INVESTMENTS AND GOVERNANCE OF THE PUNJAB PENSION FUND AND THE PROPOSED GENERAL PROVIDENT INVESTMENT FUND

PUNJAB GOVERNMENT EFFICIENCY IMPROVEMENT PROGRAM
TA – 7003 (PAK)

PRESENTED TO THE

MANAGEMENT COMMITTEE OF THE PUNJAB PENSION FUND
AND THE
GOVERNMENT OF PUNJAB
FINANCE DEPARTMENT
AND
THE ASIAN DEVELOPMENT BANK

SUBMITTED BY

THE ARIES GROUP, LTD.
USA

MARCH 2009

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INTRODUCTION

1. The Asian Development Bank is providing technical assistance under the Support to Governance Reforms in Pakistan, subproject Punjab Government Efficiency and Improvement Program (PGEIP) ADB TA 7003 - PAK. Assistance has been extended to the Punjab Finance Department to improve financing its accrued pension and general provident fund liabilities.

2. The Punjab Assembly passed the Punjab Pension Fund Act of 2007 for the purpose of creating and managing an Investment Fund from which to accumulate reserves to finance future expenditures from the Punjab Pension scheme. A similar Act is before the Assembly to create an Investment Fund for the purpose of managing investments to finance future expenditures of the Punjab General Provident Fund. As required under the Punjab Pension Fund Act an Investment Policy was created and approved by the Management Committee, the governing and oversight body of the Punjab Pension Fund.

3. This Report examines and comments on the approved Investment Policy of the Punjab Pension Fund. Many investment aspects of the Punjab General Provident Investment Fund Act are similar to those of the Punjab Pension Fund Act and as approval is expected in the near future, comments from this Report would apply equally to the Investment Policy for the Punjab General Provident Investment Fund.

4. The Consultant was asked to review the Investment Policy and its operating environment (Governance). This was completed through multiple meetings and discussions with members of the Management Committee, the Acting General Manager and the Chief Investment Office of the Punjab Pension Fund and with officials of the Finance Department.

5. The remainder of this Report is divided into an Executive Summary, Rationale for the Punjab Investments Funds, Governance Policy and Investment Policy.

   a. The Executive Summary outlines key findings, recommendations and describes Asian Development Bank proposed technical assistance to the Government to implement recommendations.
   b. The chapter on Rationale for Creating Investment Funds explains the purpose of Investment Funds and attempts to clarify common misunderstandings related to a partial or pre-funding strategy.
   c. The Governance chapter includes best practices and special concerns when governments manage Funds, a section on strengthening Governance and recommendations to consider structural changes.
   d. The chapter on the Investment Policy consists of international best practices and recommendations to strengthen the approved Investment Policy.

I. EXECUTIVE SUMMARY

6. An Investment Fund's Investment and Governance Policies are inseparably linked – each directly impacting the other. Global financial industry experts increasingly analyze the impact of Governance Policies on a Fund's investment returns – gains or losses. It is easy to understand how a set of rules that defines allowable investments will impact investment returns. Understanding the practices of a structure that enables good Governance is often more subtle but just as dramatically impacts investment gains and losses.

   a. Typically an Investment Policy defines an investment objective and explains how such objectives will be achieved through permissible and impermissible investments. It defines limits and processes and explains rules relative to allowable brokers through which trades can be placed. How investment activity is to be reported, disclosed, measured and the frequency of such are also often part of the Investment Policy.

   b. By contrast Governance translates to be the oversight of the environment in which the implementation of an Investment Policy occurs. Governance is the statutory obligation to exercise all reasonable prudence in the discharge of the duty to implement an Investment Policy. Good Governance occurs in an atmosphere of transparency, in easy to monitor and audit results and procedures and through independence from political influence and conflicts-of-interest. In a study [1]by the World Bank of the impact of governance structures on investment returns of publicly managed Investment Funds, one conclusion was, "The worst [investment] returns are produced by publicly managed pension funds in countries with poor governance records."

7. The development of the financing strategy that originally introduced the concept to pre-fund future expenditures, and was the impetus behind the Act and Rules, envisaged a process by which the Finance Department, the management of the Punjab Pension Fund and the Actuary would prepare the Fund's cashflow estimates. The management of the Fund would develop an investment strategy guided by the Investment Objectives and Investment Policy.

8. The Investment Policy, defined in a separate document, integrates the Act and Rules and is designed to guide the Management Committee and the management of the Pension Fund. The Consultant does not propose modifications to the list of permissible or impermissible investments or the defined allowable limits except as regards foreign investments. At present foreign investments are prohibited under the Act and Investment Policy (unless Government approval is received). A key concern in restricting investments exclusively to Pakistan's financial markets is the inadequate supply of suitable domestic investments. Exposure to foreign markets expands the supply of securities but creates foreign exchange hedging needs to

[1] Managing Public Pension Reserves - Part I: Evidence From the International Experience by Augusto Iglesias and Robert J. Palacios, 2000. World Bank Working Papers series 21311.

manage the risks associated when repatriating investment proceeds. It is industry practice to reduce the impact to foreign currency fluctuation by implementing hedging tools when permitting foreign investment. Other suggestions are to strengthen the Investment Objective, redefine performance benchmarks (a tool to evaluate the investment performance of the Pension Fund) and tighten the use and implementation of other terms.

9. Governance is expressed through the Act and the Rules as well as the organization of the Management Committee, which oversees management of the Fund. Key areas were identified to bring Governance into conformance with statements made by Government officials and members of the Management Committee that indicate they want oversight to be free of the risks associated with political interference and to ensure clear accountability of decisions taken relating to the oversight, management and day-to-day investment operations of the Fund.

10. This Report presents a series of recommendations, summarized below, and more comprehensively covered in the following chapters. Recommendations are organized in terms of priority and divided into three groups.

Immediate priority: Issues Related Managing the Punjab Pension Fund Investments

11. Formally transfer investment management control of the investment functions to the investment team of the Punjab Pension Fund. If appointments of the independent trustee, legal advisor and auditor are still pending, accelerate as possible to allow for immediate implementation of the formal transfer.

12. Once a new financing strategy[2] has been developed, generate Punjab Pension Fund cashflow estimates necessary to implement an investment strategy. Develop between the Finance Department, the investment team of the Punjab Pension Fund and the Consultant an ongoing plan to coordinate actual-to-estimate expenditure and budget transfer projections on a quarterly basis so as to allow for changes if necessary to the investment strategy.

13. Amend the language in the Rules to ensure that the description of outflows of money from the Fund is as adequate and in parallel with the description of inflows of money.

Next priority – Issues Related to Governance

14. Following the approval of the General Provident Investment Fund Act, it is advisable to create a single investment unit to manage investments of both the Pension Fund and the General Provident Investment Fund. Reorganization is proposed of (i) the oversight functions presently represented by the Management Committee into the Punjab Investment Oversight Board; and (ii) the investment functions presently represented by the management of the Punjab Pension Fund into the Punjab Investment Unit. The Board would

[2] The Asian Development Bank is assisting the Government through the Finance Department in developing a revised strategy to finance the long-term expenditures of the pension and general provident fund benefits. The Asian Development Bank is providing technical support through the pension expert and actuary,

provide oversight of the Investment Unit that would manage the investments of both Funds. The Board and Investment Unit would be guided by the Investment Policy. This is not a recommendation to commingle the assets of the two Funds.

15. Strengthen oversight by (i) phasing-out ex-officio members to make oversight more independent from potential conflicts-of-interest or outside (political) influence; (ii) phasing-in members who have deep and broad experience in Pakistan's financial markets and are knowledgeable about risks associated with various investment objectives and processes to enhance the technical capacity of the oversight function; (iii) reducing the size of the oversight board to chairman and five members to streamline the oversight process; and (iv) revising membership rules, member nomination and appointment process to support full private sector membership.

16. Adopt Sub-Committee recommendations: Investment, Audit/Compliance and Membership.

17. Change the role of the General Manager, who is presently a voting member of the oversight group, to a non-voting, advisory role – although he will still be the General Manager and CEO of the Investment Unit.

Next priority: Issues related to the Investment Policy

18. Strengthen the Investment Policy by (i) reviewing whether the financing strategy projects a Fund of such size as to warrant revisiting the decision on whether to allow foreign investments; (ii) clarifying the Investment Objectives; (iii) redefining performance benchmarks; (iv) reinforcing and amplifying the powers of delegation; (v) requiring adequate liability insurance against errors, omissions, fraud or embezzlement for employees managing investments or involved in financial transactions of the Fund; and (vi) reviewing and accepting recommended Investment Policy text changes.

19. The Asian Development Bank has committed technical support to the Finance Department, Management Committee and management of the Punjab Pension Fund. The Consultant (Pension Expert) would provide specific support by:

   a. Presenting the technical recommendations of this Report for review and discussion.

   b. Advising the Finance Department in the development of the financing strategy by (i) working with the Actuary, who is revising his projections of the liabilities of the accrued pension and general provident fund; (ii) assisting the investment management team of the Punjab Pension Fund illustrating various investment scenarios; (iii) assisting the Finance Department as it determines fiscal capacity and preparing the revised financing strategy document.

   c. Following a decision by the Government on the financing strategy, assist the Management Committee and the management of the Punjab Pension Fund implement recommendations in this Report (dependent on financing strategy design and which Report recommendations are approved) by:

i) Assisting the Management Committee by preparing a time-bound action plan for restructuring the Management Committee into the Punjab Investment Oversight Board and the management of the Punjab Pension Fund into the Punjab Investment Unit.

ii) Assisting the Management Committee by (i) revising rules of membership, member nomination and appointment process; (ii) Sub-Committee rules and appointment; and (iii) on modifying the role of the General Manager.

iii) Assisting the management of the Punjab Pension Fund by preparing and/or reviewing (i) revised Investment Objectives; (ii) revised Fund performance benchmarks; (iii) revised reference to powers of delegation; and (iv) adequate liability coverage.

iv) Dependent on the projected size of the Fund, assist the management of the Punjab Pension Fund in analyzing the merits of the Investment Policy prohibition against foreign investment.

v) Assisting the management of the Punjab Pension Fund develop a comprehensive list of actions that would result in closer alignment between the operations of the investment functions and the SECP issued rules and regulations on NBFCs for recommendation to the Management Committee.

vi) Assisting the Legal Advisor[3] by (i) commenting on revisions to the Act, Rules and other legal norms that may be required for restructuring; and (ii) revising the Rules to ensure consistent descriptions of the Fund's money inflows and outflows.

d. A copy of the PGEIP Investment and Governance Updated Workplan prepared by the Asian Development Bank is provided at Appendix A.

[3] The Asian Development Bank has included a legal advisor as an additional technical resource if needed, based on the decisions taken on the final design of the financing strategy and the recommendations agreed to from this Report.

II. RATIONALE FOR CREATING INVESTMENT FUNDS

20. In response to growing fiscal pressures expected to result from an ageing workforce that is resulting in increased projections of future pension expenditures, the Punjab Finance Department formalized a plan to partially fund its otherwise pay-as-you-go (PAYG) pension scheme. The strategy targeted accumulating Rs 100 billion in the Punjab Pension Fund by Fiscal Year 2015-16 through budget transfers and investment earnings or losses. The terms commonly referred to as pre-funding and partial funding entail growing an investment fund from which future expenditures would be financed as a tool to better manage planned expenditure increases. The Finance Department Pension Fund Investment Strategy Policy Note, included as Appendix B, proposed a capitalization plan as follows:

Table 1: Capitalization Plan for the Punjab Pension Fund

Fiscal Year	GoPb Budget Transfer
2007-08	Rs 6 billion
2008-09	Rs 14 billion
2009-10	Rs 16 billion
2010-11	Rs 14 billion
2011-2030	10% of basic pay budgeted of provincial employees in a financial year

Source: Government of Punjab, Finance Department

21. To date Rs 3 billion has been transferred by the Finance Department to an account in the name of the Punjab Pension Fund at the Bank of Punjab.

22. The development of a financing strategy has been reviewed by the Asian Development Bank missions with the Finance Department. Most recently in two ADB Punjab Missions (November 2008 and February 2009), Senior Finance officials indicated that they would seek more time to determine if revisions to the targeted investment fund balance or pre-funding strategy are warranted. Since the approval of the initial strategy by the Chief Secretary in 2007, global financial markets have turned down sharply into an economic crisis of such proportions as to be referred to as a global meltdown. In reality, many Asian countries were insulated from exposure to sub-prime assets that caused leading developed financial markets to decrease sharply in value. Nonetheless, financial markets in Pakistan and other emerging economy countries have responded with a lack of confidence from investors and caution by financial regulators. There are fewer financial products today available for investment in Pakistan's financial markets, and fewer products still that would provide a conservative institutional investor (as the Government of Punjab has characterized itself in discussions) opportunities to achieve investment returns that meet or exceed the rate of inflation. To further compound the negative effects of the global financial market turmoil, in 2008 the Government of Pakistan reduced its budget transfers to the provincial governments. While these outside factors are not the only reasons

to reconsider the appropriateness of developing partial or pre-funding as a suitable financing strategy, they contributed to questions being asked as to the best direction to proceed.

23. A review of the financing strategy is underway by the Finance Department with support from the Actuary assigned by the Asian Development Bank. Part of that process consists of revising expenditure projections that rely on revised data of the underlying PAYG scheme. Simultaneously the Consultant was asked to review and comment on the Investment Policy created for the present Punjab Pension Fund and the proposed Punjab General Provident Investment Fund. Once the Actuary has completed his revised projections the Consultant will also assist the Finance Department prepare the revised financing strategy.

Investment Fund Structure

24. The Government of Punjab established the Punjab Pension Fund (and initiated[4] the process to establish the Punjab General Provident Investment Fund), as an Investment Fund into which provincial budget transfers would be made for the sole purpose of using the accumulated monies to finance future civil service pension (and soon to be general provident fund) payments. The structure of the Investment Funds is a trust into which monies accumulate and are managed by one group for the benefit of another. For purposes of commenting on the structure, both are referred to as Investment Funds. (This does not indicate intent to recommend commingling monies between the two. Indeed, assets of the two must always remain segregated. Reference is made to Investment Funds solely for ease of comments in this Report.)

