The Anguilla House of Assembly

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Public Accounts Committee

The medium to long term financial sustainability of social security arrangements

Third Report of the Public Accounts Committee

Published on 3 December 2019 by authority of the Anguilla House of Assembly

Summary

The Anguilla Social Security Board (the Board) does not have a well-developed financial strategy to secure the long-term financial future of social security arrangements. While its actuarial model appears sound in that income continues to exceed costs, this is at a declining rate and there are as yet no plans to increase income generation. This does not constitute a long-term financial strategy.

The Board underestimates the potential financial implications on pensions of the difference between the reserves of the Fund and the actuarial present (or expected) value of future benefit obligations. This means it has not considered the risk of under-providing for pensions in the long run.

The Board continues to ignore warnings from its Auditors about the risks associated with the geographic concentration of its investments. We are concerned about the risks of another hurricane or other crisis on those investments, and about the Board's ability to manage the Fund through changing economic and social circumstances and not blame those circumstances for its failures. We expect the Board to explore alternative opportunities for its investments outside of Anguilla.

The Board is overly reliant on a favourable outcome from the purchase in 2010 of the Cinnamon Reef property by its subsidiary ASSIDCO in partnership with the Government. This is particularly myopic given that the Government has indicated it is no longer interested in the lease agreement and the market for that type of

property, should it decide to sell, is limited. This is an unsustainable investment for which the returns so far have been a cost to ASSIDCO.

The Board should increase the transparency of its decision-making processes and post-project evaluation of funding allocated by the Social Development Fund. There should also be a limit on the proportion of that funding which can be allocated to government departments and projects closely allied to the work of a government department.

Chapter 1: Introduction

1. The Anguilla Social Security Board (ASSB) (or, the Board) has overall responsibility for the system of national insurance to provide for the security of workers and their families. Created in 1980, the Board is appointed by, and reports to, the Finance Minister. Social security is financed through contributions paid into the Social Security Fund by employers and employees. The Board invests this income to generate investment income and pays out long and short-term benefits from it. For the social security arrangements to be sustainable in the long term, the Board must ensure that those investments receive a rate of return to meet the anticipated future demand for benefits.

2. The purpose of this inquiry is to determine whether the current social security arrangements are financially sustainable in the medium to long term. The terms of reference were to examine:

- The financial strategy of the Anguilla Social Security Board, and the cost and demand pressures on that strategy;
- Potential changes to pension contributions in the medium to long term;
- The implications of the Government's debt of $214 million on the financial standing of the Anguilla Social Security Board;
- The current financial position of ASSIDCO and plans to remedy the impasse with the Government; and,

- The decision-making process for funding projects under the Development Fund and the post-project evaluation of those projects.

The figures in this Report are all in Eastern Caribbean Dollars and are taken in the most part from the 2016 draft financial statements of the ASSB.[1]

3. The Committee took oral evidence on 5 November 2019 from the Permanent Secretary Finance, Dr Aidan Harrigan, the Director of the Social Security Board, Mr Timothy Hodge and the ASSB Actuary, Mr Hernando Perez Montas. We are grateful to them for their time and their cooperation with the inquiry. We would like to thank all those who have helped in the production of this report including the Chief Auditor, his team and the transcriber Ms Carla Ritchie. We are also grateful to the Commonwealth Parliamentary Assembly for its continued support for the Public Accounts Committee and for providing interim staff to help the Committee carry out its remit. We extend our thanks to Dr Anna Dickson who has been seconded to us from the UK House of Commons for her excellent work and support to the Committee.

[1] Anguilla Social Security Board, Draft consolidated financial statements 31 December 2016. Not yet published or laid before the House of Assembly. These were the most recent financial statements available at the time of writing.

