

REPORT

OF THE

JOINT SELECT COMMITTEE

ON ITS DELIBERATIONS ON

**GREEN PAPER # 2/ 2011, ENTITLED “OPTIONS FOR
REFORM OF PUBLIC SECTOR PENSION SYSTEM”**

October, 2012

1. Establishment, Composition and Terms of Reference of the Committee

Members of this Honourable House are reminded that on January 24, 2012 the Minister of Science, Technology, Energy and Mining and Leader of the House, the Honourable Phillip Paulwell, having obtained suspension of the Standing Orders, moved:

BE IT RESOLVED that, notwithstanding Standing Order 76 (1), this Honourable House appoint a Special Select Committee comprising the following members:

Hon. Horace Dalley - Chairman

Hon. Derrick Kellier, CD

Hon. Dr. Morais Guy

Dr. the Hon. Omar Davies

Mr. Fitz Jackson

Mr. Derrick Smith, CD

Mr. Pearnel Charles, CD

Mr. Rudyard Spencer, OD

To sit jointly with a similar committee to be appointed by the Senate to consider and report on Green Paper No. 2 of 2011 entitled “Options for Reform of the Public Sector Pension System”.

On February 10, 2012, the Leader of Government Business in the Senate, the Honourable Arnold J. Nicholson, having obtained suspension of the Standing Orders, moved the following motion:

BE IT RESOLVED that this Honourable Senate appoint a Special Select Committee comprising of the following members:

Senator the Hon. Mark Golding

Senator Navel Clarke, CD

Senator Norman Grant

Senator Imani Duncan-Price

Senator Arthur Williams

Senator Dr. Christopher Tufton

To sit jointly with a similar committee appointed by the House to consider and report on Green Paper No. 2 of 2011 entitled “Options for Reform of the Public Sector Pension System”.

Members are reminded that the Green Paper No.2 of 2011, on the Options for Reform of the Public Sector Pension System which is the subject of the Committee’s deliberations was first referred to a Joint Select Committee in 2011. That Committee opened its deliberations on the Green Paper on October 13, 2011, and held five (5) meetings before the Parliament was dissolved in December, 2011. In recognition of the invaluable work that the previous Joint Select Committee had undertaken in respect of the subject matter your Joint Select Committee which was appointed in January and February, 2012, in the House and Senate respectively, took the decision to adopt the work of that Committee.

Members are further reminded that, by virtue of a resolution approved by this Honourable House on May 1, 2012, and in the Senate on May 4, 2012, the composition of the Committee, as set out above, was made to continue in force for the 2012/2013 session of Parliament and the Committee empowered to proceed with matters that were before it from the stage reached at prorogation. Your Joint Select Committee held **9** meetings, the first of which was held on February 29, 2012 (*Appendix I*). Your Committee also went into retreat with the technical officers to deliberate and develop the appropriate recommendations for the report to the Parliament. (*Appendix II*)

2. INTRODUCTION

Pension is a very sensitive issue as it is an important component in the compensation package for public sector workers. The importance is reflected in the fact that the legal basis for payment of any pension can be found in the Constitution and different pieces of legislation. All of these provide for pensions to be paid from the Consolidated Fund. However, over the years, the cost of pensions has been increasing and this is likely to continue as pensioners live longer and the amounts contributed by the workers continue to be an insignificant portion of the required amount necessary to pay pensions.

The Government is the largest employer of labour in Jamaica. Presently, 80,971 public sector employees may be eligible for a pension: 37,465 persons employed to Central Government, 16,835 employed to the Security Forces (JCF and JDF) and 26,671 employed as teachers. Currently, the Public Sector pension system is unfunded in the sense that no contributions are set aside in a discrete fund for the payment of those pensions. Instead, pensions are paid on a recurrent basis out of the Consolidated Fund, in what is called Pay-As-You-Go (PAYG) system.

As at 2011, pension payments represented 1.4% of GDP or about 5% of total Government revenue. It is projected that public pension payments will continue to increase in the upcoming years. These figures and subsequent projections indicate that the system is becoming unsustainable and consequently has serious implications for the country's already inhibiting public debt. Public sector pension is an implicit liability of the Government of Jamaica (GOJ) and therefore not accounted for in any public sector balance sheet although it can be measured. Without the implicit pension liability factored in, Jamaica's public debt currently represents 129% of GDP. The implicit pension debt is estimated at around 20% of GDP and under current conditions it is expected to grow significantly unless steps are taken in time to contain it within sustainable levels.

Since 2005, the World Bank has been assisting the GOJ to carry out the diagnostics to undertake public sector pension reform. Extensive preliminary work was done which culminated in the signing of a loan agreement with the World Bank in 2007 for the Social Protection Project. As such, the Public Sector Pension Reform was included as a component under the Social Protection Project. There are two broad aspects to this component, i) improving administration of the pension system and ii) building the capacity of selected public sector officers to carry out the reform.

Reform of public sector pension is not unique to Jamaica, as the experience is that other countries have changed their pension arrangements based on their fiscal situation. Legislation guiding the pension process stipulates that pension may be granted and analysis of those laws shows that government can alter pension arrangements since Parliament can amend or repeal legislation. This, however, does not remove the responsibility from the government to ensure

that public sector workers are protected economically and socially after retirement as they have what is referred to in law as a legitimate expectation that the pensions promised in respective Acts will be met.

