Report on Review of Cayman Islands National Pensions Law
Cayman Islands National Pensions Office

March 26, 2007

MERCER
Human Resource Consulting
Contents

1. Executive Summary ....................................................................................................... 1
2. Actuarial Analysis ........................................................................................................... 4
3. Legislative Analysis ...................................................................................................... 13
4. Investment Analysis ..................................................................................................... 27

Appendices
Appendix A – Wage Increase Assumption Table
Appendix B – Asset Mix and Return Assumptions
Appendix C – Typical Post-Retirement Non-Discretionary Expenses
Appendix D – List of Sections in the National Pensions Law that Provide for Fines
Appendix E – Maximum Withdrawal Amount
Appendix F – Comparative Summary of Pension Legislation
Executive Summary

This report has been prepared pursuant to Tender NPO-T-06/01 issued by the Cayman Islands National Pensions Office (the “NPO”). It encompasses a review of the Cayman Islands National Pensions Law, 2000 (the “NPL”) and recommendations for change to the Cayman Islands pension system.

As requested in the Tender our report covers the following areas:

- Actuarial Analysis
- Legislative Analysis
- Investment Analysis

Recommendations for future change are contained within each area.

The NPL originally had effect from June 1, 1998. It introduced mandatory pension coverage for individuals employed in the Cayman Islands. The NPL specifies minimum benefits for both defined contribution (“DC”) and defined benefit (“DB”) pension plans. Since its inception, the vast majority of plan participants are covered by multi-employer DC plans. Our review has focused on the DC provisions, however our recommendations will also apply as appropriate to the limited number of DB plans that remain.

Our research consisted of the following activities:

- Review of the NPL
- Review of policies and procedures of the NPO
- Meetings with:
  - Plan Administrators
  - NPO Staff
  - National Pensions Board
  - The Ministry
  - Investment Managers
- Review of certain pension legislation in other countries to identify best practices
Review of certain multi-employer and single employer files of the NPO
Review of NPO documentation including:
- Guidance notes
- Board minutes
- Suggested changes to NPL
- Internally generated policy papers and interpretations.

Review of Offshore pension plan document

Our research has shown that the NPL has been effective in establishing a pension system in the Cayman Islands. However, as could be expected, certain challenges with the NPL have become evident to the regulator, administrators, investment managers and plan members. The most significant of these challenges include the following:

- Compliance and enforcement of the current NPL is the largest challenge facing the Cayman Islands Pension system. All parties identified areas of non-compliance and the difficulty of enforcing compliance.
- The investment regulations do not currently reflect global best practices, impose restrictions on the implementation of new investment products and do not allow for member choice in investments.
- Based on current economic expectations the minimum DC contribution rate of 10% of earnings is not projected to provide adequate retirement income security.
- Lack of understanding regarding the need and level of retirement savings required to support a minimum standard of living in retirement.

Our key recommendations are summarized below and a more detailed discussion is contained in the body of this report.

**Compliance and Enforcement**
We recommend increasing the fines available in the legislation and providing the NPO the ability to levy fines directly (subject to appeal to courts) for offences that are more minor in nature. In addition, non-monetary sanctions should also be implemented. We note, however, that fines and sanctions will only be effective to the extent there is sufficient political, judicial and regulatory will to impose them.

**Investment Regulations**
We recommend that legislation move to a prudent expert approach as adopted by the OECD countries with limited restrictions imposed by the legislation.

**Benefit Adequacy**
In order to address the gap that currently exists with respect to benefit adequacy, we recommend the following changes:

- increase normal retirement age to 65 and the early retirement age to 55
- implement a catch-up adjustment to $72,000 over an appropriate transition period and thereafter index the fixed maximum pensionable earnings to increases in the consumer price index
- remove barriers to additional voluntary contributions, in particular the locking-in requirement
- increase the minimum contribution rate from 10% to 12% split equally between employer and employee.

**Miscellaneous Legislative Changes**

We have noted a number of areas where change to the NPL would resolve ambiguities and generally make the NPL more workable and consistent. We recommend that the government revise the NPL to address those areas noted in this report as well as any others that are identified in the process of drafts.

**Communication and Education**

Overarching all recommendations is the clear need for enhanced communication and better understanding for employers and employees of their rights and responsibilities under the NPL. There is a need to move from merely an awareness of the pension system to understanding and committing to the pension system. This will ultimately result in better informed and more appropriate action by employees and employers with respect to pension matters.

The communication effort should include internet, print, radio and television advertisements by the NPO. Ideally, employees should have available to them appropriate modelling tools to evaluate their retirement savings. The NPO should investigate partnering with providers especially the multi-employer plans and others involved with retirement/financial planning in the Cayman Islands.

These recommendations among others are discussed in detail in the body of the report.

We would be pleased to answer any questions concerning our recommendations.

Respectfully submitted,

Paul Forestell, F.S.A., F.C.I.A.
Principal

Mark Eagles, LL.B., B.Comm.
Principal
Actuarial Analysis

This portion of the project involved detailed modeling of the projected DC pension benefits payable based on the minimum contribution formula under the NPL to assess the adequacy of the benefit payable. Benefit adequacy was first tested under a base case economic scenario for sample plan members with differing demographic characteristics. It was then tested by applying alternative economic scenarios to the model.

Demographic Characteristics

We considered the following sample participants in the analysis.

Full Career Participants – each member commences participation in a pension plan at the age and earnings shown below with no employment interruptions.

<table>
<thead>
<tr>
<th>Participant</th>
<th>Category</th>
</tr>
</thead>
<tbody>
<tr>
<td>A (Age 18, CI$20,000)</td>
<td>Non graduate – low income</td>
</tr>
<tr>
<td>B (Age 20, CI$24,000)</td>
<td>Early graduate – average income</td>
</tr>
<tr>
<td>C (Age 25, CI$24,000)</td>
<td>Post graduate – average income</td>
</tr>
<tr>
<td>D (Age 25, CI$60,000)</td>
<td>Post graduate – high income</td>
</tr>
</tbody>
</table>

Participant A represents an individual that commenced work without attending university, whereas all other participants are examples of university graduates commencing employment at various ages and earnings.

Partial Career Participant – member commences participation in pension plan at age 40 (due to immigration, absence from the workforce, or a member who was already in the workforce in 1998). For this member we have assumed current annual earnings of CI$24,000 and CI$60,000.
Base Case Economic Scenario

The Base Case Economic Scenario used is summarized as follows:

Investment Return (net of expenses)
- Pre retirement: 6.75% per annum
- Post retirement: 5.5% per annum
Inflation: 2.5% per annum
Wage Increases: 2.5% per annum plus age based merit increases

The pre-retirement investment return was determined based on an assumed long term rate of return of 8.2% on equities and 5.3% on fixed income and an asset mix of 70% equities and 30% fixed income. The gross rate of return of 7.75% has been reduced by 1.00% to reflect expenses paid from account balances.

Please note that we have not reflected in our analysis certain investment restrictions currently found in the NPL. For instance we have not provided for the restriction on investing only in companies who have made a profit in 3 of the last 5 years.

Furthermore, we have estimated that, post-retirement, a greater proportion of assets would be invested in fixed income investments than is currently permitted. For the purposes of our analysis we have assumed that the exchange rate remains fixed at CI$1.00=US$1.25.

Actual experience will vary from our assumptions and actual results will differ from our projections.

Benefit Adequacy

Often retirement benefit adequacy is measured by comparing the retirement pension to the pre-retirement income of an individual. This is used as a proxy for a more rigorous approach of modelling post-retirement expenses. In most developed economies, a replacement of 60%-70% of pre-retirement income is considered adequate, although, this is subject to significant debate. The actual replacement ratio needed will vary greatly by individual. For example, an individual who has a number of children could require less retirement income as a percentage of pre-retirement income than an individual with no children, in order to reproduce a pre-retirement standard of living. For couples with children, a significant portion of pre-retirement earnings would have been spent on costs of raising children. Less than 100% replacement of pre-retirement income is considered adequate in most countries due to a reduction in post retirement spending that can be attributed to elimination of mortgage payments, dependent costs, employment related expenses and a reduction in income taxes payable.

---

1 Refer to Appendix A for a detailed wage increase assumption table.
2 Refer to Appendix B for additional details on asset mix and return assumptions.
Retirement income is typically provided from government pensions, employment pensions and personal savings or investments. In the Cayman Islands, no government pension program exists. Consequently retirement income is provided only through personal savings and employment pensions.

In the Cayman Islands, no income taxes are payable. Consequently, a higher replacement ratio is likely required. In order to estimate post-retirement expenses we have estimated the cost of a typical basket of non-discretionary post retirement purchases in 2006 based on *The Cayman Islands 2005 Annual Economic Report* and the *2004 Cayman Islands Compendium of Statistics*. (See Appendix C for details).

For the purpose of determining minimum benefit adequacy, it is important to focus only on non-discretionary spending that is required to maintain basic living standards. We have excluded from the analysis costs related to vacations, internet access, cable TV, etc. that can be considered discretionary in nature. This is not meant to imply that retired individuals will not incur these expenses, but rather that they have not been included to determine minimum benefit adequacy.

Based on our analysis, we estimate that someone currently earning $30,000 would require an income replacement of approximately 70%-75% at retirement. For an individual currently earning $60,000, we estimate that a replacement ratio of 55%-65% would provide minimum benefit adequacy. Individual preferences and needs will vary from our assumptions.

Using the base case economic scenario, we have then projected the replacement ratios for the sample members shown above. The replacement ratios are based on pension plan payments only and do not take into account other sources of retirement income such as continued employment earnings, inheritances and investments. The results of our calculations are shown in the following tables.

### Full Career Participants

<table>
<thead>
<tr>
<th>Participant</th>
<th>Retirement Age</th>
<th>50</th>
<th>55</th>
<th>60</th>
</tr>
</thead>
<tbody>
<tr>
<td>A (Age 18, CI$20,000)</td>
<td>24%</td>
<td>34%</td>
<td>50%</td>
<td></td>
</tr>
<tr>
<td>B (Age 20, CI$24,000)</td>
<td>22%</td>
<td>31%</td>
<td>45%</td>
<td></td>
</tr>
<tr>
<td>C (Age 25, CI$24,000)</td>
<td>18%</td>
<td>26%</td>
<td>39%</td>
<td></td>
</tr>
<tr>
<td>D (Age 25, CI$60,000)</td>
<td>12%</td>
<td>17%</td>
<td>24%</td>
<td></td>
</tr>
</tbody>
</table>
Partial Career Participants

<table>
<thead>
<tr>
<th>Earnings</th>
<th>Retirement Age</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>50</td>
</tr>
<tr>
<td>CI$24,000</td>
<td>6%</td>
</tr>
<tr>
<td>CI$60,000</td>
<td>5%</td>
</tr>
</tbody>
</table>

The following observations can be made:

- In the absence of other retirement earnings such as continued employment or outside investments, the current pension contribution formula is not expected to provide adequate retirement income.
- The lack of benefit adequacy for partial career participants is particularly acute due to their shorter participation in a pension arrangement. However, no pension system, outside of a social security system with a minimum benefit regardless of employment history, can address partial career employees.
- For workers currently earning (or projected to earn) more than CI$60,000, the replacement ratios are lower due to the fixed maximum pensionable earnings of CI$60,000 in the NPL. Note that for the purposes of this base case illustration we maintained a fixed maximum earnings of $60,000 for the full projection period.
- The remainder of our analyses do not address partial career participants.

The shortfall in benefit adequacy can be addressed in a number of ways:

**Increase in Contributions**

Contributions may be increased through an increase in the minimum contribution required under the NPL or through additional voluntary contributions made by plan participants.

The following table illustrates the effect of an increase in minimum contributions on the projected replacement ratios of full career participants for each 2% increase in the minimum contribution rate for retirement at age 60, the normal retirement date under the NPL.

