Public Service Pensions Board

2007-2008 Annual Report

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BOARD OF DIRECTORS
AS AT 30 JUNE 2008

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 FOR 2007/08

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 2007/2008 fiscal year proved to be more challenging for the Public Service Pensions Board (PSPB) than the previous as the full effects of the global recession were experienced by all. The impact was significant as the Fund suffered a $17.3 million unrealized loss as a result of devaluation across all asset classes, global equities in particular. This came as a result of the slowed growth and tightening credit crisis which has driven many to abandon their stocks regardless of profitability. Global real estate equities have experienced problems as many have become nervous over the eventual impact that slowing economic growth and rising inflation may have. History, however, suggests that real estate is a good long-term inflation hedge. US fixed incomes fell victim to the fastest inflation in 17 years along with the Federal Reserve's choice not to raise rates, a decision which turned out to fuel the downfall of the US dollar and the rise of commodity prices.

It should be noted that while the vast majority of markets were suffering across the board, the PSPB Fund fared well as its investment strategy is designed to minimize the impact that downturns in the market have on returns, and the intent of the strategy became a reality.

Despite the unavoidable nature of investment performance during the 07/08 fiscal year the PSPB remains confident that the markets will sufficiently recover and investor confidence will increase as a result.

On a brighter note, the PSPB staff was able to make good on their commitment to supporting the local community by pooling together almost CI$11,000 which was donated to the Cancer Society of the Cayman Islands, Kiwanis Club and Kimberley Myles to aid her fight against Wolf Parkinson's White Syndrome. The PSPB takes great pride in working with its clients to ensure that they can enjoy as comfortable a retirement as possible. However, the larger community cannot be ignored and measures are taken annually to lend a helping hand to those in need.

We sincerely believe that as time passes we will begin to move ever closer to the end of this financial crisis and regain our stability and confidence as a country. With patience and sound decision making we should all emerge from this situation stronger and better equipped to manage the inevitable "black swans" of the markets and future challenges.

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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 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. 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 prescribed by the Board based on 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 any 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 were 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 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 2005 based on assets and liabilities as at 1 January 2005.

The results of the actuarial valuation as at 1 January 2005 which determined the past service liability to be $317 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 2008, the Fund stood at $240.99 million, which represents a 1.88% or $4.46 million increase in net assets from 30 June 2007.

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

During the period under review, the Fund lost $17.3 million, with Global Equities experiencing the greatest loss. This segment of the Fund underperformed by negative 2.1% relative to its benchmark, which has been attributable to the slowing economic growth and borrowers experiencing tighter credit conditions. Equities have underperformed its benchmark over the last three years.

In terms of outlook, the credit crisis could prolong and there could be further financial scares, however the equity markets are refocusing their attention back to the fundamentals of the economy that of maintaining a defensive approach by owning high quality stocks.

The PSPB continues to monitor closely its asset mix especially as it relates to equities (currently underweight in this area).

Fixed Income

The sluggish economy and intensifying inflation fears contributed to the negative 2.1% value added for the period ending June 30, 2008 compared to a negative 1.3% for the previous period. Fixed income represents 46% of the Fund's total assets.

Performance slippage coupled with information that the Manager's parent company continues to experience financial difficulties has resulted in the Board maintaining this Manager on "watch" status as they manage almost half of the PSPB Fund.

Fund Performance

2007/8 proved to be a challenging year for Investment Management firms and our Managers were not immune. Our plans overall earned a negative 5.4% return, slightly higher than the policy benchmark of negative 5.3%. The fund was most affected in the global equities segment which accounted for 49.3% of our assets as slow global growth and consumer reluctance to invest presented a challenge. Accordingly, the Board appointed a new manager in December 2007 who specializes in Global Real Estate to broaden the diversification. The Board is pleased to report that the value added for this segment was 2.1%.

In response to the poor investment performance of the two managers and other factors of concern, the Board placed them both on "watch" status pending completion of calendar year 2008's performance. The Board continues to monitor and evaluate each manager's performance and re-balance the asset mix as and when needed to ensure optimum performances.

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 -0.41% for calendar 2008. All participant contribution accounts would have been credited at calendar year end with an interest base of –0.41%. Table 1 indicates the CRR earned for the period 2000 to 2008 expressed in percentages.

Table 1

Year	2001	2002	2003	2004	2005	2006	2007	2008
Return	-6.00	-5.08	8.10	4.40	7.85	12.78	4.40	-15.56
CRR	1.86	-4.41	-1.20	2.32	6.77	8.29	8.29	-0.41

APPENDIX 1

Copy of Public Service Pensions Board Certified Financial Statements and Notes for the six months ended 30 June 2007 and for the year ended 30 June 2008