25. The civil service pension benefit is a non-contributory, unfunded defined benefit scheme and the general provident fund is a contributory, unfunded (also called notional) defined contribution scheme. The calculation to determine the amount of commuted pension benefit and lifetime monthly pension payments (and invalidity and survivor payments) will not decrease or increase relative to the investment gains or losses experienced in the Punjab Pension Fund. As such, pension benefits are not impacted by investment results. Similarly, investment gains or losses will not impact the value of an employee's general provident fund account balance. Two factors solely determine the value of a retiree's account balance: amount of monthly subscriptions and declared annual interest rates. Since neither factor is a function of or related to investment gains or losses, there would be no impact. Further, in chapter VI, paragraph 22 of the Act, there is reference that an employee's (or an allowable survivor's) right to his pension shall not be

[4] The proposed Punjab General Provident Investment Fund Act was presented in the Assembly through Bill Number 7 of 2009 in February 2009. The Speaker of the Assembly forwarded the bill to a Standing Committee. Dr. Sajid Yoosufani presented before the Standing Committee on 25 February 2009 and the bill was approved by the Standing Committee the same day. The Consultant was advised that the bill is expected to be approved in the next Assembly Session. The Punjab General Provident Investment Fund Rules are prepared for adoption, pending passage in the Assembly of the Act.

circumvented by the Investment Fund. Similar language was included in the proposed Act for the rights to a payment from the General Provident Fund.

26. While the recipients of pension and general provident payments are retired employees and their survivors, in fact the "owners" of the Investment Fund are not civil service employees, retirees or their survivors. The ultimate owner-beneficiary is represented by the taxpayers of Punjab but they do not have legal or beneficial ownership[5] over the reserve funds' assets.

27. The risk of investment gain or loss is assumed, however, by the Government of Punjab. The taxpayers of Punjab ultimately benefit from investment gains, if any, to the Investment Funds in that increased budgetary fiscal capacity may result in the long term-through this financing strategy. By contrast, investment losses, if any, increase the future fiscal burden of the Government, whether losses result from an appropriately selected investment that incurred a loss due to changing market conditions; an inappropriately selected investment that incurred a loss due to any reason; or financial control-related losses such as errors, omissions, fraud, deception, theft or embezzlement.

28. The implementation of a partial funding strategy through budget transfers to finance future expenditures is independent of decisions to retain or modify the underlying policy of the civil service pension and general provident fund benefits. That is, the Government could continue or change the policy of pension benefits and there would be no impact on the Investment Funds.

Relevance of Investment Policy and Governance Policy

29. Investment funds around the world are subject to potential conflicts-of-interest arising between investment managers and the ultimate beneficiaries of the fund. As described above, the ultimate beneficiaries of the Punjab Investment Funds are the taxpayers of the Government of Punjab, which is a vague concept in that there is no single person or single group that speaks on their behalf. International best practices require a set of internal statutes and external regulations to ensure that Investment Funds are managed in the best interest of beneficiaries. The balance between internal statutes and external regulations is a delicate one that relies on and is largely influenced by cultural expectations and legal structures and norms. The Investment Policy and Governance Policy should define internal statutes, legal structures and norms. External regulations are critically important but as the financial regulators in Pakistan (State Bank of Pakistan and the Securities & Exchange Commission Pakistan (SECP)) lack jurisdiction over the actions of an entity created through the provincial government, there is no specific requirement to conform to external regulations. Both Finance Department officials and management of the Punjab Pension Fund, however, expressed a strong desire to reflect

5 OECD and ISSA, Juan Yermo, Financial Market Trends: Governance and Investment of Public Pension Reserve Funds In Selected OECD Countries. ISSN 1995-2864 - OECD 2008, Paris France.

through their actions and implemented policies[6] as though the Investment Funds were subject to the SECP rules applicable to licensed investment advisors under the Non-Bank Finance Companies (NBFC) Rules 2003 and NBFC Regulations 2008. As such, this Report references the potential impact that external regulations can have on a Governance Policy and Investment Policy.

30. The Investment Funds established by the Government of Punjab possess similar characteristics of sovereign wealth funds, often defined as government-owned investment funds operating in private financial markets. Additional risks of political influence are associated with such funds, which also applies to the Investment Funds established for the purpose of financing pension and general provident fund liabilities.

[6] One example is the extension of chapter III – A of the Securities and Exchange Ordinance, 1969 to apply to the Management Committee membership, employees of the Punjab Pension Fund, or any other person associated with the Fund. http://www.secp.gov.pk/corporatelaws/pdf/sep_08_00.pdf

III. GOVERNANCE POLICY

International Best Practices

31. Governance consists of fiduciary duty[7], accountability and transparency. Governance can influence – positively and negatively – the establishment of structures, policies, procedures and decision-making lines of authority that support financial operations and investment management functions. Governance is critically important for Investment Funds, more so for those that are government-created and government budget funded. A properly structured Governance Policy provides tools to protect against outside (political) influence, hinder fraud and corruption, maintain accountability and transparency, manage new and existing financial risks, and supervise day-to-day decision making. An Investment Fund's Governance Policy should ensure that a Fund is being managed in accordance with the Investment Policy and the norms of good government such as the example of the officials and management who have identified a desire to operate the Punjab Pension Fund according to the rules of a licensed asset management company. Equally important is that good governance should inspire confidence among stakeholders – the taxpayers, the Government of Punjab and the Government of Pakistan.

32. The Governance Policy of the Investment Funds is reflected primarily in the establishment and operating norms of the Management Committee, defined Sub-Committees and rules of membership of the Management Committee. The Punjab Pension Fund Act of 2007 and the Punjab Pension Fund Rules formalize these relationships and actions as well as others such as the requirement to hire an independent Auditor and Trustee. Some actions are defined for the Government, others for the Management Committee and still more for the management team of the Investment Fund. Similar Act and Fund Rules have been drafted for the Punjab General Provident Investment Fund.

33. Governance structures and external regulations both play a critical role in investment strategies. The former determines the investment objectives, strategies, and tools of fund managers, while the latter can affect the asset allocation of the portfolio. There are varied opinions to the extent in which different governance structures and investment regulations affect the investment strategies of Investment Funds and consequently their investment performance but a growing consensus is supporting the belief that poorly structured governance will result in lower investment returns over time.

[7] Fiduciary duty is commonly regarded as the legal duty of acting wisely (such as in the case of investing money) and in the best interest of another.

34. In a study[8] by the International Monetary Fund (IMF) anecdotal evidence pointed to an indisputable link between good governance and investment performance. The conclusion reached in the study is that weak governance often produces weak investment performance or fraud – in either case the result can lower investment gains or incur losses. A joint World Bank and IMF study[9] expanded on this: when governments manage pension investments almost all results were rated disastrous. The investment results of six countries were rated mediocre; no country in which governments directly managed pension investments were rated higher than mediocre. The study concluded that the better alternative may be to outsource to investment professionals to manage pension investments. Other key findings in the IMF World Bank Study were that:

a. Government officials often

   i) Lack specific technical experience of investment management and an understanding of financial markets.

   ii) Struggle to make investment decisions free of political interference.

   iii) Are plagued by conflicts-of-interest as multiple ministries that have varying goals compete for limited resources.

b. Governments frequently

   i) Cannot afford to pay market wages for investment professionals as they are bound by government pay scales.

   ii) Lack coordination among themselves, lack proper financial regulatory supervision and are exempted from regulations that they need as much as the private financial institutions when they take on the roles of private financial institutions.

   iii) Fail to establish clear goals designed to result in maximum investment return while assuming the least market volatility risk.

35. Governments can be more effective providing supervisory oversight and policy setting and in making final selections from a pool of qualified, vetted nominees for Board membership. Officials can maintain control of the investment policy while supervising the licensed experienced investment managers who carry out the work. In such scenarios officials still control and can change, modify and improve their investment policy but if they become dissatisfied with the performance of licensed investment managers, officials can immediately remove, change or add investment managers.

36. Examples of structural features that can enhance governance –

a. Investment Oversight Board –

   i) Maintain an oversight board separate from and independent of the government to diminish opportunities for outside influence;

[8] IMF, Gregorio Impavido, November 2007. Washington DC, USA.

[9] Vittas, Impavido, O'Connor (2007) "Upgrading the Investment Policy Framework of Public Pension Funds" Forthcoming WB policy research working paper series. Washington DC, US.

b. Board Membership –

   i) Comprise the oversight body of a small group of experts – not large and not ex-officio members. Allow no political interference in selecting Board members.

   ii) Stagger board memberships so not all members' terms expire simultaneously and allow for reappointments.

   iii) Compensate board members with competitive wages to enable qualified board members to be recruited.

   iv) Must determine to whom Board members are accountable; clearly identify each member's mandate; and define who recommends, selects and hires board members; the Government should appoint the initial board membership but thereafter the members of the Membership sub-committee should draft the rules and enforce their application.

   v) Select a General Manager and Chief Executive who is an investment professional with deep experience in managing teams who manage assets and have an understanding of how financial markets work with specific experience implementing financial controls. Allow no political interference in selecting, retaining or removing the chief executive and his key officers.

Strengthening the Governance Structure

37. A review of the Act and Rules indicate several well designed elements of both the Management Committee and Membership. Strengths of the current structure include:

a. Use of an external (independent) auditor and legal representative, although the auditor being selected by the Punjab Pension Fund management but hired by the Government creates a potential conflict but that is partially offset by requiring that the external auditor report both to the Government and the Management Committee;

b. Use of a trustee selected by the Management Committee;

c. Attempt to balance the lack of investment experience among the ex-officio members by requiring that four members of the Management Committee have experience in financial markets and be from the private sector, although all are selected and appointed by the Government which may open them to influence from officials;

d. Allowance of renewable terms for the private sector members, which is a strength in that it signals a desire to ensure that there is not interruption in the Management Committee's continuity;

e. Use of an approval hierarchy that includes delegation authority for medium- to short-term decisions while maintaining full control of the Investment Policy at the Management Committee level; and

f. Use of Sub-Committee structures that often can develop expertise and allow focused attention at a technical level on key issues such as investment, human resources (hiring practices, use of job descriptions, promotions based on proven competency – not tenure) and audit / compliance.

38. Some weaknesses identified in the current structure include:

a. While the financing strategy is being re-evaluated and correspondingly a decision on the level of budget transfers is being taken, the Investment Unit does not have an understanding of the Fund's incoming budget transfers and disbursement needs to properly estimate the Fund's cashflow projections for purposes of defining investment time horizons.

b. The control of the Fund's investment functions has not been turned over to the General Manager of the Punjab Pension Fund and his team. It was explained that three pending appointments (auditor, trustee and legal representative) were delaying this transfer. These appointments are also referenced in the list below.

c. The deferment of appointments (independent auditor, trustee and legal representative) is in conflict with the Punjab Pension Fund Rules. There is also a requirement that the Management Committee nominate and the Government select from among qualified nominees a General Manager. In the absence of the appointment of the General Manager, the Government may appoint an acting General Manager for a period not to exceed six months. The appointment deferments and extension of the retention of the Acting General Manager for more than six months puts the Government in violation of the Rules with no negative consequences to officials. If this requirement were important it would be adhered to or action taken against officials. If it is not important or cannot be enforced, the Consultant questions why this is in the Rules and what purpose it serves. Lack of action and failure to enforce the Rules ultimately sends a signal that failure to adhere to the Rules is tolerated. The Consultant has raised this issue with the Finance Department on several occasions, including in writing in an effort to assist officials focus on this matter. See Appendix C, Recruitment for the General Manager.

d. The majority of the members of the Management Committee are ex-officio, which provides a very real risk that could impair future members' ability to act objectively as both Government officers and on the Management Committee. An example is a recent meeting of the Management Committee that was last minute canceled due to Government officers being required for other purposes elsewhere. It is unlikely to change that Government officials are called to last minute competing priorities – indeed there seems to be more of it the higher ranking an officer becomes. For this reason it is not recommended that such senior officers be mandated as part of the Management Committee – doing so risks weakening the oversight structure.

e. The very nature of ex-officio Management Committee members results in changes to the membership when one officer is replaced by another. This interruption places a great deal of pressure on the newly assigned officer to be immediately familiar with technical issues. Continuity of the oversight process can be compromised in these scenarios.

f. The General Manager of the Punjab Pension Fund is also the Secretary[10] of the Management Committee. International best practices increasingly consider it difficult, if not impossible, to objectively oversee oneself. The Acting General Manager has explained that when issues are put before the Management Committee related to his position he recuses himself and does not participate. This is an appropriate and professional response by the Acting General Manager but not a long term solution or action that can be ensured will be followed by future executives in that position.

g. Ex-officio members of the Management Committee are asked to take decisions on technical issues for which they have not been trained and for which they lack previous experience as investment professionals. Their other official government duties are often so demanding it is difficult for them to pick-up "on-the-job training". Members complained that due to competing priorities for their attention, there was not always enough time to thoroughly review and understand complex matters put before them.

h. Members are not directly accountable for their actions due to the lack of recording and publicly sharing of all votes. The current process to act on proposals was described by the Acting General Manager. He explained that a proposal is made, discussion is undertaken, ultimately a consensus is reached among Board members and then a decision is given: approval, lack of approval or request for more information or more time. The result is lack of accountability for individual actions. The Consultant does not recommend modification to the voting rules that permit Management Committee action based on a majority vote. The majority vote is a useful process and supports open transparency. It is the lack of recordation of each member's vote that compromises accountability.

i. Ex-officio members could be influenced by hierarchy and chain of command. A member who is not ex-officio is often more influenced by the opinions of other members based on their experience. Whereas future generations of ex-officio members may be at risk of being influenced by the opinions of superiors.

j. There are no specific terms of reference for each Board member that would define exactly his duties and responsibilities by which to measure his participation.

k. The size of the current membership is large, which has resulted in postponement of Management Committee meetings when it was not certain that a quorum would be met. Further, large memberships can deceivingly distract other officials and the public that such substantial a group is providing more than adequate oversight.

l. The Management Committee is provided little guidance regarding the establishment and monitoring of Fund expenses. There is no definition of what constitutes allowable Fund expenses or a limit over which expenses cannot exceed. As the Rules provide that investment expenses shall be paid from the Fund, the risk to the Management Committee is that costs that should not be attributed to managing the Fund could be paid from

[10] As explained in the Act, Chapter III Management Committee, paragraph 6, Composition of Management Committee.

the Fund. The very purpose of creating the Fund – to partially pre-fund the financing of future pension expenditures – could be put at risk through erosion of the Fund balance by inappropriately allocated expenses. It is financial industry practice to define allowable expenses and an expense limit. Both are mandated by the SECP under the NBFC rules.

