PERFORMANCE AUDIT

OF

THE MONTSERRAT SOCIAL SECURITY FUND:

GOVERNANCE & SUSTAINABILITY

Office of the Auditor General
Montserrat

June 2020

THE MONTSERRAT SOCIAL SECURITY FUND: GOVERNANCE & SUSTAINABILITY

This is a Report of a Performance Audit conducted by the Office of the Auditor General pursuant to Section 103 of the Montserrat Constitution Order 2010.

Marsha V E Meade
Auditor-General (Ag)
Office of the Auditor General
June 2020

PREAMBLE

Vision Statement

To be a proactive Supreme Audit Institution that helps the nation to make good use of its resources.

Mission Statement

The OAG is the national authority on public-sector auditing issues and is focused on assessing performance and promoting accountability, transparency and improved stewardship in managing public resources by conducting independent and objective reviews of the accounts and operations of central government and statutory agencies; providing advice; and submitting timely Reports to Accounting Officers and the Legislative Assembly.

The Goal

To promote staff development, enhance productivity, and maintain a high standard of auditing and accounting in the public sector, thereby contributing to the general efficiency and effectiveness of public finance management.

AUDITOR GENERAL'S OVERVIEW

This audit examined the operations and financial condition of the Montserrat Social Security Fund. Overall, the evidence that we gathered shows that there is an adequate framework of oversight and accountability. The Fund has had very low turnover of staff and has demonstrated strong internal controls over the payment of benefits. Generally, governance was satisfactory and has continued to improve during the past several years.

In terms of sustainability, however, we found rapidly worsening financial trends and repeated warnings in every actuarial report of the past 10 years. Key areas requiring urgent and major improvements include:

[1] The rate of contributions is already far below the actual cost of current benefits and has been adjusted only twice in 30 years; hence, it cannot sustain payments of all of the future benefits promised and already owing to past and present contributors;

[2] The ceiling for insurable earnings is too low and has not been adjusted for several years, rather than rising every year, as is common in many other jurisdictions;

[3] As the cost of pensions (now 96% of total Social Security benefits being paid) is rising much faster than contributions, the Fund has incurred a large deficit every year for the past decade; of great concern for all stakeholders, the deficit accelerated sharply in the past 3 years, seriously undermining the entire future of the already financially fragile Fund;

[4] With growing annual deficits, the Fund's reserves are being rapidly depleted, at a growing rate, and are projected to be exhausted within as little as the next 4 years.

We have also provided a number of recommendations that we are confident would benefit the Government and the citizens of Montserrat once they are implemented as soon as possible. Given the seriousness of the status quo, immediate action is required.

I wish to thank the Director and Deputy Director and the staff of the Monserrat Social Security Fund and all other persons who provided information, clarifications or extended any courtesy to my staff during this assignment.

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ABBREVIATIONS

CARICOM	Caribbean Community
CAROSAI	Caribbean Organisation of Supreme Audit Institutions
DFID	Department for International Development, UK Government
DITES	Department of Information Technology & E-Government Services
GDP	Gross Domestic Product
GOM	Government of Montserrat
ICT	Information and Communication Technologies
INTOSAI	International Organisation of Supreme Audit Institutions
ISSAI	International Standards for Supreme Audit Institutions
MOFEM	Ministry of Finance & Economic Management, Montserrat
MPS	Montserrat Public Service
MSSF	Montserrat Social Security Fund
OAG	Office of the Auditor General, Montserrat
OOP	Office of the Premier, Montserrat
PEFA	Public Expenditure and Financial Accountability
PS	Permanent Secretary
SDP	Sustainable Development Plan: 2008 to 2020, Government of Montserrat
TC	Technical Co-operation (refers to GOM posts directly funded by the DFID)
TOR	Terms of Reference

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EXECUTIVE SUMMARY

1. Following natural disasters in years 1989 and 1995, up to 75% of the population emigrated and the private sector declined sharply, greatly reducing the inflows and the number of contributors to Social Security. Thus, the public sector became the main employer and the driving force for the economy, but was not contributing significantly to Social Security (until 2012), as most public employees were enrolled in the Government's Pension Plan. In the past two decades, the scope and the total cost of public services and goods required have increased even as [a] the population declined, [b] the workforce became smaller, and [c] the society diversified ethnically while gradually aging. The GOM and, by extension, the MSSF are challenged by the need to increase (i) the number, (ii) the range and (iii) the quality of services and benefits, including social security and pensions, to meet the more complex demands of a modern, aging, and increasingly immigrant society in a small open economy with globalised communication, travel, trade, and movement of goods, services, and people. As a major part of the broader public sector, all of the MSSF's urgent challenges and major issues are affected by these trends.

Main Findings

2. Good governance overall, but lagging digitally. There is adequate oversight of strategic planning, budgeting, operational processes, and spending. Internal financial controls are strong. However, there is excessive use of paper, and too little use of all the available digital technologies for information, communication, services, & payments, including the MSSF's website.

3. Contribution rates and the ceiling for insurable earnings are too low. The current ceiling on insurable earnings and the rates of contribution are both very low, have not been raised for several years, and are well below the cost of the benefits that are being paid.

4. Declining population; smaller workforce. The 2018 Census showed a further decline in the population. Falling and aging population directly leads to (a) reduced contributions to MSSF's revenues, and (b) sharp increases in spending on benefits and especially on pensions.

5. The investment portfolio is poorly diversified and returns are too low. Contrary to best practice and to the MSSF's Investment Policy, the portfolio has been heavily concentrated in low-yield and short-term assets, which are unable to achieve the rate of return needed to pay benefits. The Social Security building represents a large portion of the portfolio.