The stakes in pension reform are particularly high, given that along with tax reform it has been flagged by the multinational financial institutions as an issue that requires urgent action, to ensure their continuing support. In light of that recognition, your Committee is quite cognizant that the matter warrants urgent attention. The hope is to reform the public sector pension system so that there are adequate benefits that would be in line with international best practices and would drastically reduce the implied liabilities and lead to a fully funded system after the period of transition. In addition, the aim is to devise modifications to the system and its delivery so that public sector workers would buy into the revisions.

At the end of the Public Sector Pension Reform process, the expected outcome is a system that provides benefits that are adequate and consistent with human resource policies in the public sector, affordable to the government and sustainable in the future as we try to reduce our debt to GDP and put the country on a path to sustainable development. Your Committee realizes that there is no choice but to reform the system. In undertaking this, some compromises will be required and some improvements will be enshrined.

Your Committee recognizes the importance of the subject matter and the far-reaching impact that the outcome of the deliberations would have on the entire nation and as such, the decision was taken to use a consultative approach. In light of the nature of the reform various stakeholders, both from within the public sector and in the wider society were given the opportunity through a Public Notice which appeared on March 4, 2012, in The Sunday Gleaner and the Sunday Observer to make submissions to the Joint Select Committee. A Public Service Advisory was also sent to the different media houses in order to give a wider cross section of the population the opportunity to make submissions.

The previous Joint Select Committee received submissions from the following organizations and individuals:

- Milestone and Lifestyle Planning Services

- Jamaica Medical Doctors' Association (JMDA)
- IOS Partners
- Jamaica Teachers' Association (JTA)
- Jamaica Police Federation
- Caribbean Actuarial Association (CAA)
- The Special Constabulary Force Association & the ISCF Officers Association
- Mrs. Constance Dalmadge Hall – Fellow Society of Actuaries
- Jamaica Civil Service Association (JCSA)
- Jamaica Confederation of Trade Unions (JCTU)

Four (4) of the abovementioned submissions, The Special Constabulary Force Association & the ISCF Officers Association; Mrs. Constance Dalmadge Hall – Fellow Society of Actuaries; JCSA, and the JCTU were not heard in the previous Parliamentary session and therefore were heard in the Parliamentary Session which began in January, 2012 along with the following which were also received:

- Mr. Hartley Stewart
- Private Sector Organization of Jamaica (PSOJ)
- Jamaica Defence Force (JDF)

Your Committee felt that it was necessary to get a legal opinion on the proposed reform of the public sector pension and therefore the Attorney General's Chambers was requested to provide an opinion. The opinion, supported by case law, showed that there would be no breaches in the contractual arrangement between the Government and public sector employees if changes were made to the pension system.

Your Committee received technical assistance from representatives from the MOFP, Mrs. Constance Dalmadge Hall and the CAA. In particular, a significant body of work, comprising extensive consolidation and cleaning of relevant data, technical analysis and multi-scenario financial modelling was done by the CAA to inform the substantive projections. The Committee now has the honour of presenting its findings and recommendations.

3. FINDINGS

3.1 *Current Pension System*

Your Committee is aware that the existing pension system is administered in accordance with various pieces of legislation which are similar in many respects but have variations which make administration cumbersome and difficult. These variations are reflected, for example, in the specified normal retirement age, level of mandatory employees' contributions and the benefit formulae. The result is that, although the Government is the sole employer for all public servants, if an employee should move from one category of employment to another, the pension formula for mixed service varies for different parts of such pensionable service. These differences render the system unwieldy, and in some cases inequitable for employees whose service span more than one pension Act.

Your Committee found that the following features are characteristic of the current pension system:

- i. Normal age of retirement for most Public Sector workers is 60 years.
- ii. The pension benefits are all based on the Defined Benefit model.
- iii. The Police, Parish Councillors and Parliamentarians must contribute 1.7%, 6.0% and 6.0% of salaries respectively. No employee contributions are mandated for teachers.
- iv. Central Government workers contribute 4.0% salaries in accordance with the Pensions (Civil Service Family Benefits) Act.
- v. Employees' contributions, where applicable, are deducted from salaries and paid into the Consolidated Fund.
- vi. Ten (10) year vesting period to benefit from pension arrangement.
- vii. In computing retirees' pension, the accrual rate is 2.2% final pensionable emoluments (equal final salary for most) for each year of pensionable service. Pensions are payable monthly.
- viii. A retiree has the option to commute one-quarter of his calculated pension for a cash sum (gratuity) and receive the three-quarters in equal monthly instalments for the rest of his/her lifetime. The commutation factor is twelve and one-half (12½) for all ages at retirement.

- ix. Surviving spouses' and children's pensions are a fraction of the deceased employees'/ retirees' own pensions, but are payable only in respect of those staff categories that actually made pension contributions.
- x. Pension payments are made from the Consolidated Fund.
- xi. Increases to pensions in payment (to retirees and beneficiaries) have been granted on an *ad hoc* basis by special allocations from the Budget, but are not provided through the respective pensions Acts.
- xii. On surviving twelve and a half (12½) years on pension a retiree receives a restoration of the one-quarter pension that was commuted for cash. This amount is added to his or her *ad hoc* increases to date which are shown as "temporary supplements".
- xiii. Early retirement at the employee's own option is allowed at any time between ages 55 and 59 years. Most categories of employees, except teachers, may retire between ages 50 and 54 years, with the permission of the Governor General on the recommendation of the relevant Service Commission.
- xiv. Retirement later than the Normal Retirement Age may be allowed by the Governor General on the recommendation of the relevant Service Commission.