Full Career Participants

<table>
<thead>
<tr>
<th>Participant</th>
<th>Minimum Contribution</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>10%</td>
</tr>
<tr>
<td>A (Age 18, CI$20,000)</td>
<td>50%</td>
</tr>
<tr>
<td>B (Age 20, CI$24,000)</td>
<td>45%</td>
</tr>
<tr>
<td>C (Age 25, CI$24,000)</td>
<td>39%</td>
</tr>
<tr>
<td>D (Age 25, CI$60,000)</td>
<td>24%</td>
</tr>
</tbody>
</table>
Under the Base Case economic scenario, a full career graduate participant with a 16% minimum contribution would have a replacement ratio between 63% and 72% for an average earner and 39% for a high earner at age 60 if all other aspects of the pension legislation remain unchanged. The replacement ratio, under similar conditions, for a non-graduate, full career participant would be 80%. We note that a higher employee contribution will reduce an individual’s pre-retirement disposable income and consequently a lower replacement ratio would likely be required.

Any increase in the minimum contribution rate is likely to meet with significant resistance from employers and employees. The current employee contribution rate of 5% of earnings is viewed as significant, particularly by lower-paid employees and any increase will exacerbate this view. The expected resistance to such a change may also negatively affect compliance with the NPL.

Globally, a 10% contribution rate is competitive, if only mandatory retirement plans are considered. For example, mandatory pension benefits in Bermuda are based on a 10% contribution and Australia has a 9% contribution rate. However, it is worth noting that both Bermuda and Australia provide a social security benefit in addition to the mandatory private pension system. In Bermuda in 2006, employees and employers each contributed $1,317.68 per year to social security. This represents an additional 11% of pay for a member earning $24,000 and an additional 4.4% of pay for a member earning $60,000. In Australia, social security benefits are paid from general tax revenues and do not require a direct contribution. In Canada, the Canada Pension Plan (mandatory social security benefit) requires a total contribution of 9.9% split equally between employee and employer. In addition, Canadians may receive an Old Age Security Pension and Guaranteed Income Supplement that are paid from general tax revenue. Therefore, while the 10% contribution rate is competitive for mandatory pension schemes globally, it is lower than other countries when other social security benefits are taken into account.

An alternative to increasing the minimum contribution rate would be to encourage additional voluntary contributions (“AVCs”) by members. The first step to encourage AVCs is to remove any existing barriers to members making AVCs to their pension arrangement.

The most significant barrier to AVCs under the current system is a lack of education and understanding of the needed level of retirement savings to support individuals after their working careers end. In most countries, the education and encouragement of retirement savings is market driven by the investment managers and advisers. It appears that the Cayman Islands market is willing to encourage additional saving through AVCs but before any meaningful improvements in saving rates can be achieved an increase in worker’s confidence in and understanding of the pension system must be achieved.
Please note that in most other jurisdictions income tax incentives are provided to encourage individuals to save for retirement. Although tax incentives cannot be provided in the Cayman Islands, other incentives may be possible.

One psychological barrier to AVCs is that the current NPL “locks-in” AVCs until age 60, removing the flexibility associated with in-service withdrawals. This lack of flexibility likely discourages members from making AVCs and should be removed from the legislation.

**Increased Retirement Age**

As can be seen from the tables on previous pages, the longer an employee works, the higher the replacement ratio at retirement. Currently, the NPL permits early retirement at age 50 and does not require pension contributions for employees age 60 and over. The normal retirement age of 60 is inconsistent with most developed countries (US, UK, Canada, Australia, as well as Bermuda and the Bahamas) that specify a normal retirement age of 65 with early retirement permitted at age 55. As well, we note that several jurisdictions are increasing normal retirement ages under their social security programs in order to reduce cost. For example, in the US, the normal retirement age for full social security benefits is increasing to 67. Increasing the early retirement age to 55 will encourage members to continue saving for retirement longer and requiring contributions from age 60 to 65 will provide greater flexibility in retirement savings for late entrants into the pension system (partial career participants).

The following table shows the projected replacement ratio for full career participants at age 65 (with the age 60 ratio in brackets) under the base case economic scenario.

<table>
<thead>
<tr>
<th>Participant</th>
<th>Age 65 Replacement Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>A (Age 18, CI$20,000)</td>
<td>73% (50%)</td>
</tr>
<tr>
<td>B (Age 20, CI$24,000)</td>
<td>66% (45%)</td>
</tr>
<tr>
<td>C (Age 25, CI$24,000)</td>
<td>58% (39%)</td>
</tr>
<tr>
<td>D (Age 25, CI$60,000)</td>
<td>35% (24%)</td>
</tr>
</tbody>
</table>

As can be seen in the table above, requiring pension contributions after age 60, combined with members deferring receipt of their pension to age 65, will significantly increase the projected replacement ratio for employees who remain in the workforce to age 65.

Requiring pension contributions after age 60 will increase the cost of employing individuals over age 60 and therefore remove any cost advantage that they had in the employment market. However, the increase in cost will put them on equal footing with members under age 60 and therefore we believe that this should not have a material impact on the employment prospects for individuals who are age 60 and over.
Increase the Fixed Maximum Pensionable Earnings of $60,000

The current maximum pensionable earnings of $60,000 significantly reduces the projected replacement ratio for employees earning in excess of $60,000. The maximum has been in place since 1998 and has not increased with increases in wages or inflation. The following table illustrates the effect of increasing the maximum earnings to $72,000 immediately to allow for inflationary increases since 1998 and then continuing to index the maximum to increases in inflation. We have shown the base case projections in brackets.

<table>
<thead>
<tr>
<th>Participant</th>
<th>Retirement Age</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>50</td>
</tr>
<tr>
<td>A (Age 18, CI$20,000)</td>
<td>24% (24%)</td>
</tr>
<tr>
<td>B (Age 20, CI$24,000)</td>
<td>22% (22%)</td>
</tr>
<tr>
<td>C (Age 25, CI$24,000)</td>
<td>18% (18%)</td>
</tr>
<tr>
<td>D (Age 25, CI$60,000)</td>
<td>17% (12%)</td>
</tr>
</tbody>
</table>

As can be seen, increasing the maximum pensionable earnings under the NPL improves the projected replacement ratio for low, average and high earners. The current maximum earnings level of $60,000 is lower than the comparable limits under pension systems in other countries which typically range from $100,000 to as much as $220,000. Globally, the maximum earnings level is typically set by tax authorities to limit the amount of tax deferred savings available to an individual and therefore those limits are not directly relevant to the Cayman Islands.

As well, we note that the maximum pensionable earnings currently imposed under the NPL is a minimum benefit standard and employers are permitted to include earnings above $60,000 for pension purposes. It is our understanding that where competitive pressures exist, Caymanian companies do include earnings above $60,000 in pensionable earnings.

Therefore, the decision to index the maximum earnings level must be evaluated from the perspective of whether it is desirable to require minimum pension coverage on an earnings level above $60,000. In most jurisdictions, the minimum level of pension benefit is provided by social security and consequently does have a maximum earnings level reflected that is consistent with the $60,000 specified in the NPL. In almost all cases the social security limits are indexed to increases in average wages or inflation.

Sensitivity Analysis

All calculations shown are sensitive to the assumptions used in the projections. All calculations were based on best estimate assumptions determined as of September 2006.
The key sensitivities are with respect to assumed future investment return and projected salary growth. Each are discussed in more detail below.

**Investment Return**

Under the Base Case economic scenario, we have used an assumed investment return pre age 65 of 6.75% per annum. This rate was derived using the Mercer Portfolio Return Calculator (“MPRC”) and represents the median expected return assumption based on current fixed income yields and a normal equity risk premium of 3.0%. Appendix C includes a table of the assumed asset mix and rates of return for the various asset classes assumed to be part of the asset mix. The MPRC produced a median expected gross return of 7.75% which has been reduced by 1.0% to allow for expenses paid from the fund.

The gross expected return at the 25th percentile is 6.0% and at the 75th percentile is 9.75% over a 20 year period. After adjustment for expenses the range of future expected returns from the 25th to 75th percentile is 5.0% to 8.75%. The following table shows the estimated replacement ratios at age 60 based on this range of expected returns for full career participants.

<table>
<thead>
<tr>
<th>Participant</th>
<th>5.0% (25th percentile)</th>
<th>6.75% (median)</th>
<th>8.75% (75th percentile)</th>
</tr>
</thead>
<tbody>
<tr>
<td>A (Age 18, CI$20,000)</td>
<td>33%</td>
<td>50%</td>
<td>82%</td>
</tr>
<tr>
<td>B (Age 20, CI$24,000)</td>
<td>30%</td>
<td>45%</td>
<td>73%</td>
</tr>
<tr>
<td>C (Age 25, CI$24,000)</td>
<td>28%</td>
<td>39%</td>
<td>58%</td>
</tr>
<tr>
<td>D (Age 25, CI$60,000)</td>
<td>16%</td>
<td>24%</td>
<td>38%</td>
</tr>
</tbody>
</table>

As can be seen above, the projected replacement ratio falls within a broad range based on variations in the assumed expected return. Only at the 75th percentile will the expected return result in a replacement ratio of 82% for an employee currently earning $20,000.

The above ranges of expected return are based on the broad asset mix restrictions present in the Investment Regulation. To the extent that asset mixes change due to our recommendations in Section 3, the expected returns will change, however, the sensitivity to returns will remain broadly consistent.

**Future Salary Increases**

Under the base case economic scenario we have assumed that future salary growth will be equal to inflation of 2.5% plus an age based merit increase of 3.0% at age 18 grading to 0% at age 50. A detailed wage increase assumption table is included in Appendix B. If

---

3 See Appendix B for additional details on asset mix and return assumptions.
future salary growth is higher than this scale, the projected replacement ratios will decrease. For example, for participant B (graduate, average earner), the projected replacement ratio at age 60 with median investment return will decrease from 42% to 30% if we assume merit increases that are 1% higher for the projection period.

The decrease in projected replacement ratio as a result of higher projected salaries is a combination of the effect of the fixed $60,000 maximum pensionable earnings and the nature of DC plans that results in the earliest contributions made having the greatest effect on the eventual pension.

At the extreme, if we assume investment returns at the 25th percentile and higher projected earnings, the replacement ratio for a full career employee could be as low as 20% for an average earning graduate and 12% for a high earning graduate.

These sensitivities demonstrate the large variability in possible outcomes with respect to retirement income and highlight the need for appropriate education of plan participants.

Recommendations
Based on the above analysis, our recommendations for changes to the NPL to deal with benefit adequacy are as follows:

- Increase the normal retirement age to 65 and restrict access to retirement funds until age 55 (excluding AVCs).
- Implement a catch-up adjustment to $72,000 over an appropriate transition period.
- Once any catch up adjustment has been implemented, index the maximum pensionable earnings to increases in inflation.
- Remove the locking-in requirements for additional voluntary contributions.
- Increase the minimum contribution rate to 12% (6% employee and 6% employer). We do not recommend implementing this increase prior to addressing the existing compliance issues with the NPL and the implementation of an education program for plan members to increase their understanding of the pension system.

The following table illustrates the projected replacement ratios, for full career participants if all recommendations are implemented. The table also shows, in brackets, projected replacement ratios if all recommendations, except the change in minimum contributions, are implemented.

<table>
<thead>
<tr>
<th>Participant</th>
<th>Retirement Age</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>55</td>
</tr>
<tr>
<td>A (Age 18, CI$20,000)</td>
<td>43% (36%)</td>
</tr>
<tr>
<td>B (Age 20, CI$24,000)</td>
<td>40% (33%)</td>
</tr>
<tr>
<td>C (Age 25, CI$24,000)</td>
<td>32% (27%)</td>
</tr>
<tr>
<td>D (Age 25, CI$60,000)</td>
<td>30% (25%)</td>
</tr>
</tbody>
</table>
Legislative Analysis

A. Non-Compliance with the National Pensions Law

It is our understanding that most employers in the Cayman Islands have taken appropriate action to come into compliance with the NPL. Even so, the NPO is concerned that there are still a significant number of employers who are not in compliance. While many incidents of non-compliance may originally have been based on an ignorance or misunderstanding of the law, it is increasingly likely, eight years after the introduction of the NPL law, that many incidents are now based on wilful disregard for the law.

Non-compliance is a serious issue that, left unchecked, could undermine the purpose and effectiveness of the NPL resulting in many citizens, often at the lower end of the economic spectrum, not having sufficient funds to retire from active employment in their old age.

