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Executive Summary

OVERVIEW

The concept of pension as a retirement benefit is new for Bhutan. Until recently, the benefits on retirement were limited to gratuity and a provident fund scheme, which provided lump sum benefits on separation from service. However, lump-sum payments during retirement have been argued as insufficient and disadvantageous as an old age security. These concerns encouraged the Royal Government in initiating changes on the present retirement schemes, which would provide a proper safety net and income security to the salaried employees after exit from employment.

In order to accomplish the changes and manage the modified retirement scheme the Royal Government established the National Pension and Provident Fund Bureau as an autonomous organization on March 30, 2000 under the governance of the National Pension Board. The establishment of the National Pension and Provident Fund Bureau is yet another significant step taken towards the realization of His Majesty the King's noble aspiration of "**Gross National Happiness**".

THE YEAR IN REVIEW

Soon after its establishment, on July 3, 2000, the National Pension and Provident Fund Bureau took over the GEPF operations including the Real Estate operations from the RICB. An asset size of about Nu.1.97 billion was transferred to the NPPFB in the form of fixed deposits, cash and real estate assets from the RICB. Since then, the assets have grown over Nu.2.3 billion with net inflow of funds at around Nu.25 million a month. Consequently, it has now become the largest institutional investor in Bhutan. Despite adverse investment climate and constraints, the Bureau generated a net surplus of Nu.114.3 million for the first year ended 30th June 2001, which works out to a return of about 5% to the members' funds.

It has been an eventful year for the Bureau. Reviewing the present retirement scheme and conceptualizing and formulating a new retirement plan without any institutional memory has been a major challenging task. In its early stages of establishment, its strategy was principally directed towards institutional development and streamlining of GEPF operations. For the NPPFB to be fully functional, the Bureau had to hire new staff, create appropriate administrative systems including refurbishing of computer application to manage GEPF operations, and deal with investments of funds in an adverse investment climate. These have all been accomplished with the support of the Government Working Committee and the Investment Management Advisory Committee and with the overall governance and guidance of both the Interim Board of Directors and the National Pension Board.

FUTURE OUTLOOK

Prior to the establishment of the NPPFB, the Interim Board of Directors and the Government Working Committee with the involvement of the Asian Development Bank had carried out preliminary work on the conceptualization and formulation of pension program. While acknowledging the significant accomplishments of the Interim Board of Directors and the Government Working Committee, much more is required to be achieved in future to introduce and institutionalize the proposed pension plan. The responsibility of institutionalizing the new Pension Plan still vests

collectively both with the Government Working Committee and the National Pension and Provident Fund Bureau under the governance of the National Pension Board.

As we prepare for the launching of the proposed National Pension and Provident Fund Plan, the Bureau is confronted with significant challenges in managing the expectations of the present GEPF members. Expectations are very high particularly amongst the civil servants and many of them are eagerly waiting for the launching of the National Pension and Provident Fund Plan.

To achieve its long-term goals, the Bureau is preparing a master plan stratifying the medium and long-term strategic plans. The Master plan shall include organizational, IT and human resources capacity development incorporating both short and long-term requirements of the Bureau.

Legislation of the National Pension Act will provide legal base for the National Pension and Provident Fund Plan. The Bureau is presently engaged in the drafting of the National Pension Act, which will ultimately be legislated by the National Assembly of Bhutan.