3.2 *The Proposals of the Green Paper*

In our deliberations on the Green Paper on the Options for Reform of the Public Sector Pension we recognized that it was developed as a response to Government's recognition that the current system poses several challenges including fiscal sustainability and administrative inefficiencies.

Your Committee is aware that pension reform must be addressed within the context of the realities of the economic environment. The inflation rate has had a tremendous impact on the purchasing power of the income stream of the Government pensioner. Despite *ad hoc* adjustments to pensions over the years, pensioners often received inadequate pension benefits due to the impact of inflation after their pension commenced.

Your Committee noted the reform options presented in the Green Paper. Firstly, Parametric Reform which involves retaining the structure of the current system while modifying some elements of the benefit formulae (parameters). Secondly, Structural Reform which involves

replacing the current PAYG system with one that changes the source of funding for the benefits. The administration of the system was also considered.

Your Committee learnt that an important element of the reform is the choice of benefit type: either the Defined Benefit (DB) or the Defined Contribution (DC) model. A DB model promises a pension based on a factor times salary and service. In a DC model, the pension is determined by the amount of contributions paid by and in respect of an employee, investment income on the assets and interest rates prevailing at retirement. The Green Paper considered the DC model as well as a variation, the Notional Defined Contribution (NDC) model. This would be achieved by Parametric Reform of the current DB packages, inclusive of grandfathering for the older employees, or Structural Reform to ultimately produce DC or NDC type benefits.

A significant feature highlighted in the Green Paper that was of great interest to your Committee was the use of the Pension Reform Option Simulation Toolkit (PROST) to run simulations on different reform options. This computer model was created by the World Bank and has been used in many countries to assist in the reform of pension policies. Several reform scenarios were modelled using PROST and five (5) of these options were presented in the Green Paper. A Parametric Reform was chosen as the best option, as it would best serve the function of ensuring that the system is sustainable and affordable for the Government while also providing adequate benefits. The main features of this proposed reform were:

- i. A Defined Benefit system with a combined contribution rate of 10% salaries (5% employee and 5% employer).
- ii. Pension benefits indexed to both inflation and nominal wages at 50% of each.
- iii. An increase in the normal retirement age to 65 years with a gradual increase of one year every two years. This would only affect all new entrants and current workers 40 years and younger and take effect in 2030 with the retirement age reaching 65 years for all by 2040.
- iv. The proposed accrual rate to compute the pension would be gradually reduced from 2.2% to 1.8% and would be applicable only to persons under 50 years old. All benefits accrued up to the effective date of the reform would be preserved.

- v. Pension benefits would be calculated using the final 5 year average salary beginning in 2015 and would gradually increase to a valorized career average salary by 2040.
- vi. Ten (10) years vesting period for entitlements would be retained.

Your Committee also recognizes the specific recommendations made in the Green Paper which are as follows:

- i. Implement the re-engineered business process which is being developed to ensure a more efficient administration of pensions to participants in the existing system.
- ii. Establish a new computerized database, in order to facilitate electronic processing, track career history of employees and allow more accurate estimates on pension expenditure.
- iii. Establish a Division/Commission staffed with personnel with the requisite skills to calculate pension liabilities and advise Government on options for further pension reform as necessary. The factors that impact pensions are dynamic and close attention needs to be paid to them and implications for fiscal accounts.
- iv. As far as possible, implement the recommendations of the legal analysis, so that public sector workers in the same scheme can easily link their years of service. Currently, the legislation for each group is similar therefore one piece of legislation with pensions for specific groups will make the system less complex and more efficient.
- v. Separate the issue of making posts redundant from pensions. Pensions should only be associated with retirement, not the abolition of posts or retrenchment.
- vi. Conduct an extensive financial education programme so that public sector workers become aware of the importance of saving for retirement;
- vii. The NIS, which is a first tier contributory national PAYG system, must be reformed to properly supplement the pension benefits received, in light of its low replacement rate. It is recommended that the basic Social Security System (NIS) should be enhanced through the development of improved funding arrangements and more efficient administrative procedures. This will facilitate the provision of more meaningful benefits on a national scale.
- viii. The Pensions (Civil Service Family Benefits) Act should only be applicable to workers who are in the old scheme.

- ix. Indexation of pensions should be standardized to avoid *ad hoc* increases, allow transparency and better predictions.

3.3 Responses to the Proposals in the Green Paper

As mentioned previously, your Committee heard from various organizations and individuals in response to the Green Paper. The information gleaned from those discussions revealed that there were certain points of convergence. We now present our findings in this regard.

3.3.1 Type of Pension Arrangement

Your Committee realizes that there was general agreement (with the exception of the Jamaica Medical Doctors Association) that a Defined Benefit scheme should be retained. The PSOJ and Mrs. Constance Dalmadge-Hall both postulated a combination of Defined Benefit and Defined Contribution Scheme while the World Bank proposed a combination of the Defined Benefit for past service and a Hybrid Scheme to cover service after the start up date.

