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# Think Strategically

## Puerto Ricans Are Paying for Failure: How PREPA's Collapsed Pension Plan Became a Hidden Tax

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### Why PREPA's Pension Needs a Haircut

If you work in Puerto Rico's private sector, you know the reality: there is no guaranteed pension waiting for you. You save what you can, maybe contribute to a 401(k) if your employer offers one, and count on Social Security and discipline to sustain you in retirement. Across the United States, only about **53 percent** of private-sector workers have access to any employer-sponsored retirement plan, and barely **15 percent** participate in a traditional defined-benefit pension. This kind pays a fixed income for life. In Puerto Rico, where nearly **three out of every four jobs** are in the private sector, most families rely entirely on personal savings rather than a public pension.

Yet since late 2024, every time Puerto Ricans pay their electricity bill, they are quietly funding someone else's retirement. Embedded within the Puerto Rico Electric Power Authority's (PREPA) rate structure is a new charge—money not used to modernize the grid, strengthen resilience, or expand renewable energy, but to cover the cost of PREPA's **collapsed pension fund**.

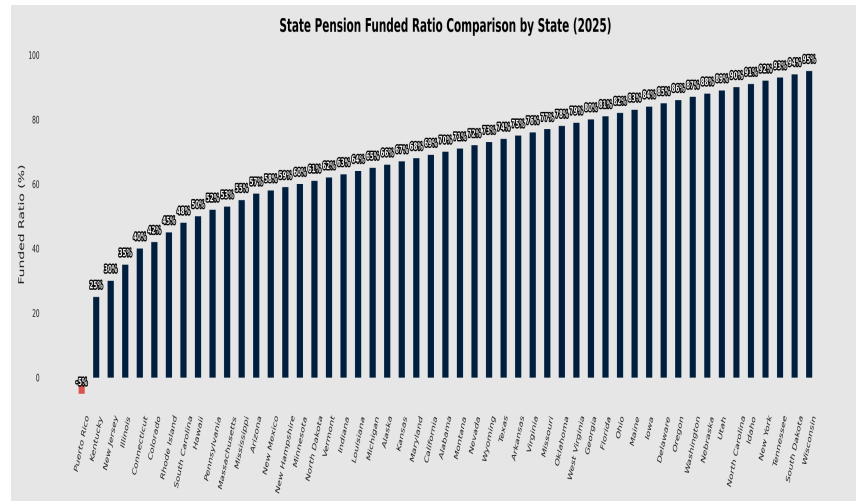
Ordinary citizens—many without retirement coverage—are now financing the unfunded promises of a bankrupt utility. It is a regressive, hidden tax that penalizes workers who have saved for themselves while protecting those who benefited from a structurally unsustainable system.

### A Decade of Losses and Fiscal Evasion

PREPA's financial collapse did not happen overnight. For more than a decade, the utility operated at a loss—hundreds of millions of dollars per year—while postponing critical reforms. Instead of modernizing operations or aligning labor costs with fiscal realities, PREPA borrowed heavily and deferred maintenance. Mismanaged fuel contracts, political patronage, and cost overruns eroded its balance sheet. Auditors and internal managers issued repeated warnings about the growing pension deficit and the lack of actuarial discipline. Yet the response was silence and self-preservation. Payrolls continued to grow, executive bonuses were maintained, and the pension fund received only partial employer contributions.



### U.S. States and Puerto Rico Pension Funded Ratio Comparison 2025



By 2024, the system's reserves were exhausted. PREPA's pension fund officially **ran out of assets**, and retiree payments began to flow directly from electricity revenues—shifting a purely employer obligation onto Puerto Rico's 1.2 million ratepayers.

### Three Decades of Actuarial Neglect

The roots of PREPA's pension crisis trace back more than three decades. The Employees' Retirement System (ERS) once stood as a model of fiscal strength. In the **1980s**, the plan was **\*\*fully funded—indeed, slightly over 100 percent—\*\***with consistent contributions and strong investment returns. But the decline began in the **early 1990s**, when PREPA started **missing employer contributions** while **expanding benefits**. By the **late 1990s**, the plan had already fallen below the **80 percent funding benchmark**, a threshold that signals actuarial underfunding.

