

**Bahamas Institute of  
Financial Services**

**ANNUAL WEEK OF  
SEMINARS**

**May 17, 2007**



## The Link between Pensions and Long Term Social Financial Stability

- *Begin presentation with revisiting the pre 2000 environment when Bahamas was blacklisted:*
  - *Europeans concerned with the existence of Tax Havens*
  - *Determination to plug the long-term leakage in their tax base*
  - *Black – listing of sovereign nations...Bahamas included*
  - *'Money Laundering' and now 'Anti –Terrorism' now main drivers of public face of the movement.*



## The Link between Pensions and Long Term Social Financial Stability

- *Submit that there was a very powerful ‘SOCIAL’ driver of these concerted initiatives:*
  - *Many European nations facing the consequences of completely ‘broken’ social systems*
  - *France, Italy, Germany and Japan have antiquated pay-as-you-go social systems*
  - *Many mature industrialized nations are nearing the threshold where the number of persons working is exceeded by those retired (Bahamas is not far away from this)*

*Resulting in the long term financial sustainability of the economy being placed ‘at risk’*



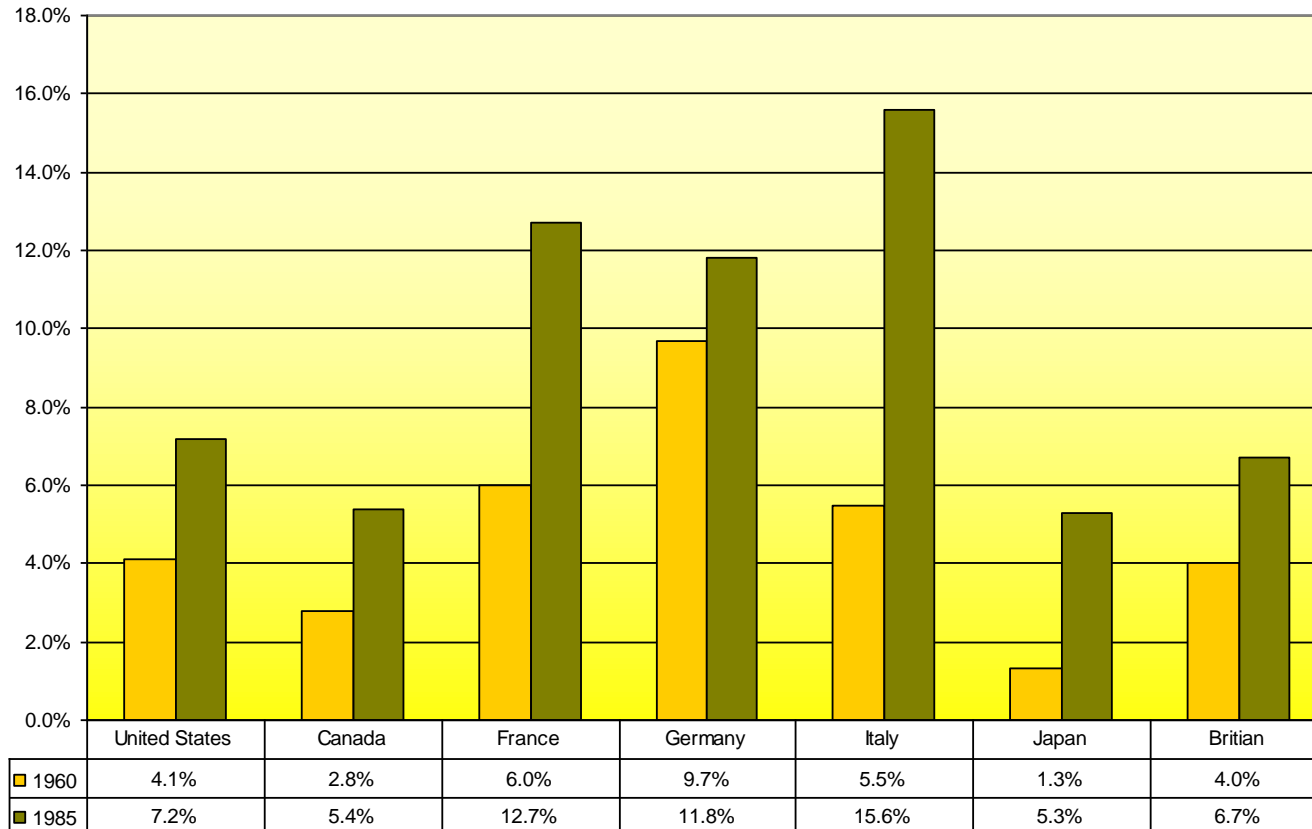
## The Link between Pensions and Long Term Social Financial Stability

