



**PRESENTATION ON PENSION
REFORMS BY
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Pension Reforms - Basic Concept

Article 38(c) of the Constitution of the Islamic Republic of Pakistan stipulates that the State shall provide for all persons employed in the service of Pakistan or otherwise, social security by compulsory social insurance or other needs. While the system of compulsory social insurance has not so far been introduced by the Government for all the persons employed in the service of Pakistan excepting the Group Insurance Scheme administered by the Establishment Division; entitlement for pension & gratuity has been provided in Section 19 of the Civil Servants Act, 1973. That Section is reproduced as under:-

Pension & Gratuity.- (1) On retirement from service, a civil servant shall be entitled to receive such pension or gratuity as may be prescribed.

(2) In the event of the death of a civil servant, whether before or after retirement, his family shall be entitled to receive such pension, or gratuity, or both, as may be prescribed.

(3) No pension shall be admissible to a civil servant who is dismissed or removed from service for reasons of discipline, but Government may sanction compassionate allowance to such a civil servant, not exceeding two-thirds of the pension or gratuity which would have been admissible to him had he been invalided from service on the date of such dismissal or removal.

(4) If the determination of the amount of pension or gratuity admissible to a civil servant is delayed beyond one month of the date of his retirement or death, he or his family, as the case may be, shall be paid provisionally such anticipatory pension or gratuity as may be determined by the prescribed authority, according to the length of service of the civil servant which qualifies for pension or gratuity; and any over payment consequent on such provisional payment shall be adjusted against the amount of pension or gratuity finally determined as payable to such civil servant or his family.

2. The present Pension Scheme was introduced in 1954 in the form of pension-cum-gratuity scheme, 1954 as amended from time to time. Its salient features are as under:-

- **Retiring age 60 years.**
- **Voluntary retirement on completion of 25 year service.**
- **Pension rate (70 % of the last pay drawn) on completion of 30 years service.**
- **If service is less than 30 years, proportionate reduction is made according to**

the following table:-

PENSION TABLE

COMPLETED YEARS OF QUALIFYING SERVICE	SCALE OF PENSION EXPRESSED AS FRACTIONS OF AVERAGE EMOLUMENTS
10	70/300
11	77/300
12	84/300
13	91/300
14	98/300
15	105/300
16	112/300
17	119/300
18	126/300
19	133/300
20	140/300

21	147/300
22	154/300
23	161/300
24	168/300
25	175/300
26	182/300
27	189/300
28	196/300
29	203/300
30 and above	210/300

● Commutation is restricted to 35% of gross pension whereas the remaining is paid in the form of net pension.

3. **BENEVOLENT FUND** This is a kind of a collective welfare fund to which every Federal employee is required under the Federal Employees Benevolent Fund and Group Insurance Act 1969 to pay a monthly subscription at the rate of 2% of pay, subject to a maximum of Rs.155/-. From the Fund, a monthly grant is provided for life to :-

- a) An employee invalidated out of service on Medical Grounds.
- b) His/her spouse if the employee dies while in service or after retirement upto the age of 70 years or to other dependents for 15 years or upto the time the employee would have attained the age of 70 years if he had been alive.

4. **GROUP INSURANCE FUND** Under this scheme, a lump sum financial relief is provided to the bereaved Member/Members of the family if the employee dies during service. Every Federal employee (BPS-16 and above) is required to pay a monthly subscription @ paisa 35 per thousand of Sum Assured to the Fund. However, the contribution on behalf of employees in Basic Pay Scale 1-15 is paid by the Government/employers. As per present pay structure, the minimum amount payable on death of the lowest Grade employees is Rs.70,000. The maximum limit is Rs.520,000.

5. Gratuity

- Qualifying service – Five years or more but less than 10 years.
- Gratuity is equal to one month's pay for each completed year of service.
- In case of in service death/invalidation – Gratuity is 1 ½ months pay for each completed year of service.
- Retirement due to Abolition of a post or replacement by FPSC nominee (Gratuity is 1 month pay for each completed year of service. If service rendered is less than 25 years but more than 10 years).
- Maximum amount of gratuity = Rs. 1,75,000.

6. Family Pension.

- In case of in-service death, the widow / eligible family members get 50% of gross pension plus gratuity equal to 25% of gross pension.

- In case of death after retirement, widow/ members of family get 50% of the pension drawn by the deceased.
- Family pension is admissible for life/ remarriage of the widow/ marriage of daughter/marriage of dependent sisters/21 year sons..
- Dependant disabled/retarded children get family pension without any age limit.