Chapter 2: Financial strategy

4. The Anguilla Social Security Board is a statutory body established in 1980 by the Social Security Act, Revised Statutes of Anguilla Chapter S45 (R.S.A.c.S45) to administer the Social Security Fund with the objective of providing various insurance and retirement benefits to persons described in the Act. [2] The Board invests its income in the Social Security Fund from which long term and short term benefits are disbursed namely: long term benefits branch, short term benefits branch, Social Security Development Fund and its Reserve Fund.

5. We asked the Director of Social Security whether the Board had a financial strategy which sets out the organisation's medium and long-term goals. We wanted to know how the Board planned for the future, taking into account current and predicted trends in the economy and society.

6. Mr Hodge told us the financial strategy was to collect all the revenues due, pay meaningful benefits on time, and prudently invest surplus funds and administer the social security system efficiently.[3] The Actuary Mr Perez Montas, carried out a review every three years to ascertain the adequacy of the statutory contribution rate and to quantify the projected level of reserves.[4]

[2] Draft Financial Statements 2016, p 13
[3] Oral evidence, Mr Hodge, p 4, lines 6-11
[4] Written Evidence SS1 Montas

7. In response to questions about cost and demand pressures, we were told that the Board considered the following:

- Changing demographics—an ageing population;
- Incidence of illness—more people leaving the workforce early for health reasons;
- Changes in the job market—lower wages meant lower contributions; and,
- Migration—migrants did not always stay long enough to claim benefits.[5]

Mr Hodge explained that as a result of the first three factors the Board was paying out increasing long-term benefits while contribution levels had fallen. We were also told that external events had a negative effect on the Board's financial situation. In particular, the 2016 Banking Crisis led to lower interest rates on the Board's investments, which had therefore not yielded expected returns, and Hurricane Irma had negatively affected employment.

8. Mr Hodge insisted that the actuarial system was performing well despite the pressures identified because income from contributions and investment still exceeded its expenditure in terms of benefits paid and administrative costs.[6] He said he was confident that the system would be able to meet changing

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[5] Oral evidence, Mr Hodge, p 5-6
[6] Oral evidence, Mr Hodge, p 7

demands on both short and long term benefits.[7] Mr Montas said he too was confident that in the medium term there was no need to adjust current contribution rates.[8]

9. What we did not hear was how the Board responded to such external events or how it planned to take account of demographic or other internal demand pressures, an ageing population for example. Two issues concern us greatly and are discussed in the following chapters:

- The increase in payments from the long-term branch with no corresponding increase in income or plans for such; and,
- the Board's reliance on income from investments—which has declined—and is heavily dependent on the Government's ability to honour its financial obligations to the Board.

10. **In seeking evidence of a well-developed long-term financial strategy, we expected to be told about how the Board was making provision for the future, taking account of known and anticipating potential factors and pressures which might cause it to revise that strategy. While the actuarial model presented to us appears to be sound, it does not constitute a long- term financial strategy. Moreover, it appears to take account only of the next few years. This is short-sighted in view of the (1) evidence discussed later in this Report about the over-reliance on investment income from Anguillan sources, the returns for which there**

[7] Oral evidence, Mr Hodge, p 12, lines 7-13
[8] Oral evidence, Mr Montas, p 23, line 4

is no reason to feel confident, and (2) the possibility of another hurricane or financial crisis which would further decimate contributions. It is not obvious to us that management can lead the Board through changing economic and social circumstances and not blame those circumstances for its failures. *The Board must develop and publish an evidence-based long-term financial strategy within the next six months.*

Chapter 3: Potential changes to pension contributions

11. The Board allocates 81.25 per cent of its income from contributions to the long-term branch from which it pays Age, Disability and Survivors Pensions and Grants and the Non-Contributory Old Age Pension. The system for the long-term branch is based on a contribution rate which is fixed at a level so that the income from those contributions and investments will exceed expenditure on benefits and administration. This excess is accumulated in a reserve fund that should increase steadily, but which will decline over time in the absence of any adjustment to the contribution rate. The contribution rates have stayed at the same level since the inception of that system 37 years ago. This has been possible because investment and contribution income have continued to exceed benefits paid out and the administrative costs of the system.[9]

12. However, looking at the draft 2016 financial statements, income for the long-term benefits branch, from which pensions are paid, decreased from $38 million in 2015 to $35 million in 2016. Over that same period, expenses for this branch have increased from $21 million to $27 million. While income continues to exceed expenditure, it is doing so at a declining rate—net income fell from $18 million to $8 million during that same period.[10]

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[9] Written Evidence, SS3 Mr Hodge, p 1

[10] Draft financial statements 2016, p 10. All figures in this paragraph have been rounded to the nearest million.