Types of Non-Compliance

In general, we can divide incidents of non-compliance into three broad categories:

1. Non-compliance based on an ignorance or misunderstanding of the law
2. Non-compliance resulting from unclear or fundamentally impractical legislation
3. Intentional non-compliance due to indifference, greed, philosophical belief or belief the NPL would not be enforced or would lack serious consequences.

The first category is best addressed through dissemination of information and education, but can also be addressed through the simplification of legislation. The second is most effectively addressed through amending the legislation to make it more clear or more practical. The third must be addressed either through effective enforcement activities and/or through changes in legislation (i.e., to amend the legislation so as to enhance enforcement capabilities or to reduce philosophical conflict or indifference).
Examples of Non-Compliance
The following are some of the more common acts of non-compliance in the Cayman Islands:

- employer does not establish a pension plan for employees or does not enrol them in an existing plan
- employer deducts contributions from wages but does not remit them to a pension plan
- employer does not remit employee and/or employer contributions in time required
- miscellaneous non-compliance with technical aspects of the NPL such as:
  - investment restrictions
  - treatment of non-residents
  - application of the law to international pension plans

Each of these examples can be ascribed to one or more of the three types of non-compliance listed on the previous page. Below we discuss several ways in which different aspects of non-compliance can be addressed.

Exclude Non-Resident Employees From the NPL
It is understood that one of the larger groups of employees who are not being enrolled in a plan or for whom contributions are not being remitted, contrary to the NPL, are non-resident employees who have met the 9 month non-resident waiting period.

One possible solution would be to entirely exclude from the application of the NPL those employees who are not residents. If excluded from mandatory coverage, the NPL should still permit non-residents to participate in NPO registered (or non-registered) plans if an employer chooses to do so. We note that this is the approach that Bermuda has taken.

However, we understand that many in the Islands have a strong philosophical belief that all workers, resident or not, should be covered by the NPL and we respect that position. An alternative approach that would maintain the current treatment, but better coordinate it with other aspects of Caymanian law, would be to replace the 9 month waiting period with one that exempts workers while they are on a “temporary work permit” as that term is used in the Immigration Law (which, we understand has just been amended) – but with an overall maximum waiting period of 9 months.

---

4 By “international plans” we are referring to pension plans that are registered and administered in other countries. For example, an employee of a Canadian financial institution may work in the Cayman Islands for a period of time, say 3 years, and then return to work in his home country. That employee will have participated in a pension plan registered in Canada prior to arriving in the Cayman Islands, then would have continued membership in that plan while in the Islands and also upon returning to Canada. As it is currently drafted, the Canadian registered pension plan must comply with the NPL while that employee is working in the Islands. Many aspects of such NPL compliance is technically impossible in most such situations.

5 By non-resident, we mean persons who do not have Caymanian status or who are not permanent residents within the meaning of the Immigration Law.
Inclusion of Household Help

We note that section 25(2)(b) of the NPL currently exempts from coverage employees who are not permanent residents of the Cayman Islands but who are employed to do housework in private residences in the Islands. If it is determined to retain the aspect of the NPL that generally includes non-resident employees (after a nine month waiting period), then our recommendation is to remove the exemption of housework employees. Given the lack of a formal payroll for these employees, special administrative rules may be appropriate for this category of employee. For example, a longer time period for remittance of contributions may be necessary. In any event, this change to the NPL should be accompanied by a determination of what, if any, special considerations should be provided for. Public input would likely be helpful in this regard.

Permit a Waiting Period For Eligibility

Residents of the Cayman Islands are currently required to immediately join a plan and commence earning pension benefits upon becoming an employee. In situations where an employee is hired and then is terminated or quits a month or so later, he or she may never have been enrolled in a plan by the time employment ends. Establishing an account in those situations may be difficult. In addition, since the amounts will be small, they will be able to be cashed-out by the terminated employee in any event6.

We do not know whether this is a common problem, however, to the extent that it may be determined that a significant number of non-compliance cases involve employees who are only employed for a short period of time, the NPL could be amended to permit plans to have a short waiting period (say, 3 months or shorter). Under such an approach, if an employer wishes to provide for a waiting period, the waiting period should be made applicable to all employees of that employer. Either way, the waiting period rules would need to be spelled out in the plan documents and communicated to employees. Once the waiting period is met, the employee would become a member of the plan; membership would normally be prospective, not retroactive, although a plan could provide for retroactivity if that was desired – again, such treatment would need to be clearly spelled out in the plan rules.

It is recognized, however, that the imposition of a waiting period will likely result in lower retirement savings in the long run. The benefit, if any, from a compliance standpoint should thus be measured against the resulting degradation of savings ability and any such waiting period, if permitted, should be minimized.

Increase the Level of Fines

The NPL contains several provisions that establish fines against offending parties (see Appendix D). The fines under the NPL are at set amounts ranging from $1,000 to $10,000 (in some cases $500 per day) and do not provide for any discretion.

6 As is discussed below, section 42 of the NPL permits cashing out of benefits below $5,000.00, regardless of residency.
While in many cases the current level of fines may be effective, in some cases they may not provide adequate deterrence. We note that most other jurisdictions provide for significantly higher maximum levels of fines. For example, most Canadian jurisdictions provide for fines of up to $250,000 (and some even higher). Experience in Canada has shown that, when actually applied, most fines are typically applied at a level that is much lower than the maximum, but the fact that a higher maximum is available provides the regulator with a useful compliance tool.

We recommend that the government increase the maximum level of fines throughout the Act and in some cases provide that fines can be “up to” a stated maximum. The new level of fines could be determined by looking at fines provided in other Caymanian legislation. We note that fines were increased under the Immigration Law from $2,000 to $15,000 in respect of a first offence and from $4,000 to $25,000 in respect of a second or subsequent offences. A similar approach could be taken with the NPL. We also note that in Bermuda’s pension legislation, fines under summary conviction can be up to $10,000 or 12 months in prison and under indictable offences can be up to $50,000 or 5 years in prison.

The government could also look at the range of earnings levels of employers in the Cayman Islands in order to arrive at an effective maximum level of fines, recognizing as discussed above, that the maximum level may not be applied in most cases. Finally, the government wants to be cognizant of the fact that if fines are imposed at too high a level, the result could be that an otherwise viable entity could be put out of business and forced to declare bankruptcy – in most cases, this will not be a desirable effect. The government should seek input on an appropriate level or range of fines from its legal services branch and other knowledgeable sources.

In connection with an increase in fines, the NPL could also be amended to provide that all or a portion of any fines that are be paid, are to be paid to the NPO rather than to general government coffers. It is also noted that in any case of non-compliance, the first remedy should be compensation for the employee(s) who were the victim of the non-compliance. The employer must be forced through the NPL and the courts if need be, to make good on any missing contributions and any required interest on those contributions. Fines are intended as a deterrent penalty over and above whatever is required to set the matter straight with the affected member(s).

**Provide the Superintendent with More Direct Authority**

We recommend that the government consider amending the NPL to provide that for fines under a certain amount and for certain types of non-compliance, the Superintendent can issue a fine or take other steps (see heading below) if he believes and has evidence that there has been an act of non-compliance. This approach would be for violations which are relatively obvious on their face – e.g., failure to remit contributions within a given time period or failure to file required documents, etc.. This approach would result in the
Superintendent not having to always initiate a court action, but would permit the person who has been fined to appeal the decision of the Superintendent to a court of law.

Depending on what level fines are raised to and what other repercussions of non-compliance may be added to the NPL (see heading below), if this approach is adopted, the government should consider providing that the more severe consequences and fines (i.e., fines above a certain level or certain penalizing activity set out in the NPL) could still only be applied by the Superintendent by bringing the matter to court.

It should be recognized that even with this more direct penalty mechanism, certain employers may still neglect to take appropriate action and may refuse to pay fines without further legal action being taken by the Superintendent.

**Provide Alternative Non-Compliance Tools**

In most countries that have national pension schemes or minimum standards regulatory environments, the regulatory agency has more than one “tool” to incent compliance. In addition to the levying of fines, the most common tools available in other jurisdictions involve the threat of removing the tax deferred status that typically applies to retirement plans or using the tax system to collect un-remitted contributions. The repercussions of a loss of tax status is usually so significant, that *wilful* non-compliance is relatively rare in these jurisdictions. Obviously, this particular tool is not available to the Cayman Islands. However, other tools, as alternatives to monetary fines, should be considered.

For example, the NPL (and other legislation as necessary) could be amended to provide that an employer’s business licence, liquor licence, driver’s or truckers’ licence and/or “Work Permits” can be withdrawn or suspended for failure to comply with specified sections of the NPL. As well, certain performance bonds could be forfeited. We believe these types of penalties would provide very useful compliance tools, similar in effectiveness to the tax status tool in countries with general income taxation. We strongly recommend that the NPO adopt one or more such compliance tools. In order to make these tools work, not only would the NPL need to be revised, it is possible that other legislation may also need to be revised. The NPO should get advice in this regard from the appropriate persons in the Legal Affairs branch of the Cayman Islands’ government.

**Inform and Educate**

Based on the notion that an informed population will be much more likely to comply with a country’s legislation, we believe that significant communications efforts should be made concerning the basic requirements, rights and benefits under the NPL. This should be aimed at both employees and employers, and would tie into communications recommendations made elsewhere in this report.

To the extent that it is possible, all new entrants to the labour market should be provided with a brief summary of their rights under the NPL. There should also be ongoing
communications in print, on radio and the internet and through any other viable media in the Cayman Islands. To the extent that the government of the Cayman Islands ever undertakes to assist employers with the recruitment of labour, dissemination of information concerning the NPL should be an automatic part of such efforts.

The NPO should publish guidelines from time to time to address common areas of misunderstanding or neglect.

**Provide Explicit Whistleblower Protection**

To the extent that it does not already exist, the government might consider amending the NPL, or other laws governing employment, to specifically provide that an employee cannot have his or her employment terminated by an employer due to any complaint made to a government agency concerning compliance with the NPL. While this approach on its own will not likely have a significant impact, it would be one more step to indicate to employers that the government is serious about compliance. On the other hand, if identifying situations of non-compliance and applying fines and other penalties are not hampered by the lack of such legislated protection, it may not be necessary.

**Name and Shame**

The government could consider publicly identifying employers that have been found to be in non-compliance with the NPL. In many jurisdictions, publicity surrounding non-compliance with a law can be a significant deterrence factor. The easiest way to do this is by posting names on the NPO’s website.

Furthermore, if this approach is to be considered, the government would want to obtain legal advice concerning the application of libel law in order to ensure that it does not create situations where it could be successfully sued. Finally, we note that some other jurisdictions have concluded that while the threat of having one’s name published in this context will act as a deterrent for many, once it has been so published the deterrent factor may be lost for that particular offender.

**Structure and Speed Up the Regulatory Response**

We understand that the NPO has generally taken the approach that when it becomes aware of acts of non-compliance, it will give the employer some time to fix the problem. This approach, which we generally agree with, recognizes that in many cases there is at least some degree of misunderstanding or ignorance of the law – especially in the first few years after the law was brought into place. As the years go on, however, ignorance of the law will diminish and acts of non-compliance will more likely be the result of wilful disregard. As such, we recommend that while the regulator should still at first instance allow the employer to “make things right”, an internal NPO guideline should be established that sets out:

- The type of incident that should trigger further action
The type of information that is needed before proceeding
- The nature and content of any letters that are sent out and the timing of those letters
- Deadlines for the employer to respond to the Superintendent’s request or to otherwise satisfy the Superintendent that it is taking appropriate steps to rectify the situation.

The longer a situation of non-compliance festers, the greater its scope and magnitude can grow and the more difficult it may be to correct. In general, the regulatory process should err on the side of caution (i.e., send out request for information letters even if the non-compliance is not certain) and should ultimately result in the regulator implementing steps to bring about fines or other penalties, in most cases, within no more than 6 to 9 months after initiating contact with the employer concerning any non-compliance.

**Deal Decisively with Fraud/Theft**

Where employee contributions are being deducted from employees’ pay but are not being remitted to a pension plan, the activity may be criminal in nature and criminal sanctions (for fraud, theft, etc.) should almost always be sought by the Attorney General’s office - the only exception perhaps being *de minimus* cases and cases where the employer immediately corrects the behaviour. To do otherwise, sends a very negative message to employees in the Cayman Islands and only encourages further like behaviour. Any successful prosecutions should be widely publicized so as to maximize the deterrence effect.