ACKNOWLEDGEMENT

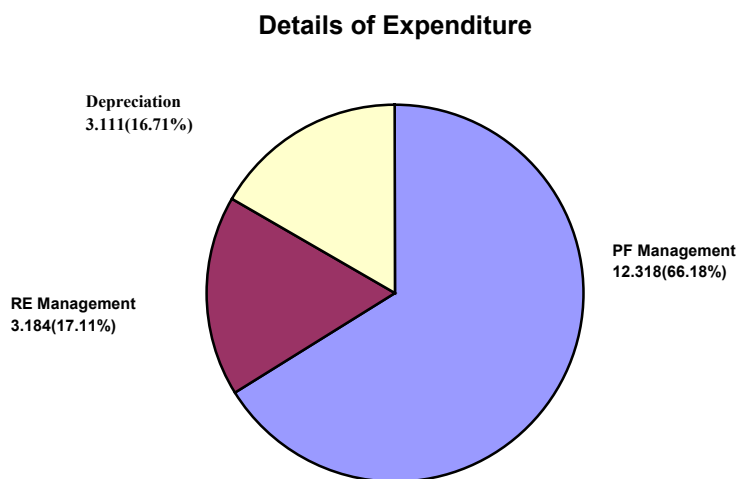
The establishment of the National Pension and Provident Fund Bureau is the result of the initiatives taken by the Royal Government to provide superannuation benefits to the GEPF members on retirement. The Bureau would like to express its appreciation to those individuals and organizations that have made crucial contributions in the preparation of the draft National Pension and Provident Fund Plan. In particular, the NPPFB is grateful to the Asian Development Bank and the UNDP who had been instrumental in the preparation of initial documents for the proposed retirement plan.

Credit for its accomplishments must go to the Government Working Committee, Investment Management Advisory Committee, Interim Board of Directors and the National Pension Board. They have been the sources of guidance and provided overall direction to the National Pension and Provident Fund Bureau. Although it has been into operation for one year only, the Bureau is thankful for enjoying the trust, confidence and co-operation of the members of the Committee, National Pension Board and the Royal Government.

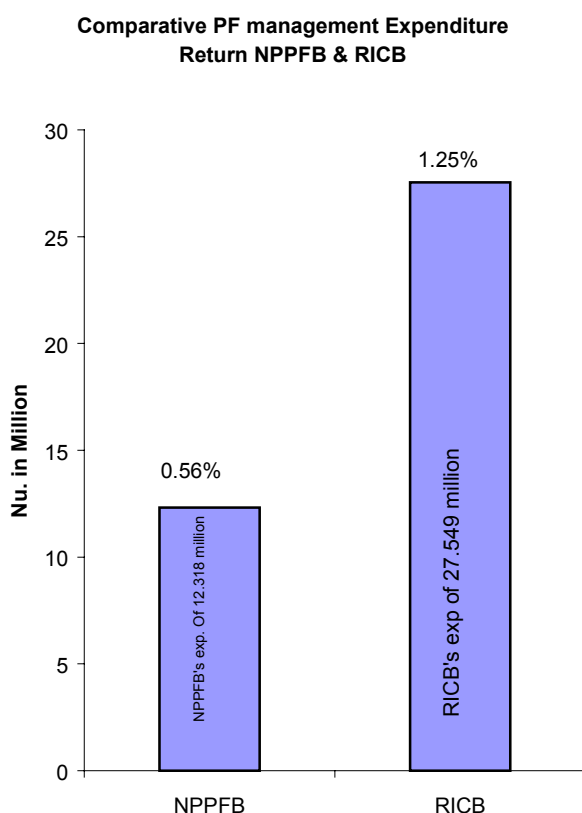
Finally, the smooth take over of GEPF would not have been possible without the involvement of the RICB and the Ministry of Finance. The NPPFB would like to express its appreciation to the management and staff of the RICB for their co-operation and assistance during the handing over of the GEPF. The Bureau is also grateful to the Ministry of Finance for providing overall guidance in taking over of GEPF operation from the RICB.

1 FINANCIAL PERFORMANCE HIGHLIGHTS OF THE YEAR 2000-2001

1.1 EXPENDITURE HIGHLIGHTS



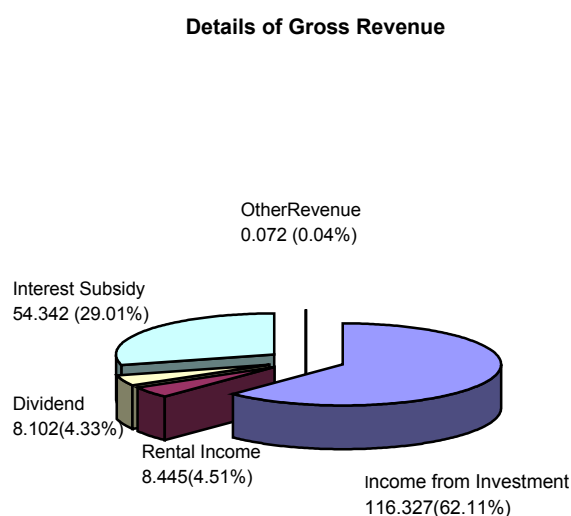
During the first year of its operations, the total expenditure of the Bureau amounted to Nu.18.613 million, which works out to 93 % of the approved budget for the year registering a favorable variance of 7%.



