PENSION STANDARDS, LEGISLATION AND BEST PRACTICES GUIDELINES IN MOST JURISDICTIONS REQUIRE AN INVESTMENT POLICY TO BE DEVELOPED.

INTRODUCTION

Prior to 2004, there was no specific law regulating the Pensions Industry in Jamaica except for the Income Tax Act. Through the Tax Administration Jamaica (formerly the Tax Payer Audit and Assessment Department) pension plans were approved and granted tax exemption status.

The Pensions Act came into effect in 2004, followed by the supporting regulations, one of which was the Investment Regulations which was written into law in 2006. One provision of these regulations was the preparation of a Statement of Investment Policy and Principles (or SIPP) for each approved superannuation fund or retirement scheme.

BEST PRACTICES

Preceding the advent of the Pensions Act and Investment Regulations, prudent investment management techniques and internationally recognized best practices were adopted by players in the Pensions Industry. Asset selection was undertaken after extensive research and due diligence in achieving the investment objectives of the pension plan.

Effective asset liability management took into consideration the long term nature of the pension plan, and therefore sought to maximize long term real returns by investing in appropriate assets with acceptable levels of risk to ensure solvency for benefit payments. These were embodied in an Investment policy, with the main objectives being:

1. Prudent risk management through diversification of investments while seeking to ensure capital preservation.
2. Maintenance of sufficient liquidity to pay expenses and benefits as they become due.

3. Maximization of long term returns through economic cycles, within the investment guidelines and constraints of the Investment policy framework.

The establishment of an investment policy was undertaken with input from the actuary who assessed the liabilities and solvency of the plan, which formed the basis of the investment advice given to the trustees regarding the nature and time horizon of investments to pursue.

The investment manager worked collaboratively with the trustees conducting periodic portfolio reviews to determine a target asset mix which took into consideration the following:

1. Membership and liability distributions of the pension plan.
2. Trustees balance of risk and reward
3. Macro economic climate.

Diversification across the main asset classes of stocks, bonds and real estate was always recommended, as this is essential for prudent long term management of risk and reward.

While an Investment Policy was in place which did not cover all the specifics of the Regulations, the framework was always guided by Best practices and prudent investment management and incorporated a broader investment strategy.

INVESTMENT REGULATIONS 2006

The Investment Regulations was a welcomed development as it provided a clearly defined framework within which the investment manager should operate and mandated the establishment of an investment policy for all pension plans.

Some of the specifications of the Regulations are:

1. The duties of the Investment Manager and trustees, a few examples of which are:
    a. To prudently invest and manage the assets of the plan
    b. To ensure that an investment is in keeping with the stated objectives of the plan

c. To ensure that due diligence is conducted prior to making an investment
d. To avoid leaving funds idle, for not more than a period exceeding one month
e. Give due consideration to the expenses of the plan, and only incur what is appropriate and reasonable.

2. The preparation of a SIPP for each pension plan
    a. The trustees shall prepare a SIPP and submit to the Commission within 60 days of approval.
    b. The trustees shall review the SIPP al least once per year
    c. If there is a material change to the fund, the trustees shall review the SIPP within 90 days
    d. The trustees shall make a record of every review.

3. The contents of the SIPP; which include among other things
    a. The fund's rate of return objectives, gross and net of expenses
    b. The fund's risks and risk tolerances
    c. The maturity profile of the assets and liabilities
    d. Liquidity needs
    e. Target mix of the plan
    f. Related party transactions.

4. The types of investments that are allowed for pension plans
    a. Government Securities issued by Jamaica or any other approved jurisdiction with a credit rating of 'A' or equivalent;
        i. USA, UK or Canada
    b. Equities listed on a stock exchange of Jamaica or recognized jurisdiction
    c. Loans, mortgage or deeds of trust collaterised by real property in Jamaica
    d. Real property in Jamaica

e. Foreign securities issued by Jamaica or a recognized Jurisdiction
f. Multilateral financing bodies with which the Government of Jamaica has lending arrangements.
g. Leases
h. Type I or Type II Pooled Funds

5. The types of investments that are prohibited for pension plans
   a. Short Sales
   b. Securities issued by an insolvent institution
   c. Unsecured loans or leases
   d. Investments in entities which are owned by the auditors, accountants or actuaries for the fund
   e. Speculative investments
   f. Mortgages for properties located outside of Jamaica
   g. Any investment or security which, in the opinion of the Commissioner is designed to evade any prohibitions under the Act

