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Risks and Challenges – Identification of Gaps

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SUMMARY PAPER

The European Union has defined governance as “*rules, processes and behaviours that affect the way in which powers are exercised*”. It identifies five principles that support good governance: “*openness, participation, accountability, effectiveness and coherence*”. Many other institutions have their own definitions that are similar to that of the EU.

In 2006 the International Social Security Association surveyed all our membership: around 360 members in 150 countries involved in the administration and regulation of social security schemes. It asked them “*What challenges will your organization be facing over the coming 3 to 5 years?*”. The second most important challenge identified was “*the need to achieve greater administrative and operational efficiency*”. And there is no doubt that the most effective prescription for coping with challenge is **good governance**.

In 2004, at the General Assembly in Beijing, the ISSA issued an international benchmark through the publication of the “*Guidelines for the investment of social security funds*”. These Guidelines are intended to provide social security institutions – whether they are government ministries, statutory bodies or private bodies – with general principles and considerations for the investment of social security funds and governance. The most important issues included in the Guidelines are:

- Appropriate division of operational and oversight responsibilities, and the suitability and accountability of governing body members.
- Independence from political interference: there should not be political interference in the decisions taken by the governing body within the legislative mandate given to it.
- The governing body should strive to maintain the financial sustainability of the social security scheme by monitoring and managing all the risks associated with the scheme, including in particular the demographic, financial and broader economic risks.
- In some instances, there may be advantages to establishing an investing institution which is distinct from the entity administering the social security scheme (e.g. Canada, Norway, Ireland, France, etc).
- Disclosure of all business interests and affiliations that may result, or appear to result, in a conflict of interest with the execution of duties in the governing body.

- Governing bodies of the social security scheme and of the investing institution should seek expert advice or appoint professionals when needed.
- An actuary should be appointed by the government or the governing body to carry out periodic actuarial reviews of the scheme.
- There should also be suitable governance mechanisms: systems of control, internal reporting, public disclosure and redress mechanisms.
- In establishing the investment policy and strategy, the governing bodies of the social security scheme and of the investing institution should determine the degree of risk and risk tolerance the scheme is able to sustain.
- Periodic analysis of each asset class and the portfolio as a whole should be carried out to determine nominal, risk-adjusted, and inflation-adjusted rates of return.

In 2007, the ISSA published the results of a survey of public pension scheme reserve funds (downloadable from the ISSA website). The reserves of the public pension schemes in the 20 countries studied total nearly USD 3.5 trillion. It indicated that public pay-as-you-go pension schemes that have established reserve funds have successfully incorporated some advantages of pre-funding in their overall design. Consequently, they may constitute an alternative to the introduction of the so-called second pillar. The main findings of the survey were:

- Public schemes and their reserve funds are accountable to contributors, beneficiaries and the public through ministers and are in many cases subject to parliamentary oversight.
- Managing reserves in funds that are legally separated from the associated social security scheme may have some advantages over managing reserves as part of the scheme.
- Administration and investment costs of public pension reserve funds that are legally separated from the management of the associated social security scheme compare favourably with those of privately managed pension or savings scheme.
- Investment returns of public pension reserve funds that are legally separated from the management of the associated social security scheme match those of privately managed pension or savings schemes.

The ISSA has managed to identify a conceptual framework to help social security organizations direct their policy choices and administrative decisions. This framework is called: “***Dynamic Social Security***”. The wider aim of this framework is to help social security organizations better realize improvements in organizational performance and to better achieve desired programme outcomes. One of the main themes of the framework includes promoting activating, proactive, integrated and forward-looking social policies. These should be aimed at better ensuring accessible and sustainable social protection systems which also provide protection, encourage prevention and support rehabilitation. They should also contribute to better realizing socially inclusive and economically productive societies.

Dynamic social security is also about building high-performing and well-governed institutions. It is self-evident that high-performing and well-governed institutions are of paramount importance to address current and emerging policy challenges.

To this end, the ISSA is implementing a ***“Project on governance and social security”***. *The aim* of the project is to improve the capacities of social security administrators taking into account the complex political, economic and social environments that ISSA members and other social security bodies are operating in. This objective of the project is to develop principles and guidelines of “good governance” for social security schemes that will be presented at the World Social Security Forum to be held in 2010, in Cape Town, South Africa.

The ISSA, upon demand on its membership, has just created a Technical Commission on the Investment of Social Security Funds which undoubtedly will boost ISSA’s involvement in this vital area.