Public Service Pensions Board

Annual Report 2005–2006

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BOARD OF DIRECTORS
AND OFFICERS OF THE BOARD
AS AT 30 JUNE 2006

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. A.C.E. Long CMB, CBE
Chairman, Public Service Commission

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

OFFICERS OF THE BOARD

Ms. Leisa Welcome
Executive Secretary to the Board

BOARD ADVISORS FOR 2005/06

Professional Services

Actuary

Watson Wyatt Worldwide
Chicago, Illinois
U.S.A.

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.

Scotia Cassels Investment Counsel Ltd.
Toronto, Ontario
Canada

CIBC Bank & Trust Co. (Cayman) Ltd.
Grand Cayman
Cayman Islands

Close Asset Management (Cayman) Ltd.
Grand Cayman
Cayman Islands

Attorney

Legal Department
Grand Cayman
Cayman Islands

Custodian

RBC Dexia
Toronto, Ontario
Canada

Investment Advisors

Watson Wyatt Worldwide
Chicago, Illinois
U.S.A.

Ashford Consulting Group (Canada) Inc
Toronto, Ontario
Canada

CHAIRMAN'S REPORT

The eighteen-month period ending 30 June 2006, was an exceptionally busy time for the Public Service Pensions Board (the Board). In 2005, the Board concluded a comprehensive review of its investment policy and procedures, and undertook the search and appointment for both equity and fixed income investment managers. The Public Service Pensions Fund (the Fund) also underwent the manadated actuarial valution in 2005 to determine the sufficiency of contributions in sustaining a viable fund.

During the eighteen-month period ended 30 June 2006; the Fund grew over $40 million or some 28.2% from 2004. The increase is due in much part to positive investments earnings which almost doubled that of the previous year. The asset mix of equities and fixed income securities met with continued success as the Fund earned 9.5% for the year ended 30 June 2006. Due to the poor investment performance of the previous core equity and fixed income investment managers, the decision was taken by the Board to replace both managers in early 2005. The full transition of invested assets was completed in the summer of 2005.

During the period covered by this Report, an actuarial valuation, which is legally required by the Law to be carried out every three years, to assess the financial health of the Fund and determine future contribution rates, commenced in early 2005. This actuarial valuation will be the first valuation to include separate contribution rates for the Defined Contribution and Defined Benefit components of the Public Service Pensions Plan. The results of the actuarial valuation are to be tabled for consideration in the Legislative Assembly in the upcoming year.

The Judges Emoluments and Allowances Order outlining the details and specifics of the Judicial Pensions Plan was signed by His Excellency the Governor, in late 2005, promoting equity amongst the plans administered by the Board. The finalization of this Order was a result of the Managing Director's tireless efforts in conjunction with that of the Legislative Drafting Department, the Judges of the Grand Court and His Excellency the Governor.

The Board's goals for the 2006/07 year remain the long-term financial health of the Fund, the practice of good governance and the commitment to high standard of service to all stakeholders in the Fund.

Kenneth Jefferson JP
Chairman, Public Service Pensions Board

MANAGING DIRECTOR'S REPORT

In addition to the ongoing recovery from hurricane Ivan, the Public Service Pensions Board (the Board) undertook a number of initiatives in improving the quality of the Public Service Pensions Fund (the Fund). These initiatives included a comprehensive review of the Board's Statement of Investment Policies and Procedures (the SIPPs), the appointment of two new core investment managers and finalization of the Judges Emoluments and Allowances Order 2005. The Board also commenced an actuarial valuation in 2005, fulfilling its legal obligation under the Public Service Pensions Law (the Law) which requires a valuation to be carried out every three years.

In response to a trend of negative returns in the Fund's overall earnings, the Investment Committee and the Board, based on recommendations from the Investment Advisor, made the decision to terminate both of the investments managers in place at the time. A search for both a core equity and core bond manager commenced, culminating in the appointment two new managers in early 2005. The Board, as is required annually, and in an effort to achieve optimum results, also conducted a review of its SIPPs. There were no philosophical or any other significant changes made to the SIPPS as a result of the review.

Net Asset Available for Benefits were at $185.3 million as at 30 June 2006, with growth of over 28.2% from 2004. Growth was attributable to a steady flow of contributions and strong investment performance. The Fund earned a positive return of 9.5% or $15.6 million for the year ended 30 June 2006 and outperformed the total relative benchmark by 0.6%.