Between **2000 and 2010**, PREPA **repeatedly failed to make the actuarially required contributions**. Despite mounting losses, pension formulas remained untouched, and early-retirement incentives multiplied. By 2009, the plan's **unfunded liability exceeded \$1.7 billion**.

According to the **Fiscal Oversight and Management Board's October 2025 analysis**, the system's funding ratio continued its steep descent—from **around 60 percent in 2007**, to **40 percent in 2014**, to complete **insolvency by 2023**. The Board attributed this collapse to *"inconsistent contributions and unrealistic actuarial assumptions,"* noting that earlier projections had been *"overly optimistic about investment returns and discount rates."* More realistic assumptions adopted in 2010 and 2017 exposed the accurate scale of the system's liabilities.

By 2016, the funding ratio hovered near **17–20 percent**, and the Oversight Board formally classified the plan as **"critically underfunded."**

When the collapse came in 2023, the fund had no assets left to liquidate. PREPA's **10,000 retirees** and **2,400 surviving spouses** began receiving roughly **\$24 million per month**, financed directly through ratepayer charges rather than investment income or employer contributions. Today, PREPA's **unfunded actuarial liability stands at nearly \$3.8 billion**, with an **effective funding ratio of approximately 15 percent**. The system is no longer merely underfunded—it is **fully unfunded**, and every Puerto Rican ratepayer now bears the cost of its insolvency.

### Self-Awarded Benefits and Structural Mismanagement

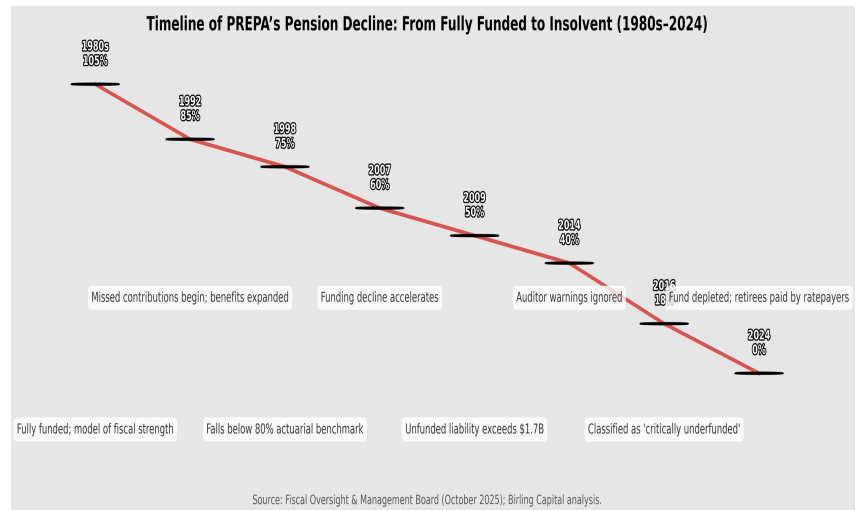
For decades, PREPA's pension system operated as if it were immune from financial gravity. The Employees' Retirement System was **self-governed**, with its own board empowered to expand benefits without independent actuarial review or external oversight. This lack of accountability created a feedback loop of self-awarded generosity and chronic underfunding.

Over time, both employees and management approved provisions that made the plan increasingly expensive and unsustainable:

- **Participants hired before January 1, 1993:** Eligible for retirement at **age 60 or upon attaining 20 years of service**.



### Timeline of PREPA's Pension Decline: From Fully Funded to Insolvent



- **Participants hired on or after January 1, 1993:** Eligible for retirement at **age 60 with 5 years of service, age 65 regardless of service, 20 years of service, or at age 50 with 30 years of service.**
- **Benefit calculations** were based on the average of final-year salaries—an approach that inflated payouts during periods of salary acceleration.
- **Automatic cost-of-living increases** were granted without corresponding funding sources or actuarial validation.