**Political Will**

Regardless of whichever approaches are taken to enhance compliance, they will only be effective if there is the political will to adequately enforce the NPL. In other words, the NPO and Attorney General’s office must have sufficient resources and have the support of the government in these initiatives. Furthermore, other government departments must be persuaded/required to cooperate with the NPO to the extent necessary.

**B. Miscellaneous Changes to the NPL**

*Defined Contribution Plans*

Some of the defined terms and rules under the NPL purport to apply to both DB and DC plans, but in reality appear to be structured primarily with DB plans in mind. Some such provisions are highlighted elsewhere in this report. We recommend that any amendment to the NPL include changes to better reflect the very different nature of these two types of plan. Identifying these changes and providing the appropriate treatment in the NPL should comprise part of the legislative drafting exercise that may flow from any actions taken in response to issues identified in this report.

*Earnings*

In the definition of “earnings”, we suggest that the 20% bonus exemption be removed and agree with the proposal of the National Pensions Board to clarify that employer paid
benefits are not included in earnings. These changes will simplify and clarify the NPL and reduce the possibility of parties structuring earnings for the sole purpose of minimizing pension coverage.

Residents
We understand that the NPO previously considered amending the NPL to add a definition of “resident” – we agree that this would be a useful thing to do.

Bankruptcy
Section 8(6) provides that the administrator of a plan can be replaced when the employer is bankrupt. We believe this would only make sense where the employer is the administrator – which, in the Cayman Islands, is not usually the case. Consider amending this provision to adequately handle other situations.

DC Plan Allocation of Contributions
Section 11(2) currently reads as follows:

“The Superintendent shall not register a defined contribution pension plan if the formula governing allocation of contributions to a pension fund and the investment yield of such accumulated contributions among members of the pension plan is variable otherwise than at the discretion of a majority of the members of the pension plan.”

It is unclear what this provision is intended to accomplish (why/how would members determine the allocation of “contributions”?), and it could be interpreted in a way which would make DC plans impossible to administer.

Plan Amendments
Section 12, which deals with plan amendments, is very restrictive, as two thirds of members must agree to any substantive amendment. Consider revising this requirement to require that one third must object in order for an amendment not to succeed. Also, related section 21 in conjunction with section 12 provides for a very cumbersome amendment process which perhaps could be simplified.

Employer Consent to Conversion
Section 12(9) which requires employer consent to a plan conversion appears to be redundant in light of section 12(1)(b) – which requires employer approval of any plan amendment. We suggest deleting section 12(9).

DC Actuarial Report
Section 16(2)(c) - We strongly suggest removing the requirement for an actuarial report every 5 years for each defined contribution plan, as the report serves little or no purpose. Instead, the NPO should commission benefit and income replacement projections for the
DC pension industry as a whole every 5 or 10 years so as to determine the adequacy and success of the NPL and the need for further adjustments.

**Expenses**

The syntax of subsection 17(7)(c) could be improved by changing the words to read “such administrative fees and expenses as are provided for by the terms of a pension plan.”, where the added words are shown in bold italics.

**Portability**

Section 34(1) of the NPL sets out portability options available to someone who is entitled to a deferred benefit. We suggest that, as an alternative to annuities, the Superintendent prescribe a “maxima” withdrawal formula under section 19(2)(iv) of the regulations that is designed to permit members’ annual withdrawals during retirement based on a Retirement Savings Account type schedule similar to the Canadian Locked-In Registered Retirement Income Fund. In Canada, such an account imposes a minimum and maximum limit on annual withdrawals. In the absence of taxation in the Cayman Islands, however, there is no requirement for a minimum annual withdrawal limit. The overarching idea being to limit withdrawals such that they will be less likely to totally deplete retirement savings before the end of a person’s expected lifetime. An example of such a formula is as follows:

The maximum permissible withdrawal during any given year would be the higher of amounts A and B where:

A. is the actual investment return on the retirement fund during the previous year (assumed to be 6% during the first two years following retirement); and

B. is a fraction of the beginning of year fund value, with the fraction increasing as the member ages. An age-related table of fractions, based on the Canadian Registered Retirement Income Fund design, is included in Appendix E.

In years of high investment returns, “A” will be the dominating component, and will provide members the option to immediately make use of any extraordinary investment gains. In years of low or negative investment returns, “B” will be the dominating component and will reduce the likelihood that members deplete their accounts during their lifetimes. This and other possible formulas could be sampled and projected under various scenarios to provide evidence of their effectiveness and flexibility. For example, a provision for “indexation” could be built into the withdrawal equation.

A phasing in of such a rule would likely be required, in order to reflect the fact that current and near future retirees will not have very large amounts in their accounts. The NPL could also be revised to permit such withdrawals to be made directly out of a member’s DC account within a pension plan (i.e., rather than only after transferring to a separate account).
Furthermore, it is unclear whether a DC plan member who is entitled to an immediate pension benefit (i.e., they are age 50 or older) is entitled to portability options. This should be clarified to provide that the same options are available as are available to someone who is entitled to a deferred pension.

In any event, it must be recognized that any withdrawal regime will not guarantee sufficient income for life, as investment fluctuations and a lifespan that exceeds the average may deplete funds prior to a member’s death. The only way to avoid this in the context of a defined contribution plan is to mandate the purchase of annuities - however, that approach has two drawbacks: (i) the absence of an annuities market in the Cayman Islands and (ii) the potential resulting payment of a significant portion of the member’s retirement savings as “profit” to the insurer who issues the annuity.

**Shortened Life Expectancy**

Section 40 of the NPL provides for “greater benefits” for a person whose life expectancy is considered to “be reduced” due to mental or physical disability. We suggest that this be revised in a number of ways as follows. First, in order to provide greater clarity and to limit this provision to extraordinary situations, we suggest that “be reduced” be replaced by either “be shortened considerably” or “shorten his or her life expectancy to less than two years” (or some other fixed time frame), or “be reduced as prescribed” and set out rules in the regulations.

Furthermore, the words “may provide for the payment of greater benefits” is somewhat ambiguous, and we suggest that the provision be revised to say that a plan may permit “variation in the terms of payment of a defined benefit member’s pension or the distribution of funds from a defined contribution member’s accounts” or some other language that basically indicates that the entire benefit could be cashed out or paid out over a shortened period of time – again, the details could be spelled out in the regulations.

**Unlocking for Non-Residents**

The current rules permit unlocking after two years of non-residency. We suggest that the NPL be revised to clarify whether this treatment applies regardless of a person’s Caymanian status. We understand that the rule concerning the ability for a non-Caymanian to return to the island after the application of the 7 year rollover rule may be changed from a two year waiting period to one year. If that happens, we recommend that the non-residency unlocking rule remain at two years for non-Caymanians. A different rule, perhaps linked to both time away from the Islands (say 2 or more years) and age (e.g., age 55 or older) would be appropriate for those with Caymanian status, in order to permit release of funds where a person is legitimately not intending to reside or retire in the Islands.

**Small Benefit Rule**

We query whether the $5,000 cut-off for small benefit payouts in section 42 is an appropriate amount. It appears to be low in comparison to other jurisdictions. The NPO
may want to consider this and amend it if appropriate. In any event, we recommend that
the amount should be indexed or otherwise automatically escalated each year; one way to
do that would be to make it a percentage of the “year’s maximum pensionable earnings”
(assuming that number is indexed in the future).

*Automatic Indexation – DC Plans*
Section 45 provides for automatic inflation protection and section 8 of the Actuarial
regulations sets indexation at 2% per year. Except, perhaps, when an annuity is
purchased, it is not clear how, if at all, this is intended to be applied to DC plans. The
NPL and regulations should be amended to clarify how this section applies to DC plans.

*DC Plan Employer / Employee Contributions*
It is our understanding that the intention of the NPL is that for all DC plans, the combined
total employee and employer contribution rate should always be at least 10%. Our
reading of section 47 of the NPL and Part V of the General Regulations is that, in fact, a
plan could be established so that an employee contributes less than 5%, while the
employer contributes 5% - i.e., the total combined DC contributions would be less than
10%. The NPL should be amended to provide for the intended result.

Also, we note that references in the NPL and regulations to “subsection 9” of section 47
appear to be erroneous and should in fact be to “subsection 8” – this should be corrected.
See subsection 47(3)(c) of the NPL and section 30 of the General regulation.

*Interest*
Section 50 of the NPL requires that interest shall be payable by an employer “on all
money that is due to be paid by him to that pension fund…” We suggest that this be
clarified by adding “in accordance with prescribed timeframes” after the word “him” so
as to refer to the remittance timeframes in the regulations (i.e.,15 days after the month for
which they were deducted or due). Also, the concept of contributions being “due” as that
term is used in general regulation section 29(2)(b) is somewhat ambiguous and would
benefit from additional clarity by perhaps referring to a timeframe “after the month of
service for which they are payable.

Finally, we suggest increasing the timeframe from 15 days to perhaps 30 days to avoid
inadvertent non-compliance. Anecdotally, it is our understanding that in many cases
contributions are remitted after the 15 day period but within 30 days, so expanding the
time frame would make the administration of plans more realistic.

*Additional Voluntary Contributions*
We suggest that the NPL be amended to clearly provide that additional voluntary
contributions can be fully or partially withdrawn from a pension plan at any time. As
discussed elsewhere in this report, this would encourage more people to make such
contributions and, given their voluntary nature, it is unclear from a policy perspective why they should be subject to any withdrawal restrictions.

**Death Benefits**

We suggest that the NPL be amended to recognize common-law spouses for purposes of entitlement to spousal death benefits. We also suggest that the definition of spouse be amended to provide that someone is not a spouse if they are living separate and apart at the relevant date of determining a pension entitlement. These issues may also require consideration of any applicable property law dealing with splitting property on marriage breakdown.

In addition, the NPL currently requires that pensions be paid in the form of “joint and 100% survivor” pensions if the member has a spouse at the time of pension commencement. Most other jurisdictions use a joint and 60% or \( \frac{2}{3} \) survivor pension and we suggest that the survivor % be reduced. If not reduced, then we suggest that the member and the spouse be permitted to at any time waive entirely or partially the spousal pension upon completion of a prescribed form. This would better allow for members and spouses to make more appropriate decisions concerning their retirement finances.

Furthermore, we note that portions of sections 36 and 39 of the NPL do not make sense in the context of a DC plan. We suggest that those sections be amended to clearly indicate rules that are applicable to only DB plans or those rules that may be applicable to both DB and DC plans. In particular, in the context of a DC plan, when a member dies, the death benefit is not in the nature of a joint and survivor pension, but rather, it is simply a payment of the account balance. In most jurisdictions, such account balances must be paid to the member’s spouse if there is one, and otherwise it is paid to any named beneficiaries or to the member’s estate (to be disbursed in accordance with any will or applicable intestacy laws) if there are no named beneficiaries. Payments of death benefits to spouses are required to be “locked-in” in some jurisdictions while in many other jurisdictions such death benefits can be paid on a non-locked-in basis; which ever approach is taken, the locked-in or non-locked-in treatment of spousal death benefits should be the same for DB and DC plans.

Finally, it is unclear how dependent children’s benefits are to be paid or otherwise dealt with if there is no “trustee” appointed by the Director of Social Services. These rules may benefit from additional consideration and may need to be simplified, clarified or removed altogether.

**International Plans**

The NPL basically requires that international plans in which some non-residents are enrolled must comply with the NPL. We believe that this is unnecessary and unrealistic. Most international plans will be continually offside certain provisions of the NPL and it is very difficult if not impossible to bring them on-side. Instead, we suggest that the NPL simply recognize registration with a foreign regulator (e.g., ERISA, OSFI or provincial
equivalent, etc.) as long as the Superintendent determines that benefits under the international plan are similar in value to those that would be earned under a NPL registered plan or are otherwise acceptable to the Superintendent. It may also be appropriate to consider coverage under social security programs in other jurisdictions. The Superintendent could continue to collect an annual fee from employers taking advantage of this option.