6. Large annual deficits; rapid loss of reserves. The Fund has incurred a large deficit every year for the past decade. In just two recent years, it more than tripled: from $1.42 million (2015) to $4.63 million (2017). In turn, the reserves are falling rapidly and at a rising rate. Without immediate corrective action to boost contributions to the Fund, all reserves will be gone within as little as 4 years.

Key Recommendations

7. Increase contribution rates and the ceiling for insurable earnings. The MSSF should continue to request the Cabinet to act immediately to approve the much needed increments in the current very low rates of payroll contributions to Social Security. The great urgency of the Fund's situation requires boosting contributions at least one percentage-point per year for both employers and employees for the first 2 or 3 years and then a shared percentage-point or less per year thereafter. There is also the need for the Cabinet to create an automatic mechanism to raise the ceiling each year. We strongly recommend that the increment be at least 10% per year for the next 2 to 3 years and 5% per year thereafter. This will immediately boost contribution revenues, reducing the deficits and rapid loss of reserves.

8. Gradually raise the qualifying age for full pension. In line with rising life-expectancy (hence, more years in retirement), a smaller workforce, and the rising portion of the population over 65 years of age, the MSSF should advise the Cabinet to continue to approve small increments to the qualifying age at which contributors become eligible for full pension-benefits.

9. Abolish, suspend, or reduce early pensions. The MSSF should continue to advocate for the Cabinet to act immediately to address the unsustainable burden of early pensions, including reducing the percentage of pension benefit for each month or year that persons claim pension earlier than their full qualifying age. Until the fund will be returned to a sustainable basis, suspend any new claims for early pensions, except for cases of hardship.

10. Rebuild & diversify the reserves to support payment of benefits. To manage the MSSF's large and growing liabilities to past and current contributors to the Fund, the MSSF must have adequate reserves. As the biggest employer and the biggest stakeholder in the MSSF, the GOM should begin to make periodic extra contributions to the Fund to replace the accelerating decline in the MSSF's reserves over the past 10 years.

Audit Conclusion

11. With an adequate framework for governance, the Montserrat Social Security Fund is effectively managing the administration of benefits, which, in dollar terms, are almost entirely pensions. This will greatly improve with increased utilisation of available technology. Most urgently, all of the actuarial reviews of the past 9 years have warned that the MSSF is no longer sustainable. The retroactive addition of GOM's employees to the MSSF (in 2012) without adequate contributions to fund their full actuarial cost placed an immediate (and continuing) unaffordable burden on the Fund. The introduction of the option of early pensions then greatly worsened the Fund's already weak financial position, as the number of pensioners has more than doubled since then.

12. Losses over $14 million on investments with CLICO/BAICO were another major blow to the reserves. With low and falling returns on the portfolio, poor diversification of the assets, and annual deficits since year 2008, the reserves are rapidly falling and cannot sustain current benefits beyond the next few years. Outflows to pay current pensioners already far exceed the total contributions and investment income to the MSSF, resulting in losses that grow larger each month. Prompt actions by the Cabinet to boost both inflows and reserves are paramount.

CHAPTER 1: INTRODUCTION

1. This report represents a performance audit within the theme of Social Security and moves beyond the central public service to evaluate a major entity in the broader public sector. This audit focused on (1) the governance and processes of the MSSF's Departments for managing and using information and financial assets, (2) the MSSF's policy framework for strategic planning, budgeting, and investing and (3) the Departments' efficiency, effectiveness, and accountability in their provision of services to contributors and beneficiaries. These connected dimensions have implications (a) for governance, (b) for the sustainability of assets and benefits, and (c) for the quality of outputs, of outcomes, and of the delivery of services to the public. In turn, the number and the quality of the MSSF's assets and public services affect the entire economy and society of Montserrat. This is important, since in the post-1995 era, the central GOM and the wider public sector together constitute, directly and indirectly, up to 75% of GDP and roughly 65% of full-time employment in the national economy, and they have numerous multiplier effects.

Objectives of the Audit

2. The audit sought to examine the level of governance and the quality of the processes of planning, budgeting, and use of investments in the MSSF. We considered (a) the quality of internal records, monitoring and reporting for financial assets, (b) the related management of human and other resources, (c) interviewees' reported issues, limitations, and challenges and their causes, and (d) their impact on the efficiency and effectiveness of participating Departments. Finally, the study aimed to assess the use of investments and the provision of Social Security benefits in relation to the Social Security Act, as well as GOM's Policy Agenda, the Montserrat Energy Policy, and the SDP 2008 to 2020. In particular, we sought to identify the major planning challenges, budgeting deficiencies, issues surrounding investments and reserves, and operational issues facing the MSSF, and, hence, opportunities and recommendations for improving the outcomes of invested assets and their uses for all stakeholders, especially pensioners.

Scope of Performance Audit

3. The scope of this performance audit was to examine the status and the past 10 years' trends of planning, budgeting, and use of financial assets within the MSSF. We included all of its departments in our review in order to assess the perspectives and the experiences of internal stakeholders regarding services, benefits, processes, and investments vis-à-vis their mandate, structure, efficiency, quality of outputs, communication, quality of service, and overall performance. Financial and other data-analyses focused on periods covered by the last three actuarial reviews (i.e., years 2009 to 2018).

Scale of Performance Audit

4. The scale of this performance audit was limited to the Montserrat Social Security Fund. The Government's pension scheme for public servants is a parallel but separate arrangement and was not covered in this study. Public servants were retroactively added to the MSSF in 2012.

