



First Citizens

How Pension Funds in the Caribbean come to term with Investment Risk

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The Primary Objective...

- Is to accumulate sufficient assets, through...
- **CONTRIBUTIONS** and **INVESTMENT INCOME**
- ...to satisfy all pension obligations of the contributors on a timely basis.
- Everything else is driven by this overarching objective.

Opportunities, Obstacles and Threats

- Opportunities, Obstacles and Threats to the “Primary Objective” arise when:

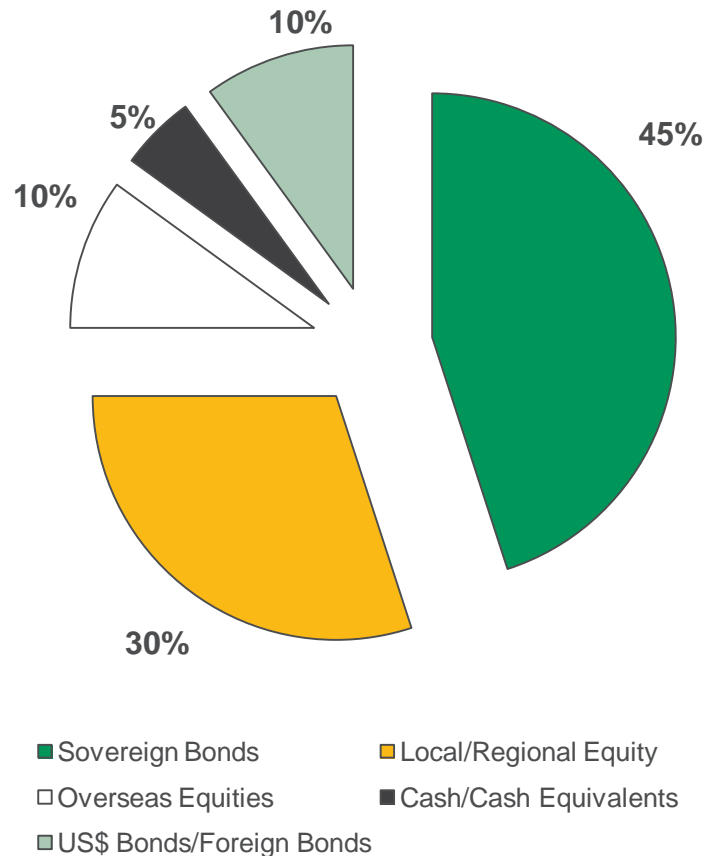
- The Assets of the Fund don't behave the way we expected them to; or

- The Obligations of the Fund don't behave the way we expected them to;

- Either they behave better than we expect, worst than we expect, or they just behave different.

