FIRST INTERIM REPORT

COMMISSION ON PENSION AND PENSION ADMINISTRATION REFORM IN THE EASTERN CARIBBEAN CURRENCY UNION (ECCU)

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EASTERN CARIBBEAN CENTRAL BANK
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Chairman
Commission on Pension and Pension Administration Reform

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FIRST INTERIM REPORT

COMMISSION ON PENSION AND PENSION ADMINISTRATION REFORM IN THE EASTERN CARIBBEAN CURRENCY UNION (ECCU):

INTRODUCTION

This First Interim Report will be addressed under the following seven headings:

(1) Mandates and Terms of Reference

(2) Report on Progress to Date

(3) Methodology, Approach and Rationale

(4) Objectives, Imperatives and Dimensions of Pension Reform in the context of the ECCU

(5) Proposed Chapter Outline of The Final Report

(6) Conclusions and Time Frame for Completion

(7) Executive Summary of Tentative Recommendations for State Pension Reform

The Appendix includes the work that has been to date on State Pension Reform. It is presented in the same form and structure as will be included in the Final Report.

1.0 MANDATES AND TERMS OF REFERENCE

At its 55th Meeting on February, 17, 2006, the Monetary Council established The Commission on Pension and Pension Administration Reform to examine the pension arrangements in the ECCU and to make recommendations for reform. The Commission comprises the following members:

Mr Marius St Rose	Saint Lucia	Chairman
Justice Albert Matthew	Dominica	Commissioner
Mr Richard Peterkin	Saint Lucia	Commissioner
Mr Jasper Scotland	Antigua and Barbuda	Commissioner

The four-person Commission was appointed with specific and detailed Terms of Reference with respect to roles and operations; and to operate in a manner similar to that of the Commission on Tax and Tax Administration Reform. The role and operations are to:

(a) Role of the Commission

(1) Direct the Research Staff in its research activities on the issue of Pension Reform

(2) Review the economic and financial context of pension reform

(3) Review the existing government pension systems

(4) Review the degree to which there is integration or coordination with national social security systems

(5) Examine the Anguilla experience

(6) Review the pension arrangements in the private sector and in statutory bodies

(7) Identify best practices

(8) Identify governance, administrative and legal gaps

(9) Establish benchmarks and indicators

(10) Make recommendations for improving and harmonizing the administration of private and statutory bodies' pension plans

(b) Operations of the Commission

The Commission should:

(1) Determine the objectives and structure of the Final Report.

(2) Based on the structure of the Report, identify and assign areas of research either among the Commissioners, the research Staff, or through consultancy.

(3) Discuss the issues identified at regular meetings.

(4) Hold discussions with representatives of the public and private sector throughout the Currency Union to obtain input on the critical issues.

(5) Document deliberations throughout the Currency Union to provide a basis for the Final Report.

(6) Circulate the Draft report to member governments and discuss the Draft report in consultations with representatives of the private and public sectors.

(7) Present the Draft Report, together with input from the above consultations, to the Monetary Council.

(8) Prepare a Final Report and present it to the Monetary Council.

(9) Establish a Technical Group to implement the recommendations contained in the Final Report.

The ECCB should pursue financing for the operations of the Commission.

The Commission is to be assisted and supported by the Staffs of the Research and Statistics Departments of the ECCB on administrative, research and statistical matters relating to the assignment.

2.0 REPORT ON PROGRESS TO DATE

The Commissioners who were informed of their appointments in July 2006 began immediately to conceptualize the assignment and to plan its execution. The Commission held two preliminary meetings with ECCB Management in February and May 2007 to discuss: their understanding of the assignment; scope of work; approaches to be adopted; resource requirements for data and information collection and collation; useful literature to be reviewed; identification of original research work which would need to be undertaken; need for public sensitization and interaction with the public on pension reform through town hall meetings; and work programme, budget and report preparation. The Commissioners felt that, with adequate resource availability, the exercise could be completed in an elapsed time of twelve months from inception.

The ECCB Management sought the necessary funding from donors and international financial institutions (IFI) but support was less than enthusiastic because, despite the expressed statement that the exercise was useful and commendable, these donors and institutions had an aversion to providing budget support, moreso, to a successful and profitable ECCB. However some donors and IFI were not averse to funding the consultancy and research components of the proposal but not such other costs as Commissioners' fees, travel and subsistence and even research support costs. Eventually, CDB, in June 2008, approved a grant of US$82,457, to ECCB to finance four research exercises; but negotiations are currently in train with the institution to shift the use of the CDB funding to two research studies, data collection and collation exercises and some preliminary investigative legal work.

During the long period while the resources were being sought the Commissioners have been engaged, informally, in desk research by getting acquainted with the relevant literature on theory, policies, practices and national experiences with pension reform; and in preparing a preliminary list of data and information requirements to commence work. This list has been submitted by the ECCB secretariat to the relevant national authorities but progress with the data capture has been slow.

The work of the Commissioners can be said to have commenced in earnest from May, 2008 and so far, from that date, three meetings have been held: the first a two-day inception meeting at the ECCB on June 12 to 13, followed by a teleconference on 1 August and a morning videoconference involving Saint Lucia and ECCB headquarters on Friday September 5.

The intention is to have meetings every six weeks alternating between teleconference, videoconference and direct face to face meetings with a focus on the more central location of Saint Lucia.

Given the priority that ECCU governments give to State Pension Schemes (Note related initiatives by the governments of Anguilla, and Antigua and Barbuda) and the inherent fiscal and social urgency of this exercise the Commission has expedited its conceptualization work in this area. As a result the work done on State Pension reform is sufficiently advanced to allow some preliminary thoughts to be included in this Report in the same form and structure as it would appear in the final report (See Appendix).

Not much difficulty is expected with the main plank of the Pension System: Social Security, as much work has been done on these systems by such institutions as the World Bank, International Monetary Fund and the International Labour Organization. Moreover, these are managed by well established statutory institutions, which are subject to periodic national and international monitoring and surveillance, and hence have a wealth of data and information.

The main area that is expected to pose the greatest challenge is Private Occupational Schemes. This is because there is very limited legislative framework in the countries; totally inadequate statutory monitoring; very limited coverage (mainly among the very few large employers); passive and uninformed membership, and the actuarial review and management of these schemes is largely in private sector hands outside the ECCU.

The biggest challenge in the work of the Commission, however, will be to try to develop the beneficial regional arrangement option for any, or all, of the various main planks: social security, private occupational and state pension schemes.

3.0 METHODOLOGY, APPROACH AND RATIONALE

The approach and evolution of the study can be viewed from the three perspectives of: goals and objectives; scope and coverage; and the organization and structure of its execution.

From very early the Commissioners recognized that the exercise is, and should be, much more than another study no matter how accomplished, path breaking and seminal the written output. And path breaking and seminal they intend the written output to be! However, the Commissioners did not want the study simply to be another celebrated document that would grace the shelves of libraries and used as reference material. Recognizing, on the one hand, the importance of savings for one's retirement and also for national economic development; and on the other, the public's unwillingness and aversion to engage in this effort, it was felt that this exercise should have an important public sensitization content to get greater public buy-in, and, participation. The public awareness should be geared towards how individuals in particular and society in general can benefit from the work of the Commission. In fact, the Commission expects to measure its success more on the basis of public sensitization of the issues and consequently an increase in long term savings; and less on the acceptability of the recommendations to the authorities.

The analysis is targeted to cover as broad a sweep that is consistent with the mandate given to us. Because integration, harmonization and coordination are the most effective and acceptable approaches in overall pension scheme analysis and reform we look at all the possible pillars in a national pension scheme structure to include:

(1) The first pillar from state support to the elderly indigent and poor who are outside the contributory social security framework.

(2) The support provided from the second pillar through contributory Social Security.

(3) Contributory pension arrangements for state employees outside of, and supplemental to, Social Security and serving as part of the third pillar that is dedicated to state employees.

(4) Contributory private occupational schemes as the rest of the third pillar for private sector employees and operating virtually in parallel with and similar to the state pension scheme arrangements.

(5) Private medium to long term savings and investment arrangements managed individually or institutionally of which surplus income and capital gains could be used to supplement retirement income from the established pillars.

(6) An examination of the concept of reverse mortgages which allow residential homeowners who have a fair amount of net worth in their homes the option to use part of such net worth to provide a lump sum or annuities to supplement their retirement incomes without either having to service the loans and/or ever giving up the comfort of their homes during their lifetimes.