Out of the total outlay, expenditure on P.F. management has been restricted to Nu.12.318 million, which works out to only 0.56% of the investments compared to the management fees of 1.25% that used to be paid to the erstwhile managers of GEPF Fund, the Royal Insurance Corporation of Bhutan. Accordingly, the NPPFB has registered an overall savings of Nu. 15.231 on PF management. Whereas, the RICB had spent Nu 27.549 on the P.F. management, the expenses incurred by the Bureau on the same account amounted to Nu.12.318 million during the year.

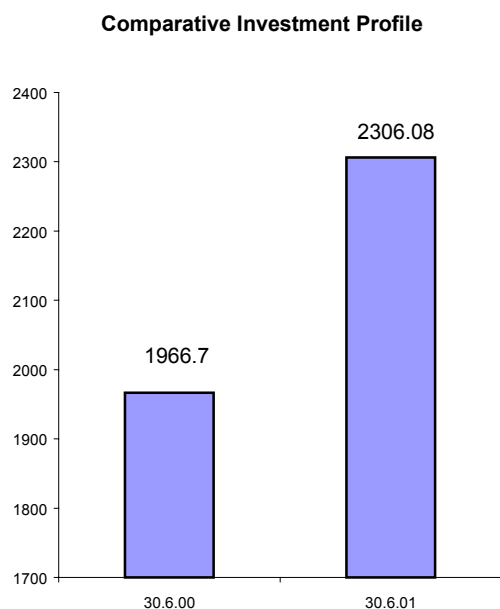
The savings on the management expenditure has been possible on account of efficient management of fund. In spite of a very unfavorable investment climate and NPPFB not enjoying the status of a merchant banker like the RICB, strict control over the expenditure resulted in positive savings in funds.

1.2 REVENUE HIGHLIGHTS



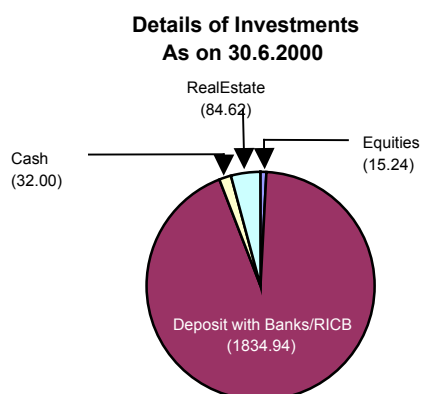
During the Financial year, the NPPFB had generated a gross revenue of Nu.187.288 million, out of which 62.11% came from investments, 29.01% from Interest Subsidy and the balance from rental income, dividend etc. Another important indirect factor that contributed to revenue generation can be attributed to the competent and full commitment of the staff at all levels. The net revenue before interest subsidy accounted to Nu.114.332 million, which is equivalent to 5% (approx.) of the GEPF fund. Such low return is due to very unfavorable investment climate within the country and overall slowdown of global economy.

2. INVESTMENT PERFORMANCE



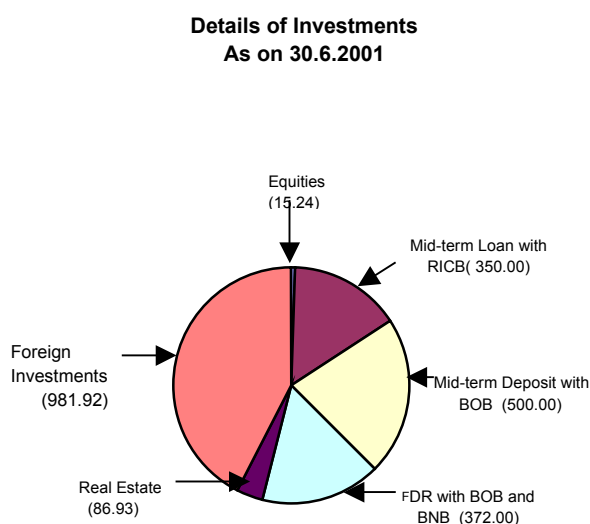
On taking over the GEPF operations commencing from 1st July, 2000, the National Pension and Provident Fund Bureau assumed the fiduciary duty of managing the funds and assets of the GEPF. In managing its investments, the NPPFB's responsibility has been to ensure that optimal investments are made while limiting risk exposures to prudent and acceptable levels. These criteria are an integral part of its investment policies and strategies.

