PENSIONS AND INVESTMENTS IN THE CARIBBEAN 2002 FUTURE BENEFITS THROUGH EFFECTIVE AND EFFICIENT INVESTMENT AND MANAGEMENT"

May 3, 2002 Trinidad Hilton

Opportunities / Obstacles for the Investment of Pension /Funds ill the Caribbean - The Legal Perspective

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Fairly similar treatment in the laws governing Pensions in many Caribbean territories.

Focus on Trinidad, St. Lucia, Barbados and Bahamas. Not dealing with NIS but with private pension funds.

Interestingly, specific legislation dealing with pensions treat only with pensions and gratuities charged on the Consolidated Fund i.e. for public service officers. This is typical throughout the Caribbean.

Laws governing private pension funds are found in different pieces of legislation. In Trinidad and Tobago and St. Lucia they fall under the Insurance legislation, with barely a few sections devoted to the subject. (The provisions in these two countries are almost identical.

Trustee legislation deals generally with trusts and most pension funds are administered by trusts. Where there is specific pension legislation, the trustee legislation will not apply.

Barbados Insurance Act deals generally with statutory funds for insurance purposes - no specific provisions on pensions. This is treated under the Income Tax Act. There is a Pensions Bill which has been out for some time but there has been no move to make it law.

Bahamas has no specific provisions governing pension funds in its Insurance Act. However, the Trustee Act of 1998 treats with investment powers of trustees and .like Barbados, the Income Tax Act deals with treatment of pensions.

Jamaica - new insurance legislation just passed but unable to obtain a copy.

In T & T, statutory provisions governing private pension funds which fall under the insurance legislation deal with form, structure, authorized investments and operational controls. There is very little emphasis on prudential requirements or corporate governance principles. S. 174 of the Insurance Act requires all pension fund plans to be registered and the qualifications for registration are set out in Part 1 V of the Act. Typically there is

- Criteria for registration. This is set out in the Fourth Schedule to the Insurance Act (T &T) which essentially provides how the Trust Deed and Rules of a Pension Plan must be structured, the protection of rights of beneficiaries being of paramount importance.
- Powers of the supervisor of insurance
- The requirement for submission of annual accounts to the supervisor
- The requirement for actuarial investigation at least every 3 years
- Types, limits and restrictions on investment of funds

The purpose of these requirements and a trustees' prime objective is to ensure that the pension fund has as closely as possible enough assets to meet its liabilities.

One of the provisions of the Fourth Schedule criteria is that the Trust Deed and Rules of a plan shall make provision for -

> "(f) The contributions payable to and the rates of benefits payable from the fund or the methods of calculating benefits so payable".

This provision leads to the setting up of a defined benefit plan that is typical in Trinidad and Tobago. This provision may be seen as one obstacle to portability of pension benefits.

Most pension funds in the Caribbean provide a pension related to salary or earnings close to retirement [final pay, average over last 3 years) or other defined benefit schemes] and the employer assumes the risk of meeting any shortfall in funding. Legislation throughout the Caribbean is silent on the issue of treatment of surpluses in a plan and if the plan itself does not treat with the issue, this could lead to serious disputes.
(Recall the BWIA issue)

The trustees of a registered pension plan may invest assets of the plans only in the type of securities that an insurance company may invest the assets of its statutory fund. (Authorised Investments). In Trinidad and Tobago, these are set out in the Second Schedule to the Insurance Act (similarly in St. Lucia) and include countries in which certain investments are allowed. The approved countries are

- any commonwealth country or dependency or the Republic of Ireland,

- the country in which the head office of the company is situated, - any country approved by the Minister of Finance.

The category of investment vehicles -

- government or government guaranteed securities;
- bonds of a T &T corporation which are fully secured by a statutory charge upon real estate plant or equipment or other tangible assets of the corporation;
- bonds, debentures of certain T &T statutory corporations
- established for public purposes (water, transport, electricity etc.);
- securities of IDB or any other international financial institutions approved by the Minister of Finance;
- guaranteed investment certificates issued by a trust company incorporated in any of the countries listed above;
- fully paid ordinary shares, preferred shares, bonds, debentures of a company from any of the above countries which has a track record of payment of dividends for a minimum of five years of at least 4% yield;
- mortgages secured by real estate (with certain prudential
- restrictions);
- real estate or leaseholds in Trinidad and Tobago (with certain prudential restrictions);
- cash balances in any bank, non-bank financial institution or building society approved by the Minister.

Investment Restrictions. In the Trinidad and Tobago legislation Maximum limits have been put on investments with regard to the following -

- investment in overseas assets - 20 % '- St. Lucia - 20%
- real estate or leaseholds - 20% of total value of statutory
- fund assets - St. Lucia same limit

- ordinary shares - 50% of total assets and 30% of the ordinary shares of any corporation - St. Lucia 30% and 30% -
- mortgage - 10% of total assets of the company - St. Lucia same limit.

