

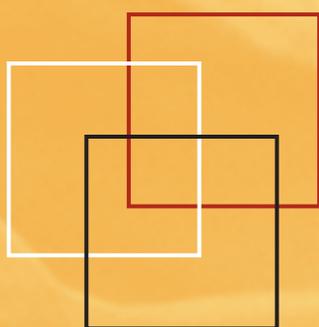


International  
Labour  
Organization



# Governance of Social Security Systems:

## a Guide for Board Members in Africa



QUATRRAIN AFRICA



International Training Centre





**GOVERNANCE OF  
SOCIAL SECURITY SYSTEMS:  
A GUIDE FOR BOARD MEMBERS  
IN AFRICA**

International Labour Organization  
International Training Centre of the ILO

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*Governance of Social Security Systems: a Guide for Board Members in Africa*

ISBN 978-92-9049-522-2

First edition 2010

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Printed by the International Training Centre of the ILO, Turin, Italy

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## FOREWARD

Social security is a fundamental human right recognized in numerous international instruments, in particular the *Declaration of Philadelphia* (1944) which is an integral part of the Constitution of the International Labour Organization, the *Universal Declaration of Human Rights* (1948) adopted by the General Assembly of the United Nations, and the *ILO Declaration on Social Justice for a Fair Globalization* (2008) adopted by the International Labour Conference. However, the exercise of the right to social security and social protection is denied to vast numbers of citizens of Africa because they do not have access to the existing schemes in most countries of the continent.

The current global economic crisis has shown that households accessing social protection are less negatively affected by the crisis, and that redistribution of wealth through social protection allows vulnerable households to continue being part of and contributing to the economy.

As the global crisis has now reached every country of the world, the importance and necessity of adequate social protection systems in bringing meaningful support to individuals and families have never been as clear. However, globally, only one person out of five has adequate social protection coverage, and in Africa the percentage in most countries is less than one in ten. The large part of the excluded are found in the informal economy, among the poor and vulnerable populations of society, persons suffering from HIV/AIDS, and migrant workers. Women are disproportionately represented among the excluded.

The enhancement of the coverage and effectiveness of social protection for all is one of the four strategic objectives of the Decent Work agenda that guides the programme of the International Labour Office (ILO). The critical importance of extending and strengthening social protection was underscored in the *Global Jobs Pact* that was adopted by the International Labour Conference earlier this year.

The effective governance of social protection schemes is an essential prerequisite for the enhancement of the coverage and effectiveness of social protection. Efficient governance can make a lasting difference. No system of social protection can achieve its objectives without good governance – and a pivotal element of good governance is financial governance.

In mid-2008, the ILO, with funding from the Federal Republic of Germany, launched the three-year QUATRRAIN AFRICA project. The overarching objective of QUATRRAIN AFRICA is to strengthen the financial governance of social protection schemes in Africa.

Sound financial governance depends on the capacity of persons supervising and managing social protection schemes. These include:

- tripartite members of the governing bodies of social protection schemes (trustees, directors, etc);
- officials of government ministries of finance and treasury and of ministries responsible for social protection;
- senior administrative staff of social protection schemes (CEOs, directors reporting to CEOs, investment committee members, internal auditors, legal and compliance officers); and
- pension fund regulators and supervisors.

This Guide is one of the tangible products of QUATRRAIN AFRICA. It is designed to assist those supervising and managing social protection schemes in Africa to better understand and carry out their roles.

The Guide draws on material from *Social Security Governance: A Practical Guide for Board Members of Social Security Institutions in Central and Eastern Europe*, which was published under the direction of Elaine Fultz by the ILO Subregional Office for Central and Eastern Europe. The Guide's principal author was Warren McGillivray, Catherine Drummond contributed a chapter.

Many individuals did not spare their time and effort to review drafts of this Guide and to make comments and suggestions for its improvement. They are too numerous to name individually, and include officials of the ILO's Social Security Department in Geneva, the Regional Office for Africa in Addis Ababa, the International Training Centre in Turin, and various participants at seminars where the Guide has been presented. I want to give special thanks to Edward Tamagno, the Chief Technical Advisor of QUATRRAIN AFRICA, for overseeing the drafting and publication of the Guide.

The ILO wishes to express particular appreciation to the Federal Republic of Germany, whose funding of QUATRRAIN AFRICA made the development and production of this Guide possible.

I am convinced that this strategic tool will greatly contribute to strengthening the financial governance of social protection systems in Africa and, through this, to moving towards the goal of social protection for all.

Charles Dan  
Assistant Director General  
Regional Director for Africa  
Addis Ababa

December 2009

## PREFACE

This handbook is intended as a practical guide for members of governing boards of social security organizations in Africa. It is inspired by *Social Security Governance: A Practical Guide for Board Members of Social Security Institutions in Central and Eastern Europe*, and draws on material in this publication. (See <http://www.ilo.org/public/english/region/eurpro/budapest/publ/social/socsec.htm>)

While the structure and mandate of social security boards varies from country to country, they all have important responsibilities: ensuring that social security contributions are used judiciously for intended purposes, providing inputs to policymakers on the scheme's recent experience, creating transparency in its operations and assuring that its policies and practices comply with the law. They are vital bodies for strengthening democratic governance and representing the interests of workers, employers, pensioners and other constituents in the national social protection system.

The ILO has been closely involved in the creation and training of tripartite governing boards, as part of its efforts to promote good governance of social security schemes in Africa. This guide is part of the ILO QUATRRAIN AFRICA project which has the objective of improving training in quantitative social security techniques in Africa.

While tripartite social security boards exist in most African countries, their impact varies. This results partly from uncertainties on the part of board members themselves about how best to fulfil their roles, and partly from weaknesses in the governance of the social security organizations.

Without prescribing precise rules for coping with particular issues, guidance for social security board members in general and on a range of specific issues is provided.

## ABBREVIATIONS

<b>CEO</b>	Chief Executive Officer
<b>GDP</b>	Gross Domestic Product
<b>IAA</b>	International Actuarial Association
<b>ILO</b>	International Labour Organization
<b>IPSAS</b>	International Public Sector Accounting Standards
<b>ISSA</b>	International Social Security Association
<b>PAYG</b>	Pay-as-you-go
<b>PRSP</b>	Poverty Reduction Strategy Paper
<b>SER</b>	Social Expenditure Ratio
<b>SNA</b>	United Nations System of National Accounts
<b>SPER</b>	Social Protection Expenditure and Performance Review
<b>SRI</b>	Socially Responsible Investment

# INTRODUCTION

*All systems should conform to certain basic principles.... Benefits should be secure and non-discriminatory; [and] schemes should be managed in a sound and transparent manner, with administrative costs as low as practicable and a strong role for the social partners. Public confidence in social security systems is a key factor for their success. For confidence to exist, good governance is essential.*

*(ILO 2001, Social Security: A New Consensus.)*

This guide is intended to help board members carry out their duties as members of the governing body of a public social security organization, in particular their responsibilities for the financial governance of a scheme. The organization might cover all branches of social security, or it could be one of a number of separate organizations covering pensions, health care, work injuries, unemployment insurance or other benefits such as sickness and maternity benefits. This guide focuses on schemes paying cash benefits. As well as overseeing the finances of a scheme, the board will oversee administrative operations such as contribution collection, record-keeping, determining eligibility for benefits and making benefit payments.

At the individual scheme level, proper financial governance means that the board ensures that resources entrusted to the social protection scheme are used effectively and efficiently so as to avoid waste or deficient delivery of promised benefits. Inefficiency and ineffectiveness undermine the credibility of a scheme, lead to contribution evasion and result in financial problems. They can lead to the failure of the scheme and possibly the entire national social protection system. Credibility is a social protection system's most important capital. Inefficient use of resources also has an opportunity cost in terms of social protection which could otherwise have been provided.

The governing body might be called a board, council, assembly or commission. It might be a single tier organization, or it could have more than one level with a larger group meeting infrequently, and a smaller executive group (sometimes called a bureau) meeting more often.

For simplicity this guide will refer to all such bodies as boards and to their members as board members, and the body administering the social security scheme is called an organization. Though the role may consume considerable time, nominated or elected board positions generally are not full-time posts. Board members are not employees of the organization, but rather holders of public offices. The board as a whole has regular meetings, usually with the chief executive officer (CEO) and senior staff of the organization also present, to oversee

the work of the organization and consider strategy and developments. The CEO may be a member of the board or may attend board meetings in an advisory capacity.

Usually board members have other public roles, for example, as the president of an employers' organization, a trade union federation or an association of retired persons or persons with disabilities. Appendix A shows the composition of social security boards in several African countries.

This guide is intended to help people who are new to the job to find their way through the complexities of being a board member, and to give them an idea of what questions to ask and what strategies and actions are available to board members in carrying out their duties.

In Chapter 1, the concepts and framework of national social protection systems, the risks faced by social security schemes and the scope of governance are described. Chapters 2 to 6 deal with social insurance schemes. Chapter 2 introduces the role of a board member and the relationship between board members and the management of the administering organization. The legal basis for a board's activities and the work of the board are discussed. Chapters 3 and 4 deal with governance of the administrative operations of an organization running a social insurance scheme. Chapter 3 covers management structures, setting objectives and measuring performance, a communications strategy and the need for transparency and fairness. Record-keeping requirements and information and communication technology issues are discussed. Chapter 4 deals with the financial governance of these operations, including financial controls, monitoring administrative expenditures, compliance with the scheme's contribution requirements and the board's relationship with auditors. Systems of financing social insurance benefits are described in Chapter 5. Actuarial valuations and the board's role in monitoring the financial status of the benefit obligations of a social insurance scheme are described. Generally accepted principles for the investment of social security funds, and how the board can monitor whether they are being followed are set out in Chapter 6. In Chapter 7, differences between the operations of non-contributory schemes and contributory social insurance schemes, and the financial governance of non-contributory schemes are described. Finally, Chapter 8 outlines the national social protection planning process.

After each section, the key points are summarized. A Glossary is provided. Sources of more information are available in the References. The Appendices include the composition of social security boards in selected African countries, extracts from International Labour Standards that concern governance of social security schemes, keys to being a successful board member, a self-assessment questionnaire for measuring the performance and needs of a board member and the International Social Security Association's *Investment Guidelines for the Investment of Social Security Funds*.

# CHAPTER 1:

## GOVERNANCE OF SOCIAL PROTECTION

### 1.1 FRAMEWORK OF NATIONAL SOCIAL PROTECTION

This guidebook adopts a broad definition of social protection. The national social protection system<sup>1</sup> refers to the legally established system for the provision and financing of transfers to individuals in case of specific needs – old-age, invalidity, survivorship, sickness, maternity, work injury and unemployment and to support families and provide health care. These are the contingencies which are mentioned in the International Labour Organization’s Social Security (Minimum Standards) Convention, 1952 (No. 102). Social protection also includes measures to provide adequate housing and nutrition, ensure access to education and alleviate poverty and social exclusion.

Social protection systems are thus transfer systems replacing income in the event of certain contingencies, providing a minimum income for persons in poverty and achieving a higher level of income equality and access to medical care. Formal social protection systems can be an effective means of modifying the national pre-transfer income distribution and reducing national poverty rates. Benefits can be in cash or in kind. Cash benefits include periodic payments, lump-sum payments and reductions in taxes or social security contributions. Benefits in kind include reimbursements and direct provision of goods and services.

National social protection systems generally comprise the following types of schemes.

- Social insurance schemes, which pool risks and resources across the covered population based on the principle of social solidarity. They are typically financed by contributions from workers and employers and may have a subsidy from the State. Except for medical care, eligibility and benefit levels are determined by an individual’s formal employment history. A portion of a members’ earnings is replaced if he/she experiences an insured contingency. Benefits are paid without reference to financial need.
- Non-contributory schemes, whereby the government establishes uniform benefits which are usually financed by general government revenues. In an unconditional (universal) non-contributory scheme, benefits are provided to all citizens or residents who meet certain eligibility criteria. In a conditional (assistance) scheme, benefits are paid to persons who establish need through a means or income test. Non-contributory scheme benefits are payable to

<sup>1</sup> The national social protection system is sometimes referred to as the loosely defined ‘welfare state’.

persons who were previously working in the formal sector and to informal sector workers and unemployed persons.

A scheme that does not involve transfers is a mandatory savings scheme, where workers (and sometimes employers) contribute a portion of their earnings to individual accounts. These accounts are administered publicly as national provident funds or by private firms under government supervision. When a worker reaches a specified age, retires, dies or becomes disabled, the contributions with interest are payable as a lump sum, in an annuity or in gradual withdrawals. Since this approach involves no pooling of risks or resources among members, a member's benefit depends on what the member contributed and the interest earned less expenses.

In addition there are supplementary benefit schemes, for example, resulting from collective or community based agreements or individual contracts mandated by law. Voluntary transfers and private arrangements between individuals and households are not considered to be part of the formal national social protection system.

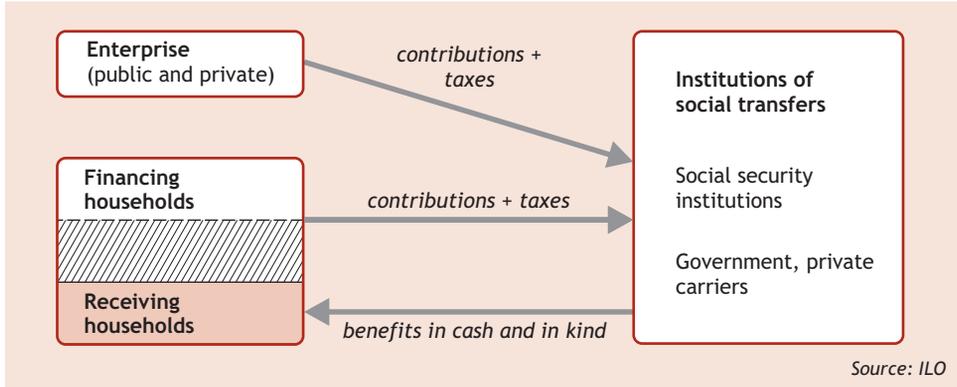
Social protection organizations administer a specific benefit or several benefits. They can be public bodies, or private institutions operating mandatory schemes. Social insurance schemes are social protection organizations. Government can also be a social protection organization. If a portion of the revenues collected by the Ministry of Finance is used to finance social protection benefits such as social assistance or a housing subsidy, then the ministries which are administering the schemes (e.g. welfare, housing) are social protection organizations. The crucial feature is whether an organization provides or delivers legislated social protection benefits.

The financial architecture of a national social protection system traces the money entering the system from its origins to its uses. Figure 1.1 shows the aggregate flow of funds in a formal national social protection system consisting of several distinct transfer schemes. Benefits are financed by taxes or contributions paid to the organizations responsible for social transfers by a subset of all private households (the financing households), as well as public and private enterprises. The social transfer organizations organize the collection of taxes and contributions and distribute them according to the applicable legislation to another subset of private households (the receiving households).

At the same time or over time, a household can be a receiving and financing household. For example, a sick wage earner may continue to pay contributions (or taxes) while at the same time receiving health care benefits, or a wage earner pays contributions (or taxes) while working and receives a pension after retirement.

The government has a redistributive role when it receives taxes (including consumption taxes) from enterprises, households and the rest of the world (e.g. through import duties), and uses part of this revenue to finance a social protection system. However, if a social insurance scheme has limited coverage, a subsidy to the scheme from general government revenues is regressive if the general revenues include taxes from (low-income) persons who are not covered by the scheme.

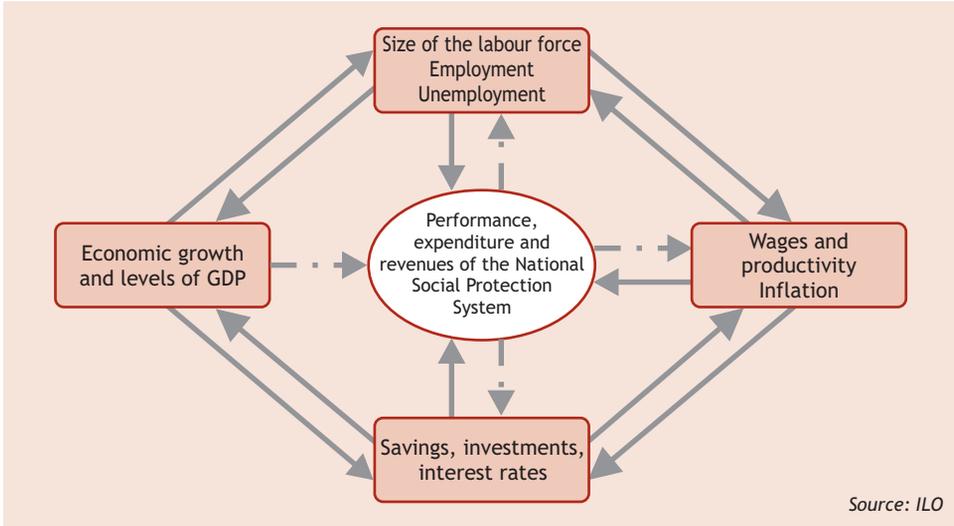
**Figure 1.1: Basic flow of funds in a national social protection system**



Income redistribution is a feature of social insurance and non-contributory schemes. For example, redistribution within a generation occurs when a cash sickness benefit is paid from funds contributed by healthy persons to those who are sick, or a social assistance benefit is paid to persons in poverty. Intergenerational redistribution – an implicit contract between generations – occurs, for example, when the old-age pensions of one generation are financed by contributions of subsequent generations. Income redistribution is socially desirable, however, the extent to which it can be applied while preserving equity, and at acceptable contribution and tax rates, is not an economic question; rather it is a political matter which depends on the values of society.

Economic variables have a direct impact on the effectiveness and efficiency of social protection systems and on the structure and levels of social expenditure. Since social protection systems are major redistributors of Gross Domestic Product (GDP), they have a major impact on the national economy. National social protection systems and individual schemes must be planned and managed with reference to the interrelationships between social protection and the economy. Along with demographic scenarios, economic scenarios are the basis for designing a social protection system. Figure 1.2 illustrates interrelationships between social protection and major economic variables (growth, the labour market, inflation, wages, productivity, savings and investments).

**Figure 1.2: Principal interrelationships between the national economy and social protection systems**



There is a vast literature dealing with the effect of social protection on the national economy. A thorough discussion of this important topic is beyond the scope of this guide. Board members should be aware that the impact of social protection systems on national economic performance is often questioned.

Social expenditure normally increases in step with national development as a result of changes in:

- the demographic situation;
- the economic environment; and
- societal values which reflect the social benefits provided.

An overview of the financial architecture of a national social protection system can be provided by two tables that show the system's income and expenditure patterns.

- Functional/institutional expenditure matrix – which traces the amounts which each social protection organization pays in respect of the different protective functions of the system.
- Financing matrix – which shows the sources of funds for the different protective functions of the system.

The relationships in the matrices are the result of prior financing and distribution decisions by government and other social protection decision makers. Management of a national social protection system requires projections of income and expenditures. Social budgets are a key tool for the financial management and planning of the social protection sector as a whole (see Chapter 8).

Individual schemes comprising an overall national social protection system have their own roles to play and objectives to meet, but, as components of the system, they must also serve the objectives of an overall national social protection policy. The national social protection system is not just a set of independent components. The schemes interact with each other. It is the design of the social protection system as a whole, with different schemes playing different roles in the coverage of population groups for different contingencies and needs that determines the ultimate effectiveness of the overall national social protection policy.

Just like each of its component schemes, the national social protection system should be assessed in terms of its objectives, notably with respect to its coverage, effectiveness and efficiency. Social Protection Expenditure and Performance Reviews (SPERs) provide a framework for assessing the performance of the social protection system as a whole (see Chapter 8).

Indicators have been developed which can also be used for comparing the social protection systems of different countries. For example, the social expenditure ratio (SER) – the ratio of total social protection expenditure to GDP – is an aggregate indicator of coverage. The coverage rate measures the number of persons covered by a contributory social security scheme divided by the labour force. The beneficiary ratio measures the proportion of the covered population receiving benefits, and the replacement rate compares the average level of individual benefits to the average level of individual earnings.

The coverage rate is a key indicator of the extent of protection provided by a scheme covering wage earners, especially in countries where coverage is limited. In Africa, schemes which are confined to wage earners have very limited coverage, and this is leading to the implementation of universal benefit and social assistance schemes to provide a modest level of social protection and thereby alleviate the poverty of many persons who are not covered by the existing schemes (see Chapter 7).

This raises the issue of the economically affordable level of national social expenditure. Every society implicitly determines an acceptable level of formal and informal income transfers. So long as that level is not exceeded, the global allocation of resources to social transfers will not be questioned, nor should it impair economic performance. But the system of income transfers which is set up must be politically acceptable, efficiently operated, and properly governed to ensure effectiveness and financial and fiscal efficiency.

## 1.2 GOVERNANCE OBJECTIVES

In many countries, the overall performance of social security schemes has been disappointing. While this may be attributable to a broad range of economic and political factors which are beyond the control of a social security organization, often it is also due to weaknesses in the design of the scheme and mismanagement.

Experience in Africa illustrates the linkage between the efficient governance of social security, a sound infrastructure and a favourable economic and political environment. If there is hyperinflation, political unrest, poor human resources development, insufficient resources to meet basic needs and ineffective communications, it is not surprising that a social security scheme does not operate as it should. But even given these negative factors, there is much that can be done to provide more effective governance, and this is recognized in many countries.