None of these enhancements was accompanied by the contributions or investment performance necessary to sustain them. The result was a structurally unbalanced system: benefits rose, assets shrank, and long-term solvency vanished.

The final blow came during the **privatization of PREPA's operations between 2020 and 2023**, when responsibilities were transferred to **LUMA Energy** for transmission and distribution and to **Genera PR** for generation. While privatization aimed to modernize Puerto Rico's electrical system, it inadvertently crippled the pension fund's revenue base.

**LUMA Energy now employs more than 4,000 workers**, the majority of them former PREPA employees. However, these workers were hired under private-sector labor structures and **no longer contribute to PREPA's pension system**. Their transfer, together with early retirements triggered by the restructuring, severed the plan's last reliable stream of payroll contributions.

At the same time, PREPA's internal workforce fell **from approximately 6,000 employees to just 259**, leaving the pension plan virtually devoid of active participants. Many departing employees withdrew their accumulated balances, further draining liquidity and hastening insolvency.

While no public source confirms exactly how many employees ultimately joined **Genera PR**, Oversight Board filings suggest only a small complement—around one hundred positions—was recruited to operate legacy generation assets. In effect, nearly the entire payroll base that once supported PREPA's pension system disappeared.

The **Fiscal Oversight and Management Board** also identified serious governance failures. It found that the **Board of Trustees of the Retirement System** granted disproportionate influence to **UTIER**, PREPA's main labor union, and relied on **overly optimistic actuarial assumptions** about investment returns and discount rates. These weaknesses allowed the fiscal gap to widen unchecked, postponing reform until insolvency became unavoidable.

Ultimately, PREPA's pension fund collapsed under the weight of **self-awarded benefits, optimistic assumptions, and structural mismanagement**. By the time reform became unavoidable, the system had already exhausted its assets—leaving the burden squarely on the shoulders of Puerto Rico's ratepayers.

## The Legal Foundation: Why Ratepayers Have Standing

Puerto Rican citizens now have both the **legal standing** and **moral authority** to challenge the pension surcharge embedded in PREPA's rates.

### 1. Standing

Ratepayers are directly harmed by higher electricity costs that include non-service-related charges.

- **Causation:** The harm flows directly from the rate structure approved by the Puerto Rico Energy Bureau (PREB).
- **Redressability:** A court could strike down or modify the unlawful rate, providing tangible relief.
- Each electricity bill is evidence of harm—satisfying the constitutional test for standing.

### 2. Act 57-2014: The Legal Framework

Puerto Rico's Energy Transformation and RELIEF Act (Act 57-2014) requires that all energy rates be "just, reasonable, and non-discriminatory." Charging consumers for liabilities unrelated to energy production or service violates that mandate. PREB's role is to regulate cost-based energy rates—not to act as a collection agent for insolvent pension systems.

### 3. Constitutional Considerations

Beyond statutory law, this practice raises profound constitutional concerns:

- **Due Process:** Imposing financial obligations unrelated to a legitimate public purpose is arbitrary.
- **Equal Protection:** It discriminates against the pension-less majority, forcing private-sector workers to subsidize a privileged class.
- **Taxation Without Representation:** By embedding the charge within utility rates, PREPA effectively imposes a tax without legislative approval.

### PROMESA's Limits and the Path to Accountability

While the **PROMESA Act** shields many fiscal-plan decisions from judicial review, that immunity does not extend to administrative acts that violate Puerto Rican law. Courts can distinguish between a non-reviewable budgetary policy and a reviewable rate action that contravenes Act 57-2014.

Furthermore, **sovereign immunity** does not protect agencies acting beyond their lawful powers. This distinction opens a narrow but crucial path for citizens and consumer advocates to challenge the pension charge in court.