Recommendations to Governance Structure

Structural Changes

39. The current structure was designed to support a single Investment Fund – its oversight capacity and investment functions. With simple structural changes the investment functions and oversight would be applied to any investment fund for which the Government is liable for investment losses and gains. These structural changes are explained in more detail below.

a. Single oversight group. There should not be a separate Management Committee and Investment Unit for each Investment Fund. It is not cost effective or conducive to achieving economies of scale – an important factor in managing investments. Indeed the Management Committee and management of the Punjab Pension Fund expressed similar concerns and took action to avoid such duplication by approving a measure that a single Management Committee provides oversight for both Funds.

b. Single investment unit. Under this scenario, the Consultant recommends that the General Manager, Chief Investment Officer, Chief Finance Officer and other employees of the Punjab Pension Fund should become the management and staff of the Punjab Investment Unit.

c. Multiple Investment Funds. The Investment Unit should manage all investments for which the Government is liable for the gains and losses, although this Report addresses only the Investment Funds of the Pension and General Provident Fund. There should be a single Investment Policy but individual Investment Objectives for each Fund as they may have different needs.

40. Reference to the following terms used throughout the remaining document follows:

Table 2: Proposed Structural Changes

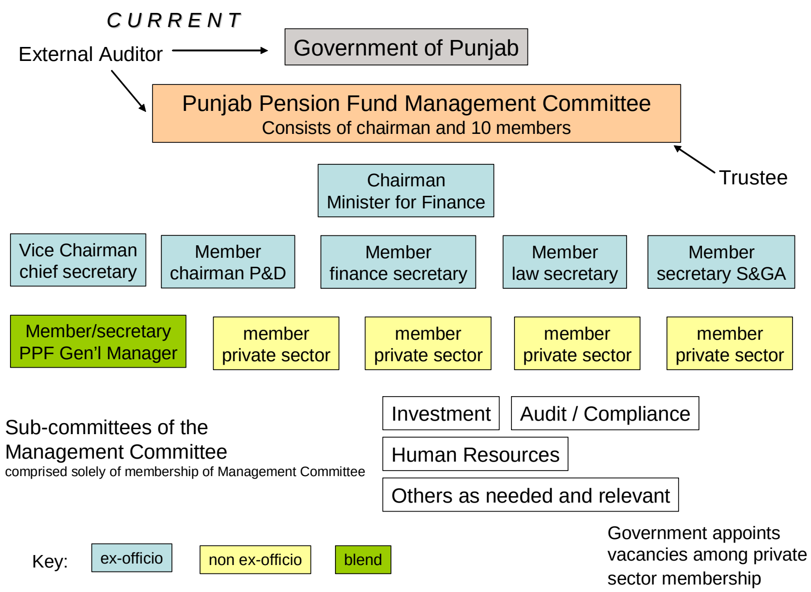
Structural Function	Current	Proposed
Oversight	Punjab Pension Fund Management Committee	Punjab Investment Oversight Board
Manage day-to-day investment decisions	Punjab Pension Fund	Investment Unit
Entity being managed	Punjab Pension Fund	1. Punjab Pension Investment Fund 2. Punjab General Provident Investment Fund
Note: The actual terminology is not critical; the structure is more the issue. The terms are referenced merely for ease in introducing changing titles.		

41. The Consultant discussed with the management of the Punjab Pension Fund, the Finance Department and the Project Management Unit that an ideal model is an organizational structure in which there are no employees of the Punjab Pension Fund or the Punjab General Provident Investment Fund. Returning to an earlier comment, such structure is aligned with that of the NBFCs – licensed asset management companies that provides investment advisory services to mutual funds. In such arrangements, there are no employees of the funds. The employees work for the investment advisory company.

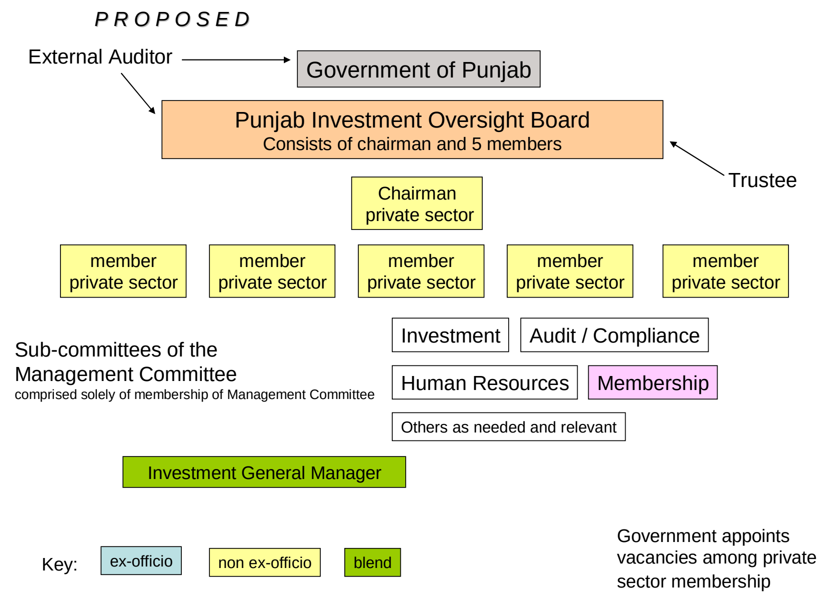
42. Implementing a single Investment Unit, would provide for the Investment Funds a streamlined structure to be authorized to enter into agreements, sign contracts, make payments, transact on behalf of and open accounts in the names of the Investment Funds. To ensure the authority of the Punjab Investment Oversight Board, the Consultant recommends that the Acts of the original Management Committees of the Investment Funds should be consolidated through an Act[11] into a Punjab Investment Oversight Board Act to assure the full weight and obligation of law on which the Board membership must discharge its duty.

43. A side-by-side comparison of the current and proposed structures appears on the following page.

[11] This suggestion should be effected through the most appropriate legal process as determined by the Law Department. This reference to consolidating Acts is merely one suggestion.

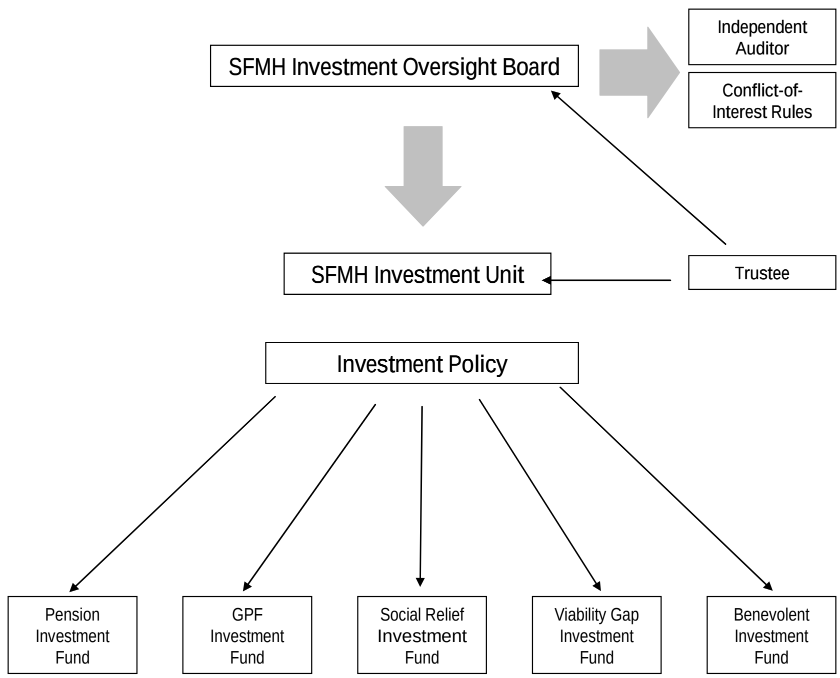


Source: Punjab Pension Fund Act of 2006 and Punjab Pension Fund Rules.



44. To reinforce the appropriateness of this structure, a similar conclusion was reached by the Government of Sindh which took the decision to design the Sindh Fund Management House. This design intended to create a skilled investment management unit to manage the various Investment Funds for which the Government of Sindh was liable for their investment performance – gains and losses. An illustration of the Sindh Fund Management House and its relationship to multiple investment funds follows:

Figure 1: Relationship of the Sindh Fund Management House to the Investment Unit



45. The Government of Sindh proposed that the initial group of Investment Funds to be managed by the Sindh Fund Management House would be:

Table 3: Government of Sindh Investment Funds

Government of Sindh Investment Fund	Inception Date	Value as at FY 2007-08
Sindh Pension Investment Fund	2002-03	Rs 17.952 Billion
Sindh General Provident Investment Fund	2007-08	Rs 4.000 Billion
Sindh Social Relief Investment Fund	2005-06	Rs 12.028 Billion
Sindh Viability Gap Investment Fund	2008-09	Rs 1.000 Billion
Peoples' Housing Cell Investment Fund	2008-09	Rs. 2.013 Billion
Total		Rs 36.993 Billion
Source: Sindh Finance Department. October 2008 and February 2009.		

46. Regardless of whether the proposed structural changes are implemented, the Consultant makes other recommendations designed to strengthen oversight.

a. The Investment Unit should jointly develop with the Finance Department and the Actuary estimates of the cashflow of the Fund once the financing strategy has been finalized. At least quarterly actual budget transfers and expenditures should be reconciled between the Investment Unit and Finance Department.

b. The investment management of the Fund should be turned over to the Punjab Pension Fund as soon as is practical, without waiting for evaluation of the structural recommendations.

c. The Management Committee oversight functions should be carried out by members experienced in investment management and recruited from the private sector. The Consultant recommends phasing-out ex-officio members as appropriately qualified public members are nominated and appointed. The Consultant recommends a nomination and selection processes below related to Membership Rules.

d. The General Manager should not also be a member of the Management Committee that oversees his work and that of the team he manages. While it is most likely that the General Manager would be invited to attend meetings and the members would depend on his judgment, experience and advice, it is not appropriate that he is a member of the Management Committee, any Sub-Committee or have voting rights. A better long term solution is to define the position as a non-voting advisory role. Most issues that will be put before the Management Committee will in some form involve decisions involving the work of the General Manager or his management team and relying on a more formal separation is not only more fair to the position, it provides a more transparent solution for future executives who hold that position. It is the understanding of the Consultant that the General Manager and Chief Investment Officer are members of the Investment Operational Committee, which is not a formal Sub-Committee of the Management Committee. Thus, there is no recommended change to the structure of membership of the Investment Operational Committee.

e. The Management Committee should be half the current size, which is a chairman plus ten members. A chairman and five board members would be adequate for the Management Committee. The rationale for a smaller and not a larger sized board is that it takes longer for a larger board to take a decision and to find a single equally convenient time to convene meetings. The larger the number of members needed to be called to ensure a quorum, the less likely that the Punjab Investment Oversight Board can be effective and respond quickly.

f. Unlike current ex-officio postings to the Management Committee, it is proposed that each member of the future Punjab Investment Oversight Board would apply for and be evaluated as candidates to serve a specific function and assigned to permanent Sub-Committees. Under this reduced size Board scenario, each Sub-Committee would be comprised of three Board members with each Board member serving on more than one Sub-Committee. Other Sub-committees would be formed from time to time to address additional needs as they arise. The proposed three permanent Sub-committees[12] are:

   i) Investment Sub-Committee. The Investment Sub-Committee would be comprised solely of investment professionals who would have an understanding of the financial markets of Pakistan and of international markets. The Investment Sub-Committee would utilize the current Investment Policy with suggested changes. Currently, the Investment Sub-Committee is defined to include at least one member ex-officio, one member from private sector and the General Manager.

   ii) Audit / Compliance Sub-Committee. Responsible for awarding a contract to an independent auditor and for reviewing the annual audit of the Investment Funds and of the Investment Unit. It would also establish and review governance rules, conflict-of-interest rules and disclosures to be made under such rules by Board members and other fiduciaries[13]. It is recommended that at least one Board member also would be a member in good standing of the Pakistan Institute of Auditors and that such Board member would serve on the Audit Compliance Sub-Committee as well.

   iii) Membership Sub-Committee (new). The Membership Committee would be responsible for establishing the membership rules, defining to whom the members report, proposing a nominating, interviewing and selection

[12] The Consultant understands that a large body of work has been prepared by an HR group or Sub-committee. The Act and the Rules do not reference a formal HR Sub-Committee. The Consultant does not recommend a permanent body be created but only one that meets ad hoc as needed for filling the position of the General Manager, CIO and CFO. As these positions are presently filled, such a group would carry out the creation and approval of the other job descriptions and hiring decisions.

[13] A fiduciary is any person who has undertaken to act for and on behalf of another in a particular matter in circumstances. Thus, all Board members and the Chairman, whether or not experienced investment professionals, would be regarded as a fiduciary. They have accepted to act on behalf of the taxpayers of Punjab as it relates to managing the government's assets.

process to secure new members when a Board membership opening is created.

47. Although the Consultant recommends that the Management Committee assign responsibilities to the Sub-Committees and Investment Unit, the full membership would retain responsibility and accountability for monitoring these delegated functions.

Membership Rules

48. The Consultant further recommends that revised membership rules be adopted by the Punjab Investment Oversight Board to reflect the above changes.

a. Membership terms should be staggered to ensure continuity of the Board with varied terms of the initial membership. Thus, the first memberships would be for two, three and four year terms. All future terms would be for three years, continuing the policy of the current Management Committee.

b. Board members should be accountable for their actions and for each of their votes. All Board and Sub-Committee matters voted upon, along with the specific voting record of each member on each issue, should be documented and publicly disclosed. The Consultant specifically recommends against matters put before the Board being agreed or disagreed with on a consensus basis. Although this is a popular method used on boards affiliated with government officials, an environment of transparency would attribute and publicly record each vote on each issue to each Management Committee member.

c. Board members should be compensated meaningful[14] amounts and their expenses (travel to Board meeting) reimbursed so as to ensure that the Board can attract and retain qualified members.

d. Board members should rely on and be supported by the Investment Unit's General Manager, Chief Investment Officer, Chief Financial Officer, and other technical staff.