13. Moreover, the auditors for the Board consider that the pension plan is exposed to several risks including:

- "Investment risk: movement of discount rate used (high quality corporate bond or regional investments) against the return from plan assets.

- Interest rate risk: decreases/increases in the discount rate used (high quality corporate bond or regional investments) will increase/decrease the defined benefit obligation.

- Longevity risk: changes in the estimation of mortality rates of current and former employees.

- Salary risk: increases in future salaries increase the gross defined benefit obligation."[11]

14. The 2016 draft financial statement highlights a difference of $148,892,323 (2010: $121,113,528) between the reserves of the Fund and the actuarial present value of actual benefit obligations and a difference of $357,740,690 (2010: $376,741,744) between the reserves of the Fund and the actuarial present value of projected benefit obligations. This means that the current reserves of the Fund are less than the cost of current and projected future pensions obligations.[12]

[11] Draft financial statements 2016, p 42
[12] Draft financial statements 2016, p 42

15. Written evidence from the Actuary, points out that Hurricane Irma in 2017, and the demise of the local banks in 2016 "restricted the progression of contributions and investment income."[13] As a result the reserves had not increased as planned. Worryingly, Mr Montas also said that for high income contributors the Social Security Fund would not be able to guarantee those people the same standard of living when they retire as in their working life.[14]

16. Mr Montas said that in the long term, this potential shortfall would need to be compensated for by future adjustments to the contribution rates by employers and employees.[15] The next opportunity to determine that would be at the end of 2019 when the Actuary would undertake his triennial review of the scheme. However, Mr Montas told us he did not expect to recommend any adjustments within the next five to seven years, assuming inflation remained low.[16]

17. **Designing a resilient pension system requires a long-term perspective. Contributions and investment returns need to be built up over a period to ensure reliable flows of consumption are possible in old age. Recent set-backs such as the banking crisis and Hurricane Irma have resulted in reduced income and contributions to the Fund. As a result, net income and reserves have both decreased.**

[13] Written Evidence, SS1 Montas, p 1
[14] Oral evidence, Mr Montas, p 21 lines 24-25
[15] Draft financial statements 2016, p 42
[16] Oral evidence, Mr Montas, p 19, line 10

18. **Given the decline in net income, and the difference between the reserves and the actuarial value of present and future benefit obligations, coupled with the risks outlined by the auditors to the Board, we would expect more clarity about how the Board's plans support pensions requirements in the long term or how it might weather future national crises.** ***As part of its long-term financial strategy, the Board should reconsider (1) the performance of its model and (2) its income generating activities (investments) without prejudice to existing contribution rates. The Social Security Board should also examine the implications of the risks outlined by the Independent Auditors in its own accounts and determine how these can be mitigated against in order to attain its long-term objectives. The pension system must ensure that people who are working now can be confident that they will be able to maintain a decent standard of living in their retirement.***

Chapter 4: Loans to the Government

19. In 2010, the Government borrowed $50 million from the Social Security Board. This loan was for a period of 10 years and will end in November 2020. The Government assured us it was on track with the repayments on that loan.[17]

20. In 2016, as part of the resolution of the banking crisis the Government made a commitment to make good on $214 million of social security investment funds which had been invested in the local banks and was lost when those banks collapsed. The interest on that promissory note is being paid according to the schedule and the principal becomes due in June 2021. In April 2018 the Government told us that it was refinancing the note and that it hoped the funds would be restored by July of that year.[18] In our evidence session in November 2019, the Government made the same suggestion but provided no evidence of progress on that matter, saying instead that it was proving difficult to find a buyer interested in the full amount over the period of the loan.[19]

