Public Service Pensions Board

2008-2009 Annual Report

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BOARD OF DIRECTORS
AS AT 30 JUNE 2009

BOARD OF DIRECTORS

Hon. Kenneth Jefferson JP
Financial Secretary
Chairman

Mrs. Sonia McLaughlin JP
Deputy Financial Secretary
Deputy Chairman

Mrs. Jewel Evans Lindsey
Managing Director

Mr. Donovan Ebanks MBE
Deputy Chief Secretary, Portfolio of Internal & External Affairs

Mr. James Watler
President, Civil Service Association

Mr. Wayde Bardswell
Crown Counsel, Legal Department

Mr. Leonard N. Ebanks JP
Private Sector Representative

Mr. Eric Crutchley MBE
Private Sector Representative

Mr. Kirkland Nixon MBE, QFSM, JP
Pensioner's Representative

Ms. Nekita Rodriques
Acting Executive Secretary to the Board

BOARD ADVISORS AS AT 30 JUNE 2009

Professional Services

Actuary

Subramanian Sundaresan
In-house Actuary

Auditor

Cayman Islands Audit Office
Grand Cayman
Cayman Islands

Investment Managers

Morgan Stanley Investment Management
London, England
U.K.

Western Asset Management
Pasadena, California
U.S.A.

ING Clarion Real Estate Securities
London, England
U.K.

Attorneys

Pillsbury Winthrop Shaw Pittman, LLP
New York, NY
U.S.A.

Legal Department
C I Government
Grand Cayman
Cayman Islands

Custodian

RBC Dexia
Toronto, Ontario
Canada

Investment Advisors

Advisory Capital Group
Toronto, Ontario
Canada

Managing Director & Chairman of the Board's Message

The Public Service Pensions Board staff as well as the Fund experienced positive growth during the year ended 30th June, 2009. A seasoned director for Plan Administration was welcomed to the PSPB team in May and comes to us with a wealth of pension knowledge after working for 24 years in the pension industry, most recently with the Royal Mail Pension Plan as Secretary to the Trustees for two of three funds and membership manager for their main Plan.

The Plan experienced growth in the form of a positive bounce back from the negative impact of the global recession experienced by all. After the devastating collapse endured as a result of the Lehman Brothers failure in September, 2008 the Fund was able to post very positive returns of 15.3% in the following quarter bringing the year-to-date returns to 3.2%. While the global economy is by no means out of the woods, we are riding a positive trend that we hope will continue to gain market share and momentum and propel us as favorably as possible in to the foreseeable future.

If we consider the severity of the financial crisis which continues to stifle the global economy even to these present times and we then consider the fact that the Fund's annual returns have ranked in the upper quartile for 3 of the last 4 years, our clients can feel confident that their pensions are being invested with care and diligence. A moderate conservative approach to investment has proven to be the most effective strategy for preserving capital and has saved the Fund from experiencing crippling losses during these trying times.

As we look towards the next fiscal year and usher in a new decade there are signs that the market will soon recover and that while it may take several years for circumstances to be completely normalized, we are heading in the right direction. The Board of Directors will continue to keep the preservation and development of the Fund as the main focus of our efforts along with delivering quality customer service.

Managing Director

Chairman

OVERVIEW OF THE
PUBLIC SERVICE PENSIONS BOARD

Background Information

The Public Service Pensions Board (the Board) was re-established as a Statutory Authority on 14 April 1999, by virtue of the Public Service Pensions Law, 1999, which was revised in 2004. The Public Service Pensions Law (2004 Revision) (the Law) repealed the Pensions Law (1999 Revision) and with its amendments governs the Public Service Pensions Plan (the Plan). The head office of the Board is located at the Government Administration Building, 133 Elgin Avenue, in George Town. Responsibilities of the Board include but are not limited to, administering the Plans, investing the Public Service Pensions Fund (the Fund), communicating with the Plan employers and participants, prescribing contribution rates in accordance with the latest actuarial valuation, and recommending amendments to the Plans and quantifying their financial impact as needed. The main functions of the Fund are to receive prescribed contributions, invest and pay out pension benefits as they become due under the Law. The Fund is vested in the Board.

The Fund has a defined benefit and a defined contribution component. All employees who joined the Plan prior to 14 April 1999 were enrolled in the Defined Benefit Part of the Plan. Those employees joining after 14 April 1999 were enrolled in either one of the two components depending on their circumstances. The Public Service Pensions (Amendment and Validation) Law, 2000 which was passed on 20 June 2000 amended the date after which all new employees were to be enrolled in the Defined Contribution Part of the Plan to 1 January 2000.

