

**CARIBBEAN CENTRE FOR MONETARY STUDIES’
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on

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

**“PENSIONS AND INVESTMENTS FOR THE
SMALL MAN”**

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PENSIONS

- **Pensions exist for 3 primary purposes**
 - **avoidance of poverty**
 - **consumption smoothing**
 - **insurance against longevity**
- **Pension arrangements pose a challenge to policy-makers for decades**
- **Globally pension reform has either taken place, is underway or is being contemplated**

PENSION REFORM

- **Nature of reform determined by**
 - **historical factors**
 - **socio-cultural factors**
 - **demographics**
 - **macroeconomic conditions**
 - **financial environment**

FACTOR DRIVING REFORM

- **Attributable to problems with legacy schemes**
 - **Financed by payroll taxes on PAYGO**
 - **Defined benefit arrangements**
- **Maturity leads to problems of**
 - **Sustainability/solvency**
 - **Equity**
 - **Effect on growth**

PROBLEMS WITH LEGACY SCHEMES

- **Sustainability/solvency**
 - **Generous benefits -> implicit debt**
 - >100% of GDP
 - **Declining dependency ratio**
 - parametric changes
 - Political feasibility?
 - Instability?
- **Growth**
 - **Negative effect on economic growth**

PROBLEMS WITH LEGACY SCHEMES

- **Equity**
 - **Rich benefit more**
 - **Larger future pension financed by others**
 - **Generous benefits to 1st generation retirees**

NATURE OF REFORMS

- **Structural changes**
 - **PAYGO to Funding**
 - Long term savings and financial market effects
 - **Defined Benefit to Defined Contribution**
 - Labour market effects
 - **Social Safety Net**
 - Poverty reduction effects

NATURE OF REFORMS

- **3-Pillar Approach (World Bank Model)**
 - **Pillar 1**
 - **Publicly managed; non-contributory; tax-financed**
 - mandatory basic pension for poverty reduction
 - **Pillar 2**
 - **Mandatory forced savings**
 - Publicly/Private managed – personal accounts
 - **Pillar 3**
 - **Voluntary savings**
 - providing more protection for old age

NATURE OF REFORMS

- **Many countries in Latin America, Europe & Asia in 1990s adopted reforms**
 - **individual variations on 3-Pillars**
 - **many common features**
 - **defined contribution**
 - **partial pre-funding**
 - **shared public/private sector responsibility**
 - **separate poverty prevention element**

NATURE OF REFORMS

- **Also significant differences**
 - **nature & size of public pillar**
 - **options for management of pillar2**
- **influenced by**
 - **initial conditions**
 - **political economy**

EXPERIENCE/SUCCESS OF REFORMS

- **Chile often cited as success story for 3-Pillar approach**
 - **longest experience - reformed since 1981**
 - **some successes**
 - **matching of assets and liabilities**
 - **average annual real returns > 10%**
 - **increased long term savings**
 - **development of financial markets**
 - **protection for the poor**
 - **reform said to be significantly contributing to high growth rate**

EXPERIENCE/SUCCESS OF REFORMS

- **However, there are downsides**
 - **Pillar 1 not very effective in mitigating poverty**
 - **Only Pillar 2 contributors eligible for Pillar 1 benefits**
 - **only about 55% of labour force covered in Chile**
 - **lower coverage in lower income countries**
 - **eg about 25% in Peru & 11% in India**
 - **low wage earners - the small man - typically excluded**

IMPACT ON SMALL MAN

- **Excludes many low wage earners, eg**
 - domestic servants
 - agricultural labourers
 - caregivers
 - workers in informal sectors
- **Forced savings generally disadvantageous to poor**
 - **increased savings = reduced consumption**
 - most of income of very poor expended on necessities
 - food, healthcare, education, etc
 - **even more so, if pooled with wealthy**

PROVIDING FOR THE SMALL MAN

- **Pension Objectives**
 - **avoidance of poverty**
 - **consumption smoothing**
 - **insurance against longevity**
- **For small man, retirement in dignity of fundamental importance**
 - **provision of stable basic income that prevents impoverishment required**

PROVIDING FOR THE SMALL MAN

- **New Zealand 2-Pillar Model**
 - **Pillar 1**
 - Flat rate, non-contributory universal pension
 - Tax financed on PAYGO basis
 - **Pillar 2**
 - Voluntary savings
 - **No mandatory savings pillar!**

PENSIONS IN THE EC AREA

- **Social Security/National Insurance Schemes**
 - **Mandatory contributory scheme**
 - **Financed by payroll taxes on PAYGO basis**
 - **Defined benefit arrangement**
- **Occupational pension plans**
 - **Public Sector**
 - **Public service pensions - non-contributory, PAYGO, funded from Consolidated Fund**
 - **defined benefit arrangement**