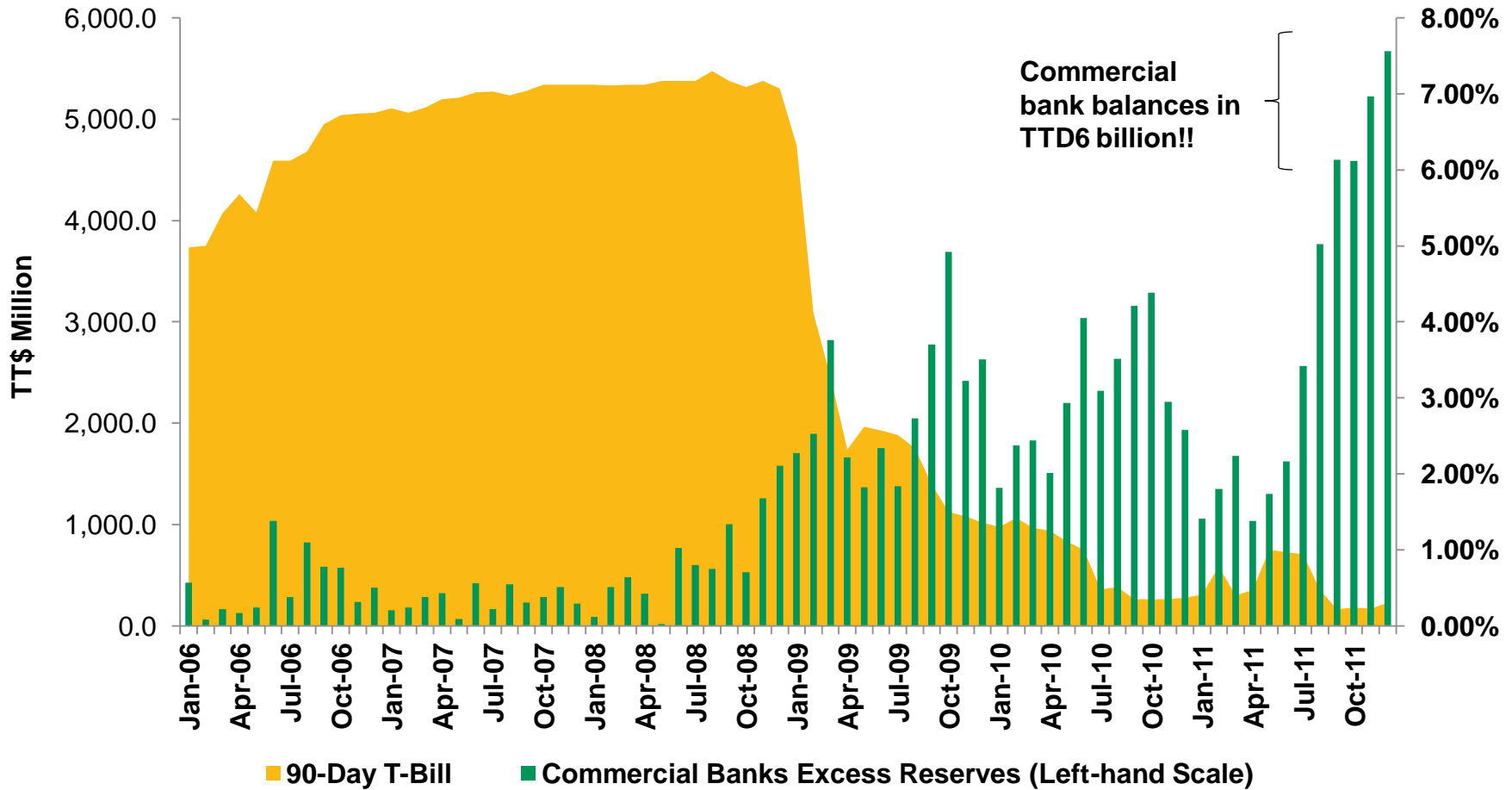
- We have many names for these Opportunities, Obstacles and Threats. Sometimes they are called Risk other times they are called Returns.

What do Caribbean Pension Funds Look Like?