In most African countries with contributory social security schemes, responsibility for their administration is entrusted by statute to a social security organization, generally with a board constituted on a tripartite basis (with worker, employer and government representatives), and under the supervision of a government department. The objective is to separate the financing of social security from the government budget, but the practice has not always corresponded with the intention. It has often happened that government, as the political authority, controls the appointment of the board and the CEO, and also determines matters that would normally be delegated to the board or the organization.

There is a significant trend towards greater autonomy for social security organizations, notably in the Côte d'Ivoire, Gabon, Ghana, Nigeria, Senegal and Tanzania. Responsibility for the operation of a non-contributory scheme almost always lies with the responsible government department as in Lesotho, Namibia and South Africa. Autonomy is not the sole requirement for good governance, and it is sometimes associated with high administrative costs and excessive staffing levels, but it helps to create an environment where accountability, participation and motivation can be developed and different interests can be balanced.

Good governance is the key to effective social security schemes. It involves strategic and macro policy issues, organizational arrangements and administrative operations. This is the framework for the conception, development and monitoring of sound and viable social security programmes. Good governance of a social security scheme involves:

- **Strategic and macro-policy issues** (Determining the social protection structure)
  - policy formulation which balances social protection needs with national resources,
  - a balanced national policy ensuring wide coverage and adequate benefits, and the desired level of income redistribution,
  - a legislative procedure to give effect to policy decisions and subsequent changes.

- **Institutional arrangements** (Deciding how to implement the structure)
  - institutional arrangements which are appropriate for implementation of the scheme,
  - opportunities for contributors and beneficiaries to influence decisions and to monitor the administration of the scheme,
  - financial control mechanisms to monitor the allocation and management of resources.
- **Administrative operations** (Making the structure work)
  - efficient collection of contributions and accurate accounting for contributions and for benefits, which must be promptly paid,
  - a minimal cost of administration within the desired level of service,
  - contributors and beneficiaries are aware of their rights and obligations,
  - monitoring and reviewing administrative performance.

Financial governance of a social protection system or an individual scheme focuses on:

- **effectiveness** – Does the system deliver the level of protection set out in the legislation and policy objectives?
- **efficiency** – Is the social protection delivered in the most efficient way possible?
- **sustainability** – Is the system financially, fiscally and economically sustainable over the long term?
- **transparency** – Is the use of social protection resources transparent?

Board members, supported by quantitative analysts (financial managers and planners), are the custodians of resources entrusted to social protection schemes that organize the transfer of resources between different population groups.

## 1.3 RISK MANAGEMENT

Risk management is a fundamental part of governance. Risk can be defined as the possibility of something going wrong which will have negative consequences. Social security organizations are at risk that certain events or conditions could undermine their plans and make it less likely that they can achieve their objectives.

The risks discussed in the following chapters include:

- **Operational risk** – computer failure, poor compliance with contribution obligations, mistakes in record-keeping, inadequate staffing, fraudulent transactions, etc;
- **Liquidity risk** – funds will not be available to cover benefits payable at some time(s) in the year;
- **Liability risk** – includes risks that increase the liabilities of a scheme (e.g. longevity risk – increasing life expectancy at higher ages);

- Economic risk – cyclical variations in employment levels, wage and price inflation, etc;
- Investment risk – declines in asset values, inadequate returns;
- Political risk – decisions that have negative consequences for the social security scheme; and
- Catastrophe risk – natural disasters, epidemics, etc.

Social security organizations should have a process for identifying, quantifying and managing risks. Generally this is carried out by a Chief Risk Officer who has responsibility and accountability for risk management. It is good practice for the board to include a summary of the risk evaluation and a report on steps taken to manage risks in its public documents.

## 1.4 SOCIAL INSURANCE SCHEME STAKEHOLDERS

According to the ILO Social Security (Minimum Standards) Convention, 1952 (No.102) the government is ultimately responsible for the proper administration of contributory and non-contributory social security schemes, and for the solvency of the schemes. The persons protected, and possibly employers and the government, are to participate in the supervision of schemes which are not directly administered by the government. In the latter case there may be a consultative committee whose members include persons specifically chosen to represent protected persons or employers.

What are the roles and responsibilities of the stakeholders who are involved in the governance of social security? The following groups have crucial roles in the development, management and supervision of social insurance schemes. They have an important bearing on the achievement of good governance and they should all be involved in the governance of social security:

- the State,
- employers,
- workers,
- beneficiaries,
- social security organizations.

### 1.4.1 The State

Social security is an essential component of a government's programme and is part of its obligation to provide adequate living standards for its citizens. The current structure of national social protection reflects prior decisions about how the State will meet social protection needs. In many countries the resources provided to finance social security account for a considerable proportion of the gross domestic product (GDP).

The government has a key role in the governance of social security, either directly, through the discharge of its responsibilities, or indirectly, through creating the environment and the framework to enable employers, workers and beneficiaries to carry out their roles and responsibilities.

The primary roles of the State are

- the development and formulation of policy,
- the drafting and enactment of legislation,
- the creation of a sound financial and monetary framework,
- the supervision of public and private organizations,
- the establishment of transparent and accountable organizational structures, and
- the establishment of consultative bodies.

Some countries have limited the role of the State to fundamental tasks and objectives and created a framework supported by strong regulation for individual and private sector provision of benefits.

The role of the State reflects the interaction of the executive and the legislature. A democratically elected parliament may be able to influence government policy, determine legislation and monitor the financial performance of a social security scheme, and generally operate as a moderating influence on government policy and on the authority of the responsible minister. Where democratic principles are well established, with freedom of the press, an educated electorate and active pressure groups, society will have mechanisms to influence government policy, and to expose weaknesses in policy and administration. In this case, social security policy and its implementation will generally be responsive to these democratic signals even if the government directly administers the scheme.

Policy formulation entails reviewing the operation of the system and weighing the merits of possible reforms in the overall social protection context and in relation to public expenditure commitments. Governments are responsible for managing the process of reform and the speed and success of reform is largely in their hands.

Usually, the enactment of legislation takes considerable time. Legislative powers should be delegated to ministerial authority for certain actions, for example, in a social insurance scheme, for regular reviews of contribution ceilings and minimum benefit levels to keep them in line with earnings levels. Democratic control must be balanced with efficiency. Ministers may be inexperienced in social security issues and there is a risk that decisions may be taken for short-term political considerations which are contrary to the long-term interests of the scheme.

There is generally a hierarchy among government departments which affects the policy-making process and the management of a scheme. While the Ministry of

Labour (or Social Affairs or Social Security) might have technical responsibility for social security, in view of the financial and economic implications, the Ministry of Finance, the ministry responsible for planning and the Central Bank usually play major roles. If the government pays a contribution or a continuing public subsidy to the scheme, or if a scheme is financed directly from tax revenues, the government will inevitably be closely involved in the management of the scheme.

### **1.4.2 The social partners: employers' and workers' organizations**

Workers and employers participate in the oversight of social security schemes:

- in recognition of their financial contributions to the schemes,
- to support the financial and administrative autonomy of the schemes, and
- by virtue of the legitimacy of employers' and workers' organizations.

Employers are generally legally responsible for the payment of social insurance contributions on behalf of their workers and for providing information about them. Workers are obliged to register with a scheme, to pay contributions and, when in receipt of a benefit, to follow rules relating to continuing entitlement.

Workers and employers normally play a role in determining the development and monitoring of a public social security scheme. Where social insurance schemes are administered by autonomous public organizations, workers and employers are represented on the boards. Participation by workers and employers ensures a better understanding and acceptance of their contribution liability, which helps make them more accountable and encourages them to fulfil their obligations.

In schemes administered by a government department, workers and employers are often members of consultative or advisory bodies. Where mandatory social security benefits are provided through State regulated private enterprises rather than public bodies, generally workers and employers are not represented on the boards of the enterprises.

### **1.4.3 Beneficiaries**

Beneficiaries have a direct interest in the structure and management of a social security scheme. They may have retired from employment or be surviving dependants who have no connection with the labour force and the workers' representatives. There is a strong case for representatives of beneficiaries to play a role in determining the development of the scheme and in monitoring its performance through membership on the management board.

### 1.4.4 Social security organizations

If a public scheme is financed only by contributions from workers and employers there is often autonomous administration by a public organization. The status and powers of an organization are generally set out in legislation and include the establishment of a governing body (a management board, a board of trustees or a commission) which represents the interests of those affected by the scheme.

Along with its board, the social security organization is responsible for administration of the scheme: identification and registration of insured persons and employers; collection, recording and enforcement of contributions; processing, award and payment of benefits; and management of funds. The chief executive must inform the board of any significant problems with these operations.

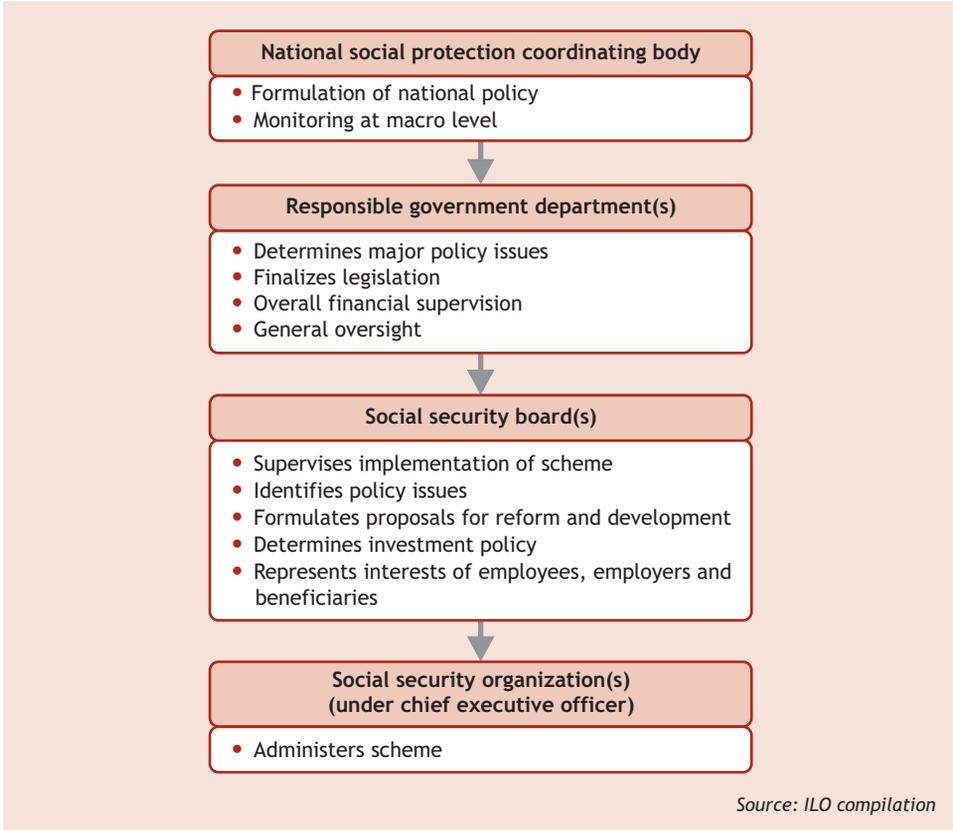
Since the government is the ultimate guarantor of the benefits, and has direct responsibility for policy and legislation, it has often proved difficult to define and apply the limits of government involvement in the governance of the scheme. Inevitably, due to the political and fiscal implications of providing effective and affordable social security benefits, particularly pensions, governments will be involved in monitoring the scheme and will seek to intervene. Figure 1.3 illustrates a typical division of responsibilities where a social security organization has been established to administer the scheme.

The board is not directly involved in the daily administration of the scheme. This is the responsibility of the chief executive officer. The board is charged with overall supervision of the scheme to ensure that it complies with the legislation and policy. This will inevitably lead to the identification of legislative weaknesses and policy issues. These subjects lie at the margins of responsibility between the organization and its parent government department, and there is often uncertainty in this area.

## 1.5 COMPOSITION OF BOARDS

In the contributory schemes included in Appendix A, the tripartite social partners (government, workers and employers) are represented on boards. The size of the boards varies considerably. In some countries special categories of workers have their own board representatives, for example, sugar industry workers in Mauritius, teachers in Ghana and Sierra Leone, the uniformed services in Sierra Leone and the police force in Burundi. Boards in Ghana, Nigeria, Sierra Leone and Zambia include representatives of the Central Bank. Public representatives are on the boards in Cameroon and a pensioner's representative is on the board in Sierra Leone and in the work injury scheme in Zambia. The CEO of a social security organization is usually a board member.

Figure 1.3: Governance of social security: Division of public scheme responsibility



## KEY POINTS

- A national social protection system arranges and finances transfers to individuals in need. It usually consists of several schemes (e.g. social insurance, universal benefit, social assistance) and administering institutions.
- Sound governance is the key to a coherent social protection structure and an effective national social protection system.
- Governance involves awareness of national policies, consultation, appropriate institutional arrangements and attention to administration.
- Financial governance focuses on the effectiveness, efficiency, sustainability and transparency of schemes.
- Autonomy with strict accountability and transparency creates an environment for good governance.
- Risk management is a fundamental part of corporate governance. An organization should have a risk management plan for evaluating, monitoring and limiting risk which is set out in published documents
- Good governance means that the roles and interests of stakeholders - the State, workers, employers and beneficiaries - and the social security organization are taken into account.

# CHAPTER 2: GOVERNANCE AND THE BOARD

## 2.1 WHAT A BOARD MEMBER DOES

### 2.1.1 Principles to follow

The details of board members' roles vary, but the principles are generally the same for all boards. Within the limits of the law, the organization is there to act in the interests of its constituents – contributors, beneficiaries and future beneficiaries – and the board's role is to see that it does this.

#### The role of a board member

Board members are 'trustees' for social security schemes. A trustee's duty is to exercise a reasonable standard of care on behalf of all the beneficiaries of that entity. This means that a board member should:

- Act in accordance with the rules of the scheme, within the framework of the law;
- Act prudently, conscientiously, and with good faith;
- Act in the best interests of the scheme's constituents and strike a fair balance among the different categories;
- Seek advice where necessary on technical and legal matters; and
- Invest the funds (where this is part of a board member's role) in line with those principles.

What other principles should a board member follow?

- A board member represents his/her constituency and ensures that its members have a voice when decisions are taken that will affect them and the wider public. However, a board member's constituency is wider than simply the organization with which the member is associated. For example, a trade union representative would be expected to represent the interests of workers as a whole, not just those in his/her own federation. At the same time, a board member needs to be balanced and fair in his/her approach, because the member is on a board that is looking after the whole social security scheme, not just the part that most affects the board member's constituency. So while a board member's role is to speak up for his/her constituency, successful governance depends critically on board members taking a broad view of their responsibilities.
- In general, a board member is not a delegate who takes instructions from his/her organization's executive body, or from a wider constituency. Rather, a board member has been entrusted by his/her constituency to debate and vote in line with its overall interests. From time to time, there will be controversial topics on which a board member will feel it necessary to find out people's opinions before

taking a position. If this happens too often, however, the board will be unable to function because it takes too long to make decisions, even on urgent matters.

- The representative function operates in both directions. Most of the people a board member represents will know much less about the social security organization than the member (that, after all, is why they put the member on the board). They may also have only a vague idea about what is practical, and about the compromises that have to be made to take account of different interests. So the board member may need to explain the situation to them, and at times tell them things they do not want to hear about what can and cannot be done. Social security requires a very long-term perspective because it has long-term impacts. A change that may look to outside observers like a ‘quick fix’ – a simple solution to solve an immediate problem – or a good use of a current surplus, may have highly detrimental consequences in the long term. One of a board member’s responsibilities is to help people understand the long-term perspective.
- A board member is responsible for his/her actions (or failures to act) on the board. The ‘duty of care’ principle can be applied to determine whether a board member is properly carrying out his/her responsibilities. Under the duty of care principle, in carrying out his/her duties, a board member is required to act honestly and in good faith with a view to the best interests of the social security scheme and its members. A board member is required to exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. If the member, by reason of his/her profession or business, has a particular knowledge or skill relevant to his/her duties, the member is expected to use that particular knowledge or skill in exercising those duties.
- There will be information that a board member receives that must be kept confidential because it is about individuals or contracts with other bodies (see Section 2.3.3). It is a good idea for a board member to make this clear to his/her own organization and to others in his/her constituency at an early stage, and to ensure they understand that while the member will be as open with them as possible, there will be issues on which he/she cannot share privileged information.
- Outside the board, there may be rivalries between different organizations in the same field, for example, competing workers’ or competing employers’ organizations. For the good of a board member’s constituency as a whole, the member needs to suppress these rivalries and try to work in harmony on the board. If there is a bitter conflict, this may not be easy, but bringing such quarrels into board meetings will reduce the member’s chances of representing his/her constituency effectively and make it harder to win debates over issues that are important to them. A board member may reach an informal understanding with his/her colleagues, or even draw up a formal memorandum of co-operation in order to increase the influence of the whole trade union movement or employers in the social security field. If there are other social security organizations with tripartite boards, or if a board member’s organization has a regional network, the member

may want to contact fellow representatives on those bodies, in order to discuss the problems that arise and work together on solutions.

- A board member's role is supervisory, and the member is there to take a view of the whole operation, not to get involved in day-to-day management. That is what the chief executive and the staff are paid to do. Board members' task is to see that they are doing it properly, not to take a hand in it themselves. This becomes even more important if the board has responsibilities such as those of an administrative court – penalizing people, hearing appeals or making awards. People will not believe that board members' judgments are fair if they have intervened in making the original decision at an earlier administrative stage.
- In a board member's normal day-to-day job, the member may well have a 'casework' function, dealing with queries from individual members of his/her union or association about decisions the social security organization has taken. It is important to establish from the beginning what a board member can and cannot properly do in response to individual members' queries. For example, asking a manager to check the file to ensure a case has been correctly dealt with may be acceptable, while asking for special treatment, such as seeing the file or sitting in on discussions about a case would not be proper.
- A board member is on the board to see that the law is upheld. If the organization has the power to waive legal requirements, it should do so in a way and for reasons that will hold up under close scrutiny. If there are weaknesses in the authorizing statutes, this does not justify legal shortcuts in administration. Rather, a board member should draw the attention of policymakers to problems in the law.
- The public does not want, and has no confidence in, social security systems that lurch from one set of reforms to another, often in response to short-term problems. If this happens, they will lose faith in the system's ability to deliver benefits. It is important for boards to work with their governments and look strategically at future developments, and for them to look at the whole system of social protection, not just at certain benefits.
- A board member is not expected to turn him/herself into an expert, but board members are expected to supervise experts, and to make sure that they bear in mind the interests of those whom the board members represent. A very important rule is to tell experts to talk in language that board members, as part of the general public, understand, rather than in their own technical jargon. For this, a board member needs to have the confidence to say at times, 'I am sorry, but I don't understand you – please explain the point in plain language.' Board members need to ensure that they understand enough about the technicalities to be able to ask intelligent questions. The self-assessment in Appendix D can help board members identify the areas where they need to build up their knowledge and skills. One step that could facilitate a board member's work is for the organization that the board member represents to employ experts to assist him/her.

## 2.1.2 Documentation and other information

Board members need a number of basic documents and other information. To ensure a well-run organization and board, some of the documents listed below will already exist, while others may need to be drawn up. If there are gaps in the material available from the organization, board members may raise the issue at a board meeting, asking why the gaps exist and press for the necessary documents to be prepared.

This basic collection of documents should be kept up to date. If the organization has a website, in the interest of transparency, most of them should be included on it. This will allow staff and members of the general public to refer to them easily. If there is no website, an alternative would be to have a set of paper copies available in each regional or district office. These documents will be referred to in more detail in the following chapters. The basic documents include:

- The statute under which the board has been set up, and which defines a board member's basic powers and duties;
- Regulations that go into detail about the board's powers and duties, including the procedures it must follow;
- The statutes and regulations setting out the details of the social security scheme the organization is administering;
- More general guidance codes for members of boards of autonomous bodies to which the government has delegated public functions. These might include, for example, standards of conduct and requirements for the disclosure of personal assets or guidance about the information to be provided to the public and the organization's accountability;
- Statistical data on the numbers of contributors and beneficiaries, and the types and amounts of benefits paid;
- Budget documents, annual reports, and financial accounts for previous years. If auditors' reports and investment reports are published separately, board members also need these;
- Any mission statement, client charter or strategy or policy document, for example, on objectives and performance targets (see Section 3.2.1);
- Actuarial reports that have been done for the organization (see Section 5.3);
- Summaries of the organization's policy on human resources management, such as the recruitment and training of the organization's staff;
- Codes of practice for tendering, competitive bidding and for dealing with outside consultants and contractors. These may be set at the national level, perhaps with some specific guidance relating to the organization;
- Other publications, such as internal or external newsletters, or sets of guidance notes;
- The minutes of past meetings of the board, and any committees; and

- Copies of protocols or standing orders, and any other codes of guidance that have been issued for board members and staff, setting out how they should do their work.

It is also useful for a new member to have information about the chairperson of the board, fellow board members, the CEO and the senior staff. New members may want to arrange to meet informally with the chairperson, board secretary and the CEO before their first board meeting in order to learn how the organization works in practice, the current controversies and how the board personalities and functions relate to each other. They should make an effort to meet all the senior directors, and to visit field offices. It is useful to obtain an organization chart, as suggested in Section 3.1.1. Since the formal structure of an organization and the way that it operates in reality are often somewhat different, after having made these contacts, a board member may want to draw a personal organization chart setting out how the organization works in practice.

