



NATIONAL INSURANCE CORPORATION

INVESTMENT POLICY AND GUIDELINES

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1. OBJECTIVES OF THE FUND

The National Insurance Act No 10 of 1978 established via the National Insurance Fund, a system of National Insurance designed to provide its members with some degree of protection from certain risks entailed by or associated with old age, sickness and occupational and other hazards. This has been achieved through the collection of contributions and other income, and the payment of various benefits in the event of sickness, invalidity, maternity, hospitalization, survivorship, retirement, injury and death. The National Insurance Act No 10 of 1978 was replaced by the National Insurance Corporation Act No 18 of 2000. However, the objectives of the Fund remain unchanged. Monies in the Fund which are surplus to current needs are to be invested in accordance with section 21 of the 2000 Act.

2. THE NEED TO INVEST

Contributions paid into the Fund must be available to meet the various benefits claims but in particular, pension obligations as they arise in the future. However, given

- (i) the incidence of inflation and
- (ii) the expected decline over time in the ratio of active contributors per pensioner,

it is imperative that moneys be invested to allow the fund to

- (i) increase the level of benefits in payment to offset inflation
- (ii) supplement contributions to meet future pension obligations.

3. INVESTMENT OBJECTIVES

Three basic objectives should guide the investment of the Fund's moneys viz **safety**, **liquidity** and **yield** in order of priority.

(a) SAFETY

Safety of principal is the foremost objective of the Fund's investment program. Investments shall be undertaken in a manner that seeks to ensure the preservation of Capital in the overall portfolio. The objective will be to mitigate risk by:-

- (i) Diversifying the investment portfolio
- (ii) Limiting investments to instruments not exposed to significant risks
- (iii) Pre-qualifying financial institutions, intermediaries and advisors with which the Fund does business
- (iv) Performing due diligence on potential investors
- (v) Performing analysis on potential investments
- (vi) Monitoring of the investment portfolio

(b) LIQUIDITY

The investment portfolio shall remain sufficiently liquid to meet all cash requirements that may be reasonably anticipated. This is accomplished by structuring the portfolio so that instruments mature concurrent with cash needs. As much as possible, the portfolio should consist largely of investments with active secondary or resale markets.

(c) YIELD

The future financial viability of the National Insurance Fund is dependant on the growth of its reserves which in itself is dependant on the projected nominal rate of return. The nominal rate used (in the 6th Actuarial review of the Fund) in assessing the financial viability of the Fund to the year 2050 is 5.67%.

Successful implementation of recommendations contained in the Report would require attainment of a rate not below the recommended 5.67%. **Consequently, in allocating funds for investments it must be ensured that the financial return is pegged at a rate which allows a sufficient buffer above that actuarially determined minimum rate.**

Overall our objective would be to minimize risk while at the same time attaining growth of principal. Since

- (i) cash inflows are projected to be higher than cash outflows until 2010 (2020 if investment income included) and
 - (ii) the greater part of the Fund's liabilities are long term,
- investments should be concentrated in instruments with longer maturities.

SOCIAL INVESTMENTS

The NIS occasionally approves loans or otherwise commit monies to projects which in themselves are not lucrative investment vehicles but nevertheless confer significant benefits to society at large. *These investments are described as Social Investment and involve the financing of facilities and equipment for the provision of services in the areas of Education, Health and Housing, and aimed at improving the condition and quality of life of the citizenry.* The interest rate required *on such investments* should not have the effect of depressing the average rate for the category within which that investment falls (land, building etc.) below the actuarially determined minimum of 5.67% **Social Investments should form no more than 10% of the Fund's total investments.**

4(1). ASSET ALLOCATION

Section 21 of the Act charges the Investment Committee with the investment of surplus moneys in

- (a) acquisition of land
- (b) purchase or construction of buildings

- (c) loans
- (d) government bonds and securities
- (e) shares and debentures in bodies corporate.

As at 30th September, 2002 the National Insurance Corporation portfolio comprised

		% of Portfolio
(a)	Land.....	\$9,650,830.....1.5 %
(b)	Building.....	\$41,950,698.....6.6 %
(c)	Loans.....	\$173,981,453.....27.2 %
(d)	Government Bonds and Securities.....	\$67,796,260.....10.6 %
(e)	Shares and Debentures (Corporate).....	\$139,773,767.....21.9 %
(f)	Fixed Deposits & Money at Call.....	\$205,809,656.....32.2 %
	TOTAL	\$638,962,577.....100.0%

The Eastern Caribbean Central Bank (ECCB) earlier carried out an extensive review of the investment portfolios of the Social Security Schemes within the OECS. The objective of the review was to allow the ECCB to recommend an investment profile which would enable the Schemes to:-

- (i) use their large pool of savings more effectively for the future development of the sub region.
- (ii) provide the schemes with a more diversified and consequently more prudent spread of investments.