Contribution Rates

Employees who participate in the Plan contribute at the rate of 6% of pensionable earnings and employers contribute a matching 6%. Contribution rates to cover additional defined benefit costs are recommended by the Board based on the latest Actuarial Valuation. This additional defined benefit cost largely reflects the eventual liability of benefits related to the past service at the valuation date. The full liability for additional defined benefit costs is borne by each respective employer.

Payment of Benefits

The Law provides for payment of retirement benefits to eligible participants. The normal retirement age is 60. However, participants with more than 10 years of qualifying service may retire at age 55 with unreduced benefits. The maximum amount of pension payable shall not exceed two-thirds of highest pensionable earnings drawn by a participant at any time during the course of his/her service. The formula used to calculate retirement benefits varies depending on whether the participant joined the service before or after 10 July 1980, with a higher rate of benefit accrual to those who commenced service before that date.

OTHER PLANS UNDER ADMINISTRATION

Ex-Gratia Pensions

The Board administers the payment of *Ex-Gratia* Pensions on behalf of the Cayman Islands Government under Section 6(1)(i) of the Public Service Pensions Law (2004 Revision), which covers these transitional provisions. The *ex-gratia* recipients are former Caymanian civil servants over the age of 60, who were not in receipt of any pension, allowance, gratuity or other retirement or termination benefit. Those with an aggregate of four or more years but less than 10 years of service receive an *ex-gratia* pension of $200 per month. Those with 10 or more years of service received an *ex-gratia* pension of $300 per month. It should be noted that these payments are not subject to increase for cost of living nor augmented annually.

The Government makes a quarterly pre-payment into the Fund to cover the expected payments for *Ex-Gratia* Pensions for each quarter.

The Board does not charge a fee for the administration of the *Ex-Gratia* Pensions.

Parliamentary Pension Plan

The Elected Members of the Legislative Assembly participate in the Parliamentary Pensions Plan (the PPP) as governed by the Parliamentary Pensions Law, 2004 (the PPL). These members contribute at a rate of 6% of pensionable earnings and the Government contributes 95% as prescribed by the Board based on the 1 January 2005 actuarial results. These contributions have been pooled for investment purposes with those of the Fund.

The Board began to administer the PPP with effect from 1 September 1999.

Benefits under the PPP were paid directly from the Government's General Revenue for the first eight months of 1999. For the remainder of 1999, the Government made quarterly pre-payments to the Fund to cover the payment of PPP pensions. This "pay as you go" arrangement continued until the passage of the amendment to the PPL in August 2004, which mandated that the payment of parliamentary pensions be made from the Fund. Under this new arrangement monthly pension contributions are made to the Fund in accordance with the latest Actuarial Valuation.

Judicial Pension Plan

Judges of the Grand Court of the Cayman Islands participate in the Judicial Pensions Plan (JPP). Judges' pensions fall under the remit of His Excellency the Governor as set out in The Judges' Emoluments and Allowances Law (2006 Revision). Members of the JPP contribute at a rate of 10% of pensionable earnings; the Government contributes a matching 10% and an additional 31% of pensionable earnings in accordance with the 1 January 2005 actuarial valuation. The assets duly belonging to the Judges of the Grand Court are under the administration of the Board and pooled with the assets of the other Plans for investment purposes.

The JPP started in 1997 notwithstanding the absence of the requisite order setting out Plan details and specifics relating to administration to the Plan. The Judges Emoluments and Allowances Order was effected by His Excellency the Governor in 2005.

FINANCIAL OVERVIEW

Growth of the Fund

The Public Service Pensions Fund (the "Fund") continues to be in relatively good financial health. The Fund holds a diversified portfolio of bonds and equity securities that, over the long term, provides above average returns with minimized variability.

The Fund is subject to an actuarial valuation every three years which assesses the financial viability of the Fund, and the adequacy of the contribution rates for funding of the Plan. An actuarial valuation was carried out 2008 based on assets and liabilities as at 1 January 2008.

The results of the actuarial valuation as at 1 January 2008 which determined the past service liability to be $455 million past service liability is based on pensionable earnings as of the valuation date, and reflects the liability in respect of benefits actually earned up to 31 December 2004. Although the Fund remains underfunded, the actuaries determined that the liability for inactive members (existing pensioners and beneficiaries, and those with deferred pensions) is sufficiently covered by available assets. It should be noted that the full liability for additional defined benefit costs is borne by each respective employer.

As at 30 June 2009, the Fund (inclusive of foreign and local investments) stood at just over $285 million, which represents a $37.1 million or 15% increase in net assets from 30 June 2008.