It is important to find out who provides services for the board – who arranges the meetings, sends out the agendas and papers, takes the minutes and deals with routine queries and correspondence for board members. Throughout this guide, the term board secretary is used, however the job might have a different name and may be a team rather than a single person.

Board members will generally have been appointed because of their roles in other organizations or their expertise in particular areas. At the beginning of a term on the board, nobody can be expected to know everything about the relevant law or the organization's activities. It is good practice, therefore, for new board members to be given the chance to attend seminars about the board's work, as well as for existing members to have regular updating sessions. There will be areas where external experts should be brought in, for example, to explain overall principles, discuss the general background and offer an independent perspective. Employees of the organization should take board members step-by-step through the procedures they use, explaining the reasons for them and any plans for changes in procedures.

An important element is the structure of the benefits that are administered by the organization. In many cases there will be different systems of benefits that originated at different times in the organization's history, as well as subgroups of the covered population with different entitlements. The principal focus should be on the current benefit structure, but for a thorough understanding of the scheme, the historical picture is necessary.

### Training of board members: An example

The General Association of Pensions Institutions for Managerial Staff (AGIRC) in France organizes and pays for two-day seminars for new members of the board that supervises AGIRC. A summary of a course appears below:

- **Day 1** of the seminar begins with a short description by a board member of his/her own experience on the board. The Director of the Secretariat then gives a history and overview of AGIRC's form of retirement provision, and how it fits into the overall system of public pensions in France. The Director of Regulation explains the broad principles of regulation and the way AGIRC has evolved, in terms of legislation and judicial decisions. After lunch, the Director of Institutional Relations explains the organization of AGIRC and the responsibilities of board members. The Technical Director then explains how budgets and estimates are made at AGIRC. This is followed by a session on the 'social action' in which AGIRC is also involved. The day ends with a round table with senior executives and a dinner for participants and speakers.
- **Day 2** starts with an explanation by the Information Director of a pilot programme for providing information to members and simplifying administration. Then there are sessions on auditing by the director of Audit and Control, and on quality controls and targets. After lunch there is a session on financial controls, followed by a final summing up by the Chairperson and Vice-chair and the Chief Executive Officer.

Such a seminar provides a valuable opportunity to get to know fellow board members and senior staff of the organization in an informal setting.

The board might agree that there should be an annual exercise for each board member to assess his or her own areas of strength and weakness. (The self-assessment exercise in Appendix D is an example.) Following this assessment, the board secretary could draw up a programme for each board member to follow over the course of the year. Some of the programme could fit in with the cycle of work of the board itself, so that training is provided at the time when it is most relevant. For example, in the month when the audited accounts are due to be presented to the board for approval, there could be a training session beforehand. This session would cover the accounting methods used and what can be learned from a set of accounts. It could be given by an expert from the national public auditing body or the organization's own staff, or by an academic or an external consultant.

A board member may also want to think about specific areas where the member needs more information. For example, a board member might wish to have a personal session with an expert who reviews the legal framework of the organization and discusses possible future developments. Or, the member might wish to have a personal explanation of the system of finance which the organization applies in order to have the funds to pay benefits.

It is often hard for busy people to set aside time for personal development. Agreeing on an objective for the amount of time that each board member should

spend on improving his or her skills and knowledge over the year, and on an arrangement where each member would keep a standardized record of his or activities could be an incentive to do this. A simple example is included in Appendix D. This record can be shared among board members at an annual review session as an item on the board's agenda, and perhaps also included in the organization's annual report.

At its International Training Centre in Turin, the ILO organizes regular seminars for officials of social security systems. Some courses are for those who manage and run the systems, while others are for people working with the models developed by the ILO for making demographic and financial projections of social security benefits.

The International Social Security Association (ISSA) organizes short executive development courses for chief executive officers and board members of social security organizations.

For those who want to go into greater depth, there is a one-year Master's Degree in Social Protection Financing, a joint initiative of the ILO and the University of Maastricht in the Netherlands ([www.fdewb.unimaas.nl](http://www.fdewb.unimaas.nl)). It is designed to train specialists in social protection and in social protection financing for social security organizations, insurance companies, governments, research organizations, and consulting companies. It is possible to take just one course or a block of courses. In Switzerland, the University of Lausanne has a two-year Masters Degree in Actuarial Science which includes a component on social protection provided by the ILO ([www.unil.ch](http://www.unil.ch)). As part of the QUATRRAIN AFRICA project, from the 2010-2011 academic year, the University of Mauritius, in partnership with the ILO, is offering a one-year Executive Masters of Science in Social Protection Financing programme in English and French (<http://quatrain-africa.itcilo.org/>).

## KEY POINTS

- The primary duty of a tripartite board of a social security organization is to see that the organization is acting in the interests of its constituents - contributors, beneficiaries and future beneficiaries - and in accordance with its authorizing legislation. From this, a series of other principles follow.
- Board members need a full set of documents concerning the organization, including the legal statutes, operating statistics, budget and accounting documents, and protocols for the running of the board meetings.
- It is useful for a new board member to meet the CEO and senior staff, as well as others who provide services for the board.
- No one can be expected to know everything about the relevant law or practices from the beginning, so seminars and opportunities for updating board members' knowledge are essential.

## 2.2 THE LEGAL FRAMEWORK

Social security organizations and their governing bodies are set up by law to perform specific functions. The Law specifies who sits on the boards, how they are appointed and what role they are expected to play. More detailed regulations and guidance may come from the relevant ministry or government department. In principle, autonomous social security organizations deal with administration, while the government makes policy and adopts legislation dealing with:

- who is covered by the scheme,
- the type and level of benefits to be provided, and
- the system of financing the scheme, including the contribution rate for each benefit branch.

This looks like a clear-cut division, but in reality the lines are somewhat blurred. One person's policy decision becomes another person's set of requirements to be implemented. As the policy decision is implemented, the policy itself can change – vague commitments may harden into clear statements in an administration manual, or alternatively they may be found to be too vague to be workable. The next time the issue is reviewed, the practical experience with implementation is the policy starting point. Clearly, for policies to be successful there needs to be dialogue and feedback between the government policymakers and the social security organization.

### 2.2.1 Legal status

The extent of independence of a social security organization varies considerably from country to country. Some organizations have the power to engage their own staff and build their own premises, while others rely on secondments from the government. Some may have a free hand to invest funds, while in other cases this authority belongs to the Ministry of Finance.

The statutes covering the board's role may be lengthy and technical, so it is helpful to board members and the public if a brief summary in plain language is available. If there is a controversy about the board's powers, of course it is the precise text of the law rather than its popular interpretation that counts. Thus, board members need to be familiar with the full documents and refer back to them whenever necessary. For this purpose, it is useful if board papers include extracts of the relevant parts of the law or references to it.

Practices may have developed that are not in line with the strict wording of the law. For example, the law might provide that the board as a whole draws up and approves the annual budget, when in fact the chairperson and chief executive officer do this, and then bring it to the board for approval – when it is too late for

## Board of Trustees of the Tanzania National Social Security Fund (NSSF)

Under a 1997 Act, the NSSF Board of Trustees has the following detailed oversight objectives, functions, duties and powers.

Objectives for Board oversight of the NSSF:

- business or financial commitments undertaken consistent with the objectives of the scheme and the interests of contributors;
- system for financing pensions followed and account taken of long-term liabilities and the link between higher benefits and higher contributions;
- adequate arrangements for preservation of pension rights;
- contribution records for insured persons maintained and available for inspection by them;
- NSSF administered with priority to improvements in benefits and controlling administration costs;
- adequate steps taken to avoid non-compliance and evasion of obligations;
- other aspects of management conducive to the attainment of the objectives of the NSSF performed.

**Functions:**

- formulate, implement and review policy relating to the NSSF;
- control the NSSF in accordance with the Act;
- invest NSSF funds in accordance with the Act;
- provide technical assistance and advisory services for promoting social security programmes;
- promote occupational health and safety measures;
- take action for the proper and efficient administration of the NSSF.

**Duties:**

- supervise the NSSF in accordance with the highest standards to which a person with a fiduciary responsibility may reasonably be expected to conform;
- protect, safeguard and promote the interests of insured persons;
- do what the Board may reasonably be expected to do to maintain the credibility of the Board, the confidence of the people of Tanzania and insured persons in particular, and avoid and minimize any loss.

**Powers:**

- arrange for triennial actuarial valuations of the NSSF;
- appoint person(s) it deems necessary for proper and efficient conduct of the business of the Board;
- appoint and employ consultant(s), agent(s) and contractor(s) the Board deems necessary;
- appoint external auditors;
- take other action necessary to give effect to the provisions of this Act.

The Board consists of a chairperson appointed by the President of Tanzania, the Principal Secretary to the Ministry responsible for social security and three members each representing the Association of Tanzania Employers, the Tanzania Federation of Trade Unions and Government. These nine members are nominated by the organization or Ministry concerned and appointed by the Minister responsible for social security.

meaningful review, deliberations and changes. In such cases, though it might take some time to achieve, board members can work together to recover the board's power, and insist on a full discussion.

Sometimes the terms of the statute that set up the organization lead to frustration for board members because the organization does not have some powers that would make it easier to operate, or the statute may be unclear as to who has the powers the board lacks. Equally, some requirements may be very inconvenient or difficult for some employers or individuals to meet. Until the law is changed, the organization must follow the law as it is. Over the long term, taking shortcuts that are convenient will erode respect for the law and weaken the board's position. If the board has the power to make procedural changes itself, it should do so in a fair and transparent way that will hold up under close scrutiny.

There may be other laws dealing with more general topics that board members need to be aware of and to refer to when necessary. Examples include national:

- human rights legislation;
- legislation covering the ethics and behaviour of public servants, and anti-corruption legislation;
- legal requirements for auditing of public bodies, including the terms of reference of the national audit office or similar body;
- requirements on freedom of information – what public bodies' documents the general public is entitled to ask for and receive, and which are required to be published or made available on the bodies' websites; as well as
- codes of guidance on relevant issues, such as the ISSA *Guidelines for the Investment of Social Security Funds* (see Chapter 6 and Appendix E) and the International Actuarial Association (IAA) *Guidelines of Actuarial Practice for Social Security Programs* (see Section 5.2).

## 2.2.2 Relationships with other bodies

Within a tripartite board, the government will have its own representatives as members, and often these are senior officials. Political parties – both in government and the opposition – will also be interested in what the board is doing. In some cases, the opposition party or parties will also be represented on the board.

In most cases, the organization will also have relationships with other bodies, within or outside the government. Generally, the most important of these is with the responsible government ministry, usually the ministry responsible for labour, social affairs, social security or health, and sometimes the Ministry of Finance.

At least as important in practice, though possibly not in the legal framework, is the Ministry of Finance which is responsible for the overall State budget. Social security contributions and benefit payments have a major influence on the national economy. A government guarantee that any social security deficit will be

covered from general revenues is a further reason for the Ministry of Finance to be involved. Benefit payments are not subject to budgetary discretion since they are set out in the legislation. While the organization is normally left to act autonomously in the way it carries out its supervision of administrative functions, the ultimate power for setting the organization's operating budget will typically lie with the government, as will decisions about reforms in the structure and level of benefits. It is good practice, however, for the board to be involved in drawing up the operating budget, and in consultations and negotiations before final decisions are taken. It may be difficult to persuade the government to share responsibility and ensure that board members' role is a real one rather than merely formal. However, the perspective of board involvement is a valuable asset to the government in making budget decisions. Making the board's presence felt is very much part of its job, and it is in the public interest.

There will also be other bodies with which the board will need to have a relationship, for example:

- The government auditing office may be responsible for monitoring the finances of the organization (see Section 4.5).
- Private sector institutions, such as banks and insurance companies, which employers use as intermediaries for paying contributions. If the scheme collects contributions which must be transmitted to private sector individual account managers, the board will deal with these managers.
- Regulators, for example, health insurance schemes maintain a relationship with the government body which licenses health care providers and monitors quality standards.
- In the medical and disability fields, relationships are maintained with professional bodies such as the medical practitioners' association, hospital associations and organizations offering vocational rehabilitation.

The law may not always be clear about how responsibilities are divided between the organization and other bodies, or whether, for example, one body has the power to veto actions by another or can only recommend that certain actions not be taken. In practice, these issues can be resolved by working in partnership, either formally or informally. A memorandum of understanding between the different bodies, setting out an agreed framework and ratified by the relevant government departments, is one way whereby a partnership can be formalized. Copies of the memorandum should be available to board members and to the public.

In general, an organization should try to maintain good but not too close relationships with outside bodies. A degree of formality will help preserve both parties' independence. There may be occasions when the board has to 'agree to disagree' with another party or interest group. Putting the issues in writing, with reasoned arguments to back up each point of view, may help to clarify the matters at issue and provide a useful record for future reference.

### 2.2.3 Formal supervision

The InterAfrican Conference on Social Security (Conférence Interafricaine de la Prévoyance Sociale – CIPRES) was set up in 1993 when most of the social security schemes in the CFA Franc zone were facing financial difficulties. CIPRES comprises 14 French-speaking African countries (Benin, Burkina Faso, Cameroon, Central African Republic, Chad, Comores, Congo (Brazzaville), Cote d'Ivoire, Gabon, Equatorial Guinea, Mali, Niger, Senegal, Togo). Objectives of CIPRES are to establish common rules for management, set up a system of management control, harmonize social security legislation and implement a training policy.

While social security schemes are ultimately responsible to the legislatures which established them, in some countries supervisory bodies have been set up. Senegal has a Commission for the Supervision and Regulation of Social Security Institutions (see box). In Kenya and Zambia, statutory bodies regulate and supervise the establishment and management of employer-sponsored occupational retirement benefits schemes. The Retirement Benefits Authority in Kenya also regulates the National Social Security Fund. In Zambia, the law excludes the National Pension Scheme Authority from regulation by the Pensions and Insurance Authority. If the public social security scheme has been placed under the supervision of the regulator of occupational pensions, it is important that the regulator understand the difference between occupational or personal pension schemes and social security pension schemes, in particular, how public pension schemes are financed.

It is possible that a strong role for the government can pose a threat to the social security system. This could happen, for example, if the party in power chooses to try to win votes through popular benefit improvements with deferred costs that jeopardize the long-term solvency of the scheme. If the board is to play a meaningful and useful role, it should be able to act as an 'independent but responsible' body in its relations with the government and the legislature, pointing out the policy and financial implications of various proposals.

The board should be able to:

- prepare a draft budget that meets the needs and administrative costs of the organization, and which takes account of the economic realities of the country;
- negotiate on this budget openly with the relevant ministries, rather than having the ministries' representatives dictate to the board what the budget proposal should be;
- report directly to the legislature and to the public, for example, on the actuarial valuation of the scheme (see Section 5.3);
- be formally consulted by politicians in advance about legislative changes that would have an impact on the organization's finances or the board's work;

- prepare a realistic timetable to plan properly for the introduction of new technology or new requirements and make the necessary alterations in working practices;
- negotiate changes in areas where the law or the administration is not working well and revisions are needed; and
- play a major role in planning for the future of the national social protection system of which the organization is a part.

### **Senegal - Commission for the Supervision and Regulation of Social Security Institutions (COSRISS)**

(Commission de supervision et de régulation des institutions de sécurité sociale)

In 2003, the Government of Senegal set up the Commission which is attached to the Ministry of Public Administration, Labour, Employment and Professional Organizations.

The Commission meets at least once every three months, and has the following tasks:

- To help define social security policy based on studies and consultations with the social partners;
- To participate in monitoring the implementation of agreed social security reforms including social assistance and health insurance reforms;
- To participate in the supervision and regulation of deliberations or decisions of directors of social security institutions;
- To ensure the timely preparation of independent audits of social security institutions, and to monitor the audits;
- To monitor the investment policy of the reserves of the social security institutions.

The seven member Commission comprises representatives of the Ministries of Finance and Labour, an independent person with experience in social protection, a lawyer, an auditor, a financial expert and a social security specialist.

## **KEY POINTS**

In principle, autonomous social security organizations deal with administration, while the government takes decisions on policy matters. However, this is not a clear-cut division, and for a social security scheme to be successful there needs to be dialogue and consultation.

- The degree of a social security organization's independence from government ministries varies. In some countries, practices may have evolved which are not in line with the statutes. Board members need to insist on compliance with the law, and if changes are needed, to pursue them in a fair and transparent way.
- In addition to governing statutes, there will also be a number of other laws and codes of practice with which an organization must conform, and board members should be familiar with these.
- The board's aim should be that the organization acts as an 'independent but responsible' body in its relations with the government. With other public or private organizations with which the organization must work, the aim should be to maintain a good but relatively formal relationship.

## 2.3 THE BOARD'S ACTIVITIES

There are variations in the way that boards in different countries conduct their business. Some points are common to all boards, and this Section covers these.

### 2.3.1 Time commitment

The frequency of board meetings depends on the scope and volume of the board's responsibilities. In general boards should meet at least quarterly, and in many cases monthly. There may also be meetings of committees or working groups. Some of these will be permanent committees, for example, an audit committee that looks in detail at the audited accounts of the organization and holds discussions with the external auditor, or an investment committee that oversees the management of investments. Other temporary committees may be set up for various purposes, for example, to draft a report on a particular topic or to oversee an information technology project.

While board meetings are usually held in the headquarters of the organization, holding some of them in regional or field offices will let board members see what the general public sees. It could also be worthwhile to combine a board meeting with meetings and discussion groups with staff and clients (i.e. workers, employers, beneficiaries) of the organization. Board members should arrange with the CEO to tour field offices from time to time, to meet staff at all levels and see their working conditions. This is helpful not only for the board, but also for the staff. Seeing and talking to board members will improve morale and help employees who may be doing routine jobs to understand how their contributions serve the organization's broader purposes.

Boards have responsibility for developing strategy, planning and looking to the future. A meeting with routine business on the agenda may not leave enough time for an in-depth debate on strategy and the future programme. The board may hold an extended review meeting, perhaps once a year, taking a whole day or two days, often in a venue away from the main office so that there are fewer distractions. A key element of this meeting is reviewing the organization's objectives – what it is there to do, what has been achieved and what can be achieved over the next time period (see Section 3.2).

Before accepting appointment as a board member, a potential board member should find out the full extent of the time commitment and decide whether he/she can meet it. As well as reserving time for the formal meetings, a board member must read the meeting documents in advance.

There may also be other preparatory work. For example, the members representing workers might find it desirable to meet separately before a board meeting to decide their approach on particular issues; or they might want to be briefed by experts within their own constituency, perhaps on medical or financial issues, or on drafts of proposed legislation. It may also be necessary to report back and discuss together after each meeting, especially when there are plans to make changes that a board member knows are needed but which will be unpopular.

Anyone who is representing a particular constituency on a board needs to be a real and not a nominal member. Otherwise, the constituents do not have a voice. This is unfair to them and will upset the balance on the board. It may also cause difficulties for the board's own operations – for example, it could make it more difficult for a quorum to be achieved. If the time commitment is too great, or if board meetings regularly clash with a board member's other meeting commitments, the member must consider resigning from the board. Taking up a seat without attending the meetings regularly, or attending without doing the advance preparation and follow-up, serves neither the board member's constituency nor the board's broader purposes.

In many countries, members who fail to attend board meetings regularly are dropped from the board. In Zambia, the National Pension Scheme Act provides that if a member is absent from three consecutive board meetings without a reasonable excuse, the member is removed from the board. The same provision applies in the Guinea National Social Security Fund.

### 2.3.2 Board meetings

The protocols or 'standing orders' for any board dictate how the meetings are run and what formal procedures must be followed. In some cases, there will be a standard formula which may be included in formal regulations. In other cases, the board itself will have decided on them. If such protocols do not already exist, board members should formulate them.

Topics that should be covered include:

- The quorum – How many members from each group of tripartite representatives must be present before the board can take valid decisions?
- Rules for taking decisions – If there is a vote, is the outcome determined by a simple majority, a majority of each group or some other rule? Does the chairperson have a deciding vote if the vote is split? Who can call for a vote?
- The position of committees – Whenever a committee is appointed, its terms of reference should be set out clearly in writing. Is the committee making recommendations to the board, or taking decisions that need only be reported to the board?
- Rules for putting items on the agenda and proposing formal resolutions – What is the procedure for a board member other than the chairperson or CEO to put

an item forward for discussion? Who has to be notified, and what kind of notice must be given? Can an individual do this on his or her own, or must another board member 'second' (support) the proposal?

- Rules concerning public attendance and participation at board meetings – Are they observers only or are they permitted to ask questions? Are the agendas, documents and minutes of the meetings available to the public? If only some parts of the meetings and documents are public, what are the criteria for deciding what is open to the public and what is closed? It is good practice to hold as much as possible of the board meeting in public. A private session should cover only those matters for which there is good reason for confidentiality. Similarly, documents and reports should be made available to the public unless there is good reason for them not to be.
- Rules about confidentiality and conflicts of interest are covered in Sections 2.3.3 and 2.3.4.

It is good practice to make these board protocols available to the public. This helps people understand how the board conducts its business and provides reassurance that it is acting properly.

The board secretary is normally responsible for organizing the board's programme of work. It is good practice for the secretary to share the details of the agenda with the board in advance. Most board agendas will have a mix of regular and specific items. Regular items might include:

- chairperson's and CEO's reports,
- management accounts,
- operational reports, including details of work loads, progress on meeting targets, etc.,
- report on communications and publicity, and
- investment report (if relevant).