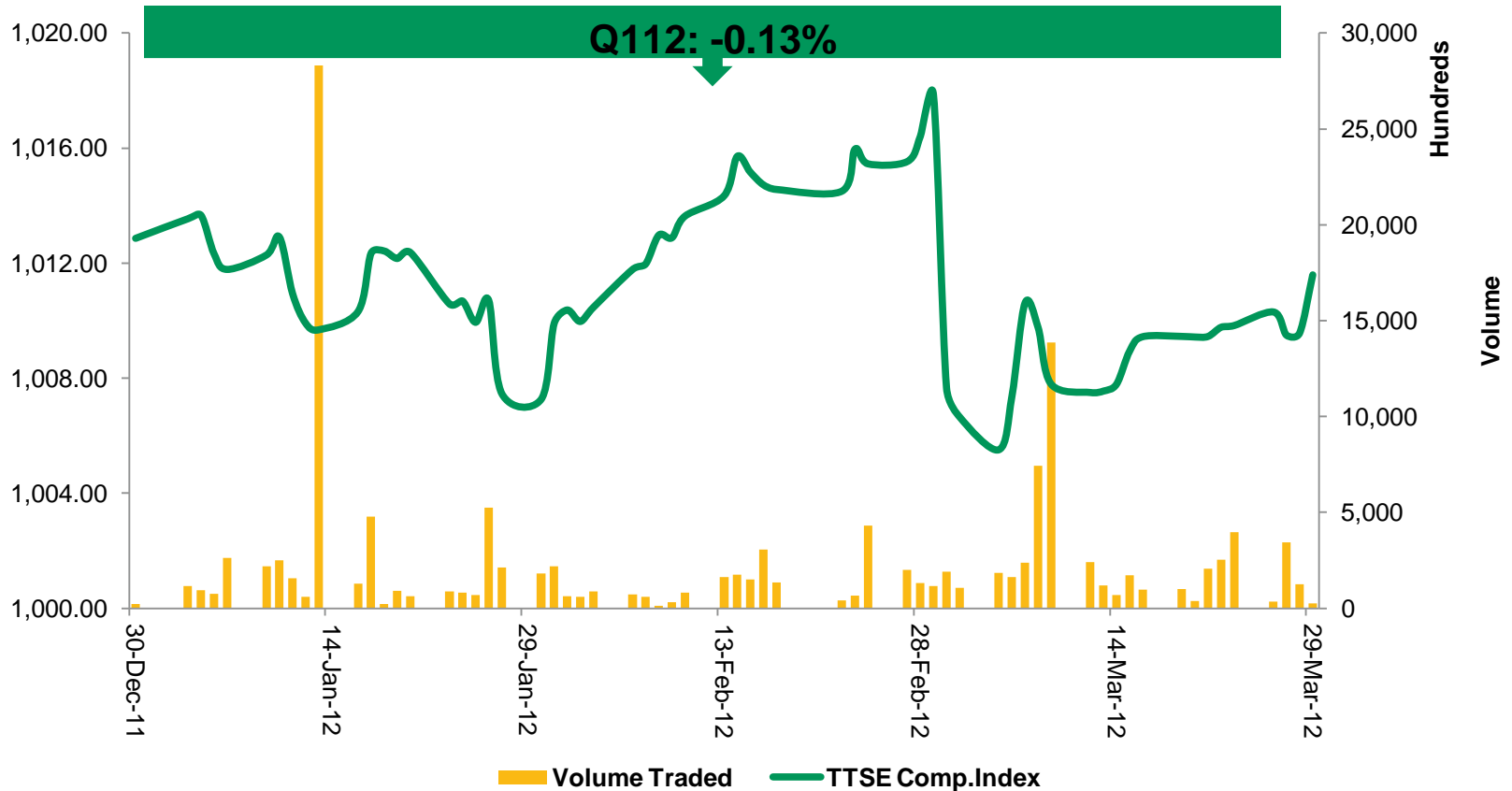


- Long-term investment horizon
- Overweight in fixed-income securities
- Overweight in long-term Government Bonds
- Local currency investments
- Regulation dictates that 50%-70% must be in fixed income securities and
- 80%-100% must be in locally issued securities, be it in Local Currency or US Dollars
- Diversification is a challenge.
- No Hedging or Use of Derivatives are allowed

Excess liquidity (2006-2012)...