2.1 TAKING OVER FROM THE RICB:



The NPPFB took over a total asset of Nu. 1.97 billion from the Royal Insurance Corporation of Bhutan as on 1st July 2000 most of which were in the form of cash equivalents.

2.2 DEVELOPMENTS DURING THE YEAR:



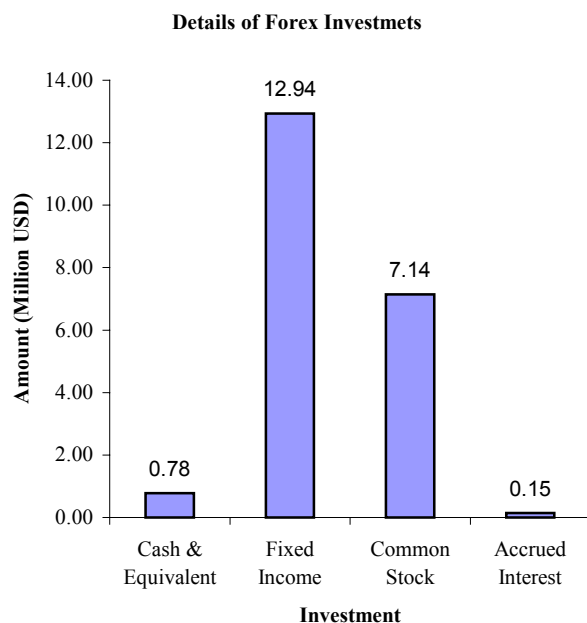
On May 23, 2000, the Royal Government established a 5 member Investment Management Advisory Committee to provide technical advice and direction on the investment decisions of the Pension Fund with the Managing Director of the Royal Monetary Authority as the Chairman.

The GEPF funds were initially kept with the Bank of Bhutan and the Bhutan National Bank at very low yields of 5.5% per annum. With bleak investment climate and opportunities, excess liquidity in financial sectors and underdeveloped capital markets for securities and bonds, investment

avenues are very limited. With the pension fund sustainable rate being well above 8.25%, the NPPFB has been forced to look out for other avenues of investment to enable it to generate returns above the cost of funds.

Currently, the balance funds are kept at very low returns with the Bank of Bhutan, Bhutan National Bank and the RICB. As the net inflow of funds is around Nu. 25 million a month, there is a surplus accumulation of over Nu.300 million per annum. Over the year, the assets have grown over Nu.2.3 billion due to surplus accumulation of funds.

2.3 INVESTMENT IN FOREIGN EXCHANGE



Due to limited investment opportunities in the domestic market, the Royal Government permitted investment in US worth \$ 25 million. 1838 Investment Advisors has been appointed as the Investment Manager for the management of US Dollar 25 million and the First Union National Bank as the Custodial Bank. Investments of USD 25 million in lots commenced since January 15, 2001. As of date, it has transferred \$ 21 million and the balance of \$ 4 million will be transferred at an appropriate time in future.