### The Economic Reality: A Tax Without a Name

Puerto Rico now faces what economists would call a **non-transparent intergenerational transfer**. It is not merely an electricity rate—it is a **tax without a name**.

A worker earning \$28,000 a year with no pension must now subsidize someone else's \$2,500 monthly benefit. That is not fiscal discipline; it is moral inversion.

When the pension fund collapsed, policymakers chose not to reform the system or reduce benefits. Instead, they transferred the cost quietly to the people—without hearings, consent, or accountability. If this precedent holds, any failed public pension could be disguised as a "rate adjustment." Such a mechanism undermines transparency, equity, and the rule of law. It is not governance—it is systemic unfairness institutionalized through billing.

### The FOMB's Proposal: Making the Pension Charge Permanent

In its **October 2, 2025, report**, the **Fiscal Oversight and Management Board (FOMB)** urged the **Puerto Rico Energy Bureau (NEPR)** to convert the current **1.92¢ per kilowatt-hour (kWh)** pension surcharge—originally temporary—into a **permanent fixed monthly charge** applied uniformly to all electricity customers. The report stated that "*LUMA deberá convertir la tarifa de aproximadamente 1.92 centavos por kWh en un cargo fijo por cliente lo antes posible.*" In practice, every Puerto Rican household and business, regardless of their level of consumption, would pay a fixed pension fee. Allow me to show three examples:

- **A household with a monthly consumption of 1,472 kWh is paying approximately \$28.25** under the current 1.92¢ per kWh pension surcharge—representing a **7.6 percent increase** in the total electricity bill, implemented without transparent disclosure.
- **A small business**, such as a restaurant or retail store, consuming around **12,000 kWh per month, is paying nearly \$230 monthly** toward the pension surcharge alone. For such establishments, this represents an additional **2.5 to 3 percent increase** in total operating costs—costs that often must be passed on to consumers through higher prices.
- **An industrial facility or manufacturing plant**, with consumption levels of nearly **500,000 kWh per month, is paying approximately \$9,600 per month solely** for the pension component. For large energy users, this is equivalent to a **low five-figure annual surcharge**, directly eroding margins and discouraging reinvestment or expansion.

These examples illustrate how a seemingly small per-kilowatt-hour charge accumulates across sectors—impacting households, small businesses, and large manufacturers alike. What began as a temporary adjustment has become a structural financial burden embedded in Puerto Rico's energy economy.



The Oversight Board justified the proposal as a way to secure a “stable and predictable” funding source for PREPA's insolvent pension system. Implementation, however, remains delayed because **LUMA Energy** claims its billing system cannot yet apply a universal fixed-fee structure.

If adopted, the measure would institutionalize what began as a temporary surcharge, embedding it permanently into Puerto Rico's electricity rates. Rather than a bridge to reform, it would become an enduring obligation—transferring decades of fiscal mismanagement onto every ratepayer, including those with no pension of their own.

In essence, Puerto Ricans would be paying not just for power, but for the failures of the past. A policy once intended as a short-term fix would evolve into a **permanent hidden tax**, converting a stopgap into a structural burden on Puerto Rico's energy economy.

### Impact on Competitiveness

The proposed permanent pension charge highlights one of Puerto Rico's most pressing structural challenges: **the island's high electricity costs and their impact on economic competitiveness.**

Puerto Rico already faces the **highest electricity rates in the United States**, averaging **30 to 33 cents per kWh**, nearly double the mainland average. Embedding a fixed pension charge would widen this cost gap.