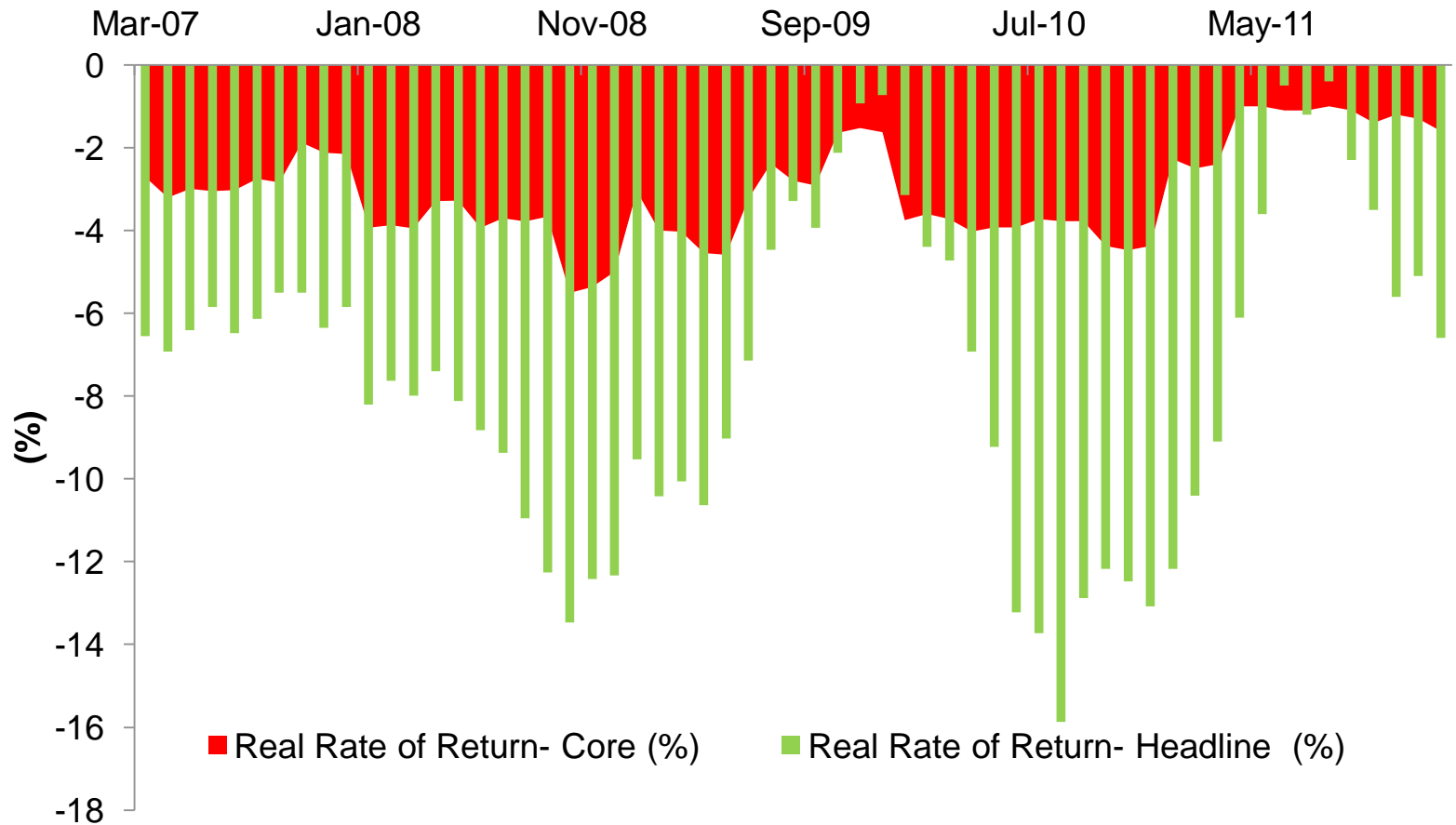


Trinidad and Tobago Composite Index



2011 Return: 21.21% as investors chase high dividend yielding stocks

Local investment environment...



Negative real rate of return on core and headline inflation since 2007!!

Obstacles and Threats:

- **Credit Risk:** the risk that the borrower does not repay
- **Market Risk:** the risk of declines in the prices of securities
- **Interest Rate Risk:** the risk of decline of interest coupons and the value of interest bearing securities as a result of movements in market interest rates
- **Reinvestment Risk:** the risk that cash inflows will be reinvested at yields that are lower than those historically earned
- **Currency Risk:** the risk that foreign exchange rate movements result in realized or unrealized translation losses
- **Inflation Risk:** the risk that the fund earns negative real rates of return

Obstacles and Threats:

- **Concentration Risk:** significant exposure to a few issuers or investments.
- **Lack of Diversification:** regulatory constraints limit the ability to diversify broadly.
- **Limited investment opportunities:** the available opportunities and investment instruments is limited compared to the quantum of assets needed by Institutional Investors. The market does not have the capacity to absorb the funds available for investment.
- **Skill capacity improvements:** the need to continue to deepen the capacity of both industry professionals, investment committees and policymakers in order to improve how Funds are monitored and controlled; and how risk is measured and assessed.

The Greatest Risk of All

- **Systematic Risk: The Risk inherent to the entire Market – the “undiversifiable risk”**

- the concentration in Government securities and the inability to diversify broadly has led to increased systematic risk for Pension Funds.

