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TOPIC: "PENSIONS AND INVESTMENTS FOR THE SMALL MAN"

INTRODUCTION

Mr. Chairman, fellow panelists, specially invited guests, ladies and gentlemen. I am delighted to be here this afternoon and to be afforded the opportunity to address this seminar, on what I, and indeed all at the Unit Trust Corporation, consider to be a very important subject - PENSIONS and INVESTMENTS.

It is now well known both at home and abroad that at the core of the Corporation's mission, are the concepts of wealth creation and the formation of a shareholding democracy. It is therefore quite easy to appreciate why Pensions, which essentially deal with the individual's wealth position in his/her after-work life, is of such immense importance to us at the UTC.

In my presentation I shall briefly address the following areas:

- the efficacy of the present Pensions environment; - the need for reform;
- the UTC's response and performance since inception; and
- a pioneering effort through Fund conversion.

EXISTING DOMESTIC PENSIONS ENVIRONMENT

The domestic pensions market is broadly divided between the public and private sectors.

THE PUBLIC /STATE SECTOR PENSION INITIATIVES

As you are no doubt aware, the state sector comprises the Old Age Pension Scheme that began in the 1930s, the non-contributory Civil Service Pension Program that became operational in 1934 and the National Insurance System, which was introduced in 1972. All of these components function somewhat independently.

Old Age Pension is an important component of the Social Security System. It is administered by the Ministry of Social Development under the Old Age Pension Program and provides for a monthly pension of $1,000.00. To qualify, participants must be 65 years and over and their financial positions must not exceed $8,640 per year. This sum, while not exceptional in and of itself, represents a substantial increase over previous pension payments, which ranged from $620 in 1999 to $800 in 2001. It should be noted however, that this increased pension, like all fixed income, remains susceptible to the ravages of inflation. Additionally, it is also vulnerable to possible change in govemment's expenditure policy owing to its considerable size, which is projected at $816 million in 2002.

The Non-Contributory civil service system, better known as the "pay as you go" system, is an unfunded pension plan, whose liability is the responsibility of the Government. The cost to taxpayers in this system was estimated at $562 million in 1997 as compared with $391 million five years earlier (1992). This bill is projected to be in excess of $1 billion by year-end 2002. In addition, the dependency ratio is high due to the growing number and longer life expectancy of retirees on the one hand, and a static contribution rate on the other hand. The extent of the future liability may be tempered by the Government's hiring practices and can be impacted by an overhaul of the public service.

An anomaly under the pay as you go system, which has assumed increasing significance in the recent past, is that some beneficiaries now find that their pension payment is less than the current old age pension.

The NIB system was intended to provide income security for all workers, including the self-employed, so that their normal living standards would not be seriously eroded in the face of contingencies such as sickness, maternity and employment injury. Additionally the NIS also provides a mandatory retirement savings program. It was established to ensure that -workers would not face poverty in their retirement years and was designed to supplement the income of individuals at retirement. However, given the level of existing pay-outs, it is obvious that the system has not been achieving the desired objective. These pay-outs are insufficient for those at the low end of the income scale and in many instances the recipients would often seek to access the Old Age Pension, thus exerting additional pressure on the Treasury. On the other hand, pension pay-outs at the high end are not needed.

Even though it is available to the entire work-force, a large portion of the self-employed remain outside the NIB system, and are therefore disadvantaged at retirement, particularly those at the lower end of the earnings spectrum.

The State's Pension programmes have not been without their fair share of challenges. Both the Old Age Pension and "pay as you go" systems have been subjected to the vagaries of Central Government's revenues, which are evidenced by their stagnation. The NIS programme has been a victim of low contributions and concomitantly low payments.

In the 5th Actuarial Review of the NIS completed in 1996, the system was considered to be at risk of being marginalized if contribution and benefit provisions were not substantially revised. Accordingly, weekly pension payments to the lowest qualifying class were increased from $30.00 to the princely sum of $50.00. On the other hand, increased payments to the highest qualifying class ranged from $77.00 to $243.00. Indeed, man shall not live by bread alone.

The challenge therefore, facing the policy-makers, is to devise a system, which is more meaningful to low-income earners, so as to ensure that their demands on the Old Age Pension system are minimized or eliminated.

PRIVATE SECTOR PENSION INITIATIVES

A review of the private pension plan arrangements reveals the presence of two types of Occupational Pension Plans. These are 1) Traditional, and 2) Non-traditional. The traditional plan refers to those set up by trust deeds and rules providing the whole gamut of retirement and ancillary benefits with trustees, auditors, actuaries, investment managers, etc.

On the other hand, the non-traditional plans refer to those purchased from an insurance company or other financial institution and set up with minimal documentation and statutory requirements. These would either be set up as individual plans where the company and the employee both contribute or as a company plan which is non-contributory.

At .present, in Trinidad and Tobago, there are approximately 44,353 active members of 204 privately administered pension plans, with a combined asset base of $13.5 billion. Notwithstanding its prevalence, this pensions vehicle is faced with several challenges. These include:

1) ownership and treatment of surpluses - the members generally do not have access to all the wealth created by the contributions made on their behalf; some surplus is always withheld, as in the case of WASA and T&TEC.

2) in the event of a merger between two plans of unequal financial strength, the stronger is required to _fund the weaker to the detriment of members of the former;

3) limitations in the regulatory framework as there is no regulatory body to ensure that employers' contributions are fully paid.

