THE ROLE OF NATIONAL INSURANCE SCHEMES IN CARICOM IN THE TRANSFORMATION OF THE FINANCIAL SYSTEM

BY ENID E.BISSEMBER
Economic Intelligence and Policy Unit
CARICOM Secretariat
enidb@caricom.org

Key words: Capital Markets, Investments, and National Insurance

Introduction

National Insurance Schemes have been known to mobilize and control large sums of financial resources. Because of this, they can act as countervailing forces to the dominant position of commercial banks and therefore if they desire, can promote competition and efficiency in the overall financial system. In some countries, National Insurance Schemes are considered large and influential non-bank financial institutions with tremendous financial power and the potential to:

a) Promote and /or stimulate financial innovation,
b) Aid in the modernization of capital markets,
c) Enhance transparency and disclosure of financial information;
d) Mobilize domestic savings which can be used to finance domestic investment; and
e) Be providers of long-term capital.

Although the National insurance schemes throughout the CARICOM Region have the potential to be large influential players in both the money and capital markets they rarely persue that role aggressively.

A number of the Schemes have not been proactive in their investment decisions, preferring the traditional safe areas of investing, in which large portions of their portfolio are held in highly liquid assets, usually commercial bank accounts and government securities[1].

The national insurance scheme are very liquid but suffers from a number of administrative inefficiencies and sometimes strategic and convenient political manipulation. These compulsory savings schemes or mandated long-term savings schemes have, on occasions, been called upon to:

a) Provide financing for governments' social and/or infrastructure projects
b) Assist Central Government in areas requiring large financial outlays which could not be provided through the regular banking system; and

[1] Government Securities include Bonds, Debentures, Treasury bills

c) Provide financial assistance to government-supported or government-sympathetic private sector initiatives on generous terms and conditions.

The investments of the national insurance schemes are concentrated in a few categories of securities which, to some extent is the result of the limited number of investment opportunities that exist and the need to exercise extreme caution when investing national insurance scheme resources.

The investment practices of the national insurance schemes have been the topic of major interest by both supporters and opponents. The opponents contend that there is a lack of aggressiveness in investing the resources controlled. They argue that the national insurance schemes undertake investment that sacrifice returns in order to preserve the funds for use to achieve social goals and so support the political and social objectives of politicians.

Supporters of the investment strategy felt that prudence in investing national or social security resources is the best policy and high returns can be waived for low, stable and guaranteed returns. Scheme managers on the other hand, whose duty it is to preserve the value of the fund by undertaking safe investments, felt that fiduciary responsibility is very important in investing NIS resources, with economic development a spin off and not one of their primary objectives. The Manager of the Board of the Trinidad and Tobago National Insurance Fund said

> ***"Because of the method of funding National Insurance System plays an important role in the mobilization of savings and as a provider of long term capital. The Scheme therefore has an obligation to ensure that the savings are prudently managed and not influenced by considerations which have no investment merit"***[2]

These schemes in the Caribbean have played a rather insignificant role as providers of long term financing for the corporate sector with most of their resources directed to the government securities market with varying maturity structures. Token amounts of private sector investment are undertaken in the

[2] The National Insurance Board, Trinidad and Tobago Annual report July 1992-June 1993

form of debentures, bonds and some direct loans, mainly in those countries where the financial market is more developed. Even less investment is undertaken outside the domestic market and cross border investment by these national insurance funds is almost unheard of and often times legislated against.

The paper argues that because of the large volumes of resources controlled by national insurance funds in the Region, they have the potential to positively impact on the development of the capital markets in Member States, to help in the development of the cross border financial services sector and the transformation of the entire financial system.

The aim of this paper is to briefly examine investment portfolio of the National Insurance Scheme in a sample of CARICOM Member States namely, The Bahamas, Dominica, Guyana and Trinidad and Tobago from the early 1980s to the late 1990s. It also attempts to evaluate the role of national insurance funds in the development of the capital markets by increased participation, recognizing that the funds can play an important role in that development by the sheer size of the assets controlled.

3) The National Insurance Scheme in CARICOM

This section gives a brief description of the national insurance funds in the Region paying particular attention to The Bahamas, Dominica, Guyana and Trinidad and Tobago. The fund covers the entire population of salaried workers between the ages of 16 and 60; and 14–60 in Dominica. It includes waged workers, public servants and the self-employed. Basically there are three categories of contributors to the Scheme. They are, the employed, the self-employed and the voluntarily insured.

The Scheme is a mandatory one to which all workers are required to make periodic contributions during their working years and are entitled to benefit in retirement, or under special circumstances, before retirement. The scheme which is mainly financed through employers and employees contributions can be considered a payroll tax system; some countries however have referred to it as an income replacement programme.