Board Membership: Nomination, Appointment, Removal

49. The Membership Sub-Committee should create a formal membership policy that clearly states qualifications of individuals being nominated for Board membership, define who nominates members (for example, it is common that the Membership Sub-Committee would seek members, vet their qualifications and nominate from among qualified candidates) and who selects from among nominees. Selection, from the vetted nominees, in some countries is carried out

[14] While the term meaningful is ambiguous, reference is intended to act as a guide that Board compensation will need to strike the balance between paying a high enough amount to secure qualified individuals to serve but not too high so as to increase the overhead cost of operating the Funds. One suggestion is to compare amounts paid by private sector Board memberships and to develop a plan using that as a baseline.

by the Government in others it is the full oversight Board that would vote on nominated membership.

50. A statement that Board members can only be removed for cause should be adopted and included in the Act to bring legislative strength to the commitment of ensuring no outside (political) interference to membership decisions. It is appropriate and may offer some degree of comfort to define what is considered "cause" such as failure to pass a fit and proper test or to meet the disclosure requirements of the conflict-of-interest rules. Being convicted of a crime is one example. Currently the Rules appropriately define conviction of a financial crime as reason for membership termination (although it could be improved to state conviction of any felony). Ex-officio memberships invariably create conflicts that slow a review and decision for termination. The cause for hesitancy is that the Act defines and obligates an official holding a senior post to membership on the Management Committee while violation of a rule will disqualify him. It is difficult for one ex-officio member to vote to remove another ex-officio member.

51. The Consultant recommends that the Management Committee adopt the definition of allowable expenses to operate the Investment Funds as set by the SECP for NBFCs and that the Rules should be revised accordingly. Doing so will provide immediate guidance to the Management Committee in terms of what constitutes an allowable expense and provide a comparison of similar costs for similar services. This action would continue to reinforce the statement of Government officials to voluntarily follow rules set by the enforcement agency as though subject to SECP oversight. Further, it reinforces industry standardization and an industry-vetted defined rule to the oversight of the investment management process.

Comments on Sub-Committees

52. Membership Sub-Committees. See paragraph 49.

53. Investment Sub-Committee. The Investment Sub-Committee must operate independent of interference from provincial departments and federal ministries, and politicians of any level, unions and special interest groups. In order for investment returns to meet expectations of the Government, the focus can only be on managing investment risk and investment returns. When a vacancy for the Chief Investment Officer is created, the Investment Sub-Committee should recommend hiring a replacement, approve its operating budget and ensure that a current investment strategy has been articulated and is implemented. Changes to the investment strategy, including the investment horizon, should not require the full approval of the Punjab Investment Oversight Board approval (unlike changes to the Investment Policy, which should require a majority Punjab Investment Oversight Board vote), but should be articulated and routinely refined to reflect current market conditions and the continually changing cashflow and income needs of the Investment Funds. Additional comments are integrated in Appendix D, which relates to the Investment Policy.

54. Audit and Compliance Sub-Committee. The Punjab Pension Fund Rules reflect that an independent Auditor shall be named by the Government within six months of the formation of the Management Committee. The Consultant is not aware of this timeline being met but does understand that the Punjab Pension Fund has completed work to finalize an Auditor selection and that a Terms of Reference has been prepared.

a. Paragraph 30 of the Punjab Pension Rules states, "Directions and guidelines of the Commission. The Management Committee shall take into consideration guidelines and directions issued by the Commission." It is not clear to the Consultant whether the term Commission in this case was intended or if it is an error. The only other references to Commission in this document is commissions paid in transactions and trades and referring to the SECP as the Commission. Neither use seems appropriate in this case. If it is intended to refer to guidelines and directions issued by the Auditor, the Consultant would add a need for clarification. For example, how does the Management Committee indicate it has done so? And to whom is such a report made? It is the Consultant's concern that the Auditor, who is hired by the Government, could make reports for improvements to the Management Committee, but the Management Committee does not follow. The Government appears to only have authority to hire the Auditor. The Management Committee is obligated to review the report of the Auditor but is not obligated to meet any specific standard. Again, in this case the Consultant would once more recommend that the Management Committee continue to reinforce its stated plan to operate as though it were subject to oversight by the SECP and treat any report from its independent Auditor similarly as though it were subject to the NBFC rules for investment advisors.

b. The Consultant was advised by the Chief Investment Officer that the management of the Fund recommended and the Audit Sub-Committee agreed to add another requirement to the already defined duties[15] of the Auditor – a statement that indicates whether the Fund's investments conformed to the Investment Policy. The Consultant reinforces that this is appropriate and would recommend the addition of this language in the next revision to the Rules.

Other Issues

55. Liability insurance. For added protection there should be a requirement that insurance coverage be in place on officers and employees of the Punjab Pension Fund who are involved in financial transactions to protect against financial loss associated with: errors, mistakes, criminal activity, fraud, embezzlement, bankruptcy of investment manager. This would follow a similar requirement that the SECP imposes on NBFCs.

[15] Referenced in the Rules: Schedule of Accounts, paragraph 6, Contents of the Audit Report.

56. Inflows (budget transfers) into the Investment Funds are well documented but there is inadequate language supporting the description and rules to authorize and transact outflows of money. This issue was raised with and concurred by the Additional Finance Secretary in a meeting November 2008; see Appendix E, Summary Finance Department.

57. Union Representation. The question was informally asked whether it is appropriate to consider representation of the union to any governance oversight board or Management Committee. The Consultant believes that when the matters before an oversight board directly relates to changing the amount of benefits paid to employees at retirement or changes to the formula of how and when benefits are paid that union representation may be valuable. In the case of the proposal to create a Punjab Investment Oversight Board neither investment gains nor losses will affect the amount of benefits paid to employees. For this reason, the Consultant does not recommend the addition of union representation. As stated earlier, investment gains or losses will only impact the amount of budget transfers made into the Punjab Pension Investment Fund and Punjab General Provident Investment Fund. Thus, the Government of Punjab – and the federal government as well as other provincial governments – should consider whether it is appropriate to include union representation when policy reforms are being considered and debated.

IV. INVESTMENT POLICY

58. The Investment Policy chapter reviews international best practices, addresses managing investment risk, explains the use of performance benchmarks, comments on the strengths of the Investment Policy and recommends areas that should continue to be strengthened. The main recommendations are to clarify the description of the Investment Objective, reinforce and amplify the philosophy on delegating powers and on enhancing the benchmarks as a tool by which to evaluate the performance of the Funds. The majority of the comments on the Investment Policy are made on Appendix D, Comments on Investment Policy which presents a side-by-side commentary on the areas of concern.

International Best Practices

59. The purpose of an Investment Policy is to create a prudent and systematic investment program, to organize and formalize investment-related activities and to define investment objectives and policies acceptable for the Investment Fund's asset allocation portfolio. A well defined Investment Policy should achieve the following:

a. Establish reasonable expectations, define financial objectives and guidelines in the investment of assets;

b. Determine allowable investment structure, eg, internal management, outsourcing through hiring licensed asset management company or investing in mutual funds;

c. Define permitted asset allocations among short term investments, term finance certificates (TFCs), government securities (NSS bonds, PIBs), equities and financial products such as mutual funds;

d. Define limitations within classes of the credit ratings and credit ranges;

e. Define exposure limits within asset classes and in a single investment, eg, no single investment can exceed 5% of the value of the Investment Fund at the time of investment or at any time, etc.;

f. Define prohibited investments and other restrictions, eg, cannot short securities, limitation on percentages traded through single broker, cannot invest in single instrument to take control of underlying company or engage in transactions with members of Management Committee, employees, etc.;

g. Define and set forth rules to address next steps when errors occur, limitations are accidentally surpassed, market fluctuations identify that strategies or rules have been exceeded, credit ratings change or range of credit limits are exceeded, or other violations occur – minor and major;

h. Explain reporting requirements – purpose, frequency (weekly, monthly, quarterly, annually and when certain events occur), type (such as aggregate, single, year-to-date, life-to-date), to whom and from whom and how (in formal reports, in public financial statements, online); and

i. Encourage effective communication between the Management Committee and the Investment Unit.

Managing Investment Risk and Returns

60. The newly created Investment Policy states that it is important for the Management Committee members to acknowledge the existence of risks that must be managed. The Consultant concurs with this important statement and also outlines additional background information on managing investment risks and return.

61. Investment professionals typically separate investment risk from market volatility, which is not in itself a significant risk when considering long term investment horizons. (Long term for purposes of investment outlooks refer to 10 years or longer.) As investment outlooks for the Investment Funds have not been analyzed and proposed, however, market volatility are expected to be a factor for shorter term investment horizons given the current economic crisis facing Pakistan and virtually all other countries today.

62. Investment risk is considered the degree of uncertainty that the Government can accept in regard to a negative change in the value of the Investment Fund's assets. An investment is a commitment of money for a period of time in order to derive a future payment that compensates for the time value of money, the expected rate of inflation and the risk that is involved. The relevant risk measure for an individual asset is its co-movement with the market portfolio. In measuring an Investment Fund's performance it is common to measure financial return (gains and losses) and the risk that is being undertaken to arrive at that financial return. Risk measurement is referred to as beta, a measure of the systematic, non-diversifiable risk of a single investment. When measuring the beta of an Investment Fund it is appropriate to analyze the rupee weighted average – the rupee value of each security multiplied by its risk value. The beta coefficient of a security, fund, or portfolio represents its market sensitivity, relative to a given market index and time period.

63. As the Government defines its investment risk tolerance it would evaluate factors contributing to the volatility of the investment returns. Examples include, but are not limited, to:

a. Business Risk. Anything that can harm a company's profitability, from poor management to obsolete products and changes in the business sector / industry of a company is considered a business risk.

b. Credit Risk. If a bond issuer fails to make promised interest payments or does not repay principal at maturity, investors are experiencing credit risk and risk of credit quality reclassification.

c. Liquidity Risk. The risk that a holder of security (shares or debt instruments) cannot find a ready buyer when interested in selling. As recent global current market conditions have shown, liquidity risk will drag down the price of a security if there are no ready buyers. More illiquid investments are often real estate, ownership in infrastructure development projects and other investments which are not easily valued.

d. Inflation Risk. The risk that the return on an investment may maintain pace with, out pace or under perform compared to the rate of inflation

e. Interest Rate Risk. Rising interest rates are bad news for fixed income investments because bond prices often – but not always – move in the opposite direction of interest rates. As the prices of bonds adjust to a rise in interest rates, the price may decline.

f. Currency Risk. The performance of international investments can be impacted by the strength or weakness of the Pakistan rupee against currencies of other countries. As the rupee gains strength, international investments may suffer when foreign investments proceeds are repatriated into Pakistan rupees. Conversely, international investments may perform well when the rupee weakens.

g. Country Risk. Political instability, financial crises, civil unrest and other problems that weaken Pakistan's economy influence foreign direct investment and all domestic investment, which also will affect domestic investments.

h. Risk of changes in government regulations. The risk that changes imposed by new or changing government regulation will be impact investors' views of securities that the Investment Funds may sell at a later date.

64. Understanding and defining the Government's acceptable risk and targeting investment returns are important but difficult tasks that will be required of the Punjab Investment Oversight Board with input from the Investment Unit. The development of the Investment Policy is the articulation of this task.

a. In conversations with officials the opinion was expressed that the Government is not comfortable to assume any investment loss, regardless of whether a loss is actually incurred or the loss is a paper loss based on the date valued. If that is the case then the Investment Policy should restrict the Investment Funds from investing in any security which could be subject to market value fluctuations, such as equities or corporate bonds. In reality, losses or gains are realized only when the security is sold. For example, if an Investment Fund holds 1000 shares of company X purchased at Rs 100/share and after six months the share price has declined to Rs 90/share, no actual loss has been incurred if the security has not been redeemed. Similarly, if using the same example, after seven months the share price has increased to Rs 110/share, no actual gain has been realized. Again, until the security is redeemed, neither loss nor gain has taken place.

b. Nonetheless, the objective of setting forth an Investment Policy is to define exactly what the monies of an Investment Fund may or may not be invested in. If the Government of Punjab is unable to assume market fluctuation risk, then restrictions should be placed in the Investment Policy accordingly.

Performance Benchmarks

65. The industry practice is to compare Investment Fund results to benchmarks – weighted indices that measure returns available in the investment markets during the measurement period from the universe of acceptable investments. The following types of benchmarks are used by the financial industry:

a. Well recognized price or total return index using actual returns on market assets,

b. Tailored composite of assets or indices, or

c. Index calculated using the average returns of a peer group of similarly targeted investment funds.

66. There are two risks associated with not using a benchmark.

a. The investment return performance would be compared against a security with a lower risk profile. For example, comparing the performance of the Investment Unit against the rate paid on government bonds. In such a case the government bond is considered a safe investment in that there is a low probability that the Government of Pakistan would default on its obligation to repay bondholders and there is virtually no chance of fluctuation with market changes. If by contrast the Investment Unit is managing the Investments according to a different risk measurement than government debt, the risk is higher. It is inappropriate by industry standards to measure and compare performance between two unlike investments in which the underlying risks are different. Indeed it would be expected that two investments with different risk profiles would perform differently. In this case the risk is that the Investment Funds would be expected to outperform government bonds if the Investment Funds were invested in a traditional portfolio in which the risk assumed was higher than government bonds.

b. The investment return performance would be compared against a security with a higher risk profile. For example, comparing the performance of the Investment Unit against investment returns earned on a more risky portfolio. In such a case the riskier portfolio could be subject to wider market fluctuations and in return for assuming more risk would be expected to achieve more competitive returns in the long term. It is inappropriate, as mentioned above, to compare to unlike portfolios as the results would tend to be regarded as potentially misleading.

67. A benchmark[16] allows the Punjab Investment Oversight Board to review like-to-like comparisons to be able to answer the question of how well the Investment Unit is performing. The comparison should be made with the same frequency as the valuation of the investment returns, e.g., monthly. The following sample portfolio mix and weightings illustrate how a corresponding benchmark might be defined.

Table 4: Benchmark Example

Sample Investment Fund Holdings	**Sample Benchmark**
25% domestic equities	25% KSE index
10% international equities	10% MSCI[17]
30% 2 year PIB	30% medium term government of Pakistan debt
35% bank term deposits rated AA or higher	35% PACRA average for banks rated AA or higher

Reliable and Objective Evaluation of Each Investment Fund

68. The key factor in the calculation of investment performance is reliable and objective evaluation of portfolios adjusting for all changes in the balances of the Investment Fund including expenses. The evaluations should be done every day new assets are accepted into or paid from the Investment Funds and on days used for performance measurement purposes, e.g., last working day of the month. The changes in these evaluations with the inclusion of all investment gains and losses and expenses constitute the total investment return of each Investment Fund. The periodic changes are expressed as percentages and are directly linked to calculate and measure investment returns over time.

