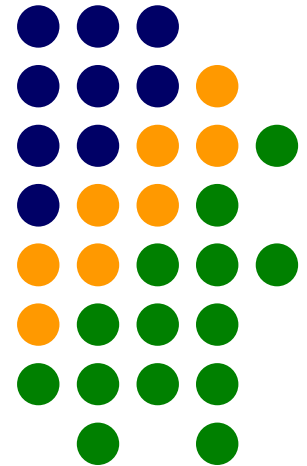


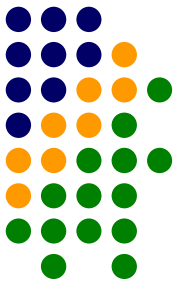
The Rationale, Implementation Challenges and Status of Pakistan's Pension Reforms

**Yawar Zia
Additional Finance Secretary (Regulation)
Ministry of Finance
Government of Pakistan**

**IEF Regional Pension Policy Roundtable
1st May 2008
New Dehli, India**

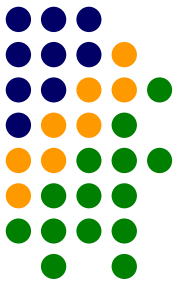


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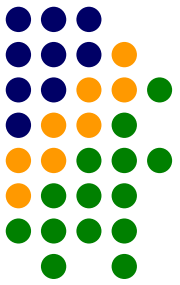
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Background – Pakistan’s Civil Service Pension Scheme- Benefits



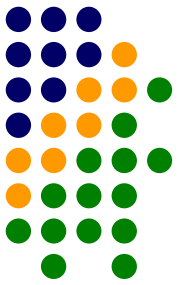
<u>Scheme Parameter</u>	<u>Level</u>
Normal Retirement (Superannuation) Age	60 years
Normal Retirement Pension for a full career employee	70% of last drawn basic pay
Pension Accrual Rate	2.33% p.a.
Vesting Condition for Normal Retirement Pension	10 years
Vesting Condition for Early Retirement Pension	25 years
Commutable proportion of gross pension	35%
Commutation Factor at age 60	12.3719
Spouse Pension for death in service	75% of deceased member’s pension
Spouse Pension for death after retirement	50% of deceased member’s pension

Background – Pakistan’s Government Employees’ Pension Scheme- Size



	Number of In-Service Employees in million	Number of Pensioners in million
Federal	1.27	1.43
Provinces	1.75	0.70
Total	3.02	2.13

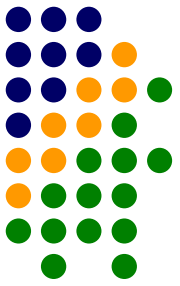
Background – Pakistan’s Government Employees’ Pension Scheme- Payments



Trend in Pension Payments (Pak Rs Billion)

	2001-02	2006-07	2011-12 (Projected)
Federal	31	46	63
Provinces	19	23	31
Total	50	68	94

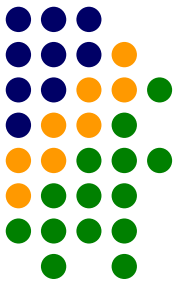
Rationale of Pakistan's Pension Reforms



(1) Un-sustainability:

- Pension Expenditures for 2006-07 were around Rs **68 billion** restricting the room for developmental expenditure
- Pension Debt of Government as indicated by various studies is a significant percentage of GDP affecting the long term sustainability of the Scheme

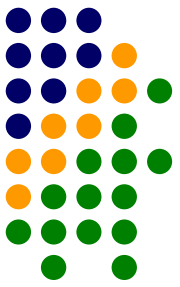
Rationale of Pakistan's Pension Reforms contd.



(2) Government Exposed to Risks:

Current Scheme is a **Defined Benefit** based on last drawn pay and running on PAYGO basis. A Few **implications** of this design are:

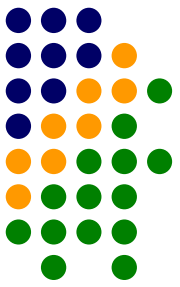
- Govt bears the inflation, salary and longevity risks
- Vulnerable to un-informed decisions. It's easier to make generous promise now which will be paid by future generations.



Pakistan's Pension Reforms

- Focused on government employees pension
- Rising pension expenditures forced serious thinking in public sector
- Started in late 1990's
- Provincial Governments have created pension and GPF Investment funds
- Provincial Governments have not taken into account the long term pension debt (Except the Punjab)

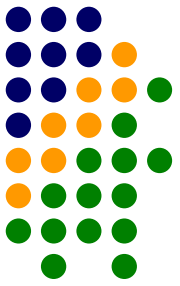
Pakistan's Pension Reforms contd.