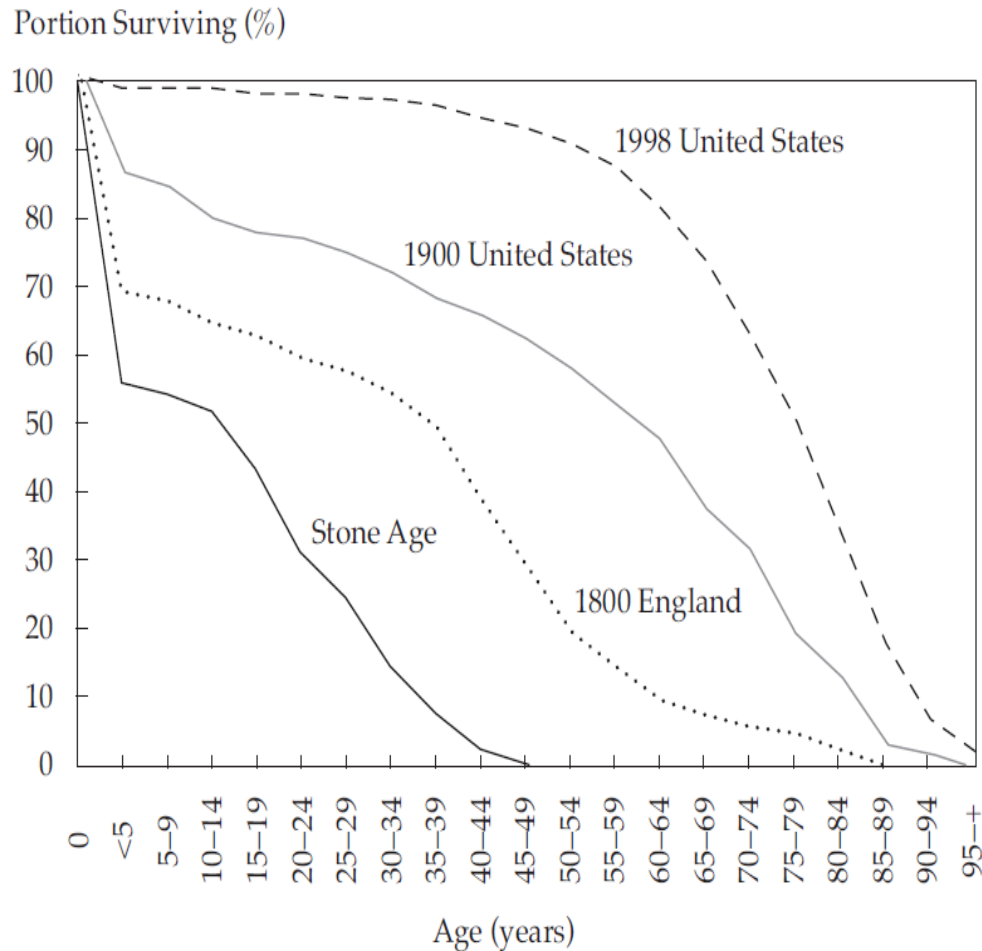
- This is one of the greatest challenges.

- We have all our eggs in one basket.

- Limited options available to Hedge this risk.

- The overweight in local currency and government securities heightens the challenge of Systematic Risk.

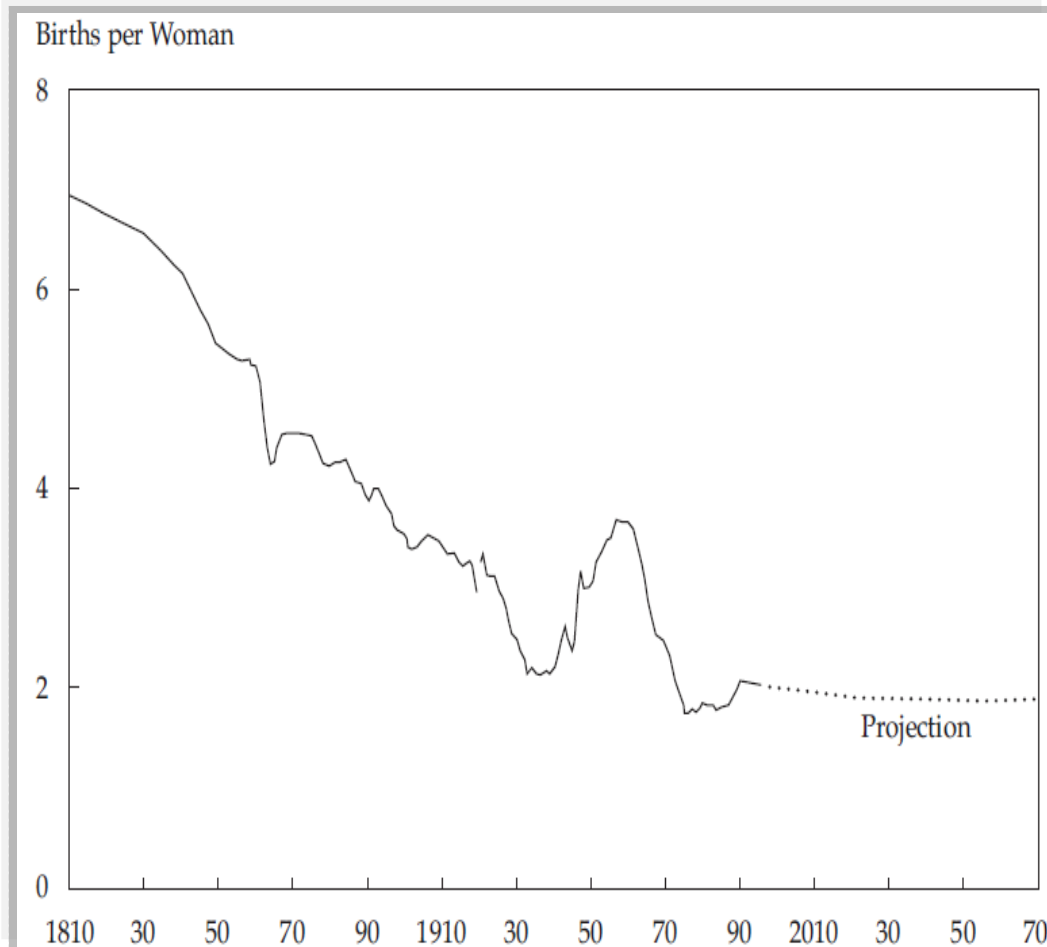
We are living longer.....