- *Implications:*
  - *Public Finances may not be sustainable*
  - *The impact of aging populations may impact future economic growth and living standards*
    - » *Financial Markets (forced selling)*
    - » *International capital flows*
- *Remedy:*
  - *Pension Reform*
  - *Labour market reform*
  - *Fiscal prudence*



# The Link between Pensions and Long Term Social Financial Stability

## Social Security Expenditure as % GDP

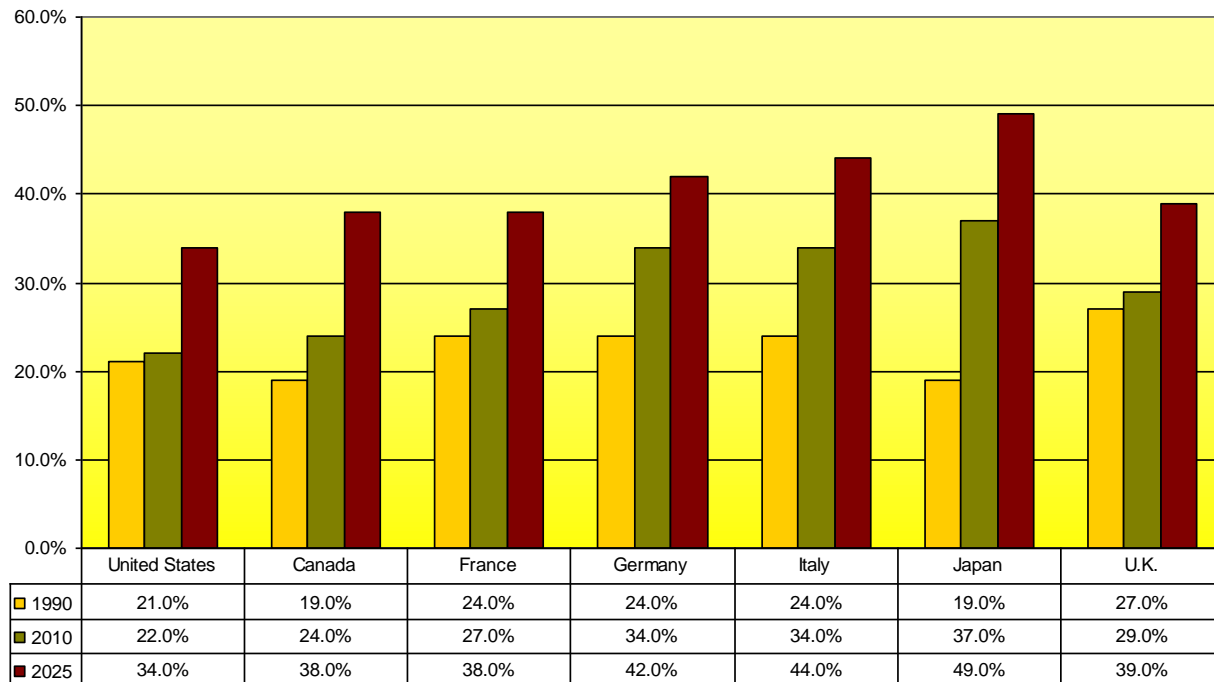


Ratio of public expenditure on pensions to current year GDP. (Privately sponsored pensions not included)  
Source: Mitchell 1993