Parametric Reforms Introduced in 2001

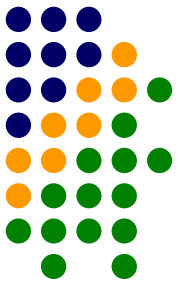
- Commutation Factors were reduced by 20%
- Commutable proportion of the gross pension reduced to 40% (reduced to 35% in 2005)
- Abandoned Restoration
- Reduced maximum pension from 77% to 70%
- Future pension increases to be based on Net Pension instead of Gross Pension
- The above package was offered with salary scale revision of 50%-60% increase

Pakistan's Pension Reforms contd.



- Federal Government created an Actuarial Office in Oct 2002 after Cabinet's decision to introduce a Defined Contributory Pension Scheme
- A Pension Reform Working Group (PRWG, an inter-ministerial group) was formed in 2004 which submitted its report in 2005 with the technical support from Actuarial Office and inputs from the World Bank
- Pay and Pension Committee 2004 also gave recommendations to implement pension reforms
- The proposal of Actuarial Office for a DC Pension Scheme is under active consideration

Pakistan's Pension Reforms contd.



Proposed Pension Reforms under consideration

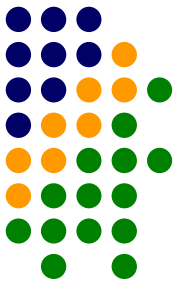
For Existing Employees

- Parametric changes to the existing pension scheme

For New Employee:

- A proposed fully funded Defined Contribution Pension Scheme for new employees entering into Government service with effect from 1 July 2008

Pakistan's Pension Reforms contd.

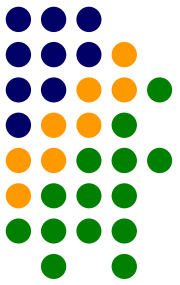


Parametric Reforms for Existing Employees:

The following reforms are under consideration

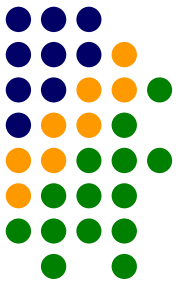
- Changes to pension accrual rate
- Changing the last drawn pay scheme to using one year's average
- Revising Commutation Table on actuarial basis
- Introducing early retirement reduction factors to bring the scheme in actuarial neutrality
- Pension Indexation linked to inflation. Currently pension is increased on ad-hoc basis
- Introducing a lump-sum benefit for employees leaving the service between 10-25 years of service
- The parametric reforms will be introduced after giving an option to employees to choose between a new pay scale with new scheme or old pay scale with old scheme

Salient Features of the Proposed DC Scheme



- Mandatory for New Employees,
- Government's Contribution Rate: 20%
- Employee's Contribution Rate: 10%
- Expected Replacement Rate: 82%
- Lump sum at retirement: 25% (of Account Value)
- Mandatory Annuitization 75% (of Account Value)
- Programmed withdrawal may be allowed for a period reflecting life expectancy
- Premature withdrawals are not allowed initially
- Individual Pension Accounts for each employee
- Centralized Record keeping
- Fully funded scheme
- Portability of Pensions – Integration with VPS

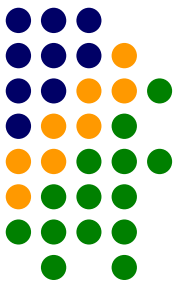
Pakistan's Pension Reforms - Status



- The new team of actuarial office has interacted in 2007 with provincial finance departments, AG/CGA/PIFRA (local bodies involved in pension management and disbursement), Aries Group USA. It has made presentations to the Finance Secretary. The proposed DC Pension Scheme is under active consideration
- Presentation to be given to the Finance Minister shortly
- Expected to be approved by the Federal Cabinet with effect from 1 July 2008

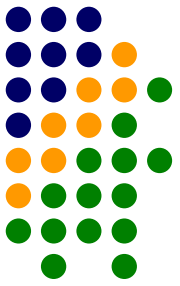
Proposed Road Map for Pension Reforms

- A Pension Reforms Implementation Group to be formed
- A Pension Policy Workshop to be held
- A regulatory, administrative and institutional framework to be designed
- An option to be given to existing employee with service less than 10 years to join the DC Pension Scheme
- A Proposal to be developed to broaden the scope of the scheme



Implementation Challenges

- Designing administrative, regulatory and institutional framework
 - Supervision by SECP or MOF ?
 - Aligning the objective of the managing body with the objectives of the beneficiaries
 - Assuring the independence of the managing board from government to keep separation between tax revenue and DC Fund
 - Assuring transparency and accountability
 - Cost effectiveness
- Provision of Funds to make initial contribution on account of past service liability in respect of employees opting for the proposed DC scheme
- Broadening the coverage of the proposed scheme to Provinces, Public Sector Corporation, and Military



Implementation Challenges contd.

- **Development of Annuity Market**

In Pakistan, there is almost no annuity market. This is attributable to the following:

- Strong preference for a lump sum over a stream of monthly income
- Lack of awareness
- A small number of pension schemes in the private sector which are mostly self insured
- Excessive conservative pricing and reluctance of the insurance companies to enter into this market