Average life expectancy has improved considerably over the last century

Post retirement life expectancy has improved from an average of 12 years in the 1900's to 16 years in the 2000's

We are multiplying less...

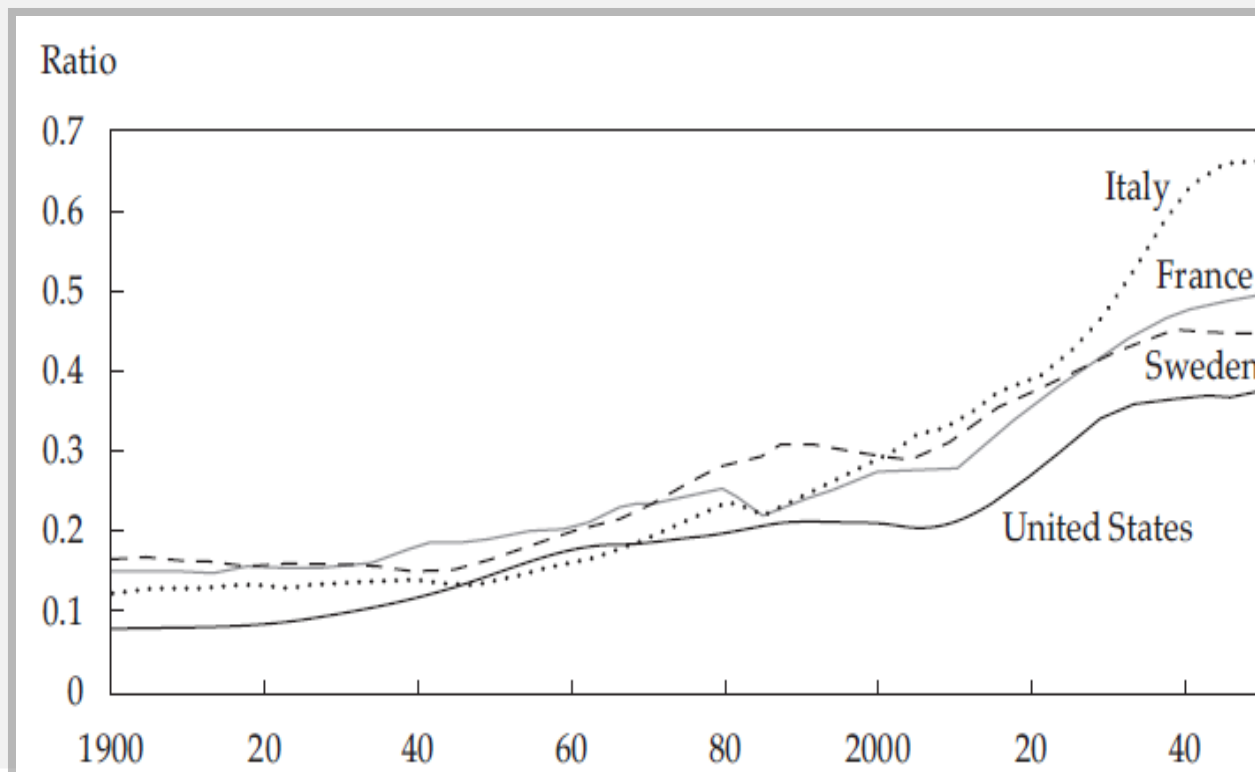


Fertility rates have declined sharply in the later half of the 20th century.