Registration and contribution by employers is compulsory regardless of the size of the labour force. Between 1990 and 2000, in both Guyana and Trinidad and Tobago, the largest number of new employers have been those with up to 10 employees.

Table 1: Number of New Employers Registering with The NIS Guyana 1983-1999

The National Insurance Board in Trinidad and Tobago in its 1991/92 Annual report noted that

"There continues to be an inverse relationship between the number of new employers registered and the size of establishments, over 50% of the newly registered employers started their operations with a maximum of 4 persons"[3].

The national insurance schemes in the countries studied first appeared in the late 1960s and early 1970s, with the governments recognizing that provisions for the aged and infirmed were not only the responsibility of Central Governments but also that of the employed worker who should take some responsibility for saving towards old age. The schemes were also seen as a means of alleviating poverty among the working population as they aged while providing protection against possible economic and social hardship.

Because of these, the investment strategy has to be such that there is always a steady stream of income to the scheme.

A contributor to the fund contributes to the following benefits which can be classed as either short term or long-term: -

Short -term benefits

a) Sickness
b) Medical care (local and overseas)
c) Maternity benefit which has three components

[3] National Insurance Board Trinidad and Tobago Annual Report 1991/1992

i) Maternity allowance

ii) Maternity grant

iii) Medical care

d) Funeral grant

Long-term benefits

a) Invalidity benefit

b) Retirement grant

c) Retirement pension

d) Survivor benefit

Workers are also covered for industrial benefits, which include: -

a) Injury benefits

b) Disability benefits

c) Industrial death

3) The National Insurance Scheme Investment Philosophy

The over-riding investment philosophy of most national insurance schemes in CARICOM is that all investments should be undertaken with a view to preserving capital and to provide sufficient liquidity to enable the scheme to meet all of its future obligations as they become payable. It is fair to say that national insurance schemes which are in fact public pension funds, like private pension fund, exist to provide post retirement income to employees but goes a bit further in that a number of other benefits are also provided.

The fundamental investment objective is to provide long-term capital growth and investment income by investing primarily in a well-diversified, balanced portfolio so that the long-term demands can be met when required.

The Chairman of the Dominica Social Security in his 1997 report stated

" The investment policy of the Board had to be carefully executed so as not to venture into risky investment opportunities that would in the long term impact negatively on the fund this was clearly articulated in no apparent changes in the overseas investment

portfolio despite the possibility for greater yield to be had there from"[4].

Throughout the Region, and in particular, the countries studied, investments tend to be in gilt edged securities and where equity investment is undertaken in common stock it is usually in high quality ones with the potential for creating wealth over the long run.

These schemes, because of the nature of their liabilities have a portfolio mix including short, medium and long-term instruments thus guarding against a mismatch of assets and liabilities. It has been observed that the total income of the scheme is spread between different investment mix, perhaps to allow for payment of benefits and assistance under various categories and as a result there are short, medium and long term investments

There is nonetheless a preference for instruments that provide high yields, relatively low risks, liquidity and safety of capital. There is a demonstrated preference for investing in government securities, debentures, bonds, and fixed deposits. the following major categories of instruments:

a) Bonds
b) Commercial bank fixed deposits
c) Debentures
d) Equities
e) Government securities including treasury bills
f) Real estate / mortgages

For the period 1990/1991 to 1992/1993 the average yield on the different classes of instruments in Trinidad and Tobago are given below.

Instrument	% 90/91	%91/92	%92/93
Commercial loans	1.85	0.82	1.30
Debentures	5.75	5.79	5.53
Equities	5.01	2.54	2.71
Fixed deposits	8.98	9.10	12.42
Government securities and bonds	10.37	12.81	12.33
Mortgages	10.66	12.02	10.32
Other bonds	9.91	6.55	7.16
Gross yield	7.35	7.66	8.13

Source: National Insurance Board Annual Reports

[4] Dominica Social Security Annual report 1997

In the case of Dominica the total returns on the portfolio for the period 1996 and 1997 are given below.

Instrument	1996 % Return	1997% Return
Government debenture	21.8	21.60
Treasury bills	13.7	12. 2l
Loans	31.3	29.00
Fixed deposits	29.4	30.80
Equity	3.6	4.60
Real property	0.2	1.80
Total	100%	100%

Source: Dominica Social Security Annual Report

They acknowledged that some of the Board's investment are termed "social investments" and are undertaken at lower interest rates so as to assist with the development of socially desirable areas of the national economy.