Other items may appear on the agenda for a period, for example, a report on the progress of a computerization project. Still others will be part of a regular cycle, annual or perhaps longer, for example, the triennial actuarial report.

Over time, each aspect of the organization's work and its relationships with other bodies and contractors should be scrutinized. The need to deal with immediate problems may at times pre-empt this regular review work, but it should be resumed when there are fewer urgent demands.

Standard requirements should be set in the regulations or by the board for the way that members are notified of meetings and the information that is sent to them, both in advance of and after the meeting. A written protocol might include the following:

- Dates, times, and venues of meetings are announced to all members well in advance.
- At least ten working days before each board or committee meeting, the agenda is sent out, with copies of all the supporting documents. The secretariat can use e-mail or the organization's intranet for this purpose if these are efficient means of communication with board members. If any documents have to be sent late, this should be clearly noted and the reasons explained.
- Minutes of the meetings are taken in whatever format the board has decided and circulated in draft within a specified period to all board members so that they can make corrections of any factual inaccuracies. (In some cases only decisions will be recorded; in others there will also be a summary of the debate.) A final draft version of the minutes should be circulated with the materials for the next meeting. Many organizations also find it helpful to have an 'Action Sheet' attached to the minutes, showing what action is to be taken and by whom.

Sometimes documents will be transmitted late, for example, where there has been a sudden development just before a board meeting, or where it is important to receive the most up-to-date investment data. The information that is available should be sent with the agenda, and the rest provided in a short updating report, rather than delaying all documents until the last minute.

New issues for decision – unless they are minor – should not be brought to the board without advance notice. Chairpersons and CEOs sometimes raise important issues in their reports or under 'Any Other Business', and ask for immediate decisions. At the very least, any item for decision should be put in a brief memorandum to the board, with a clear statement of why it is urgent and what decision is needed. The board should decline to take decisions on matters where they have not received adequate background information. If the matter is not urgent, the memorandum should be treated as notice of the item for the next meeting; and a proper report should be prepared.

Sometimes deadlines for notification of agendas drift, becoming later and later, while papers are sent still later or provided only on the meeting day. The consequence is that members do not have enough time to read the documents properly and are unable to consult others or to check facts. Thus, there cannot be informed discussion during the meeting. This is generally due to a lack of proper organization, but it can also be a sign that the organization's officials are taking the board for granted and not giving sufficient priority to its business. Providing documents late has the accidental or deliberate effect of ignoring the board and concentrating power in the hands of officials who have prepared the documents. It is important for board members to object whenever documents are sent late, and to insist that the agreed deadlines be observed.

### 2.3.3 Confidentiality

The rules and conventions about what should be public knowledge and what should be kept confidential vary among organizations and countries. Much depends on the laws on freedom of information. If these are limited, the board might wish to go beyond them in the interests of transparency and building public trust. Openness must be balanced against the need for individual privacy and for dealing with current business efficiently.

A rule of practice might be:

- Information about the organization's overall strategy, its current budget, the objectives and targets it has set, how they are being met, and future plans should be freely available.
- Information about tenders for services or negotiations with providers or government bodies that could have financial implications or weaken the board's negotiating position if publicly known should not be provided until after the event.
- Information about the personal situation of individuals, whether employees, insured persons or beneficiaries should not be made public without their consent.

The same guidelines would apply to board members discussing the affairs of the board elsewhere, even with colleagues or experts in the constituencies that they represent. Relationships with commercial providers are particularly sensitive, since large sums of money may be involved.

There will also be cases where board members will have information that could be damaging to a firm if it were divulged, for example, a firm's failure to pay contributions owed to the organization. It may be argued that such failures should be treated with confidentiality. A better approach, however, is to make the organization's operations so transparent that there is little information that is confidential. For example, in the press or on its website the organization could identify firms which are substantially in default of their contribution obligations. For large debtors, non-payment of contributions would be public knowledge, and damage to a firm's reputation would be the firm's own fault. Keeping the information secret means that the organization cannot use it as a tool to enforce compliance, and the information is denied to others who have a real interest in it – workers whose benefit entitlements could be affected.

It is always worthwhile for board members to discuss whether secrecy is necessary in a particular case. If it is agreed that secrecy is appropriate, loyalty to the board and the organization mean that a board member must maintain the confidentiality of information received as a member of the board.

A particularly difficult issue is negotiations on political issues, where the media and political parties are interested, and where a board member may or may not support the approach that the majority of the board or the chairperson is taking. What a board member does depends on the circumstances, but if it is decided that a matter should be kept confidential, or if it is clear from the general policy guidelines that it should be confidential, breaking confidence could have serious implications for the member's credibility and relations with other board members. Different levels of confidentiality are appropriate for different occasions, for example, an informal discussion with a limited group within his/her constituency on whom the board member could rely to keep the matter secret, compared to making a statement in public or to a journalist which would make a confidential matter public.

It may be possible to arrange for other bodies, such as a government tripartite economic and social council, to receive documents in draft so that they can take part in the discussions of controversial issues. Sometimes, without breaching confidence, a board member might suggest to an interested outsider the relevant questions to ask the organization about particular issues.

If there is a confidential matter about which a board member feels he/she must make a statement that breaches confidence, the member would usually be expected to resign (or be dismissed) from the board. A board member needs to balance the possible results of his/her departure from the board against the consequences of failing to bring the matter to public attention.

### **2.3.4 Conflicts of interest and lobbying**

What should a board member do if he/she has a conflict of interest – a personal or business interest in a body which is dealing with the organization? A member might, for instance, be (or be related to) a director of a firm that is bidding for business from the organization. This will make it difficult for the member to make an objective decision – and to appear to have made an objective decision. It may put the member under pressure to help those with whom the member is associated, or lead to accusations of corruption.

Most countries have statutes or codes of conduct about conflicts of interest. These may require declaration of the conflicting interests, or prohibit persons with conflicts of interest from taking part in particular decisions, or both. If the legal requirements are limited, the board may develop more specific and comprehensive standards. Even if the legislation governing the organization does not require a declaration of financial interests, it is good practice for the board to require members to make declarations.

### Guidance from Transparency International (TI)

Transparency International is an international, non-governmental body dedicated to combating corruption in business and public life throughout the world. TI makes the following observations on conflicts of interest.

*For legislators, ministers, or officials to decide a matter even partly on the basis that it will benefit their interests is to betray the trust of the people. The decision must be made solely on the basis that it is in the best interests of society. For to allow any other consideration may result in a decision other than that most appropriate in the public interest. The primary test is subjective, that is, one which the politician or official must apply personally according to his or her own conscience.*

*But even if this test is satisfied, there is also an objective assessment to be made. Might the decision be viewed by the people as one made other than solely on the basis of their welfare? This must also be considered by the legislator, minister or official but, unlike the subjective test, the ultimate judgement on this issue rests with the people. Why must this be so? The reason is public confidence. The people are entitled to feel confident that their power or sovereignty is being exercised for their benefit....*

*At times the requirement to avoid apparent conflicts of interest appears unfair and harsh, especially when abused by political opponents. Yet a politician or official who creates the appearance of a conflict of interest is simply inviting the closer inspection of his or her motives. It is a self-imposed vulnerability. (Carney, 1998)*

The register of financial interests should be made available to all members of the board so that all board members are aware of the interests of their colleagues. If a board member has a conflict of interest over a particular issue which the board is debating, the board member should declare his interest at that time. If the interest is significant, the member should take no part in the debate and leave the meeting during the discussion. The principle of 'declare, and then take no part' should extend beyond financial interests to direct and indirect interests, for example:

- A board member may have a relative who is applying for a post or stands to benefit or be penalized by a particular ruling of the board.
- A board member who sits on a health insurance board and has shareholdings in a private health company will be affected by decisions relating to these companies irrespective of whether the member's own company has direct dealings with the organization.

A board member may believe that he/she is perfectly capable of being dispassionate and not allowing his/her personal interests to affect his/her judgment. While the member may be correct, this is not the point. The important question is: 'What would a person in the street – someone who is neither a friend nor an enemy – think

if he or she heard about this?' If it could lead the person to suspect that there was something dubious about the board decision or the process that led to it, then the board member should take no part in the discussion or the decision.

Firms lobby board members for the organization's business (e.g. information technology hardware and software, financial services). More subtly, lobbyists promote policies which would be of financial benefit to those who employ them. For example, moving elements of the social security system from public to private provision can be rewarding for financial institutions (banks, insurance companies, private savings funds, etc). Board members may find that they are the target of lobbying by these institutions, which may include hospitality, seminars, study tours or offers of equipment or software.

Lobbyists are well versed in public relations and communications skills, and these offers can be very attractive. One defence is to remember the phrase, 'there is no such thing as a free lunch' – in other words, people who offer gifts usually have an ulterior motive. It would be good practice for the board to adopt a formal rule that board members must decline all gifts from individuals or companies with a current or potential financial interest in the organization's operations. A second best alternative would be for the board to require public disclosure of all gifts accepted by board members in the register of financial interests suggested above.

## KEY POINTS

- The time commitment for board members can be considerable, taking account not only of regular meetings but also of the necessary preparation and follow-up work. Anyone who is representing a constituency on an organization's board needs to ensure he or she has enough time to be a real rather than nominal board member.
- There should be a set of procedures for board meetings. It is good practice for the procedures to be available to the public.
- There should be a regular cycle of work at board meetings over the course of each year.
- Members should insist that documents for board meetings are issued sufficiently in advance that they have time to read and digest them.
- Board members should agree on rules for confidentiality, balancing the need for openness against the need for protecting the privacy of individuals, and for establishing an environment in which board business can be conducted efficiently. The less secrecy, the less damage that can be done by unauthorized leaks of information.
- There should be a clear board policy for conflicts of interest and dealing with lobbyists. Board members should refrain from taking part in decisions where they have a personal interest. A register of financial interests of board members should be made publicly available.



# CHAPTER 3:

## GOVERNANCE OF ADMINISTRATIVE OPERATIONS

### 3.1 MANAGEMENT STRUCTURES

The board's role is supervisory. It is there to oversee the operation of the entire organization, not to get involved in day-to-day management. That is what the CEO of the organization and the staff are paid to do. Positions will have different names in different organizations. We use the terms 'chief executive officer' (CEO) for the head of the organization and 'directors' for the senior managers. The board members' task is to see that the management team are doing their jobs properly. What is the relationship between board members and the management team?

The statute or regulations setting up the organization normally include a statement of the responsibilities of the board and the CEO, and new board members must be aware of this. If, in reality, the division of responsibilities does not seem to be working as set out in the law, it is important to bring practice into accord with the legal requirements. Strategies to do this could be discussed with board members who have held their positions longer or perhaps be raised formally at a board meeting.

#### 3.1.1 The management team

Directors normally include:

- Director of Finance – responsible for budgets, accounts, internal audit; and
- Director(s) of headquarters and field office operations
  - Contributions – registration of employers and members, maintenance of records, contributions collection, compliance
  - Benefits – applications, adjudication, payment.

Other directors or senior officers are responsible for:

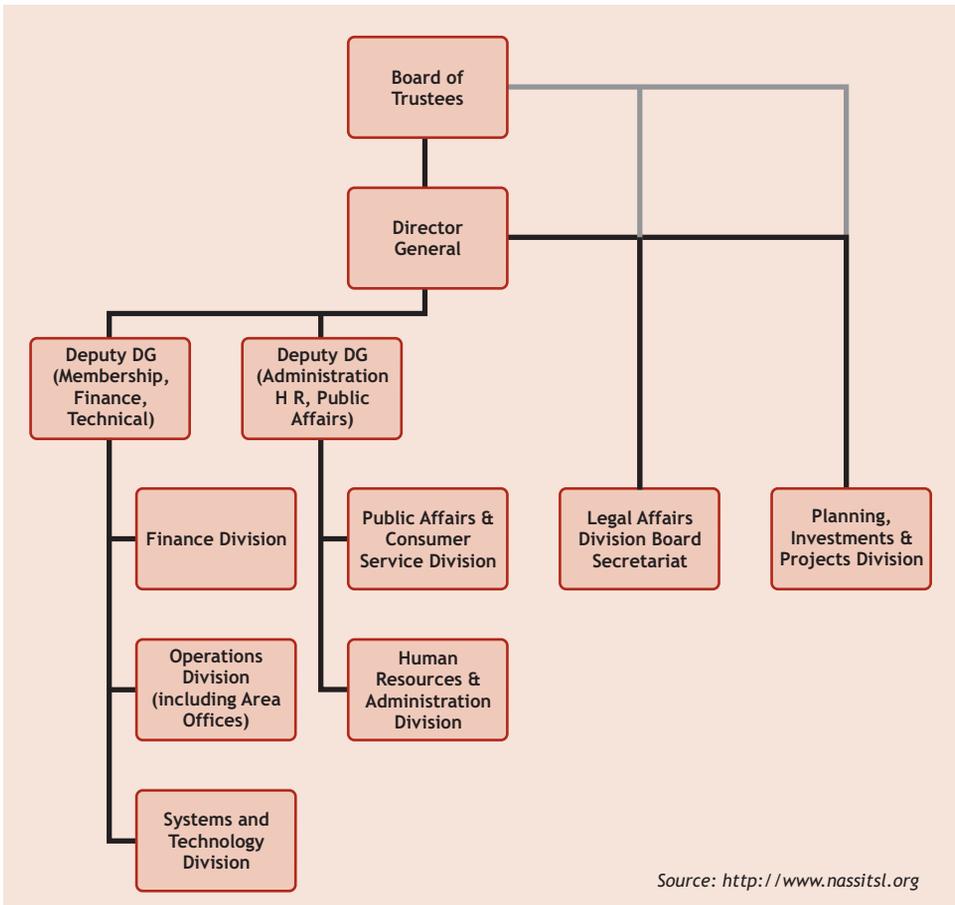
- Information and communications technology;
- Investments;
- Legal matters – advice, prosecutions, appeals;
- Human Resources – staffing of the organization, training;
- Research – collection and analysis of data (e.g. claims, work flow, backlogs), actuarial studies, policy formulation and planning (including advice to ministers);
- Communications, public relations and public information:

- Internal administration – premises and equipment of the organization; and
- Medical matters – advising on disability and employment injury claims.

There should also be senior officers responsible for security, such as computer security and data protection, and for risk management for the entire organization. Board members will find it helpful to have an organization chart showing the management structure, job descriptions showing the responsibilities of each senior staff member and résumés of key persons. These need to be kept up to date, with revised versions circulated to board members.

The following chart illustrates the organizational structure of the Sierra Leone National Social Security and Insurance Trust.

**Sierra Leone National Social Security and Insurance Trust**



Source: <http://www.nassitsl.org>

Often, the CEO will be appointed by the president, the responsible minister or a committee of the legislature rather than the board. Nevertheless, it is good practice for the board to be involved in the process, since the board must work closely with the appointed CEO.

If the board appoints the CEO, it may be useful to create a committee to do the detailed selection work. Normally, the whole board ratifies the final appointment. It is important that the committee's terms of reference be clear from the start so that committee members know what they can do on their own and what they must refer back to the board. If the board is only being consulted about the appointment of the CEO, it may select a representative to participate in a ministerial committee or one set up by the legislature. Again, the board member would need clear terms of reference.

Since the CEO is the public face of the organization, it is essential that the appointment be made openly and fairly. It is also important that anyone who is qualified to do the job has an opportunity to be considered for it. It is good practice to advertise the job, along with a detailed job description and a 'person specification' – a statement of what qualities, skills and knowledge are essential for the job, and what additional attributes would be desirable. Short-lists of applicants should include individuals who meet the criteria set out in this specification, and the final appointment should be made on an objective basis after interviews of all those who have been short-listed.

A small number of people will be qualified for the job, so it is very likely that some of the applicants will be known to board members. The points discussed in Section 2.3.4 on conflicts of interest apply. If an applicant lobbies board members for the appointment, or others put pressure on the board on behalf of an applicant, this should lead to disqualification of the applicant. In many cases, legal codes or the codes of practice for appointment of civil servants require this. Where they do not, the board may want to adopt the principle.

For other staff on the senior management team, the CEO would normally make the appointments. Sometimes the board is involved. The same principles of openness, fairness and equal opportunities should apply.

A newly appointed CEO or senior manager will often have managed a major public or private sector organization, but have little knowledge of social security. The new CEO will need to acquire the knowledge and skills for the CEO job in much the same way as board members do for their job.

The pay scales for the CEO and senior staff may be set out by the Minister, the legislature, the board, or some combination of these. However they are established, the scales should be set according to clearly defined criteria that can be publicly defended.

Sometimes part of senior managers' pay package is related to performance. Clear and objective targets must be set so that the board can measure performance against them. While targets for the CEO will often be unique to the CEO position, they are realistic only if they are related to the targets for the organization and its staff as a whole. Even if remuneration does not depend on performance, setting targets for the staff of the organization, and annual reviews whether they have been met are useful. When targets have not been met, this may be due to circumstances beyond a staff member's control, and a case can be made for paying all or part of the performance bonus. In this situation the reasons for doing so should be documented. This is especially important if the issue comes to the attention of the media.

The appointment and remuneration of senior staff are areas where a board may need outside advice, possibly from consulting firms specializing in personnel recruitment. They can provide a useful service, but it is important for the board and the recruiting organization to agree on the prerequisites for a vacant position and where the recruitment should be undertaken. Social security organizations compete for top managers or administrators in the local market, not in the international market, since it is essential for the person recruited to understand the national context, and, of course, the national language(s). The remuneration offered should be based on the national level of remuneration for comparable positions.

### **3.1.2 Relations with management**

In general, board members are likely to build closer relationships with the CEO and senior directors than with the other members of staff – indeed, these may be the only ones that they get to know well. The relationship should remain professional, however friendly it is at a personal level.

The chairperson of the board is likely to have the closest working relationship with the CEO. As the chairperson will be operating at a level of greater detail than other board members, the chairperson is likely to have many meetings with the CEO that do not involve other board members.

There may also be good reasons for other board members to be involved in discussions with senior staff of the organization outside board or committee meetings. For example, as part of their job at a ministry, government officials who sit on the board may have meetings to discuss the draft annual budget before it is presented to the board.

It is good practice for these discussions to be reported at board meetings, or at least for the major points to be described to the board in the reports of the chairperson or CEO. The aim should be for all board members to be equally

knowledgeable about what is going on. It is bad for there to be an 'inner circle' of board members who know what is happening and an 'outer circle' of members who are on the board only to formalize decisions taken by the insiders.

Sometimes, the chairperson or CEO may meet individually with board members to review topics before the board meeting. Though it may not be intended, such meetings can create suspicion that there are deals being made behind other board members' backs, and they should be discouraged. If such meetings do occur, a written note of what was covered and any conclusions could be prepared and circulated. This could be done by the board member concerned.

Some boards may have a smaller Executive Committee (sometimes called a Bureau) that meets more regularly and handles certain routine issues. This body should be formally set up, and have clear reporting lines so as to avoid its becoming a clique or an informal or 'unofficial' body.

The CEO will normally participate in board meetings either as a voting or non-voting member of the board. Rather than having the CEO present reports on behalf of the senior management team, individual members of the team may attend board meetings when relevant items are on the agenda. The Finance Director could report on the budget process and discuss its details with the board. The Operations Director could report on the organization's performance of its core tasks.

In the interest of efficiency, it is desirable for other staff members of the organization to be present at board meetings to support their directors for the business items with which they are involved. If they are present, questions can be answered which otherwise would have to be answered after the meeting when the director has obtained the information from a staff member.

Board members should not seek information from the staff of the organization without the knowledge of the CEO or directors. This does not mean that a director has to be present at a meeting between a board member and a staff member, which can be very inhibiting. Rather, directors should be kept informed about such discussions. On the other hand, staff members may wish a director to be present when they meet board members in order to avoid possible subsequent recriminations.

Unless there is a very compelling reason, board members should not be involved with individual appointments, promotions or disciplinary actions. It is up to the CEO to manage the day-to-day operations of the organization and report to the board. If the board has set the right benchmarks for monitoring the performance of the organization, the board should be able to identify any disturbing issues or trends that need investigation. For example, a report showing a rising level of staff

turnover in a field office or a unit could be a symptom of management problems and the board might investigate.

It is a useful practice for board members to set aside time, perhaps at the beginning or end of board meetings, for a private discussion without any of the organization's staff present. This allows board members to raise concerns with their colleagues and to discuss whether to raise issues, without creating unnecessary ill-will, tension or problems in the working relationship with the CEO and directors. A private session of board members might be useful before the annual strategy meetings or the annual performance review of the CEO.

If there is dissatisfaction with the CEO's performance, it is best to deal with the problem openly. Otherwise, the problem will fester, rumours will circulate and factions will develop. Private discussions within the board, in particular with the chairperson, are a first step. This may be followed by confidential discussions with the responsible minister and relevant senior civil servants. If the issues involve the CEO's style, the problem can be explained and an opportunity for improvement given. The same applies to questions of competence, although this can be a much more difficult issue. If the problems involve mismanagement or fraud, swift action may be needed, sometimes involving secrecy, in order to avoid destruction of evidence.

If there are suggestions of serious misconduct of the CEO, whether the CEO is a political appointment or not, disciplining or dismissal of such a high-profile official will have political implications. Allegations must be backed up by hard evidence, and it may be necessary first to suspend the CEO and then undertake a full investigation.