7. **SPECIAL FAMILY PENSION / GRATUITY:** In case of death/disability in course and consequence of government duty the family or the employee is allowed additional pension and gratuity as under:-

Disability Class 'A'/Death.

a) Pension @ 20% of pay subject to a minimum of Rs.500/- and maximum of Rs.3000/- p.m.

(Note:- After death it will devolve on the widow)

- b) Each child with own mother living $2\frac{1}{2}\%$ of pay subject to a minimum of Rs.125/- and maximum of Rs.250/- per child.
- c) Each child without own mother 5% of pay subject to a minimum of Rs.250/- and maximum of Rs.300/- per child. The pension is admissible to un-married daughters and to sons upto the age of 18.
- d) Gratuity equal to six months pay.

Disability Class 'B'

- a) Pension @ 15% of pay subject to a maximum of Rs.2500/- and minimum of Rs.375/-.
- b) Each child with own mother living 2.5% of pay subject to a maximum of Rs.125/- and minimum Rs.250/- per child.

c) Each child without own mother 4% of pay subject to a maximum of Rs.400/- and minimum of Rs.200/- per child.

Disability Class 'C'

Pension @ 15% of pay subject to a maximum of Rs.2500/- and minimum of Rs.375/-.

8. HEALTH FACILITY AT GOVERNMENT EXPENSE EXTENDED TO RETIRED GOVERNMENT SERVANTS.

Retired government servants are entitled to medical treatment (both indoor and outdoor) at government expense at par with the facility available to the serving government servants. They are also allowed facility of reimbursement of medical charges.

9. **GENERAL PROVIDENT FUND SCHEME ON CONTRIBUTORY BASIS.** Government servants are required to contribute to General Provident Fund on prescribed rates. Against their credit in the fund, they have the facility to get an advance refundable in installments from their pay. Facility of a non refundable advance to the extent of 80% of their balance in the fund is also available to them on attaining the age of 45 years and 100% on attaining the age of 50 and 55 years. The balance amount at the time of his retirement is paid to him alongwith any interest accrued thereon. However, an option is available to a government servant as to whether he wants to receive interest on the amount contributed by him or not. In case he opts not to receive interest, he is given the facility of interest free house building/conveyance advances.

10. **ISSUES:** (1) Pakistan's present pension scheme for its public servants is a Defined Benefit in nature. Pension is determined as a percentage of final salary and length of service. There are no contributions to the scheme and is maintained on an unfunded basis that is presently there is no Pension Fund. The expenditure is exclusively financed by the Government of Pakistan by obtaining a provision in the yearly budget for this purpose. There is a need to establish a separate National Pension Fund to provide for regulatory frame work.

(2) The objective of the scheme is to (i) attract workers to service by offering a reasonable compensation package after retirement and (ii) to assure that on retirement they will not experience any drastic reduction in their monthly income. While this objective is welfare-oriented, there is now a strong need for contributions from the Government servants towards their pension, because the resources of the country are not abundant

to entirely finance the expenditure on account of government pensions from the national budget. This is a collective Welfare Fund to which every Government servant should now pay a monthly subscription.

(3) The cost of pension has increased sharply from Rs.14.6 billion in 1993-94 to about Rs. 40 billion in year 2002-03, as more and more workers are retiring and the number of pensioners is rising. According to figures in year 2003, there were two pensioners for every three workers than workers. Pension spending now consumes more than one tenth of the tax revenues.

Vital Statistics for the Government Pension Scheme as of 30 June 2003. Please see also increasing pension cost for the year 1993-2004.
(Rs. In millions)

	Workers	Total	Pensioners		Pension as %age of Pay & allow
	Number		Number	Total	
Federal Government		Pay & allowances		Pension Expenditure	
Federal Government (including Rangers & Coast Guards)	221,932	25,612	148,261	4,691	18.3%
Civil Armed Forces (FC etc)	65,000	3,790	58,500	1,276	33.7%
Sub Total	286,932	29,402	206,761	5,967	20.3%
Armed Forces					
Armed Forces – Personnel	602,690	47,417	951,866	30,723	64.8%
Armed Forces – Civilians	197,530	9,176	126,372	2,730	29.8%
Sub Total	800,220	56,593	1,078,238	33,453	59.1%
Civil Pension Scheme	419,462	34,788	274,633	7,421	21.3%
Military Pension Scheme	667,690	51,207	1,010,366	32,000	62.5%
Grand Total:	1,087,152	85,995	1,284,999	39,421	45.8%

Further, there are inequities inherent in the current system; the important ones are briefly discussed below:

(4) Certain allowances are not counted towards the calculation of pension such as House Rent allowance, conveyance, utilities etc. A target benefit of 70% of pensionable pay comes to about 45% of take home pay. The cost of pension could have been much higher if these allowances were counted in the calculations of Pension.