2.1 National Insurance Schemes Investment Activities

.An examination of the investment portfolio of the NIS revealed a strong home bias. In The Bahamas, for example, the National Insurance Board is heavily invested in Government and quasi government institutions with large unsecured exposure to some entities. Among the institutions benefiting from National Insurance Board loan facilities are :

The Bahamas Electricity Corporation,

Water and Sewage Corporation,

The Bahamas Development Bank,

The Bahamas Telecommunications Corporation.

Table 2: The Bahamas National Insurance Board

Investment Mix 1995-1999

The National Insurance Board in The Bahamas has a stated policy that the contributors must benefit from its investment. In that regard investments are undertaken in areas where it is believed that a large segment of the population will derive some direct benefits such as health care where the stated philosophy is that ***"The programmes which entails constructing, equipping and maintaining quality health care facilities, is a major part of the Board's Social investment programme, designed from the very inception to improve the quality and accessibility of health care services for insured persons and other residents*** **"**[5]

It also showed that the scheme has been an important supplier of resources to Government corporations. In some cases the NIB was lending to agencies that have not been able to satisfactorily service their loans to the commercial banking system. One such loan has been in default and the national insurance scheme has had to make a provision for its eventual write off. However because of its philosophy to support institutions with the potential to reach a wide cross section of contributors the institutions have been able to access those Public resources. Between 1983 and 1999 a total of B$69 million of National Insurance resources was lent to government agencies in the Bahamas.

Table 3: The Bahamas National Insurance Board

Loans to Government Corporations 1996-1999

Entity	Years facility extended	$ MN	Purpose of loan
Bahamas Electricity corporation	1983	10mn	Modernize plant, refinance loan due to commercial banks
	1989	10MN	Plant expansion
Water and Sewage Corporation[6]	1984	4.2 MN	To refinance Commercial bank loans
	1987	1.2 mn	Plant maintenance and rehabilitation
Bahamas Development Bank	1984	3. 5mn	To lend to deserving borrowers in the field of agriculture, small scale industry and fisheries
	1999	4 mn	Bridging financing

[5] 25th Anniversary 1974-1999, 1999 Annual report, the National Insurance Board The Bahamas
[6] July 1991 both loans went in default on the repayment of principal and interest. Both loans are guaranteed by the Government of the Bahamas

Bahamas Telecommunications Corporation	1986	20 mn	Capital development projects
	1988	19 mn	
Bahamasair [7]Holdings Ltd	1989	6mn	For capital investment and expansion. Loan is unsecured
Broadcasting Corporation of The Bahamas	1990	250,000	Purpose not stated

Source: Annual reports, NIB, The Bahamas

Table 4: <u>Dominica Social Security Investment Mix 1995-1997EC$mn</u>

Category	1995	% of total investment	1996	% of total investment	1997	% of total investment
Total investment	132.10		136.25		149.13	
Government debentures	28.31	21.27	28.31	20.78	28.31	18.98
Treasury bills	17.59	13.22	17.59	12.91	17.59	11.79
Real property	4.54	3.41	4.70	3.45	5.59	3.75
Loans outstanding	34.40	24.93	39.75	29.17	39.26	26.33
Fixed deposits	41.81	31.41	37.46	27.49	39.37	26.40
Equity	6.11	4.59	6.16	4.52	7.21	4.83
Demand deposits			2.27	1.67	11.79	7.90

Source: NIB Annual Reports Dominica

[7] 1991 company in default on principal and interest. Full provision made for principal and accrued interest

Table 5: Dominica Social Security

Loans as a % of Total Investment Portfolio 1995 and1996

Loans to government of Dominica

Loans to statutory bodies

Student loan fund

Credit union loans

Loan to trade union

Loan to National Development foundation of Dominica

The bulk of the loans made by the Dominica Social Security scheme in 1995 went to the credit unions and by 1997 statutory bodies were the largest recipient of loans by the scheme.

Such investment activities by the National Insurance Board serve to marginalize the banks and other financial institutions that might have developed as a result of market forces.

Table 6: Guyana NIS Investment Mix 1990-1999 GY$' 000

Year	Total Investment	Government Debentures	Fixed deposits	Equity	Municipal bonds	Others

Source: NIS Guyana Annual reports

The composition of the investment portfolio is representative of the characteristics of investment by other institutional investors where lack of well developed capital markets, coupled with the small number of financial instruments, has forced them to have a heavy concentration in Government Treasury Bills and other government securities.

The scheme is one of the largest shareholder in TCL a publicly listed company in Trinidad and Tobago. The firm is also one with cross-border operations in two other CARICOM Member State.

