4 ΣΕΛΙΔΕΣ ΓΙΑ ΕΛΛΑΔΑ - ΣΟΦΟΚΛΕΟΥΣ ΣΕ ΣΥΝΕΡΓΑΣΙΑ ΜΕ

Financial Mirro

Pension fund liabilities at CYP 760 mln

• *Expert calls for gradual diversification of investments*

Pension funds in Cyprus have as much as CYP 760 mln in unfunded liabilities, some of which may need to be covered by increased charges from the public and some by injections from the government, itself strapped for cash to balance the national Social Insurance Fund and ensure its future survival.

Generous benefits, early retirement and low investment returns are pushing the funds into the red, according to George Psaras, Managing Actuary, Social Insurance, Pension and Provident Funds at i.e. Muhanna & Co., Actuarial Services.

Psaras told the Financial Mirror that according to a study undertaken by his firm and the University of Cyprus, of the 50 major pension funds from the semi-government sector and municipalities, the amount of unfunded liabilities may reach about CYP 760 mln.

"Some of the funds are well funded and cash-rich, but the majority are not. The problem cannot be fixed easily, but everybody concerned should take notice and discuss the problem," said Psaras, adding that there are a number of options to help lessen the burden.

The first option would involve preventing newcomers from joining with the same generous terms as enjoyed by existing staff employed at the semi-government, municipal and independent authorities. Other options include extending the retirement age and increasing contributions while at the same time exploring ways to merge and bring the smaller funds under one umbrella.

Psaras is calling for industry wide multi-employer funds similar to the Doctors' Pension Fund. He says there are 20 mostly small municipalities, employing less than 100 staff.

"They could join as one group." Muhanna & Co has advised to bring the pharmacists and dentists under the umbrella of the Doctors' fund. The construction workers already operate an industry-wide provident fund and the same holds for the hotel employees, and could attract related funds to merge under one group.

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Pension fund liabilities at CYP 760 mln

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The study undertaken by Muhanna & Co. on the strengths, sustainability and future prospects of funds in Cyprus covered 50 funds which have CYP 690 mln available for investment.

It found that CYP 320 mln or 46% of the total was held in cash, CYP 245 mln or 35.5% of the assets were invested in Cyprus government bonds, CYP 33 mln or 4.8% in corporate bonds, CYP 28 mln or 4% in equities, CYP 9 mln or 1.3% in land and CYP 55 mln in loans, mutual funds and other forms of investments.

"There are a total of 2000 (provident and pension) funds in Cyprus with some CYP 2 bln assets available for investment and we reckon they have invested along the same lines."

The state-managed Social Insurance Fund (SIF) is reported to have assets of CYP 2.5 bln, all of which is exclusively invested in government bonds for a 4.2% maximum return (subject to 10% defense tax).

Low return

In view of the small; amount of money invested in equities and land investments, the rate of return of Cyprus pension and provident funds is comparatively low, at a time of rising liabilities. The Muhanna & Co. study found that while in Cyprus, the contributions average around 11.4% for provident funds, which are on average made equally by employers and employees, the benefits are far lower than comparable provident funds elsewhere in Europe with average contributions of 6%.

Selective Cyprus Pension Fund assets		
Asset	CYP mln	%
Cash or cash equivalents	320	46.3
Government Bonds	254	35.5
Corporate Bonds	33	4.8
Other (mutual funds)	29	4.3
Shares	28	4
Credits	26	3.7
Land	10	1.4
Total	700	100
source: Muhanna & Co		
Sample of 50 semi-governmental, municipal funds		

Pension vs. Provident

Psaras explained that most people in Cyprus confuse a provident fund with a pension fund. In layman's terms, a provident fund gives a lump sum after the employee leaves the company. There is no defined benefit and since employer and employee usually contribute the same amount, whatever is available in the fund and pertains to the particular member is paid out in a lump sum at the end of employment.

The pension fund on the other hand promises a specific amount that will be given out as a pension at the end of employment, or upon retirement. The pension usually amounts to 50% of the last salary paid until the death of the employee indexed to inflation and general pay increases, of which 75% is passed along and paid to the widow upon death of the pensioner.

Most pension funds covering semi-government agencies, municipalities and independent boards also give 4.3 (moving gradually to 4.6) times of the pension amount multiplied by 12 to the pensioner as a lump sum.

Do it gradually

The new law which was voted through last November and is now being implemented stipulates that all provident funds covering more than 100 persons and all pension funds irrespective of size need to implement the full provisions of the law.

The law stipulates that funds need to appoint a fund manager and invest their funds according to an investment policy. The largest funds are now asking for quotations from the approved financial services firms (KEPEYs).

Psaras said it would be wrong for all the funds, with some CYP 1.8 bln assets available for investment, to rush and diversify into equities and land investments in Cyprus and abroad since it would have a disastrous impact on the economy as "a lot of cash would chase few good assets available for investment."

Even for those contemplating to go overseas, Psaras warned that most assets, like equities and real estate, are at record highs and ripe for a correction.

Instead, he is calling for a gradual shift and investments only in line with the future liabilities of the funds. He is also calling for the appointment of independent investment advisors in addition to asset managers.

"They are two different things and should not be confused," says Psaras. Other safety measures include the appointment of custodians for the safekeeping of the assets purchased in the name of the funds in order not to repeat the same mistake with the missing assets of the EAC pension fund, which is facing a CYP 7.5 mln deficit as funds under Suphire management went missing.

Since the EAC pensions are guaranteed, any shortfall will be covered by the EAC, either in the form of higher charges, or higher taxes or even lower profits passed to the state.

No easy fix

As regards the public row between Finance Minister Michalis Sarris and coalition partner communist AKEL over raising the retirement age but at the same time keeping the SIF in balance, Psaras said there was no easy fix.

"The retirement age should be increased from 63 to 65, but that alone will not solve the problem, as contributions must be increased, returns improved through diversification of assets and changes introduced in the promised benefits," says Psaras.

Other developed countries including the U.S., most Europe and others are facing similar problems. Britain under Margaret Thatcher rushed to address the problem years ago with the UK having cut benefits and allowed for voluntary opt-outs, while Norway transfers a tiny fraction of its oil proceeds into its own SIF.

"The Cyprus SIF was set up seven years after the 1974 invasion and in the first years it invested heavily in local infrastructure for the benefit of all.

That was then. Now, after 27 years, the time has come to think and act differently and address the new realities," said Psaras, adding that the problem becomes more acute, if one considers that the government has a separate pay-as-you-go Civil Servants Pension Fund, which similar to the SIF is also under-funded and needs practical measures to fix.

The Financial Mirror reported last week that social insurance contributions will be increased very soon and are expected to rise by 1% a year over the next five years, with employers, employees and the state sharing the cost equally.

Currently, Cyprus employers and employees contribute 16.3% (employee, employer and government = 16.6%) of the declared salary of an employee to the SIF every month.