(5) The Government servants who get retirement at early ages continue to receive pension for a long time ranging from 40 to 60 years and become a source of burden on the national exchequer on long term basis. Currently there is no adjustment in pension for workers who retire early to take care of the fact that pension will be paid for a longer time period than those who retire at superannuation. Further pension is paid on completing a minimum of 25 years of service. A worker who quits the service after 25 years gets substantial pension, while if he leaves service before

completing 25 years of service, say at 24 years, he is denied any pension benefits. There is a need to prescribe a minimum age, say 50 years, before which pensions may be earned but not received. Such pensioners may be given an option either to receive gratuity at the time of their retirement equal to one month's pay for each completed year of service or receive pension after they attain the age of 50 years.

(6) The increase in pension is allowed to make up for the increase in cost of living; it is given on an ad hoc basis. There is no commitment on the part of government for pension indexation, no regular reviews are carried out and there is no formula to determine the scale of increase. These ad-hoc increases and the current indexation policy have led to inequity among old and new pensioners. Further the practice to wait for a few years and then announce the pension increase works against the pensioners. Resultantly, their value of pension has deteriorated over time, especially for old

pensioners (retirees prior to 1994).

From 1973 to date the Government has, increased pension on 17 occasions and gave indexation in pension on four occasions mainly to old pensioners, who had retired at a very low gross pension which have not been able to stop erosion in the income levels of the old pensioners.

(7) The disparity has further increased owing to the periodical revision of pay scales alongwith ad-hoc increases in pension drawn. In order to make up this gap between the rate of pension admissible to the old and new pensioners, increases were given in the past which were based more on perception than analysis and had little or no correlation with the changes in the pay scales. The result was that disparity in both gross and net pensions continued to rise.

While it is a desirable objective to completely eliminate disparity among pensioners of the same rank, it is not possible to do so at one go because of the complexity of the task and financial implications involved.

(8) One method suggested by a number of service groups and individuals for equalizing pensions is to adopt a "one rank-one pension" scheme irrespective of the date of retirement and last pay drawn. It however is not advisable to adopt it across the board for all pensioners. Firstly the concept of rank cannot be clearly defined in the existing complex administrative system as there are a large number of pay scales and designations. Furthermore pension is appropriately a function of the pay drawn and number

of years of service rendered and it is not justifiable that the same pension be allowed to two officers who retired at different rates of pay after having put in varying years of service in Government. This is a very vital issue, which needs immediate attention of Government of Pakistan. The logical method for equalizing pensions is a complex formula which involves the notional fixation of pay, of old pensioners, in the current pay scale and then adopting the same formula for calculating their pensions afresh on the same basis as for serving employees who are due for retirement. This would bring the past and present pensioners on a common platform and all can then be treated on an equal footing. This procedure would, however, require the availability of records of all old retirees and it would take considerable time for revision of the old cases. The most daunting reason however is the financial implication involved which would be very substantial.

9. Commutation Issues:

- More than 40% of pension expenditure each fiscal year is spent on commutation, which only benefit the new retirees (about 6% of total pensioners).
- Commutation factors are not based on fair assumptions, and ignore, for instance, the time value of money. Further the factors benefit early ages, which are much higher than the fair values; however, at ages close to retirement age or at 60 years, the factors are lower than the fair values.
- Higher commutation percentage means lower pension in future, which is not in lines with the original objective of preserving the standard of living.

10. **Recommendations:** (1) The Pay & Pension committee of 2001 took notice of the above issues, and recommended a number of changes to pension scheme / rules that were subsequently implemented. It also recommended that for new entrants a new (Defined Contributions) DC system should be considered. Since then the government has been taking different actions and initiatives to appropriately consider and evaluate different proposals for reforms. In year 2002, Cabinet decided that a Contributory Pension Scheme be introduced for employees entering the service after a set date.

(2) In the light of the Cabinet decision and as part of a comprehensive reform to improve financial management in the country the Federal government established an Actuarial Office (AO) under the Ministry of Finance (MoF) towards the end of 2002. The AO took up the challenge of estimating the existing liability on account of pension schemes and proposing different options to reform the pension scheme.