As required by the Law, an actuarial valuation assessing the sufficiency of the Fund to meet its liabilities over a specified period, commenced early in 2005. The actuarial valuation utilized financial data for the Fund as at 1 January 2005 and required extensive input from all departments in the organization. The actuarial valuation is scheduled to be finalized in the first quarter of the 2006/07 financial year.

I would like to thank the management team and staff of the Board for their continued dedication to and provision of professional and caring service to all our clients, and their commitment to the efficient and effective management of the Fund during the past eighteen months. As a new year approaches, we will continue look for new opportunities to better serve our clients and deliver a quality product.

(Signed)

Mrs. Jewel Evans Lindsey
Managing Director

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 governs the Public Service Pensions Plan (the Plan). The head office of the Board is located at Century Yard, Cricket Square, 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. Main functions of the Fund are to receive prescribed contributions, invest and pay out pension benefits as they come 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 were prescribed by the Board based on the 1 January 2002 actuarial results ranged from 1% to 10% of pensionable earnings. This additional defined benefit cost reflects the eventual liability of benefits related to the past service at the valuation date. The full liability for additional defined benefit costs will be borne by each respective employer.

The Plan has experienced an increase in the number of employers joining the Plan as a result of the increasing number of Statutory Authorities being established by the Government. It was not possible to determine an appropriate additional defined benefit rate for the newer authorities as they have not been subjected to an actuarial valuation. An interim rate of 1% was applied to all authorities from 2003 until the finalization and tabling of the 1 January 2005 valuation in the Legislative Assembly.

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 66 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 any fee for the administration of the *Ex-Gratia* Pensions.

Parliamentary Pensions 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, and does not charge any fee for this administration.

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 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 PPP.

Judicial Pensions 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, 1997. Members of the JPP contribute at a rate of 10% of pensionable earnings; the Government contributes a matching 10% and an additional 21% of pensionable earnings in accordance with the 1 January 2002 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 made by His Excellency the Governor late 2005.

FINANCIAL OVERVIEW

Growth of the Fund

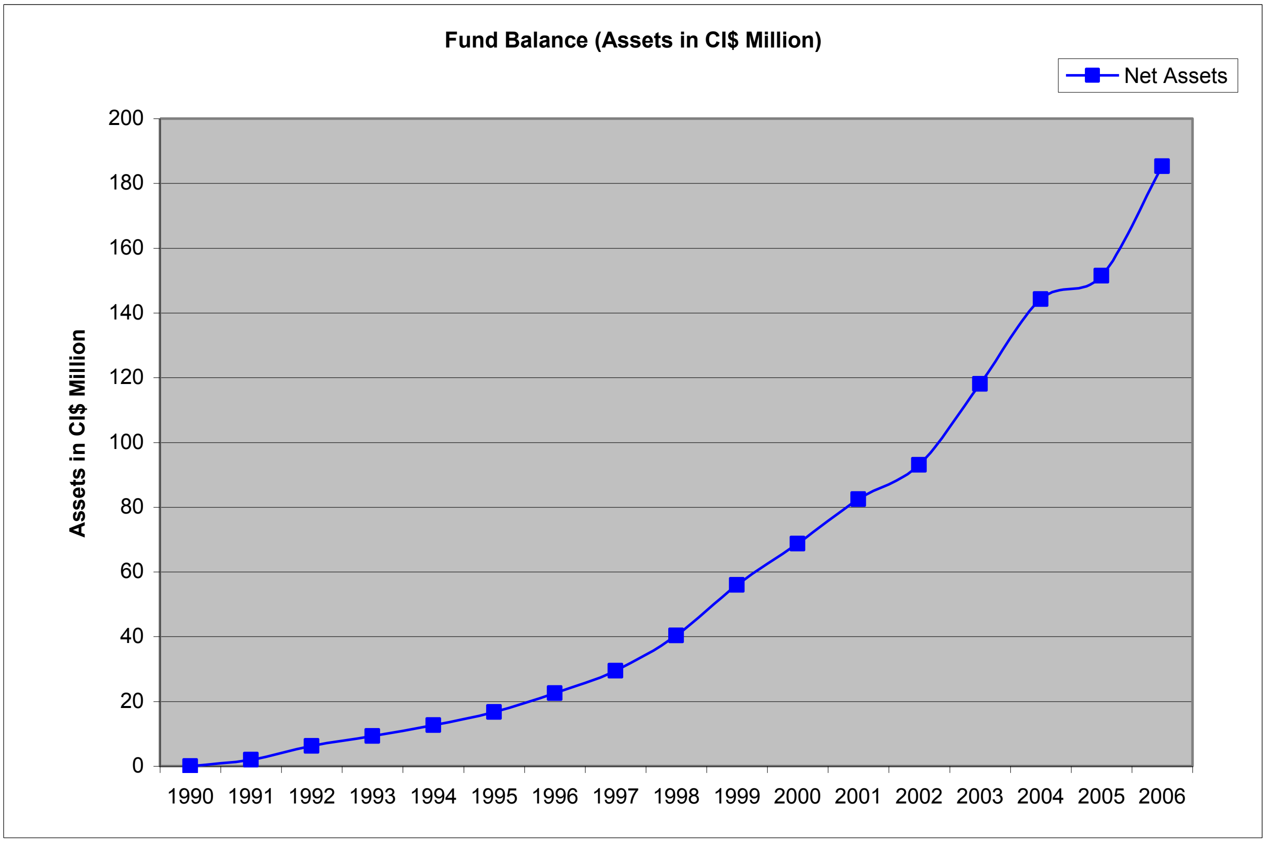
The Public Service Pensions Fund (the "Fund") continues to be in good financial health. The Fund holds a diversified portfolio of debt and equity securities that, over the long term, offers optimum return with minimized risk.