What We Excluded from this Audit

5. We excluded data preceding those of the year 2008, except for background knowledge and local context. We excluded comparative analyses and other cross country reviews. We also largely excluded regional and international data sets, except for background information, thus emphasising Montserrat-specific current and very recent historical data-sets. Future performance audits and the MSSF's own strategic plans and capital budgets will need to address these areas in order (i) to reach optimal resources management, including major areas such as green energy, governance, environmental safety, and sustainable development, (ii) to embed a culture of effective financial management and public accountability, and (iii) to exceed comparative Caribbean standards and global best practices, as Montserrat competes with other countries for talent, for funding, and for investments, all of which affect the sustainability of Social Security.

Why We Performed This Audit

6. **Quality of Public Services**. Since most of the island's employment is within the public sector, any deficiencies in public planning, budgeting and/or performance affect the entire country, including the sustained development of businesses and job creation in the private sector. The pooling of funds and the effective investment of financial assets are essential parts of the delivery of social security. All citizens and residents interact with the public sector directly and indirectly, and they depend on the efficient, reliable, and effective provision of public services such as Social Security, ranging from sickness benefits and maternity benefits to Old Age grants and pensions. In recent years, large numbers of GOM's employees were retroactively added to the MSSF, including significant numbers of persons who have newly qualified for early pensions, thus adding unexpectedly large demands on the MSSF to pay pensions years ahead of original projections. Hence, the MSSF's sustainability of benefits is of great importance for a large and growing part of the population, and, above all, the fast rising numbers of pensioners and survivors.

7. **Governance & Investment**. Over 60% of the GOM's recurrent spending and up to 90% of its capital spending are funded [1] by external aid from the UK Government and [2] by grants from multilateral institutions. Hence, the public sector faces increasing scrutiny and accountability [a] for the management of public funds, [b] for the execution of strategic plans, and [c] for the delivery of programmes, of services, and of outputs. The MSSF's assets represent large fiduciary investments of public funds. Therefore, they require adequate planning, budgeting, and deployment to maintain [i] high levels of reserves to sustain the payment of insured benefits and [ii] high levels of service to the public, including employees, employers, survivors, and pensioners.

How We Performed This Audit

8. **Interviews**. Initially, we engaged in correspondence followed by an interview with the executive Director. With the guidance provided by these channels, we proceeded to devise questionnaires and data gathering techniques suitable for the purpose of assessing (i) the governance of the MSSF, (ii) the efficiency and the effectiveness of data gathering, reporting, human resources, and interdepartmental communication and co-operation, and (iii) the financial trends and the projected outcomes of the uses of investments to pay benefits.

9. **Reviews of relevant law, regulations and literature**. Before and during our fieldwork, we researched relevant GOM policies, laws, and regulations in order to establish the legislative framework for our performance audit. The programme of research also included literature on such relevant subjects as (a) governance, (b) strategic planning and national budgeting, (c) public sector efficiency and effectiveness, (d) asset management, financial management, and investments, (f) actuarial science and pensions and (g) Social Security performance benchmarks and standards of service. These sources supplemented our reviews of various internal and external documents related to the MSSF's policies, structures, and operations affecting the issues of planning, budgeting, benefits, pensions and deployment of financial assets.

10. **Internal & External Evidence**. Various information requests were made during August to October, 2019. Owing to several late responses, the fieldwork extended to November, 2019. Emphasis was placed on factors affecting the Departments' governance, planning, budgets, implementation, asset management, efficiency, and performance. In particular, we sought to know (a) whether staffing and skills were adequate for managing investments and the satisfactory administration of benefits during the past few years, (b) issues affecting the Departments' processes, progress, and outputs, (c) the quality of reporting, communication, and co-operation among the stakeholders, and (d) recommendations/opportunities for improvements.

11. **Standards used**. This audit was conducted according to standards promulgated by the International Organisation of Supreme Audit Institutions (INTOSAI) for performance audits. Those standards require that we plan and perform our audit in order to obtain sufficient and reliable evidence to reach a reasonable conclusion about the performance of the project with regard to [a] its governance and [b] its management during the period under review. The international standards used to perform this audit-engagement and to assess the findings of this audit include ISSAI 1, ISSAI 100, ISSAI 3000, and ISSAI 3100.

CHAPTER 2: GOVERNANCE FOR SOCIAL SECURITY

12. The MSSF was created by statute in 1985 (effective July, 1986) and has become a mature, stable entity. The prescribed framework for governance includes an executive Director, a Deputy Director, and a multi-stakeholder Board, including appointees from the GOM, and representatives of contributing employees and of contributing employers. Under the Board's oversight, a variety of committees and units provide review, monitoring, inputs, and accountability for the approval, the implementation, and the outcomes of plans, budgets, operations and investments.

Findings of the Audit

13. Good framework for oversight. The Board meets several times per year and is complemented by (a) the Audit Committee, (b) the Management Committee, and (c) the Investment Committee. The MSSF has annual external audits as well as independent triennial actuarial reviews.

14. Central database for benefits. The MSSF uses the standard software that is also used by a number of other Caribbean islands for Social Security or National Insurance Schemes. This is externally supported by a service-provider in Barbados, including any modifications that the MSSF requires to the software, or the activation or addition of new modules requested by the MSSF to the software.

15. Extensive use of paper and manual processes. In spite of the available technologies, the Board, the committees and the staff of the MSSF continue to use paper widely. Accounting is done via software, but most aspects of operations, including the handling of contributions and the administration of benefits, remain heavily oriented towards manual processes, in-person transactions, physical meetings, physical payments, and paper-forms.