Establishing Risk Patterns

69. A benchmark is an important tool for establishing the risk patterns of each Investment Fund only if each benchmark accurately reflects the investment goals of each Investment Fund. A carefully constructed benchmark should be regarded as an aid in communicating the goals and objectives of the Investment Funds to the Government of Punjab and concerned departments. In most countries, investment managers tailor a portfolio mix to represent the benchmark's asset distribution. Whether the benchmark is very aggressive or risk averse, the investment manager must manage the fund accordingly. The selection of the composition of the benchmark is critically important as it impacts the performance of an Investment Fund. No rational chief investment officer

[16] A benchmark, however, is not an investment objective. A suitable investment objective may be to earn above the rate of the inflation, but that is not a benchmark.
[17] MSCI, an international index of emerging market capital markets, is maintained by MSCI Inc, formerly maintained by Morgan Stanley Capital International. www.msci.com

would allocate a significant portion of assets that varies from the benchmark assigned to it. The Consultant acknowledges that the process of selecting appropriate benchmarks can be difficult in Pakistan where there are only a few indices from which to choose but promotes the use of the benchmark nonetheless as to fail to use such a tool, no matter how imperfect, would not otherwise provide a basis of evaluating investment performance.

Peer Group Comparisons

70. In the case of the Investment Funds being managed by the Punjab Investment Unit it is expected that the asset class mix of all Investment Funds will not be able to be captured by commercially published indices. For such Investment Funds a popular solution employed in other countries is the use of a peer group universe of managed assets. The advantage of employing peer group benchmarks is that they reflect actual returns earned by other managers operating in the specified market taking full account of transactions and other operating costs and reflect decisions taken across the funds on available investment alternatives. Peer group benchmarking is also considered helpful where the investment goal is to outperform competition rather than an abstract calculated index. The disadvantages of using peer group comparisons are that they are not available on a real time basis; there is usually a time lag for comparison. Also, peer group comparisons cannot readily be replicated preventing the manager from taking a neutral position. Often there is no oversight process for determining peer group universe participants and thus the question may be raised as to how accurately a universe represents the entire asset class. Without careful attention “survivor bias” can develop over time, which is the result that occurs when poor managers are deleted from the universe of a peer group comparison compromising the actual historical performance of the peer group.

Recommendations to Investment Policy

71. The Punjab Pension Fund created an Investment Policy, which was approved by the Punjab Pension Fund Management Committee 15 October 2008. The approved Investment Policy represents a well-organized and comprehensive approach to defining a diversified domestic investment management program. Expanded Consultant comments are included at Appendix D. The majority of the comments are related to:

a. Strengths of the current Investment Policy.

b. Areas to continue to strengthen in the Investment Policy:

   i) Investment Objective.

   ii) Re-examine the prohibition against foreign investments.

   iii) Delegation of Investment Decisions.

   iv) Enhancing the use of benchmarks to evaluate performance of the Funds.

72. There are four main strengths of the current Investment Policy:

a. Formalized rules defining permissible and impermissible investment classes including exposure (percentage) limits;
b. Formalized rules defining the standards of allowable brokers for purposes of placing trades and effecting transactions, banks for purposes of placing deposits and third party products such as mutual funds or insurance;
c. Formalized rules defining transactions that would be prohibited; and
d. Philosophy to delegate some of the investment authority to the Investment Operational Committee while maintaining full control of the Investment Policy with the Management Committee.

73. There are aspects of the Investment Policy that should be strengthened:

a. Clarify the Investment Objective. Establishing a Fund's Investment Objectives is the continuation of the Investment Policy – it links the universe of possible investments (as expressed by the Investment Policy) to the risk tolerance and need for income and/or appreciation defined by the Government of Punjab at a specific point in time. It is appropriate that the Government may change its risk tolerance based on changing its financing strategy, market conditions, current cash needs and whether budget transfers can be made in the near term or if there is a need to accelerate disbursement plans. It is important to constantly validate the Investment Objectives with current officials. The Consultant would strongly recommend at least an annual review of the Investment Objectives for the express purpose of re-validating the Investment Objectives. As explained in Appendix D Comments on the Investment Policy, the Consultant suggests that the current Investment Objective should be clarified out of concern that readers would not completely understand intent. Four examples of clear Investment Objectives are provided at Appendix F, Investment Objectives – Sample Language. The four objectives offered range from most conservative to conservative to balanced and to growth.
b. Re-examine the merits of restricting investments solely to domestic markets. The concern about limiting investments solely to Pakistan's financial markets is that they provide a limited range and an inadequate supply of suitable investments for Institutional Investors, of which the Punjab Pension Fund is considered. By expanding the Investment Policy to permit investment ex-Pakistan opens markets that have a deeper supply of investments and creates opportunities for economic diversification. With an international exposure added to the Fund, there is a need for the development and implementation of tools to manage currency conversion risks that occur when repatriating investment proceeds. The Consultant recommends that once the revised financing strategy has been finalized and budget transfer plan established, a determination should be made whether the projected value of the Fund is expected to be of a large enough size to warrant

consideration by the Management Committee[18] for purposes of expanding the supply of suitable investments.

c. Reinforce the Delegation of Investment Decisions. The Consultant agrees with the concept to delegate investment decisions as outlined in the Investment Policy. The philosophy put forward in Delegation of Powers on page 21 of the Investment Policy states: "to keep the long-term decisions with the Management Committee while the Investment Sub-Committee and the Operational Investment Committee will take medium and short term investment decisions." Such an outlook is consistent with industry standards of investment delegation on other Investment Funds and is referenced by the Organization for Economic Co-Operation (OECD) and Development and the International Labour Organization (ILO). Delegation permits the Management Committee to maintain full control of the Investment Policy while enabling efficient day-to-day management to the group directly responsible. The Consultant also recommends adding language to the Investment Policy that clarifies that no member of the Management Committee shall be liable for any action taken or omitted with respect to the exercise of or delegation of these powers if such member shall have discharged the duties of his position in good faith and with diligence and care.

d. Enhance the Performance Benchmarks to Conform to Industry Standards. While the Investment Policy speaks to the need for a benchmark for purposes of creating a standard by which to compare the investment performance of the Investment Fund, it appears that work on finalizing the benchmark is continuing. The Consultant recommends that an investment benchmark be designed for each Investment Fund against which the performance of the Punjab Investment Unit would be measured. Government officials must have strong standards for determining how well the Investment Unit is managing the assets entrusted to them. Specific changes to the Investment Policy language on performance benchmarks are included in Appendix D, Comments on the Investment Policy.

[18] The Investment Policy, like the Act, references that a change to allow foreign investments must be made by the Government. The Consultant would propose that it is the Management Committee that should have sole control of the Investment Policy. See further comments regarding changes to the Investment Policy in Appendix C, including language that if the Policy is expanded to permit ex-Pakistan investments simultaneously the Fund will need to be provided currency hedging tools.

APPENDIX A

PGEIP INVESTMENT AND GOVERNANCE UPDATED WORKPLAN

ASIAN DEVELOPMENT BANK PGEIP INVESTMENT AND GOVERNANCE UPDATED WORK PLAN

Martha

		2009										2010	
	Activities	**March**	**April**	**May**	**June**	**July**	**August**	**September**	**October**	**November**	**December**	**January**	**February**
	Pension & GPF Conversion Activities												
1	Support PAT on daily basis (Hamdani with Martha's support)												
2	Assess accuracy of pension and GP Fund conversions					■							
3	Draft illustration current pension procedures (Hamdani with Martha's support)		■										
4	Draft illustration current GP Fund procedures (Hamdani with Martha's support)		■										
5	Recommend changes in pension procedures - draft rules						■						
6	Review of draft pension rules by Law Department						■						
7	Recommend changes in GP Fund procedures - draft rules						■						
8	Review of draft rules by Law Department						■	■	■				
9	Approval of new rules (by Finance Department and the Pension Administration Taskforce)						■	■	■				
10	Preparation of new forms, booklets,…								■				
11	Notification of new rules, preparation of training, …								■				
12	Develop GP Fund pilot project		■										
13	Advise on implementation of pilot project			■	■	■							
14	Evaluate results of pilot project						■						
15	Assist in the preparation of a comprehensive written plan (detailing scope of project, targeted goals and strategy to reach the goal, tasks to be completed and resources needed)						■						
16	Assist in roll-out of comprehensive plan							■	■	■	■	■	■
	Investment and Governance Activities to Support Investment Funds												
17	Advise on strengthening of governance structure of Punjab Pension Fund		■										
18	Recommendation on investment policy		■										
19	Review of pension and GP Fund financing strategy		■			■							
20	Recommendations on disclosures, reporting, conflict-of-interest rules						■						
21	Recommendations of audit, financial control policies						■						
22	Recommendations on rules for outflows of Punjab Pension Fund						■						
23	Prepare and support action plan to reform Management Committee and Sub-Committees					■	■	■	■	■			
24	Advise on design of a single Investment Unit to manage the investments for Punjab Pension Fund and Punjab GP Investment Fund					■	■	■	■	■			
25	Review Pension and GP Investment Acts (legal advisor)								■				
	Deliverables												
25	Review of accuracy of pension and GP Fund conversions					★							
26	Documentation of current pension procedures			★									
27	Documentation of current GP Fund procedures			★									
28	Recommendations on changes in pension procedures					★							
29	Recommendations on changes in GP Fund procedures						★						
28	TOR for GP Fund pilot project		★										
29	Evaluation of pilot project						★						
30	Written plan to convert GP Fund data for all districts in Punjab							★					
31	Investment governance report (incl. presentation to FD and PPF			★									
31	Design of single Investment Unit									★			
32	Action plan to reform Management Committee and Sub-Committees									★			
33	Mid-term report		★										
34	Draft final report											★	
35	Final report												★
	Inputs (136 consulting days: 78 home and 56 field)												
	M. Kelly - Lahore			■			■			■			■
	M. Kelly - Home Office		■			■	■	■	■			■	■

Nauman

Activities	**March**	**April**	**May**	**June**	**July**	**August**	**September**	**October**	**November**	**December**	**May**	**June**
Pension & GPF Conversion Activities												
Update liability and cash flow projections for pensions and GP Fund	■	■	■									
Support in preparation of pension and GP Fund financing strategy	■	■	■			■						
Report on inaccuracies and anomalies of computerized pension and GP Fund records	■	■	■									
Prepare study on accrual pension and GP Fund liabilities of contractual workers in case of regularization			■	■								
Prepare pension and GP Fund expense report in line with IPSAS 25			■	■								
Support Finance Department and Pension Administration Taskforce			■			■						
Prepare pension and GP Fund expense report in line with IPSAS 25											■	■
Deliverables												
Actuarial report (liabilities and cash flow projections for pensions and GP Fund, report on inaccuracies, 3-4 initial financing strategies)			★									
Pension and GP Fund expense report in line with IPSAS 25 (FY2008/09)				★								
Study on accrual pension and GP Fund liabilities of contractual workers in case of regularization				★								
Final financing strategy						★						
Pension and GP Fund expense report in line with IPSAS 25 (FY2009/10)												★
Inputs												
N. Cheema - Lahore	■	■	■	■		■					■	■

APPENDIX B

GOVERNMENT OF PUNJAB FINANCE DEPARTMENT PENSION FUND INVESTMENT STRATEGY POLICY NOTE, 2007

Pension I. 5(i)

GOVERNMENT OF THE PUNJAB
FINANCE DEPARTMENT

NOTE FOR THE CHIEF SECRETARY

SUBJECT: **FUNDING STRATEGY FOR THE PENSION FUND**

Chief Secretary may kindly recall the meeting held with the ADB mission on 11.09.2007 in which the long term strategy for the Pension and the General Provident Investment Funds came under discussion.

2. It was decided in the above meeting that as an evidence of commitment of the Government of Punjab to provide funding for the above, a funding strategy note may be appended to the Medium Term Budgetary Framework document which is being finalized and if necessary it may also be discussed in the Cabinet for approval in principle.

3. A draft funding strategy note for the Punjab Pension Fund has been prepared and is placed at Annex-A for kind perusal and views of the Chief Secretary before finalization.

PSIFS 1554 15/9

(SOHAIL AHMAD) 15/9/07
FINANCE SECRETARY

CHIEF SECRETARY

Good. Go ahead.

10/9/07

9099 15-9-07

8178 17-9-07

17/9/07

AFS (B)

DS (R)

17/9

FUNDING STRATEGY FOR THE PENSION FUND

Introduction

The Government of Punjab in the last five years has been able to generate fiscal space for development expenditures on account of better expenditure management. In 2003 two areas of expenditure management were identified for creation of necessary fiscal space. They were the following:

(1) Retirement of expensive domestic debt through cheaper foreign loans obtained as budgetary support from the Asian Development Bank.

(2) Setting up of an off budget Pension and GP Funds that will eventually pay for the Pension and GP Fund liabilities that are being currently paid through the current budget of the Provincial Government.

In the last five years the province has been able to retire expensive loans amounting to Rs. 17.45 billion resulting in a saving on account of debt servicing of Rs.27.33 billion till 2020 thereby creating significant fiscal space for other priority expenditures.

However, since discontinuation of expensive Cash Development Loans in 1999 the expensive loan portfolio has been gradually decreasing and further retirement of expensive loans may not result in significant savings. In fact there is considerable capacity to take new loans for viable economic projects.