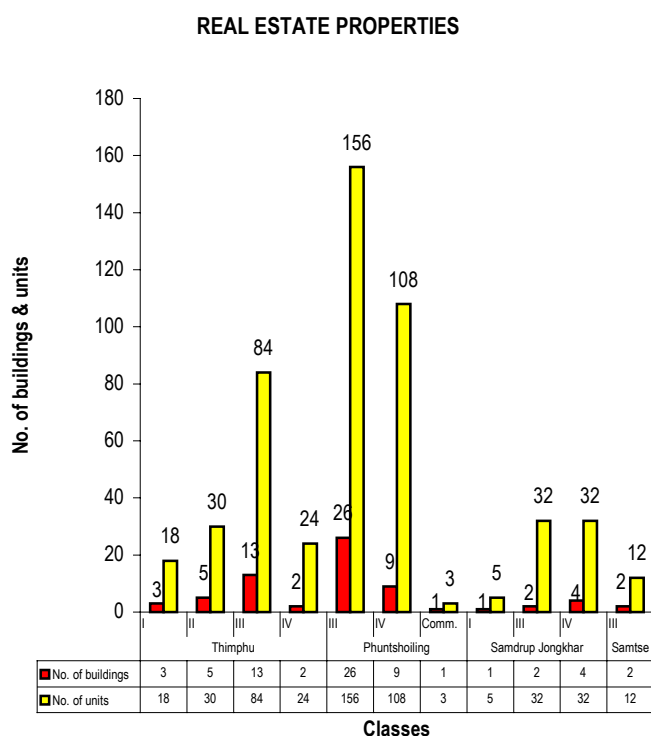
The investments have been made in a Globally Balanced Portfolio. Its objective is to earn a return of 5 percent above the US CPI over an investment horizon of 5 years. To achieve the objectives, investments have been made in equities, fixed income assets and money market.

2.4 PLANS DURING NEXT FINANCIAL YEAR

Presently, the National Pension and Provident Fund Bureau is faced with the unique situation of lack of investment opportunities, which needs immediate attention. Given the huge asset size compounded with poor domestic investment climate in the country, the NPPFB has a challenging task of prudently managing its investment. The NPPFB shall explore further investment avenues with a view to optimize returns to the NPPFB members.

The Royal Insurance Corporation then as an investment manager of GEPF was explicitly mandated by the Royal Government to function as a Financial Institution and Development Banker. In order to ensure adequate returns to the GEPF funds, the RICB was authorized to participate in a host of commercial activities. However, on taking over the GEPF operations, NPPFB has not yet received such mandate. The NPPFB has been pursuing the matter with the Ministry of Finance and Royal Monetary Authority for an appropriate mandate that would permit it to directly invest in Industrial Projects of Government Companies/Corporations and providing housing loans to GEPF members etc. If such a mandate is received, the Bureau will carry on commercial activities to optimize returns on the GEPF Fund.

3. REAL ESTATE MANAGEMENT



One of its main investment avenues for the NPPFP funds is in the Real Estate Development Projects. While the foremost objective of investment in Real Estate is to generate adequate returns on its funds over a long-term horizon, it also aims to provide decent accommodation to its members. The Bureau's another goal is to assist the society at large by providing affordable housing accommodations in view of acute housing shortages in the major towns of Bhutan.

Investment in Real Estate accounts to about 4.5% (percent) of the total investment portfolio. As of June 30, 2001, the Bureau owned 504 flats worth Nu 82.11 million

located in four major towns of Bhutan. These Real Estate assets had been transferred to the Bureau by the RICB on separation of the GEPF operations.

3.1 OPERATIONAL RESULTS:

The gross rental income from Real Estate operations as on 30th June 2001 before depreciation accounted to Nu.5.26 million, which works out to a return of 6.40% on the carrying value of Nu.82.11 million in Real as follows:

	Nu. in millions.	Rate of Returns (WDV)
Rental Income during the year.	8.45	10.29 %.
Less: Expenses		
a. Management expenses	1.31	
b. Maintenance	0.74	
c. Insurance Premium	0.86	
d. Rates & Taxes	0.28	
	(3.19)	(3.89%)
Gross Income	5.26	6.40%
Less: depreciation	(2.67)	
Net rental income	2.59	3.15%

NB: The returns does not account for the appreciation in the value of land and buildings.

After taking over the management of Real Estate from the RICB, the Bureau has been reviewing the viability of investments in Real Estate in terms of cost benefit analysis. Immediately on its establishment, the Bureau created a technical cell supported by two Civil Engineers under the Real Estate Department to enhance its capacity to carry

out additional Real Estate Development Projects. It also approached the City Corporation for allotment of additional land for the construction of additional residential buildings and its office complex. The City Corporation has already earmarked 50,000 sft. of additional land for allotment to the Bureau.