Disability Pension Provisions
Issues concerning disability provisions arise primarily in defined benefit plans. Given the nature and purpose of the NPL (i.e., to create basic retirement savings and not to represent a social security scheme) and given the fact that such benefits cannot, except as noted below, be addressed in DC plans, it should be left to each plan to provide or not provide disability benefits. For example, an employer with a DB plan could decide to provide that benefits continue to accrue while a person is disabled and the plan would then need to define what is meant by “disabled” (an employer could also decide to adopt this approach for DC plans). The NPL should permit but not require such treatment (unless it is determined that such benefits are desired to be part of the basic premise of the NPL).

Alternatively (or optionally) a DB plan could provide that a disabled person can commence an immediate unreduced pension (regardless of age) or a subsidized reduced pension. This will of course have cost and benefit level implications. Again, an employer should be able to choose to implement such provisions but should not be required to do so, absent a determination by Caymanians that such benefits are desired to be a part of the NPL. In a DC plan, a disabled employee could be permitted to draw down his account balance, however, this will result in insufficient retirement income.

In general, the need for disability income is likely better served through disability insurance, assuming such insurance is generally available and affordable. Absent a change in overall policy, the treatment of pensions during disability does not appear to need legislative change, however, publishing a guideline could be helpful to plan administrators.

Written Acknowledgement of Plan Membership
We understand that the NPO has previously considered amending the NPL to provide that “Each employer will maintain a written notification acknowledged by the employee of the pension plan adopted by the employer, if not already included in the written contract of employment”. We agree with that suggestion, as it will provide an additional opportunity to ensure employees are aware of their membership in a plan and will provide a simple way of demonstrating a delinquent employer’s non-compliance.
Unclaimed Benefits
We suggest that consideration be given to amending the NPL to set out specific rules dealing with un-located former members who leave money in a plan. Several options exist, the most common being to provide that unclaimed benefits can at some point be paid to a public trustee or other appropriate body and that the proceeds may ultimately, after an expiry of an appropriate amount of time, escheat to the government or be used to provide for some stated purpose. This may be an issue to revisit in the future, as it is one that, in other jurisdictions, has grown in significance over the years as a pension industry develops and matures.

Miscellaneous Changes Discussed by the National Pensions Board
As part of our review, we considered the minutes of meetings held by the National Pension Board on June 1, 2005 and June 8, 2005. Various detailed housekeeping amendments to the NPL were discussed at those meetings. In our opinion, some of the proposed changes may be useful, while others would not add clarity to the legislation and are arguably not necessary. We suggest that these proposed revisions be considered as part of any comprehensive drafting of revisions to the NPL and its regulations.
Investment Analysis

The NPL and the Investment Regulation currently impose very specific quantitative limits on investments available to pension funds in the Cayman Islands. The restrictions apply to asset mix, individual security selection and currency exposure, among others. Our recommendation is to reduce the number and type of constraints imposed on pension fund investments and implement a “prudent expert” approach.

As a general premise, any constraint imposed on investment decision-making leads to a sub-optimal range of outcomes within the risk-reward continuum. That said, history is replete with examples demonstrating the need for and effective use of legislation to ensure that integrity is upheld in the pursuit of delivering upon the promise of asset safety and security, and to provide an environment to obtain the best returns within acceptable risk limits.

A long-standing policy debate has pitted whether pension assets should be regulated by explicit quantitative limits or by the behaviourally-oriented “Prudent Man (Person) Rule”. It should be noted, that OECD nations are now principally regulated by the Prudent Man Rule, (but used to follow the other approach) while other nations with less robust regulatory infrastructure have tended to opt for a quantitative limits approach.

The Prudent Man Rule, which has largely been the regulatory guidepost for the management of pension assets in the USA, UK, Canada, Japan, Australia, Netherlands and Ireland was first articulated in 1830 in The Supreme Court of Massachusetts (Harvard College vs. Amory). Application of the rule has evolved through time, with the greatest impact being delivered when this concept was formally enshrined by the US legislature under ERISA\(^7\) (1974). This formal adoption witnessed two key developments:

- i) extension of “Prudent Man/Person” to “Prudent Expert”, and

---

\(^7\) Employee Retirement Income Security Act
ii) development of a “whole portfolio approach”, rather than a security-by-security application/interpretation

Effectively, the Prudent Expert holds a fiduciary to a higher standard of “care, skill, prudence and diligence” by requiring fiduciaries to be “familiar with such matters” (i.e., a good heart and empty head are insufficient).

At its core, this rule is process-oriented rather than outcome-focused. Judgement is based on how decisions are made, not whether the decision is successful. In essence, a reasonable process implies effective due diligence as prudence is evidenced by the process of how risk is managed, rather than by defining specific risks that are imprudent.

Application of the rule at the “whole portfolio” level recognizes the advancement of modern portfolio theory (“MPT”) and the concept of risk management through the “Principles of Diversification” (which are geared to minimizing the risk of large losses). Addressing the issue of prudence at the total portfolio level, rather than by individual security, specifically recognizes that any investment represents a potential risk if not appropriate to the total portfolio objective at hand. To this end, seemingly riskless assets like short-term government T-bills can represent significant risk if the objective is long-term capital growth and high yield (or junk) bonds, properly diversified can represent an attractive investment.

Against this backdrop, Mercer recommends the adoption of the Prudent Expert approach in conjunction with certain quantitative limits, as opposed to maintaining the myriad specific constraints now contained in the NPL. In doing so, we view the role of government/legislation as a means to ensuring that the interest of beneficiaries are governed fairly, without conflict and requiring a high standard of care and skill – and that these elements of prudence are effectively monitored and enforced via legal liability. Accordingly, Mercer recommends that, subject to a few remaining qualification limits, investment-specific considerations and/or constraints be governed under the unique needs and objectives of the plan and its members, consistent with the principles and beliefs of the sponsor as articulated in a Statement of Investment Policies and Procedures and associated investment management agreements. Within the global investment arena, there is a general trend toward removing explicit quantitative constraints (for example, the 30% foreign content rule in Canada, which was repealed in 2005) and relying more on a process-oriented governance framework.

With regard to the NPL and the National Pensions Regulations, Mercer recommends the following:

Article 3 – Asset Allocation
Subsection (SS) (1): The current asset allocation ranges fail to provide sufficient flexibility to meet the unique risk/return requirements of a broad beneficiary base. More specifically, the 40% minimum equity allocation raises important questions since its exposure to risk, as represented by the comparatively higher volatility level of equity
markets, may not be commensurate with the goals of beneficiaries approaching retirement. Mercer recommends that specific asset allocation ranges across the three broad asset classes (equities, bonds and cash equivalents) should not be legislated. Individual investors and/or plans should be afforded the choice of selecting their own asset allocation strategy based upon their specific needs, objectives and risk tolerance.

SS (1)(a)(ii): Limiting small-to-mid cap equities to 10% appears arbitrary and fails to recognize the extent of the potential diversification benefits of this asset class. Also, this limit implies a higher risk/lower quality asset class across all geographies which could be quite misleading. Further, such a constraint fails to recognize the higher value-added opportunities available through active management in this segment. Mercer recommends that no legislative limit should be applied to small-to-mid cap equities. Individual investors and/or plans should be afforded the choice of selecting their own investment structure strategy based upon their specific needs, objectives and risk tolerance.

SS (1)(b)(i): As fixed income securities typically represent the ‘anchor’ for the portfolio, it would be prudent to limit exposure to non-government guaranteed bonds to 50% of the total fixed income allocation. Furthermore, the government guaranteed bonds should be restricted to OECD nations.

SS (4)(a): The 70% US-denominated restriction should be eliminated to allow for the greatest global security opportunity set. Many OECD nations (including USA, UK and Canada) do not place restrictions on the allocation to foreign securities. Interestingly, a strong home-country bias is present in each of the USA, UK and Canada, despite no restrictions on the aggregate allocation to foreign securities.

Given the unique nature of the Cayman economy, we recommend maintaining or possibly tightening the restriction on direct investment in the Cayman Islands.

SS (9): Actual conflicts-of-interest should not be allowed.

**Article 4 – Prohibited Investments**

SS (1)(a), (c), (d), (e) and (f): All these securities represent viable investment options which can provide necessary risk and return diversification. Such restrictions fail to recognize that strategies employing these securities can be used to reduce risk, not increase risk. Mercer recommends the removal of these investments from the prohibited list.

**Article 6 – 5% Aggregate Restriction**

SS (1): This limitation at the country level (ex-USA Treasuries) places undue constraint on global security selection and hence the ability to provide value-added performance. This restriction fails to recognize that the majority of the world’s market capitalization for equities is represented by only three countries – USA, Japan, and the UK. Mercer recommends that the country level restriction be eliminated.
SS (4)(c): This profitability metric would significantly reduce the opportunity set of available investments, particularly for equity managers employing value-oriented strategies (where they are buying into temporarily weakened businesses). Furthermore, this requirement fails to recognize that reported earnings can have little correlation to the economic reality, strength and investment quality of a business.

SS (4)(e): The wording needs to be amended to exclude shares/units of mutual funds or pooled funds as they are not typically publicly traded. That is, they are offered for purchase and redemption by the issuer (i.e., mutual fund units are not traded between beneficial owners).

Article 7 – 10% Restriction
The limitation prevents a plan from being a significant investor in a pooled fund. Look-through provisions should be considered to address the intent of this restriction. Pooled funds, by their very nature, are adequately diversified and represent a convenient method of investing. Furthermore, this restriction could limit accessibility to highly rated investment opportunities.

Article 10 – Financial Statements
SS (4)(e): The AIMR reference should be updated to GIPS (Global Investment Performance Standards).

Schedule – Permissible Stock Exchanges
This listing is too restrictive for the implementation of a fully discretionary global mandate. For example, an investment in Samsung Electronics, the world leader in microchip technology and manufacturing, would be ineligible due to its domicile listing in South Korea.

Complimentary Changes to the NPL and/or the Investment Regulations
In order to implement the Prudent Expert approach we recommend adding the following requirements to the Investment Regulations:

- Establishment of formal Governance Structure, highlighting roles and responsibilities of all involved parties, creating monitoring and review schedules, documentation of minutes, etc.
- Requirement for a Statement of Investment Policies and Procedures for each registered plan; commitment to an annual review
- Written communication plan, and robust communication/education materials for distribution to beneficiaries

We also recommend amending the NPL to explicitly permit member investment choice for their individual account in the pension plan. Member choice should only be provided

---

8 Look through provisions refer to evaluating the underlying securities held in the pooled fund rather than evaluating the pooled fund as one security.
in plans where the administrator has provided appropriate education on investment decisions to plan participants. The selection of investment options that is permitted to be made available should only be in the nature of pooled funds selected by the plan administrator. In addition, the administration systems used by the administrator must be robust enough to support individual investment choice.

If our recommendations with respect to the removal of most explicit investment constraints and explicit permission for individual member choice with respect to investments are implemented, there will be no barriers in the legislation to having “life cycle” type investments.

**Governance Issues In the Investment Regulation Context**

Pension Governance is a form of risk management. It consists of both a decision making *structure* and reporting & monitoring *processes*. These structures and processes are intended to ensure that: (i) the plan is operated in accordance with plan documents and legislation; and (ii) the plan sponsor and administrator fulfil their respective fiduciary responsibilities. If successful, this helps to protect members’ benefits as well as to avoid or reduce an employer’s (or administrator’s) potential liability as a fiduciary⁹.

The details of establishing proper pension plan governance are beyond the scope of this paper. However, there are aspects of governance that are impacted by our investment recommendations discussed above. For example, we have suggested that members of DC plans be given investment options. By doing so, the employer trades one risk (e.g., the risk of making investment decisions for the members) for other risks (e.g., the risk of offering members appropriate investment choices). As a result of this shift, members would need to be provided with the appropriate tools and education to make effective retirement planning decisions.

In the United States, ERISA Section 404 (c) addresses certain aspects of the fiduciary investment risk issue by purporting to relieve the employer of potential liability for investment decisions and outcomes - but only if the employer/plan administrator complies with certain criteria. In particular, the plan must offer members at least three core investment options, each with materially different risk and return characteristics (among other requirements) and which are sufficiently diversified to minimize the risk of large losses. The U.S. is somewhat unique in this approach.