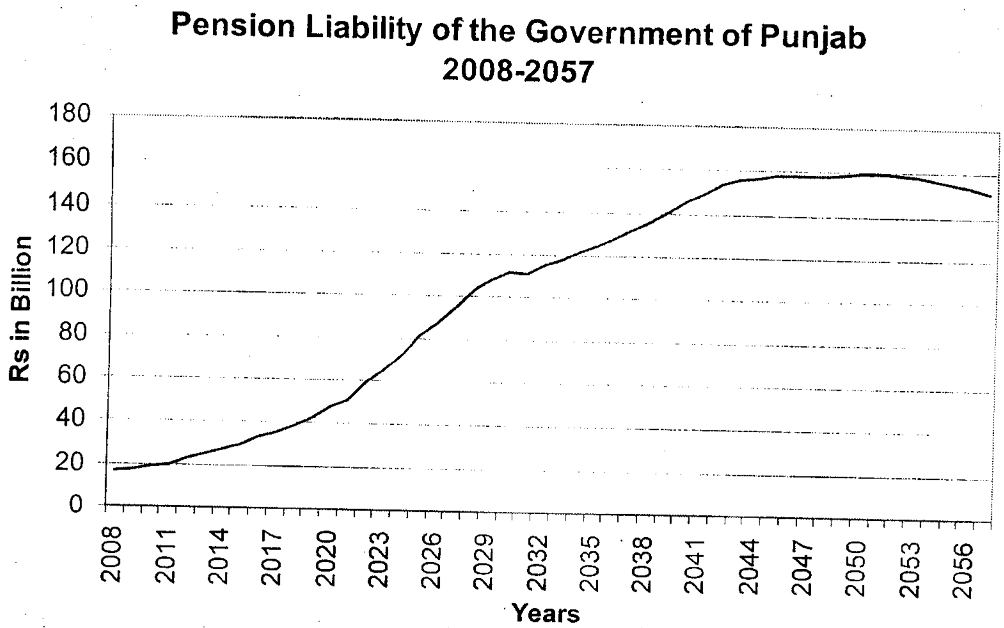
The strategy for making the Pension and GP Fund liability an off budget item was more complex than simple debt retirement. The Provincial Government was required to evolve a legal framework and had to ensure that it had the proper fiduciary safeguards in place so that investments from the capitalization of the Pension and GP Funds are prudently made. This has been made possible by the passage of the Punjab Pension Fund Act 2007 and the finalization of the rules for operations of the Punjab Pension Fund. The General Provident Investment Bill is also expected to be presented to the Provincial Assembly soon.

With the legal and operational framework in place for the Punjab Pension Fund the next step is to determine the extent and impact of our pension liabilities in future years and evolve a strategy for funding the Pension Fund in such a manner that in the future a significant if not the entire amount of our pension liabilities are covered by the investment returns of the Punjab Pension Fund.

Expected Pension liabilities of the Government of Punjab

The Government of Punjab was never expected to calculate pension liabilities for future years as it was assumed that it would bear the liability from its current budget. Therefore, it was not making any provisions to cover this liability and neither had an idea of the size of this liability. With the assistance of the Asian Development Bank the Punjab Government has been for the first time able to make a rough actuarial assessment of the pension liabilities of its employees in the next 50 years.

The accrued pension liability of the Punjab Government as of 30.06.2007 is in the range of Rs.425 – 485 billion. The annual pension liability of the Government of Punjab would be Rs.158.24 billion by the year 2047 as compared to approximately Rs.12.65 billion during the current financial year. More important is the fact that the annual pension liability is going to grow very rapidly in the next 20 years and will reach Rs.94.89 billion by the year 2027. The graph below shows the rate of increase in pension liabilities over the 50 years period. In the next five years the pension liability is expected to almost double of what it is right now.



The actuarial assessment clearly identifies the need for a rapid capitalization of Pension Fund so that the rapidly increasing pension liability in the next 10 – 15 years can be met to some extent from the returns of the Punjab Pension Fund.

Funding Strategy for the Pension Fund

Funding Strategy 2007-11

In this regard the Asian Development Bank is ready to provide budgetary support loan in the next 3 – 4 years of $750 million. This budgetary support would allow access to funds for capitalization of the Pension Fund and the General Provident Investment Fund in the next 4 years without the Punjab Government using its own resources which are already committed to other priority expenditures. However, there is a need to clearly indicate a funding strategy for the next 4 financial years and include them in the medium term budgetary forecasts. The table below shows the capitalization amounts up to the financial year 2010-11:

Funding Strategy 2007 – 11

2007-08	Rs. 6 billion
2008-09	Rs. 14 billion
2009-10	Rs. 16 billion
2010-11	Rs. 14 billion

Funding Strategy 2011-30

The Punjab Government intends to achieve a capitalization target of Rs.100 billion by the year 2015-16, therefore, for years subsequent to the financial year 2010-11 the Punjab Government intends to make a provision for funding in the annual budgets that is linked to the estimated payroll expenditure (basic pay) of the Government of Punjab. This amount would be a percentage of the estimated payroll expenditure and would go beyond 2016 up to 2030. The reason for linking pensions to basic pay is that essentially pension payments are deferred salary liabilities and therefore capitalization should be on the budgeted basic pay which is the basis of determining pension payments. In this manner it does not affect other current expenditures that are not related to pensions. It is proposed that the funding strategy for financial years subsequent to 2010-11 be as below:

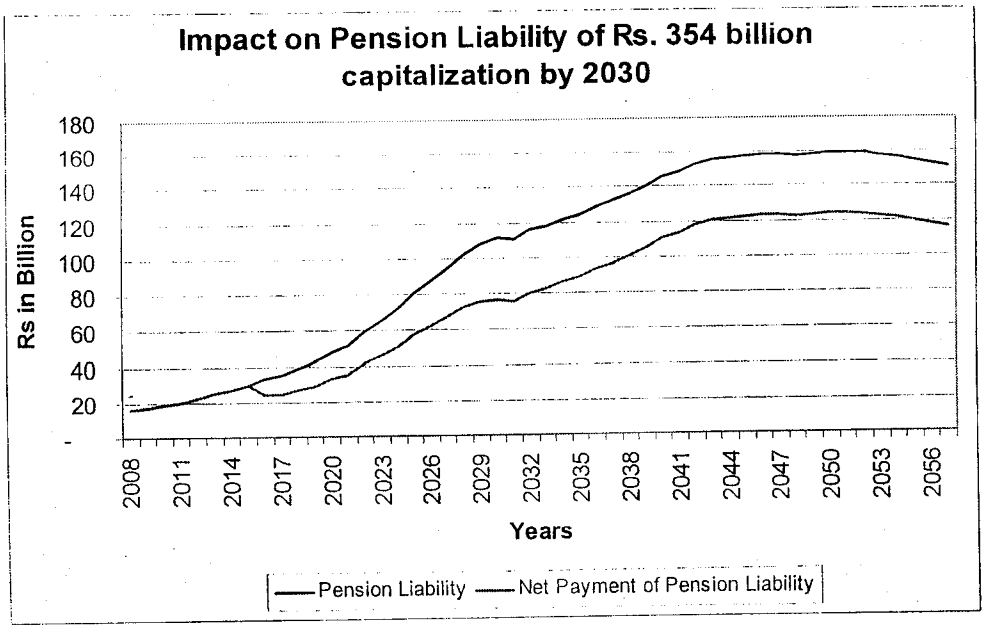
Funding Strategy 2011 – 2030

2011 – 2030	10% of basic pay budgeted of provincial employees in a financial year

The basic salary budgeted during the current financial year for Punjab Government employees is Rs.62 billion approximately. By following the above strategy and assuming a 7% annual growth rate in basic salary expenditure over the period 2008-2030 the Fund would have total capitalization of Rs.354 billion by 2030 (see Annex-1).

Impact of the Funding Strategy of Rs.354 billion by 2030

Assuming that the Fund starts making payouts to defray pension liability after 2016 from its return on investment it is expected, (assuming a rate of return of 10% on the total capital of the Pension Fund) that the Pension Fund would be able to cover approximately 30% of pension expenditures from 2016 – 2030 (see Annex-1). In case the capitalized amount is kept of Rs.100 billion and not increased after 2016 the Pension Fund would only cover 9% of the pension expenditures by the year 2030 and only 7% by 2040. Therefore, there is a need for constant capitalization of the Pension Fund to make it a truly off budget item.



(Annex-1)

Year	Pension Liability	Additional Capitalization	Cumulative Capitalization	Return on Pension Fund	Net Payment of Pension Liability	Pension Liability covered by Pension Fund
	(Rs. in billion)					
2008	16	6	6	-	16	
2009	17	14	20	-	17	
2010	19	16	36	-	19	
2011	20	14	50	-	20	
2012	23	8	58	-	23	
2013	25	9	67	-	25	
2014	27	9	76	-	27	
2015	30	10	86	-	30	
2016	34	11	97	10	24	29%
2017	35	11	108	11	25	31%
2018	39	12	120	12	27	31%
2019	42	13	133	13	29	31%
2020	48	14	147	15	33	31%
2021	51	15	162	16	35	32%
2022	59	16	178	18	41	30%
2023	66	17	195	20	46	30%
2024	72	18	214	21	51	30%
2025	81	20	233	23	58	29%
2026	87	21	254	25	62	29%
2027	95	22	277	28	67	29%
2028	103	24	301	30	73	29%
2029	108	26	326	33	75	30%
2030	112	27	354	35	76	32%
2031	111	-	354	35	76	
2032	116	-	354	35	80	
2033	118	-	354	35	82	
2034	121	-	354	35	86	
2035	124	-	354	35	89	
2036	129	-	354	35	93	
2037	132	-	354	35	97	
2038	136	-	354	35	101	
2039	140	-	354	35	105	
2040	146	-	354	35	111	
2041	149	-	354	35	113	
2042	153	-	354	35	118	
2043	156	-	354	35	120	
2044	157	-	354	35	121	
2045	158	-	354	35	122	
2046	158	-	354	35	123	
2047	158	-	354	35	123	
2048	158	-	354	35	122	
2049	159	-	354	35	123	
2050	159	-	354	35	124	
2051	159	-	354	35	124	
2052	159	-	354	35	124	
2053	158	-	354	35	122	
2054	157	-	354	35	121	
2055	155	-	354	35	120	
2056	153	-	354	35	118	
2057	151	-	354	35	116	

Appendix C

Recruitment for the General Manager

Project Contact: Ms. Martha Kelly
Email: mkelly@ariesgroup.com
Mobile: +92 323 463 2201

Consulting services provided by: **The Aries Group, Ltd.**
8609 Second Avenue, Suite 402B,
Silver Spring, MD 20910, USA
Tel: (+1-240) 247-1300
Internet: www.ariesgroup.com

To: **Mr. Tariq Mahmood Pasha, Finance Secretary**
Mr. Naveed Alaudin, Special Secretary Finance
Mr. Omar Masud, Additional Finance Secretary

Copy to: **Ms. Sona Shrestha, project officer Asian Development Bank**
Ms. Emma Fan, project officer Asian Development Bank
Mr. Mujtaba Piracha, PRMP Program Director
Ms. Mehnaz Bhaur, Deputy PRMP Program Director

Date: 15 December 2008

From: Martha Kelly, Pension Expert

Subject: General Manager of the Punjab Pension Fund

1. In a memorandum to the Finance Secretary, Special Secretary Finance and the Additional Finance Secretary prior to my departure in December 2008, I summarized several outstanding issues and proposed which issues should be given priority and be addressed at the earliest convenience.

2. I received a request from the PRMP deputy program director asking once more to comment on the status of the General Manager position for the Punjab Pension Fund.

3. During my final communiqué prior to departure I had written: *Another issue we discussed is related to the GM of the Pension Fund. Presently the Management Committee is operating outside of the Pension Fund Act [Pension Fund Rules] by not having a GM and as the authorization of the acting General Manager has expired for the second time. We should finalize this discussion before I depart.*

Requirement for a General Manager

4. This topic was reviewed with the Additional Finance Secretary before my departure. We discussed that the Punjab Pension Fund Rules state: ***15. Appointment and duties of General Manager***.*– (1) The Management Committee shall in the appointment of the General Manager by the Government, after advertising and an open process of selection submit to the Government a list of suitable candidates. (2) In absence of a General Manager* <u>*the Government may appoint an acting General Manager for a maximum period of six months*</u>.*[emphasis added by Consultant]*

Background ADB Consultant and Role as an Advisor to the PPF Management Committee and the Finance Department

5. The Consultant advises the members of the Punjab Pension Fund Management Committee that the Finance Secretary has expressed to the ADB project officer that the Management Committee and the government are strongly committed to following the Punjab Pension Fund Act and the Punjab Pension Fund Rules. Yet as the ADB project officer is updating the major action plan items to the ADB Board of Directors prior to the approval of the loan request and the general manager position continues not to be filled there is a risk of sending conflicting signals. It is important that the general manager position be filled but it is more so urgent to act as the PPF Rules state that the acting general manager's term cannot exceed six months. This six month period has been exceeded.

6. Please advice on this issue at your earliest convenience.

APPENDIX D

COMMENTS ON THE INVESTMENT POLICY

Appendix D: Comments on the Investment Policy

Reference	Current Language	Consultant's Comments
Preamble		Consultant recommends inserting a section on defined terms for ease of interpreting this Investment Policy. For example, some terms used but not defined that may be helpful to ensuring proper interpretation over several years include: • Accounting Year • Actuary • CFS • Collateralized repurchase agreements (repos) • Investment Sub-Committee • Operational Investment Committee
Page 3, Fund's Objective	The objective of the Fund is to generate revenue for the discharge of the pension liabilities of the Government of the Punjab. Hence, it is desired to achieve financial equilibrium in assets portfolio and the pension liabilities in accordance with actuarial assessment.	Recommendation, not suggested language change. The Investment Unit must develop an understanding of the Fund's monthly, quarterly and annual incoming budget transfers and its disbursement needs in order to estimate the Investment Fund's cashflow projections for purposes of defining investment time horizons. These estimates should be developed jointly with the Finance Department and the Actuary and should be reconciled at least quarterly to actual expenditures between the Investment Unit and the Finance Department.
Page 3, Operational Framework	The Management Committee shall: Approve an Investment Policy and make amendments thereto. Appoint an Investment Sub-Committee. Appoint an Operational Investment Committee for day to day investment decisions of the Fund.	Explanation, not suggested language changes. Consultant was advised by CIO that the intent of the Investment Sub-Committee is to be comprised solely of membership of the Management Committee – if this is correct, it should be stated in this section and/or in Definitions. Consultant was further advised by CIO that the intent of the Operational Investment Committee is to be comprised of membership of the Management Committee and membership of the management of the Investment Unit – if this is correct, it should be stated in this section and/or Definitions.