PENSIONS IN THE EC AREA

- **Private Sector**
 - mainly fully funded, contributory plans
 - some partially funded non-contributory
 - defined benefit/contribution schemes
- **Private Individual Arrangements**
 - Typically insurance policy-based
 - Defined contribution arrangement

PENSIONS IN THE EC AREA

- **Small Man typically covered only by SSS/NIS**
 - **Dependent on SSS/NIS for retirement income**
- **As SSS/NIS mature, issues driving reform in other countries increasingly relevant**
 - **Will need to reform schemes**
- **Issues affecting Small Man will apply**

PENSIONS IN THE EC AREA

- **Pension funds portfolio allocation inefficient**
 - **Concentration in domestic bank deposits**
 - **Exposure to National Governments**
- **Investment Opportunities**
 - **Traditionally, limited**
 - **Underdeveloped financial system**
 - **Dominated by commercial banks**
 - **Agency insurance market**
 - **Lack of organised capital markets**

EC AREA SSS/NIS Portfolio Allocation 1980 –1995 period average

Asset Category	EC Area Holdings %
Cash	1
Deposits	40
Gov't Securities	19
Other Local Investments	18
Foreign Investment	7
Other	15

THE NEW CAPITAL MARKET REGIME IN THE EC AREA

- **Early 1990s Council mandate ECCB to act on Article 4(3)**
 - *“to promote credit and exchange conditions and a sound financial structure conducive to the balanced growth and development of the economies of the territories of the participating Governments”*
 - development of money and capital markets

THE NEW CAPITAL MARKET REGIME IN THE EC AREA

- **Diagnosis:**
 - **Financial system fragmented**
 - 8 separate markets
 - **Institutions highly fractionalised**
 - Large number of small entities
 - **Existing markets - all primary**
 - Money markets
 - Treasury Bill market
 - Government Bond market
 - Corporate Securities market

THE NEW CAPITAL MARKET REGIME IN THE EC AREA

- **No organised secondary markets**
- **Result:**
 - **Inefficient allocation of resources**
 - **Constraint to development**
- **Response:**
 - **thrust to develop and integrate markets => greater efficiency in mobilising and allocating resources across single financial space**

CAPITAL MARKET DEVELOPMENT PROGRAMME

- **4 key regional institutions identified for development:**
 - **E C Home Mortgage Bank (ECHMB)**
 - **E C Securities Exchange (ECSE)**
 - **E C Unit Trust (ECUT)**
 - **E C Enterprise Fund (ECEF)**

IMPLEMENTATION

- **Successes to date:**
 - **Inter-bank market**
 - **secondary mortgage market**
 - **ECSM**
- **to be delivered**
 - **Regional Government Securities Market (RGSM)**
 - 2002

IMPLEMENTATION

- **ECUT**
- **ECEF**
- **Other Initiatives**
 - **ECIB**
 - **Human resource development**
 - **Institute of Accountants**
 - **harmonised accounting standards**

EASTERN CARIBBEAN SECURITIES MARKET (ECSM)

- **ECSM launched 19 October 2001**
- **will transform ECCU financial landscape**
- **Modern, state-of-the-art market:**
 - **1st fully electronic regional market in Western Hemisphere**
 - **fully dematerialised**
 - **T+1 settlement cycle**
 - **DVP settlement**

ECSM - MARKET STRUCTURE

- **Key Institutions**
 - **The EC Securities Regulatory Commission**
 - **The EC Securities Exchange**
 - **The EC Central Securities Depository**
 - **The EC Central Securities Registry**

LEGAL & REGULATORY FRAMEWORK

- **Securities Act**
 - **Passed in all 8 member countries**
 - **Provides a common legal framework for regulating securities business**
 - **Vests regulatory authority in the EC Securities Regulatory Commission**
- **Securities Regulations**
 - **8 of 10 finalised**
 - **Issued in some Member Countries**

EC SECURITIES REGULATORY COMMISSION (ECSRC)

- **ECSRC Agreement**
 - All countries party to Agreement
 - Has force of law with commencement of Securities Act
- **Fully and ultimately responsible for regulation of ECSM**
 - licensing
 - formulating regulations
 - monitoring activity to ensure fair, efficient & transparent markets & investor protection

EC SECURITIES REGULATORY COMMISSION (ECSRC)