4) the performance of pension fund managers is generally hidden, so contributors have no idea as to the comparative performance of their pension fund. In this regard, pension fund managers should be regulated as mutual fund managers are at present.

From the foregoing it is obvious that there is need for a clear statement on the ownership of pension plans by the individual members, so that it is regarded as property registered in the name of the individual rather than being owned by the trustee or the employer. This, in my view will enhance portability in light of the fact that the average worker entering the labour force changes a job on average three or four times during his or her working life.

In the private arena there are other arrangements available to individuals, whether they are employed with an organization or self- employed. These range from individual deferred annuities and other plans registered under section S134 (6) of the Income Tax Act, these plans either operate under Trust law in the case of banking institutions or the Insurance Act in the case of insurance companies.

This implies varying investment guidelines, taxation considerations and ownership status amongst others. Maybe the time is appropriate to consider a common legal and institutional framework governing the entire industry as part of the State's continuing effort to level the playing field.

THE CASE FOR REFORM

In light of the numerous deficiencies identified above and others that exist within both the public and private sectors, the question seems unavoidable. What are the characteristics of **"the"** pension product that will address all of the aforementioned issues? I will list just a few:

1) 100 percent tax-free accumulation;

2) daily valuation;

3) full transparency;

4) full flexibility of contributions;

5) full portability;

6) full compatibility with company plans;

7) easily identifiable assets;

8) no traditional administrative charges;

9) no front-end or rear-end charges;

10) full indexation;

11) universal coverage;

12) individual ownership; and

13) it must be a defined contribution model.

In addition to this, fiscal incentives for the pension industry should be universal, with application to existing products as well as future products, which conform to agreed criteria.

THE UTC'S ALTERNATIVE AND ITS PERFORMANCE SINCE INCEPTION

It is in the above context that the Unit Trust Corporation designed and subsequently launched its revolutionary Universal Retirement Fund on 28th November 1997. In essence the structure of the Fund addressed all those issues that have consistently plagued the operations of the local industry, thereby providing a superior product for all individuals. As such, all of the above benefits will accrue to individuals in the Fund upon retirement.

The URF is a variable contribution plan that will provide a powerful investment vehicle for retirement. The fund will allow for regular and periodic investment of any amount, automatic re-investment, asset accumulation and capital growth.

The URF can be used by employers as an alternative to traditional defined benefit plans or annuity type plans. The URF is flexible enough to allow it to be modified to suit the needs of each individual company since the URF's options can be structured exactly as necessary to ensure a proper fit with the needs of any organization.

It is heart-warming to note that from inception to the present day, the URF has outperformed the Composite Index, by almost 1,500 basis points. On a price basis, the URF, which started off at $10.00 per unit in November 1997, is currently valued at $14.87 as at April 25th 2002, an increase of 49%. The Composite Index on the other hand, grew by 34% over the corresponding period, from 346.90 to 464.17 on April 26th 2002.

One of the reservations usually held in respect of the equity-backed pension facility is the fear that a decline in the stock market influences an erosion in value of the members' holdings. What is the evidence with the URF?

	1999	2000	2001
Stock market Composite Index	(4.32%)	5.76%	(1.66%)
URF	1.40%	15.38%	12.96%

What this highlights is the critical role of the investment function in the management of pension resources, with a clear investment philosophy, which focuses on hedging as an important investment tool in the armory of techniques employed by the Manager.

UNIT TRUST PENSION PLAN CONVERSION

We at the Corporation do not only talk the talk but walk the talk, so effective January 01, 2001 we completed the conversion of our then existing traditional defined benefit plan into a fully unitized equity- backed defined contribution facility, which embraces the following features: -

1) The allocation of the then surplus amongst existing members utilizing a formula which takes into account age, plus service and salary history of individual members;

2) Individual accounts for members were established;

3) Incorporation of the entire Fund int9 the Universal Retirement Fund which itself was recognized by the Supervisor of Insurance as an approved security for pension purposes;

4) Continuous contribution on a monthly basis by individuals with a fixed contribution by the employer distributed in accordance with an established distribution formula also based on age, service and years to retirement; and

5) Allocation to individual accounts in the form of units, determined on the basis of the Net Asset Value (NAV) per unit in the Universal Retirement Fund on the day of allocation.

The foregoing enable members to determine the value of their pension holdings, virtually on a daily basis, since the net asset value of the Universal Retirement Fund is determined and published on a daily basis.

There are certain concepts, which are foreign to this far reaching and progressive mechanism. For example: -

i. Actuarial surplus; and

ii. Contribution holidays to either the individual member or the employer.

The individual member benefits fully from the investment performance of the Fund. A simple check with the potential of this new facility and what the old defined benefit facility would have produced indicates that the difference depending on age, service and years to retirement has varied between a low of 40 per cent and a high of 110 percent in additional value. The ultimate beneficiary of course is the member of the plan.

CONCLUSION

In conclusion, I wish to echo the sentiments expressed by Jose Pinera, President of the International Center for Pension Reform, before the US House Committee on Ways and Means. "I believe that there is no economic issue facing the world today that is more important than converting unfunded pay-as-you-go social security systems into fully funded systems of individual retirement accounts." Mr. Pinera was a former Minister of Labour and Social Security in Chile, who was responsible for the creation of the Chilean social security system, after which the URF was modeled.

I hope that if my contribution here this afternoon has done anything at all it is to expose to all present, an alternative approach to pension management and delivery, with the uncompromising objective being the optimization of the benefits provided to the individual participant.

I thank you.