Investment Policy

The stated investment objective of the Board is "To preserve capital while adding value above its policy benchmark." The Board is committed to the investment objective, and has actively managed investment portfolios which are diversified, within the constraints of the Law as well as the Board's investment policy, to ensure that risk is not unduly concentrated in any one type of investment or area of currency. The Board adheres to internationally recognized benchmarks, and has established an asset mix policy, in collaboration with its investment advisors, for the purpose of achieving long-term returns of 3–4% above inflation. The asset mix policy establishes the percentage holdings by asset class and permissible ranges within the broad classes of investments. Within this framework, each investment manager is not limited by sector or country restrictions and is able to make discretionary decisions to capitalize on market opportunities. The Fund is biased to equities over the long term in order to achieve optimum returns. Equities, when compared to other classes of investments over the long term, have historically proven to generally out perform other forms of investments.

Market Summary

Global Equities

By the beginning of the 2nd quarter of the fiscal year stocks were 3 weeks into a rally that continued almost uninterrupted for 2 months due to optimism surrounding the leveling off of initial jobless claims in the U.S.

During the last quarter, it became clear that the extreme risk aversion which characterized the last quarter of 2008 was likely over which allowed equity markets around the world to rise substantially by more than 20%. Against this market movement, global equities within the pension plan advanced 18.1% for the quarter. As a result, year-to-date performance is now a positive 5.5%, while the 1-year performance ending June 30, 2009 remains negative at 11.7%.

In terms of outlook, interest rates are expected to remain low for an extended period. Economic conditions are starting to improve or at least settle globally, stimulus programs are beginning to impact economic growth and inflation appears to be contained over the short term. The substantial round of cost cutting that has occurred at many companies should lead to profit growth once the global economy turns around. On balance, the global equity markets appear to be in the early stages of a moderate rebound based on strong profit growth and low inflation.

Fixed Income

Risk aversion in the fixed income markets continued to subside during the 2nd quarter, as data suggested that constrained economic activity had slowed.

For the periods ending June 30, 2009 the fixed income segment experienced an excellent quarter generating a 12.0% return, bringing the year-to-date performance to 2.0% and the 1-year performance to 5.1%. This is due largely to the manager staying the course with bond holdings that became deeply oversold but began to rebound as the fundamentals bolstered the underlying value.

Regarding relative value, the bond manager's performance placed in the 14th and 28th percentile ranks, for the last quarter and year-to-date periods respectively. Over the 1-year period the relative rank is below average but the 4-year period is now recording above average performance which supports the value added assessment of 70 basis points.

Real Estate Equities

During the quarter pension plans became more constructive about real estate equities as the macroeconomic news increasingly suggested that the worst may be over with the property market slump being eased.

The fundamentals improved markedly for global real estate over the quarter, producing an impressive 32.5%, being the best returns within the investment mix of the Fund and, on a forward-looking basis, reinforcing the underlying value.

The strong performance pushed the year-to-date performance into positive territory at 3.1%. Despite this, value added performance for the quarter was negative 3.3% and year-to-date value added performance was negative at 2.5%. However, value added performance for the 1-year period was a positive 2.5% which was ahead of its benchmark of negative 35.5%.

Fund Performance

Many pension plans experienced one of their best quarters in recent years during the period ending June 30, 2009. The average pension plan recorded a return of 10.8% for the second quarter following six straight quarters of losses.

During the 2nd quarter the Fund witnessed the capital markets break from the devastating collapse began following the failure of Lehman Brothers in September, 2008. As a result the Plan experienced an excellent quarter, recording a 15.3% return which brought the year-to-date returns to a positive 3.2%. It should be noted that the Plan derived further absolute and relative advantage from the bond segment which performed consistently well.

Bond holdings, which had become very cheap and deeply oversold, began to rebound as it became clear that a financial Armageddon had been avoided. In spite of the excellent quarterly performance, the 1 –year performance remains negative at 5.7%.

Credited Rate of Return

The Credited Rate of Return (CRR) on contributions, calculated annually, is based on a three-year geometric average of actual returns, net of expenses, amounted to a negative 0.49% for calendar 2009. All participant contribution accounts would have been credited at calendar year end with an interest base of –0.49%. Table 1 indicates the CRR earned for the period 2002 to 2009 expressed in percentages.

Table 1

Year	2002	2003	2004	2005	2006	2007	2008	2009
Return	-5.08	8.10	4.40	7.85	12.78	4.40	-15.56	11.77
CRR	-4.41	-1.20	2.32	6.77	8.29	8.29	-0.41	-0.49

APPENDIX 1

Copy of Public Service Pensions Board Certified Financial Statements and Notes for the year ended 30 June 2009