# The Link between Pensions and Long Term Social Financial Stability

## Old-Age Dependency Ratio's by Selected Countries



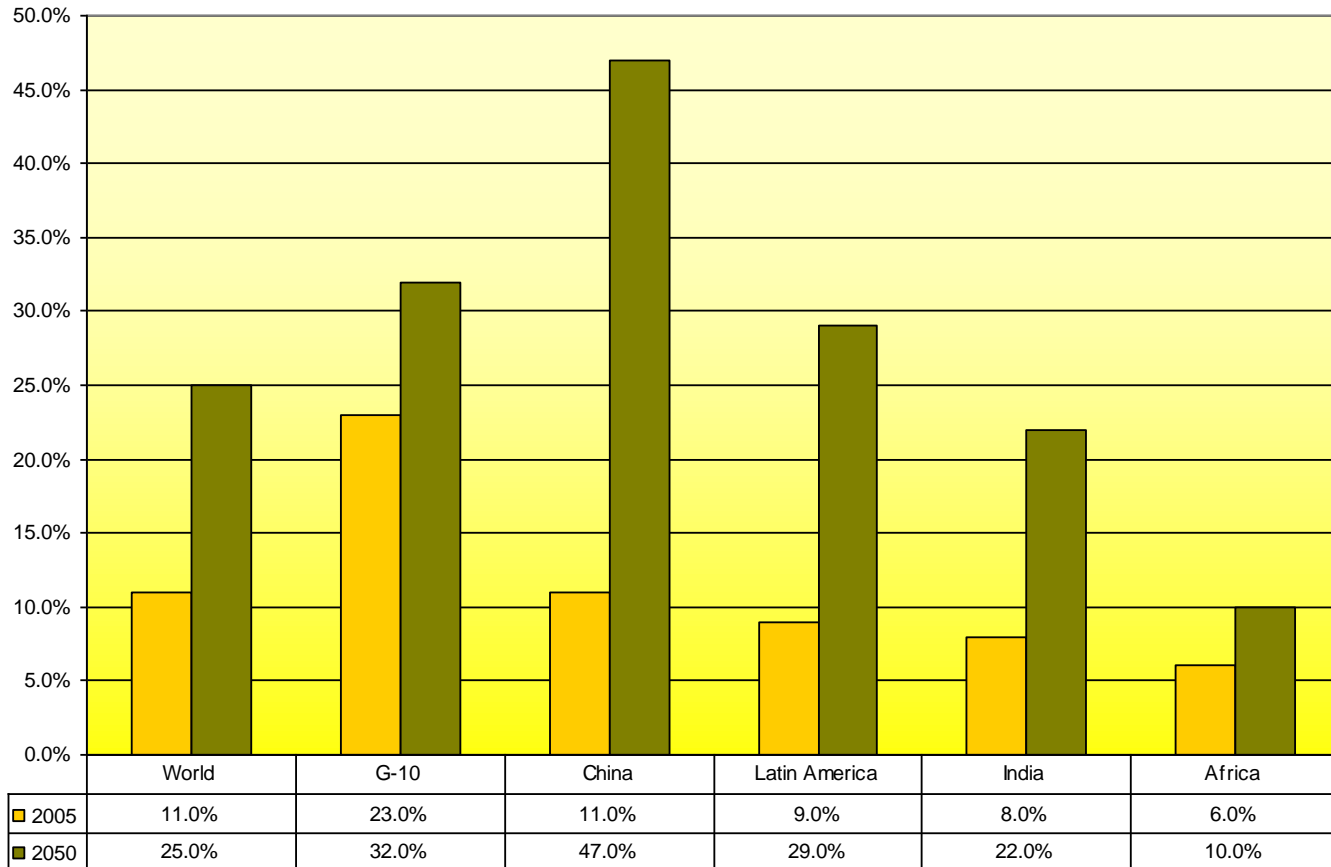
Ratio of the number of persons 65 years and over as a percentage of persons aged 20-64 years.