- (3) In 2004, government created a special Pension Reform Working Group (PRWG) to evaluate the different proposals and to develop recommendations for reforming the pension system in the country, with members from the Ministries, Actuarial Office. PRWG submitted report to the Pay & Pension committee in March 2005.**
- (4) On the basis of recommendations of the PRWG, studies of the Actuarial Office and the deliberations of the Pay & Pension committee of 2004, the government has now been contemplating to introduce a Defined Contributions (DC) scheme, applicable only to workers joining the service after 1st July 2006.**
- (5) To introduce the Contributory Pension Fund Scheme for the new entrants, Actuarial Office has submitted reports / made presentations, from time to time, evaluating various Pension Reform Options, along with the cost projections.**

- (6) To reform the existing Pension Scheme for the existing employees, parametric reforms were proposed alongwith the rationale for each parameter and cost projections. The Government of Pakistan considered these recommendations at the time of the finalization of the Budget proposals for the FY 2005-06 and keeping the affordability and other factors in view only reduced the commutation percentage by 5%.
- (7) Decisions on the proposed options in regard to new entrants have yet to be taken. In case any changes in the proposed options are to be made, fresh pension cost projections will have to be prepared.
- (8) Implementation of parametric reforms may be relatively simple, with a very little Actuarial input like the Actuarially fair commutation tables, fair early retirement penalties etc. However, for the implementation of Contributory Pension Fund scheme (systemic reforms), significant work needs to be done like basic

infrastructure including record keeping, capacity building in government and the following arrangements:-

- i) Institutional arrangements, preparation of legal framework and Rules & Regulations for Contributory Fund Management and record keeping.**
- ii) Contribution level for employees and employer.**
- iii) The investment strategy for managing the Fund.**
- iv) Preparation of parameters with different options.**
- v) Circulation of scheme with different options among stakeholders and other experts for comments and preparation of draft of final scheme.**

(9) In this connection, the Pay & Pension Committee constituted a sub-committee with representatives from Actuarial Office, Finance Division and Private Sector. The sub-committee reviewed the existing pension system keeping in view the recommendations of Actuarial Office and working group on pension reforms. The sub-committee have recommended (these recommendations are part of the Pay & Pension Committee report) following reforms in the existing pension system both for civil and Armed Forces personnel to be implemented in two phases with the premise that existing pay scales are increased by 40% (The GOP, however, increased the basic pay scales by 15% and also allowed 15% Special Relief Allowance given from 01-07-2003 and 15% ad-hoc relief given from 01-07-2004 to continue to be drawn at frozen level as on 30-06-2005):-

i. I. First Phase (2005-06)

a. Civil Servants-Existing Employees:- The recommendations of the Pay & Pension Committee given for the first phase and comments thereon are given as under:-

Recommendations

Comments

➤ For normal retirement the Accrual rate will be 2.2 for each year of service.

Proposal is supported - Since the existing accrual rate is 2.33 per year, its reduction to 2.2 per year will cause a reasonable amount of savings.

➤ The maximum pension will be 70% which will be earned after 32 years of service.

Supported.

➤ The pension will be based on the last drawn pay. The pay being defined as at present.

Supported.

➤ For employees leaving before the age of 60 years, the accrual rate will be 2.0% and the pension will be actuarially reduced.

Supported. The reduction percentage will be 3.5% for each year less than the age of 60 years from the age at early retirement, subject to the maximum reduction percentage being 50%. This means that an employee

retiring at the age 50 years after completing 25 years of service, will get his gross pension based on the accrual rate of 2.0% per annum, reduced by 35% (Age 60 minus age 50 is 10 years and this multiplied by 3.5% gives reduction factor as 35%).

➤ The Commutation will be allowed up to 30% of the gross pension.

➤ As from FY (2006-07) the annual increase in pensions

The Government of Pakistan has already reduced it from 40% to 35%. Further reduction not recommended.

Recommended. The representatives from the

will be indexed to CPI. The increase being 60% of CPI, subject to maximum increase being 10%. For this purpose the CPI of the immediately preceding calendar year will be used.

ii. Second Phase

The Actuarial Office will make efforts to collect further data and will submit recommendations after detailed study, on some of the following proposed parametric reforms to be

World Bank have also supported it.