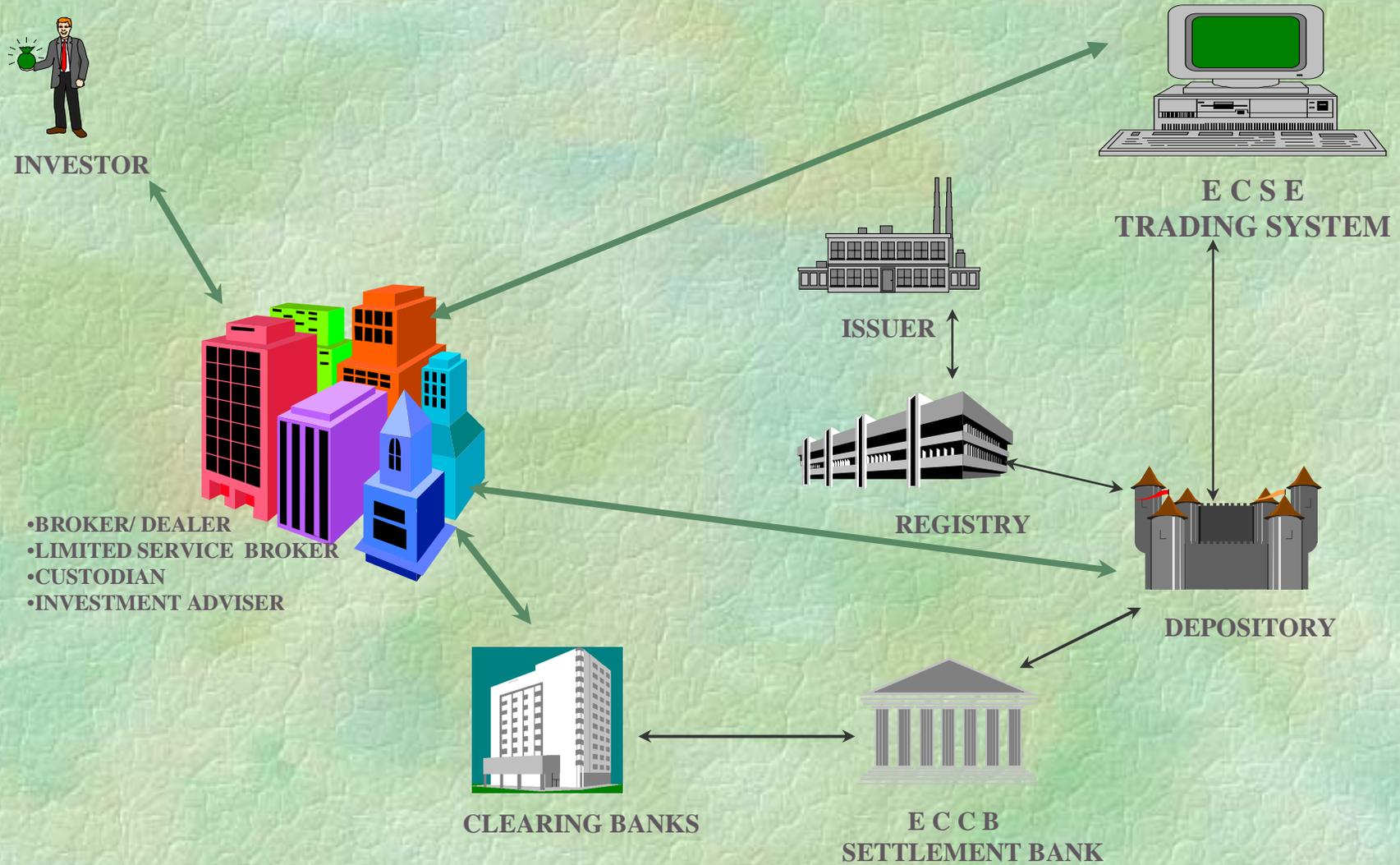
- **Commission**
 - **independent**
 - **Appointed by Monetary Council**

- **ECCB providing technical & administrative support**

ECSM - MARKET INSTITUTIONS

- **EC Securities Exchange Ltd (ECSE)**
 - **Pivotal market institution**
 - **Provides trading platform for buying & selling securities**
- **2 wholly-owned subsidiaries:-**
- **EC Central Securities Registry Ltd (ECCSR)**
 - **Maintains security-holders' records in electronic form**
- **EC Central Securities Depository Ltd (ECCSD)**
 - **Facilitates post trade clearance & settlement**

ECSM - MARKET INSTITUTIONS



ECSM - MARKET INSTITUTIONS

■ **Ownership Structure**

● **ECSE**

- **Class A - ECCB (30% of issue)**
- **Class B - Public Sector Institutions**
- **Class C - Financial Intermediaries**
- **Class D - regional entities, issuers, individuals, etc**

● **ECCSD & ECCSR**

- **Wholly owned subsidiaries of ECSE**

ECSM - MARKET INSTITUTIONS

■ **ECSE CAPITALISATION**

- **Subscription still opened**
 - \$10.0M to be raised
 - Subscriptions & commitments - about \$9.1M
- **Purpose**
 - Initial capital expenditure
 - Ongoing working capital
 - Medium term expansion
- **Terms of Offer**
 - Max Subscription - 200,000 shares - 20% of issue
 - Min Subscription - 2,500 shares