3.3.2 Vesting

Only four groups (JTA, Jamaica Police Federation, JCSA and JCTU) explicitly mentioned the issue of the vesting period. They all suggested a reduction in the vesting period from 10 years to 5 years. This would be consistent with the practice for pension funds in the Private Sector, Statutory Bodies and Government companies.

3.3.3 Employees' Contribution Rate

All groups, with the exception of JDF, were in agreement that employees' contributions have to be made towards their pension. The JTA however would only contribute if their members were given a one-off increase in their salary. When pressed by members of your Committee as to what they would recommend they were strident in stating that although it would be tantamount to a policy shift they would be willing for their members to contribute 5% salaries towards their pension.

There was however a point of departure by both Mrs. Constance Dalmadge Hall and the PSOJ as they posited that for existing workers, the employee should contribute 5% of their salary, while for new workers, the employee and employer should both contribute 5% to the pension fund.

3.3.4 Pension Accrual Rate

The pension accrual rate applies to the Defined Benefit model only. The accrual rate for most categories is currently 2.2% of final pensionable pay for each year of service.

The JTA and the Jamaica Police Federation are of the view that the accrual rate ought to remain at 2.2% or be increased. The JDF would like the *status quo* to remain. The JCSA and the JCTU are amenable to an accrual rate of 2% for future service only, but the 2.2% should be retained for past service. However, the CAA recommended a 2% accrual rate for future retirees' pensions in respect of all service, past and present.

Mrs. Constance Dalmadge Hall and the PSOJ envisage an accrual rate of 1% for current workers only for future service. The World Bank suggested that the accrual rate should be reduced to 1.5% for existing workers, 55 years and younger and they should be given the option to choose between the system proposed for them and the one proposed for new workers. The World Bank also suggested an accrual rate of 1% for new workers.

3.3.5 Placement of Contributions

The Green Paper proposed that contributions should be placed in the Consolidated Fund while all other presenters proposed a segregated fund. The CAA was emphatic that there should be a segregated fund established under Trust, administered by a Board of Trustees appointed by the GOJ. The employer's contributions should be invested in real assets, that is, excluding financial sector and government securities. The PSOJ and Mrs. Constance Dalmadge Hall expressed the viewpoint that contributions should be placed in Approved Retirement Schemes, while the World Bank posited that the contributions should be made to the individual account of employees.

3.3.6 Salary Used for Pension Computation

The groups and individuals making submissions to your Committee had different viewpoints on the salary that should be used in computing the pension at retirement. The World Bank's view was that the salary used for pension computation should be the average of all salaries during an employee's career. However, each year's salary would be indexed to a national wage index until retirement. The CAA proposed a final five (5) year average salary to be used in pension computation. All other groups favoured retention of the current final salary formula.

3.3.7 Indexation

Indexation refers to post-retirement increases to pensions in payment. Currently, increases are granted on an *ad hoc* basis through appropriations from the Budget. The groups had a diversity of views as shown below:

<i>Groups</i>	<i>Views on Indexation</i>
Green Paper	50% of Wage Growth plus 50% of Inflation
Jamaica Teachers' Association	100% Inflation
Jamaica Police Federation	100% Inflation
World Bank	100% of Inflation
Jamaica Civil Service Association	60% of Wage Growth plus 40% of Inflation
Jamaica Confederation of Trade Unions	60% of Wage Growth plus 40% of Inflation
Jamaica Defence Force	100% of Wage Growth
Private Sector Organization of Jamaica	Only if funded
Mrs. Constance Dalmadge Hall	Only if funded
Caribbean Actuarial Association	Only if funded
Island Special Constabulary Force	100% of Wage Growth by Post

3.3.8 Retirement Age

Your Committee is aware that currently the age of retirement for most public sector workers is 60 years and that there is a small group of individuals who constitutionally, may work up to the age of 65 years and 70 years. All the groups and individuals, except for the JDF, recommended that the retirement age should be increased to 65 years. The Jamaica Police Federation and the ISCFJA although accepting that the retirement age should be increased to 65 years, would like to

have the option to retire with full pension after 25 years of service given the work related peculiarities of that group.

3.3.9 Early Retirement Age

Currently, the employees have the right to retire up to five years prior to Normal Retirement Age with no reduction in benefits on account of the earlier commencement. The CAA and Mrs. Constance Dalmadge Hall suggested that pensions should be reduced on early retirement except where such retirement occurs on medical grounds. In addition, the CAA proposed an explicit reduction factor of 5% for each year that the employee retires early.

3.3.10 Transition

Although a slow transition period to a new benefit arrangement would be preferred by employees, this would result in delayed savings to the Government. The recommended approaches for transition vary as shown in the table below:

<i>Groups</i>	<i>Transition to New Benefit Arrangement</i>
Green Paper	Starting in 2015 Gradually increase normal retirement age to 65 over 10 years, starting in 2030
Jamaica Teachers Association	Not known
Jamaica Police Federation	Not known
World Bank	As soon as possible, starting before 2015 Gradually increase normal retirement age to 65 over a period shorter than 10 years, starting before 2030
Jamaica Civil Service Association	Not known
Jamaica Confederation of Trades Union	Not known
Jamaica Defence Force	Not known
Private Sector Organization of Jamaica	2016 for current employees Immediately for new employees
Mrs. Constance Dalmadge-Hall*	To be determined after further analysis of the data
Caribbean Actuarial Association	Immediately
Island Special Constabulary Force	Not known

* Mrs. Constance Dalmadge Hall stated that after 2015 persons could still retire at age 60 years except that the pension benefits should be reduced.