Each of the pillars identified above is examined in the classical analytical approach. This is to identify and establish an “ideal arrangement” which may never exist in practice and to set a bench mark or standard against which the existing and/or recommended situations and arrangements can be assessed. Against this benchmark the existing situations are evaluated by identifying their weaknesses and limitations. Thereafter sub-ideal recommendations are made that are considered to be the best possible under existing circumstances. These are considered to be not only pragmatic and feasible but also optimal for the circumstances.

The following approach was instituted to execute the study:

(1) Extensive study of the theoretical and applied literature on experiences, policies, performances.

(2) Allocation of subject and country lead responsibilities among the various Commissioners on the understanding that the report findings are the responsibility of all and that its assertions and recommendations are attributable to all.

(3) Convening meetings periodically, on average of every six weeks, through the medium of roughly equally, the telephone and videophone and face to face contact.

(4) Staff from the Research and Statistics departments to give professional guidance and background support.

(5) Use of consultants to study certain areas that needed more intense examination in the context of the ECCU area.

(6) Convening of a conference involving international and regional experts and national practitioners to discuss the subject and to serve as a sounding board for some of the proposed recommendations.

(7) Construction of a website to provide information on pension reform, pension and retirement; personal savings and investment issues; the work of the commission and to get feed back from the public through a dialog blog.

4.0 OBJECTIVES, IMPERATIVE AND DIMENSIONS OF PENSION REFORM IN THE ECCU

The ***objectives*** of Pension Reform in the ECCU may be conveniently summarized as to:

(1) Make adequate arrangements for the post retirement benefits of the region's peoples.

(2) Enhance the package of benefits to members.

(3) Increase the pool of domestically mobilized savings through voluntary and mandatory means.

(4) Minimize, or at least seek to maintain, the current retirement-related fiscal burdens on the State.

(5) Ensure that pension schemes are adequately and prudently managed, actuarially sound and efficiently run.

(6) Allocate more resources to feasible domestic/regional projects and investments that promote national and regional development.

(7) Optimize financial and economic returns while ensuring prudent risk management.

(8) Help develop the ECCU's capital markets.

The three broad and critical ***imperative***s that drive the need for Pension Reform in the ECCU are:

(a) Social Development Enhancement and Poverty Alleviation for more than fifty per cent of our populations in some countries. This is to be pursued by ensuring that adequate provisions exist for the welfare of the indigent and poor and for the financial welfare of post-retirees to minimize, if not to eliminate, poverty among them. This is particularly urgent in a situation of increasing life expectancies and hence an increasing dependency ratio at a time when nuclear and extended family support is rapidly diminishing, partly, as a consequence of less binding family and social ties, more rapid rural-urban drift and more fluid globalization-induced international migration;

(b) *Savings and Investment for Economic Growth* at both the micro and macro levels to smooth out lifetime household consumption and to reduce dependence on taxation on the one hand; and, on the other, to mobilize financial savings that could be used to finance national economic growth, thus reducing the need for and dependence on external financing from aid and debt; and

(c) *Institutional Development and Efficiency to*

i. Broaden the financial institution environment to help channel more surplus financial resources from consumption to long term productive activities that are feasible;

ii. Contribute to the development of the nascent and fledgling capital market by increasing the flow of resources to it, and by expanding its breadth and depth to give, *inter alia*, more scope, definition and transparency to savers to allow them to make their own money and capital market transaction choices; and

iii. Provide adequate administrative, operational, regulatory and monitoring institutional arrangements to achieve maximum efficiencies at two levels of intervention: the per unit cost of administering pension programmes, and, optimizing the returns that are achieved from the deployment of these resources. Both of these are to enhance the benefits to all programme participants and beneficiaries and improve productivity in the economies.

Trying to meet all the objectives simultaneously or even concurrently may be mutually conflicting. Therefore there will be need for prioritization and balance. All the objectives should give priority to cost-effectively increasing members' benefits and national savings but consideration could be given to such other considerations as economic capital market development where it is prudent to do so.

Basically the reforms need to be guided by the recognition of:

1. The critical importance of long term savings and ***real*** productive investment for growth and development and even for the viability and sustainability of pension schemes;

2. The comparative importance of productive capital expenditure versus immediate consumption to value added, employment, foreign exchange and fiscal;

3. The inequities in the distribution and composition of post-retirement benefits;

4. The burden of publicly funded social safety nets on the fiscal and the effect on other economic and social programmes;

5. The need for the viability and sustainability of existing arrangements in terms of solvency and optimality; and that

6. The ***success of pension reform hinges not only on the recommended sector specific reforms but critically on the quality and astuteness of national and sub-regional economic management***.

From one perspective the dimensions of the reform will be influenced by the objectives and imperatives. From another its scope would include an examination and analysis of policy, legislative and institutional frameworks; and governance and management inefficiencies. The scope of the exercise will cover all ECCU members and all types of formal financial retirement arrangements in the public and private sectors.

5.0 PROPOSED CHAPTER OUTLINE OF FINAL REPORT

At this stage it is envisaged that the Report of the Commission on Pension and Pension Administration Reform will be covered under the following Chapter headings:

Letter of Transmittal and Executive Summary

Chapter:

1. Mandate and Terms of Reference
2. Methodology, Approach and Rationale
3. Objectives, Imperatives and Dimension of Pension Reform in the ECCU
4. An “Idealized” Pension System Structure
    a. Support for the Elderly Indigent and Poor
    b. Social Security
    c. State Pension Schemes
    d. Private Occupational Pension Schemes
    e. Other Retirement Savings and Investment Schemes
    f. Reverse Mortgages

5. Existing Pension Legislation and Arrangements in the ECCU

6. Weaknesses in Existing ECCU Pension System

7. Issues and Challenges of Pension Reform Generally and in the ECCU

8. Comparative Analysis of Pension Reform in Other Parts of the World and Relevance to the ECCU

9. Recommendations and Rationale: A Sub-optimal but Pragmatic National and Sub-regional Structure for the Typical ECCU Member

10. Costs and Benefits of Proposed Arrangements

11. Macro-economic and Institutional Environmental Prerequisites for Successful Pension Reform in the ECCU

12. Proposed Legislative Framework

13. Conclusion

Statistical Appendices

Bibliography and References

List of Contacts

Conference Agenda and Programme

Chapters 5, 6, 9, 10 and 12 will be treated in the same detailed way as is Chapter 4. In other words ***each*** of the six planks will be examined for:

a) What a theoretically “ideal” arrangement could look like;

b) What are the current existing legislative and operational arrangements in the ECCU;

c) What are the weaknesses in existing arrangements in the context of the "ideal";

d) What are pragmatic recommendations for Pension Reforms in the context of the social, economic, financial and institutional situations and realities in the ECCU members;

e) What are the costs and benefits of the proposals; and

f) What is a proposed legislative framework to handle each plank individually and in an integrated way.

6.0 CONCLUSION AND TIME FRAME FOR ASSIGNMENT COMPLETION

It is expected that the Commissioners will complete the first final draft of the exercise by June 2009. Thereafter, following review by the ECCB Management and approval in principle by the Monetary Council the Commissioners will complete the Final Report by about September, 2009. Apart from the essential data gathering and undertaking the necessary original research the Commission intends to:

a. Launch a web-site on the ECCB platform to give information and to seek views and reaction from the public at large;

b. Plan a regional/international conference around the end of February, 2009 under the aegis of the ECCB to thoroughly articulate the issue of pension reform particular in the context of a regional arrangement of sovereign states;

c. Have two town hall teleconference meetings one for the Windwards and the other for the Leewards to hold discussions with the relevant publics in these countries.

The exercise is a work in progress. It will only be complete when the whole is done as all the elements have to be integrated and consistent with each other.

7.0 EXECUTIVE SUMMARY OF MAJOR BUT TENTATIVE RECOMMENDATIONS FOR STATE PENSION REFORM

It is generally recognized, particularly by the national governments and the International Financial Institutions, that the existing State Pension Arrangements in the ECCU leave much to be desired and are in need of urgent reform. They are not in the best interest of the beneficiaries, are a fiscal burden on the state employer and are virtually unsustainable. Given the stated objectives and imperatives of Pension Reform, the analyses of best practices, modern trends and developments, and the peculiarities of our own national and regional situations, we make the following preliminary recommendations for State Pension Reform in The ECCU. The objectives of these recommendations are to create a secure source of optimally managed resources that have been affordably but compulsorily contributed by the state employer and all its employees to provide a guaranteed stream of income commensurate with historical contribution and consumption levels to take care of the consumption needs of state retirees.