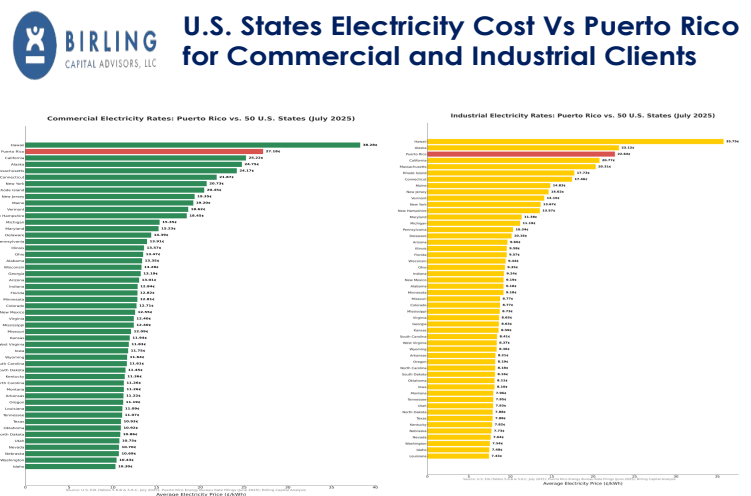
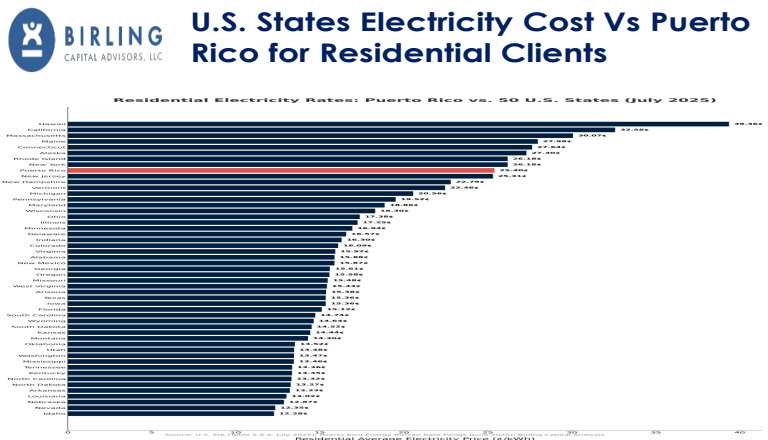
For businesses, each additional cent per kWh translates into millions in lost profitability. Energy-intensive sectors—such as manufacturing, healthcare, hospitality, and technology—see their margins eroded by costs unrelated to service delivery.

For households, the effect is equally regressive. Puerto Rican families spend nearly **10 percent of disposable income** on electricity—about **four times** the U.S. average. With pensions now financed through the power bill, families are not paying for energy; they are subsidizing legacy promises.

The **demographic imbalance** compounds the problem. PREPA's pension system now supports **about 12,500 beneficiaries but only 2,750 active contributors**—a ratio of nearly five retirees per worker. No defined-benefit plan can sustain that arithmetic without external subsidies. Economically, this is a **competitiveness penalty** on every enterprise and household. It discourages new investment, limits nearshoring potential, and constrains growth in renewable energy. Puerto Rico risks pursuing economic development while financing the past through the very rates that define its future.

### The Need for a PREPA Pension Haircut

A PREPA pension haircut is not about punishing retirees; it is about restoring **fairness, solvency, and public trust**. Puerto Rico cannot build a competitive energy future on the foundation of a bankrupt pension system sustained by ratepayer surcharges. The goal must be sustainability—balancing compassion with accountability.



A credible, equitable reform plan should rest on these principles:

- **Fiscal Sustainability:** A system with no assets cannot rely on surcharges indefinitely. A calibrated haircut—actuarially necessary, not punitive—is essential to realign obligations with available resources.
- **Shared Sacrifice:** Under PROMESA, bondholders, municipalities, and public employees have all endured cuts. PREPA retirees cannot remain the only exempt group.
- **Intergenerational Equity:** Younger and private-sector workers, most of whom lack pensions, should not finance promises they never received.
- **Progressive Fairness:** Protect retirees earning under \$1,000 per month, while scaling reductions for higher pensions to preserve social fairness.  
A PREPA pension haircut is not austerity—it is **equity in action**. It transforms a failed system into a sustainable one and ends a regressive, hidden tax on Puerto Rico's working class.
- **Toward Real Reform**
- Puerto Rico's path forward must combine fiscal integrity, institutional discipline, and transparency. Reform begins by acknowledging the structural flaws that allowed PREPA's pension system to operate without oversight for decades.
- It must continue with a **comprehensive actuarial restructuring**, independent governance, and a funding mechanism tied to performance—not to ratepayer surcharges.
- In the longer term, all public retirement systems must adhere to **sustainability metrics**, including regular actuarial audits, contribution discipline, and explicit rules that prevent benefit expansions without adequate financial backing.