In most other jurisdictions, especially those based on the British common law, employers and plan administrators generally avoid legal liability as a fiduciary by demonstrating that they have acted appropriately in the circumstances. Applied together, the Prudent Investor Rule and the modern portfolio theory hold fiduciaries to a required standard of care at the total portfolio level (versus a security-by-security approach). It focuses on process, or how decisions are arrived at, and NOT whether the outcome of a decision is positive or

---

⁹ A fiduciary is generally someone who has an obligation to act for the benefit of another person, where the obligation carries with it a discretionary power; and where the other person is vulnerable to the exercise of that discretion.
negative. In other words, if a decision to offer certain investment options is arrived at through a sound consideration of relevant information and the application of the necessary expertise, then liability is mitigated regardless of actual investment returns. Sound governance not only provides the framework and rationale for decision-making, but also documents such activities to ensure the integrity of the process is upheld.

In Canada, the operating framework known as the “CAP Guidelines” were recently created in order to establish clear common standards and expectations with respect to the prudent oversight and discharge of fiduciary duties in connection with DC plans. To this end, they outline and clarify the rights and responsibilities of sponsors of DC plans as well as those of DC plan members. The key plan sponsor requirements for compliance with the Guidelines include:

- Selection of the investment options
- Ongoing monitoring of the investment managers and their mandates
- Periodic monitoring of the recordkeeper
- Disclosure to plan members of all fees paid by the plan members
- Content and plain language standards for all member communication
- Provision of investment information and decision-making tools to plan members (with no cost disincentive to their use)
- Requirement of written documentation retention policy that sets out what information must be retained and by whom, as well as who has access to such information

The Guidelines are relevant to member claims for negligence or breach of fiduciary duty in that they present evidence of how reasonable plan sponsors are expected to operate DC plans. Plan sponsors are at risk if they fall below the standard of reasonableness evidenced in the Guidelines.

It should be noted that the CAP Guidelines apply only to DC plans that offer members investment choice. Here, a key differentiating feature exists between Canada and the USA. The US system is more stringent in that in order for an employer to be able to use the 404(c) “safe harbour” defence, a minimum of three “core” options that have distinct risk and return characteristics (as well as other requirements) must be offered. Such specific covenants are not explicit in the CAP Guidelines.

From the practical standpoint, the Cayman Islands has the benefit of being able to reflect on 20 plus years of competitive DC market development in the U.S. and Canada (under a prudent investor legislative framework). Both the US and Canadian DC market environments have undergone substantial market evolution to advance to the current standard where a series of broadly diversified retirement date allocation options (lifecycle options) are held up as prudent solutions-oriented approach to satisfying the retirement planning needs of the majority of DC members. The accumulation of such a large body of empirical and theoretical knowledge provides an ideal leverage point from which the
Cayman Islands can initiate legislative reform oriented toward a choice-based, participant-directed system.

In this light, we recommend that the Islands adopt guidelines similar to the Canadian CAP Guidelines and also contemplate instituting protections similar to those offered under ERISA section 4.04(c). If it chooses to add such protections in the NPL, the NPO may want to get additional advice from U.S. regulators and advisors as to how best to enact such protections.

**Advertising Standards**
The adoption of GIPS for reporting purposes (as per our earlier recommendation), while not proving an all-encompassing antidote, goes a long way in requiring appropriate disclosures and standards to facilitate meaningful comparisons – reporting will be required to be on an annual basis and over other specified time periods. This of course does not absolve investors from making appropriate comparisons. One idea to address this issue is of comparing life cycle fund returns is to have standardized ‘buckets’ with established asset mix ranges that are relatively ‘tight’, providing an environment that more closely compares ‘apples-to-apples’ and focuses attention on the selection of managers and fees. This, in combination with GIPS reporting standards, would ensure similar funds are presented under the same standards.

**Making Investment Decisions - The Role of the Plan Administrator**
It is important to note that under our proposed changes, most if not all investment decisions will be made by the legal plan administrator (acting on the advice of professional money managers); individual plan members will not be called upon to make such decisions. Individual plan members will only be able to decide between those pooled fund options that may have been made available to them by the plan administrator. As a result, plan administrators will be responsible, as fiduciaries, for the decisions that they make in that regard.

In order to ensure that only appropriate organizations/persons become legal plan administrators, we recommend that the government consider further limiting those who can serve as a plan administrator to organizations or persons who can demonstrate the required resources and capabilities to fulfill that role. This would likely have the effect of prohibiting small employers from establishing their own pension plans - such employers would effectively be required to join an existing multi-employer plan (which is largely what happens today). The government might also consider requiring plan administrators to demonstrate that they have a certain level of fiduciary insurance.
## Wage Increase Assumption Table

<table>
<thead>
<tr>
<th>Age</th>
<th>Assumed Inflation Rate</th>
<th>Merit Increase</th>
<th>Total Increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>18 - 24</td>
<td>2.5%</td>
<td>3.0%</td>
<td>5.5%</td>
</tr>
<tr>
<td>25 - 29</td>
<td>2.5%</td>
<td>2.5%</td>
<td>5.0%</td>
</tr>
<tr>
<td>30 - 34</td>
<td>2.5%</td>
<td>2.0%</td>
<td>4.5%</td>
</tr>
<tr>
<td>35 - 39</td>
<td>2.5%</td>
<td>1.5%</td>
<td>4.0%</td>
</tr>
<tr>
<td>40 - 44</td>
<td>2.5%</td>
<td>1.0%</td>
<td>3.5%</td>
</tr>
<tr>
<td>45 - 49</td>
<td>2.5%</td>
<td>0.5%</td>
<td>3.0%</td>
</tr>
<tr>
<td>50+</td>
<td>2.5%</td>
<td>0.0%</td>
<td>2.5%</td>
</tr>
</tbody>
</table>
### Appendix B

**Asset Mix and Return Assumptions**

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Proportion of Funds Invested</th>
<th>Expected Rate of Return</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Fixed Income</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Government/Corporate</td>
<td>30%</td>
<td>5.30%</td>
</tr>
<tr>
<td>- Total</td>
<td>30%</td>
<td>5.30%</td>
</tr>
<tr>
<td><strong>Equities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- U.S. Large Cap</td>
<td>35%</td>
<td>8.00%</td>
</tr>
<tr>
<td>- U.S. Small Cap</td>
<td>5%</td>
<td>8.40%</td>
</tr>
<tr>
<td>- International</td>
<td>30%</td>
<td>8.40%</td>
</tr>
<tr>
<td>- Total</td>
<td>70%</td>
<td>8.20%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>100%</td>
<td></td>
</tr>
</tbody>
</table>
## Appendix C

### Typical Post-Retirement Non-Discretionary Expenses

<table>
<thead>
<tr>
<th>Item</th>
<th>Estimated Annual Expense – 2006 (CI$)</th>
<th>Fraction of Total Expense</th>
</tr>
</thead>
<tbody>
<tr>
<td>Food</td>
<td>4,600</td>
<td>14%</td>
</tr>
<tr>
<td>Alcohol &amp; Tobacco</td>
<td>600</td>
<td>2%</td>
</tr>
<tr>
<td>Clothing</td>
<td>1,800</td>
<td>5%</td>
</tr>
<tr>
<td>Household &amp; Equipment</td>
<td>2,300</td>
<td>6%</td>
</tr>
<tr>
<td>Transport &amp; Communication</td>
<td>6,500</td>
<td>20%</td>
</tr>
<tr>
<td>Personal Goods &amp; Services</td>
<td>6,500</td>
<td>20%</td>
</tr>
<tr>
<td>Medical Insurance (Member Only)</td>
<td>4,500</td>
<td>14%</td>
</tr>
<tr>
<td>House Insurance</td>
<td>6,300</td>
<td>33%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>33,100</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

The above amounts are based on March 2002 – March 2006 Consumer Price Index published in the *Cayman Economic Report – Released June 7, 2006*

The amounts shown are estimates as of December 31, 2006 for an individual aged 65 years with an income of approximately CI$35,000. Actual expenses may vary depending on the individual’s age, marital status and household income level.

For years after 2006, we have assumed an annual inflation rate of 2% on all expense items, except for *Medical Insurance* and *House Insurance*, for which we have assumed an annual inflation rate of 5% and 3% respectively. As a result, the relative cost of *Medical Insurance* and *House Insurance* are expected to rise as compared to the other expense items.
The *Transport & Communications* expense estimate comprises $3,000 for car insurance, $2,000 for fuel and $1,500 for telephone and internet. We have assumed that the individual owns a car, and does not replace it frequently.

The *Personal Goods & Services* item comprises discretionary expenses such as holidays, gifts and entertainment. Therefore, the annual expense under this item can be expected to be almost NIL for a low income individual, and up to $20,000 for a high-income individual.

The *Medical* expense is determined as the annual medical insurance premium for a single individual of age 65. This estimate is based on premium rates received from *Fidelity Pension Services (Cayman)*. A low-income individual (income below CI$30,000), aged 60 years or above, would be eligible for coverage by *CINICO*, at an annual premium rate of approximately CI$800.

The *Household Insurance* amount is based on a 2.5% annual premium rate, applicable for concrete waterfront or inland wood houses. This is based on rates received from *Cayman National Corporation* and *Fidelity Insurance (Cayman) Limited*. We have assumed a house and content value of $250,000.
## List of Sections in the NPL that Provide for Fines

<table>
<thead>
<tr>
<th>NPL Section</th>
<th>Offence</th>
<th>Description of Fine</th>
</tr>
</thead>
<tbody>
<tr>
<td>4(2)</td>
<td>not providing a pension plan or not making contributions for an employee</td>
<td>$5,000 on summary conviction, $10,000 on indictment</td>
</tr>
<tr>
<td>6(5)</td>
<td>administering a plan that has not been registered</td>
<td>$5,000 on summary conviction, + additional $500 per day</td>
</tr>
<tr>
<td>7(3)</td>
<td>administering a plan whose registration has been revoked</td>
<td>$5,000 on summary conviction, + additional $500 per day</td>
</tr>
<tr>
<td>48</td>
<td>failure to pay contributions into a plan within timeframe given by Superintendent</td>
<td>$500 per day (upon commencement of proceedings in court)</td>
</tr>
<tr>
<td>81(4) 82(3)</td>
<td>failing to comply with the Superintendent’s or the Board’s request for information in the timeframe set out by the Superintendent</td>
<td>$1,000 on summary conviction</td>
</tr>
<tr>
<td>82(6)</td>
<td>failing to comply with the Superintendent’s or the Board’s request for an appraisal in the timeframe set out by the Superintendent</td>
<td>$5,000 on summary conviction</td>
</tr>
<tr>
<td>88(2)</td>
<td>hindering or obstructing a person from carrying out their duties under the NPL</td>
<td>$1,000 on summary conviction</td>
</tr>
<tr>
<td>90(1)</td>
<td>contravening the NPL or an order under the NPL except if provided elsewhere in NPL</td>
<td>$5,000 on summary conviction</td>
</tr>
<tr>
<td>90(2)</td>
<td>failure to pay contributions into a plan</td>
<td>a court can order employer to pay contributions owing into the fund</td>
</tr>
</tbody>
</table>
### Appendix E