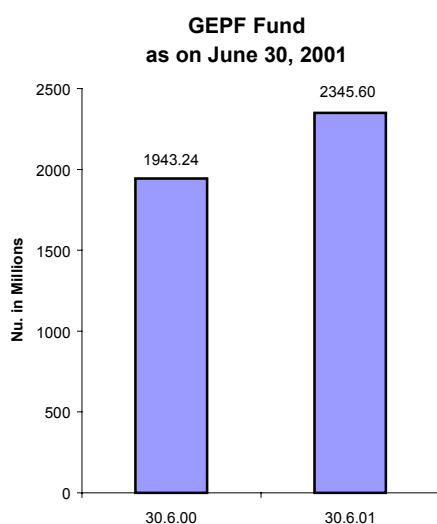
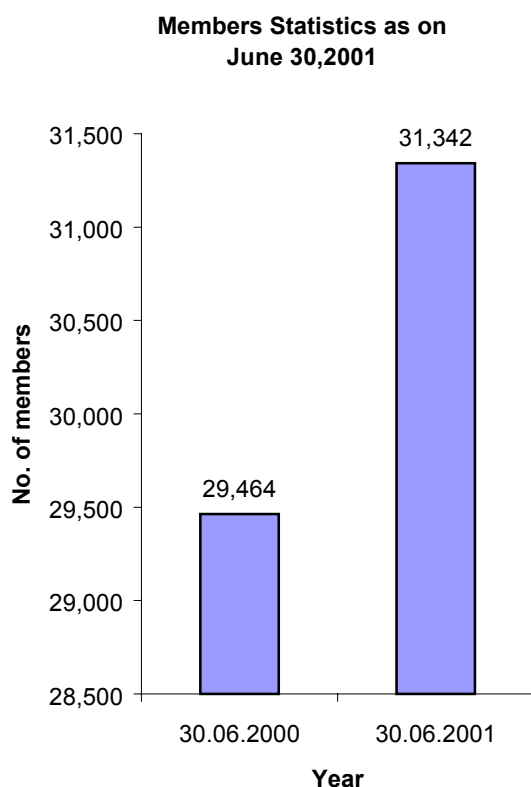
There has been heavy demand for accommodation in the NPPFB Housing Complex. Perhaps, the basic rationale behind the demand could be attributed to the low rental charges of the NPPFB housing complex coupled by acute housing shortages in Thimphu and Phuentsholing. This is evident from the 836 applications received by the Bureau during the year. Although, vacancies of flats are rare, the Housing Committee was established to oversee allocation of flats in a fair and transparent manner. The Housing Committee consists of 9 members with three-member representation from the residents of the NPPFB housing complex. Other members include representatives of the City Corporation and Department of Urban Development Housing.

3.2 PLANS DURING THE NEXT FINANCIAL YEAR

In its next financial year, the Bureau will explore for additional investment opportunities in Real Estate. Some of the initiatives, which are programmed during the next financial year, are as under:

- ▶▶ Preliminary studies have been completed for the construction of 19 new buildings in the existing housing colony in Thimphu, which will accommodate 158 families. Department of Urban Development and Housing through Gyeltsen Consultancy is carrying out the detailed drawings and designing work for the project, which includes provision of amenities such as parking spaces, garages, children's park and shopping complexes. Actual construction of 19 buildings shall be taken up during the next financial year.
- ▶▶ Studies shall be carried out with the help of Department of Urban Development and Housing to further develop the NPPFB housing complexes.
- ▶▶ Studies are being carried out for the construction of the office building at Kawajangsa the site being considered by the City Corporation for allotment for Office construction.
- ▶▶ The Bureau has a total of 68 buildings in four different locations. Out of these, 80 percent of them are buildings constructed during 80's and are very old. To this effect, technical estimates have been drawn for the maintenance works. The same shall be carried out phase wise during the next financial year.