(a) Transitional Arrangements

It would be administratively cumbersome and financially costly to try to implement the reforms over a short period of time and for all persons simultaneously. The reform has to be transitioned and this could take as long as four to five decades. For this purpose all existing and potential state pension beneficiaries and all remaining central government employees would be classified into three groups as follows:

GROUP 1:

Who would be the ***beneficiaries of the main reform*** and for whom participation would be compulsory, would include all new central government employees who are employed after the agreed and defined commencement date. This could be three months after the decision is taken and the proposals communicated to the public at large.

GROUP 2:

For ***whom existing arrangements*** would, in general, continue to apply and would include:

(a) all existing pensioners and those to be retired (normal or early) within five years of the defined commencement date; and .

(b) non-established and other workers who are 45 years and older at the defined commencement date.

GROUP 3

Who would ***have the option***, for a period, to continue with their existing arrangements in whole or in part and/or to buy into the Group 1 Plan by exchanging their existing benefits, at actuarially determined exchange values, for Group 1 participation and benefits. This Group would include:

(a) Existing tenured employees who are expected to retire (normal or early) after five years of the defined commencement date;

(b) Non-established and other workers who are under 45 years of age at the defined commencement date.

The intention is, ultimately, for all central government employees to be covered under Social Security (SS) and the Group 1 State Pension Scheme (SPS).

For each of these Groups will be developed:

(a) Benefit packages
(b) Governance structures
(c) Funding arrangements
(d) Investment considerations

But the emphasis will be on the Group 1 Plan which will be the permanent one. In addition the arrangements for each group would not be exclusive and will all eventually merge into the Group 1 arrangements.

BASIC FEATURES OF REFORM FOR GROUP 1

(1) A hybrid scheme incorporating both Direct Benefit (DB) and Direct Contribution (DC) features.

(2) Integrated with Social Security thus requiring all employees to be members of both the SS and the SPS.

(3) Contributory and funded in a fixed ratio of 2:1 between state and employees for all required contributions.

(4) A much improved benefits package to make it attractive to employees (See Appendix I subsection 9.3.4.1)

(5) Independently and professionally managed outside state control where possible - regional

(6) That all gains and liabilities to the account of the Fund

REFORM FOR GROUP 2

The following arrangements are being proposed for existing pensioners and workers who are expected to retire (normal or early) within the next five years from the defined commencement date. The existing benefits package applicable to them would continue to apply except that pensions will be adjusted automatically every three years at the cumulative annual inflation rate but restricted to a maximum of 3% cumulative for the period. This enhanced benefit is to give more predictability to cost of living adjustments to pension enhancement.

(1) New funding arrangements will not be necessary as the non-contributory and pay-as-you-go features will continue. As is the current practice annual amounts will be appropriated from the annual recurrent budget to meet the annual obligations.

(2) Existing contract employees will be under this group but new more realistic contract gratuity terms (that are more reflective of the actuarial equivalent of existing pension arrangements on a lifetime basis) should be determined for new contracts.

(3) There is also the need to discuss and resolve the issue of whether to allow the encashment of full contract gratuities where there is a National Pension Scheme and with full portability. Encashment of full contracts could possibly defeat the idea of employees having adequate income to take care of their consumption needs during their retirement years.

REFORM FOR GROUP 3

Persons classified into Group3 would have three possible options which they must formally exercise within two years of the Defined Commencement Date. The three options are:

Option 1 which is to elect to continue under existing arrangements and who will be treated exactly like those in Group 2 i.e the *status quo* both in terms of contributions (nil) and benefits (old existing arrangements) except for the small but regular inflation adjustments;

Option 2 which is to elect to convert all their existing benefits to the actuarial equivalent of Group 1 benefits and who, from the date of election would be treated just as Group 1 participants both in terms of benefits and contributions going forward; and

Option 3 which is to elect to either:

(1) Freeze their old existing benefits in the old arrangement and, at retirement, be entitled to an actuarially equivalent pension for these values; and, from the date of election, to commence participation in the Group 1 SPS/SS schemes. This would mean contributions going forward and the receipt of two sets of pensions at retirement: one from the Group 2 and also another from the Group 1; or

(2) Join the Group 1 scheme on the date of election and use some of the existing benefits to buy actuarially equivalent but a reduced number of years in the Group 1 SPS. Again, contributions have to be made going forward and at retirement the retiree will receive two sets of pension payments each from Group 1 and Group 2.

Costs

The cost to the State for these reforms and the much enhanced benefits in the short to long run should not be more than the costs to the State under current arrangements, and where it is, the enhanced benefits can be proportionately scaled back to ensure that the costs to the State are no more than it was previously. Moreover, the costs to the State are predictable and not open-ended as under existing arrangements. This limit and control on State costs is so for the following reasons:

a) Employees will now become contributors and their contributions will fund a large part, if not all, of the improved benefits;

b) The funded approach will allow income to be earned from the management of the fund and this would help finance the additional benefits to retiree employee/beneficiaries;

c) The arrangement is both a hybrid of the typical DB and DC schemes and the funding is a fixed 2:1 proportion between employer and employee;

d) The estimated period of retirement is ten years to average life expectancy for the gender thus giving more predictability to retirement costs;

e) Obtaining critical mass, improved management and diversification of geographical risk, and greater independence and autonomy through sub-regional arrangements together with efficient and transparent governance arrangements would help to significantly reduce the per capita costs of managing these schemes and as a result either reduce the costs of providing the service and/or increasing the benefits; and

f) Annual escalations for cost of living increases though provided are capped.

Benefits

Since there is hardly a financial difference to the State between the existing and proposed pension arrangements what then are the benefits particularly at the macro-economic level? These could be summarized as:

1. The establishment of a fund that will be able to make long term productive investments and also stimulate the development of the capital market;

2. Conversion of a process of continuous consumption into a beneficial cycle involving: savings (denied consumption), financial intermediation, investment, productive growth, income generation, consumption;

3. Encouragement of savings and some self sacrifice and participation by members;

4. Helping to promote financial literacy, interest, and involvement among a significant proportion of the population;

5. Helping to develop the financial management climate in the economies;

6. Providing improved pension benefits to members which should result in a more contented work force which could hopefully improve work force productivity;

7. Modernizing the State Pension system which could set a progressive example for private sector occupational schemes;

8. Minimizing inter-generational burdens;

9. Making government obligations more transparent;

10. Assisting, through the portability provisions, with the freer and hence more productive use of labour throughout the economic system;

11. Increasing and or stabilizing economic activity through the process of the consumption smoothing of retirees as consumption itself with exports, investment (in that order) being the principal drivers of economic activity in our economies;

12. Helping in mobilizing some contribution from persons who have been nurtured, educated and worked at home but later migrate to the extent that their contributions stay behind (but still accessible to them at retirement) to help develop the economies. It could also serve to foster a link between their natural and adopted homes and encourage them to visit and supplement their savings in their natural homes; and

13. Offering scope by serving as platform and springboard for essential public sector reform (which will be discussed in the Full Report.)

APPENDIX 1

PRELIMINARY WORK ON STATE PENSION SCHEMES

CHAPTER BREAKDOWN

CONTENTS OF PRELIMINARY WORK ON STATE PENSIONS

Chapter 4

STATE PENSION IDEALS, SITUATIONAL ANALYSIS, WEAKNESSES, RECOMMENDATIONS FOR, AND COST-BENEFIT OF REFORMS IN THE ECCU

4.3 "IDEALIZED" STATE PENSION SYSTEM

4.3.1 *Scope and Coverage*

All reference to State Pension Schemes in terms of the reviews, analyses and recommendations in this and subsequent chapters, particularly Chapters 5, 6, 9, 10 and 11 apply to all casual, temporary and permanent employees in the central government including daily paid workers and the established and tenured employees in the civil, police, teaching and nursing services in the national jurisdictions and economies of the ECCU Area. However, it excludes coverage of:

(1) Persons employed under contract in national services;

(2) Parliamentarians and the Governor General for whom there are separate provisions and arrangements;

(3) Employees of national statutory bodies who would be covered under private occupational schemes; and

(4) Employees of sub-regional supra-national organizations including the OECS Supreme Court who would be outside the remit of this Commission and who have separate and independent arrangements for terminal benefits and pensions.