## KEY POINTS

- The board's role is supervisory. The organization's management team is responsible for the day-to-day operations of the organization.
- There should not be an 'inner circle' of board members who know what is happening and an 'outer circle' whose function is to 'rubber stamp' board decisions. Any discussions between individual board members and managers outside the board meetings should be reported to the board.
- The appointment of a CEO should be done openly and based on objective criteria. The basis for the CEO's remuneration should be clearly set out.
- The board should not interfere with the organization's management reporting system. Board members should inform the CEO if they seek information from the organization's staff, and they should not interfere with individual appointments or disciplinary actions.
- If there is dissatisfaction with the CEO's performance, it is best to deal with the matter openly. Whatever action is taken will have political implications.

## 3.2 OBJECTIVES AND MEASUREMENT OF PERFORMANCE

Clients of a social security organization – the worker and employer contributors and beneficiaries – deserve and expect the same quality of service as clients of other financial institutions. A social security organization exists for the benefit of its clients. The stereotype of a slow and unresponsive bureaucracy is unacceptable for the organization. A social security organization is fulfilling its mission if it:

- collects the correct amount of contributions when due (or, if contributions are collected by another organization, monitors the process to ensure that the amounts it receives are correct);
- pays benefits to the correct people in the correct amounts at the correct time; and
- undertakes these operations with a reasonable level of administrative costs.

In its day-to-day work, the organization must have the administrative machinery to achieve these objectives. In its supervisory role, the board needs to have the information to judge whether the objectives are being achieved, so that it can take or recommend any necessary corrective action.

The board has an important role in setting organizational objectives and targets, and working with management to monitor whether the objectives and targets are being achieved, and if not to identify the reasons why.

### 3.2.1 Mission statements and objectives

Many organizations begin with a ‘mission statement’ and a ‘vision statement’ which state broad principles. Then they set out concrete objectives. These terms are widely used in management circles, but there is no generally accepted definition of them.

Definitions for mission statement and vision statement could be:

- the vision statement is what the future will look like if the mission is achieved;
- the mission statement sets out the long-term broad goals of the organization, generally in terms of:
  - What does it do for its clients?
  - What do the stakeholders want?
  - What does it do for its employees?

Ideas about the long-term goals of the organization may differ among the various stakeholders, and it is desirable for the organization to highlight these differences and establish where there is common ground. In this way, the process of drawing up a mission statement and objectives can be almost as important as their

content. The following box shows examples of vision and mission statements of social security organizations in Africa.

Objectives and targets are more specific than vision and mission statements. Broadly, an objective is a result to be achieved, usually within a specified period of time, and a target is the measurement indicating its fulfilment. To be workable, objectives must be defined precisely, include a time element and be quantifiable. For example, it is not enough simply to state that ‘the processing time for benefit claims must be reduced’. A precise objective and target date for achieving the improved service would be ‘at the end of six months, 75 percent of all claims are settled within ten working days of receipt, and the remainder within 15 working days’. During the six months, milestones – intermediate targets – can be set, for example, by the end of the second month 50 percent of all claims are settled within ten working days of receipt, 65 percent by the end of the fourth month, etc. Meeting the milestones makes meeting the final objective more likely. Failure to meet a milestone triggers questions by the board about the problems encountered and what corrective action is required.

### Vision and Mission Statements

#### **Ghana: Social Security and National Insurance Trust (SSNIT)**

##### **Our Vision**

To develop SSNIT into a World-Class Financial Institution dedicated to the promotion of Economic Security of the Ghanaian Worker

##### **Our Mission**

SSNIT is committed to Providing Cutting-Edge Income Replacement Schemes to Ghanaian Workers and their Dependants in the Event of Old Age, Permanent Disability, or Death Through a Motivated Staff and Diligent Leadership

Source: <http://www.ssnit.com>

#### **Morocco: National Social Security Fund (Caisse Nationale de Sécurité Sociale - CNSS)**

##### **Our Vision**

The CNSS is a public agency with a social objective which offers sound, sustainable and dependable benefits, and which is managed with respect for the environment. Appreciated by its partners for the quality of its services and respected for its human approach and concern for health care, the CNSS has the duty and the desire to protect you always.

##### **Our Mission**

Given the strength of our capacity to manage the social security scheme for the entire private sector and awareness of our responsibilities, we propose appropriate solutions, provide high quality service and operate an extensive network of offices covering the entire country.

##### **Our values**

##### **Towards employers, insured persons, health care providers**

We commit ourselves to mobilizing all our resources to focus on listening to, advising, satisfying and anticipating the expectations of employers, insured persons and health care professionals by setting up as soon as possible interactive services which meet their specific needs in a professional, innovative and reliable manner.

##### **Towards our employees**

We invest in human resources by training and motivating our employees to make their skills available to employers, insured persons and health care providers.

##### **Social responsibility:**

As a citizen with a social protection mission, the CNSS is duty-bound to assume its social responsibilities:

- **Health care:** The extension of health care protection to the entire population is one of our main concerns.
- **Safety:** In order to guarantee the security of our insured persons and beneficiaries, we assure them an income in the event of disability, disease, maternity, old age and death.

- **Environment:** We manage with the long-term well-being of our fellow citizens in mind by respecting the environment of the community.

Source: <http://www.cnss.ma/>

### ***Namibia Social Security Commission***

#### **Vision**

Social Security Commission: a Household Name in Namibia

#### **Mission**

To Professionally Administer the Funds for the Provision of Social Security Benefits to the Namibian Workforce and their Dependents.

#### **Core Values**

- Equity
- Integrity
- Efficiency
- Transparency
- Accountability
- Confidentiality
- Ethical behaviour
- Customer satisfaction
- Mutual trust and respect
- Effective communication

Source: <http://www.ssc.org.na/>

### ***Sierra Leone: National Social Security and Insurance Trust (NSSIT)***

#### **Our Mission**

To administer a Social Security Scheme that provides financial security to all employees in Sierra Leone in the form of Old Age Benefits, Invalidation Benefits and Survivors' Benefits, based on Social Insurance Principles.

#### **Our Vision**

The National Social Security and Insurance Trust will be the center of excellence providing quality Social Security protection through promoting a culture of high quality performance among its staff.

Source: <http://www.nassitsl.org>

### ***Swaziland National Provident Fund (SNPF)***

#### **Vision**

To be the best security scheme in Africa and a major contributor to Swaziland's social-economic growth.

#### **Mission**

In compliance with the SNPF Order No. 23 of 1974, we are committed to providing the Fund's members with the best retirement packages through collecting all due contributions, investing wisely, paying out at the shortest possible time, educating

stakeholders, and engaging a well motivated and committed staff with efficiently managed systems.

*Source: SNPF Annual Report, 2007.*

### ***Tanzania: National Social Security Fund (NSSF)***

#### **Our Vision**

The vision of NSSF is to maintain its position as a leading provider of social security in Tanzania, based on the internationally recognized social insurance principles.

The Fund aspires to be a leader in membership coverage, provision of a wide range of benefits, provision of meaningful benefits and in the knowledge of the social security discipline.

#### **Our Mission**

The Mission statement of the Fund is to be committed to meet members' evolving social security needs and expectations through the utilization of dedicated human resources and modern technology.

#### **Our Core Values**

The Fund will provide services to its members and the general public on the basis of respect, integrity, innovativeness, promptness, accountability and reliability.

*Source: <http://www.nssf.or.tz>*

### ***Tanzania: National Health Insurance Fund (NHIF)***

#### **Vision Statement**

The NHIF vision is to be the leading health insurance scheme of choice in the sub-Saharan Region in terms of sustainability and quality of service.

#### **Mission Statement**

Dedicated to providing support to our beneficiaries to access health services through a wide network of accredited quality health facilities throughout Tanzania.

*Source: <http://www.nhif.or.tz>*

## **3.2.2 Measuring performance**

Performance indicators are the ongoing measures that show whether the organization is achieving its targets or not. They are tools for supporting the organization's decision-making, as well as providing a clearer picture of current performance and the direction of trends.

The organization's performance can be observed and measured by:

- descriptive measures of the process – the administrative efficiency of converting inputs (resources used by the scheme) into outputs (benefits delivered to beneficiaries). These indicators focus mainly on the human and other resources used in the process (e.g. personnel and administrative expenses).

- analytic measures of allocative efficiency – assessment of the outcomes in terms of economic or social changes resulting from a policy or programme. These indicators focus on the resources used to finance particular social security schemes or the system as a whole. They involve Social Protection Expenditure and Performance Reviews (SPERs), which are described in Section 8.2.

The two assessments of performance are closely linked. A social insurance programme may be well designed in theory, but if clients are unable to access benefits because of onerous administrative procedures, the outcomes will be poor.

It is important to choose the right indicators. Unfortunately, ‘what gets measured gets done’ is usually true. For example, measuring ‘how many letters are answered within 14 days of arrival,’ results in most employees maintaining their performance ratings by responding to all their correspondence by day 14, regardless of whether their responses are correct. A better indicator would be, ‘how many letters are answered correctly within 14 days of arrival.’ When performance indicators are drawn up, how they are to be reported, in what format and how often must be decided.

A distinction can be made between managing activities and managing service processes. Institutions that manage service processes operate in terms of workflows rather than tasks. They design their processes to produce the services they are obliged to provide, and they aim for fast, consistent, high quality and cost-effective workflows. An organization which manages activities might track, for example, the number of benefit claims processed per hour, while one managing service processes will look at the number of hours to correctly complete its benefit claim process.

The board will analyze operations performance and administrative expenses and set targets for measuring performance and the cost of achieving it. The outcomes of spending are as important as the spending items themselves, and getting the appropriate balance between spending enough on administration so that the system runs well, but not more than is needed is not easy. Administration expenditure may be low because controls are loose, but this can lead to excessive benefit expenditure due, for example, to lax standards of medical assessment of disability claims or outright fraud. Or, in a system where expenditure controls are very tight, clients may feel uncomfortable being so closely investigated. They may be discouraged from applying for benefits for which they are eligible or appealing wrongful denials of benefits.

A board member’s constituency and the general public want the organization to carry out its role efficiently and effectively. The difference between those two words is important. For example, the organization might be very efficient in recovering benefit payments made in error. To be effective, it would need to find why incorrect payments were made, and design procedures to reduce them.

It is also important to ask: efficient and effective for whom? A measure that leads to greater internal efficiency for an organization may be bad for its clients. For example, reducing the hours when offices are open to the public, or requiring clients to come to the offices rather than making contact by phone or e-mail, may lower the organization's administrative expenses and make it internally more efficient, but these measures would be very inefficient from the viewpoint of its clients.

Establishing appropriate administrative performance indicators is an important process. The discussion itself can enhance the governance of the scheme.

Indicators should be:

- comprehensive – with as wide a scope as possible,
- quantifiable – expressed in numbers,
- consistent – with each other and over time,
- relevant – for comparisons, ratios (for example, beneficiaries/contributors) are preferable to absolute numbers.

As well as measuring internal processes, performance indicators should include how clients view the organization. The internal perception of staff members who understand the organization can be very different from that of poorly informed beneficiaries who depend on the organization to provide their monthly pensions or health care. Thus, it is essential to examine performance from the point of view of clients. An annual survey of client satisfaction is a useful instrument for obtaining this perspective. Regular annual surveys can be compared to track the organization's performance.

### ***Statistics***

Once targets and indicators have been set, the organization has the continuing task of collecting data to show whether they are being met, and the board must monitor the statistical indicators. The utility of introducing a new set of statistics on a particular aspect of the organization's operation must be balanced against the complexity and cost of gathering the data. Key questions to ask are:

- Is there a specific need that can only be met by collecting the additional data?
- Will the resulting statistics show whether the organization is fulfilling its targets?

Statistics are only as good as the data on which they are based. Persons charged with collecting data normally do a better job if they understand why they are collecting the data and how it will be used. Careless, inaccurate or poorly maintained data lead to unreliable statistics. This affects performance indicators and other studies (see Sections 5.2 and Chapter 8). Forms and spreadsheets must be carefully designed and easy to use, and the staff trained on how to collect the information and the reasons for collecting it.

### ***Publication of performance measurements***

The organization should publish its targets and indicators so that the public knows what is expected in terms of performance. Some targets may be included in a 'public service agreement' between the organization and the responsible ministry. There may also be a 'client charter' that tells clients what they have a right to expect, for example, the time that a beneficiary should expect to wait for the first payment of a newly-awarded benefit, or the time a client should expect to wait for a reply to a query.

The board should receive regular reports on the organization's performance, with the performance indicators compared to agreed targets. These reports should be available to the public. This practice should be regular, and not limited to times when the performance results are positive. Measurements that are embarrassing for the organization, such as those showing work backlogs or increasing arrears in contribution payments, should be reported. The further behind any organization falls in its operations, the more difficult it is to catch up, so quick recovery and preventive action must be taken. If it is known that delays are going to occur, for example, because of the introduction of a new benefit or a new information technology system, this should be announced. Alternative arrangements should be made for handling urgent work, and these should also be publicized.

A potential perverse effect of performance statistics should be borne in mind: what is not measured is often neglected. It is important that the selected statistics measure important matters, and if staff members are rewarded based on performance statistics, that the statistics not be subject to manipulation.

Performance measurement is limited in social security schemes in many African countries. Introducing performance targets and indicators provides an opportunity for board members and management to increase the transparency of their organization's operations and to improve its administrative efficiency. Without openness about the organization's problems, and the effects they are having on its clients, it is difficult to be open about recovery plans and to take the action necessary to correct deficiencies.

The organization may not be in a position to take corrective action by itself. For example, if the bulk of the contribution arrears is due to non-payment by large State-owned enterprises (or the State itself), whether and how the arrears can be collected may be a political decision. This serious situation also encourages non-compliance among private sector employers. Without transparency about contribution arrears, there is no pressure on the enterprises or on politicians either to put things right or to face up to the implications of inaction.

## KEY POINTS

- It is helpful to have an organization mission statement setting out broad principles, and then to set out specific objectives and targets.
- Board members' constituents and the general public expect the organization to perform efficiently and effectively. Their support for the organization depends on this.
- To fulfil its supervisory role, the board needs information showing whether the organization is receiving and paying the correct amounts, and whether its level of administrative expenses is reasonable.
- Performance indicators should be simple, widely accepted and meaningful measures of the service being provided to clients.
- Client satisfaction with the organization's performance should be measured.
- The organization should publish its targets and indicators, possibly in a 'client charter'.
- Staff must understand the reasons for collecting data. Statistics (indicating bad as well as good performance) should be published regularly.

## 3.3 RECORD KEEPING

Record keeping is a subject which is sometimes neglected, but it is crucial for good social security administration. In any scheme where eligibility for a benefit or the amount of the benefit depends on periods of contribution or employment, the scheme can function only if its data is current, reliable and available. Ensuring that the necessary record-keeping systems are in place and functioning properly is a key role and challenge for social security board members.

### 3.3.1 The need for records

Most individuals have their main contact with a social security organization at the time they claim a benefit. The credibility of the scheme depends on the quality, efficiency and accuracy of the service they receive at that time. This depends on whether the scheme maintains accurate and up-to-date records that can be retrieved quickly.

Contributions which have been allocated to an insured person establish the person's entitlement to a benefit and usually the amount of the benefit. Contributions must be allocated to the correct insured persons. This reconciliation creates problems – names which are uncertain, incorrect member numbers, etc. The organization must strive to minimize the number of unallocated contributions.

The social security organization must maintain its own records, and not expect claimants to reconstruct their work and contribution history. At one time, some

organizations relied on insured persons and employers to keep records and provide the information to the organization when it was required. This is an unsatisfactory approach given the period during which the records have to be kept, the increasing mobility of workers and employers who might have gone out of business.

The need to maintain records arises not just when a benefit becomes payable but also for other purposes. For example, the auditors must check samples of them, and the actuary needs information from the records for the actuarial valuation (see Sections 4.5 and 5.2).

The basic records need to be maintained for as long as the individual is a contributor or a beneficiary of the scheme, and throughout the period that surviving dependents are beneficiaries. This can be many decades. Certain source documents, such as initial registration forms or employers' contribution schedules, may also need to be kept for long periods in case of a query or for legal or accounting reasons. Consequently, social security organizations must store large amounts of data. Nowadays, this is on microfilm or in electronic form. A social security organization must maintain data storage systems that are up to date, secure and properly backed-up, and ensure that material held in previous formats is maintained or transferred to the new system.

### **3.3.2 Information and communications technology (ICT)**

Social security organizations are now generally computerized. Without computers, the ever-growing flow of social security scheme data becomes unmanageable.

Since social security scheme databases are very large – often the largest in a country – social security ICT projects are very large and complex. Since an ICT system will not resolve data problems – it will simply import them to the new system – the existing system's data must be checked to validate the input to the new system.

There should be a system of checks on input data so that it is difficult to enter erroneous information into the system. For example, insured persons' contributions should be reconciled with employer remittances, and incorrect or duplicate record numbers should be flagged.

#### ***Getting a computer project right***

Large scale ICT projects are notorious for going wrong. This occurs due to unrealistic expectations of social security organizations and overzealous promises

by hardware and software suppliers, and due to the need to import legacy data (from a previous ICT system) and the complexity of implementing leading-edge technology needed to support more complex, distributed and collaborative ICT service models.

Board members should not try to take over the work of the organization's ICT managers, but at the same time board members do not want to face an ICT project failure, so they should ask the managers to identify weak points and determine where more attention and planning are needed. They could ask questions such as the ones in the following box.

### Questions to ask ICT project managers

- Why is new technology being considered?
- Who made the decision whether to buy or build the new ICT system? Why was a particular decision taken? What were the risks under each alternative? Is the ICT project supporting the organization, or is the organization supporting an ambitious ICT showcase project?
- Is the project well-defined? Are there clear descriptions of the project objectives, how the project will begin and end and how it will be evaluated?
- Is there a concise statement of expected achievable and measurable outcomes in a form that stakeholders can readily understand?
- Are board members and senior managers on the project communications distribution list? Are they aware of project milestones, and will they be kept informed of progress towards each one?
- What is the real attitude of the project team to the stakeholders? Are stakeholders part of the problem or part of the solution?
- Are there training sessions which board members and senior managers can attend to familiarize themselves with the project?
- Have tolerance levels for project risks been set? Is there a statement of acceptable consequences which takes into account cost, timing, impact on the public, adverse publicity, etc?
- Before problems arise, have well-defined procedures for project review been set up?

*Source: Adapted from ISSA/IBM 2004. Stakeholders refers to all users of the system: the social security organization's staff, insured persons, employers, beneficiaries, banks, suppliers, legislators, pressure groups, etc. Milestones are the intermediate targets on the road to the conclusion of the project.*

Reports on computer failures and breaches of data security, and on what has been done to prevent recurrence, should be provided to the board. What should the board do if there is a major failure and the ICT system or a new ICT system which is being implemented fails totally? This has happened in many social security organizations. The measures which were taken by the Social Insurance Institution in Poland are described in the following box.

### Recovering from a computer crisis

In Poland, reforms adopted in 1999 left little time for advance planning and led to delays in the creation of a new computer system. The old ICT system was discontinued before the new one was ready, leaving the Social Security Institution temporarily without the capacity to monitor contribution payments. The Institution implemented a crisis plan, including:

- reinstating the old software with some updating,
- revamping its plan for implementing the new system in clearly defined stages,
- requiring employers to send additional annual reports summarizing their obligations and payments, and
- requiring the use of two identification numbers to facilitate the assignment of contributions to the correct individuals.

Gradually improvements were made. In 2002, the processing of contributions was transferred to the new ICT system. However, the cost of the ICT crisis was considerable. Government bonds were issued to make up for the contributions that were not properly handled during the crisis period and its aftermath.

*Source: Fultz and Stanovnik, 2004.*

### Computer security

Maintaining the integrity and security of computer systems is important. There is no point in an organization purchasing a state-of-the-art system if it does not also spend money on state-of-the-art security for it. The board needs to ensure that the organization has:

- dedicated staff concerned with computer security, with a mandate to be constantly vigilant to attacks and with the capacity for rapid response;
- high security standards which are fully enforced and monitored, not only on new systems and subsystems but also on enhancements to existing programmes;
- tried and tested back-up arrangements;
- clear guidance to staff on what they must and must not do, for example, opening attachments to e-mails, along with an explanation of the reasons; and
- a robust disaster recovery plan which is frequently tested.

### KEY POINTS

- Up-to-date, accurate and accessible records on individual insured persons and beneficiaries are a prerequisite for a scheme to operate properly.
- ICT systems can ease the management of data, but do not dispense with the need for input data to be accurate.
- ICT projects are notorious for going wrong. The board should closely monitor ICT projects, and ask pertinent questions in order to spot signs of trouble.
- Board members should ensure that there is good computer security and a robust recovery plan in case of failure of the ICT system.

## 3.4 TRANSPARENCY AND FAIRNESS

It has been stressed that social security organizations are there to ensure the well-being of persons who depend on them. Yet many people distrust social security organizations along with other government bodies. They suspect that those who run the organizations are looking after their own interests with little regard for the welfare of their clients. Tripartite governing boards have an important role to play in countering this distrust. The boards' fundamental role is to ensure that the organization acts in an open and honest way, putting the organization's clients first. Among other things, this means that the amount spent on administration and staff is adequate for doing the job, but not excessive. Frugality in the use of resources needs to be both real and visible.

### 3.4.1 Personnel issues

The organization should be open about:

- its pay structure,
- how many employees it has, and its recruitment and promotion policies,
- how it assesses employee performance,
- what training it offers (to whom, and who travels abroad for study tours, etc),
- how it decides on capital investments (e.g. new offices, new computer systems) and
- fees paid to board members (which should be modest).

