Pensions and Investments in the Caribbean 2002 - Future Benefits Through Effective and Efficient Investment and Management

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Corporate, individual and public pensions are being reformed worldwide. Providing financial security for the world's ageing population is a topic of critical importance in every country's agenda today. The obligations of government in providing appropriate pension plans can lead to significant economic difficulties. At the same time, a well-managed pension security can generate large funds for investment and help to develop capital markets. There are many pages of literature on 'why have pension plans'. Plans can be set up as insurance against uncertainty about retirement income, to create tax-efficient means of saving, and to induce an efficient life cycle model of consumption. Pension plans, therefore, have three clear obligations:

i. a social obligation to ensure that all citizens especially the old have resources to meet their basic needs;
ii. a macro-economic imperative to encourage citizens to save for capital formation which is so essential for economic growth;
iii. an individual objective to alter a pattern of consumption so that individuals may save from one's youth in order to provide for one's old age.

Regardless of the reasons, the philosophy behind funding a pension scheme is to set aside funds today to invest appropriately to support some future consumption. In order to realise these objectives there is a rich dialogue on the approaches to pension reform.

Much of this recent debate has taken place within the International Labour Organisation which deals with labour and social security issues and the World Bank following the publication in 1994 of the landmark Averting the Old Age Crisis. In that debate certain key issues have arisen in developing the ideal type pension system; the three-pillar approach i.e. to set a basic level of welfare, to provide fundamental benefits, and to make the programme supplementary or voluntary.

There are strong divergent views as to whether these pillars should be mandatory or voluntary; whether they should be defined benefits or defined contribution systems; and whether these systems should be fully funded or privately or publicly funded. Within recent times, the privatisation of social security schemes has also been raised. I am sure that these issues would engage your attention today as you respond to the pressing needs for pension reform in the Caribbean. Recent population projections for the region suggest that by 2030 the percentage of the population that would be over sixty years will be: 11% in St. Lucia, 17.8% in Trinidad and Tobago and 19.8% in Barbados. No doubt the greying of CARICOM would begin to create pressures on regional governments to reform existing private and public systems.

Within CARICOM, the national insurance pension is the single most important retirement income for most workers, except perhaps in Trinidad and Tobago, and Jamaica where there are a variety of pension vehicles. The financial performance of many of the national insurance schemes in the region has been lack-lustre and it has been a challenge to ensure positive real rates of return over time. It is against this background that this Seminar "*Pensions and Investments in the Caribbean in 2002 - Future Benefits Through Effective and Efficient Investment and Management"* could not be more appropriate to our circumstances. The CCMS must be commended for continuing to choose very relevant subjects for their Annual Seminars.

This seminar provides a platform for clarity of both the theory and practice of pension reform and the challenges to be faced now and in the future. Several questions specific to our local environment must be addressed. For example:

- in the current situation of liberalized financial markets, should there be limits on the foreign asset portfolio of pension funds?

- should the pension from the NIS be the floor - a basic minimum retirement income for all citizens?

- what should be the relationship between the NIS pension and the Old Age Pension which is non contributory and means tested?

- are indexation issues irrelevant given low rates of inflation at present?

There are two significant issues which will influence the direction of change in pension reform; the use of incentives in promoting market-based solutions, and the increasing globalisation of the financial sector. The latter will impact significantly on the risk management system for investment. The key issues on the matter include:

- the need for knowledgeable personnel and a good information base;
- the selection and implementation of the correct mix for the portfolio;
- monitoring risks and performance of the portfolio.

Let me say a brief word on the regulatory aspect of pension management. An assessment of the pension sector in Trinidad and Tobago has revealed the following:

i. approved pension plans comprise assets of more that TT$15 billion which is growing rapidly;
ii. the types of pension arrangements have diversified in Trinidad and Tobago, as bank accumulation products and Unit Trust offerings now have a significant market share;
iii. because of the favourable investment conditions over the last ten years many plans are now in a significant surplus position. Some have taken contribution holidays, but the issue of who owns the surplus in such plans remains to be resolved,
iv. the circumstances that have generated the current surplus situation could easily be reversed and good financial and corporate governance must be put in place now to mitigate this possibility;
v. the size of the industry implies that more flexible but prudent investment rules need to be put in place, as I have mentioned before. These rules should be aimed at protecting the interest of plan members; and
vi. the issue of portability of pension benefits as the workforce becomes more mobile also needs to be addressed.

The development of non-bank financial institutions is an important sector in the financial landscape. The financial system plays a key role in the smooth and efficient financing of the economy. The most fundamental contribution of the financial system is to make us channel resources from individuals and companies with surplus resources to those with resource deficits. A recent study published by the World Bank entitled "*Development and*

Regulation of Non-Bank Financial Institutions" asks the following questions on the relationship between financial development and growth:

i. whether the level of financial intermediary development exerts a causal influence on economic growth;
ii. whether cross country differences in legal and accounting framework explains cross country differences in the level of financial development.

Their findings support a positive relationship between financial sector financing and economic growth.

In order to deepen this relationship, it was recognised in Trinidad and Tobago that a wider regulatory net should be encouraged. The Central Bank has been engaged in building the capacity for an integrated supervision of the banking, insurance and pension fund sectors. The structure of the new integrated supervision system is now being finalised. This is an important departure in the regulatory development in Trinidad and Tobago and it is our expectations that within a reasonable timeframe the integrated regulatory system will be put in practice. In this regard, the specific issue of pension fund investment is being addressed. In light of the forces under- pinning the globalisation of finance there would be need to adopt a more flexible approach for investment portfolio by pension fund managers.

The long term sustainability of the pension fund depends, however, on the overall performance of the economy. In this context the Central Bank in its pursuit of monetary policy has recently introduced a new report entitled "*Monetary Policy Report"* which would be published bi-annually. The most recent issue published in February of this year outlines the conditions for monetary stability that exists in Trinidad and Tobago, which includes a low domestic inflation and an orderly exchange market.

On the latter, the report states "the exchange rate movement within the year thus played a useful role in helping to stabilise the domestic economy in the face of external terms of trade and domestic shocks". The Central Bank has also announced a new framework to implement monetary policy featuring an announced overnight interest rate for Central Bank's re-purchase ("repo") operations. Thus the Central Bank will announce a Central Bank repo rate, with a reverse repo rate 50 basis points lower. The Central Bank will routinely conduct open market operations at these rates, thereby attempting to keep money market yields, such as overnight inter-bank interest rates, close to its own repo rate.

Monetary and financial stability are critical macro-economic conditions that are essential to 'good' economic policy and effective management of the investment of pension funds. Monetary stability was well maintained in Trinidad and Tobago during 2001. In the face of international slowing, the Central Bank eased monetary policy, and at the same time worked towards the strengthening of the international balance sheet for Trinidad and Tobago, increase in official foreign reserves, low inflation and a well-behaved foreign exchange market. As elaborated upon in the *"Monetary Policy Report"*, we expect to see continued output growth and monetary stability in 2002.