Table 7: National Insurance Board Trinidad and Tobago

Investment Mix 1991-2000

Year	Total investments	Debentures	Gov't Securities	Fixed deposits	Equity	Other bonds	Mortgages and Real Estate

2:2 Investments in Government Securities

Investing in government securities seems to be one of the choice investment instruments for National Insurance Schemes in the Region.

The national insurance scheme, like a number of institutional investors tends to have a significant portion of its investment portfolio invested in government securities. Perhaps because of the surety of the returns from that instrument and the low default risk attached to it.

.

Along with the growth in total NIS assets in recent years, there has been a shift in the investment allocation of those funds toward higher yielding and slightly riskier assets. In Trinidad and Tobago investment in Government securities became prominent only after that in Mortgages began to decrease and government securities was seen as a better investment alternative.

2:3 Investments in Equity and Other Securities

The national insurance schemes in the countries studied have displayed very little interest in investing in equity. Investment in equity by the National Insurance Schemes has been confined to domestic firms.

The thinness of the markets coupled with the culture of buy and hold has to some extent resulted in the schemes not trading in those equities. Investment in equities can be considered a relatively recent phenomenon, as the stock exchanges in the Region are a fairly recent addition to the capital market infrastructure. The number of listed companies in the Region is very small, being under 150 for the entire Caribbean region. As such, the opportunity for buying large volumes of shares is not available in the domestic market and investment rules preclude them from buying in the rest of the Region. Despite those, however, investment in equity has never been given active consideration by the schemes. The highest percentage of investment in equity is in Trinidad and Tobago, perhaps because that country has a vibrant capital market and a functioning stock exchange. In 2000 the Executive Director of the National Insurance Board said

"It is also our intention to exploit the opportunities provided by recent legislative amendments for investing up to 10% of the portfolio in foreign denominated securities,"[8]

Table 10: National Insurance Scheme Assets Invested in Equity 1995

Country	% of financial assets Invested in Equity 1995
The Bahamas	0.29
Dominica	4.62
Guyana	9.66
Trinidad and Tobago	18.15

Source: National Insurance Annual Reports

.

The behaviour of the NIS in CARICOM is closely related to the macro economy, and because investment market follows the real economy the downturn in the macro economy affected the investment income from investing in real estate resulting in a reduction in investment in that category.

In general , the schemes have adopted a very conservative investment strategy intended to minimize risk to the portfolio, but at the same time taking on large exposure to the government sector and in the case of the Bahamas to the

[8] NIB 2000 annual Report page 14

quasi government sector. Some of the individual securities in the portfolio can be considered risky and pose a greater risk to it than if the portfolio was diversified geographically.

3. The Role of National Insurance Schemes in the Development Of The Capital Markets

The National Insurance Schemes (sometimes referred to as social security schemes) throughout the Region, because of the volume of resources controlled can be effective sources of long-term savings which is necessary to support the development of the capital markets.

Additionally, these institutions can also force financial innovations in the markets.

Although they have displayed a preference for investing in safe short to medium term financial instruments, they have been participating as passive investors in the domestic capital markets and in particular the equity markets.

Since the mid 1990s a significant change was observed in the investment portfolio, with a move away from investment in government securities into other areas. In 1992 the chairman of the National Insurance Fund in Trinidad and Tobago noted in his yearly review that

> ***"In recognition of the fact that an adequate yield on investments could only result from prudent management of a carefully designed investment portfolio, the Board has been closely reviewing its investment strategy and the range of investment instruments available to it with the intention of ensuring that it earns more acceptable returns on its reserves. Fixed deposits, government securities and other non government bonds which are currently generating higher and safer yields are therefore being paid closer attention, while decreasing the Board's exposure to investments such as mortgages which have produced a lower yield due to the high level of default and administrative deficiencies "***[9]

The schemes, despite high liquidity, have failed to provide a direct stimulus to the development of the securities market. In Dominica for example, there is a Board decision that all funds should be invested in the domestic

[9] The National Insurance Board Annual Report July 1991-June 1992

market. However in 1997 there was a deviation from that policy when a small portion of the portfolio was invested in the Home Mortgage Bank in St Kitts and Nevis. The Board noted, “This was done primarily to support that venture and encourage local participation in the bank, mindful of course, of the minimum risk involved therein”[10].

This though is not confined or unique to the Caribbean as in some developed and some Latin American countries there are similar constraints regarding quantitative investment limits. There are also some limits favouring conservative investment policies and these have operated to restrict the National Insurance schemes from exerting a beneficial effect on capital market development.

The behaviour of the national insurance scheme in the capital markets is similar to that of individual investor who tends to buy and hold rather than trade securities.

It has been accepted that NIS like other institutional investors are highly liquid yet they have insufficient investment in equity or other investment products outside the traditional areas.