The organization should lead by example by following policies it hopes others will follow. It should be open about issues where it disagrees with individuals, and it should be willing to publicly admit mistakes.

This does not mean that questions such as 'why X got the job rather than Y', or 'why A was paid this amount while B received a different amount' should be discussed at a board meeting. It means that the procedures adopted, and the rules or guidance codes followed should be open to all. Making internal rules and procedures publicly available improves accountability to the public and to the legislature.

Sometimes existing arrangements are beyond the scope of the organization to change. For example, conditions of employment that apply to civil servants may apply to the organization's staff. (This usually means that they do not contribute to the scheme which they are administering!) The board should be aware of these employment arrangements, and if they are being reviewed, the board can play a key role by working with counterparts in government and in other institutions which are affected by them.

On other issues, the organization may have considerable autonomy, so that the board and the CEO can play leading roles in deciding matters that affect the quality of administration and the way that the organization is perceived by the public.

### ***Recruitment policy***

Transparency and fairness are essential in the recruitment of staff. The organization's image is reinforced not only through job advertisements but also by how those doing the recruiting, usually the Human Resources or Personnel Department, treat applicants. People who are treated well when they seek employment with an organization generally speak well of it afterwards, even if their applications were unsuccessful. Recruitment policy should be set out in a published document. It is good practice to:

- search for possible candidates only on the basis of their ability and suitability to perform the job required,
- inform each applicant of the basic details of the vacancy and the conditions of employment,
- avoid exaggerated or misleading claims in recruitment literature or job advertisements, and
- ensure that there is no discrimination on the basis of sex, race, religion, physical disability or any other irrelevant factor in the recruitment process.

An important element in a fair recruitment policy is a proper definition of the job and the skills and experience required to do it. These should be formulated clearly before the job is advertised and maintained as the decision criteria during the selection process. In addition to providing details about the organization, the remuneration and the working conditions, an advertisement should clearly state the essential personal requirements, including academic qualifications and desirable personal attributes.

Interviews and tests should be conducted with an objective marking system and on the same basis for all candidates. At the end of the process, if a candidate is appointed who does not meet the original specifications, those making the appointment should be prepared to explain and justify why. It is good practice for the board to receive a report on recruitment as part of the CEO's regular report, with comments on any exceptional cases.

### ***Setting a good example***

Since public organizations have credibility only if they follow policies that they wish others to follow, they should be model employers. They should have a policy of equality of treatment which prohibits employment discrimination on the basis of race, colour, sex, religion, political opinion, national extraction, nationality, ethnic or social origin, disability or age. In addition, they should follow the ILO

Employment Promotion and Protection against Unemployment Convention, 1988 (No. 168), which promotes employment of disadvantaged persons such as women, young workers, disabled persons, older workers, the long-term unemployed, migrant workers and workers affected by structural change.

The following box includes questions which board members might ask concerning the organization's personnel policy.

#### **Evaluating staffing policy: Questions for board members to ask**

Below is a check list that board members can use to establish what staffing policies and procedures exist in the organization and the extent of their transparency:

- What is the code of conduct or equivalent framework for employees?
- Does the code include a requirement to disclose conflicts of interest? If so, how is compliance with this monitored?
- Is there open access to information for staff? Can staff members look at their own personnel files?
- What is the grading structure of staff, and how are grading decisions taken?
- Is there any evidence that grades are creeping upwards, to get around salary limits? If so, what, if anything, is being done about this?
- Are bonuses or other allowances paid? If so, on what basis, who decides and what criteria are used?
- Is recruitment based on merit?
- Are there performance appraisals for staff? If so, what is measured, and how are these appraisals linked to other personnel procedures?
- Is there an open and transparent procedure for deciding on promotions, is it used consistently and are results published?
- Is there a way in which staff can appeal if they have a grievance?
- Are disciplinary procedures based on transparent and fair principles?
- Is there a formal process for conducting disciplinary hearings and appeals? Are the outcomes published?
- Is there a training system to prepare new recruits and upgrade the skills of existing staff?
- Is the effectiveness of training monitored and, if so, how?

*Source: Adapted from Nunberg 2000.*

### **3.4.2 External contractors and consultants**

In most countries, there is a law or a code of practice which applies to government bodies entering into contracts. If the social security organization is not subject to such a law or code, the board must set up rules of procedure for entering into contracts for the organization. Contracts must be monitored to confirm that they meet the procedural requirements, and board members should receive regular reports on the performance of contracts.

The more care that is put into specifying the work of a project when the contract is prepared, the more likely the contractor will produce the desired result. What happens when things go wrong must also be specified. Imposing large financial penalties on the contractor is not always the best approach, since they may make it cheaper for the contractor simply to abandon the project leaving the problems unsolved, rather than come to an agreement with the organization how to proceed with the contract.

A frequent mistake is to assume that once a contract is signed, the contractor gets on with the work and at the end of the contract term the organization receives the completed work in a nice package. In reality, few projects work this way. There are always problems, questions and unexpected issues. A cooperative approach, with a continuing dialogue between the contractor and the organization is necessary.

### 3.4.3 Ethical code

Ethical issues were considered in Section 2.3.4 as part of the role of board members. The same points apply equally to the staff and to the organization's dealings with the outside world. Ethical behaviour starts at the top, and good leadership is essential. Employees of the organization should be subject to a code of ethics, either a code which applies to civil servants or one set up by the board. To be useful, the code must be accepted by the staff, and maintained and implemented with vigour. The staff must be trained in the use of the code and reminded of it periodically.

A practice that poses a danger for social security organizations is when staff accept gratuities from clients, in the form of cash or in kind, for providing services that they should provide as part of their regular jobs. This means that the client is paying twice for the same service, once with his or her contributions and once with a bribe. Like other public bodies, the organization should take a strong stance against this.

Effectively combating corruption and unethical behaviour of employees requires a range of measures. Key instruments to minimize the risk of unethical behaviour include:

- fair selection and recruitment procedures,
- clear description of tasks,
- transparent division of responsibilities and separation of competencies,
- job rotation and job enrichment opportunities,
- objective promotion criteria,
- screening of staff, and
- sharing of responsibilities among staff members.

Any instance of corruption must be dealt with firmly and openly. Otherwise, the public credibility of the entire organization will suffer.

### 3.4.4 ‘Whistle blowing’

‘Whistle blowing’ refers to reporting of wrongdoing in an organization. It is in the interest of any organization to make such reporting possible, and to have procedures for protecting whistleblowers from victimization, not only as a deterrent to wrongdoing, but also because the only alternative may be for an employee who observes wrongdoing to inform the media which might be much more damaging to the organization. Caution is necessary in implementing any procedures to enable whistle blowing in order to avoid the staff feeling that they are under suspicion.

If national whistle blowing legislation exists, are the staff of the organization aware of it, and how effectively is it being implemented in the organization? If there is no legislation, should the organization, after full consultation with the staff, adopt a code?

There should be a special arrangement outside the normal hierarchy where employees can report evidence of possible wrongdoing. This might be, for example, an ombudsman, an independent commission or top management. A ‘Code of Conduct’ with an independent overseer can protect employees who report wrongdoing from reprisals or retaliatory measures, and promote ethical behaviour.

If such an arrangement is in place, a board member who is approached by a potential whistleblower should refer him/her to the appropriate person. Board members must be wary, since disgruntled staff members can try to exploit them by providing inside information that is incomplete, incorrect or contrived in the hope that the board member will raise the matter at a board meeting and thereby embarrass management. This possibility is a reason for caution in dealing with allegations, but not for inaction.

### 3.4.5 Transparent benefit decisions

The way social security organizations make and monitor decisions on eligibility for benefits must be transparent and open to question. Mistakes are inevitable, and there must be a willingness to admit when this happens.

Ideally, the laws and regulations under which an organization operates should allow it to verify whether a claimant meets the qualifying conditions for a benefit without time-consuming correspondence. When new benefits are being planned or existing benefits revised, operational aspects should be considered at an early stage. It is useful to include operational staff – employees actually making eligibility determinations – at the planning stage. There should be feedback on implementation from those who deal directly with claimants, and from the claimants themselves through opinion polling and focus groups. This feedback can lead to adjustments to the procedures.

There should be formal rules for determining the acceptability of benefit claims. The internal procedures should identify which level of staff can make a decision on various types of claims. Complicated cases will generally be referred to senior staff.

There should also be a procedure for the normal rules to be overridden in an emergency, even at the risk of some claimants being paid benefits without the usual checks, for example in case of an external crisis such as an epidemic, or an internal one such as a computer crash that prevents access to records for several days.

All decisions on acceptability of claims should be made in writing, and thus permanently recorded. Reasonable time limits for settling claims should be set, and compliance with the time limits monitored. Without time limits, unsettled claims could be left pending with claimants not knowing what has happened or their right to appeal. If the time limits are too short, there is a danger of rushed and incorrect decisions being made simply to meet the deadline. Where there are good reasons for delay in settling a claim, it is useful to have a formal procedure for overriding the time limits, with notification to the claimant.

Successful claimants are entitled to know not only the benefit they will receive, but how the benefit was calculated. The written notification should provide these details, as well as explaining a claimant's right to have the decision reviewed.

Generally, a social security scheme provides for two levels of appeal by a claimant whose claim has been denied. The first level is internally, where a senior officer of the organization who was not originally involved in the claim decision reviews it. The second is external where the claim is reviewed by a social security tribunal or a court.

The board should monitor the appeal process which must work quickly and efficiently to ensure that justice is not denied by complex appeal rules that claimants do not understand. While providing advice and representation is an important part of the work of trade unions and pensioner associations in many countries, it should not be necessary for claimants to have the help of these bodies (or lawyers) for their appeals to be properly heard.

The attitude of the organization's staff to claimants who appeal negative decisions is important. Organizations inevitably make mistakes, and there can be honest differences in the way that two people interpret the same facts. An overly defensive attitude on the part of the staff is not helpful, and it can prevent the organization from learning lessons from dissatisfied clients. Even where a claimant has no case, it could be that the information provided was misleading, or that there was misinformation provided in the past.

## KEY POINTS

- A fundamental job of a board member is to ensure that the organization acts in an open and honest manner in pursuing its policies and activities.
- The board should ask a number of questions on staffing policy, mainly concerning recruitment, performance appraisals and disciplinary procedures.
- High levels of transparency are essential in the recruitment of staff and in dealing with contractors and external consultants. The organization should lead by example.
- There should be a code of ethics for the staff of the organization which the board monitors, and the board should ensure that 'whistleblowers' are adequately protected.
- All decisions on eligibility for a benefit should be provided in writing to claimants, and if negative should include the reasons why.
- The board should strive to create an organizational culture in which staff members are willing to admit when mistakes - which are inevitable - have been made.

## 3.5 COMMUNICATIONS

Good communication and public relations are essential in building public confidence in a social security organization. Communications should be not just reactive – waiting for someone to ask a question and then answering it, but proactive – reaching out to people to convey the organization's messages. This is especially important when launching a new scheme or reforming an existing one. Having a communications strategy and carrying it out should be a permanent feature of the organization's work.

The key points in developing a communications strategy are:

- identifying the audience(s);
- identifying the information to be delivered;
- identifying how and when to deliver the information; and
- designing the message.

When reviewing the communications strategy, board members should put themselves in the audience's place – What do they need to know? How much do they know? How well will they understand? If too much information or information that seems irrelevant is provided, people will lose interest, and will not take in the message. If too little information is provided, the board risks misleading people. For example, although it is factually accurate, pensioners do not need to know that 'Under Section 87 of the Social Security Act, the Minister for Social Welfare has decided to exercise his/her discretion to provide an increase correlated to the rise in the Consumer Price Index between November 2006 and 2007. This

increase will be included in pensioners' payments in week nine of the financial year'. This may appeal to lawyers, but not pensioners. What the pensioners need to know is 'Your pension is being increased in line with the rise in the cost of living. The increase will be in pension payments from March onwards'. The rule to follow is to make every message as simple and clear as possible, whether it is written or spoken.

### **3.5.1 Working with the media**

The press, radio and television are all powerful media for delivering messages. Organizations sometimes suffer from 'bad press', for example, due to a scandal or a case of blatant incompetence. The reporting can be exaggerated and hold the organization up to ridicule. To ignore the negative reports, or to use them as a reason for not working with the media, is self-defeating. The media are there, and it is through them that the public gets information. Any body which has a message to get across must work with the media.

A social security organization should develop a strategy for raising public awareness of the organization and its activities. A senior staff member should be designated as the media officer responsible for responding to queries and taking the lead in providing information. In its branch offices, the organization should also have media contact staff who are responsible to the head officer/media officer. The head office and branch offices need to work together so that a consistent message is conveyed. The media officer can give the branch office staff advice about the message to put across and support on how to do it.

Problems, such as delays in benefit payments or computer 'crashes', should be openly admitted. This is preferable to letting the media discover a problem, and it gives the organization an opportunity to explain what is being done to resolve the problem. If the organization operates openly with its media contacts, whilst ensuring the confidentiality of information about individuals, it is less likely that there will be sustained media criticism of the scheme's operations.

The relationship with the media is always two-way. Many newspapers and radio stations run inquiry services or 'help lines' where their readers or audiences can ask for information or air grievances. It is good practice to encourage those who run these services to meet with the organization about the queries and grievances before they are published or aired, and for the organization to respond promptly and helpfully. This gives the organization a chance to correct misunderstandings and reduces opportunities for attacks on the organization's competence. It also gives the organization valuable feedback about what may be wrong or what its clients perceive as being wrong.

Board members may have contacts with the media and thus be in a position to act as ‘ambassadors’ for the organization. To perform this role effectively, they must be well informed about the organization and current issues. Board members can be regularly provided with press releases and press cuttings or transcripts of programmes so that they are aware of current issues and forewarned about topics that are likely to be raised with them by their contacts – all of which makes them better ambassadors of the organization.

When there are controversial issues, board members may be contacted by journalists, in the hope of obtaining damaging quotes or comments that contradict official statements. In such situations, the board members must be well briefed in advance. If a board member is not well briefed on a controversial issue, the board member should refrain from commenting. In some cases, the board may agree that only one person, usually the chairperson, should speak to the media.

### 3.5.2 The organization’s communications

From time to time, the board should review all the public relations material produced by the organization. Forms, leaflets and standard letters should be reviewed from the point of view of the reader. Will a reader understand the contents? Is a reader told what steps to take next? If a reader needs more information (for example, to prepare an appeal), does the material explain where to find it?

Tests of public relations material can be carried out on small groups of the target population to learn whether they receive the intended message. Changes, such as writing shorter sentences and using concrete examples rather than abstract terms, can improve understanding and user-friendliness. If the organization does not test public relations material, board members could do so with their own constituencies. Organizations of scheme beneficiaries could also be invited to help with drafting of the material.

Forms for collecting information from contributors or beneficiaries can be difficult to design. They must be ‘customer friendly’ and not alienate recipients. It should be clear that they come from an official body, and they must be easy to understand, legally correct, unambiguous and inform persons of their rights and options.

Clients should not be repeatedly asked to provide information that the organization already has on record, or to fill in several different forms for payments that come from one social security scheme. Clients should not have to repeatedly produce documents that staff of the organization has already reviewed and verified. These procedures show that instead of the organization operating an efficient and accessible record system where this information is stored and retrieved as required, it is treating its clients as human filing systems to be called upon at the organization’s convenience.

This transfers costs to clients that should be borne by the organization, since the clients may have to travel, take time off work and queue in a social security office.

If records are maintained in a central electronic database and field offices are 'on line', a client with a query can visit any of the organization's offices and the staff will be able to view the client's file electronically and receive computer-assisted guidance on the answer to the query. A modern approach is a 'one-stop shop' where all government departments are linked to a central register, so that people do not have to provide the same information several times to different bureaucracies. Privacy and data security must be assured. Even without such innovations it is possible to make incremental improvements when a form or leaflet is revised or a procedure is changed.

In a pension scheme, providing annual statements to contributors showing their contributions in the year and estimated pensions at retirement boosts confidence in the social security scheme and the organization, and it lets the organization correct mistakes identified by scheme members before they apply for benefits.

### **3.5.3 Methods of communication**

In the past, the main means of communication were paper and face to face, and this is still the case in many social security organizations. Increasingly, electronic methods and telephone 'call-centres' are being used. These can be very helpful, but many clients with whom the organization must deal will not be able to use them. While internet usage is expanding, older people and people in rural areas are less likely to be connected. The new methods of communication should supplement the traditional ones, which may be streamlined and trimmed to fit reduced demand, but not totally eliminated.

The clients of social security organizations will include elderly and disabled people. If many clients are illiterate, they must be taken into account when public information material is prepared and communication methods are arranged. The organization may provide leaflets in large print, and Braille and tape versions. Using pictures and symbols to convey basic information can be useful. Social security organizations should be models in terms of accessibility to their publications and websites for persons with disabilities.

The organization's offices are also a form of communication. The public areas should be physically accessible to people with disabilities. In order to make the office as accessible as possible, the administration should consult people with disabilities, or an organization which specializes in supporting them, about such things as the height and design of counters, the seating, how to serve people who are blind or deaf, etc. Making it easy for persons with disabilities to manage will help other clients as well.

Using the internet for filling forms or making claims raises questions of security as well as accessibility. Web designers must bear in mind that most of the computers that people have at home are slower and have less memory than state-of-the-art models. Graphics that take a long time to download or require sophisticated software will be frustrating for many clients, and at worst useless. Users should be able to save and print forms that they have filled online, however antiquated their software may be.

Seeking information or querying decisions by telephone has limitations. Older people may have less confidence using a telephone, and people in rural areas may have less access to telephones. Some people are hard of hearing, and older people may not be sufficiently mentally or physically agile to make notes at the same time as taking part in a telephone conversation. Employees engaging in telephone or face-to-face conversations with clients should speak slowly and clearly, and take the time to confirm that the client understands each step. They should take notes on the conversation and keep them in the client's file.

A call centre with fully trained staff who are knowledgeable about the scheme's eligibility conditions and benefits and who have access to the clients' records can be a useful means of communication. However, a call centre that places callers 'on hold' for extended periods aggravates the callers and is a failure as a means of communication. A call centre that employs poorly-trained staff is frustrating for both callers and the staff. It is a false economy, because time will have to be spent later to correct problems that should never have occurred.

For clients in rural areas that are hard to access, with many clients distant from an office of the organization, third parties can be used to provide general information. Provision of services can be sub-contracted to individuals if information privacy can be maintained.

### **Websites**

Most social security organizations have websites that provide great opportunities for making information available to the public. Websites can provide information at several levels. For example, a summary of the general eligibility conditions for a benefit can be shown. One or two clicks of the mouse can lead to detailed guidance and the text of the legislation. The website can show a wealth of information about the organization – composition of the board, the management team, area offices, statistics, etc.

Just as with web design for filling forms, the website must be designed and maintained so that it is accessible and useful to the ordinary user. There can often be a huge gap between the technical expert's approach and what the ordinary client needs. Board members can help their constituents by pressing for

realism and simplicity when the website is being designed. They can test it on their own home computers and ask their constituents to do so.

### ***Annual reports***

The board members of a social security organization aim to ensure that administration is efficient, and that it is perceived to be efficient by the general public. The annual report – the account of the stewardship and activities of the organization over a financial year – is a key communications document. The report should be well-designed, user-friendly and accessible to non-specialists.

Usually the report is addressed to the responsible minister who presents the report to the legislature (sometimes the report is submitted directly to the legislature) where it may be debated. Sometimes the report is discussed at a meeting between a committee of members of the legislature and the CEO.

The audience for the annual report is wide. It is the general public – contributors, beneficiaries, the media and researchers. The annual report is usually presented at a press conference. It is good practice for the board to present the annual report at a public meeting where questions can be asked. If senior staff of the organization are reluctant to participate in the meeting since the social security scheme and the organization are apt to be criticized, the board should insist on their attendance due to the importance of an open exchange of views at a public meeting. The annual report should be put on the organization's website and provided to research bodies and libraries as a printed document.

#### **WHAT SHOULD BE IN THE ANNUAL REPORT?**

- The duties, objectives and mandate of the organization
- Members of the board and the management team
- Narrative of activities during the year and management's expectations for the future. What changed and why? How did the organization cope with the changes?
- Operations information - number of registered employers (new/total), number of employee contributors (new/total), number of beneficiaries by type of benefit (new/total), staffing, public relations material prepared, training activities, performance measurements against targets set, work backlogs
- Financial information - contribution income, investment income and performance, benefit expenditures by type of benefit (new/total), administrative expenses, contribution arrears
- Audited accounts and auditor's opinion
- Summary of the report on the actuarial review (if a report has been submitted since the previous Annual Report)

It is useful to show numbers and amounts for the previous five or ten years to indicate the trend over time.

Most of the material for the annual report can be drawn from management's regular reports to the board. While many of the organization's publications are short-lived, the annual report is a permanent record.

Publication of the annual report provides an excellent opportunity for a board member to report back to the member's constituents – not only to the member's own union or employers' association, but also to others whom the member represents on the board. A board member can arrange special meetings for this purpose. The member could request briefings beforehand by officials from the organization to ensure that the member is able to answer difficult questions. Indeed, it could be helpful to have officials from the organization present at the meeting for technical back-up, but it should be clear that it is the member's report and that they are there to assist the member.