The focus of the Report is on post-retirement benefits in the form of gratuities and pensions and the benefits payable for permanent disability. While such other benefits as medical, educational and vacation benefits do impact positively on the quality of life both during employment and in retirement, and therefore desirable,
these are not factored in here.

4.3.1.1 General Principles and Features

In an ideal system particularly where financial and managerial resource availabilities were not constraints the general principles governing an ideal state pension scheme should be to:

1. Include all government paid workers into either into the state pension plan and/or into the social security. Consideration could be given to withholding part of the gratuity payments to contract workers as their contribution to the social security scheme.

2. Have real consumption smoothing at best such that the level of real consumption could remain as stable and steady during retirement years as they were during employment years and, at worst, poverty alleviation. (The quality of life of retirees should be no worse than during their best working years and no retiree should be an indigent poor).

3. Equitably share the burden of the contribution rate such that it is neither a fiscal burden on the state and its economic and social activities and programmes or on future generations nor is it a disincentive to work and/or on the current quality of life and current consumption of employees.

4. Be contributory to inculcate the saving habit, minimize dependency, and foster a greater public and employee interest in the governance and management of their terminal benefits.

5. Make every effort to manage the resources mobilized from contributions to optimize the returns generated which could be used to either minimize the burden of contributions and/or maximize the level of benefits.

6. Gain critical mass, economies of scale, risk diversification and greater management autonomy by centralizing the management of the national schemes at the sub-regional level or seeking as much sub-regional functional cooperation as is possible.

7. Integrate the state schemes into the national social security schemes so that the benefits dove tail and are supportive and consistent with each other.

8. Make the modalities, benefits and contributions of state pension schemes as close and consistent with private occupational schemes and also across the countries of the sub-region to allow a freer movement of labour between the state and the private sectors and amongst the countries.

9. Have a funded arrangement which will both reduce fiscal burdens but also create a pool of resources that could be used to finance development and/or help stimulate the capital market and help to develop a pool of financial expertise in wealth and asset management.

10. Have a regime of benefits including what have been specified before that can be financed from mutually agreed contribution sharing levels between the state and the employees and from the beneficial proceeds of good and optimal fund management.

11. Have governance that is professionally competent, politically independent and free to operate to optimize returns to achieve clear and specified unambiguous medium to long term objectives.

4.3.1.2 System Design

The specifications of an ideal state pension system are hardly expected to exist in practice but become a standard that schemes try to attain depending on the income levels, cultural values and resource capacities of their economies. The structure of an ideal system is presented below:

1. ***Coverage***: All daily, weekly, fortnightly, monthly paid employees of the central government who are 18 years old and over.

2. ***Scheme Type***: Direct Benefit.

3. ***Integrated with Social Security***: Yes. All employees, including contract employees, would be covered, firstly, by Social Security followed by the State Pension Scheme.

4. ***Normal Retirement Age***: Fifteen years from life expectancy (to the nearest year) and determined at the time of each ten–year census.

5. ***Early Retirement Age***: Five years earlier than normal with a proportionately actuarially reduced pension.

6. ***Annual Pension:*** Two per cent of highest annual pensionable salary earned for each completed year of pensionable service subject to a maximum of 90% of highest annual pensionable salary including pension income from Social Security. Social Security pays first and the balance to the maximum possible is made up by the State Pension Scheme. (The increase to 90% is due to the fact that retirees have lots more time to engage in such expensive retirement

activities as learning enrichment, entertainment, travel, have heavier medical expenses with reduced coverage and access to medical insurance, and do not enjoy the many perquisites and benefits that they once enjoyed on the jobs.)

7. ***Guaranteed Pension:*** Ten years from retirement.

8. ***Spousal and Dependent Children's Pension:*** Fifty percent of pension payable to the widow/widower after the guarantee period for life or at remarriage. Twenty percent of the pension payable after the guarantee period to each dependent child until the age 18 or 23 if attending full time a tertiary level institution. All such spousal and dependent pensions shall be proportionately reduced so that these payments do not exceed 100% of pension payable.

9. ***Inflation Index:*** Annually indexed to cost of living increases subject to a maximum of 5% p.a.

10. ***Portability:*** The actuarial value of pensionable rights and benefits to be easily transferable between the public and private sectors and within the countries in the ECCU Area.

11. ***Commutation:*** At retirement up to one-quarter of the actuarial value of a pension can be commuted to a gratuity.

12. ***Vesting:*** All employer contributions are immediately vested in the employee.

13. ***Use of Pension Benefits as Collateral:*** Under no circumstances would pension benefits be pledged or assignable as collateral. This is to ensure that the retiree has sufficient resources to enjoy his retirement and stay away from poverty.

14. ***Contribution Rates:*** Contribution rates from employers and employees for participation in the Social security scheme would be determined by the Social Security Scheme and based on the specified pensionable wage. Employee contributions for state pension scheme would be a flat 2% on the Social Security pensionable wage and 5% on amounts above that. The state would meet the contributions necessary to provide the defined benefits.

15. ***Costs to the State:*** The costs to the state (as a percentage of payroll) of providing these idealized benefits under different assumptions of returns on investment (ROI) and increases in salaries are estimated as follows:

	Return On Investment %							
Rate of Salary Increase %	3	4	5	6	7	8	9	10
2								
3								
4								
5								
6								
7								
8								
9								
10								

CHAPTER 5

5.3 EXISTING STATE PENSION ARRANGEMENTS IN THE ECCU

5.3.2 Legislative Framework

The framework governing the operations of public sector pensions in the ECCU are covered in the following three documents with legislative origins and/or authority:

1. The Pensions Act(s) which incorporates the laws governing pensions for the four central government establishments of the civil, police, teaching and nursing services;

2. The Pensionable Officers Orders which specify the list of officers who are eligible for pensions; and

3. The Pensions Regulations, as amended from time to time, which give effect to the provisions of the Act.

Each establishment has its specific legislative authority though not necessarily in specifically designated legislation. All three documents in their most current form must be consulted or studied together to get the indication of what are the currently applicable provisions.

Each of the countries have their own legislative framework but these are more or less very similar in intent, substance and provisions. For this analysis the main reference would be to the framework of St Vincent and the Grenadines but major differences in the other countries will be highlighted.

The Act in its various provisions specify:

1. A pension is not of right but granted at the beneficence of the Crown and can be reduced, or altogether withheld, because of negligence, irregularity or misconduct.

2. Pensions are granted at:
   (a) Normal retirement age of 60 or early at age 55 except for non-gazetted police officers who are eligible for pensions after usually 20 years of service;

   (b) Abolition of a person's post;
   (c) Compulsory retirement for the purpose of organizational rationalization;

(d) Termination of employment in the public interest; and

(e) Justified medical evidence of permanent physical and/or mental incapacity to perform on the job.

3. Maximum pension at two-thirds of the 'highest pensionable emolument' drawn by the officer during the course of his service.

4. Eligibility for pensions is 10 years of pensionable service; otherwise gratuity equal to five times the annual amount of the pension which, if there had been no qualifying period, would have been due.

5. Pensions shall be terminated in the event of :

   (a) bankruptcy; or

   (b) conviction and a term of imprisonment by the State

      (i) pensions can be suspended if pensioner renews employment with the State;

6. Pensions and/or gratuity cannot be assigned except for satisfying a debt due to the Crown or by the order of the Courts.

7. Gratuity is payable where an officer dies in service.

8. Pension to dependents is payable where an officer is killed in the line of duty.

The Regulations defines:

1. Qualifying service
2. Pensionable service
3. Service to be taken into account
4. Leave without salary
5. Emoluments to be taken for computing pension or gratuity

It specifies:

1. The payment of gratuities to female officers who retire from the service to marry or about to marry;

2. The commutation of pension to a maximum of 25% of actuarial value or equal to twelve and a half times the amount of the reduction in his annual pension;

3. The payment of compassionate gratuities.

Pensions for non-established central government employees are taken care of by Social Security to which the State (and employee?) contribute.

Severance for daily paid (non-established) workers is provided under the Protection of Employment Act which allows at the prevailing rate of pay:

1. Two weeks payment for each year of continuous service from 2 to 10 years;

2. Three weeks severance for each year of continuous service between 11 and 25 years; and

3. Four weeks for each year of continuous service in excess of 25 years.

In addition, by recent Cabinet decree it was stipulated that persons would be paid a compassionate gratuity equal to two weeks pay for each year of service to a maximum of 26 weeks.