4 DEFINED CONTRIBUTION – Provident Fund



The Government Employees Provident Fund is a fully funded defined contribution retirement scheme introduced in 1976 for the benefit of civil servants. The scheme was extended to cover the members of the Armed Forces and the employees of both the Government owned and joint sector corporations. The Royal Insurance Corporation of Bhutan managed the fund till 30th June 2000 as a trustee of the fund under a special contractual agreement established through a Memorandum of Understanding (MOU) between the Royal Government and the Royal Insurance Corporation of Bhutan.

On 1st July 2000, under an executive order from the Government issued by the Ministry of Finance, the GEPF operations were transferred to the newly established organization the National Pension and Provident Fund Bureau. In total 29,464 members account with members fund balance of Nu.1,943.24 million were transferred to the NPPFB.

Due to computer application problem, the RICB transferred the members' balances with a mismatch of Nu.5.5 million as on 1st July 2000. The mismatch therefore created an excess liability of Nu.5.5 million, which was not supported by corresponding assets. However, as instructed by the Ministry of Finance, RICB has finally reconciled the accounts by adjusting the rate of return from 9.23% to 8.68% for the period ended 30th June 2000.

With the separation of GEPF from the RICB, the Bureau had to totally restructure the administration system of the GEPF operations while at the same time it had to maintain continuity of the operations without much disruption. Opening of branch offices were not feasible in terms of logistics. The only option left for Bureau was to take up the assistance of the Bank of Bhutan in carrying out the responsibility of timely collection of contributions and disbursement of funds. It therefore entered into a new arrangement with the Bank of Bhutan for the purpose. Under the new arrangement, all the member agencies deposit monthly contributions to the nearest branch of the Bank and at the same time, the Bureau is intimated both by the agencies and the Bank branches accordingly.

The actual rate of return on GEPF Fund for the year 2000-2001 worked out to about 5 percent as on June 30, 2001. Although the Bureau has to provide returns to its members based on its actual earnings, the Royal Government has kindly considered one time support to it in view of its first year of operations. The provision of the subsidy of Nu.54.34 million to top up the deficit has enabled the Bureau to declare a return of 8 % to the GEPF members for the year 2000-2001.

In 2000-2001, the GEPF funds grew by 20.69 percent up from Nu.1.943 billion on July 1, 2000 to Nu.2.345 billion on June 30, 2001. Three main reasons can be cited for the increase in PF funds. Firstly, there has been a significant increase in contributions from the new members. While 2,887 new members joined service during the financial year, only 1,009 members retired.

Secondly, the **Contribution to Payout ratio** continues to be positive. Out of the total addition of Nu.335 million, the annual withdrawal worked out to a minimal of Nu.93 million. All these indicators suggest that a significant percentage of the members are of relatively young age.

Thirdly, return of about 5 percent earned on the GEPF funds contributed to the growth of the total fund.

As in the past, the contribution rates of the GEPF continue to be 8 percent for the civil service, 10 percent for the Corporations and 12 percent for the Armed Forces.

4.1 PLANS DURING THE NEXT FINANCIAL YEAR

By early next year, the Bureau would have completed the up-gradation of the new IT system of the Provident Fund. To administer the new pension and provident fund system, it is necessary to have a comprehensive set of Personal Information System (PIS) of the members. It is presently in the process of carrying out a major exercise of collecting PIS of every individual member both in the hard copy as well as soft copy.

In order to ensure that the information collected is reliable, it is now checking and verifying the data collected. With the completion of the new Personnel Information System next year, the quality of service to the members should improve significantly in view of the enhancement of efficient provident fund operations.

5. DEVELOPMENT OF THE NATIONAL PENSION PLAN

Bhutan has entered the new millennium with a very positive outlook on providing safety net for the retirees and the old age. The Government Employees Provident Fund and the gratuity, two formal old-age security schemes for salaried employees available to the civil servants and employees of corporations are argued as insufficient and disadvantageous as an old age security. For these reasons, feasibility studies to introduce a multi-pillar pension scheme have been carried out and are now in the last stage of finalization. The proposed retirement plan shall attempt to address the following objectives, which shall cause to attain the aspired goal of Gross National Happiness.