21. In addition to these sums, there was an outstanding amount on term deposits and interest receivable of $1.862 million which had not been properly accounted for in the passing of the Banking Resolution Obligations Act. This had not yet been accounted for by the Government of Anguilla. In total

[17] Oral evidence, Mr Hodge, Dr Harrigan, p 49

[18] Oral evidence taken before the Committee in April 2018. The same intention is repeated in the Government Medium Term Economic Financial Plan 2018-20, p 22

[19] Oral evidence, Dr Harrigan, p 28, lines 14-25

therefore, the ASSB is owed $273 million by the Government which represents 73 per cent of its gross financial assets.[20]

22. Mr Montas' view was that “investments in government loans and bonds seems attractive” and he maintained that this situation should not have a “negative incidence on the financial standing of the ASSB”.[21] In contrast, the Independent Auditor’s report on the draft 2016 financial statements for the ASSB cautioned:

> "In view of this, the Group is exposed to significant related-party concentration and might face significant uncertainty in the collection of these financial assets based on the Government of Anguilla and the country’s current and future economic viability and financial condition. This could also materially impact the Group’s liquidity, financial position and performance should Anguilla encounter financial difficulties."[22]

23. Mr Hodge told us there was much back and forth between Government and the Board on the issuing of the promissory note. The Board had its own legal counsel which had been consulted. Mr Hodge did not consider the final agreement to be unusual or contentious, and commented that while a three

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[20] 2016 draft financial statements, p 3
[21] Written evidence, SS1 Montas, p 2
[22] 2016 Draft financial statements, p 3

per cent interest rate might have seemed low at the time, it had turned out to be a good rate in the current low inflationary environment.[23]

24. Nevertheless, the promissory note means that a substantial part of the Board's investments is tied up with the Government, reducing its independence from that organ. This has led the Independent Auditor to express concern about related-party concentration. Mr Hodge acknowledged that a resolution—for example via refinancing—would reduce the concentration of the Board's investments[24] and place the Board on a more secure footing.

25. **We are persuaded that the Government intends to repay the monies owed however we are not confident that it has the means to do so, and it does not appear to have a plan of action. This is worrying—not least because it has resulted in a significant proportion of the Board's investments being tied up with the Government of Anguilla.** ***While repayments of the principal are not due to begin for 18 months, given the lack of progress on the sale of the debt, the Government must begin to actively plan for how it will meet its obligations and ensure provision is made in the budget for 2021 and onwards for those repayments.***

26. This related party concentration of investment and reliance of the Government to secure those investments should be of concern to the Social Security Board. A similar reliance on non-performing loans, and

[23] Oral evidence, Mr Hodge, p 25

[24] Oral evidence, Mr Hodge, p 32

in related-party concentration was a significant contributor to the collapse of the indigenous banks in Anguilla in 2016. It is myopic to treat a debtor as a good investment when they have a long record of not being a good debtor. This places the Board in a shaky financial position.

27. Anguillans make contributions to social security to help guard against the vagaries of the economy. They want to be certain that they will be provided for if they fall ill or lose their job and when they retire. The current situation leaves those people's future security heavily exposed to the economic well-being of the country. There is a potential conflict of interest with such a close relationship between the economic well-being of the Fund and that of the Government. It is a risk which we urge to Board to address and proactively manage.