6. The limits that are applicable to investments, and these are
   a. The Fund may not acquire more than 30% of the voting shares in a corporate body or the interest in any entity
   b. Loans shall not exceed 80% of the remaining value of the collateral at the date of grant
   c. Total value of loans to any related party shall not exceed 1% of the fair value of the assets of the fund
   d. Foreign securities shall not exceed 20% of the fair value of the assets of the fund. The regulator, however, has advised that this limit is superceded by the Bank of Jamaica Act, which places a 5% limit on investments in foreign securities. This limit is applicable even to investments in GOJ global bonds based on the statutory definition of a foreign security.

e. The total of related party investments, other than Deposit Administration contracts and Type 1 Pooled Funds shall not exceed 10% of the fair value of the assets of the fund
f. Investments in any one person or associate of that person should not exceed 5% of the fair value of the assets of the fund. This limit shall not apply to Government of Jamaica securities, deposit administration contracts or Type 1 Pooled Funds.

It could be argued that the specifications and limits in some areas are counterproductive to the achievement of investment objectives, with the three main areas being:

1. Investment limit for foreign securities
2. Approved recognized jurisdictions, which notably excludes the Caricom region
3. The prohibition of investments in unsecured loans. This therefore excludes investments in unsecured bonds issued by financially sound Corporate entities.

SOCIALLY RESPONSIBLE INVESTING (SRI)

An investment is considered socially responsible based on its nature or type of business. It involves an investment strategy which seeks to better align investment activities with the broader interests of society by screening for profitable companies that make a positive contribution to society. SRI mutual funds are a growing area in US markets.

Common examples of socially responsible investments include seeking out companies that are involved in environmental sustainability or alternative energy/clean technology companies while avoiding companies that:

1. Pollute the environment,
2. Produce or sell addictive substances such as cigarettes, alcohol or gambling,
3. Have bad corporate governance practices or
4. Do not respect human rights.

These areas of concern can be summarized as ‘environmental, social and corporate governance issues’.

While this is morally a sound concept, unfortunately in the Jamaican context it is generally not adopted. This is not to say that the concept is not supported, however in our role as investment manager the focus is on maximizing real positive long returns while minimizing risk through diversification. Some of the locally listed companies that would be excluded with the adoption of SRI are well managed, financially sound companies that have provided strong returns for our pension clients, such as Lascelles (alcohol) and Carreras (cigarettes).

In recapping, some points to consider in relation to the development of an Investment Policy are as follows:

1. We are governed by the specifications of the Pensions Investment Regulations.
2. Our Regulations place a limit of 5% on investments in foreign securities, and these are limited to the approved jurisdictions of USA, UK and Canada. This severely limits our investment options.
3. Jamaica is a relatively small country with limited investment opportunities.
4. The Regulations do not place any investment limits on GOJ securities, which tends to cause a heavier concentration in GOJ bonds than in any other asset class, further raising issues of concentration risk.
5. While we can invest without limit in GOJ securities, with a credit rating of ‘B-/C’ which is below investment grade, we can only invest in ‘A’ rated bonds in the approved jurisdictions up to a 5% limit.
6. Local interest rates were significantly reduced with the Jamaica Debt Exchange Programme in 2010, and have continued to trend down to the lowest levels in decades. This will force investment managers to consider broader investment options to maximize real long term returns, while operating within the constraints of the Regulations.

7. We have seen an increasing shift from DB to DC plans which shifts the investment risk to the member. The importance of maximizing real long term returns is therefore more imperative.

With increasing expenses to the pension plan, limited investment options and the changing investment climate coupled with the general uncertainties that currently prevail, achieving the objectives of an investment policy have become more challenging.

Investments in mutual funds, such as the Type II Pooled funds managed by Sagicor present a viable option in achieving the objectives of an investment policy for the following reasons:

1. This approach maximizes diversification across all asset classes.
2. Allows small pension fund to participate in offerings that require a large investment that can be accommodated through a pooling of funds. This is most significant when considering investments in real assets.
3. Facilitates liquidity support through the purchase and sale of units.
4. Affords cost efficiencies through lower transactions costs.