5.3.2.1 Scheme Design

Existing State Pension Arrangements are virtually similar in the ECCU Area. They have the following basic structure:

1. ***Non-contributory*** on the part of beneficiaries.

2. ***Unfunded pay-as-you-go*** with pensions being an annual recurrent charge on the Consolidated Fund and appropriated annually at the time of the Budget.

3. ***Automatic in practice for all tenured, established staff*** who are 18 years and over.

4. Becoming an ***increasing proportion of outlays as a percentage of GDP*** and of government expenditures and wages and salaries as employees retire earlier, live longer, salary adjustments for inflation, and as governments restructure the public service and downsize and rationalize their organizational structures.

5. Annual allocations for pensions are only mitigated by the fact that there is ***no automatic inflation adjustment mechanism*** resulting in pensions in payment lagging significantly behind cost of living increases.

6. Generally, state pension is ***not integrated into National Social Security*** Schemes and tenured and established central government employees are generally exempt from contributing and participating in Social Security Schemes. However, because of the burgeoning costs associated with pension payments some governments, notably A B C have abandoned the State pension Arrangement for new employees and have shifted them to Social Security and make the necessary employer contributions on their behalf.

The detailed specifics of the various schemes at the national level are comparatively tabulated in Appendix and are summarily provided here. Basically the schemes are the same but with some having slightly different emphases and provisions. The main specific design features are:

1. Eligibility for pension entitlement varies and is determined by age (between 50 and 60) and/or by number of years of service (from about 20 in the case of special occupations e.g. police).

2. Provisions exist for normal and early retirement with the latter being up to five years less than the normal retirement age.

3. Pensions are commuted on the basis of: number of years of pensionable service (with maximum of 40); monthly benefit rate (usually 1/600 of final pensionable salary for each month of pensionable service); and final pensionable salary (which could be the highest, the average or highest in the last 3 or of the last 5 years).

4. Maximum pension payments are two-thirds of the highest pensionable emolument drawn by him at any time during the course of his pensionable service.

5. Pension payment options or either full or partial at the prospective pensioner's discretionary. Prospective pensioners are allowed to commute up to 25% of the actuarial value of their pensions to a lump sum gratuity.

6. Pension payments are taxable though larger personal allowances are allowed for retired employees or persons above the age of 60.

7. Contract employees obtain gratuity equal to 25% of their salary emoluments during their contract period. The first drawdown of contract benefits is tax free.

5.3.2.2 Utilisation and Coverage

Table - Central Government Employment and Coverage

	ANG	ANU	DOM	GND	MNT	SKN	SLU	SVG	ECCU
SS alone % #									
SPS alone % #									
SS and SPS % #									
CE % #									
# of P									
# E									
Year of data									

SS = Social Security
SPS = State Pension Scheme
CE = Contract Employees
P = Pensioners
E = Employees

Table - Wages, Salaries and Benefits

	ANG	ANU	DOM	GND	MNT	SKN	SLU	SVG	ECCU
W and S and B									
W and S									
PIP									
PCG									
CG									
C to SS									
D for SS									
W and S % of RE									
Year of data									

W = Wages
S = Salaries
B = Benefits
PIP = Pensions in Payment
PCG = Pensions Converted to Gratuity
CG = Contract Gratuities
C = Contributions
D = Deductions
RE = Recurrent Expenditures

Table - Distribution of Central Government Employment by Social Pillars

	ANG	ANU	DOM	GND	MNT	SKN	SLU	SVG	ECCU
# in Group 1									
Salaries in Group1									
# in Group 2									
Salaries in Group 2									
# on C									
CS									

Group 1 are persons whose salaries are up to SSPW
Group 2 are persons whose salaries exceed the SSPW
C = Contract
CS = Salaries subject to Contract

5.3.2.3 Administration

Governance, management and administration are virtually non-existent under existing state pension arrangements as there are no contributions to mobilize and no funds to manage. Whatever administration exists is governed by the existing legislation and taken care of in the same way as normal payroll salary administration. In fact pension administration is handled by payroll administrators.

The typical pension administration begins with the annual request from the Ministry of the Public Service to the various government departments to provide a list and particulars of persons who are expected to retire from between one to five years. This list is processed with priority given to those who are around one year to retirement. The processing involves the calculation of pension benefit entitlements including the commutation to gratuities where such requests are made. (Invariably all eligible retirees elect to commute the maximum allowable proportion of their pensions into gratuity.) This information is communicated to the prospective pensioner who would then instruct the Ministry as to where the pension is to be paid when they become due. Invariably this is to a bank account. Receipts of payments are not provided as is done with salary payments but such receipts can be obtained from the Treasury Dept. It is said that the Ministry monitors pensioner's life through death notices in the media!

Pension payments and gratuities come from a block vote approved annually in the budget for this purpose and, unlike salaries, is not classified by departments or ministries. Reports on aggregate payments would be submitted to parliament annually and reviews and audits of expenditure which should be undertaken annually is also reported to parliament except that in practice they are in serious arrears.

CHAPTER 6

6.0 WEAKNESSES AND LIMITATIONS IN EXISTING STATE PENSION ARRANGEMENTS

6.3 STATE PENSION SCHEMES

6.3.4 Socio-Economic

The existing state pension arrangements have serious disadvantages for all of its major stakeholders who include the employees or beneficiaries; the employer, state or government; and the society and economy as a whole.

The main ***limitations for the employees/beneficiaries*** are:

1. Unattractive pension benefit packages particularly in terms of spousal and dependent benefits, pension guarantees, in-service death benefits and real income stability and at least predictability.

2. That they could give employees a false sense of security about the adequacy and stability of their retirement incomes and, as a result, reduce their own commitment to the need to supplement their retirement incomes at the times when they can.

3. Inequitable arrangements between contractual and tenured employees with the former (professionals and senior management) having more beneficial and favourable arrangements.

4. The absence of integration with Social Security (which is normally more reliable) denies employees the benefit of the second pillar of retirement income support.

6.3.3.1 ***Employer/state/government disadvantages*** of the existing arrangements include:

1. Increasingly heavy recurrent burden on government which results in the reducing availability of resources for other critical economic, social and administrative needs and also results in very limited inflation adjustments particularly in tight fiscal situations which are more the norm in these small economies.

2. The non-contributory aspect of the arrangement places a burden on government that are, most times, unappreciated by employees. Thus in comparing compensation in the public and private sectors public sector employees do not factor in the benefits inherent in their non-contributory pensions and tend to want their salaries to be equivalent to the net comparable salaries in the private sectors.

3. Absence of integration and non-involvement with Social Security increases the fiscal burden on government as employees do not have to contribute to theses schemes. The cost burden of retirement is placed solely on the state with the consequence of either very heavy costs and/or inadequate benefits.

4. The absence of compulsory universal coverage of central government employees and others in Social Security places an unnecessary cost burden when governments have to negotiate gratuities with contract employees. Gratuities which are normally at 25% of salary is based on the premise that this is the amount required to secure an adequate pension at retirement for a high income middle age professional who is assumed to have no other social security support. If all had social security from the commencement of the working life then the contract gratuity burden would be much lower on the government than it is.

6.3.3.2 ***<u>Economy/society could suffer the following losses</u>*** from the present arrangement:

1. Pay-as-you-go is a burden on two sets of stakeholders: future generation of taxpayers who would have to bear the fiscal burden for benefits enjoyed by prior generations; and/or pensioners who may be denied the stability and adequacy of their pensions in real terms because of the cost burden of keeping abreast with inflation.

2. Unfunded schemes deny the economies and societies the opportunity to create and develop a pool of domestic expertise in financial and investment planning and management.

3. Unfunded schemes deny the economies and societies of the opportunities to develop a pool of long term funds that could be used to finance real investment and economic development.

A sound state pension system should facilitate lifetime consumption smoothing, eliminate or at best alleviate poverty among retired government workers, mobilize long term savings that could be used to finance long term real investment, efficiently manage its portfolio to optimize benefits to its members, minimize inter-generational inequities of burden sharing, and for periodic contributions to be a comfortable and sustainable proportion of governments' current expenditures. The existing arrangements fail significantly in meeting these objectives. Because of the absence of early and universal coverage of all central government employees many retired state employees are outside of the net to receive retirement benefits mobilized from lifetime savings and/or those benefits are inadequate to keep them out of poverty during those retirement years. While a funded scheme generates long term savings for long term real investment the unfunded approach does not allow for intermediation for capital formation and is simply continuous consumption. Additionally, the existing non-contributory arrangement does not encourage the savings habit and does not help foster self reliance on ones efforts for determination of retirement needs.