One important restriction in the Trinidad and Tobago and St. Lucia legislation is that no trustee may invest the assets of a pension fund in the equity, debentures or other evidence of indebtedness of the employer or any subsidiary or associate of the employers or of any company of which the employer is a subsidiary or an associate. [This provision ensures that an Enron type situation regarding workers pensions' would not apply here.]

In stipulating the type of assets in which statutory funds may be invested the Second Schedule list of authorised investment seeks to provide for safe and reliable investments and facilitate some diversification to avoid excessive concentration of risks.

Interestingly, the Bahamas Trustee Act does not stipulate authorised investments. It states that a trustee must make, retain and change investments as a prudent investor would, having regard to the purposes, distribution requirements and other circumstances of the trust. The Act (section 5) has set certain prudential criteria pertaining to -

. reasonable care and caution and the skill of ordinary persons;
. overall balance of risk and return;
. need for diversification as the trustees consider appropriate.

And it sets out circumstances which trustees must consider in choosing investments e.g. size of trust property, general economic conditions, possible tax consequences, needs of liquidity and other issues that a prudent investor will normally consider when making investments.

Trustee Act -

The Trustee legislation in the respective countries governs essentially,
form, structure and operations -

. the manner of investment by trustees

. general powers of trustees
. appointment and discharge
. powers of the court

The Barbados legislation stipulates the type of investments in which trustees shall invest trust funds. These are very restrictive in that they must be securities generated or registered Barbados.

Other legislation which affect pensions are -

- Income Tax Legislation / Finance Act (which allow a few tax benefits to beneficiaries. (Pension funds do not pay taxes).

- Financial Institutions Act, 1993 which regulates the establishment and operations of trust companies that manage pension funds. These institutions are subject to regulation by the Central Bank and must comply with various prudential criteria.

- Securities Industry Act, 1995 which regulates market actors; certain provisions relate to Pension Plan managers and Trust companies.

- Companies Act which governs all corporate pension fund administrators.

At present work is being undertaken on the integration of supervision of banks, insurance companies and credit unions. Pension reform legislation, I understand, is also being considered.

As a result of existing legislation, pension fund managers face the following limitations / obstacles -

- Investment opportunities are somewhat limited. By stipulating authorised investments, managers have limited opportunities to invest overseas or in products derived through financial innovation.

- Quantitative restrictions may limit higher profitability.

- Limit on overseas investment that would permit country risk diversification. However, the implicit currency risks that go with such investments would require asset managers to use hedging instruments. The training and capability of asset managers to meet this challenge are, therefore, of great importance.

- In many Caribbean countries investments in overseas markets are limited largely due to exchange controls or where those have been abolished, lack of interest or knowledge of overseas markets.

- There is little emphasis on prudential regulation and corporate governance.

- Lack of portability of pensions.

- Of course, the difficulty in changing legislative provisions. Ministerial orders are easier to change. In T &T, the local assets ratio provision of 80% is stipulated in the Insurance Act and can only be changed by Parliament.

Other factors not strictly related to legislation which are limitations to investments are -

- Primary market for securities is thin - the need to encourage existing family enterprises to provide acceptable domestic instruments is pressing. However, the latest developments regarding takeovers in an unregulated market will be a disincentive to private companies going public. Tax incentives could go a long way in moving these companies to be listed on the stock exchange.

- Inadequate supply of long term financial instruments.

- Secondary market for securities not very liquid as investors tend to hold corporate bonds to maturity - the need to develop an active bond trading market is critical.

- Lack of a Caribbean Stock Exchange.
- Need for more efficient settlement of transaction (settlement cycle too long at present).

- Tardiness of BIR in processing plans and amendments.

Opportunities

Even with the restrictions on authorised investments, there are still opportunities with regard to investment of private pension funds.

- Exchange controls no longer exists in Trinidad and Tobago or Jamaica so that managers can now take advantage of investing overseas, albeit with the existing limits.

- Greater utilisation of tax benefits. Employees should persuade employers to utilise the tax benefit under S. 134 of the Income Tax Act which provides a deferred tax benefit available up to one third of chargeable income. (Although this is beneficial to employees in the higher income bracket and could be considered punitive to the lower income bracket.)

- Growth in local mutual funds which to date have been giving good returns.

- Retirement assets will build up as GDP grows. Government has announced a major housing initiative. Opportunities are there for investments in mortgage bonds to finance housing and could contribute to the further development of the secondary mortgage market.

- Because of expected large inflows of revenue expected in Trinidad and Tobago over the next few years and given the country's monetary stability, low inflation and general favourable economic outlook, it is a good opportunity to review pension development and encourage greater participation in pensions. Market actors should seek to have their views heard and influence the Government especially with regard to removing investment limits or at least phasing them out.

Such development will help deepen the capital markets.

The Bahamas provisions under the Trustee Act reflect the "prudent person" approach and are appropriate pa11icularly where employers operate defined benefits schemes and assume the investment risk of the funds. Those provisions could serve as a model for Caribbean countries.