#### Maximum Withdrawal Amount

<table>
<thead>
<tr>
<th>Age</th>
<th>Fraction</th>
</tr>
</thead>
<tbody>
<tr>
<td>50</td>
<td>2.50%</td>
</tr>
<tr>
<td>51</td>
<td>2.56%</td>
</tr>
<tr>
<td>52</td>
<td>2.63%</td>
</tr>
<tr>
<td>53</td>
<td>2.70%</td>
</tr>
<tr>
<td>54</td>
<td>2.78%</td>
</tr>
<tr>
<td>55</td>
<td>2.86%</td>
</tr>
<tr>
<td>56</td>
<td>2.94%</td>
</tr>
<tr>
<td>57</td>
<td>3.03%</td>
</tr>
<tr>
<td>58</td>
<td>3.13%</td>
</tr>
<tr>
<td>59</td>
<td>3.23%</td>
</tr>
<tr>
<td>60</td>
<td>3.33%</td>
</tr>
<tr>
<td>61</td>
<td>3.45%</td>
</tr>
<tr>
<td>62</td>
<td>3.57%</td>
</tr>
<tr>
<td>63</td>
<td>3.70%</td>
</tr>
<tr>
<td>64</td>
<td>3.85%</td>
</tr>
<tr>
<td>65</td>
<td>4.00%</td>
</tr>
<tr>
<td>66</td>
<td>4.17%</td>
</tr>
<tr>
<td>67</td>
<td>4.35%</td>
</tr>
<tr>
<td>68</td>
<td>4.55%</td>
</tr>
<tr>
<td>69</td>
<td>4.76%</td>
</tr>
<tr>
<td>70</td>
<td>5.00%</td>
</tr>
<tr>
<td>71</td>
<td>7.38%</td>
</tr>
<tr>
<td>72</td>
<td>7.48%</td>
</tr>
<tr>
<td>73</td>
<td>7.59%</td>
</tr>
<tr>
<td>74</td>
<td>7.71%</td>
</tr>
<tr>
<td>Age</td>
<td>Fraction</td>
</tr>
<tr>
<td>-----</td>
<td>----------</td>
</tr>
<tr>
<td>75</td>
<td>7.85%</td>
</tr>
<tr>
<td>76</td>
<td>7.99%</td>
</tr>
<tr>
<td>77</td>
<td>8.15%</td>
</tr>
<tr>
<td>78</td>
<td>8.33%</td>
</tr>
<tr>
<td>79</td>
<td>8.53%</td>
</tr>
<tr>
<td>80</td>
<td>8.75%</td>
</tr>
<tr>
<td>81</td>
<td>8.99%</td>
</tr>
<tr>
<td>82</td>
<td>9.27%</td>
</tr>
<tr>
<td>83</td>
<td>9.58%</td>
</tr>
<tr>
<td>84</td>
<td>9.93%</td>
</tr>
<tr>
<td>85</td>
<td>10.33%</td>
</tr>
<tr>
<td>86</td>
<td>10.79%</td>
</tr>
<tr>
<td>87</td>
<td>11.33%</td>
</tr>
<tr>
<td>88</td>
<td>11.96%</td>
</tr>
<tr>
<td>89</td>
<td>12.71%</td>
</tr>
<tr>
<td>90</td>
<td>13.62%</td>
</tr>
<tr>
<td>91</td>
<td>14.73%</td>
</tr>
<tr>
<td>92</td>
<td>16.12%</td>
</tr>
<tr>
<td>93</td>
<td>17.92%</td>
</tr>
<tr>
<td>94</td>
<td>20.00%</td>
</tr>
</tbody>
</table>

Note: The maximum withdrawal percentage for ages below 75 is based on the following formula:
\[ \frac{1}{(90 - \text{Age})} \]
### Appendix F

#### Comparison of Pension Regulation in Selected Jurisdictions

<table>
<thead>
<tr>
<th>Covered Employment &amp; Eligibility</th>
<th>Cayman Islands</th>
<th>Canada (Ontario)</th>
<th>United States</th>
<th>Bermuda</th>
<th>UK</th>
<th>Australia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pension plan membership optional to the employer (in addition to mandatory social security benefits)</td>
<td>Pension plan coverage is optional to the employer (in addition to mandatory social security benefits)</td>
<td>Pension plan coverage is optional to the employer (in addition to mandatory social security benefits)</td>
<td>Pension plan membership mandatory for all Bermudian employees (in addition to mandatory social security benefits)</td>
<td>Every employer who employs Bermudians or their spouses must either establish and maintain a private pension plan or participate in a financial institution pension plan. Self-employed persons are covered by this.</td>
<td>Pension plan coverage is optional to the employer (in addition to mandatory social security benefits). Companies with 5 or more employees must provide access to a Stakeholder pension plan (a defined contribution plan with costs controlled by statute) within 3 months of the start of employment if employees not eligible for membership of an occupational plan within 12 months of the start of employment or the employer contributes at least 3% of salary to a group personal pension scheme.</td>
<td>Pension plan membership mandatory for all Australian resident employees (or employees of Australian-resident companies) who earn $450 base salary or more a month and eligible independent contractors. Not required to contribute for part-time employees under age 18. Not required to contribute for employees aged 70 or more. Immediate eligibility for membership</td>
</tr>
<tr>
<td>1. do not have Caymanian status; or</td>
<td>employees who work in employer establishment in Ontario</td>
<td>Employees who work in private industry in the United States.</td>
<td>Employees must be allowed to join pension plan after the later of:</td>
<td>Employees must be allowed to join pension plan if they:</td>
<td>Employees must be allowed to join pension plan if they:</td>
<td>Employees must be allowed to join pension plan if they:</td>
</tr>
<tr>
<td>2. who are not permanent residents; and</td>
<td>1. completion of 1 year of service* (in which employee worked not less than 1,000 hours); and</td>
<td>1. are 23 years old or more; and</td>
<td>1. are 23 years old or more; and</td>
<td>1. are 23 years old or more; and</td>
<td>1. are 23 years old or more; and</td>
<td>1. are 23 years old or more; and</td>
</tr>
<tr>
<td>3. have been working in the Cayman Islands for a continuous period of nine months or less; or</td>
<td>2. attainment of age 21.</td>
<td>2. have completed 720 or more hours of employment with the employer in preceding calendar year.</td>
<td>2. have completed 720 or more hours of employment with the employer in preceding calendar year.</td>
<td>2. have completed 720 or more hours of employment with the employer in preceding calendar year.</td>
<td>2. have completed 720 or more hours of employment with the employer in preceding calendar year.</td>
<td>2. have completed 720 or more hours of employment with the employer in preceding calendar year.</td>
</tr>
<tr>
<td>4. are employed to do housework in private residences</td>
<td>*ERISA allows 2 year service requirement to join plan if 100% vesting of pension benefit is provided after no more than 2 years of service.</td>
<td>Employer must allow entry after requirements are met no later than the 1st day of the first plan year after the day eligibility requirements met or 6 months after that date, if earlier.</td>
<td>Employer must allow entry after requirements are met no later than the 1st day of the first plan year after the day eligibility requirements met or 6 months after that date, if earlier.</td>
<td>Employer must allow entry after requirements are met no later than the 1st day of the first plan year after the day eligibility requirements met or 6 months after that date, if earlier.</td>
<td>Employer must allow entry after requirements are met no later than the 1st day of the first plan year after the day eligibility requirements met or 6 months after that date, if earlier.</td>
<td>Employer must allow entry after requirements are met no later than the 1st day of the first plan year after the day eligibility requirements met or 6 months after that date, if earlier.</td>
</tr>
<tr>
<td>Self-employed persons must either be a member of a pension plan or contribute to an individual retirement account.</td>
<td>Caymanians have Immediate eligibility for membership if between age 18-60. Plan can provide for a 9 month waiting period for Non-residents.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cayman Islands</td>
<td>Canada (Ontario)</td>
<td>United States</td>
<td>Bermuda</td>
<td>UK</td>
<td>Australia</td>
<td></td>
</tr>
<tr>
<td>---------------</td>
<td>-----------------</td>
<td>---------------</td>
<td>---------</td>
<td>----</td>
<td>-----------</td>
<td></td>
</tr>
<tr>
<td><strong>Vesting</strong></td>
<td>Immediate vesting</td>
<td>Accrued benefits vested after two years of plan membership</td>
<td>Two options (at least): 1. full vesting after 5 years of service; or 2. graded vesting according to schedule: Yrs. Service % vest 3 20% 4 40% 5 60% 6 80% 7 100% Full vesting at age 65</td>
<td>Immediate vesting</td>
<td>Accrued benefits vest after 3 months of qualifying service.</td>
<td>Immediate vesting</td>
</tr>
<tr>
<td><strong>Locking-In</strong></td>
<td>Immediate locking-in</td>
<td>Funds locked-in after two years of plan membership</td>
<td>Immediate locking-in</td>
<td>Immediate locking-in</td>
<td>Immediate locking-in</td>
<td></td>
</tr>
<tr>
<td><strong>Normal Retirement Date</strong></td>
<td>No later than one year after a member’s 60th birthday.</td>
<td>Age 65 (or earlier, if the plan allows).</td>
<td>The later of age 65 and attainment of 5 years of plan membership.</td>
<td>No later than one year after a member’s 65th birthday.</td>
<td>50 (increasing to 55 from April 2010) – 75</td>
<td>None.</td>
</tr>
<tr>
<td><strong>Early Retirement Date</strong></td>
<td>Any time within 10 years of normal retirement date.</td>
<td>Any time within 10 years of normal retirement date.</td>
<td>Any time within 10 years of normal retirement date.</td>
<td>Any time within 10 years of normal retirement date.</td>
<td>50 (increasing to 55 from April 2010) – 75</td>
<td>55-60 depending on date of year of birth</td>
</tr>
<tr>
<td><strong>Mandatory Spousal Survivor Pension</strong></td>
<td>Mandatory joint and 100% survivor form if member has spouse on day first installment of pension is due (minimum value actuarial equivalent of life only pension).</td>
<td>Mandatory joint and 60% survivor form if member has spouse on day first installment of pension is due (minimum value actuarial equivalent of life only pension).</td>
<td>Mandatory joint and 50% survivor form if member has a surviving spouse on or after annuity starting date (minimum value actuarial equivalent of a life-only pension).</td>
<td>Pension payable to spouse in form set out by terms of pension plan (minimum value actuarial equivalent of life only pension).</td>
<td>None unless contracted-out of the State earnings related pension: 1. defined benefit basis – 50% of reference scheme test pension 2. defined contribution basis – protected rights used to buy pension of 50% of member’s pension. Available to qualifying registered civil partners (in respect of accrual from 5 December 2005) and married couples.</td>
<td>None</td>
</tr>
<tr>
<td>Country</td>
<td>Mandatory Pre-Retirement Death Benefit</td>
<td>Unlocking Permitted</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>------------------</td>
<td>-----------------------------------------------------------------------------------------------------------------------------------------------</td>
<td>---------------------------------------------------------------------------------------------------------</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
| Cayman Islands   | Survivor may elect immediate or deferred pension equal to commuted value of member’s accrued benefit payable no earlier than earliest retirement date under the plan, or to have commuted value or DC account paid out into one of the portability options on termination as set out below. Child benefit payable in certain circumstances. | 1. If annual pension or commuted value of pension benefit is less than $5,000 or such other sum as may be prescribed.  
2. “Payment of greater benefits” to member if life expectancy likely to be reduced because of mental or physical disability.  
3. Lump sum of a portion of the benefit may be paid to former member if annual benefit payable at normal retirement date exceeds minimum annual benefit of 1.5% of pensionable earnings for each year of plan membership (max 42).  
4. If member terminates employment, ceases to be a resident of the Islands, and no contributions are made on his behalf to a plan for at least two years. |
| Canada (Ontario) | Must provide lump sum payment equal to commuted value of member’s accrued pension benefit.                                                                                     | 1. If commuted value of pension benefit is less than $5,000 or such other sum as may be prescribed.  
2. “Payment of greater benefits” to member if life expectancy likely to be reduced because of mental or physical disability.  
3. Lump sum of a portion of the benefit may be paid to former member if annual benefit payable at normal retirement date exceeds minimum annual benefit of 1.5% of pensionable earnings for each year of plan membership (max 42).  
4. If member terminates employment, ceases to be a resident of the Islands, and no contributions are made on his behalf to a plan for at least two years. |
| United States    | Life annuity to spouse not less than payments which would be payable to member if he terminated on date of death and opted to immediately retire (if he reached earliest retirement date) or to receive deferred pension payable on earliest retirement date. | Unlocking generally not permitted except for compliance with marriage breakdown order or with the authorities in the event of criminal or other charges.  
DC plans may allow for “hardship” withdrawal for medical expense, educational expense, or purchase of a primary residence. However, special additional taxes are payable on such withdrawals.  
Plan loans up to lesser of $50,000 or 50% of accrued vested benefit/balance permitted without adverse tax consequences if repayment guidelines met.  
DC Plan may pay out benefits on termination without employee’s consent where present value of benefit is less than $5,000. |
| Bermuda          | Must provide lump sum payment equal to commuted value of member’s accrued pension benefit, but survivor may elect to receive actuarially equivalent immediate or deferred pension under for provided by the terms of the plan. | 1. Exception for divorce or maintenance orders.  
2. “Payment of greater benefits” to member if life expectancy likely to be reduced because of mental or physical disability.  
3. Lump sum may be paid to former member if commuted value of pension or value of account balance on termination is less than 5% of average employment income prescribed by regulations. |
| UK              | None unless contracted-out of the State earnings related pension:  
1. defined benefit basis – 50% of reference scheme test pension  
2. defined contribution basis – protected rights used to buy annuity for qualifying surviving spouse/civil partner. | 1. On grounds of serious ill-health.  
2. Value of benefits - if the total of the member’s benefits from all registered occupational and personal pension schemes do not exceed 1% of the lifetime allowance (or £15,000 at 6 April 2006).  
3. Severe financial hardship, serious or life-threatening illness, total and permanent disability, or death. |
<p>| Australia        | None                                                                                                                                        | None                                                                                                     |</p>
<table>
<thead>
<tr>
<th>Pay out options on termination/retirement</th>
<th>Cayman Islands</th>
<th>Canada (Ontario)</th>
<th>United States</th>
<th>Bermuda</th>
<th>UK</th>
<th>Australia</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1. Deferred pension equal to minimum benefit payable (1.5% earnings per year of service up to 42 years) 2. Transfer to prescribed retirement savings arrangement. 3. Transfer for purchase of life annuity. 4. Transfer to another pension plan which accommodates transfer.</td>
<td>1. Deferred pension payable under the plan (equal to accrued vested benefit). 2. Transfer to a locked-in vehicle on tax-deferred basis. 3. Transfer to an insurance company for purchase of life annuity. 4. Transfer to another pension plan which accommodates transfer.</td>
<td>1. Deferred pension or deferred distribution if CV of benefit is greater than $5,000 2. Right to roll over amount into eligible retirement plan. 3. Right to purchase annuity with balance. 4. Accept payment in lump sum (10% penalty tax if received before age 59.5).</td>
<td>1. Transfer to a financial institution pension plan. 2. Transfer to a prescribed retirement product. 3. Transfer for purchase of life annuity. 4. Transfer to another pension plan which accommodates transfer.</td>
<td>Qualifying service: under 3 months - refund of contributions between 3 months and 2 years - refund of contributions or transfer of accrued benefit over 2 years – full vested deferred pension or transfer of accrued benefit. Transfers permitted to a pension plan or to an insurance company to purchase an annuity.</td>
<td>Lump sum if from approved deposit fund. Deferred annuity if from assurance company. Lump sum, pension, or combination of lump sum/pension if from complying superannuation fund.</td>
</tr>
</tbody>
</table>