Source: U.S. Department of Commerce 1993



# The Link between Pensions and Long Term Social Financial Stability

Old-Age Dependency Ratio's  
by Region



Ratio of the number of persons 65 years and over as a percentage of persons aged 15-64 years.

Source: U.N. World Population Prospects 2004



## The Link between Pensions and Long Term Social Financial Stability

- Economic insecurity among the retired/elderly is a universal problem
- Countries are being forced to focus on managing the huge financial burden being placed upon their future annual budgets to finance social security systems

*The following countries have already lowered future social security benefits by legislation:*

**United States 1983**

**Japan 1985/1994**

**United Kingdom 1980/1986**

**Germany 1989**

**France 1993**

**Italy 1993**

**Sweden 1994**



## The Link between Pensions and Long Term Social Financial Stability

### *Additional Initiatives:*

- *Countries are plugging loopholes in tax systems*
- *Many countries are considering extending the mandatory retirement age into 70's*
  - » *UK now 65 / Avg. 63 / 68 by 2020*
  - » *History of age 65 retirement age (Bismarck 1870's)*
- *Companies are eliminating traditional defined benefit pension plans and replacing them with defined contribution plans*



# The Link between Pensions and Long Term Social Financial Stability

## TYPES OF PENSION PLANS

### ***Defined Benefit:***

- A retirement plan through which employers (and sometimes employees) contribute to a fund for which a clearly defined and guaranteed level of benefit will be paid to retirees. Promises specified annuity benefits, typically in the form of a monthly retirement pension based on levels of compensation and years of service. Contributions are actuarially calculated to provide amount of pension payments. Formula driven e.g.

$$1.5\% \times \text{Annual Salary} \times \text{No. Years of Service}$$

### ***Defined Contribution:***

- A defined contribution plan is a plan providing for an individual account for each participant, and for benefits based solely on the amount contributed to the account, plus or minus income, gains, expenses and losses allocated to the account. Plan contributions are paid into an individual account for each member. The contributions are invested and the returns on the investment (which may be positive or negative) are credited to the individual's account. On retirement, the member's account is used to provide retirement benefits.



## The Link between Pensions and Long Term Social Financial Stability

*There are 2 ways we can provide for a secure old age:*

### ***Funded:***

- *We can save part of our wages each week and draw on the accumulated funds after we retire to buy goods produced by younger people.*
  - » Company sponsored DC pension plans
  - » National Insurance Scheme