16. Inadequate use of website. The MSSF has a website with limited functionality and mostly outdated information, with little recent news. The MSSF lags far behind other systems in the Caribbean in such areas as (1) provision of online accounts to contributors and beneficiaries, (2) online payments of contributions and/or benefits, and (3) self-service mechanisms such as (a) electronic pension calculators and (b) personal history of contributions and benefits.

17. **No surveys of customers were ever done**. We found that the MSSF has not done any surveys of its clients, despite being in business for more than 30 years.

18. **No statements are issued to contributors**. The MSSF lacks an active marketing unit and has no direct proactive communication with most of its stakeholders. There is mostly passive receipt of information, of contributions, and of queries from stakeholders. One exception relates to delinquent employers: in this case, the MSSF's Inspector routinely performs fieldwork and liaises with persons who are lagging in remitting their contributions and/or their employees' contributions to the MSSF.

Recommendations

19. **Digitise operations.** To improve the efficiency, the effectiveness, and the security of data and documents, the MSSF should move immediately towards adopting electronic channels and storage for all information and for all communication both internally and externally. The Board and Committees, for example, can eliminate paper and use electronic documents and a projector for meetings. All forms for clients can be web-enabled for easy access and submission. Payments can be prepared, approved and processed electronically, eliminating the cost of paper, printing, and cheques. Cloud computing can save significant I.T. hardware and software costs.

20. **Provide annual statements to contributors**. In the spirit of transparency and accountability, the MSSF should move immediately to start providing at least one substantive communication with each of its participating employees and employers each year. Recommended items include (a) contributions paid for the year, (b) accumulated contribution-periods, (c) lifetime contributions made, (d) level of eligibility or qualification for each type of benefit, and (e) indicative pensionable ages and levels of benefit, based on average insured earnings to date. An annual statement also provides an opportunity to educate stakeholders about new developments within the MSSF, about their benefits, and about their responsibilities.

21. **Upgrade the website to provide full service to clients**. This can be implemented in phases, starting with online accounts, and progressing through online submissions of forms, and online submissions of contributions. Clients need to be able to see their full history with the MSSF so that they can make sure that all contributions (both theirs and their employers') have been made for the periods that they worked. This will enhance communication and compliance.

22. **Do periodic surveys of clients**. This can be done on a phased basis, ensuring that major groups of stakeholders are reached and provide feedback about MSSF every 1 to 2 years.

CHAPTER 3: SUSTAINABILITY OF SOCIAL SECURITY

23. All Departments are functioning as intended in support of the effective administration of benefits to insured persons. However, the key parameters of the MSSF are long overdue for adjustments in line with the actual trends of the Fund and with the growing number of pensioners in particular. As almost all of the benefits that are being paid are pensions (96%), the focus of this study was the MSSF's long-term benefits. Short-term benefits are available, but the bulk of the workforce is employed by the GOM, which provides equivalent or greater benefits to its employees. Therefore, the actual claims on the MSSF for short-term benefits have been greatly reduced, especially since the GOM, as of 2016/2017, offset maternity benefits and sickness benefits, for example, and no longer permits public employees to have double-dipping of benefits (i.e., claiming Social Security short-term benefits while already being paid full salary by the GOM). Overall, in spite of this, the MSSF's inflows from total contributions and investment income are well below its outflows for current payments of benefits, and the deficit is rising rapidly each year.

Findings of the Audit

24. **Rapid increases in persons choosing early pensions.** Since the Cabinet amended the Social Security Act in 2016 to introduce the option of reduced pension as early as the claimant's 60th birthday, large numbers of persons have claimed pension benefits years ahead of the age for standard benefit. This surge also followed GOM's retroactive addition of public servants to the Social Security Fund, including many persons who were at, or nearing, pensionable ages. Hence, in just four years, 2015 to 2019, the number of pensioners increased 25% (p. 2 and p. 6, 8th Actuarial Review; MSSF internal statistics). As the Fund was already experiencing annual deficits since year 2008, this has placed a large, growing, and unaffordable burden on the MSSF.

25. **Inadequate funding for benefits to GOM's employees.** Following the retroactive addition of public servants to the MSSF, the GOM agreed to, but then delayed the payment of, its catch-up contributions. This further limited the already much shortened timeframe for the Fund to earn a return on reserves before paying benefits. Overall, the GOM's cumulative contributions to date have not been adequate to provide for the full cost of benefits promised [a] to all the civil servants who were retroactively added to the MSSF and [b] especially, to those who then shortly afterward elected to claim early pensions. This caused a triple financial strain on the MSSF: [1] the challenge of suddenly handling many more beneficiaries; [2] the escalating number and amounts of pensions being paid years ahead of previous planned dates; [3] not having the usual decades to invest contributions and to grow reserves before starting the payment of pensions.

26. Pensions are being paid to working persons. In Montserrat, unlike what is practised in many countries, full pensions are being paid to persons who reach the age of 65 years even when they continue in employment. The current regulations also allow working pensioners to stop making contributions to Social Security. This combination of reduced contributions (inflows) and increased benefits (outflows) places a large and unaffordable burden on the MSSF.

27. Heavy reliance on the reserves. Over the past several years, revenues and actual collections have been below expectations and, in any case, even the projected amounts are inadequate to meet the Fund's total recurring spending needs. Hence, the MSSF has already passed a number of critical warning points: (a) firstly, when benefits paid exceeded contributions received; (b) next, when benefits paid exceeded contributions plus income from investments; and (c) currently, where reserves have to be used every month to cover payments of current benefits. In these circumstances, the MSSF cannot afford to pay any benefits to new claimants/pensioners.