Reference	Current Language	Consultant's Comments
Page 5, Investment Objectives: New section as part of Investment Objectives	While minimizing risk the Fund will endeavor to generate sustained earnings consistent with reasonable concern for safety of principal amount. However, the Fund's management must acknowledge the existence of risks associated with investments as is universally known, ~~greater the risk greater the return~~. [The Consultant strongly advises striking this statement altogether or, if not striking, than at minimum rewording as follows: …the greater the amount of investment risk that is assumed, the greater the opportunity for investment gains and losses.]	Explanation, not edit. A clearly stated investment objective is missing. An Investment Objective ideally should state whether the objective of the Investment Fund is to attempt to create capital appreciation, income through interest or dividends or both and also whether preservation of capital is an objective. Preservation of capital means that there is no opportunity for fluctuation of principal – which means the original money that was transferred from the budget (called principal) could increase or decrease in value. Consultant strongly recommends that the language be modified and provides suggested options in Appendix E.
Page 9, Exposure Limits	No investment shall be made from the Fund for (A) a period of more than three years or (B) in any foreign market or firm, except with the prior approval of the Government. *[Alphabetical reference added by for ease of directing comments to the different parts of same sentence.]*	Explanation, not edit. There is no natural connection[1] between these two issues: duration of an investment being held in the Fund and a statement to disallow foreign investments. The Consultant strongly recommends addressing each separately. Further, (A) Consultant was informed by the CIO that the intent of reference to the limitation on the duration of holding an investment is not a specific intent to force divestment of any security as the third year anniversary of a security's purchase approaches but to require review and approval by the Management Committee for long held securities, eg, three years. This is not clear in the current language. The risk is that a later date this language could be mis-interpreted. If the Management Committee is more comfortable with a three year review or feels compelled to include this based on the footnote reference of similar language in the Act, Consultant suggests that the language be removed from the Exposure Limits section and inserted in its own section called Duration of Investment Holding and also modified as follows All investments held for a period of 36 months or longer shall be

[1] The Consultant noted that this connection appears also in the Punjab Pension Fund Act of 2007 at Chapter-IV, Powers and Functions of the Management Committee, paragraph 15(a) but reinforces the need for clarity in the Investment Policy on these two important issues nonetheless.

Reference	Current Language	Consultant's Comments
		annually reviewed commencing with a review prior to the third anniversary of the purchase date and re-approved by the Management Committee. (B) Consultant does not believe that the Government as an approving agent is appropriate here. The only other reference in this Investment Policy to a requirement that Government approve a change is related to pledging of securities and merger of the Punjab Pension Fund with another fund and recommendations have been made for both of those references to change as well. Given the lack of supply of suitable investments in the financial markets of Pakistan, it is reasonable to consider that a review will be made at some time (and likely more than once) to analyse the appropriateness of permitting Punjab Pension Fund investments in markets outside of Pakistan. In consideration of these issues, the Consultant strongly advises that this language be modified as follows: …in any security traded or listed on a foreign exchange except in the case that the Management Committee approves modification to the Investment Policy to permit foreign investment and has developed and in tandem approves a strategy to enable the Fund to hedge currency conversion and other risks associated with investment ex-Pakistan.
Page 12, Exposure Limits.	5. Deposit with Scheduled Banks: c) No deposit in a scheduled bank shall be made for a period exceeding six months.	It is not clear from the statement what is expected to happen if / when a six-month time period is exceeded. From reading this sentence it would appear that a prompt withdrawal of funds from a scheduled bank no later than day 182 is mandatory. If that is the case, the Consultant poses two questions: 1. Is it not correct that the present deposit of the original Rs 3 billion has been in the same bank for a period exceeding 182 days? 2. Why would the situation be appropriate in the case when the Government (not the Management Committee or the Punjab Pension Fund) has placed a deposit with a bank for a time period exceeding six-months but not while there is focused oversight of a Management Committee and the daily focus of the management and staff of the Fund, who were hired based on their experience?

Reference	Current Language	Consultant's Comments
		Consultant recommends either to delete (significance of time period is not clear to Consultant) or if preferred to retain then explain what must occur if the six-month rules is breached. Consultant proposes the following language (only if Management Committee wants to retain): No deposit in a scheduled bank shall be made for a period exceeding six months without prior approval by the Investment Committee [note, not the Management Committee to retain consistency with time period issues elsewhere in document.]. Alternatively, if the intent was to restrict the management and the employees of the Fund from entering into an agreement with a bank for greater than six-months, Consultant proposes the following modifications instead: No deposit in a scheduled bank shall initially be made for a period exceeding six months, but after six-months the deposit may be renewed and not required to be withdrawn if the scheduled bank is still within allowable credit ratings and offers the most competitive rate for the desired renewal term.
Page 12, Exception to Exposure Limit	In the event the exposure limits laid down in the Investment Policy change as a result of the relative movement in the market prices of the investments or through any disinvestments or through corporate actions, the Management Committee shall bring excess exposure within the prescribed limits within three months of the event. However, this restriction of further investment shall not apply to any offer of right shares or bonus shares.	Consultant reminds that this type of exception is actually common and recommends against being too restrictive in the Investment Policy to avoid the risk that too restrictive will be administratively expensive to implement. Consultant recommends that the language be modified as follows: In the event the exposure limits defined in the Investment Policy are exceeded solely due to market fluctuations redefining limits, through corporate actions such the merging of more than one current holding of the Investment Fund, or in the case of a shares issuer exercising buy-back options, the Investment Unit shall immediately advise the Investment Committee, but in no case may notice be made later than three business days following the Investment Unit's alert to limits being exceeded. The Investment Unit shall have five business days to prepare and propose a plan to reconcile the holdings exceeding the limits. Such a plan may be implemented over a period not to exceed 12 months from the date limits were exceeded. Restriction against

Reference	Current Language	Consultant's Comments
		additional investment shall not apply to any offer of right shares or bonus shares. Consultant notes that there is no similar reference in the Investment Policy or the procedures if investment limits are exceeded outside of the exceptions. As this is likely to happen more often it should be addressed. Consultant recommends the following addition: In the event the exposure limits defined in the Investment Policy are exceeded for reasons not included above, then the reason shall be considered an error. Determination must be made as to who is the cause of the error: the Investment Unit, the trustee or the broker. The transaction must be corrected immediately upon notification. The Investment Unit shall prepare rules for operating an error account. If the error is the responsibility of the Investment Unit, the error shall be processed through its error account. The purpose of the error account is to account for the transactions of error trades – both surpluses and deficits generated by these transactions. If the error is the responsibility of the trustee or broker, the error shall be processed through their error accounts. In such cases the trustee or the broker, as agent, shall bear full cost of the error. The financial loss or gain incurred in processing the correction (reversal of trade) plus the cost of any transaction expense shall be borne by the responsible agent.
Page 12, Restrictions on Connected Persons.	For the purpose of this restriction the term member and officer shall include spouse, lineal ascendants and descendants, brothers and sisters.	Consultant points out the increased cost and difficulty of attempting to monitor such transactions and advises against attempting to do so, for reasons solely associated with the impracticalities of administering the rule. For example, to administer according to the stated description would entail preparation of a notice to Board members and officers to notify their relatives using the approved notice. Enforcement can only be practically administered by insisting that spouses, lineal descendants (sons, daughters and their spouses), and brothers and sisters (and their spouses) complete the same financial disclosures as would be requested of Board members and officers. When such disclosures are prepared, the information would need to be verified against the

Reference	Current Language	Consultant's Comments
		portfolio holdings by a staff member of the Investment Unit. In the event that such holdings of family members are found to be in conflict with stated policies, the relative would be instructed to divest of such holding but there is no authority to make them do so. The Management Committee would be in the position with little recourse if such family members are not agreeable to divest their holdings except to terminate the Management Committee member or officer. Again, a very unlikely proposition if membership is made up of a majority of ex-officio members. Consultant recommends that this policy statement be re-examined for intent. What is the objective? Presumably to ensure lack of conflict-of-interest among Board members and officers. If so, the use of non ex-officio members results in a difficult to enforce rule. If the intent is to do so, the Consultant recommends that the enforcement be limited solely to Board members and officers and not to their relatives.
Page 13, General Restrictions on the Fund.	The Fund shall not: a) merge, acquire or take over management of any other pension fund ~~unless it has obtained prior approval of the Government for the merger, acquisition or take over~~; b) pledge securities owned by the Fund except for the benefit of the Fund ~~and with prior approval of the Government;~~ c) make a loan or advance money to a person. ~~except in connection with the normal business of the Fund~~; d) participate in a joint account with a person in any transaction; e) invest in the real estate ~~except that it may~~	a) Consultant strongly recommends the strike-though. There are no circumstances in which it would be appropriate to merge[2] the Punjab Pension Fund with any other pension fund. None. The issue of approval of the Government is not relevant. By retaining the language there is an implication that such allowable circumstances may exist. b) Consultant advises that this statement be reworded as it does not appear to be consistent with intent. The Consultant strongly recommends omitting the phrase "with prior approval of the Government" as that should not occur. The strikethroughs are recommended at the least, but a full revision is more important: pledge securities owned by the Fund except in the case of collateralized repurchase agreements using TFCs or governments bonds as collateral. c) Consultant strongly recommends that this language be revised to reflect the strike through. There are no circumstances in which a loan should be permitted from the Fund to a person. Never.

[2] The concept of using the merge reference in Investment Policies of private employer schemes is common as in these situations it is appropriate to plan for the future mergers (whether likely or unlikely) between more than one private employer. Such similar opportunities do not exist with provincial governments.

Reference	Current Language	Consultant's Comments
	~~purchase or rent real estate for its official use~~; f) employ as a broker, directly or indirectly, a Member, the General Manager or an employee or a member of the family of such a person; g) acquire, purchase or sell any security to a Member, the General Manager or an employee or a member of the family of such a person; h) enter into a short sale transaction in any security, whether listed or unlisted; i) enter into transactions with any single broker that accounts for 20% or more of the Fund's brokerage commission in any one Accounting Year of the Fund; j) lend, assume, guarantee, endorse or otherwise become directly or contingently liable for or in connection with any obligation or indebtedness of any person. ~~However, sale and repurchase transactions involving Government Securities or listed debt securities can be made~~; k) seek to acquire a controlling interest in any enterprise in which it has invested or has any other interest, which would give it primary responsibility for management, except where it is necessary to protect its investments; l) purchase shares on leverage i.e. through CFS; m) accept deposits from a company, unit trust, mutual fund, collective investment scheme or a third party; n) undertake brokerage services on stock exchanges or in the money market; and	d) No edits; Consultant strongly agrees. e) Consultant points out the potential conflict-of-interests in attempting to structure such transactions and would strongly recommend against its inclusion. The Fund, as a defined Investment Portfolio Fund should not invest Fund money in real estate to be used for official use by itself. Perhaps what is meant is to say that a building could be purchased by the Investment Unit for its own official use. In that case it is not relevant to the Investment Policy of the Punjab Pension Fund. f) No edits; Consultant agrees. g) No edits; Consultant agrees. h) No edits; Consultant agrees. i) No edits; Consultant agrees j) Consultant recommends deleting the last part of the phrase, as indicated, as sub-paragraph b above with recommended revisions makes the statement more clearly than this sub-paragraph. k) Consultant disagrees with reference to allowing the Investment Fund to take controlling interest in a company for reasons as ambiguous as "where it is necessary to protect its investments." If the Management Committee is keen to retain the spirit of this meaning, the Consultant strongly recommends that the following language be added: except where is deemed necessary by a majority vote of the Management Committee / Investment Oversight Board and only after a full presentation of the takeover plan and ongoing management expertise has been presented to the Board. l) No edits; Consultant agrees. m) No edits; Consultant agrees. n) Consultant agrees but considers that the statement is too limiting and recommends extending the sub-paragraph as follows: undertake brokerage services on any exchange or in any financial market.
Page 15,	The purpose of benchmark return is to gauge	Consultant respectively submits that there is a misunderstanding over

Reference	Current Language	Consultant's Comments
Benchmark Return	performance of the Fund over a period of time. It also reflects on the performance of the General Manager, Chief Investment Officer/Fund Manager, Operational Investment Committee, Investment Sub-Committee and the Management Committee. ~~While establishing a benchmark return, associated risks must be taken into consideration. Greater risk in pursuit of higher benchmark return may be counter productive to the establishment of the Fund. Hence, sustained earning over a period of time is preferred to unusual returns over a short period~~. ~~Monetary policy of the State Bank of Pakistan (SBP) has a direct bearing on the returns of different class of assets. Hence, continuous review of the benchmark return needs to be made based on inflation rate, SBP's discount rates etc.~~ ~~The Fund will adopt inflation rate based on Consumer Price Index (CPI) as criteria for establishment of overall bench mark return. The Fund will endeavor to generate an annual return equal to inflation rate of that year plus 3%. For this purpose inflation rate will be taken from the Federal Bureau of Statistics.~~ ~~In addition to a single benchmark return for the Fund, we have set following benchmark returns for each class of asset:~~ ~~References 1-8.~~	what constitutes a benchmark for an Investment Fund. The use of benchmarks in the selection and monitoring of investment returns is standard fiduciary practice and outlined in more detail in Appendix G. The reference to seeking to outperform the rate of inflation, based on CPI, is a goal; it is not a benchmark. A benchmark serves as a comparison point: compare the investment performance of the Fund to the investment performance of a similarly weighted index (most likely blended indices). For example, if 10% of the Fund is invested in shares on the KSE and 90% is invested in government bonds, then 10% of the benchmark would be made up of the KSE 100 Index and 90% of a comparable government bond index. A well structured benchmark will level the playing field for the Management Committee by allowing them to compare like-to-like. Oversight groups always ask, how well did our Fund Manager perform? The answer should be in terms of comparing to benchmark, for example: The benchmark performed XX% as an annual return and the Fund Manager exceeded the benchmark or the Fund Manager failed to meet the benchmark. As a side issue, it may be a point of interest of the Management Committee to know how well the Fund Manager performed against the CPI, but this is not a benchmark. Consultant recommends modifying the remaining language as follows: The Investment Operations Committee will construct a benchmark objective for approval by the Investment Sub-Committee and the Management Committee that mirrors the Fund's actual holdings. As the actual benchmark will adjust for all changes in the balances of the Fund including expenses, benchmark performance to actual Fund performance will be conducted of historical returns. Evaluations and adjustments to the benchmark will be done for every day new assets are invested into or disbursed from the Fund and on days used for performance measurement purposes, such as the last working day of the month. The changes in these evaluations with the inclusion of all investment gains and losses and expenses will constitute the total investment return of the Fund. Periodic changes shall be expressed as