| Maximum Pensionable Earnings | (in 2000 revision): $60,000.00 | (in 2006): $105,555.55 | (in 2006): $220,000 (Can receive max annual DB benefit of $176,000 with max annual DC contributions of $44,000 for total of $220,000.) | (in 1999 revision): $200,000 | No limit on earnings. Tax will effectively be recovered where total benefits from all registered occupational and personal pension schemes exceed a Lifetime Allowance (£1.5m at 6 April 2006) and where total contributions exceed an Annual Allowance (£215,000 at 6 April 2006). | (in 2001-2) $27,510.00 per quarter (indexed thereafter) |

<p>| Minimum Benefit/Contributions | Minimum annual defined benefit of 1.5% of pensionable earnings multiplied by years of plan membership up to a maximum of 42 years or total employer / employee DC contributions of at least 10% (no more than 5% required from employee). | 1% of earnings (defined contribution plans). | No minimum benefit. | Minimum annual defined benefit of 1.5% of pensionable earnings multiplied by years of plan membership up to a maximum of 42 years or total employer / employee DC contributions of at least 10% | None unless contracted out of the State earnings related pension: 1. satisfy reference scheme test if defined benefit. 2. minimum contribution is national insurance rebate if defined contribution - 1.6% employee, 1% employer plus age-related rebate. | Employers must contribute 9% of pensionable earnings up to quarterly maximum. Additional contributions by employees possible through salary sacrifice. |</p>
<table>
<thead>
<tr>
<th>Restrictions on Investments</th>
<th>Cayman Islands</th>
<th>Canada (Ontario)</th>
<th>United States</th>
<th>Bermuda</th>
<th>UK</th>
<th>Australia</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Market value of pension fund must be allocated according to following restrictions:</strong></td>
<td>(federal regulations) Restrictions:</td>
<td><strong>The primary responsibility of fiduciaries is to run the plan solely in the interest of participants and beneficiaries and for the exclusive purpose of providing benefits and paying plan expenses. Fiduciaries must act prudently and must diversify the plan’s investments in order to minimize the risk of large losses. ERISA requires fiduciaries to diversify the investments so as to minimize the risk of large losses. The diversification requirement is not stated as a fixed percentage, but fiduciaries are warned against investing an unreasonably large portion of plan assets in a single security, or in one type of security.</strong></td>
<td>1. Bank certificates or deposits must not exceed: - 1% of issuing bank's or deposit company's equity; or - 5% if institution licensed in Bermuda and reg. approval</td>
<td>2. GIC’s must be from “A” rated insurer (or higher)</td>
<td>1. The primary responsibility of trustees is to run the plan in the interest of participants and beneficiaries.</td>
<td>2. Superannuation Trustees must meet fiduciary-like standards designed to protect benefits and to prevent fraud or gross mismanagement. They must act honestly and prudently, and make decisions in the interests of all fund members. Strict disclosure/non-disclosure requirements akin to securities laws. Superannuation fund may not invest more than 5% of book value of fund in “in-house” assets-namely loans to or investments in related (i.e. non-arm’s length) entities.</td>
</tr>
<tr>
<td>1. 40-70% in large, medium or small cap equities, investment grade convertible debt, or stock-exchange listed mutual funds (small-medium cap equities cannot be more than 10% of pension fund assets);</td>
<td>1. No more than 10% of plan assets to be invested in one corporation or its affiliates (exceptions for certain segregated or mutual funds, index funds of a public exchange, investment, real estate or resource corporations, securities backed by the Canadian govt, funds backed by an insurer, etc.).</td>
<td>2. Maximum 10% of fund may be invested in securities of single company, person, association etc., unless: - held by Bermuda licensed bank or deposit company - government-issued bonds /debentures rated A or more - Commission-approved insurance contract</td>
<td>2. Scheme assets must mainly be invested on regulated markets;</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. 40-70% in U.S. bonds, Eurobonds, investment grade commercial paper, money market funds, cert. of deposit or fixed-term deposits or cash held with C.I. bank</td>
<td>2. No more than 5% of plan assets may be invested in any one parcel of real estate or Canadian resource property.</td>
<td>3. Maximum 10% of fund may be invested in securities of single company, person, association etc., unless: - held by Bermuda licensed bank or deposit company - government-issued bonds /debentures rated A or more - Commission-approved insurance contract</td>
<td>3. Scheme assets must be properly diversified;</td>
<td>3. Investment in derivatives is permitted only if it facilitates efficient management of the portfolio or works to reduce investment risk.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. 25-40% in U.S. T-Bills, T-Bills of foreign countries, investment grade commercial paper, money market funds, cert. of deposit or fixed-term deposits or cash held with C.I. bank</td>
<td>3. No more than 15% of plan assets may be invested in Canadian resource properties.</td>
<td>4. Commission-approved insurance contract opened-ended mutual funds or units in a unit trust.</td>
<td>4. Scheme assets must be properly diversified;</td>
<td>4. Investment in derivatives is permitted only if it facilitates efficient management of the portfolio or works to reduce investment risk.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>At least 70% M.V. of assets must be in U.S. denominated assets and not more than 20% C.I. denominated</td>
<td>4. No more than 25% of plan assets may be invested in real property.</td>
<td>4. Funds must not be loaned on security of a mortgage or other real estate / leasehold agreement if amount paid plus prior or equal ranking debt is greater than 60% of market value of real estate.</td>
<td>5. Trustees are prohibited from acting as guarantors and from borrowing (except on a temporary basis to provide liquidity).</td>
<td>5. Trustees are prohibited from acting as guarantors and from borrowing (except on a temporary basis to provide liquidity).</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Assets of pension fund cannot be invested in derivatives, margin-based securities, venture capital, limited partnerships, shares in private companies, or real estate.</td>
<td>5. Plan assets may not be invested in more than 30% of the voting shares of a corporation.</td>
<td>7. No more than 5% of total market value of assets may be invested in single real estate parcel.</td>
<td>6. Not more than five percent of the scheme’s assets may be invested in employer-related investments.</td>
<td>6. Not more than five percent of the scheme’s assets may be invested in employer-related investments.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Other rules/restrictions)</td>
<td>6. Plan assets may not be invested in more than 30% of the voting shares of a real estate corporation, resource corporation, or investment corporation without undertakings and filings to regulator.</td>
<td>8. Except if publicly-traded, assets may not be loaned to or invested in securities of: - administrator or his officer, directors, agent or employee - person responsible for holding or investing fund or his officer or employee, etc.</td>
<td>7. Investment in an employer-related loan is not permitted.</td>
<td>7. Investment in an employer-related loan is not permitted.</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>30% foreign property limit in IITA recently repealed</td>
<td>9. Funds must not be loaned or used in securities lending unless secured by cash or equivalent with a market value of 105% of loan, etc.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Mercer Human Resource Consulting
<table>
<thead>
<tr>
<th>Penalties for Non-Compliance</th>
<th>Cayman Islands</th>
<th>Canada (Ontario)</th>
<th>United States</th>
<th>Bermuda</th>
<th>UK</th>
<th>Australia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contraventions of law can result in fine of up to $10,000. In cases involving non-remission of contributions/funds, there may be an order to remit funds, as well.</td>
<td>Contraventions of minimum standards could result in compliance orders by Superintendent and a fine on conviction of not more than $100,000 for first offence, $200,000 for subsequent offences. Failure to comply with maximums can result in revocation of plan registration by CRA (resulting in punitive tax rates of RCA rules).</td>
<td>Contravention of reporting/disclosure requirements of ERISA, shall upon conviction result in fine of not more than $100,000 or imprisoned not more than 10 years for individual, or both; or a fine not exceeding $500,000 for non-individual (i.e. corporation). Deregistration by IRS for non-compliance. A fiduciary may be ordered to personally restore the benefits due plan participants; Other “appropriate equitable relief” may be ordered; A civil penalty may be assessed for failure to provide documents to plan participants on demand (up to USD 110 per day); Imprisonment may be ordered for embezzling or stealing plan assets; Attorney’s fees.</td>
<td>Summary contravention of legislation can result in fine not exceeding $10,000 and imprisonment not exceeding 12 months. Indictable contravention of legislation can result in fine not exceeding $50,000 and imprisonment not exceeding 5 years.</td>
<td>Penalties include: 1. Civil penalties ranging from £200 to £5,000 for an individual, £1,000 to £50,000 for a corporate body. 2. Prohibition from acting as a trustee. 3. Criminal sanctions of a fine or imprisonment or both.</td>
<td>Imprisonment, fine. Loss of tax advantages. Fine for contravention of Superannuation Guarantee Administration Act: $5,500.00 Contravention of record retention and privacy provisions $33,000.00 Trustees can be fined up to $220,000.00 for breach of duties. Interest payable on amounts not remitted in timely manner by employer is 7% plus the Bank of Australia’s benchmark interest rate, calculated daily.</td>
<td></td>
</tr>
<tr>
<td>Treatment of Extra-Jurisdictional Plans</td>
<td>In theory, Law applies to all mandatory private pension plans provided by employers in Cayman Islands - including those that are established and regulated in other jurisdictions.</td>
<td>Minimum standards legislation may extend to foreign plans to the extent that such plans provide benefits for employees in covered employment. Extra-jurisdictional plans are exempted from registration requirements of ITA (to avoid RCA status) if the plan is maintained primarily for the benefit of non-residents in respect of services provided outside of Canada.</td>
<td>Rules do not apply to a plan maintained outside of the United States primarily for the benefit of persons substantially all of whom are non-resident aliens.</td>
<td>Requires pension coverage from all employers of Bermudians and regulates such coverage. Because non-residents are not covered by this legislation, possibility of coverage of extra-jurisdictional plans is low.</td>
<td>A pan-European protocol provides for the mutual cooperation of the relevant authorities responsible for the operation of cross border schemes in each member state. Not applicable.</td>
<td></td>
</tr>
</tbody>
</table>