The resulting recommendations which still obtains were approved by the Monetary Council of the ECCB (Monetary Council comprises Ministers of Finance of the OECS countries) in 1993.

The guidelines below for the allocation of the Fund's investments have therefore given due weight to the recommendations of the ECCB. The following are the only departures:-

- (i) The ECCB recommended specific percentage allocations; this policy specifies a minimum and maximum allocation per asset category.
- (ii) The ECCB classifies lending to Statutory Bodies as **Loans**; this policy reserves the category 'Loans' for non government lending and categorizes lending to Statutory Bodies as **Government Lending**.

The allocations affected are as follows:

Assets		
<u>Category</u>	ECCB %	Policy %
Loans	34%	20-25%
Government Lending	25%	20-25%

The **Targeted Asset Allocation** of the fund to be achieved within the next 5 years is as follows:

(A) **CASH < 1%**

Holdings should not exceed 1% of total investments. The level will be determined mainly by the level of benefits payable in the short term and working capital requirements.

(B) **FIXED DEPOSITS 20 - 25 %**

Holding should range between 20% to 25% of total investments. To assist with liquidity, fixed deposits should be placed in a manner which will ensure that maturities occur evenly throughout the year. In addition, in order to take advantage of the higher rates and to avoid reinvestment risk, up to 75% of fixed deposits should, where the opportunity proves attractive be placed for periods in excess of one year.

The National Insurance Corporation should ensure that the rates of interest on its fixed deposits are competitive.

(C) **LOANS AND OTHER DEBT INSTRUMENTS (Non Government) 20 - 25%**

Holding should be in the range of 20% to 25% of total investment. Advances can be made to

- (i) other financial institutions for on-lending under specific programs established by the National Insurance Board.
- (ii) other financial institutions engaged in on-lending for educational, housing agricultural, manufacturing, tourism and information technology projects.
- (iii) companies engaged in the *Essential Services*. *Essential Services for the purposes of this section comprise*
 - (i) *Electricity generation, transmission and distribution*
 - (ii) *Supply of pipe borne water*
 - (iii) *Provision of health care*
- (iv) *subsidiaries established by the National Insurance Corporation*

In all cases, lending should only be to reputable institutions that are properly managed with a good track record. **However, monies will not be advanced to applicants where those monies will be used to finance products or services which compete directly with those provided by the subsidiary companies of the National Insurance Corporation.**

The following particulars of the Applicant must be considered before an application for a loan can be approved.

(i) **Character**

Character refers to reputation. One must examine the company's past behaviour for signs of 'good character' especially its willingness to repay. The background of the firm, its related businesses and company structure can also reveal aspects of the firm's character.

(ii) **Capacity**

Capacity is the track record and prospects of the company and its ability to meet its financial obligations. Use will be made of the financial statements to quantify the firm's ability to borrow. Different measures of soundness will be used to establish capacity. At its simplest it involves the ability of the company to generate the required cash flow to service the additional obligation. Capacity also covers the legality of the transaction for the company or its agent.

(iii) **Capital**

Capital refers to the amount of equity in a Company. It is the cushion or risk capital element that is available to absorb losses. All other things being equal, the more the equity in the business, the safer is the investment.

(iv) **Collateral**

Collateral refers to the amount of security provided in a credit or loan situation. The degree to which an investment is secured will have an impact on the potential risk since the amount of recovery (albeit at a potential cost) will be higher the greater the degree of protection.

Lending should be backed by collateral which value is no less than 67% of the initial loan.

Acceptable collateral include:

- Government guarantee
- Guarantee from 'substantial net-worth companies'
- Fixed Deposits with commercial banks
- Share certificates in listed companies
- Land
- Buildings
- Mortgage receivables

Floating assets should form no more than 25% of the security offered.

(v) **Condition**

Conditions are composed of the national, regional and local economic and business environment as well as potential changes in fiscal policy, regulations and technology. These are outside the control of the company but may have a severe impact on its prospects.