6.3.3.3 Micro-economic Inconsistencies in Scheme Design

6.3.3.4 Administration

CHAPTER 7

7.0 ISSUES AND CHALLENGES OF PENSION REFORM GENERALLY AND IN THE ECCU

7.3 STATE PENSION SCHEMES

In tailoring a reform programme for state pensions a number of factors peculiar to that pension arrangement must be taken into account. These include specific objectives and imperatives; peculiar economic circumstances and operational constraints.

7.3.4 The ***improvement imperatives for state pensions*** must include:

1. Contributory arrangements between employers and employees.
2. Establishment of a self sufficient and self-financing fund,
3. Its design must be enhanced to improve particularly the aspects relating to size of pension, scope of coverage, pension guarantees, spousal and dependent pension benefits and some indexation to inflation. As a minimum the reform scheme must be an improvement on what currently exists.

7.3.4.1 ***Challenges and constraints*** can be expected not least of which will be:

1. Willingness of employees to accept proposed changes and in particular the contributory arrangements.

2. Employee capacity to meet the increased costs.

3. The fiscal and debt situations of governments and their consequent capacity to meet the reform costs.

4. The need for and the capacity to manage the transitional arrangements.

7.3.4.2 Current economic circumstances and the direction and growth path for these economies will help determine the parameters of the reform and the timing of the transition arrangements. The Monetary Council of the Eastern Caribbean Central Bank has established the following macro-economic benchmarks and Guidelines to direct the growth path of the economies and to monitor their comparative performances. The main ones are:

1. Minimum annual economic growth rate of 6%
2. Minimum surplus on recurrent budget of 6% of recurrent revenue
3. Maximum rate of unemployment of 6%
4. Gross Debt/GDP ratio of no more than 60%
5. Maximum Interest on Debt/GDP of 3%
6. Recurrent Revenue/GDP ratio ranging between 28% to 32%
7. Total Investment/GDP of a minimum of 30% of GDP
8. Public Sector Investment/GDP of about 10%
9. Public Sector Salaries and Wages and Other Benefits/Recurrent Expenditure ranging between 40% and 45%
10. Maximum Incremental Capital Output Ratio (ICOR) of 5
11. The intention of the reform is to improve on these indicators in the medium to long run but to never worsen any of them even in the short run.

CHAPTER 9

9.0 RECOMMENDATIONS AND RATIONAL: A SUB-OPTIMAL BUT PRAGMATIC NATIONAL AND SUB-REGIONAL STRUCTURE OF THE TYPICAL ECCB MEMBER

9.3 RECOMMENDATIONS FOR STATE PENSION REFORM

9.3.4 Reform Objectives

The objectives of these recommendations are to create a secure source of optimally managed resources that have been affordably but compulsorily contributed by the state employer and all its employees to provide a guaranteed stream of income commensurate with historical contribution and consumption levels to take care of the consumption needs of state retirees.

Transitional Arrangements

It would be administratively cumbersome and financially costly to try to implement the reforms over a short period of time and for all persons simultaneously. The reform has to be transitioned and this could take as long as forty years. For this purpose all existing and potential state pension beneficiaries and all remaining central government employees would be classified into three groups as follows:

Group 1 who would be the beneficiaries of the main reform and for whom participation would be compulsory would include all new central government employees who are employed after the agreed and defined commencement date. This could be three months after the decision is taken and the proposals communicated to the public at large.

Group 2 for whom existing arrangement would, in general, continue to apply and would include:

1. All existing pensioners and those to be retired (normal or early) within five years of the defined commencement date; and

2. Non-established and other workers who are 45 years and older at the defined commencement date.

Group 3 who would have the option, for a period, to continue with their existing arrangements in whole or in part and/or to buy into the Group 1 Plan by exchanging their existing benefits, at actuarially determined exchange values, for Group 1 participation and benefits. This Group would include:

1. Existing tenured employees who are expected to retire (normal or early) after five years of the defined commencement date;

2. Non-established and other workers who are under 45 years of age at the defined commencement date.

The ultimate intention is for all central government employees to be covered under SS and the Group 1 SPS.

For each of these Groups will be developed:

1. benefit packages;
2. governance structures;
3. funding arrangements; and
4. investment considerations.

But the emphasis will be on the Group 1 Plan which will be the permanent one. In addition the arrangements for each group would not be exclusive and will all eventually merge into the Group 1 arrangements.

9.3.4.1 Reform for Group 1

Basic Features

The main basic features that are proposed for the Group 1 SPS are:

1. It is a *hybrid scheme incorporating both DB and DC features*. DB schemes are posing considerable financial problems for the corporate world and even for employees who are left with unfulfilled promises and DC schemes, it is felt, leaves employees exposed to meeting the fluctuations in values of investments. In the hybrid a benefits package is agreed to and then the contribution required to finance it is then determined and an allocation agreed between the state and the employees. The employer has no more liabilities beyond his contribution while the employee gets the additional benefit if investments exceed their expected returns or suffers from reduced benefits if the opposite happens.

2. It is *integrated with Social Security thus requiring all employees to be members of both the SS and the SPS*. Moreover the basic benefits are paid by the SS with the SPS supplementing these payments as necessary.

3. *Contributory and funded in a fixed ratio of 2:1 between state and employees for all required contributions* including SS, SPS and a special 6% of salary (this charge is to be actuarially determined) that is recommended to be levied on salaries below the SSPW to meet the additional benefits (above SS) that are associated with the SPS package .

4. *Much improved benefits* to a level that is comparable with what will be recommended by this Report for private occupational schemes and are currently being offered by progressive firms in the private sector. This will facilitate the freer movement of labour (which is good for economic development) not only between the public and private sectors but also within the region.

(a) *Independently and professionally managed outside state control within possible sub-regional arrangements* to obtain scale economies, risk diversification and to insulate from potential possible political pressures in the way the ECCB itself is governed. (See governance).

5. *All gains and liabilities to the account of the Fund* and ultimately to the account of the employees. This is all the more reason for the state not to have majority control over the Fund management.

Benefits Package Design

Specifically the following Benefits Package is recommended for SPS Group 1 Scheme:

1. ***Hybrid of the best features of DB and DC Schemes*** with overall contribution levels determined by annuity necessary to buy mutually agreed benefits package. It moves towards the emerging trend to shift from DB to DC schemes so that the burden of contributions is predictable and equitable. It helps the competitiveness of the corporate sector and recognizes the fiscal burden of the central government.

2. ***Integrated into SS*** with that pillar kicking in before the SPS benefits which simply supplements what are provided by the SS. All central government employees have to contribute and be participants of both schemes.

3. ***Mandatory participation*** for all new entrants into the central government and with no minimum age limit.

4. ***Normal retirement is*** determined every five years or after each census results have been preliminarily tabulated and is ***recommended to be ten years before after average life expectancy overall or for the particular gender***, whichever is the policy choice. For Saint Lucia for instance the average life expectancy in 2008 is 74.32 years with male and female being 70.77 and 78.12 respectively.

(It may also be more useful to use life expectancies nearer to retirement, say at age 50, rather than for full life.)

5. ***Early retirement is at the employee's option and is up to five years before normal retirement.***

6. ***Pension accrual rate is between 1.5% and 2.0% per year of service depending on the availability and adequacy of a national health service.***

7. ***Maximum pension, including SS pension, in the first five years in retirement, is 85% of the highest annual salary in the last five years prior to retirement and reduced by ten percentage points during the remainder of the retirement years.*** This is to recognize the fact that consumption expenditures on such activities as travel and entertainment are normally higher during the early retirement years and considerably reduced as the body becomes more indisposed. Also, the higher than normal maximum pension is to recognize that in retirement people not only have more time to consume but also are denied the many "perquisites" that are available in the workplace.

8. Pension accruals cease when maximum pension level is attained but contributions should continue with that excess used to either finance later employee contributor deficiencies 7/or improve benefits 7/or made available as additional gratuity at time of retirement.