These may be examined by the new Actuary as and when appointed.

adopted in second phase:-

- **Commutation Factors to be determined on sound actuarial basis.**
- **Gradual reduction of the current accrual rate to 2.0% for Civil Servants and 2.5% for Armed Forces for normal retirements.**
- **Pay for pension purposes to include certain allowances to move towards more fairer pensionable pay base.**

- **Changes in the accrual rate corresponding to any changes in the pension able pay base.**
- **Benefits in the form of lump sum to employees leaving service voluntarily after 10/15 years of service before the age of 60 years for Civil Servants. Presently no benefit is payable.**
- **Merging of GPF, Group Insurance and Benevolent Fund Systems into one package of retirement benefits System on contributory or non contributory basis.**

New Employees

New employees will be covered under a new Defined Contributory Benefit Scheme w.e.f. 01-07-2006. For the new scheme a study is to be undertaken by the Actuarial Office to make recommendation about (i) institutional arrangements for legal oversight for Pension Fund Management and for record keeping, (ii) contribution levels for employees and employer; and (iii) the investment strategy for managing the Pension Fund.

What then must we do now? - Main Issues and the decisions required to be taken thereon.

	Issues	Comments of the Regulations Wing
1.	A new Actuary is required to be recruited to complete the unfinished work of the Actuarial Office.	The post has been advertised to recruit a suitable person.
2.	<p><u>For the New Employees:</u></p> <p>What would be the salient features of the Defined Contributions Scheme for the employees joining service on or after 1st July, 2006 – (i.e. the Systemic Reforms)?</p>	<p>In order to ensure equity and justice, the benefits admissible under the Defined Contributions Scheme must be comparable to the present pension scheme of the Government. The Actuarial Office has estimated that if a contribution equal to 25% of the pay is made and invested and which yields a real interest rate of 3% then the accumulation at the end of service would be enough to generate annuities that would be comparable to 70% of the pensionable pay i.e. it would be just equal to the benefit admissible under the current scheme.</p>

3.	<p>Who would contribute and at what rate? Whether the government or the employee or the both.</p>	<p>Normally the sharing of the contribution should be on 50:50 basis. GOP's contribution can be on notional or actual transfer basis. In order to reduce future liability, GOP's contribution should be on actual transfer basis.</p>
4.	<p>Should the government increase the pay of the new employees to cover the cost of contribution and whether simultaneously it would be mandatory to retain the GP Fund Scheme?</p>	<p>The principle of justice and equity demands that the pay of the new employees be increased to cover the cost of employee contribution. With the introduction of the Contributory Pension Scheme, the government may consider either abolishing the General Provident Fund scheme or may consider removing the condition of mandatory contribution in the General Provident Fund Scheme.</p>

5.	<p>Would the scheme offer assured or variable returns? Would the pensioners face the risk of getting a low return or suffering a loss?</p>	<p>Normally the Defined Contribution Schemes do not guarantee any assured returns and the pensioners may get a low return or even suffer a loss but if the funds are well invested, the benefits can increase manifold.</p>
6.	<p>Would the government provide guarantees against the invested funds?</p>	<p>The government may not offer the guarantees but may put in place a transparent arrangement of (i) reporting regular investment (ii) portfolio performance updates (iii) choice of portfolios with low risk low return and higher risk higher return (iv) option to choose asset manager and (v) employee representation on the Board of Directors. Alternatively the GOP may consider assuring the all concerned that there would be a 3% real return on investment, but if the fund does better than the ceiling, the government would keep the difference or the government may guarantee a low floor - that the return will not go below say 2.5%, but if the fund does better, the account holder would keep the difference.</p>

7. What type of governance arrangement would be put in place for the investment of all contributions into individual pension accounts?

A Pension Authority may be established with a clear mandate to oversee either the only government pension scheme or the entire pension sector. If this is not considered feasible a lean organization that relies on AGPR for contribution record, and asset management entities may be established which may cover only the pension of the Federal Government employees.

8. Would the pension be portable – can the employee take the scheme elsewhere if he leaves the federal government employment earlier?

Normally, there should be no objection to it but these features may be fine tuned around the basic model that will emerge from the above decisions.

9. Would the above guarantees /arrangements of the government make the scheme successful.

The government may only ensure that the pension accumulation is used to purchase an annuity and for this purpose may strengthen the insurance and annuity sector and the SECP may draw up a long to medium term plan in consultation with the Ministry of Finance in this regard. Once this is done, the government should have no further liability.

Parametric Reforms Package for the existing employees:

The current commutation table, which encourage younger employees to get pension on higher rate may be made actuarially fair and the concept of pension adjustment may be introduced for early retirees. Indexation of pension may be introduced and balanced by the following provisions:-

- (a) Reduce the level of commutation to 25% which would ultimately help to protect the pensioners life style and regulate the trend of consumption after retirement through higher annuity payments.
- (b) Service required for full pension be increased from 30 to 32 years.
- (c) Some system of gratuity for service between 10 to 24 years may be introduced so that the people who have lost interest from government service do not hang on till 25 years just to earn pension.

Thank You...