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 commenced in early 2005 based on assets and liabilities as at 1 January 2005. The results of the actuarial valuation are expected in the first quarter of the 2006/07 financial year.

The total Fund deficit of $75 million was established using the results of the actuarial valuation as at 1 January 2002 which determined the past service liability to be $260 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 2001. 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 will be borne by each respective employer.

As at 30 June 2006, the Fund stood at $185.3 million, which represents a 28.2% or $40.8 million increase in net assets from 2004. Graph 1 depicts the growth of the Fund from 1990 through to 2006. The growth of the Fund was gradual up to 1997, when a financing plan was implemented based on the results of an actuarial approach.

Graph 1


Fund Balance (Assets in CI$ Million)
Net Assets
Assets in CI$ Million
200
180
160
140
120
100
80
60
40
20
0
1990 1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006

Investment Policy

The stated investment objective of the Board is "To Preserve Capital while Adding Value." 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

For the year ended 30 June 2006, the mix of global equities and fixed income produced positive results for the total Fund. The global equity markets were strong throughout most of the year despite a minor setback when markets corrected in May to June. Fixed income markets performed moderately well during the year.

Global equities produced strong returns in the 2005/06 financial year. Favourable economic conditions and solid corporate earnings supported positive results in this asset class. The S&P 500 index boasted a double digit return at the end of the financial year. Energy was the strongest sector, outperforming the index during the year, with the financial sector coming in at a close second gaining more that 1.5 times the S&P 500 index's return.

Fixed income markets were weak relative to equities. Concerns with inflation, consumer prices and housing data and Federal Reserve tightening plagued the market during 2005/2006. The sector experienced negative returns as real interest rates rose and real return bond prices fell.

Fund Performance

The Fund earned a positive 9.5% for the year ended 30 June 2006 and outperformed its relative benchmark by 0.6%.

The Board replaced the Fund's global equity manager in early 2005 due to concerns with earnings over the past few years. With the strong performance of the new manager over the first half of 2006, the Fund was on par with its target benchmark for global equities, earning 16.9% for the year. Global equities accounted for 61.4% of the total Fund as at 30 June 2006.

In early 2005, the Board also appointed a new fixed income manager. The fixed income segment of the Fund earned a rate of negative return of 1.3%. While absolute returns on the fixed income segment of the Fund were less than expected, the value added performance was a positive 5.2% for the year.

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, amounted to a positive 6.77% in 2005. All participant contribution accounts would have been credited at year end with an interest base of 6.77%. Table 1 indicates the CRR trends for 2000 to 2005 expressed in percentages.

Table 1

Year	2000	2001	2002	2003	2004	2005
Return	-2.11	-6.00	-5.08	8.10	4.40	7.85
CRR	5.16	1.86	-4.41	-1.20	2.32	6.77

APPENDIX 2

Public Service Pensions Board
Certified Financial Statements and Notes for the six months ended 30 June 2005 and for the year ended 30 June 2006