In no case would implementation result in a change of pensions already in payment under any of the proposals.

3.4 Major Recommendations made by Different Groups Making Submissions

In addition to the above, the following recommendations were made by the groups and individuals:

3.4.1 Special Constabulary Force Association/Island Special Constabulary Force

- i. The restriction which bars members from accessing other pension schemes be removed and the government to grant proper approval for them to be involved in those schemes.
- ii. The existing workers remain on the current arrangement and be given a period of five (5) years to review the performance of the new plan with an option to join at any time within that period.
- iii. A detailed research and a comprehensive analysis of the existing and proposed schemes to be done using empirical data and examples to highlight the advantages and disadvantages.

3.4.2 Jamaica Civil Service Association

- i. A review of the entire social contract which should include the National Insurance Scheme (NIS) and the entire social protection floor and not just a review of the pension system in isolation.
- ii. Provide for portability of public sector pensions to give workers the ability to move between statutory, public bodies and central government.
- iii. Improve the time in which pension benefits are delivered so that persons can start getting benefits within 30 days of retirement.
- iv. Repeal the Pensions (Civil Service Family Benefits) Act.
- v. Harmonization of the pieces of legislation governing public sector pensions.
- vi. Consider a grandfathering clause for appointed and longstanding temporary workers over the age of 40 years so that they have the option to choose to accept the new pension arrangement when established.

3.4.3 Jamaica Defence Force

- i. The calculation pertaining to the resettlement benefits for officers should remain as per the Defence Act, 1962.
- ii. Portability of service, if an officer decides to move from the JDF to another department of government that should not impinge on the benefits earned under the JDF pension scheme.

3.4.4 Private Sector Organization of Jamaica

- i. Include the NIS benefits as a part of the overall pension benefits
- ii. Cap the maximum pension at 75% of final salary.
- iii. Deploy resources for a public education campaign because most public sector workers have no idea of the pension they would likely receive on retirement.

3.4.5 Caribbean Actuarial Association

- i. No restoration of the pension commuted for a gratuity. Currently this is done after 12½ years after retirement.
- ii. The refinancing of the national debt which was incurred to resolve the crisis in the financial sector in the mid 1990s by obtaining low cost debt from the multilateral agencies which could generate savings of 3.5% of GDP. The bailout of the financial sector amounted to 45% of the country's GDP at the time. This portion of the country's debt continues to be funded on commercial terms, in contrast to, the concessionary terms that have been made available to other more wealthy countries during the recent financial crisis.
- iii. Use of the existing capacity and expertise within the private sector for the establishment and administration of the new Trust Fund.

4. ACTUARIAL ANALYSIS

Your Committee was very interested in getting a sense of the cost of the current pension arrangements compared to the recommended structure.

Under the current benefit structure, the Legacy Liability was determined by the CAA to be \$222.6 billion at the end of 2011. Alternatively, the Legacy Liability is the equivalent to a one-

time cost of 18% of GDP. If the Legacy Liability were spread over 40 years, the equivalent cost would be 36.4% of payroll per annum. These figures are shown in **Table 1** below.

Under the current benefit structure, the GOJ Future Service Contribution (the cost of one year’s service after 2011) was determined by the CAA to be a recurring cost of 10.8% of payroll per annum. This is equivalent to \$5.4 billion in 2012. Alternatively, the GOJ Future Service Contribution is the equivalent to a recurring cost of 0.4% of GDP (at constant prices). These figures are shown in Table 1 below.

Table 1

	Current Benefit Structure		
	\$ Billion	% GDP	% Payroll
Legacy liability	222.6	18%	36.4% p.a.
GOJ Future Service Contribution	5.4 p.a.	0.4% p.a.	10.8% p.a.

Under the recommended benefit structure, the Legacy Liability was determined by the CAA to be \$162.9 billion at the end of 2011. Alternatively, the Legacy Liability is the equivalent to a one-time cost of 13% of GDP. If the Legacy Liability were spread over 40 years, the equivalent cost would be 19.8% of payroll per annum. These figures are shown in Table 2 below.

Under the recommended benefit structure, the GOJ Future Service Contribution (the cost of one year’s service after 2011) was determined by the CAA to be a recurring cost of 3.4% of payroll per annum. This is equivalent to \$1.5 billion in 2012. Alternatively, the GOJ Future Service Contribution is the equivalent to a recurring cost of 0.1% of GDP (at constant prices). These figures are shown in **Table 2** below.

Table 2

	Recommended Benefit Structure		
	\$ Billion	% GDP	% Payroll
Legacy liability	162.9	13%	19.8% p.a.
GOJ Future Service Contribution	1.5 p.a.	0.1% p.a.	3.4% p.a.

Table 3 shows the projected GOJ savings, as determined by the CAA, if the recommended structure were to be adopted.

Table 3

	Projected GOJ Savings		
	\$ Billion	% GDP	% Payroll
Legacy liability	59.7 (one time)	5% (one time)	16.6% p.a.
GOJ Future Service Contribution	3.9 p.a.	0.3% p.a.	7.4% p.a.