(vi) **Compliance**

Compliance with the law must be taken into account to avoid any legal risk. Confirmation must be received that the company has the legal right to undertake the transaction (i.e. avoid the ultra vires problem).

(vii) **Company**

An assessment of the skill, experience and integrity of the company's principal officers as well as the soundness of the company's Internal Control System should be undertaken.

The Fund should not engage in direct lending to the general public. However the Fund may lend to specialized subsidiaries set up or acquired to meet the demand identified.

(D) **GOVERNMENT LENDING 20 - 25%**

Holdings should fall within the range 20% to 25% of total investments. Eligible investments would include:-

- (i) Treasury Bills
- (ii) Bonds
- (iii) Loans for capital projects
- (v) Loans to statutory bodies with sound management structures

Any decision to invest in Government Securities will depend on the assessment of the Government's ability to service the debt as evidenced by the satisfaction of the conditions as per G 1 (a).

Lending to government shall be secured as per **C (iv)** above.

No loans to government should be approved where such loans are to be used to finance recurrent expenditure.

(E) LAND AND BUILDINGS 10% - 15%

Holdings should range between 10% and 15%. Land and building have in the past displayed:

- (i) higher yields
- (ii) greater asset appreciation

than other traditional investments. This category also generally provides an effective hedge against inflation and devaluation of currency. Land and buildings are however relatively illiquid assets.

(F) EQUITY (local) 10% - 15%

Investment in the shares of companies operating in St Lucia should range between *10%* and *15%* of total investments.

In its deliberations on whether to invest in the shares of a company, the Investment Committee must consider:

- (i) The nature of the company's business and its exposure to risk.
- (ii) Whether the company is listed on a recognized stock exchange or qualifies to be listed.
- (iii) The skill, competence and integrity of the officers and directors of the company.
- (vi) The availability of audited annual financial statements.

- (v) Trend and levels of the following over the preceding five years.
- (a) Net income
 - (b) Net assets
 - (c) Earnings per share
 - (d) Dividends yield
 - (e) *Dividend cover*
 - (f) Return on investment (ROI)
 - (g) Price / Earnings ratio (P/E)
 - (h) Share price
 - (i) Company's, or if an associated or subsidiary company, the parent company's market position.
 - (j) Other major shareholders of the company
- (vi) *Assessment of Accounting Systems and Internal Control*

EQUITY IN START-UPS

Equity, otherwise called risk capital, is by its very nature risky with equity holders being last in line to any benefits from the company and in the event of the distribution of a company's assets. There is considerably more risk where the equity is of a newly formed company with no track record. Given the significant percentage of start up companies

which fail, the National Insurance Corporation should avoid investing in the shares of such companies.

The National Insurance Corporation can however

- incorporate a subsidiary to meet an objective as identified by the Corporation.
- contribute to a Venture Capital Fund or a Development Fund, an amount not exceeding 1.5% of the total portfolio at cost which would circumscribe the NIC's exposure to that asset class.

(G) FOREIGN INVESTMENTS 10% - 20%

Foreign Investments are subdivided into

- (i) Regional Investments
- (ii) Extra-Regional Investments

The distinction is important to reflect the difference in liquidity which characterize the two, Regional Investments not benefiting from as active and developed a secondary market facility as the first world countries. To minimize exposure to Foreign Currency Risk, all Foreign Investments should be denominated in currencies with fixed exchange rates to the EC Dollar. To minimize default risk fixed income instruments must have a minimum rating of Baa (Moody's Investment Service) or BBB (Standard & Poor Corporation).

(i) REGIONAL INVESTMENTS 5% - 10%

Investments in this area should be restricted to 5% to 10% of total investments at costs. Permissible investments are:

- Sovereign debt
- Equities of established companies
- Corporate fixed income instruments

The following conditions will apply for all Regional Investments

(a) SOVERIGN DEBT

The country must be rated **BBB** or above by Standard & Poor or **Baa** or above by Moody's Investment Service.

In the absence of published ratings for sovereign debt the country must meet the ECCBs Standard Debt Sustainability Ratios:

- Outstanding Public Debt as a percentage of GDP must be less than 60%
- External Debt Service as a percentage of Exports must be less than 20%
- Debt Service as a percentage of Current Revenue must be less than 15%

Where the published rating as per the Ratings Agencies is below that specified by this Policy but the country satisfies the ECCBs Standard Debt Sustainability Ratios, the Board may deem that country's debt to be suitable for investment purposes.