There has been a long-term decline in fertility rates across the world.

The “baby-boomers” represent the spike in the trend.

Old Age Dependency Ratio



The combination of longer life expectancy and declining fertility rates:

Aging population

Rising burden on those left in the workforce

We are not out of the woods yet

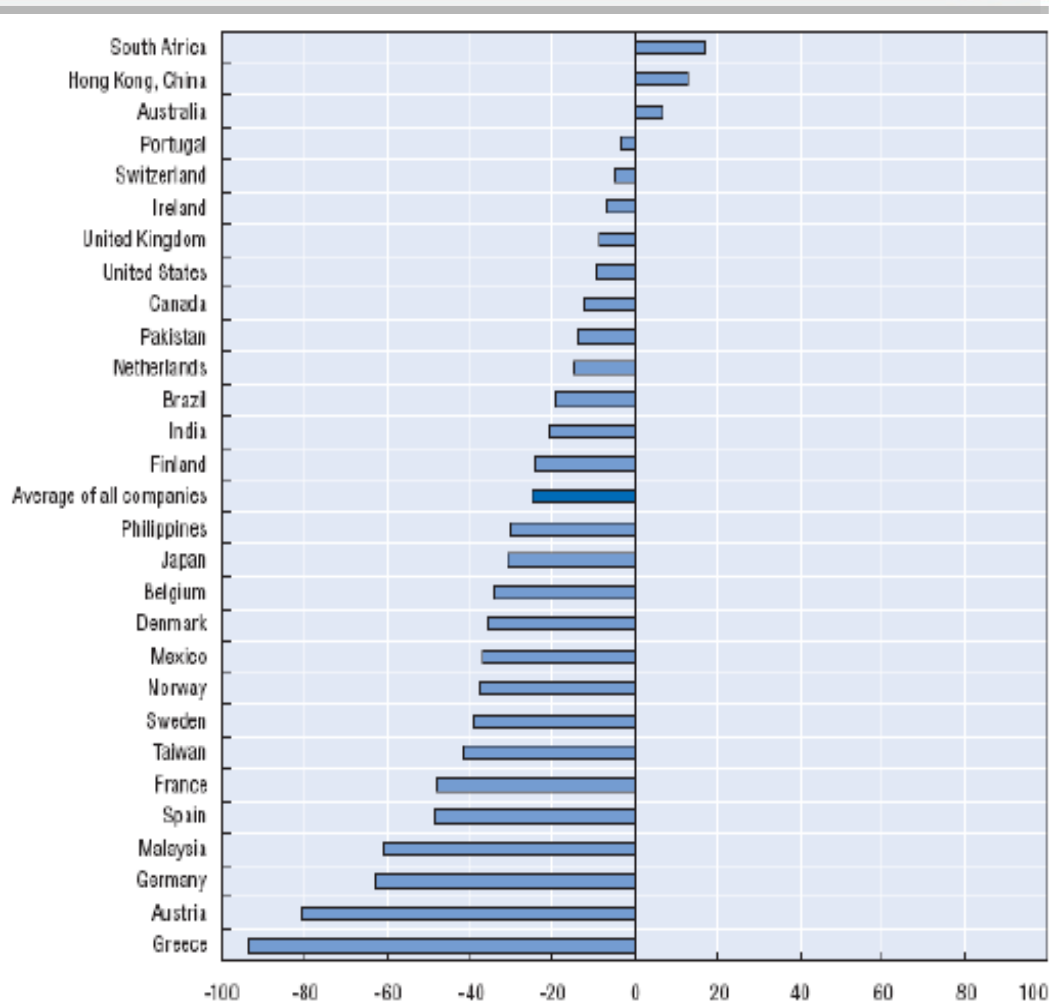


Chart shows the average Over funded (right bar) or Under funded (left bar) of major economies

All but three countries are in an Under funded position as at 2007.

This was before the Global Financial Crisis

How do we manage in this environment?

- We have to do our “home work”
- Measure and understand the Risk of each security and your portfolio
- Need to invest in our systems and people
- Pension Fund regulatory and legislative reform has to be revisited to allow for greater diversification with the necessary monitoring and controls
- The “New Normal”:
 - low yields,
 - rising inflation,
 - Government being the only game in town,
 - Ballooning liquidity.

THANK YOU