### ***Unfunded:***

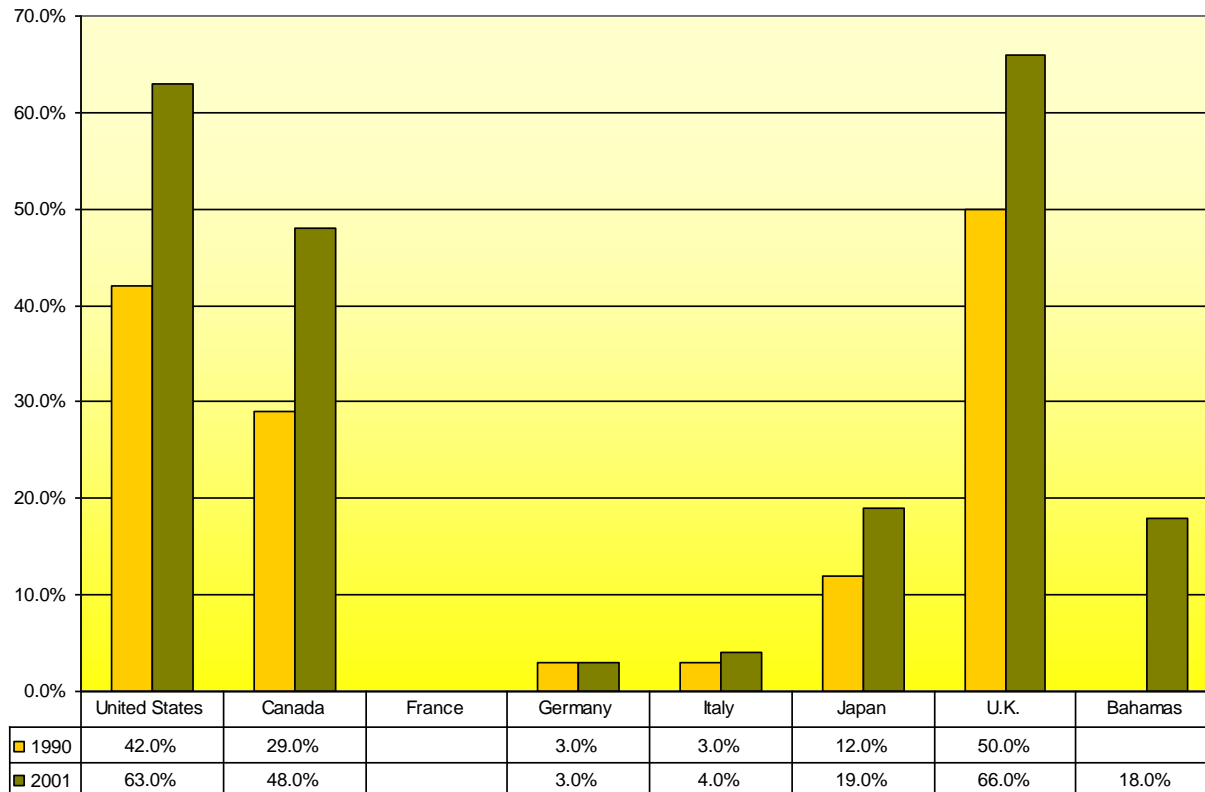
- Or we can obtain a promise—from our children or our government—that, after we retire, we will be given goods produced by others.
  - » Pension for Government employees
  - » DB plans are a mixed bag

***Global policy makers are coming to the view that future retirees would be better off investing at least part of their savings in private, funded pension plans.***



# The Link between Pensions and Long Term Social Financial Stability

## Pension Assets as a Percent of GDP



Excludes PAYGO systems



## The Link between Pensions and Long Term Social Financial Stability

The NIB Commission states: “The Social Security Reform Commission recognises that the National Insurance Retirement pension was not designed to provide sufficient income in old age for all retirees. And although many workers are members of employer pension plans and/or have their own personal savings, a great number of Bahamians retire without a secure income“.

### Social ‘time-bomb’ in the making:

- Less than 25% working population covered by a pension plan of any kind
- NIB Insolvent by 2029 – 18% contribution to maintain same level of benefits
- Average NIB cheque is about \$260



## The Link between Pensions and Long Term Social Financial Stability

Other factors contributing to the 'social  
time-bomb'

- Longer life spans
- 'Senior sandwich'
- Very low national savings rate
- Relatively low rate of home ownership