Your Committee requested calculations to show the sensitivity of the cash flows under the current and recommended structures. These were illustrated for the PAYG (unfunded) and the funded system.

Table 4, column (7) shows the projected cash required by the GOJ under the current PAYG system and current benefit structure. For example, in 2015, the cash required from the GOJ would be \$21,152 million. If the current benefit structure were funded, the amount required would be \$30,724 million-see column (10). This would be an increment of \$9,572 million. However, by the end of 2015, there would be a projected Fund of \$49,254 million- see column (11).

Further into the projection period in 2052, the projected cash required by the GOJ under the current PAYG system and current benefit structure would be \$53,637 million. If the current benefit structure were funded, the amount required from the GOJ would be \$48,165 million, a savings of \$5,472 million. However, the Legacy Liability would have been fully funded by then and there would be a projected Fund of \$2,509,640 million.

These figures are purely for comparative purposes with the recommended structure on a funded basis.

Table 4 - Projected Cash Flows: Current Benefit Structure (\$Millions)

		<i>UNFUNDED (PAYG) SYSTEM</i>					<i>FUNDED SYSTEM</i>			
Year	Actives' Payroll	Pre -2012 Pensioners' Pensions	Post-2011 Retirees' Lump Sums	Post-2011 Retirees' Pensions	Employees' Contributions	PAYG SYSTEM GOJ Cash Required	GOJ Legacy Contributions	GOJ New Service Contributions	FUNDED SYSTEM GOJ Cash Required	PROJECTED FUND AT YEAR END
(1)	(2)	(3)	(4)	(5)	(6)	(7) = (3) + (4) + (5) - (6)	(8)	(9)	(10) = (8) + (9)	(11)
2012	63,349	12,783	8,672	2,001	1,077	22,379	22,804	6,842	29,646	7,629
2013	66,516	12,674	3,201	2,762	1,131	17,507	22,804	7,184	29,988	21,497
2014	69,842	12,888	3,601	3,623	1,187	18,925	22,804	7,543	30,347	35,640
2015	73,334	13,899	3,937	4,564	1,247	21,152	22,804	7,920	30,724	49,254
2016	77,001	13,787	3,924	5,500	1,309	21,902	22,804	8,316	31,120	63,859
.
2048	366,906	309	3,236	65,019	6,237	62,327	22,804	39,626	62,430	1,696,801
2049	385,251	208	2,224	64,461	6,549	60,344	22,804	41,607	64,411	1,870,752
2050	404,514	136	1,372	63,619	6,877	58,250	22,804	43,687	66,491	2,066,481
2051	424,739	86	415	62,457	7,221	55,738	22,804	45,872	68,676	2,286,714
2052	445,976	53	144	61,021	7,582	53,637	0	48,165	48,165	2,509,640

Table 5, column (7) shows the projected cash required by the GOJ for the recommended benefit structure under the current PAYG system. For example, in 2015, the cash required by the GOJ would be \$8,864 million. If the recommended benefit structure were funded, the amount required would be \$19,162 million-see column (10). This represents an increment of \$10,298 million. However, by the end of 2015, there would be a projected Fund of \$47,318 million -see column (11).

Further into the projection period in 2052, the projected cash required by the GOJ for the recommended benefit structure under the current PAYG system would be \$66,376 million. If the recommended benefit structure were funded, the amount required from the GOJ would be \$15,163 million, a savings of \$51,213 million. However, the Legacy Liability would have been fully funded by then and there would be a projected Fund of \$812,470 million.

Your Committee is aware that the projected fund of \$2,509,640 million at the end of 40 years, if the current benefits were to be continued and funded, is substantially larger than the projected fund of \$812,470 million after 40 years, if the recommended benefits were implemented and funded. The larger projected fund requires extra cash contributions of \$245 billion by the GOJ for the legacy liability and extra cash contributions of \$566 billion for the ongoing service over 40 years.

The projected GOJ cash savings, if the recommended benefit structure and funded system were immediately adopted, would be \$56,581 million over the first five years.

Table 5 - Projected Cash Flows: Recommended Benefit Structure (\$ Millions)

		<i>UNFUNDED (PAYG) SYSTEM</i>					<i>FUNDED SYSTEM</i>			
Year	Actives' Payroll	Pre- 2012 Pensioners' Pensions	Post- 2011 Pensioners' Lump Sums	Post- 2011 Pensioners' Pensions	Employees' Contributions	PAYG SYSTEM GOJ Cash Required	GOJ Legacy Contributions	GOJ New Service Contributions	Funded System GOJ Cash Required	Projected Fund at Year End
(1)	(2)	(3)	(4)	(5)	(6)	(7) = (3) + (4) + (5) - (6)	(8)	(9)	(10) = (8) + (9)	(11)
2012	63,349	12,783	0	0	3,167	9,616	16,668	2,154	18,822	9,666
2013	66,516	12,674	0	0	3,326	9,349	16,668	2,262	18,930	20,693
2014	69,842	12,607	0	0	3,492	9,115	16,668	2,375	19,043	33,187
2015	73,334	12,531	0	0	3,667	8,864	16,668	2,493	19,162	47,318
2016	77,001	12,444	394	15	3,850	9,003	16,668	2,618	19,286	62,847
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2048	366,906	299	18,680	71,315	18,345	71,950	16,668	12,475	29,143	697,239
2049	385,251	202	16,159	74,071	19,263	71,169	16,668	13,099	29,767	723,491
2050	404,514	132	14,954	76,435	20,226	71,295	16,668	13,753	30,422	752,923
2051	424,739	84	12,854	78,190	21,237	69,891	16,668	14,441	31,109	787,494
2052	445,976	52	9,570	79,052	22,299	66,376	0	15,163	15,163	812,470

5. COMMITTEE'S RECOMMENDATIONS

Your Committee after assessing the submissions extensively flagged the following questions:

- a. Are the costs fiscally sustainable?
- b. Are the amended benefits equitable?
- c. Will the new arrangement be secured?
- d. Are the amended benefits adequate?
- e. Are the operations of the new arrangement transparent and efficient?