Chapter 5: ASSIDCO and Cinnamon Reef

28. ASSIDCO, a wholly owned subsidiary of the Board, and the Government entered into a lease and purchase agreement for Cinnamon Reef property in 2010. The property was purchased by ASSIDCO through a loan from a local bank and guaranteed by the Social Security Board. The lease and purchase agreement provided that the Government of Anguilla lease the property from ASSIDCO for a period of 10 years for a monthly rent of $300,000. Within the said period, the latter committed to purchase the said property at an agreed price of $20,250,000.[25]

29. Nearly 10 years later the Government has not paid any of the lease income to ASSIDCO. According to the draft 2016 financial statements for the ASSB, at the end of December 2016 the outstanding lease income receivables from the Government of Anguilla was $25,200,000. [26] In his oral evidence Mr Hodge said it was somewhere in the region of $30 to $32 million now.[27]

30. The Government advised ASSIDCO in May 2011 that it was no longer interested in the acquisition of the Cinnamon Reef and therefore did not wish to continue with the lease and purchase agreement. This failure to make any payments to ASSIDCO has put a strain on the cash flow and financial performance of that company.[28] As a result, the Auditors note that ASSIDCO incurred a net loss of $87,619 for the year ended 31 December 2016 (2015:

[25] Draft financial statements 2016

[26] Draft financial statements 2016

[27] Oral evidence, Mr Hodge, p 45, lines 12-16

[28] Draft financial statements 2016, page 13

$110,078) and as of that date ASSIDCO's accumulated deficit amounted to $16, 163,266 (2015: $16,075,647).[29]

31. In April 2018, we asked the Director of Social Security about the Government's failure to honour its obligations regarding Cinnamon Reef. Mr Hodge told us he was seeking a resolution to the situation. He also told us that there was no major risk of default from the Government because non-payment of the debt did not eliminate that debt.[30] Furthermore, he did not agree with the Auditor that the outstanding amounts placed the Social Security Board in a difficult position financially.[31]

32. In November 2019 Mr Hodge told us he had received an offer on the property. This initial offer was not accepted, and no further progress had been made on selling the property. In his additional written submission, the Director of Social Security confirmed that no external advice was sought on the offer of $9 million, nor had its own investment Committee provided advice on that offer. Moreover, the company which made the offer had since indicated that it was no longer interested in investing in the proposed tourism development on that site.[32]

33. The Permanent Secretary Finance suggested the Government could enter a debt for land swap with the Board.[33] Or that it could agree a settlement amount based on what that investment might have archived in an interest-

[29] Draft financial statements 2016, p 3
[30] Oral evidence 2018, p 165, lines 8-12
[31] Oral evidence 2018, p 160
[32] Written evidence, SS3 Mr Hodge
[33] Oral evidence, Dr Harrigan, p 50

bearing account. The ASSB Actuary told us that there was no active market for that type of property[34] and that the best bet would be for the Board to sell the property at a loss. Under the current situation that property had a negative impact on the Board's financial situation and the Chief Auditor would be qualifying that investment in the next set of audited accounts.[35] The Director of Social Security said the Board did not accept that there was no active market for this kind of property. He said the Board would encourage and assist ASSIDCO to conclude a sale which at least recovered the invested funds.[36]

34. **ASSIDCO purchased the Cinnamon Reef property in 2010, nearly 10 years ago. The Government declared its intention to pull out of the scheme in 2011, with no indication of how it would fulfil its obligations. No progress has been made on selling the property since an offer was received in 2018. The losses incurred and the debt owed thus continue to increase and have a negative financial impact on the Board's balance sheet. The Board's apparent lack of urgency in finding a solution to the current impasse indicates a culture of indifference to financial loss which is worrying.**

35. **As we concluded in the last chapter, this faith in a good solution turning up eventually appears to disregard historic events and the current economic situation.** ***We request the Board to seek external legal advice***

[34] Oral evidence, Mr Montas, p 46, line 2

[35] Oral evidence, Mr Montas, p 46, lines 9-16

[36] Written evidence, SS3 Mr Hodge, p 3

on how best to recoup this debt—including the option of a debt for land swap and report its progress back to us within six months of the publication of this Report.