28. Contribution rates are too low. The current rates of contribution (5% for employers and only 4% for employees) are very low and have not been raised for several years. The combined rate of 9% of insured earnings is 40% below the actual cost of the benefits that are already being paid (15% of insured earnings in the year ended March, 2018, and rising yearly). In turn, therefore, it will not be able to pay most of the future benefits (almost entirely pensions) promised and owing to past and present contributors to the MSSF (estimated in the vicinity of 21% to 25% of insured earnings) (p. 2 and p. 24, respectively, 8th Actuarial Review).

29. Declining population; smaller workforce. Montserrat's 2018 Census showed [a] a slowly declining population (4,649 persons versus 4,922 persons in the 2011 Census), [b] a steadily aging society (median age of 40 years vs. 37.70 years in 2011), and [c] that 44% of residents are immigrants (versus 39% in 2011). These demographic trends have reduced the workforce, but increased the range of public services required, and, hence, [i] the types, [ii] the number and [iii] the quality of social-security protections and benefits needed (e.g., income replacement for unemployment in the private sector, insurance for disabilities, pensions, insurance for injuries, insurance for funerals, income replacement for maternity/paternity, and mechanisms for better serving the growing minorities: e.g., those speaking French and Spanish, those with special needs, and the elderly). A falling and aging population directly correlates with (a) shortfalls in contributions to MSSF's revenues versus what is needed, (b) sharp increases in spending on benefits and especially on pensions, and (c) little or no growth in real economic output.

30. The ceiling for insurable earnings is too low. The current rates of contribution are based on a maximum of E.C.$4,000 of insurable income per month. This ceiling is too low and has not been raised for several years; by contrast, in many countries, the ceiling for insurable earnings rises automatically every year. Roughly 20% of working persons earn above this ceiling. Hence, a large and growing amount of income remains uninsured, representing an untapped pool of significant and immediate potential contributions to Social Security.

31. Large annual deficits; rapid loss of reserves. The Fund has incurred a large deficit every year for the past decade. In just two recent years, it more than tripled: from $1.43 million (2015/2016) to $4.62 million (2017/2018) (p. 7, 8th Actuarial Review). In turn, the reserves are falling rapidly and at a rising rate. Without immediate corrective action to boost contributions to the Fund, all reserves will be gone within as little as 4 years.

32. The portfolio of investments is poorly diversified. Contrary to the Investment Policy and to best practice, every allocation of the investments as at March 2018, was well above or below the target: [a] cash and short-term assets were almost twice as high as the target; [b] bonds were 90% below the target; [c] equities and real estate were 60% higher than the target (p. 12, 8th Actuarial Review).

33. The average return on investments is low and falling. Poor diversification and losses from impairments have combined to produce increasingly poor performance of the portfolio of investments. During years 2011 to 2018, for example, the already low yield fell by half: from 3.70% p.a. to 1.90% p.a. (p. 14, 8th Actuarial Review). These rates are [a] a fraction of what the MSSF needs to earn in order to provide for the benefits already being paid and [b] even less adequate to provide for the future benefits already accrued to present and future pensioners.

34. Most of the investments are short-term, low-yield assets. Over half of the MSSF's reserves as of March, 2018, were in short-term assets that have very low rates of return. Historically, the percentage of the portfolio in low-yield assets was even higher: e.g., close to 65% as of March, 2015 (p. 10, 8th Actuarial Review). Thus, investment income is inadequate to meet the current shortfall of contributions against the cost of benefits being paid. The lower the yield on assets, the faster the assets themselves must be liquidated to support the continued payment of current benefits. As pensions are very long-term obligations, the MSSF requires a much higher allocation to long-term assets to match optimally its expected inflows and outflows.

35. Over 40% of the reserves are illiquid. Underlying the already insufficient and quickly falling reserves is approximately $10 million represented by the MSSF's only building. For the MSSF's portfolio of investments, this is both [1] a long-term liquidity risk (i.e., not readily convertible to cash when it will be needed) and [2] a concentration risk (i.e., a large percentage of the portfolio in one class of assets and, worst of all, in one asset). In its current form, it earns rental income, but the principal will not be available to pay benefits. This greatly reduces the effective distributable portion of the MSSF's investments and reserves. Importantly, as the remaining financial investments are dwindling monthly, this single asset is becoming a larger percentage of the MSSF's total net available reserves each month.

36. Large losses on investments with CLICO and BAICO. The MSSF was heavily impacted by losses of EC$14.45 million of its investments with these two regional insurance-providers. This crisis arose after their multinational parent-company experienced acute financial difficulties and illiquidity-risks following the Great Recession of years 2008 to 2009. Whilst the Government of Trinidad and Tobago has provided phased restitution to clients resident in Trinidad, investors in the O.E.C.S. have been left with little recourse or assurance. This matter has persisted for over a decade to date, with little prospect of satisfactory recovery for the MSSF.

Recommendations

37. Rebuild reserves to support payment of benefits. To manage the MSSF's large and growing liabilities to past and current contributors to the Fund, the MSSF must have adequate reserves. As the biggest employer and the biggest stakeholder in the MSSF, the GOM should begin to make periodic extra contributions to the Fund to replace the accelerating decline in the MSSF's reserves over the past 10 years. This is also very important to ensure continued payments of all of the benefits promised to the GOM's employees after they were added to the MSSF.