Your Committee sought to find a balance in the discussions on the abovementioned queries.

5.1 *Secure Arrangement*

Your Committee sought an improved level of security for the new arrangement that would be consistent with compulsory employees' contributions and local experience, for example, the National Insurance Fund, the National Housing Trust and the Private Sector plans.

5.2 *Equitable Distribution of Cost*

Your Committee sought to achieve equity between the current and future generations of employees.

5.3 *Fiscal Sustainability*

Your Committee sought a meaningful reduction in the pensions cost to the Government of Jamaica, when considered in terms of GDP, payroll and absolute dollars.

5.4 *Adequacy*

Your Committee sought an arrangement that protected the employees from the majority of risks that impact retirement benefits. These include:

- i. Replacement Rate Risk: the risk that the pensions will be insufficient to maintain the same standard of living after retirement as before retirement;
- ii. Investment Risk: the risk that the assets in the plan are inadequate as a result of poor investment performance;

- iii. Interest Rate Risk: the risk that the actual pension is low as a result of low interest rates at the time of retirement;
- iv. Longevity Risk: the risk that individuals would outlive their income;
- v. Inflation Risk: the risk that inflation will reduce the purchasing power of their pensions;
- vi. Portability Risk: the risk that accrued pension rights cannot be transferred when an employee changes jobs;
- vii. Employer Insolvency Risk: the risk that the employer is in financial distress and unable to meet the benefits promised;
- viii. Political Risk: the risk of explicit changes by government in laws and policies that could adversely affect the contributions, net investment yield or benefits e.g. changes in the tax regime.

5.5 *Transparency and Efficiency*

Your Committee sought a governance-architecture for the new arrangement that would be transparent and efficient.

In light of the aforementioned considerations your Committee now makes the following specific recommendations:

- i. **Plan Type** – Retention of the Defined Benefit (DB) model as it was felt that the benefits would be adequate and the operations of the new arrangement would be transparent and efficient.
- ii. **Funding** - Establish a segregated fund under Trust as the costs would be fiscally sustainable; the new arrangement would be secured and the operations of the new arrangement would be transparent and adequate.
- iii. **Employees' Compulsory Contribution** – All employees from the implementation date to contribute 5% of salary. This would result in the costs being fiscally sustainable, more equitable benefits, a more secure arrangement and a more efficient and transparent arrangement.
- iv. **Employees' Voluntary Contribution** – All employees could make Voluntary Contributions, within the provisions of the Trust Fund. This would create more adequate benefits and would allow for transparency and efficiency.

- v. **Employer's Compulsory Contribution** – Based on the assumptions set out on page 17, the GOJ should contribute \$17 billion per annum for 40 years to fund the Legacy Liability plus 3.5% of employers' payroll for the ongoing service cost. In effect, this will create a fiscally sustainable fund, allow for equity, security and adequacy to meet the costs of the new benefit structure. This rate should be reviewed at each periodic actuarial valuation.
- vi. **Review Period** – The Fund to be actuarially reviewed every three years or earlier if there is a significant change in the economic environment. This will allow for greater efficiency and transparency.
- vii. **Normal Retirement Age** – 65 years for all employees, male and female.
- viii. **Early Retirement** – To be allowed, subject to conditions. No reduction in the pension for persons who retire early on medical grounds. Other forms of Early Retirement can take place anytime within 10 years of Normal Retirement Age with a reduction of 5% per year earlier than the Normal Retirement Age. Special groups, e.g. JDF and the Jamaica Constabulary Force, because of the peculiar nature of their jobs would be singled out and treated differently regarding age of retirement but this does not mean that these groups will be treated inequitably.
- ix. **Pension formula** – Annual pension equal to 2% times the average of the last five years' pensionable pay times years of pensionable service.
- x. **Partial Pension Commutation** - Retain the option for an employee to commute one-quarter of pension for a tax free lump sum (gratuity) and discontinue restoration of that commuted pension after being on pension for 12½ years.
- xi. **Vesting** – The period for vesting should remain at 10 years.
- xii. **Indexation** – Any future post retirement pension increases should be fully funded when given. Survivors' pensions should also be eligible for such increases.
- xiii. **Redundancy** – Separate the issue of making posts redundant from pensions. Pensions should only be associated with retirement, not the abolition of posts or retrenchment.
- xiv. **Governance** – Same requirements as obtained for regulated Approved Superannuation Funds/Retirement Schemes in the Private Sector.
- xv. **Transition** – January 1, 2013 should be the startup date for new pensionable employees. For existing employees the new arrangements are to come into effect on a date within the

Financial Year 2013/2014 to be decided by Cabinet. Pensions awarded/awardable for existing employees prior to the date decided on by Cabinet will be on the old basis, i.e., it will remain unchanged.

