees is \$90,000.

#### C. Contracts Requiring Court Approval

The contracts requiring Court approval are the Investment Consultant, Benefits and Audit Software Contract, Auditor and Actuary Contract.

The Settlement Fund issued and RFP to contacted five different investment advisory firms to solicit proposals in December 2013. Two of five investment advisory firms responded and informed the Settlement Trustee they were not interested in submitting a proposal. Wilshire was the only firm that submitted a proposal. The proposal met the requirements of the RFP. The basic fee for investment consultant services was \$145,000, which is \$20,000 less than the

amount the NMI Retirement Fund paid in 2013. Wilshire's proposal was accepted by the Settlement Fund, subject to the approval of the Court. A copy of Wilshire's Investment Consultant agreement is attached as **Exhibit D**.

The Settlement Funds requires a software program that is able to calculate the benefits and audit the members' accounts. In the past few years, the calculations were performed manually. Not only was this inefficient, but very costly. The software program is tailored to meet the requirements of the Settlement Fund, and will be operational in late March 2014. The cost to develop the software program is \$150,000, which amount is substantially less than the \$400,000 paid by the Retirement Fund, and the \$250,000 quoted by Buck Consultants. This contract is subject to Court approval. A copy of Wilshire's Benefits Calculation and Audit Software agreement is marked and attached hereto as **Exhibit E**.

The actuary and auditor RFP have been finalized and will be issued shortly.

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## IV.        **LEGAL MATTERS**

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### **A. Administrative Cases**

As of October 1, 2013, the NMI Retirement Fund (the “NMI Fund”) had various pending administrative cases that were filed by NMI Fund members prior to the approval of the Settlement Agreement. These cases were filed under the NMI Fund’s administrative appeal procedures set forth in the NMI Fund’s regulations found at NMIAC §§ 110-10-501 *et seq.* Under the NMI Fund’s regulations, appeals are filed with the NMI Fund’s Board of Trustees, which may decide the matter in the first instance or elect to appoint a hearing officer, in which case the hearing officer issues a recommended decision to the Board which then issues a final decision on the matter. The NMI statutes provide for further judicial review of the Board’s decision.

These pending cases are in various procedural postures. Specifically, five (5) cases filed in 2013 were not heard by the Board (acting through the Trustee Ad Litem) or assigned to a hearing officer. Three (3) cases were designated to be heard by a hearing officer (who were contracted for this purpose), some of which have been heard and are awaiting decision. Six (6) cases were heard by a hearing officer, and the recommended decisions were pending review by the Board. The final category of cases, numbering over 90, is referred to as the “Overtime/Comp-Time” cases (“OT/CT” cases). Mr. Jerry Cody was retained by the Board under contract (issued pursuant to an RFP), to hear and issue a recommended decision in these cases. The Trustee is informed that Mr. Cody has reviewed the case files and is ready and willing to proceed with hearing these cases on a consolidated basis.

A table summarizing the pending administrative cases is attached hereto as **Exhibit F**.

The Trustee has also been informed that several other Settlement Fund Members intend to appeal prior adverse determinations once a dispute resolution procedure is adopted for the Settlement Fund. The Settlement Agreement contemplates that the pending administrative cases filed by Members of the Settlement Fund, as well as future disputes between Members and the Settlement Fund, be adjudicated through review by a hearing officer with the right to appeal to an independent arbitrator whose decision shall be binding without any further right of appeal.

The Settlement Agreement further states that the Trustee has the authority to establish policies to govern the dispute resolution process consistent with due process. The Trustee is currently in the process of drafting a dispute resolution procedure for submission to and approval by the Court. The procedures will provide for initial determination by a hearing officer, with the right to appeal to an independent arbitrator whose decision will be final and binding. The Trustee is using as a drafting guide the existing regulations of the NMI Fund pertaining to the appointment of and review by hearing officers as well as the various sets of arbitration rules promulgated by the American Arbitration Association (AAA) for pension fund disputes. The drafting guides are not exclusive, and the Trustee may integrate the provisions of other adopted dispute resolution rules and procedures that may be relevant and useful in the drafting of the Settlement Fund's procedures.

The proposed dispute resolution procedures will likely provide for the following process with respect to the pending administrative cases: (i) all pending cases that were not assigned to a hearing officer will be treated as newly filed cases; (ii) all case that were assigned to or heard by a hearing officer but were not decided will proceed to decision by the hearing officer and the Member will then be permitted to appeal to the arbitrator whose decision will be final and binding, and; (iii) all cases that were decided at the hearing officer level and were pending

review by the NMI Fund's Board will be permitted to appeal to the hearing officer's recommended decision to the arbitrator whose decision will be final and binding. The Trustee expects to submit the proposed dispute resolution procedure for Court approval by March, 2014.

The Settlement Agreement and the Order appointing the Trustee states that the Trustee may appoint hearing officers and may select the independent arbitrator who shall be approved by the Court. The Trustee contemplates selecting a pool of qualified hearing officers to hear and decided Members' disputes. The Trustee proposes Retired Supreme Court Justice, B.J. Cruz to act as the primary arbitrator to hear appeals, and Mr. Robert Torres, to act as the alternate arbitrator in the event the primary arbitrator is conflicted from deciding any matter. The Trustee's proposed dispute resolution procedures will also outline the grounds and procedure for conflicts and the disqualification of an assigned hearing officer or arbitrator.

The Trustee would like to retain the hearing officers and arbitrators under either an hourly rate or annual set fee contract, to be submitted for approval by the Court. With respect to the pending administrative cases that are awaiting a written decision by a hearing officer and the OT/CT cases that are ready to be heard by Mr. Cody, the Trustee would like to enter into new contracts with these previously retained hearing officers to decide these matters.

For pending administrative cases, the Trustee would like to retain those hearing officers that were previously appointed to hear the matters.

#### B. Merrill Lynch Class Action

Under Section 1.1 of the Settlement Agreement, the "Assets of the CNMI Fund include "Any and all rights the CNMI Fund has relating in any way to the proceeds arising from the assigned claims asserted in the action styled, *Taitano et al. v. Merrill Lynch, Pierce, Fenner &*

*Smith, Inc.* which is currently pending in arbitration before the Financial Industry Regulatory Authority . . .”

As was stated in the Court in the Report of the Trustee Ad Litem (“TAL Report”) filed on January 10, 2013 (Document Number 348-1), with regard to the case *Taitano v. Merrill Lynch*, NMI Superior Court Case No. CV 11-0230, the NMI Retirement Fund had, at the time of the TAL Report, settled their part of the case and assigned its claims to the plaintiff/fund beneficiary who seeks to recover from Merrill Lynch on various grounds including investment negligence. The assignment of claims document provides for the payment of attorney’s fees (on a contingency basis) and costs to the Plaintiffs’ attorneys in the event of recovery against Merrill Lynch.

Arbitration has been ordered and the litigation stayed. The case is currently being arbitrated before the Financial Industry Regulatory Authority (FINRA) under docket number 12-02942. The Settlement Fund continues to assist the plaintiff with regard to the production of documents and other matters consistent with the Settlement Fund’s interests. The Trustee is analyzing the claims in the FINRA arbitration.

Respectfully submitted this 11<sup>th</sup> day of February, 2014.

CIVILLE & TANG, PLLC

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Joyce C.H. Tang  
Settlement Trustee