- Providing old age insurance (adequate level of income protection or safety net during old age)
- Inducing inter-temporal transfer of income of a member (which will shift income from service period to retirement period);
- Affect inter-generational transfer (which will transfer income and liabilities from one generation to other); and
- Redistribution of income (from higher income group to lower income members).

Under the direction of the National Pension Board, the National Pension and Provident Fund Bureau and the Government Working Committee has reviewed the studies carried out by the UNDP in 1997 and ADB project in 1999. Based on the studies, the NPPFB has drafted the Rules and Regulations on the proposed National Pension and Provident Fund Plan. The concept on the proposed Plan and the draft Rules and Regulations were presented and deliberated during many meetings both by the Government Working Committee and the members of the Board.

The proposed National Pension and Provident Fund Plan was also submitted to the Committee of Secretaries on May 25, 2001. The draft Rules and Regulations are still under deliberation of the Board for its endorsement after which, the proposal shall be submitted to the Royal Government for final approval.

5.1 ARMED FORCES PENSION AND PROVIDENT FUND PLAN

As per the instruction of the Royal Government the National Pension and Provident Fund Bureau have also been carrying out studies on the introduction of a similar pension scheme for the members of the Armed Forces. Initial proposal and the draft trust deed outlining the Rules and Regulations for the proposed Armed Forces Pension Plan were also presented to the National Pension Board.

The proposed Armed Forces Pension and Provident Fund Plan is still under review of the Board. On the endorsement of the Board, the proposal shall be submitted to the Royal Government for final approval.

5.2 FUTURE PLANS OF THE NPPFB

Preparations are being made for the introduction of the National Pension and Provident Fund Plan. The National Pension and Provident Fund Bureau shall carry out the following activities within the next Financial Year:

- ▶▶ The enactment of the Pension Act and the Rules and Regulation will provide the legal mandate for the operation of the National Pension and Provident Fund Plan.

Accordingly, the National Pension and Provident Fund Bureau shall review the proposed Pension Act and the Rules and Regulation for submission to the National Assembly.

- ▶▶ The Bureau is in the process of preparing a master plan incorporating the medium and long-term strategic plans to achieve the policy objectives of the proposed National Pension and Provident Fund Plan. The Master plan shall also include organizational and human resources capacity development incorporating both short and long-term requirements of the NPPFB.
- ▶▶ Since the establishment of NPPFB in March 2000, there has been pressure to disseminate information on the initiatives of the retirement schemes. The salaried employees who are potential members of the proposed Pension Plan have to be appropriately informed of the new Pension Plan. As soon as the concept of the National Pension and Provident Fund Plan is endorsed by the Board and approved by the Royal Government, it has to be followed by an appropriate publicity campaign in the form of seminars, workshops, notification through media and issuance of brochures.

6 DEVELOPMENT OF INFORMATION TECHNOLOGY

Upon separation of GEPF operations, the NPPFB took over the RICB's computer application developed in FoxPro DOS based version. The RICB's computer application mainly comprised of a Provident Fund module with facilities to generate MIS reports.

The computer application contained several bugs and errors thereby generating incorrect reports leading to mismatches in figures between ledgers and sub ledgers. The NPPFB with the assistance of a System Consultant spent substantial time in removing the application bugs and errors and upgraded the system application from DOS based version to window-based version.

6.1 NEW SYSTEM DEVELOPMENT

Presently, the Bureau is developing an appropriate database and computer application that would facilitate system processing of the proposed National Pension and Provident Fund benefits. This project has been initiated to facilitate efficient operation and effective decision making of the National Pension and Provident Fund Plan. Since the commencement of the project over the past 9 months, about 70 percent of work has been completed. The project will be completed in December 2001 giving ample time for the Bureau to test and familiarize with the system before the introduction of the National Pension and Provident Fund Plan.

6.2 FUTURE PLANS

With rapidly advancing technological changes in the IT sector in today's world, the Bureau is in the process of formulating a long-term IT strategy and plan. To keep in pace with the technological developments, the Bureau shall constantly review and assess its IT strategy to ensure timely updation of the technology and programs.

IT strategy shall be such that it can also benefit geographically disbursed members through improved services and making information available through remote access. In its second phase of the IT Project, the Bureau has prioritized designing of Web Page for the benefit of the members.