Finally, the **Energy Bureau** and the **Oversight Board** must establish strict firewalls to ensure that rate structures reflect service costs, not legacy liabilities. Only then can Puerto Rico restore investor confidence and rebuild a competitive, transparent, and equitable energy market.

### Lessons from Other Governments: Pension Haircuts in Practice

Puerto Rico is not alone in facing the moral and fiscal dilemma of pension insolvency. Across the United States and around the world, governments have implemented pension "haircuts" to preserve solvency, protect essential services, and restore long-term equity.

#### United States Examples

1. **Detroit, Michigan (2013–2014):** As part of the largest municipal bankruptcy in U.S. history, Detroit implemented a **4.5% reduction in base benefits** for general retirees and eliminated cost-of-living adjustments (COLAs). Police and fire retirees avoided base cuts but lost COLAs. The result: fiscal stability and preserved core benefits.
2. **Central Falls, Rhode Island (2011):** A city of just 19,000 residents became a national case study when it cut retiree pensions by up to **55%** to escape insolvency. The move, though painful, was legally upheld and later partially offset by state assistance—ultimately restoring solvency and credibility.
3. **Illinois (Ongoing Reforms):** burdened by one of the most underfunded pension systems in America, it implemented measures to **raise retirement ages, suspend COLAs, and increase employee contributions**. These reforms, though challenged, reflect the necessity of shared sacrifice over political avoidance.
4. **Stockton, California (2012–2014):** Stockton's bankruptcy settlement preserved base pensions through CalPERS but **cut retiree health benefits and supplemental plans**, representing a partial but necessary adjustment to ensure fiscal balance.

## International Examples

1. **Greece (2010–2015):** During its fiscal crisis, Greece implemented multiple pension reductions, totaling up to **40%** for some retirees, while also increasing retirement ages and contribution periods. The aim is to save the system, not destroy it.
2. **Portugal and Spain (2011–2014):** Both countries imposed **temporary pension freezes, delayed COLAs, and stricter early-retirement penalties** during the Eurozone debt crisis to stabilize public finances and meet EU sustainability targets.
3. **United Kingdom (Public Sector Reform, 2011):** The U.K. shifted from final-salary pensions to **career-average earnings (CARE)** formulas, reducing long-term benefit accruals by 15–20% while maintaining solvent and fair systems.

## The Final Word: Reform as Preservation

Across the world, from Detroit to Athens, governments have confronted the same moral dilemma now facing Puerto Rico:

**Should the promises of the past outweigh the prosperity of the future?**

The lesson is clear — **pension reform is not betrayal; it is preservation.**

When systems collapse under their own weight, reform is not cruelty; it is a sign of courage. A **PREPA pension haircut** is not an act of abandonment, but of fiscal realism and moral responsibility — an acknowledgment that fairness requires shared sacrifice.

Puerto Ricans did not cause PREPA's financial collapse, yet they are being held responsible for it. Every dollar diverted from homes, businesses, and future investment to sustain an unfunded pension is a dollar lost to competitiveness, growth, and reconstruction.

The time has come for **honest reform** — one that balances compassion with accountability and ensures that no generation is forced to finance the excesses of another. A structured, equitable haircut can restore integrity to Puerto Rico's energy system and credibility to its institutions.

Puerto Ricans will pay for light — but not for the darkness of mismanagement.

**True reform must illuminate, not obscure; it must heal, not prolong decay. Anything less is not reform at all —It is a new injustice disguised as continuity.**



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