38. Secure emergency support. At the minimum, the MSSF should liaise with the GOM urgently to ensure that, in line with the Social Security Act, emergency funding will be provided to cover the payment of benefits in the increasingly likely event that the remaining reserves will disappear within a few years. Acting immediately will allow for the convenience of annual contributions versus the very large catch-up emergency injections that will become necessary following years of delay. We recommend that the MSSF and GOM conclude a formal Memorandum of Understanding, clearly outlining the steps to be followed to provide fully for all current and accrued benefits to be paid as they will become due to current and future pensioners.

39. Increase the rates of contribution. The MSSF must continue to encourage the Cabinet to act immediately to approve the much needed increments in the current very low rates of payroll contributions to Social Security. For example, just one percentage-point extra per year for the next 5 years would largely address the current large deficits. However, given the great urgency of the Fund's financial situation, it would be even more effective to boost contributions

[1] by at least one percentage-point per year both for employers and for employees for the first 2 or 3 years and [2] then by a shared percentage-point or less per year thereafter. These would be very small amounts at the level of individuals (e.g., $10 extra per $1,000 earned), but very significant at the aggregate level of the Fund, helping to match contributions to the actual cost of the benefits.

40. Raise the ceiling for insurable earnings annually. The MSSF should continue to liaise with the Cabinet to act immediately to approve the much needed increments in the current low maximum of E.C.$4,000 of insurable income per month. To address the Fund's dangerously large shortfall of contributions versus the benefits already being paid, the actuaries have long urged that this ceiling be amended to at least E.C.$4,500 in the first instance. In line with best practice, the Cabinet should create an automatic mechanism to raise the ceiling each year. Given the Fund's crisis of rapidly falling reserves, we strongly recommend that the increment be at least 10% per year for the next 2 to 3 years and 5% per year thereafter. This will immediately boost the revenues to the Fund, start to reduce the deficits, and help to stem the rapid loss of reserves. Importantly, the reserves must not only stop falling, but be rebuilt as soon as possible to continue to pay benefits.

41. Gradually raise the qualifying ages for full and early pensions. In line with rising life-expectancy, a smaller workforce, and the rising portion of the population over 65 years of age, the MSSF should advise the Cabinet to approve further small increments to the qualifying age at which contributors become eligible for full pension-benefits. This could be done in simple steps: e.g., raising the qualifying age by 3 to 6 months per year over 5 to 10 years. For instance, in several other countries, this has already moved from 65 years of age to 67 years of age. Correspondingly, the qualifying age for early pensions would rise (if not abolished or suspended per our further recommendations below).

42. Abolish, suspend, or decrease early pensions. The MSSF should continue to advocate for the Cabinet urgently, at the minimum, to further increase the percentage of reduction for each month or year that persons claim pension earlier than the full qualifying age: e.g., 10% to 15% per year, given the Fund's already fragile position.

[a] This measure will immediately reduce the already large monthly outflows from reserves, while continuing to provide a benefit for those who need it most (e.g., in cases of disability or long-term illness).

[b] It will also reduce the current incentive to claim early pensions for those who are able to continue working to full pensionable age.

[c] On a case-by-case basis, the regulations could be reviewed to provide that, with appropriate justification, and on the recommendation of the Director/Board of the MSSF, exceptions could still be made for cases of hardship, and/or where the actual amount of the benefit would be below a specified threshold, whereby little or no reduction would be applied.

[d] Given the dwindling reserves, the MSSF should further recommend to the Cabinet that the option of early pensions be immediately suspended until the Fund would be restored to sustainability.

43. Defer/offset pensions for persons who continue working. In view of the Fund's precarious and rapidly worsening position, the MSSF should advise the Cabinet to immediately approve amendments to the Social Security Act to make retirement a prerequisite for full pension at the qualifying age. Recommended amendments include, but are not limited to, the following:

[a] Retirement should be an absolute prerequisite for persons seeking to claim early pensions.

[b] Persons who continue to earn income from employment should not automatically qualify for pension-benefits.

[c] As it is normal practice in many other countries, persons are not to be discouraged from working past pensionable age, but, rather, not to exploit Social Security. Accordingly, we recommend that pension-benefits be either deferred entirely for working persons who reach the qualifying age and/or reduced by a meaningful percentage of the claimant's earned income: e.g., 50% to 75%.

[d] Hence, there would be an incentive for continuing to work past pensionable age, as working would increase the person's total income, but subject to appropriate and affordable offset. This would also be in line with the GOM's current policy that its employees must choose either a Government pension or a Social Security pension, and not both. Without these essential conditions, working pensioners are placing an unnecessary burden on the MSSF.

44. Create incentives for those who defer pensions. In line with rising life-expectancy, and to reduce the unsustainable demands being placed on the MSSF for early pensions, the MSSF should advise the Cabinet to immediately amend the Social Security Act to provide enhanced benefits for those who defer commencing their pension beyond the standard age for full benefit.

[a] As an illustration, in several countries, persons receive an extra 6% to 8% per year (or corresponding pro-rated amount per month) for each year (or month) that they elect to delay their pension.

[b] Importantly, this strategy gives more time for the Social Security system to grow its reserves and to earn a return on its existing reserves.

[c] It also encourages able-bodied employees to continue working and earning, thus:

- **[1]** Increasing the amount of their ultimate monthly pension-benefits,
- **[2]** Continuing to contribute to the economy, to tax-revenues, and to the society, while
- **[3]** Reducing their overall lifetime need for such benefits (since, for every additional year of employment, salary and allowances are significantly more than any pension-benefit, which is based on a fraction of insured earnings only).