A firm chairperson is necessary for such a meeting, so that it is not sidetracked into discussion of individual cases. Individual cases or specific questions should be referred to the appropriate officials in the organization, and the answers provided later to the persons who raised them. It is important to bear in mind that when someone airs a grievance at a public meeting, there is often more to the story than is explained. When the board member learns the part of the story that was not told, the member may change his/her initial reaction to the grievance. Feedback from the meeting should be presented to the board.

### ***Information campaigns***

When there are major developments in a social security scheme, it is useful to mount a comprehensive public information campaign. This will generally involve media presentations, as well as advertising and presentations to groups at the local and national levels. The chairperson and board members, as well as the organization's staff, should be involved in these activities so that the message is effectively conveyed. All persons involved must be thoroughly briefed on the objectives of the campaign so they can answer enquiries from members of the press and the public.

The campaign should be undertaken with a realistic timetable. The initial impact may seem limited and discouraging, but messages usually need time to penetrate and may need reinforcing. A successful campaign is likely to do much more than achieve its primary objective – to inform and educate. It will also make a positive impression on clients, and raise public confidence in the organization.

## KEY POINTS

- A communications strategy is important to the organization, since it influences how the organization and the scheme it administers are seen by the organization's clients and the general public.
- A media officer should be designated to work with the media and to respond to queries from the public. There should be media contacts at the field office level.
- The organization's communications should be consistent, appealing and easy to understand by those at whom they are aimed.
- E-mail, the Internet and telephone call-centres have increasing roles to play. The design of a system should take into account the possibilities and the limitations of the organization's clients to use it.
- The organization's annual report is an important tool for communication and can inform the public, politicians and the constituents of board members.
- It is usual to mount a coordinated public information campaign when there are major developments in a social security scheme. The campaign should have a realistic timetable, as it will take time for the messages to penetrate.

# CHAPTER 4:

## FINANCIAL GOVERNANCE OF ADMINISTRATIVE OPERATIONS

Ensuring sound financial governance of a social security scheme and the organization running the scheme is a key function of the board. It is necessary to distinguish between governance of benefit expenditures which are authorized under the legislation establishing the scheme, and governance of operational expenditures on administration.

Since the amount of benefit expenditures depends on the legislation, it is not subject to the same controls as the amount of administrative expenditures. Consequently, different approaches apply to financial governance of benefit expenditures and financial governance of operational expenditures. Governance of the financing of benefits is dealt with in Chapter 5. This Chapter deals with financial governance of operational expenditures, in particular monitoring administrative expenses, enforcement and compliance and audits of the organization.

### 4.1 THE ACCOUNTS

The accounting framework is a reporting system for producing an organization's income and expenditure account and balance sheet, and enabling the budget to be monitored.

The income and expenditure account shows the results of the financial operations carried out during the period covered, and measures the surplus or deficit for the period. The balance sheet shows the financial position at a point in time. It lists all assets and liabilities at the balance sheet date. Management accounts can also be produced to supplement the income and expenditure account and support the monitoring and evaluation of the finances of the scheme, and hence enable a detailed analysis of costs.

The income and expenditure account is based on information in the ledgers summarizing credit and debit transfers for each ledger item. If a cash accounting system is used, the balances on the accounts are transferred without amendment. If an accrual accounting system is used, each account in the ledger is examined and the appropriate accrual adjustment is made before the balance is transferred to the income and expenditure account.

Simplified examples of an income and expenditure account and a balance sheet (in national currency units) are below.

**Typical income and expenditure account of a social security scheme for the financial year**

<b>Income</b>		
Contributions		
	Employees	5,000
	Employers	5,000
Investment income		1,000
Government subsidy		1,000
Other income		50
<b>Total income</b>		<b>12,050</b>
<b>Expenditure</b>		
Benefits		7,000
Refund of contributions		40
Administration		1,000
	Staff salaries and benefits	
	Office equipment and supplies	
	Other	
Amounts written off		100
<b>Total expenditure</b>		<b>8,140</b>
<b>Excess of income over expenditure</b>		<b>3,910</b>
Reserve at the beginning of the year		19,816
Reserve at the end of the year		23,726

The amount of contributions due, but not yet received or written off should be shown in a footnote to the accounts. The balance of the income and expenditure account is transferred to the reserves at the end of the year.

#### Typical balance sheet of a social security scheme at the end of the financial year

Assets		Liabilities	
Cash and bank deposits	95	Payables	675
Receivables	521	Benefits awarded but unpaid	600
Investments	23,029	Reserves	23,726
Fixed assets	1,356		
<b>Total assets</b>	<b>25,001</b>	<b>Total liabilities</b>	<b>25,001</b>

The audited accounts should be provided to the media, and published in the organization's annual report and on its website.

## 4.2 BUDGETS AND FINANCIAL CONTROLS

Approving and monitoring an organization's budget and accounts is a vital area of the board's work. The specific details of a budget depend on national conventions and regulations. Those who control the process of drawing up these documents have considerable power, and there may be tension between the board and the CEO, and sometimes the Ministry of Finance over the budget.

An organization needs a rolling long-term budget that looks ahead three to five years. From this, an annual budget can be constructed and used to monitor income and expenditure. Looking ahead is essential in order to give direction to the organization's current activities and to help clarify its priorities. Large projects, such as modernization of computer systems, will stretch over several years, so budgeting only over a single year will not give the full picture.

Annual budgets have three main purposes:

- Planning – quantification of the cost of actions required to achieve immediate and long-term objectives. This allows board members to see which objectives can be achieved in the coming year and which have to be postponed.
- Authorization – the approved budget creates authority to incur expenditures.
- Control – the approved budget is the basis for monitoring and control of the organization's operations. It provides a standard against which performance can be measured.

Sometimes the board receives the budget at a very late stage, leaving little time for the board to review the contents. This may be after negotiations have been completed between the CEO and the Ministry of Finance. Discussion by the board and the scope for change are thus limited. This diminishes the influence of the board and thwarts its objectives. Board members should insist that the documents come to them in good time and while they are still in draft form.

It must be clear which parts of the organization and which officials are responsible for spending in various areas, and for the monitoring of expenditure. It is useful to have information on the organization chart (see Section 3.1) about which officials at which levels control budgets. For example, can the head of a field office purchase office equipment without authorization? The official who has the authority is responsible for cost overruns.

A budgetary control system compares reports on the actual income and expenditure position throughout the year to a budget profile. To create a profile, the annual budget must be broken down into monthly or quarterly accounting periods. If certain expenditures are usually higher during some parts of the year, this must be taken into account. The budget profile provides an estimate of the amount of each budget line that will apply by the end of each accounting period.

This is compared with the accounts at the end of each accounting period, and differences between the budget profile and actual spending are reported. Differences are significant if they exceed a fixed amount of money or a percentage that is beyond the range of normal variation. When this occurs, the cause should be investigated. It might be found that an unexpected situation caused actual income or expenditure in a particular area to differ from expectations or that the profile is inaccurate.

The board should receive reports on the budget position at each meeting. The report might consolidate a number of budget sub-headings into a smaller number of main headings. There may also be a formal budget review, perhaps at mid-year. This enables action to be taken where circumstances have changed and budget revisions need to be made. The procedure for agreeing on changes should be similar to that for preparing the original budget. This review should not be used as an opportunity to obtain agreement to policy changes or new activities. The review should focus only on changed circumstances.

It is common that there be some flexibility in a budget by allowing transfers of savings in one budget line to another (virement). Rules are essential, so that it is clear where a transfer can be applied, who can authorize it and what the limits are. Any transfer should be authorized at an appropriate level, depending on the type and size of the transfer.

The budget may be subject to a cash limit. This means that once the budget has been approved by the relevant authority (e.g. the legislature or the Ministry of Finance), there is an upper limit which cannot be exceeded in the financial year. Under a cash-limited budget, if the amount estimated in the budget for a particular expenditure line is less than the amount required, the organization must find savings elsewhere. Alternatively, it may be allowed to carry deficits forward to future years up to a limit or with special permission from the relevant authority. Usually, this simply postpones the problem rather than solving it.

Social security organizations must own or rent property for the organization's use – including the head office and field offices. Board members should ensure that there is a full up-to-date register of property owned by the organization, and that it appears on the balance sheet at realistic values. Boards can periodically order a survey to establish what is owned by the organization, what it is worth and how it is being used.

People find large figures difficult to grasp, while smaller ones attract their attention. Probably everyone involved in public affairs has attended a meeting where huge spending items in the budget are accepted without comment, while there is a fierce argument about a trivial amount for travel expenses. While this tendency is understandable, it is important that board members focus on the entire budget so that the organization is held fully accountable.

### 4.3 MONITORING ADMINISTRATIVE EXPENSES

Administrative expenses include salaries, transportation, communications, professional fees, rent, maintenance, office supplies, material and equipment and amortization of buildings and equipment. These are normally only a small proportion of the total budget of a social security organization. Great economies of scale are possible in public schemes, which should have much lower administrative costs than private institutions (e.g., individual savings schemes, insurance companies). Whatever is spent on administration is not available for benefits, which is why administrative expenses must be monitored and controlled.

Administrative expenses have a major impact on the organization's public image. It is important for the board to ensure that administrative budgets are frugal, and hence contribute to a public image of the organization's careful management of members' contributions.

It is not possible to point to benchmarks for evaluating whether an organization's administrative expenses are too high. The level of administrative expenses depends on the benefits provided under the scheme and the number of contributors and beneficiaries. Ratios of administrative expenses to contribution income in different

schemes are not comparable since schemes have different contribution rates and contributory earnings ceilings. An organization that provides means tested social assistance will have higher administrative expenses than one that deals only with social insurance or universal benefits, since determining initial (and verifying continuing) eligibility for means tested benefits is labour intensive.

In order to monitor the cost of performing various administrative tasks, it is necessary to allocate administrative expenses among the different benefits (short-term cash benefits, pensions, employment injury, medical care). Detailed records are needed for a precise allocation, but this can add to administrative expenses. More simply, the trend of the ratios of administrative expenses to contribution income and to benefit expenditures in each branch of the scheme can be reviewed.

Costs per transaction (unit cost), for example, the average cost of settling a disability claim, should be analyzed. Analyzing unit costs requires careful interpretation. For example, if the cost of settling a disability claim is rising over time, this may be because the staff is becoming less efficient, or it may be because the staff is providing better service to clients. If the cost per transaction is low, but poorly-trained staff make many mistakes, the cost to clients (who must complain or lodge appeals) and to the organization to correct the mistakes could be high. 'Spending to save', that is, spending on resources and training may raise the transaction cost initially, but substantially improve the quality of the transactions.

Coordinating spending decisions in different parts of the organization, as well as with other agencies with which the organization works is important. For example, the equipment that field offices buy must be compatible with that used in the head office. Similarly, computer software must be compatible with that used by other cooperating agencies. Otherwise, much time and money will be wasted trying to set up proper communications.

'Exceptional' expenditures should be budgeted separately from on-going administrative expenses. Examples of such expenditures include start-up costs of the organization (acquiring premises and equipment), an information technology project or recalculations of benefits following a reform that changes entitlements. Board members should be wary of exceptional expenditures which are really part of the normal operating costs of the organization.

### 4.3.1 Image of frugality

The organization's administrative expenses should be 'fit for the purpose' but not extravagant. The appropriate level depends on the particular item in question. If the organization is to maintain its standards of service, there must be investment in the organization's plant and equipment. It is not prudent to forego or delay necessary expenditures, or to always opt for the cheapest item. Public offices that are dirty, with dilapidated furniture and which are located in unsavoury neighbourhoods may produce short-term savings in rent and maintenance, but such arrangements lead to confrontations between staff and clients, possible higher levels of vandalism and a loss of image for the organization, all of which increase costs in the long term.

Board members should exercise their sense of what is likely to lead to public criticism of the organization. Examples of excesses include locating offices in new or refurbished premises on a main street, when older but respectable offices are available in side streets at much lower rents; holding training courses and seminars in luxurious venues, when venues that are comfortable but less opulent are available; providing foreign trips for large numbers of staff, or for poorly defined or unsatisfactory reasons; and excessive amounts paid to board members. Board members usually receive only a fixed fee for attending board meetings, for example in the Guinea National Social Security Fund.

## 4.4 MONITORING ENFORCEMENT AND COMPLIANCE

If participants do not comply with their contribution obligations to a social security scheme the legitimacy and sustainability of the scheme is threatened, and benefits may be inadequate. Contribution evasion occurs when employers, or employers along with their employees, collude to:

- fail to register employees who should be covered by the scheme, or claim that employees are casual, part-time or temporary workers or contractors who are not covered by the scheme;
- underreport earnings of employees; and/or
- fail to remit (or delay remitting) contributions.

A social security scheme can only function with the support of its participants. Ensuring compliance is a major administrative function of a social security organization. High levels of contribution evasion are evidence of low public credibility and a failure of governance of a scheme.

An indication of compliance problems is a high or increasing amount of unallocated contributions or contributions due but not yet received or written off. This information should appear as a footnote to the income and expenditure account.

Improving the collection of social security contributions is a major challenge for many social security schemes. Board members are in a strong position to deal with weak contribution compliance since their constituents include the contribution payers. Board members can treat non-compliance as a social issue, and raise public awareness of the social consequences of failing to pay contributions – the strain on the scheme’s finances and lost or inadequate benefits. They can also urge governments to make compliance a focus of high-level social dialogue and engage the social partners in devising solutions.

Even-handed enforcement is essential for improving compliance and building public trust in the scheme’s governance. Board members should seek to ensure that contributions are collected from large firms as well as small ones, and in particular, from the government (as an employer, if applicable) and public enterprises as well as private ones. If the government or public enterprises do not comply, this sets a bad example for private sector employers, and undermines efforts to improve compliance.

For struggling firms, enforcement of contribution collection may create a risk of bankruptcy and resulting job losses. Hidden subsidies in the form of lax social security contribution collections are not an effective tool for saving jobs or enterprises. It is better to apply an even-handed approach to collection and other transparent support for the enterprises and for workers in affected firms.

Enforcement activities are expensive, but they are legitimate and necessary expenses of social security organizations. The board should ensure that the organization has the authority to aggressively enforce payment of contributions. The organization must have:

- the right to inspect employer records including bank statements, income tax returns, etc.; and
- the right to assess and collect contributions due and unpaid and assess enforceable penalties, with social security debts having priority over other creditors, the possibility of attachment of employers’ assets, etc.

Armed with this authority, the board and management can set up a strategy to enforce compliance. Some measures which the organization might take are described in the following box.

### Methods of combating non-compliance

Armed with statutory authority, social security organizations can take a number of steps to enforce compliance:

- Reduce the compliance burden by streamlining administrative procedures. A user-friendly system promotes trust and encourages compliance.
  - Provide clear, timely and complete information to employers and workers on their obligations to pay contributions;
  - Simplify contribution regulations, and reporting and remitting procedures; set up electronic filing;
  - If there are several schemes, consolidate contribution collection and reporting;
  - Set up a unit to offer assistance to contributors (including a toll-free number, website and e-mail address);
  - Meet with employers to explain collection procedures and obtain feedback from them.
- Strengthen enforcement through timely inspections. Compliance is better when employers know that they are being closely monitored.
  - Set up a real time information system that matches contributions with employers so that discrepancies can be promptly identified and investigated;
  - Employ enough inspectors so that auditing and enforcement are real threats;
  - Train inspectors in auditing methods;
  - Pay inspectors adequately in order to reduce their susceptibility to financial temptations.
- Enforce administrative penalties, fines or other sanctions for non-compliance. Penalties should be severe enough to make the cost of evasion exceed the amount that non-compliance might yield, but not so severe that they are unlikely to be respected, applied successfully or sustained by the courts. Prosecute employers who fail to pay the penalties.
- Mount public relations campaigns to encourage compliance. Compliance can be promoted by identifying non-complying employers in the media.
- Report annually to workers on contributions paid by them and on their behalf so they can verify that their contributions have been properly remitted and recorded.
- Collect pension scheme contributions along with contributions to other social security schemes, for example a medical care scheme, for which the needs of workers and their families are more immediate.
- Enforce compliance indirectly through regulations which require certification by the social security scheme that an employer's contributions are up-to-date before the employer can be issued or reissued a business license, bid on government contracts, receive an import or export license, etc.
- Remedy design deficiencies which encourage evasion, for example, pension scheme provisions which encourage strategic manipulation of contribution periods in order to maximize benefits and minimize contributions.
- Coordinate verification and enforcement activities with the tax collection agency.
- Declare amnesties to encourage evading employers to comply in the future (although declaration of an amnesty leads to the expectation of a subsequent amnesty).

Enforcing compliance in the shadow economy is not susceptible to most of the measures outlined above. The shadow economy is not a single entity, but many enterprises and individuals with different status (formal, grey or hidden). They have varying responses to incentives and sanctions, and different capacities to pay contributions. In this situation, it is best to proceed incrementally, identifying industries and sectors where workers and employers have the capacity to pay and where enforcement would be possible. Board members can set priorities and urge management to design projects to extend coverage, involving, for example, public information campaigns stressing the importance of compliance and the social consequences of non-compliance, or setting a minimum contribution threshold for all workers.

In order to benefit from expected economies of scale and to strengthen enforcement, a unified collection system where an agency, usually the national tax agency, collects both income tax and social security contributions is sometimes proposed. Such a system requires a wide tax net and an efficient collection agency which promptly transmits data on contributors that the social security organizations need to run their schemes. The collection agency must be solely an agent that collects and transmits contributions to the social security organizations. It must not divert social security contributions to meet deficits in the government budget. The prerequisites for a unified collection system are generally not present in countries in Africa.

Given the crucial importance of contribution collection, the board has an important role to play. The board should review compliance statistics and assess whether the organization's enforcement efforts are effective. Promoting compliance involves building confidence in the social security scheme and the organization administering it. It is easier and less costly to collect contributions if the public appreciates the social security scheme. Building public trust is at the core of a board member's job.

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## 4.5 AUDITS

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The board supervises the organization's audit process. An independent audit lends credibility to the organization's financial statements and helps protect everyone who has an interest in its operations. It creates public confidence in the scheme and the organization, which is necessary for the scheme to succeed. In most countries, the authorizing statute or regulation for the social security organization usually requires an independent external audit by the government auditor or a commercial firm.

Social security organizations also have internal auditors. Internal auditors are usually employees of the social security organization. It is important that they have autonomy and be perceived to have autonomy. Internal auditors provide information for internal

control and to the external auditors so the external auditors can concentrate on priority areas.

The staff of an organization sometimes has a negative attitude towards auditors. A positive approach from board members and directors will help counteract this, and a discussion with the auditors and managers about the aims of the audit should help to dispel misunderstandings.

### 4.5.1 Audit committee of the board

It is good practice for the board to have an audit committee. The committee should include board members and others with financial and risk management expertise who do not have positions in the organization. If the board is weak in the areas of finance and risk management, it could ask the responsible minister to appoint persons with this expertise to the board, or it could co-opt persons with the expertise to the audit committee without them becoming members of the board.

On behalf of the board, the audit committee has responsibility for ensuring that the internal audit programme is effectively testing the adequacy of the organization's financial and non-financial control systems. It should set the timetable for the internal audit, approve the areas of study by the auditor and receive the auditor's reports. It presents the recommendations of internal audit reports to the board and ensures that appropriate action is taken. When an external auditor is to be appointed, this is done by the board on the recommendation of the audit committee.

The audit committee should receive the report and management letter from the external auditor and satisfy itself that management is responding adequately to recommendations of the external auditor. While it can be difficult to implement an external auditor's recommendations, generally the audit committee and the board try to implement them.

The audit committee plays the leading role, but this does not absolve other board members from taking an interest in the accounts and the audit. The proper financial management of the organization and the assessments by the auditors are responsibilities of the entire board.

### 4.5.2 Internal and external audits

Internal auditors generally audit all aspects of:

- the receipt of contributions;
- the authorization and payment of benefit claims;
- the setting up and maintenance of records; and
- personnel administration.

Usually the audit of benefit claims involves examining a sample of recently-settled claims to determine the level of accuracy of eligibility decisions and benefit calculations. This is not a matter of questioning the decisions of experts such as the doctors who decide whether a medical condition is disabling. Rather, it is a check whether the proper procedures have been followed and the correct amount of benefit paid.

Internal auditing can seem like another layer of bureaucracy, but it has some major advantages for the smooth running of the organization. It is vital that the board supports the principle of auditors' independence. If after investigation, an auditor's concerns are found not to be justified, the auditor would still be right to have raised the concerns in good faith.

The external auditor's report is submitted to the board or to the responsible ministry. If the external auditor is not satisfied with the results of the audit, the accounts can be 'qualified'. This means that a statement is included indicating that a particular matter is not satisfactory, along with an explanation why. The organization then needs to take corrective action, or at least improve the situation, before the next external audit. The external auditor may also detect weaknesses that are not considered serious enough for the accounts to be qualified, but which raise some concern. The external auditor would identify these in a letter to management. Again, the external auditor would expect the organization to take corrective action before the next audit.

The report of the external auditor and the management letter (if there is one) should be made public.

### How an internal audit helps the organization

- The internal auditor provides an expert opinion on accounting issues. There may be areas where accounting conventions have to be followed. (e.g. International Public Sector Accounting Standards (IPSAS)).
- The internal auditor helps to ensure that the accounting system which is used to record transactions and safeguard funds is working properly. If there are weaknesses, the auditor will identify them and suggest ways of improving the system.
- If there are errors in the accounts, the internal auditor will draw management's attention to them so that corrective action can be taken and the reasons for the mistakes investigated.
- The internal auditor draws management's attention to inefficiencies, incompetence or fraud discovered during an audit.