(b) EQUITIES

- the company must have been in existence for at least 5 years
- the conditions as per F above must prove satisfactory

(c) FIXED INCOME

In the case of fixed income instruments the conditions as per C above *must prove satisfactory*

For all of (a), (b) and (c) above, the country invested in must be assessed as stable either by a rating agency or by the relevant regional authority.

In its selection of Intermediaries through which the Fund will purchase investment instruments the following must be provided (by the Financial Intermediary) prior to the entering into of any transaction.

- Evidence of license to undertake transaction.
- Copy of report on latest audit carried out by the relevant regulatory body (SEC in Trinidad or FSB in Bahamas or similar body or the Central Bank in the country of registration of the Intermediary.

Additionally, the institution must

- have been in existence for at least 5 years
- have name recognition.
- *be registered with the Eastern Caribbean Securities Regulatory Commission*

(ii) EXTRA REGIONAL INVESTMENTS 5% - 10%

Investments outside the region should form between 5% and 10% of total investments at cost. Permissible investment comprise:-

- (i) US large, mid and small cap value and growth stocks
- (ii) US fixed income instruments
- (iii) International Equities
- (iv) Mutual Funds
- (vii) Index Funds

Holdings of stock for the various categories should fall within the following ranges (percentages are of the total investment in stock by value).

		<i>Value</i>	<i>Growth</i>
<i>Small Cap</i>	10% - 20%	5% - 15%	5% - 15%
<i>Mid Cap</i>	10% - 20%	5% - 15%	5% - 15%
<i>Large Cap</i>	50% - 70%	30% - 50%	20% - 40%
<i>International (Non US\$)</i>	0% - 10%		

The Fund's extra-regional assets will be managed by professional financial consultants from approved financial institutions. A list of approved institutions will be maintained comprising three to five financial services companies.

To qualify for approval, institutions must:-

- (i) have been in operation for a minimum of 20 years.
- (ii) have at least US\$20 billion in assets under management.
- (iii) have adequate insurance in event of loss.
- (iv) provide proof of relevant certification.
- (v) have provided audited financial statements as requested.
- (vi) have name recognition.

The performance of Investment managers recommended by the Financial Consultant will be measured against the appropriate benchmarks

	Benchmarks
All Equities	S P 500 index
Fixed Income Instruments	Lehman Brothers Government Bond Index
International equities	MSC1 EAFE Index
Mutual funds	S & P 500 Index
Index Funds	S & P 500 Index

Holdings of Fixed Income Instruments (Bonds, Treasury Bills etc) should form no less than 30% and no more than 50% of total Managed Assets.

The Financial Consultant will be instructed to replace any Investment Manager who underperforms the respective benchmark for three (3) consecutive quarters.

The following applies to all extra regional investments:-

- (i) Investment Managers are prohibited from purchasing securities of the Manager's organization or of any firm with a controlling interest in the Manager's organization.
- (ii) Investment Managers are prohibited from purchasing unregistered or restricted securities or private placements without the prior written authorization of the Director. All securities purchased are to be fully marketable on the principal Securities Exchanges.
- (iii) There are to be no options, futures, hedges or other derivative investments without the written approval of the Board with the exception of currency instruments which can be purchased only for protection against currency devaluation. These hedges will be limited to economically attractive hedge instruments.
- (iv) There are to be no margin transactions without the written approval of the Board.
- (v) No short sales are to be made without the written approval of the Board.
- (iv) There are to be no purchases of commodities without the written approval of the Board.

REPORTING

The Financial Consultants must provide reports on the following:

- (i) Quarterly, portfolio cost and current market value.
- (ii) Monthly, transaction history of all transactions since previous report

- (ii) Quarterly, income received and reinvested
- (iii) Quarterly, fee charged for services and derivation of that fee.

4(2) TOURISM

In addition to the *raison d'etre* as legislated, the National Insurance Fund serves a secondary but equally important role; it serves as a financial intermediary in that it mandates savings which can be channeled into the productive sectors of the economy. Given that tourism is the one major area whose development can have the greatest positive effect on the local economy it is imperative that we emphasize investment therein. Allocation to this (and the other productive) sector(s) is indispensable in stimulating growth which is essential if the Fund is to perpetuate itself. To remain viable, the fund must grow, both in terms of registered contributors, and assets to support claims. Investment in this area should influence positively the attainment of that goal. It is important however that we keep in mind the nature of the Fund, being a pension fund, and that the assessment of all investment opportunities therein must be carried out under consideration of our investment objectives in order of **safety, liquidity and yield**. Investments will depend on the availability of suitable and safe opportunities.