9. ***Pension in payment is guaranteed for five years after retirement***

10. ***Spousal and/or dependent pension benefits of:***
    - ***(a) Fifty percent of final pension in payment payable to unmarried spouse for life***

(b) ***Up to fifty percent of final pension in payment payable to dependents up to the age of eighteen or up to 23 for those pursuing full time tertiary education such that no dependent receives more than 10%.***

11. ***Total vesting of employer contributions after one year of service***.

12. ***Portable to reputable and recognized pension plans*** at actuarial value; or at value of member's share in the Fund but can also be retained to provide an actuarial value of pension at retirement.

13. ***Pension adjusted for inflation annually to a maximum of 60% of the latest full year of inflation data available but subject to amaximum of 3% per annum.*** This is to encourage retirees to involve in some form of income earning activity to earn income and for health and recreational reasons. Activities could include kitchen gardening, craft work, ruminant rearing, horticulture, home agro-processing, baby sitting, home care management etc. This helps them to feel that they are still useful citizens.

14. ***Death in Service benefit would be equal to two years of salary plus member's accumulated contributions.*** This is to be financed through a group insurance whose premium would be borne by the state. However the Fund can undertake to provide this service if it has the resources and capacity to do so and would bill the state. Members who wish their estates to receive the contributor's accumulated contribution in addition to the normal death in service benefit can opt to do so by meeting the cost of the insurance premium.

15. ***Permanent disability benefit is to be determined.***

16. ***Gratuity at normal or early retirement can be provided up to one quarter of the actuarial value or the value of the accumulated and combined benefit in the Fund plus whatever excess contributions or surpluses that exist in the member's account.***

17. ***Pensions shall not be liable to be attached, sequestered or levied upon for, or in respect of any debt or claim whatsoever, even to the Crown or by an order of the Court.*** This is because a pension is designed to ensure that persons live a reasonably comfortable life during their twilight years and are not driven to poverty for whatever reason and by whatever person. However, gratuities can be used as security for loans where the loan is to be used to improve the prospective retiree's quality of life and income during retirement e.g. purchase of house or land, financing education, major medical expenses, purchase of shares, starting a business.

18. ***Pensions can be suspended in whole or in part during:***
    - ***(a) Imprisonment by and in the custody of the state; and***
    - ***(b) Recommencement of employment with the central government.***

    The amount of the suspension will depend on the presence of spouse and dependents who will need support and the level of income from the state.

Funding

The main funding elements are:

1. ***Contribution will be in a 2:1 ratio between the state and the employees*** and will cover all contribution requirements including the3% of the salary contribution to the SPS for the salaries that are below the SSPW.

2. ***All resources will be maintained in a Fund and managed to optimize*** *long term returns* taking into account the investment climate and economic situation, the

need to diversify risks, the demographic profile of the participants and the ability to optimally meet claims when due.

3. ***The Fund though managed in aggregate will be tailored and managed to meet the individual needs of each member***.

4. ***All liabilities will be to the Fund's account***

5. ***The Fund will have very restrictive borrowing rights*** which will only be allowed to help ensure its liquidity and ability to meet pension obligations when due without having to prematurely realize its investments. All borrowings will be secured, have a maturity of no more than five years, and in, aggregate shall not exceed 20% of the net value of the Fund.

Investment Considerations

Promoting general economic and capital market development are two of the primary objectives of the reform exercise. But they will be the most challenging but must never compromise or be given priority over optimizing returns and portfolio stability and security. In order to ensure this there will be need to rigorously establish and continually monitor and subject to risk management stress testing the following set of guidelines:

1. Range and limits of domestic and sub-regional portfolio exposures within the context of economic, natural and physical vulnerabilities;
2. Acceptable targets and tolerance limits for the weighted average portfolio quality (credit rating);
3. Sectoral spread of investments
4. Geographical spread of investments
5. Balance between:
   (a) real and financial assets

(b) short and long term investments

(c) equity and fixed income instruments; and

(d) state and private sector investment paying due regard to:

- (i) economic conditions;
- (ii) the state of the capital market; and
- (iii) the availability and quality of investment opportunities.

All these are to pursue the objectives of:

1. Optimizing returns (the primary focus);
2. Meeting obligations when due (supported by the borrowing capacity)
3. Promoting economic development by ensuring that projects financed have economic rates of return that are higher than the social cost of capital; and
4. Developing the domestic/sub-regional capital market.

There is very limited experience in managing investments in SPS as these are largely unfunded. The few experiences in developed economies reveal the following potential difficulties and challenges:

1. High administrative costs per unit that reduce fund returns, increase the contribution rates unnecessarily, reduce the level of benefits and the risks of fund solvency;

2. Poor investment decision-making arising from:
   (a) concentration on short term financial transactions;
   (b) a portfolio mix that does not produce optimal and timely returns; and
   (c) inflated assumptions particularly with respect to expected returns on investments.

The experience in developing economies like those in the Caribbean are even more limited but can be gleaned from the experiences of the investment management of the SS schemes. The expected problems are a ***systemic concentration*** on:

1. Short term low-yielding passive bank deposit assets when the liabilities are as long term as you can get. (This is a classic case of a reverse and negative asset and liability transformation);

2. Government paper with no defined purpose and most times used to finance recurrent expenditures and projects with very marginal economic and financial returns;

3. High proportion of long term funds in office buildings that are costly to construct, have low rental income returns, high administrative and maintenance costs, but admittedly high nominal appreciation in a market where there is very limited demand for such assets; and

4. Fixed income instruments rather than a better balance in growth creating equities in the direct productive sectors.

Governance and Administration

Governance is the overarching feature in a pension arrangement and is critical to its success. It can operate at the domestic or sub-regional level but the latter is preferred and recommended to provide economies of scale, independence of operations, insulation from national political considerations and risk diversification. If that is not adopted given the successes of the central banking arrangement and the urgent and essential push to a common economic and financial space then as much sub-regional functional cooperation is recommended as a second best approach. These proposals assume a sub-regional approach but can be easily modified for national treatment even though the avoided opportunities and benefits would be high.

The proposed governance arrangements are designed to operate at three levels:

Regulatory involving a/an:

(a) Permanent and standing sub-regional regulatory arrangement

(b) Independent(international and/or private) triennial actuarial review bodies.

Management involving

(a) An independent sub-regional management company

(b) Independent investment advisors and sub-fund managers

(c) Domestic SS apparatus.

Trustees with full accountability for the Fund, and structured as:

(a) Three nominated by the participating states

(b) Three nominated by representatives of the employees

(c) An Independent Chairman mutually agreed to between the states and beneficiaries

The proposed responsibilities for each of the governance elements are:

Regulator

(a) Keeps legislative framework and operating policies under continuous review and makes recommendations for legislative improvement and giving policy directives;

(b) Ensures that Fund administrators comply with legislative framework and operating policies and imposes and enforces sanctions for non-compliance.

(c) Ensures that Funds are financially sound and healthy.

Trustees

Has overall responsibility for the Schemes by giving strategic direction, policy prescriptions within the regulatory framework, making senior management appointments, undertaking periodic performance reviews and, in general, providing continuous monitoring of overall performance.

Management Co

Responsibility for the day to day management of the Scheme and the overall responsibility for the Fund within regulatory limits, Board and regulatory policies, performance targets and benchmarks, the overall health of the Fund and its ability to optimally meet its obligations.

(a) The company will pay due regard to the advice to the advice provided by the actuarial and investment advisors (where they exist), but ultimate responsibility will rest with the Board of Trustees and Management.

(i) Preparation of various periodic reports to the various stakeholders: regulators, actuaries, public, individual members either as individual and/or general reports.

(ii) In order to save on administrative costs, gain on scale economies, and minimize duplication of activities and functions the SS should be requested to perform the administration of the Fund provisions to the members.

(iii) SPS would reimburse the SS for the costs of incremental benefits provided to SPS members on its behalf plus the incremental administrative costs plus to the SS for providing that service.

In order to qualify as trustees and as part of senior management persons should be properly motivated, collegial, with capacity for strategic thinking and with collective skill/experience sets to carry out the necessary fiduciary responsibilities.

9.3.4.2 Reform for Group 2

The following arrangements are being proposed for existing pensioners and workers who are expected to retire (normal or early) within the next five years from the defined commencement date:

1. The existing benefits package applicable to them would continue to apply except that pensions will be adjusted automatically every three years at the cumulative annual inflation rate but restricted to a maximum of 3% cumulative for the period. This enhanced benefit is to give more predictability to cost of living adjustments to pension enhancement.