CHAPTER 4: MANAGEMENT RESPONSE

45. I have reviewed your initial findings and I am in agreement with them. We, along with our Actuary, have been in discussions with the Honourable Financial Secretary and the new Premier about the current situation and these discussions will be ongoing until we arrive at a suitable solution to these problems. Since then the 8th Actuarial Review Report was tabled in the Legislative Assembly of February 25, 2020. The debate has not taken place at the time of writing. However, the recommendations emanating from the Review will be implemented as soon as we receive the approval and the necessary amendments to our Regulations have been made.

46. One of the points that I think should be expanded upon is the fact that, even with pension reform of increasing the retirement age from 60 to 65, the penalty for claiming pension prior to one's retirement age is not much of a deterrent. Hence, the main reason for the increase in our pension bill, as everyone is claiming early pension, which is having a knock-on deficit effect. In most cases, someone taking early pension would be better off for an average of 17 years than if they had waited for their pension on attaining their pensionable age. This just cannot continue as it is negating the pension reform efforts of moving the pensionable age from 60 to 65 currently.

47. Every effort has been made over the years to diversify the investment portfolio and increase investment returns, while attempting to maintain the balance between risk and return. The asset-allocation within The Investment Policy Statement was revised in 2018. Funds were placed with an External Fund Manager, whose task was to invest those funds based on the Investment Committee's and the Board of Directors' directives, bearing in mind the asset-allocation outlined in the Investment Policy Statement.

48. A proposal was submitted to Montserrat Social Security Fund (MSSF) to develop a modern database system which facilitates the management of Employees, Employers and their contributions and benefits. The overall goal is to develop and improve on the current system with new customized additional features and online services. Customers can access these services from their internet based devices both locally and internationally by doing direct data entry into the system which will alleviate employee time spent on monotonous data entry and reduce the amount of paper used in printing forms.

49. The proposed system includes extensive consideration for data security, backup services and a variety of levels of administrative privileges. There is also provision for improvement of the present website which will feature updated information and improved user friendly and interactive.

The Director (Ag) Montserrat Social Security Fund
July 8th, 2020.

CHAPTER 5: OVERALL CONCLUSION

50. **Urgent need to fund reserves to support benefits.** The current situation is unsustainable. Without immediate corrective action to improve inflows, the MSSF will use all of its reserves within the next few years. This will create a new level of crisis in the provision of benefits to insured persons. In turn, without appropriate intervention to rebuild the MSSF's reserves, the provisions of the Social Security Act will create a corresponding growing and continuing demand on the Government's Consolidated Fund. Given the GOM's already high level of dependence on foreign aid, this will likely require significant emergency funding from the DFID.

51. **Urgent need to improve management of data and documents**. There continues to be excessive use of paper and manual processes throughout the MSSF's operations. Central databases and effective management of documents will (1) allow all stakeholders to share and to retrieve information easily, and (2) enable Departments to maintain basic services and to respond to requests for information, regardless of various employees' absences, retirements, and resignations. Digitisation of accumulated files and records will reduce the risk of (a) decay, (b) damage, (c) loss, (d) inappropriate access to, or (e) theft of, data and information. It will also enhance (i) resilience, (ii) security of data, and (iii) business recovery and continuity, in the event of natural disasters or other disruptions in the environment.

52. **Long-term planning**. Building upon digital technologies, the greater availability of complete, accurate, and timely information will improve decision-making, including strategic planning and budgeting. All Departments need to continue to strengthen their strategic asset management to ensure business continuity and improvement in the quality of public services.

53. **Improved management of risks**. Much more effort is needed by all Departments (1) to define their risks, (2) to estimate their impact, (3) to estimate their probability of occurrence, (4) to develop measures to address each category of risk both (a) in the short term and (b) in the long term, and (5) to monitor, to assess, and to report on actual progress versus estimates. An effective strategy for communication with all stakeholders, from the public to contributors to the Legislative Assembly and beyond, is important for accountability, for transparency, and for prompting the authorities to take timely actions to preserve the MSSF for generations to come.

APPENDIX 1: OFFICE OF THE AUDITOR GENERAL

Functions

By force of ***The Montserrat Constitution Order 2010***, the OAG is established and upheld in its independence and in its functions within the public sector of Montserrat. The relevant section states as follows below:

Functions of Auditor-General

103.—(1) The Auditor General shall audit and report on the public accounts of Montserrat and of all public offices, including the courts, the central and local government administrations, universities and higher education institutions, and any public corporations or other bodies or organisations established by an Act of the Legislature, and may conduct financial and value for money audits in respect of any project involving public funds.

(2) The Auditor General shall submit to the Legislative Assembly annually a report of the accounts audited by him or her under subsection (1) for the immediately preceding financial year.

(3) For the purposes of subsection (1) the Auditor General and any person authorised by him or her shall have a right of access at all reasonable times to all such documents as appear to him or her to be necessary for the purposes of the audit, and shall be entitled to require from any person holding or accountable for any such documents such information and explanation as he or she thinks necessary for those purposes.

(4) In the exercise of his or her functions, the Auditor-General shall not be subject to the direction or control of any other person or authority."

The independence of both (a) the functioning of the Auditor General and (b) the budgetary allocations from the Government's national Consolidated Fund to finance the Office of the Auditor General are clearly stated and emphatically declared as follows below:

National Audit Office

104.—(1) The Legislature shall by law make provision for the establishment of an independent National Audit Office headed by the Auditor General.

(2) The budget for the National Audit Office shall be charged on and paid out of the Consolidated Fund, and must at all times be adequate to enable the full performance of the functions conferred on the Auditor General by this Constitution or any other law.