In the event of mutually exclusive investments involving the tourism sector and any other sector or category of instrument, everything being equal, investment in the tourism sector will be preferred. **Direct investments in the local tourism sector should not exceed 10% of the NIC's total investment at cost.**

EXISTING COMPANIES (Tourism related)

Therefore, for Fixed Income Investments viz. Loans and Bonds, the factors as per (C) above, and for Equities as per (F) above should first prove satisfactory.

NEW COMPANIES (Tourism related)

The NIC should not participate in the equity of a start up company. However, the NIC can participate via fixed income instruments (loans, bonds) which should be appropriately secured and which would ordinarily have first claim on the company's assets. *The NIC can however contribute to equity in start-up businesses by contributing to a Venture Capital Fund or a Development Fund, an amount not exceeding 1.5% of the total portfolio at cost which would circumscribe the NIC's exposure to that asset class.*

5. *LIMITS TO INVESTMENT*

- a. *Investment in any one non-financial institution shall not exceed 5% of the Fund's total investment at cost.*
- b. *Investment in any one financial institution shall not exceed 10% of the Fund's total investment at cost.*
- c. *Investment in the various economic sectors shall be restricted as follows:-*

<u>ECONOMIC SECTOR</u>	<u>MAXIMUM INVESTMENT AS A % OF TOTAL INVESTMENT AT COST</u>
<i>Agriculture, Hunting, Forestry and Fishing</i>	<i>5%</i>
<i>Mining and Quarrying</i>	<i>5%</i>
<i>Manufacturing</i>	<i>5%</i>
<i>Electricity, Gas and Water Supply</i>	<i>10%</i>
<i>Construction</i>	<i>5%</i>
<i>Wholesale and Retail Trade</i>	<i>0%</i>
<i>Restaurants and Hotels</i>	<i>10%</i>
<i>Transport, Storage and Communication</i>	<i>5%</i>
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<i>Financial intermediation</i>	<i>30%</i>

<i>Real-Estate, Renting and Business Services</i>	15%
<i>Public Administration and Defense, Compulsory Social Security, Health, Education and Social Services</i>	10%
<i>Activities not Adequately defined</i>	5%

Assets under management by extra-regional investment managers are excluded from the above allocations.

- d. *Investment in any one country except Saint Lucia shall not exceed 10% of the total investment at cost. The total of the Fund's assets held outside of Saint Lucia should form no more than 20% of the Fund's total investment at cost.*

6. **DELEGATION & AUTHORITY OF MANAGEMENT OF INVESTMENTS**

(i) **Investment Committee**

According to the National Insurance Corporation Act No 18 of 2000 Section 20, the Fund's Investments are to be managed by an Investment Committee which shall consist of:

- (a) an official of the Ministry of finance, who shall be the Chairman of the Committee
- (b) two person nominated by the Minister of Finance
- (c) a member of staff other than the Director
- (d) the Director

The Investment Committee will monitor the investments and will submit quarterly reports to the National Insurance Board as required under S 21 (3) of the Act.

(ii) **Board of Directors**

The Board shall have full discretionary power to direct, allocate, rebalance or liquidate the Fund's investments in compliance with the terms of this investment policy.

The Board upon the recommendation of the investment Committee shall initiate or delegate so to do, all investment transaction.

(iii) **Investment Manager**

The board will designate an Investment Manager who will report directly to (1) the Director and (2) the Investment Committee (as required) concerning recommendations for investment decisions.

7. ETHICS AND CONFLICTS OF INTEREST

Officers and employees involved in the investment process shall refrain from personal business activity that could conflict with the proper execution and management of the investment program, or that could impair their ability to make impartial decisions.

Employees and investment officials shall disclose any material interests in financial institutions with which they conduct business. They shall further disclose any personal financial / investment positions that could be related to the performance of the investment portfolio. Employees and officers shall refrain from undertaking personal investment transactions with the same person with whom business is conducted on behalf of the entity.

Officers and Employees in breach of this provision shall be subject to sanctions as determined by the National Insurance Board.

8. GENERAL

Investments shall be made with the same judgment and care which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the safety of their capital as well as the income to be derived. Investment officers exercising due diligence and acting in accordance

with this investment policy shall be relieved of personal responsibility in the event of loss or diminution of value of an investment undertaken in accordance with this policy.

The Investment Policy will be reviewed annually.