These schemes have the potential to play an important role in the development of the capital markets, especially the development of the debt market which is just beginning to emerge in the Region.

The national insurance schemes, by their mere willingness and legislative mandate, to lend to quasi government agencies are in effect helping to retard or delay the development of the capital markets in the Region.

Take for example the case of The Bahamas; a significant amount of the NIS investment portfolio is in loans to government agencies. Those institutions, because of the size of the loans could have a positive impact on the level of activities in the capital markets.

[10] 1997 Annual Report, Dominica Social Security

If they had approached the capital markets it would have added some depth and perhaps liquidity to the market. Because these corporations have easy access to relatively cheap financing on easy terms the need to approach the market is reduced. Such loans have effectively served to maintain the status quo in the organizations and to entrench weak or inefficient management rather than forcing or demanding good governance.

There is a tendency, especially in periods of economic downturn to resort to National Insurance Schemes as ready sources of cheap financing for the government budget or social investment.

Therefore, investing in illiquid capital markets by the national Insurance schemes would not be considered prudent by policy makers.

The growth in the NIS resources should have contributed to a stronger role of capital market intermediation. Their participation would force changes in certain key areas. Modernization of the capital markets infrastructure in turn would promote the growth of securities market because they become more attractive for investment by NIS.

Vittas in his 1996 article suggested that pension funds could act as catalysts for the: -

i) development of efficient trading and settlement

ii) The adoption of modern accounting and auditing standards

iii) Promotion of meaningful information disclosure

Effective regulation, supervision and oversight are all important for the development of a sound system. The main objective is to protect beneficiary
The benefits of investment cross border needs to be carefully assessed against the risks involved. The theory states that international diversification of portfolio enhances the power of portfolio diversification. High correlation of returns between countries has, in some cases, led to a restructuring of portfolios by diversifying across sectors .

It has been found that diversifying across countries while staying within the same sector reduces volatility more than diversifying across industries in a single country.

In examining the asset portfolio of the national insurance schemes in CARICOM it is critical to take both a regional and a country approach. For these schemes, cross border investment has not been given high priority, one reason for this is again the limited instruments that are available in the cross border market.

Within the context of the CSME, the regional approach is extremely important as the Region will be treated as a single economic space in which to conduct business. Dimitri Vittas in his 1996 article observed that

> ***" Unrestricted foreign investment may institutionalise capital flight and prevent domestic markets from reaping the benefits of creating pension funds with long term financial resources"***[11]

In the Region, most of the Member States have weak capital market institutions. Where stock exchange exist they are for the most part illiquid and very thin with very few financial instruments This has affected the asset selection of the NIS schemes by limiting their choice of financial instruments. Had the institutions been proactive they could have used their financial power to force changes in the financial system. However they remain passive investors, despite in a number of cases being significant shareholders in large corporations.

Despite the vast amount of resources controlled the institutions have had no impact on capital markets development mainly because they have been constrained by factors including the absence of instruments, unwillingness or inability of management to undertake investments that are not prescribed by the relevant authorities and a prohibition in a number of instances of cross border investments. Vittas also observed that *" as pension funds grow in size and relative importance new instruments are developed to meet the needs and to fill perceived gaps in the market"*[12]

Although there are a number of firms with cross border operations none have recorded significant investments by NIS. Although the NIS can be considered a dominant public sector financial institution it has not had any impact

[11] Dimitri Vittas. Pension Funds and Capital markets, Public Policy for the Private Sector Vol 71 February 1996,the World Bank
[12] Dimitri Vittas. Pension Funds and Capital markets, Public Policy for the Private Sector Vol 71 February 1996,the World Bank

on the development or modernization of the capital markets in any of the countries studied.

National Insurance schemes, could, from their vantage point

i) Exert significant influence on the development of new financial products for trade in the domestic markets,
ii) Ensure that the systems are modernized and operate to international standards
iii) Aid in the development of other specialized capital markets institutions
iv) Ensure that shareholders rights are enhanced
v) Increase the demand for shares in the domestic market and across the region
vi) Force the expansion of the cross border markets
vii) Foster good governance in corporate entities
viii) Force governments to facilitate the development of supporting infrastructure in which the NIS can be allowed to operate.

Observations

National insurance schemes are large non-bank financial institutions that have been established to impose a payroll tax on workers and to invest the resources for later use by contributors. However these institutions have, for the most part been operating like unofficial public sector bank, providing different types of financial accommodation to both Government and quasi government agencies. Their financial power is so great that they could exert positive influence for the growth and development of capital markets institutions not only in their domestic economy but also across the Region.