(3) The accounts of the National Audit Office shall be audited and reported on by an auditor appointed by the Legislative Assembly." [Bold and underlined emphases added throughout.]

In line with international standards for public-sector auditors and global best practices for Supreme Audit Authorities, the OAG of Montserrat espouses the following values and priorities:

Our Values

Respect. We seek to build productive professional associations and cordial personal working relationships with colleagues internally as well as with other public servants externally.

Honesty. We tell the truth even when it is unpleasant or embarrassing. Accurate self-assessment is vital for every person and for every unit of Government to acknowledge its strengths and its weaknesses, and to begin to address performance-gaps and shortfalls from relevant policies, from applicable standards, and from currently binding laws and regulations.

Transparency. Our work is in the service of the Government and the people of Montserrat. Therefore, all of our final reports on engagements undertaken are made available to all stakeholders, to the public and to any other interested parties via publication on our website.

Confidentiality. In the course of our duties, we protect the identity of all persons who reveal secret information or private details. Our reports disclose general conclusions and focus on practicable solutions rather than highlighting any person or department directly.

Accountability. By definition, the work of the OAG is to hold accountable all public sector Ministries, Departments, agencies, public-private partnerships, and State-owned enterprises. In turn, we are accountable (a) to colleagues through quality control procedures and through peer-review, (b) to local, regional and multinational professional accounting and auditing bodies, and (c) to global standards setting bodies. Finally, the OAG itself is subject to annual audits by an independent external audit-firm of the highest repute.

Objectivity. Auditors must remain impartial, devoid of partisan bias, without membership of political parties, and otherwise focused on the truth and the facts, rather than personal opinions, emotions, or self-interest. All of our analyses, conclusions and recommendations are based on facts and verifiable and auditable evidence, supported by retained audit papers and work-in-paper files throughout each and every audit engagement. Information is gathered solely for the purposes of the official audit and never to be used for personal advantage of either the auditors themselves or of any other person, party, entity, or enterprise.

Independence. Vitally important to the respectability of the OAG is the independence of the Auditor-General and of his/her staff both in appearance and in fact, both in public discourse and in social intercourse. Auditors must avoid any potentially compromising personal relationships or business activities with any public-sector auditee. Where he/she has (i) any material private indirect interest and/or (ii) any direct financial or other interest in an auditee and/or (iii) in or with any of its employees, suppliers, investors, creditors, or other related parties, an auditor must either refrain from any part of an audit of such entity and/or disclose the nature and the extent of such actually or potentially compromising interest whatsoever it be.

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APPENDIX 3: TERMINOLOGY

Efficiency. Efficiency is measured as the ratio of inputs per given or desired unit of output. The performance goal is to **minimise inputs and/or input-costs per unit of output**.

Productivity. Productivity is measured as the ratio of actual units of output per given unit of each input. The performance goal is to **maximise output per unit of each input**.

Effectiveness. Effectiveness is measured as the ratio of actual units/costs of all outputs to the desired units/costs of output. The performance goal is to **minimise gaps between desired output(s) and actual output(s)**, subject to the desired quality of that output.

Value for money. This is the desired surplus and/or value of benefits derived from actual output(s), deliverable(s), or outcome(s). It is measured as the consumer's utility or economic surplus: i. e., (1) the actual (and/or user-perceived) value of all benefits of each unit of output, minus (2) the actual costs per unit of each input required to produce and to enjoy the benefits of that unit of output. The performance goal is to **maximise the total value of incremental benefits (minus marginal costs) derived from all units of output** (e. g., public services or public goods), subject to the desired quality of that output, and to any applicable standards, regulations, contractual obligations, client-service objectives, or legal requirements.

Performance. This concept defines observable behaviours in respect of a specified function or activity. In practical terms, performance is measured as the comparison of *ex post* actual outcomes with a priori desired or pre-agreed outcomes. This lends itself very well to objective definition, measurement, monitoring, reporting, feedback, and recommendations for improvement, wherever gaps are identified between (a) desired behaviours and outcomes and (b) actual behaviours and outcomes. **Learning, for instance, is measured by improved behaviours**.

Performance-audits. Performance audits are objective, external, and independent reviews of activities, processes, organisations, financial statements, and/or other objects of interest, having explicit regard to such parameters as (i) applicable laws, (ii) external regulations, (iii) internal policies, (iv) internal rules, (v) international treaties, (vi) bilateral or multilateral agreements, (vii) industrial benchmarks, (viii) contracts, (ix) codes of conduct, (xi) ethics, (xii) morals, and/or (xiii) professional standards. Performance audits go well beyond (1) financial audits and (2) internal audits, for instance, to examine the actual, observable, and measurable behaviours, outputs, efficiency, effectiveness, and value for money of an entity, a programme, an agency, a statutory corporation, or an entire public sector, as the case might be. In this regard, performance auditing is inherently more far reaching, more strategic, and more consultative than other types of audit. When it is well executed by the auditor(s), and when, thereafter, its findings are wisely attended and its recommendations expeditiously implemented, a performance-audit in the public sector has the potential to offer the greatest value for money to the Government and, ultimately, to the people of Montserrat. In short, it pays for itself many times over.

APPENDIX 4: AUDIT FIELDWORK

Questionnaire for Interviewees

Correspondents & Interviewees

(1) Executive Director, MSSF
(2) Deputy Director and Financial Controller, MSSF
(3) Administrative Assistant, MSSF
(4) Investment Manager, MSSF
(5) I.T. Systems Administrator, MSSF
(6) Operations Officer, MSSF