Chapter 6: The decision-making processes for the Development Fund

36. The Social Security Development Fund was established in 1986 to fund "socially desirable" projects. These include, but are not limited to, projects in the areas of sports, education, culture and health. Some examples include:

- the development of steel pan music in schools
- the launch of the Anguilla Community Foundation to finance philanthropy

The Social Security Development Fund is funded by 3.75 per cent of the contribution income and a percentage of investment income based on balance of reserves at the end of the preceding year.

37. In 2005 the Social Security Board created a reserve fund for which $250,000 is transferred from the Development Fund each year to build an endowment so that the Fund will eventually be able to sustain itself and fund projects from the interest generated by that reserve fund. At the end of 2016, the Social Security Development Fund Reserve stood at $3,250,000.[37]

38. The Board makes decisions about which projects to fund based on:

- If what the proposal addresses is significant and can be measured;
- The applicant has the organisational ability to address the problem;

[37] Draft financial statements 2016, p 6

- If there are other organisations addressing the same need and the best to do this work;
- The organisation has plans in place to ensure that its programs will continue to operate.[38]

The ASSB website further notes that it will not normally fund projects which cost more than $50,000, nor will it fund projects that are typically the funding responsibility of Government.

39. We asked the Director of Social Security about the decision-making processes for the Fund. He confirmed that applicants had to fill in a form to demonstrate they met the criteria. They also needed to identify outcomes. The Board expected a report back from those organisations which received funding. We were subsequently sent one example of such a report.[39] Neither the successful applications, nor the post-project evaluations were published.

40. What was less clear was the criteria being used by the Board to determine, over a period, the distribution of funding between sectors. For example, in 2014, the Fund allocated $153,000 to health-related projects. In 2015, it allocated more than five times that amount—$824,547 for such projects. We were told this was for a CAT scan machine and for the formation of the National Health Insurance Programme.[40] Funding for health services projects subsequently fell back to $254,393 in 2016. Between 2014 and

[38] Social Security Development Fund guidelines, http://www.ssbai.com/misc/SSDF_Guidelines.pdf
[39] Written evidence, SS3 Mr Hodge
[40] Oral evidence, Mr Hodge, p 52

2015, funding allocated to education and to sports development had more than doubled. Education increased again in 2016 to $307,756.[41] In contrast, funding allocated to environmental protection fell from $95, 807 in 2015 to $33,629 in 2016.

41. In response to a question about the $50,000 limit on single grants advertised on its website, the Director told us this was probably out of date, and that it was possible for one organisation to be awarded more than this. [42]

42. **While we do not doubt the social benefits associated with some of the projects funded, the Board's approach to the allocation of funding for projects is unsystematic. As a result, there have been significant differences in funding between the sectors so that some sectors benefit substantially more than others. This may reflect need, and if it does, this should be demonstrated.** ***At present the successful applications and the post-project evaluations are not published. We recommend that the Board put this information on its website in a timely manner so that there is transparency about the process and potential applicants have a good idea about (a) what is required to be successful and (b) the necessity of good post-project evaluations to demonstrate value for money.***

43. We also recommend that the Board consider whether it should be funding the purchasing of critical health care equipment which typically should

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[41] Draft financial statements 2016, p 51

[42] Oral evidence, Mr Hodge, p 36, lines 8 - 15

be the responsibility of the relevant government department, as set out in the Fund guidelines. Similarly, although we do not know the details of the education or sports projects funded, we would not expect these to be for items which the relevant department should be funding from its own core allocation. The Board should place a limit on funding allocated to government departments and projects closely allied to the work of a government department and should update its website accordingly.

Formal minutes

Monday 2 December 2019

Members present:

Ms Palmavon Webster, in the Chair, Mrs Evalie Bradley, Mr Paul Harrigan

Draft Report (The medium to long term financial sustainability of social security arrangements) proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 43 read and agreed to.

Summary agreed to.

Resolved, That the Report be the Third Report of the Committee to the House of Assembly.

Ordered, That the Chair make the Report to the House.

[Adjourned till Monday 16 December at 2.00pm