Reference	Current Language	Consultant's Comments
		percentages and directly linked to calculate and measure investment returns over time. Additional explanation, not for inclusion in the modified text – For example, if the Fund invests for 90 days between 1 June and 1 October 10% of the Fund value in shares, then the benchmark shall be 10% of the KSE 100 Index return only for 90 days and only for the return between 1 June and 1 October. If after 30 September the Fund invests for 100 days between 1 October and 1 February 9% of the Fund value in shares the benchmark shall be only 9% of the KSE 100 Index for only 100 days …. The references, therefore, made in 1-8 are not appropriate and should be deleted.
Page 19, Selection of Broker.	Brokerage houses with good reputation and integrity shall be considered Minimum paid-up capital requirement for Capital Market Broker will be Rs 50 million. Minimum paid-up capital requirement for Money Market Broker will be Rs 20 million.	Consultant points out that this is a difficult to measure standard as "good reputation and integrity" means different things to different people and fails to provide a measurement standard for the Management Committee to know if the there is success or failure in reaching this requirement. Consultant strongly recommends modifying the text as follows: Brokerage houses licensed by the SECP; Consultant strongly recommends against setting such limits in an Investment Policy and instead recommends using language that will allow such limits to be enforced by the enforcement authority – the SECP. If not, then when the SECP raises such paid-up capital requirements (as they will do from time to time) this language will immediately be outdated and impractical to attempt to monitor and enforce. There will be no licensed Capital Market Brokers or Money Market Brokers below the allowable paid-up capital amounts defined by the enforcement authority so that should be the standard. Consultant recommends modifying the language by combining the two paid-up capital references as follows: Minimum paid-up capital for Capital Market Broker and Money Market Broker shall be in conformance with the requirements of the SECP for such institutions at all times during which the Fund transacts with a

Reference	Current Language	Consultant's Comments
		broker.
Page 20, Annexure V	A list of brokers approved by the Management Committee is enclosed as Annexure-V.	This Annexure was being compiled and was not available for comment. When made available, Consultant will review and comment.
Page 20, Selection of Investment Advisor	The Management Committee may appoint: a) a non-banking finance company to provide investment advisory services, or b) a person as an investment advisor, being a person approved by the Commission for such activities, to give advice to the Fund on selection of a third party and portfolio. The person appointed as investment advisor shall attend such meetings and prepare such reports as the Management Committee may direct.	Consultant points out that in appointing an NBFC to act as an investment advisor, it is not referenced that it must be duly licensed by the SECP but does impose that requirement in appointing a person to act as an investment advisor. The Consultant recommends merging a and b and modifying the language as follows: The Management Committee may appoint as an investment advisor a person or a NBFC, either of which must be licensed as an investment advisor by the SECP and must maintain its license in good standing for the duration of the time it advises the Investment Fund. The person or NBFC appointed as an investment advisor shall attend meetings …
Page 21, Delegation of Powers	In order to facilitate decision making at the Investment Sub-Committee and the Operational Investment Committee levels, the Management Committee delegates investment / disinvestment powers in the following manner. The philosophy of delegation is to keep the long term investment decisions with the Management Committee while the Investment Sub-Committee and the Operational Investment Committee will take medium and short term investment decisions. The powers delegated shall be subject to review from time to time. All the investments / disinvestments made by the Investment Sub-Committee or the Operational Investment Committee shall be ratified in a subsequent meeting of the Management Committee	Consultant commends the Management Committee on the plan for and philosophy of the facilitation of investment decision making. Regarding the requirement that transactions made through delegated authority should be ratified at subsequent Management Committee meetings, Consultant recommends against this. The concern is that the process – referred to as after-the-fact-ratification – in which the highest authority signs-off on a transaction made under delegated authority, it is regarded to weaken and not strengthen the intent of delegation of powers. It creates a false security that the Management Committee has been involved in the transaction. The purpose of delegation is to ensure more efficient day-to-day management of investments while freeing members of the Management Committee to focus on policy oriented decisions. By adding a requirement that the Management Committee then ratify earlier transactions eliminates accountability and responsibility for actions. Industry concerns against after-the-fact-ratification are twofold: 1) once authority has been delegated to the Investment Operational Committee or the Investment Sub-Committee, such members and

Reference	Current Language	Consultant's Comments
		officers should be held responsible for their own actions; and 2) typically already executed transactions put before a higher authority for ratification places the members of the Management Committee in a difficult position to ratify. Indeed there is anecdotal evidence that almost all such after-the-fact-ratifications are ratified and that no additional review is actually taking place. If the addition of after-the-fact-ratification was proposed as a means to keep the Management Committee current on the activities of the Investment Sub-Committee and Investment Operational Committee, then address their need for communication through an efficient notification process. After-the-fact-ratification changes the issues of responsibility and accountability and should not be used as the only way to communicate transaction updates.
Page 22, Frequency of Meetings	~~If it is not possible to convene a meeting of the Management Committee the General Manager may get approval from the members of the Management Committee on any pressing matter through circulation of the same.~~	Consultant strongly recommends against the inclusion of this language in the Investment Policy and more importantly recommends against its practice. If it is not possible for the General Manager to convene a meeting of the Management Committee for the purpose of securing required approval then such approvals should not be required of a full Management and should be changed to be decided at the level of the Investment Sub-Committee or Investment Operational Committee. See also comments regarding draw-backs to having majority ex-officio membership and delegation of authority (too many small decisions require approval too high of the chain of authority) or both.
Annexures		Consultant has commented (above) on the rules relevant to developing the lists described in the Annexures.

APPENDIX E

SUMMARY FINANCE DEPARTMENT

ADB

SUPPORT TO GOVERNANCE REFORMS IN PAKISTAN TA-7003 (PAK)

SUBPROJECT: EFFECTIVE IMPLEMENTATION OF PUNJAB GOVERNMENT EFFICIENCY IMPROVEMENT PROGRAM

A TECHNICAL ASSISTANCE PROJECT FINANCED BY THE ASIAN DEVELOPMENT BANK

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To: **Mr. Tariq Mahmood Pasha, Finance Secretary**
Mr. Naveed Alaudin, Special Secretary Finance
Mr. Omar Masud, Additional Finance Secretary

Copy to: **Mr. Mujtaba Piracha, PRMP Program Director**
Ms. Mehnaz Bhaur, Deputy PRMP Program Director
Mr. Mahboobul Haq Hamdani, Consultant

Date: 29 November 2008

From: Martha Kelly, Pension Expert

Subject: **Summary of ADB Punjab Pre-Fact Finding Mission as Relates to the Issues of the Finance Department**

1. Ms. Sona Shrestha, ADB project officer, and her team have departed and I wanted to summarize the issues related to the Finance Department that were discussed and agreed to and begin to focus on the next steps. I will depart Lahore Tuesday 2 December. I am planning to return mid January 2009[1] and start my work in Lahore on my next trip.

2. Regarding the objective to improve the management of the pension and GPF liabilities, one key point was to refocus on the issue of improved management of the pension and GPF liabilities. As Sona explained, she has arranged for Nauman Cheema, the Actuary, to continue his earlier work to provide revised short and long term estimates.

    a. The AFS asked that Nauman's draft work be available for review by early January 2009. To do this, Nauman will send a written request to the Finance Department Tuesday. I have already sent a request to the Finance Secretary and the Additional Accountant General asking that Nauman's request be replied to within 10 days. If the Actuary's request is not responded in a timely manner, he will not be able to the meet the deadline requested of the AFS. Hamdani is available to assist the Finance Department in following up on this.

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[1] I am scheduled to return 18 January to Lahore but will circulate my travel dates among the three provincial projects and the ADB project officers before finalizing. I would plan to fly to Karachi 24 January, a week before the ADB Workshop, to assist in the review of presentations.

b. Nauman has been asked to prepare revised estimates on pension liabilities and has asked Sona if she is also seeking GPF liabilities. He will prepare various estimates and provide them to the AFS for review. It would be good to schedule a meeting between the AFS and Nauman before the end of January. If you would like me to be present, please advise Hamdani. This task is to be completed by January 2009.

c. The agenda for the ADB Workshop, scheduled for 30-31 January, is now proposed to include a discussion on different strategies to finance liabilities – the pre-funding investment strategy and others. Michiel Van der Auwera, ADB Social Security Specialist, will continue to organize the workshop.

d. The task on the revised action plan for CPA2 indicates February 2009 as the date for which the Finance Secretary will adopt a revised funding strategy for the pension and GPF liabilities. This would require that the decision taken by the Finance Secretary be summarized and approved. It is not clear to me who will assist the FS on this task. I will seek clarification from the ADB and follow up with the Finance Department. This task is be completed by February 2009.

3. Regarding the Pension Administration Taskforce (PAT), one task agreed to by AG Punjab was formally measuring the progress of conversions. Hamdani has prepared a request for the SSF to the AG Punjab that describes monthly pro formas to be completed. Hamdani is available to assist the Finance Department in following up on this and will distribute the reports to the PAT membership and me. This task is to be completed by November 2008.

4. The ADB included a task on the revised action plan that the PAT membership should be evaluated. In response to comments from the Secretary P&D, who suggested that the roles on the PAT be elevated, the ADB has asked that the Finance Secretary consider that the PAT be comprised of the Finance Secretary and Accountant General. This is being promoted by the ADB as Sona had first hand opportunity to understand how little measurable progress was being made when we met with the Additional AG Punjab. See table at end of this memo. Hamdani is available to assist the Finance Department in following up on this. This task is to be completed by February 2009.

5. The ADB included a task on the recent action plan that the policy note from the Finance Department should be expanded to include a description of the work being undertaken to increase the progress of the pension and GPF conversions and the accuracy of the data converted. The Consultant will prepare draft language and send to the Finance Secretary to prepare an expanded policy note. This task is to be completed by January 2009.

6. The task related to develop an action plan for improving the conversion process is related to the report that Hamdani and I are completing that describes the work of the AG Punjab to complete the data conversion process, outlines obstacles and problems encountered by the AG Punjab and recommends changes to both increase the progress of conversion and the accuracy of records converted. As part of this report, Sona asked that we recommend a pilot program so that the changes suggested can be tested in one or more districts before being formally introduced to all. The Additional AG Punjab and Deputy AG Punjab asked that the pilot be tried in a district other than Lahore and that we consider three different districts to be able to compare the results. This decision will be driven in part by the budget estimates that we prepare. The report will be completed and distributed to the PAT in mid December. A meeting to present the report to the PAT should be organized for 20 or 21 January 2009. At that time we should have collected enough information to prepare a preliminary budget for the pilot. The task to submit the report for review and comment by the PAT is to be completed by mid December 2008. The task to present the report to the PAT is to be completed January 2009. The task to approve the report and the plan for a pilot program is to be completed by February 2009.

7. One task that the SSF discussed is related to the procedures of the pension and GPF claims. Specifically Hamdani and I were asked to complete a review of the current procedures of soon to be retiring employees and claims for pre-retirement death for pension and GPF. There are two reviews:

    a. Current procedures for the paper/ forms initiating the claims, departmental workflow and approvals, explanation of support provided by the SAP/R3, payments and money flow and the regulations which define these steps.

    b. Proposed improvements to the current procedures, review and approvals, SAP/R3 support, money transfer and suggestions on which regulations should be modified.

    c. In the final editing of the action plan for CPA2, this task was dropped. I have requested clarification from Sona on whether this was an unintentional oversight or whether she wanted to defer this task to later. The ADB has indicated that the Chairman P&D can comment on the Aide Memoire and its attachments until 8 December. I would suggest that the SSF comment to the Chairman P&D before the deadline and ask that this task be reinstated.

8. Another issue we discussed is related to the GM of the Pension Fund. Presently the Management Committee is operating outside of the Pension Fund Act by not having a GM and as the authorization of the acting General Manager has expired for the second time. We should finalize this discussion before I depart.

9. The Pension Fund Act and Rules explain how money is to be moved into the Pension Fund Reserve Fund and how it is to be managed, reported, etc. But there does not appear to be a clearly delineated explanation of how money is to be moved out of the Pension Fund Reserve Fund.

Summary of Converted Records

Punjab Pension Records Total 35 districts / GPS grades 1 through 22 Number of pension records to convert: approximately 440,000	
Records compiled and punched by AG Punjab	199,634
Records verified by AG Punjab	130,618
Records uploaded by SAP CC into SAP/R3 pension module	Zero

Punjab GPF Records Total 35 districts / GPS grades 1 through 22: Number of GPF records to convert: approximately 844,000 to 1 million	
Records compiled and verified by AG Punjab	33,000
Records punched and verified by AG Punjab	33,000
Records uploaded into SAP/R3 GPF module	33,000

Appendix F

Investment Objectives – Sample Language

Appendix F – Investment Objectives

1. The Investment Objective should briefly state in language understood by non-investment professionals what types of risk the Government is comfortable in accepting as relates to the how the Funds are managed.

2. Four suggested options to insert in place of the current Investment Objective language in the Investment Policy are listed below.

Option	Suggested language to insert in the Investment Policy:	What the language means:
1	The Investment Unit shall make every effort to achieve the Fund's objective but there is no guarantee that it will do so. After consultation with the Management Committee (or Investment Oversight Board), the Investment Unit is instructed to maximize current income while ensuring preservation of capital.	This is the most conservative – there would be no possibility of fluctuation in value of original principal but very little opportunity for competitive investment returns.
2	The Investment Unit shall make every effort to achieve the Fund's objective but there is no guarantee that it will do so. After consultation with the Management Committee (or Investment Oversight Board), the Investment Unit is instructed to maximize current income and liquidity. The Investment Fund may invest in securities for which market fluctuations are expected to occur. The investment performance could, and probably will, include both gains and losses.	This is conservative, targeted to an Investment Objective that focuses on earning income probably with very short maturities in bank deposits, TFCs and bonds – not on achieving capital appreciation; there may be a risk of some fluctuation of principal but it would not be expected to be significant.
3	The Investment Unit shall make every effort to achieve the Fund's objective but there is no guarantee that it will do so. After consultation with the Management Committee (or Investment Oversight Board), the Investment Unit is instructed to pursue investment growth appreciation with some income, but would have less liquidity. The Investment Fund may invest in securities for which market fluctuations are expected to occur. The investment performance could, and probably will, include both gains and losses.	This is a balanced option targeted to generating both growth in underlying securities and some income generation; there should be an expectation that principal fluctuations will occur.
4	The Investment Unit shall make every effort to achieve the Fund's objective but there is no guarantee that it will do so. After consultation with the Management Committee (or Investment Oversight Board), the Investment Unit is instructed to pursue long term investment growth appreciation. The Investment Fund may invest in securities for which market fluctuations are expected to occur. The investment performance could, and probably will, include both gains and losses.	This is a growth option focused on generating growth in the underlying securities and not on generating income; there should be an expectation that principal fluctuations will occur. It is also possible to combine the third and fourth options.