2. New funding arrangements will not be necessary as the non-contributory and pay-as-you-go features will continue. As is the current practice annual amounts will be appropriated from the annual recurrent budget to meet the annual obligations.

3. Existing contract employees will be under this group but new more realistic contract gratuity terms (that are more reflective of the actuarial equivalent of existing pension arrangements on a lifetime basis) should be determined for new contracts.

4. There is also the need to discuss and resolve the issue of whether to allow the encashment of full contract gratuities where there is a National Pension Scheme and with full portability. Encashment of full contracts could possibly defeat the idea of employees having adequate income to take of their consumption needs during their retirement years.

9.3.4.3 Reform for Group 3

Persons classified into Group3 have three possible options which they must formally exercise within two years of the Defined Commencement Date. The three options are:

Option 1 which is to elect to continue under existing arrangements and who will be treated exactly like those in Group 2 i.e the status quo both in terms of contributions (nil) and benefits (old existing arrangements);

Option 2 which is to elect to convert all their existing benefits to the actuarial equivalent of Group 1 benefits and who would from the date of election be treated just as Group 1 participants both in terms of benefits and contributions going forward; and

Option 3 which is to elect to either:

(a) Freeze their old existing benefits in the old arrangement and, at retirement, be entitled to an actuarially equivalent pension for these values; and, from the date of election, to commence participation in the Group 1 SPS/SS schemes. This would mean contributions going forward and the receipt of two sets of pensions at retirement: one from the Group 2 and also another from the Group 1; or

(b) Join the Group 1 scheme on the date of election and use some of the existing benefits to buy actuarially equivalent but a reduced number of years in the Group 1 SPS. Again, contributions have to be made going forward and at retirement the retiree will receive two sets of pension payments each from Group 1 and Group 2.

By the end of two years after the defined commencement date when all those who were classified as Group 3 would have made their choices as to whether they stay under the old existing arrangements or transfer in whole or in part to the Group 1 SPS there will be only two pension systems: the old existing pension arrangements and/or the reformed SPS Group 1.

For contribution and funding purposes those who elected to go into Group 1, in whole or in part, would instruct the state to begin, from the date of election, to:

1. Make, and continue to make for as long is necessary, the required deductions from the employee's salary to meet the contribution requirements to the SS and the SPS Group 1 Fund;

2. Meet its own recurrent counterpart contribution obligations to the SS and SPS Group 1 schemes and to continue with these for as long as necessary ;

3. Transfer the actuarial values in present value accounting terms of their transferred benefits that they elected for, to the account of the Group 1 SPS Fund.

The state can choose to transfer these values to the account of the Group 1 SPS in any, or a combination thereof, of the following forms:

1. A lump sum cash payment;

2. Interest bearing (government ten year bond rate) marketable long term bonds in varying maturities to approximate the liquidity and income needs of future pension obligations;

3. Annual budgetary appropriations equal to the future value of what is due currently with the discount hurdle rate being the state 10 year bond rate.

Group 1 governance has already been recommended. (See section 9.3.3.5) All those who have opted for Group 1 participation, in whole or in part, would be under Group 1 governance for that whole or part. No new governance arrangements are proposed for the existing arrangements.

Special temporary and transitional arrangements will need to be put in place to introduce and implement the reform arrangements. A unit must be established to have responsibility for:

1. Undertaking the classification.

2. Informing the central government employees about the proposed arrangements, how it will benefit them and how they can go about making their selections.

3. Getting actuaries to calculate the present value of benefits that persons have under existing arrangements and what number of years they can buy under the Group 1 SPS and communicating these to all employees.

4. Offering a counseling service to employees to help them make an informed decision.

5. Setting up the administrative structure to manage the Group 1 SPS

6. Making arrangements to transfer values from the central government to the Group1 SPS on a timely basis.

7. Ensuring that by the end of the two years after the defined commencement date that all persons have been informed, properly classified, have elected for an option and have completed the necessary documentation to sanction the decisions taken.

CHAPTER 10

10.0 COSTS AND BENEFITS OF THE PROPOSED ARRANGEMENTS

10.3.5 COSTS AND BENEFITS OF THE PROPOSED STATE PENSION REFORM ARRANGEMENTS

10.3.5.1 Costs

The cost of these proposals are analyzed from two perspectives:

Perspective 1 or the incremental cost to the State of providing these enhanced benefits under the assumption that the reforms are fully transitioned, have been fully implemented, are stable and in equilibrium; and

Perspective 2 or the initial and transitional cash flow costs of getting the existing arrangements to the proposed and desired steady state equilibrium situation.

PERSPECTIVE 1

From Perspective 1 the incremental costs to the state of implementing the proposed reforms are virtually either non-existent, at best, or small, at worst. This is largely because the recommendations were designed to place the burden of financing the enhanced benefits on the employee/beneficiary through the introduction of an employee contributory arrangement; efficiencies in administration; and the establishment of a fund from which returns can be generated. (The level of these incremental costs will be determined when the value of the per $ wage costs for providing the existing and proposed benefits have been actuarially determined and compared). It should also be noted that:

1. The existing pension arrangements are a virtually inalienable right of the employees and a sacrosanct obligation of the State. Whatever are the existing costs these must be borne by the State whether as pay-as-you-go or as a funded arrangement; and both of these are, theoretically, equally burdensome in actual accounting value;

2. The proposed inflation adjustments for those who do not wish to upgrade are modest and, possibly comparable with what the state currently provides. The difference is that they are automatic and defined;

3. The enhanced benefits in the Group 1 SPS have an additional cost but this is balanced by the fact that the scheme is now contributory in a 1:2 ratio between the employee and the state. Thus it can be said that the employees' new contribution would roughly take care of the enhanced benefits.

PERSPECTIVE 2

Perspective 2 crystallizes the State's hidden and latent obligations and contingent liabilities associated with terminal and retirement benefit obligations to its employees and makes them more transparent. It gives the current cost of these obligations and a method of funding them. It is the sudden realization and meeting of these funding requirements that could result in cash flow and/or debt stock challenges. Some of the implications of the funded approach which are a neutral burden on the central government are as follows:

1. The funded approach appears to increase debt levels, but only notionally as these were always State obligations. All it does is to make the State's stated debt levels more realistic and transparent;

2. The servicing of that debt appears as an added cost but is in fact equated with and offset by the eventual charge on the appropriations for terminal benefits;

3. Similarly, making the scheme contributory is a cost that is now made more transparent as it would be subsumed under the annual appropriations for retirement and terminal benefits.

The real burden, really, is in funding the existing and committed obligations. It is a cost now only because they were avoided in the past. Funding it now reduces the cost in the future and reduces the perpetuation of future generations paying for the services enjoyed by past generations – the issue of intergenerational inequity.

The proposals as structured would have some initial cash flow implications. These are estimated at a notional increase of debt levels by about **% of GDP, and, in debt service terms, by about **% in the initial year and gradually reducing to zero after the full transition period.

10.3.5.3 Benefits

Since there is hardly a financial difference to the State between the existing and proposed pension arrangements what then are the benefits particularly at the macro-economic level? These could be summarized as:

1. The establishment of a fund that will be able to make long term productive investments and also stimulate the development of the capital market.

2. Conversion of a process of continuous consumption into a beneficial cycle involving: savings (denied consumption), financial intermediation, investment, productive growth, income generation, consumption.

3. Encouragement of savings and some self sacrifice and participation by members.

4. Helping to promote financial literacy among a significant proportion of the population.

5. Helping to develop the financial management climate in the economies.

6. Providing improved pension benefits to members which should result in a more contented work force which could hopefully improve work force productivity.

7. Modernizing the State Pension system which could set a progressive example for private sector occupational schemes.

8. Minimizing inter-generational burdens.

9. Making government obligations more transparent.

10. Assisting, through the portability provisions, with the freer and hence more productive use of labour throughout the economic system.

11. Increasing and or stabilizing economic activity through the process of consumption smoothing of retirees as consumption itself with exports, investment (in that order) being the principal drivers of economic activity in economies.

12. Helping in mobilizing some contribution from persons who have been nurtured, educated and worked at home but later migrate to the extent that their contributions stay behind (but still accessible to them at retirement) to help develop the economies. It could also serve to foster a link between their natural and adopted homes and encourage them to visit and supplement their savings in their natural homes.

13. Offering scope by serving as platform and springboard for essential public sector reform (which will be discussed in the following chapter).