ECSM - TRADING METHODOLOGY

- **Single Price Call Auction**
 - **Bids and Offers matched**
 - starting with highest bids and lowest offers
 - **A single price struck at 2:00pm daily**
 - ie price at which maximum volume of bids and offers clear
- **Continuous order matching capability exists**
 - **market will evolve when volumes permit**

ECSM - TRADING METHODOLOGY

- Pricing Example

Symbol IBM					
Sell Orders			Buy Orders		
Quantity	Price	Time	Quantity	Price	Time
1,000	10.00	9:25 am	500	12.00	2:19 pm
1,200	10.25	8:37am	700	11.75	9:19 am
1,400	10.25	8:45 am	1,000	11.50	10:44 am
800	10.50	11:55 am	2,200	11.25	10:58 am
2,000	10.75	9:15 am	1,500	11.00	2:16 pm
500	11.00	1:12 pm	1,000	10.75	1:03 pm
3,000	11.25	2:05 pm	1,500	10.50	11:22 am
1,100	11.50	2:09 pm	2,000	10.25	11:15 am
1,200	11.75	2:29 pm	3,000	10.00	1:10 pm
1,300	12.00	8:30 am	400	10.00	1:35 pm

- All successful investors will receive (sellers) or pay (buyers) the Uniform Price - \$10.75 per share of IBM

ECSM - MARKET OPERATIONS

- **Market Infrastructure/Institutional Relationships**
 - Working efficiently
 - High level of coordination between institutions
 - Clearance & settlements operating smoothly
 - No failures to date
- **ECCSR**
 - Processed first corporate action
 - Dividend disbursement

ECSM - MARKET ACTIVITY

- **Trading volumes low**
 - **Infancy**
 - **Narrowness – 2 companies listed**
 - **BON Ltd**
 - **ECFH Ltd**
 - **Limited access – 7 intermediaries**
 - **No intermediaries in**
 - **Anguilla**
 - **Grenada**
 - **Montserrat**

ECSM - MARKET ACTIVITY

- **Potential and Prospects**
 - **29 Public Companies**
 - **Market Capitalisation > \$800M;**

- **ECSE Marketing, Education & Awareness Programme =>**
 - **more listed companies**
 - **more intermediaries**
 - **increased activity**

REGIONAL GOVERNMENT SECURITIES MARKET (RGSM)

- **Developed in tandem with ECSM**
- **Will leverage ECSM trading platform**
- **Scheduled for mid- 2002**
- **Objectives**
 - **strengthen existing primary T-bill & bond market**
 - **promote development of secondary market**

REGIONAL GOVERNMENT SECURITIES MARKET (RGSM)

- **Potential and Prospects**
 - **8 Governments**
 - **Securities at 31/3/01 = \$1,089.9M**
 - **T/Bills**
 - \$451.9M
 - yields = 6% - 8.3%
 - **Bonds**
 - \$638.0M
 - yields = 4% - 11.5%

REGIONAL GOVERNMENT SECURITIES MARKET (RGSM)

■ Benefits

- deepening & integration of markets**
- provide fillip to ECSM**
- potentially lower cost financing for Governments**
- promotion of free flow of capital & liquidity across ECCU**
 - increased savings & investment opportunities**

EASTERN CARIBBEAN UNIT TRUST (ECUT)

- **Regional collective investment vehicle**
 - **Facilitate smaller investor access to Securities Markets**
 - pooling => risk diversification
 - professional management => enhanced investment returns
 - **Important element of market initiatives**
 - high priority

EASTERN CARIBBEAN ENTERPRISE FUND (ECEP)

- **Regional investment/venture capital fund**
 - **a vehicle to source and channel funds to private enterprise development**
 - **will provide equity and loan capital**
 - **focus on most productive areas**
 - **focus on entrepreneurial development**
 - **training**
 - **business advice**
 - **technical assistance & support**

EASTERN CARIBBEAN ENTERPRISE FUND (ECEP)

- **will nurture companies to facilitate graduation to ECSE listing**
- **conceptually, an omnibus financing vehicle**
 - **will collaborate with national, regional & international institutions**
 - **participation of all entities in providing capital resources**

CONCLUSION

- **ECCB promoting the**
 - **modernisation and deepening of the financial system**
 - **creation of an enabling environment to provide investment opportunities for both the institutional and the individual investor**
- **Pensions funds expected to play a major role as the leading institutional investor**
- **New investment opportunities for the Small Man.**

INFORMATION

- **Financial & Enterprise Development Dept, ECCCB**
- **Web Site: www.eccb-centralbank.org**
- **E-mail: eccbmm@caribsurf.com**



- **ECSE**
- **Web Site: www.ecseonline.com**
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