## **The Link between Pensions and Long Term Social Financial Stability**

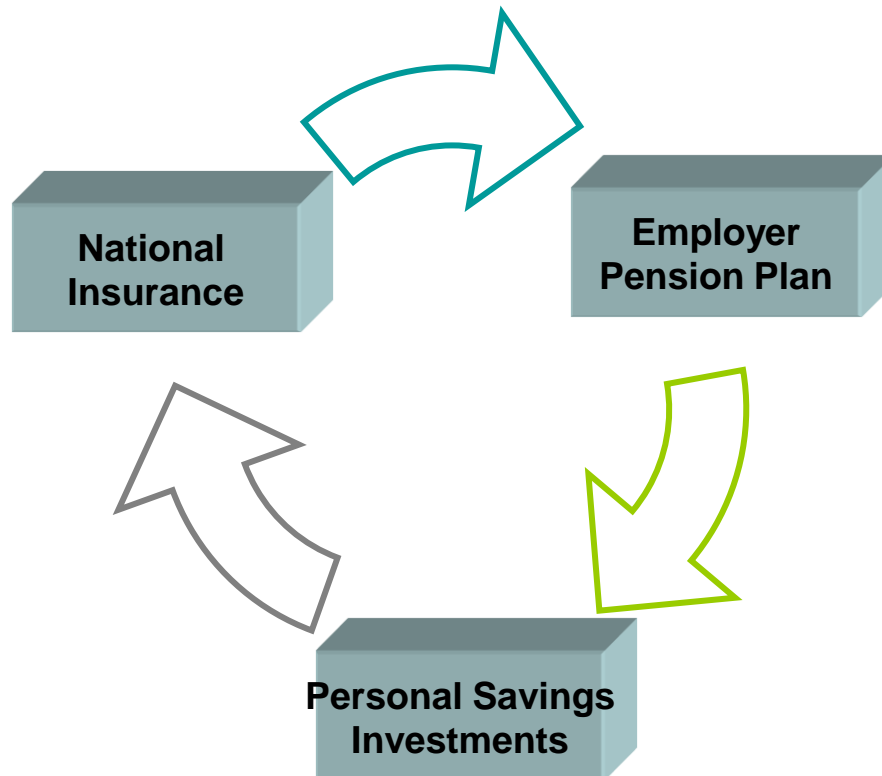
- ***According to a survey of people over 65,  
performed by the US Government:***
  - **45% - dependent on their relatives;**
  - **28% - rely entirely on public charity and social security;**
  - **22% - must continue to work as they cannot afford to retire;**
  - **5% - have enough money to meet their needs.**