- xvi. **Administrative Structure** - Improvements in the administrative structure and training of persons to become experts in pensions' administration which is a specialized field utilizing existing resources available both from the public sector and the private sector. This is required whether or not reform occurs.
- xvii. **Implementation plan** - Development of an implementation plan in collaboration with the various stakeholders which would cover the financial, legislative, communication, human resource, fiscal and actuarial aspects.

6. ACKNOWLEDGEMENTS

Your Committee wishes to express sincere gratitude to all individuals and organizations that contributed to the deliberations. In particular, the Committee wishes to thank the technical officers from the Ministry of Finance and Planning, the team of actuaries, headed by Mr. Ravi Rambarran, from the Caribbean Actuarial Association and Mrs. Constance Dalmadge Hall for their guidance throughout the deliberations. A special thank you to the Attorney General's Chambers, for providing an opinion on the legality of the reform.

Your Committee is also grateful to the Media, who ably covered the meetings and reported the proceedings to the public. To the Clerk to the Houses and her staff a hearty thank you for their administrative support and for the kind courtesies extended during the meetings.

Houses of Parliament

October, 2012

GLOSSARY

Accrued Rights: This is the accumulated benefit of a member of a pension plan based on the years of service and current salary.

Contribution: A payment made by the employee and/or employer to a pension plan through salary deduction for the purpose of accumulated capital or accruing benefits.

Contribution Rate: The amount (typically expressed as a percentage of the contribution base) that is needed to be paid into the pension fund.

Defined Benefit Pension Scheme: A pension plan where guarantee is given by the employer that an individual will receive benefits. Benefits are based on a prescribed formula (including salary, length of service and other factors) and are not linked to the contributions made.

Defined Contribution Pension Scheme: A pension plan where contributions are made and benefits are based on the contributions plus the returns on investment.

Indexation: A method of adjusting pension benefits to take into account changes in the cost of living (e.g. prices and/or wages).

Implicit Pension Debt: The value of outstanding pension claims on a pension system.

Notional Defined Contribution Pension Scheme: This system resembles a defined contribution plan, where the pension depends on contributions and investment returns. However, in notional accounts, the return that contributions earn is set by policy, not the product of investment returns in the markets.

Occupational Schemes: This scheme is organized by an employer to provide pension benefit for their employees.

Parametric Reform: A reform option that retains the structure and administration of the system but changes some main elements of the parameters, these include the contribution rate or the retirement age.

Pay-As-You-Go (PAYG): This is a system where current benefits are financed by current contributions.

Replacement Rates: The value of a pension as a proportion of a worker's wage for a given base period. It tells how much of a worker's income is being replaced by his/her pension.

Systemic Pension Reform: A type of pension reform that replaces the old system with a new one that changes how benefits are calculated, the source of funding and the administration of the system.

Transition Cost: The gap between revenues and contributions that develops when some of the contribution is diverted to a new funded system while the promised benefits continue to be paid to current retirees and older workers under the old PAYG system.

Vesting Period: The minimum time required to qualify for a full pension.

Appendix I
ATTENDANCE

9 Meetings

	Present	Absent	Apology
Hon. Horace Dalley – Chairman	7	2	2
Hon. Derrick Kellier, CD	7	2	2
Hon. Morais Guy	2	7	4
Dr. the Hon. Omar Davies	3	6	4
Mr. Fitz Jackson	7	2	2
Mr. Derrick Smith, CD	4	5	1
Mr. Pearnel Charles, CD	4	5	1
Mr. Rudyard Spencer, OD	3	6	0
Senator the Hon. Mark Golding	6	3	3
Senator Navel Clarke, CD	5	4	1
Senator Norman Grant	4	5	2
Senator Grace Imani Duncan-Price	5	4	2
Senator Arthur Williams	9	-	-
Senator Dr. Christopher Tufton	1	8	2

Appendix II

Attendance – Retreat of Committee, September 12, 2012

	Present	Apology
Hon. Horace Dalley – Chairman	yes	-
Hon. Derrick Kellier, CD	yes	-
Hon. Morais Guy	no	yes
Dr. the Hon. Omar Davies	yes	-
Mr. Fitz Jackson	yes	-
Mr. Derrick Smith, CD	yes	-
Mr. Pearnel Charles, CD	no	yes
Mr. Rudyard Spencer, OD	yes	-
Senator the Hon. Mark Golding	yes	-
Senator Navel Clarke, CD	yes	-
Senator Norman Grant	no	yes
Senator Grace Imani Duncan-Price	yes	-
Senator Arthur Williams	yes	-
Senator Dr. Christopher Tufton	yes	-

SIGNATURES

.....
Hon. Horace Dalley – Chairman

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Hon. Derrick Kellier, CD

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Hon. Dr. Morais Guy

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Dr. the Hon. Omar Davies

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Mr. Fitz Jackson

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Mr. Derrick Smith, CD

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Mr. Pearnel Charles, CD

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Mr. Rudyard Spencer, OD

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Senator the Hon. Mark Golding

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Senator the Hon. Navel Clarke, CD

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Senator Norman Grant

.....
Senator Grace Imani Duncan-Price

.....
Senator Arthur Williams

.....
Senator Dr. Christopher Tufton