**Countries have sought to correct this through the  
implementation of Pension Legislation**



# The Link between Pensions and Long Term Social Financial Stability

## Suggested Structure of Pension System Multi-pillar Model





## The Link between Pensions and Long Term Social Financial Stability

# Goals of Pension legislation

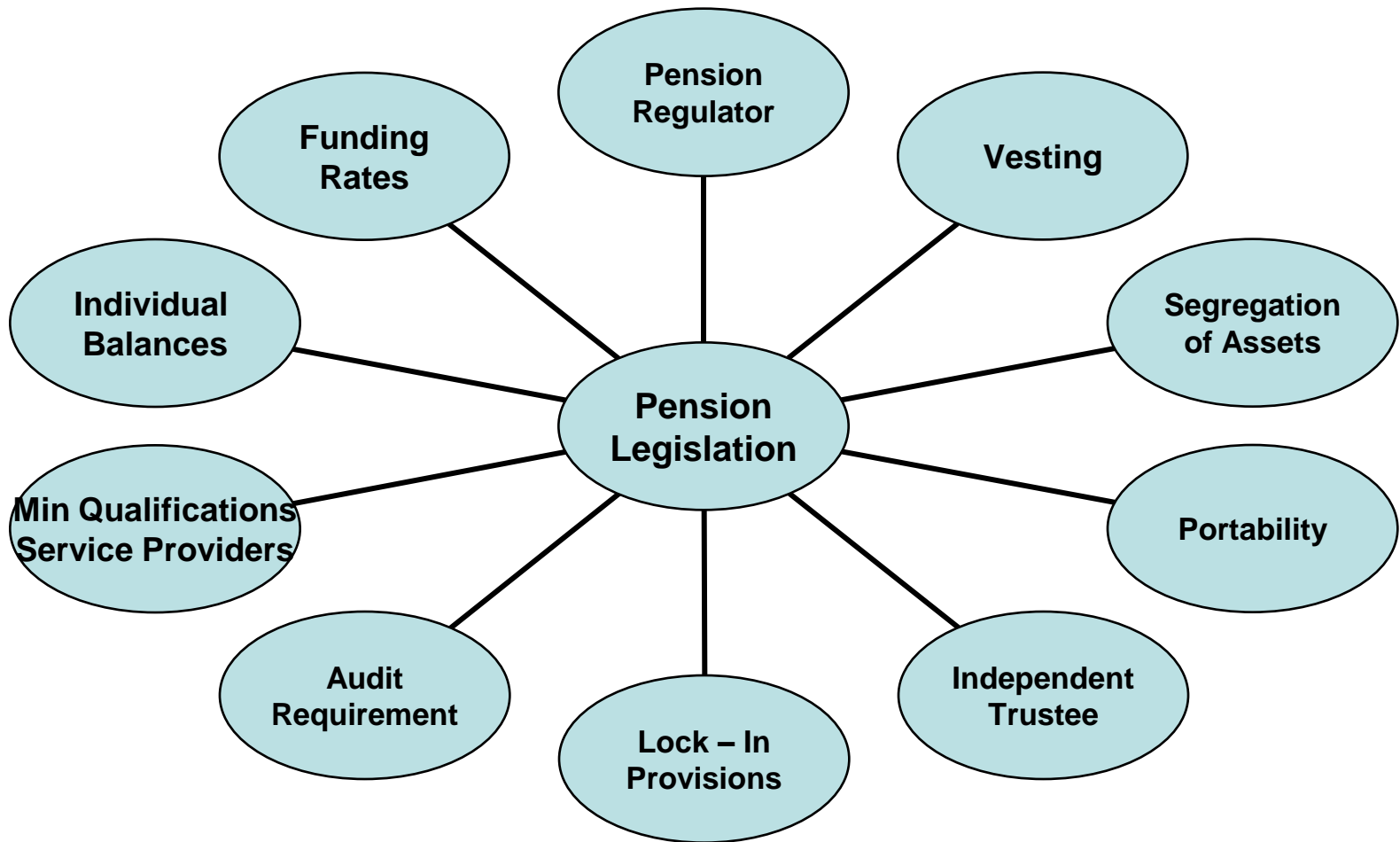
- “Our aim is a system that provides *decency for all*, which *encourages and rewards* savings and is *financially sustainable*”...and: “to provide everyone with the *opportunity to build an adequate retirement income*, and be *affordable, fair, and simple to understand*”

U.K. Labour Party  
2005 Manifesto



# The Link between Pensions and Long Term Social Financial Stability

## Features of Modern Pension Legislation





# The Link between Pensions and Long Term Social Financial Stability

## Required support mechanisms

**Education** – There must be concerted and ongoing initiatives designed to educate the workforce on the importance of retirement planning and its costs.

**Capital Markets** – There need to be public understanding of, and trust in, investment vehicles. There must be an availability of investment vehicles both local and global.

**Investment/Administrative Capacity** – Private sector expertise and capacity is a must.



## The Link between Pensions and Long Term Social Financial Stability

### Benefits of Pension legislation

- Provides for proper regulatory oversight
- Encourages long term savings
- Expands the national participation rate in pension plans (Mandatory versus Voluntary systems)
- Greatly eases the long term burden on future annual government budgets
- Supports greater social stability



## The Link between Pensions and Long Term Social Financial Stability

### CONCLUSION:

- Is there a link between Pensions (Savings Accumulations) and long term Social Financial Stability ?

I certainly believe that there is.



## The Link between Pensions and Long Term Social Financial Stability

- I submit that the Bahamas need to put pension reform 'on the table' as a matter of urgency.
- Going back to statistics quoted earlier when industrialized countries spent 5.3% to 15.6% of GDP on social security...this would equate to an annual spend of \$320m to \$936m annually.
- That is 32% to 94% of our current annual budget. Clearly such levels of spending is simply not possible, nor is it sustainable.
- Let's do the sensible thing now while we have options.

Thank you for your kind attention