### Safeguarding internal auditors' independence

- The scope of the internal auditor's work should not be restricted. The internal auditor should be free to examine and report on the work of any department. The decision about which departments or functions to audit must rest only with the internal auditor.
- The internal auditor must have an unchallengeable right of access, without having to give notice, to financial and other records of the organization. The auditor must be able to require any explanations considered necessary.
- The internal auditor should be free to report to any level of the organization. The internal auditor's line manager should be the finance director or the CEO.
- The internal auditor should not be involved in any operations that will subsequently be audited. Otherwise, the auditor's independence is compromised, and the audit will lose its effectiveness.

## 4.6 VALUE FOR MONEY

Monitoring management performance and monitoring the financial operations of an organization are linked by the search for ways to provide service to clients that is good quality at a reasonable cost, that is, 'Value for Money'.

One part of this search is the 'survey function' which focuses on organizational and procedural rather than financial aspects of an organization's work. In most large organizations, a unit is responsible for monitoring organization and procedures, and identifying gaps in knowledge, weaknesses in procedures and training requirements. The unit proposes improvements rather than disciplinary measures. The aim is to ensure that correct procedures are being followed, and to develop and advocate 'best practices' throughout the organization.

If they widen their scope to look at value for money, external auditors can recommend improvements in efficiency and effectiveness. The board should

encourage the external auditors to provide comments on value for money, or from time to time commission a value for money study. If regular reports on value for money are not received by the board, the board might request a value for money analysis from management to help set the parameters for this programme of work.

A value for money audit can be a trying but worthwhile process, since it usually challenges assumptions that the board and management have long held.

## 4.7 FRAUD

Fraud and theft are risks for all social security organizations. There will generally be a unit of the organization that deals with fraud. It should be headed by a senior official, and work closely with the internal auditor, and at times with the legal authorities and police. The organization's staff should be aware of potential areas for fraud and ways to protect against it. The board should receive regular reports on cases of fraud detection and prevention.

In the settlement of benefit claims, the board needs to ensure that there is a balance between caution to avoid fraud and service to clients. Eligibility determination procedures should allow the great majority of benefit claims that are straightforward to be processed routinely with a minimum of checks, while unusual claims are carefully scrutinized. For the low-risk group, there could be a post-payment review of a sample of cases. Benefit claims must be settled speedily and efficiently, since beneficiaries depend on benefit payments. On the other hand, social security funds have to be safeguarded from abuse.

Safeguards can be built into the system by strong security arrangements. Cheques and order books can be designed and printed so that they are difficult to forge, and then transported by secure methods. The staff involved in the preparation and issue of payments should be different from those responsible for claims processing and the calculation of benefits. This reduces the risk of collusion and increases the chances of discovery of any internal fraud.

The quickest and most secure method of paying benefits is direct payments from the social security organization into individuals' bank accounts, but not all beneficiaries have accounts and the banking system may not support this system throughout the country. If benefits are paid in cash through post offices or in field offices of the organization, there are opportunities for fraud and theft.

Staff who are involved at any stage in the payment process should be clearly identifiable, so that there is an 'audit trail' to follow. With manual systems, this involves signatures to acknowledge receipt, for example, of a batch of order books

to prepare for sending out to clients. With a computerized system, there are usually inbuilt security controls to restrict access to the system and identify any individual who has accessed it.

If the organization is hit by a major case of fraud or abuse – or even a well publicized lesser one – there should be a quick investigation and ‘damage control’. While it is tempting to stop all authorizations or payments of a particular benefit until the problem has been dealt with, this would penalize many innocent people who depend on the benefit payments and could lead to serious hardship. It is preferable to set up emergency procedures for extra checks, perhaps by temporarily transferring staff to perform this function. Damage control efforts involve responding to the media and recognizing that the implications of a particular case are apt to be wider than the office where it occurred. It is important to be open about how the organization has tackled the problem and the safeguards that have been put in place.

### KEY POINTS

- Ensuring sound financial governance of a social security organization is a key part of the board’s role.
- The board should participate actively in establishing the organization’s budget.
- Administrative expenses are normally a small part of the overall spending of the organization, but they must be properly budgeted, monitored and controlled.
- In many countries it is necessary to have greater compliance with the law on the payment of contributions. Evasion threatens social security schemes and is an important issue for social security boards, which have a key role to play in improving compliance.
- A key principle for improving compliance is to make compliance easy, and to take swift action against defaulters. Other measures include strengthening inspections, more resources and training for inspectors, public information campaigns and information sharing.
- The board supervises the audit process. The board’s audit committee should ensure that auditors’ recommendations are considered and acted on. Auditors’ independence should be safeguarded.
- Value for money studies should be carried out regularly.
- There must be safeguards against fraud and abuse.



# CHAPTER 5:

## FINANCIAL GOVERNANCE OF SOCIAL INSURANCE BENEFITS

Chapter 4 dealt with financial governance of the administrative operations of a social security scheme. In this chapter, the methods whereby funds are made available to pay social insurance benefits and the board's financial governance role are considered.

The sources of income of a social security scheme can include contributions from workers and employers, taxes earmarked for social security, State participation, investment income and other minor receipts.

### 5.1 FINANCIAL SYSTEMS

The financial system of a social insurance scheme describes the method whereby funds are made available to pay benefits. The financial system does not affect the amount of the benefits. The amounts are set out in the relevant legislation.

Short-term cash benefit schemes (sickness, maternity and unemployment benefits) and employment injury schemes provide protection during insured persons' working lives. Medical care and old-age, disability and survivors' pensions provide protection throughout their lives and to their survivors. The time horizons of these schemes are different, and the methods which are used to finance the different benefits take this into account.

Board members should understand the financial systems which have been adopted to finance the scheme's benefits. The following paragraphs summarize these systems.

#### 5.1.1 Short-term benefits (sickness, maternity, unemployment) and medical care

These benefits are payable for limited periods, generally not more than one year. Since the annual frequencies and average durations of these benefits are relatively stable, the ratio of annual expenditure to total insured earnings is relatively stable. For example, the birth rate is relatively stable from year to year, and if the maternity benefit is a proportion of the mother's wages and is payable for a fixed number of weeks.

Short-term and medical care benefits are generally financed on an annual pay-as-you-go (PAYG) system. Under this financial system, contributions are set so

that in any year the contributions (plus any investment income earned) are adequate to meet the year's benefit expenditures and expenses on administration. In order to maintain stable contribution rates, a small margin is added to the contribution rate to set up a contingency reserve to absorb unusual spikes in benefit claims (e.g. due to an epidemic or a natural disaster).

### 5.1.2 Long-term benefits (old-age, invalidity and survivors' pensions)

Estimating the future expenditure of old-age, invalidity and survivors' pensions is much more complicated. In general, benefit costs will rise for many years because:

- Each year, a new group of persons qualifies for pensions.
- Pensions generally increase according to the number of years of work or contributions by a beneficiary. As the system matures, each year pensioners will receive larger pensions.
- The average new pension generally increases each year if the benefit is related to earnings.
- Pensions being paid will generally be increased to take into account inflation.
- The life expectancy of new pensioners at retirement and of new survivor beneficiaries is increasing.

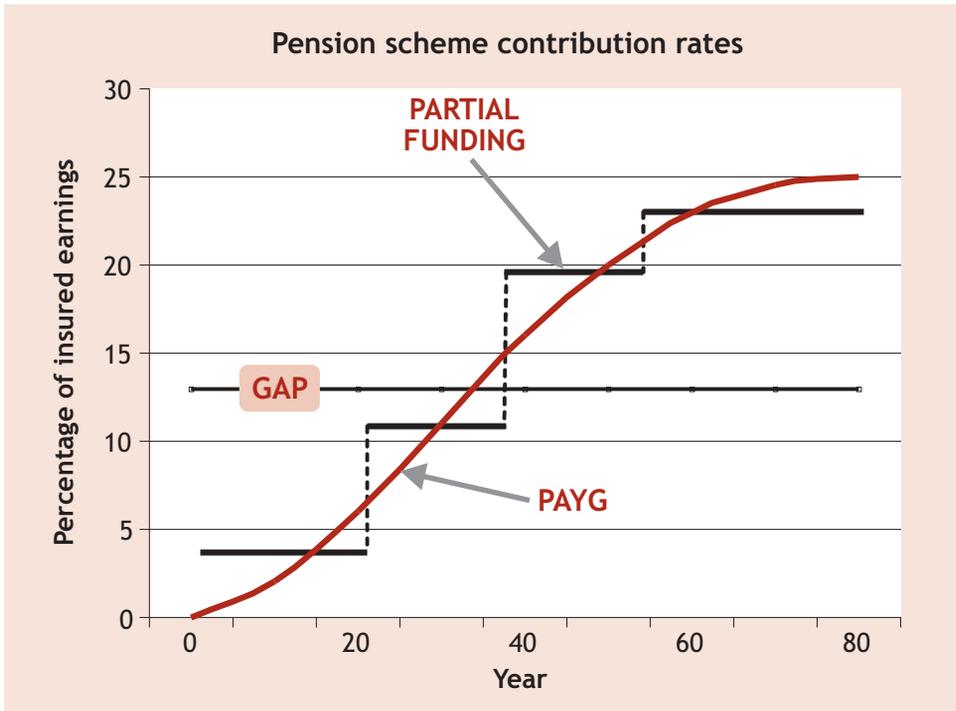
These factors lead to the PAYG contribution rate shown in Figure 5.1. If a pension scheme is financed on a PAYG financial system whereby contributions in any year (plus any investment income earned) are adequate to meet the year's benefit and administrative expenditures, the contribution rate can be very low when the scheme starts, but then it increases steadily for many years until the scheme matures. The mature public pension schemes in Western Europe generally follow a PAYG system of finance.

Under the fully funded General Average Premium financial system (GAP in Figure 5.1), the contribution rate is constant. The GAP financial system theoretically guarantees that benefits and administrative expenses can be paid indefinitely by contributions at the GAP rate and investment income from the reserves which are accumulated. Unlike the PAYG system where there are no reserves, under the GAP system substantial reserves are created.

The GAP financial system is similar to the systems used to finance occupational and personal pensions. Full funding is necessary for occupational schemes since an employer sponsor may go out of business. This is not the case for a public social security scheme which will have a continuous stream of new entrants, and which has a government guarantee of benefits.

Mandatory individual accounts savings schemes which have been implemented in some countries in Latin America and Eastern Europe are fully funded. There is no

Figure 5.1



specific benefit promise, and at retirement a pensioner receives whatever pension his/her contributions plus investment earnings less administrative expenses produces.

Most social insurance pension schemes in Africa, and those in Canada, Japan and the USA, follow a financial system of partial funding. This involves setting a contribution rate higher than the PAYG rate but lower than the GAP rate during an initial period of equilibrium, and a commitment to increase the contribution rate in subsequent periods of equilibrium. The excess of contribution and investment income over benefit and administrative expenditures is held in a reserve which is invested, and the investment income supplements contributions to pay benefits. Various partial funding rules can be established, for example, at any time the reserve ratio (reserve divided by annual expenditure) should not fall below a specified number.

A partially funded financial system avoids the annual increases in contribution rates which would apply under the PAYG system, the high GAP contribution rate at the inception of a scheme and the large and possibly excessive build-up of reserves which would occur if the GAP financial system were applied. The contribution rate in a partially funded scheme can be chosen taking into account the reserves which will be generated and whether the reserves can be invested productively, thereby avoiding the political risk of misuse or diversion of the pension scheme reserves.

In the end, the pension scheme contribution rate chosen by the government is a political decision which should take into account:

- the need to maintain a stable contribution rate for an extended period;
- the current and likely future economic situation;
- the capacity to invest and manage reserves; and
- the availability of domestic capital markets in which to invest the reserves.

A partially funded financial system requires the contribution rate to be increased from time to time. In many developing countries, public pension schemes were introduced and financed under a partially funded system, and as the schemes matured it became necessary to increase the contribution rate. There is a political risk that the necessary but unpopular increase in the contribution rate will not be made. This can lead to liquidity problems, and the longer the delay, the greater the increase in the contribution rate must be. In order to avoid a contribution rate increase, the government sometimes cuts benefits which damages the scheme's credibility and leads to claims that the scheme is bankrupt and must be reformed.

It is desirable to establish a benchmark which triggers an increase in the contribution rate, rather than relying on a consensus and the political will to legislate an increase. The benchmark could be based on a specified minimum reserve ratio (or ratios) which must be maintained over successive periods of equilibrium.

### **5.1.3 Employment injury benefits**

Temporary incapacity and medical care benefits in schemes providing protection against work injuries and occupational diseases are financed using the same PAYG system as short-term benefits.

Employment injury permanent incapacity and survivors' pensions are usually financed using a terminal funding system. In any year, the present value of all future pension payments resulting from employment injuries that occurred in the year is set aside in a reserve, and all employment injury disability and survivors' pensions are paid from this reserve.

Employment injury contributions are normally made by employers only. The terminal funding system ensures that all benefits resulting from employment injuries in a year are paid from employers' contributions in the year.

### **5.1.4 Separation of accounts**

If the organization provides several social security benefits, separate accounts and records should be kept for each benefit. In principle, the contribution and other income for each benefit branch should be adequate to pay the benefits. While transferring budgeted amounts from one administrative expense to another is

acceptable, it is generally bad practice to transfer funds from one benefit branch to cover a deficit in another branch. The board should be on guard against this practice.

Sometimes, legislation is enacted requiring a transfer, for example, from the reserves of a partially funded pension scheme to the medical care benefit branch. Such a transfer is not simply a minor accounting adjustment, and should be transparent. Board members should understand the long-term implications of the transfer for the pension scheme and explain them to their constituents and the public.

## 5.2 ACTUARIAL VALUATIONS

Actuarial valuations are tools of financial governance and planning which assist the board and management of a social security scheme to ensure the long-term viability of the scheme. Actuarial valuations are undertaken:

- to assess the present financial status and likely future financial development of a scheme;
- to assess the financial sustainability of a scheme in relation to the benefit provisions and the financial system adopted; and
- to advise and recommend possible amendments to the scheme's provisions and financing arrangements.

For actuarial valuations to be effective tools, the following conditions should apply:

- The relevant legislation should specify that no amendment to a scheme may be made without an actuarial study assessing the financial implications of the proposed change. The actuarial study is needed to ensure that no decision is taken without proper knowledge of the financial implications. The study can also be used to draw the attention of workers, employers and beneficiaries to potential financing problems and proposed solutions, and to help build a consensus on needed changes. ILO Convention No. 102 provides for such studies (see box).
- Statutory actuarial valuations should be conducted every three (or at most five) years to monitor the development of the financial situation of a scheme. These valuations allow for an early detection of emerging financial problems and the implementation of measures to maintain financial stability.
- The legislation should specify the conditions under which a scheme is considered to be in actuarial equilibrium (e.g. a minimum reserve ratio), and the authority responsible for amending the financial system.
- The actuary should be mandated to report on any matter which affects the financial status of a social security scheme. These include deficiencies in the design and operation of the scheme, the adequacy of the financial system applied, the effectiveness and cost of its administration and the investment policy and performance.

- Actuarial valuations of social security schemes must be conducted by independent actuaries, or actuaries who are obliged to adhere to strict rules of professional conduct (see Guidelines of Actuarial Practice box).

The primary focus of an actuarial valuation is not the short-term financial management of a scheme, but rather its long-term financial viability. For a pension scheme, demographic and financial projections must extend over many years to assess the cost of the scheme once it reaches maturity and beneficiaries are entitled to full benefits. Long-term projections are necessary to test how the system reacts to changing economic and demographic conditions, for example, population ageing.

‘The Member [State] shall accept general responsibility for the due provision of the benefits provided in compliance with this Convention, and shall take all measures required for this purpose; it shall ensure, where appropriate, that the necessary actuarial studies and calculations concerning financial equilibrium are made periodically and, in any event, prior to any change in benefits, the rate of insurance contributions, or the taxes allocated to covering the contingencies in question.’

#### **The role of the actuary**

‘It is the actuary who has to judge whether the vision of the future development of a given society and economy which underlies all the[se] assumptions [for an actuarial valuation] is consistent and realistic. It is the actuary who has to alert the government and the governors of individual social security schemes to obvious inconsistencies and incompatibilities in national social, economic, and fiscal policies. It is necessary for the actuary to indicate over-promising as well as under-financing, inadequate benefit levels, as well as misallocation of resources and risks for future government budgets. The actuary has to be the guardian of the financial rationality in the social policy formulation process.’

*Actuarial Practice in Social Security, ILO, page 13.*

The valuation techniques used by actuaries are complicated. Actuarial methods for valuing partially funded social security pension schemes are different from those used to value occupational schemes. It is important that the board (and the external auditors) be aware of the differences between public social security and occupational pension schemes sponsored by employers.

In some countries the social security organization (e.g. the Ghana Social Security and National Insurance Trust) has its own in-house actuaries. Otherwise, especially in smaller countries, the boards of social security organizations contract external actuaries to undertake actuarial valuations.

As part of its technical cooperation activities, the International Financial and Actuarial Service (ILO FACTS) of the International Labour Office Social Security Department carries out actuarial valuations and peer reviews of actuarial valuations done by other actuaries. The ILO FACTS toolkit of textbooks and models for making demographic and financial projections is available for an appropriately qualified national team to master and build an actuarial model of the national scheme.

ILO FACTS has published *Internal guidelines for the actuarial analysis of a national social security pension scheme* which serve as a checklist for actuaries in the Social Security Department, guidance for consulting actuaries it hires, and information for client social security organizations and governments. The International Actuarial Association (IAA) has set out *Guidelines of Actuarial Practice for Social Security Programs*. They cover scientific rigor, objectivity and the transparency, explicitness, simplicity and consistency of information provided in an actuarial report. The following box shows the IAA Guidelines of fundamental principles of actuarial practice.

### Guidelines of Actuarial Practice for Social Security Programs

#### Principles of actuarial practice

**1. Scientific rigour:** The actuary should ensure that the methodology used for the long-term financial projections is based on actuarial principles. The actuary should comply with any general or specific professional guidance that may apply in the relevant circumstances. The actuary should also ensure that the calculations accurately reflect the methods and assumptions adopted. In this context, the actuary should indicate in the report that assumptions, though reasonably determined, are not predictions. He/she should also make it clear that any differences between future experience and the report's assumptions will be analyzed and taken into account in subsequent reports.

**2. Objectivity:** If the development of assumptions to be used in making projections is part of the actuary's mandate, he/she should ensure that this occurs without inappropriate political or external influences. If the actuary is not mandated to determine the assumptions but they are set by another entity, he/she should state the origins of the assumptions and, when needed, show a sensitivity analysis of the impact of alternative assumptions.

**3. Transparency, explicitness, simplicity, and consistency of the information supplied in the report:** When preparing a report, a paper, or a presentation, the actuary should aim to communicate as clearly as possible, having regard for the various audiences to whom it is addressed and the different stakeholders who will place reliance on the results. The actuary is accordingly recommended to include in the report an executive summary written in plain language, describing the purpose and the main findings of the report.

*Source: Guidelines of Actuarial Practice for Social Security Programs, International Actuarial Association*

### 5.2.1 Data

The key to an actuarial valuation is the availability of demographic and financial data about the scheme. Incomplete or inaccurate current and historical data introduce uncertainty and result in a less reliable actuarial valuation.

For an actuarial valuation of a pension scheme, it should be possible to extract the required demographic data on numbers of contributors and beneficiaries by sex and age from the organization's records (see Section 3.3). Financial data on the earnings of contributors, benefit payments by type of benefit, contribution income, investment income, administrative expenses and the reserve fund should be available from these records and the financial statements. As well as input for the actuarial projections, the data provide information for making the assumptions which are required for the projections.

The data to be extracted from the organization's records should be a by-product of information these records must contain if the scheme has an efficient administration and a proper management information system. The actuary should inform the board of any data deficiencies, and the board should demand that management take steps to collect and maintain the required data.

### 5.2.2 Assumptions

Actuarial valuations of short-term benefits and short-term employment injury benefits do not usually involve long-term projections. Actuarial valuations of a social security pension scheme involve demographic and financial projections over at least five decades.

Depending on the benefit branch, demographic assumptions must be made about the future development of rates of mortality, fertility, migration, retirement, morbidity (sickness), disability and family composition. Economic assumptions are required about future economic growth and productivity, labour force participation rates, earnings, wage and price inflation and investment returns. For schemes with limited coverage, the rate at which coverage will be extended must be assumed.

The assumptions are based on the past experience of the scheme, relevant national and international statistics and discussions with scheme and government officials. A sound set of assumptions should be:

- realistic, both overall and individually,
- stated explicitly,
- internally consistent with each other, and
- consistent overall.

Board members should satisfy themselves that the above principles are observed, and that the economic and demographic assumptions are consistent with the experience and the outlook for the country. It is good practice for board members to certify the assumptions to be used in an actuarial valuation, including the baseline assumptions and alternatives that are more optimistic or pessimistic. Input from the board is useful to the actuary, and the involvement of the board helps to commit board members to the actuarial report.

### 5.2.3 Implicit debt

Governments are the ultimate guarantors of public pension schemes. Calculating implicit pension debt is an attempt to quantify the potential public pension debt of the government. Curiously, this concept is applied to public pension schemes, but not to other government obligations such as education, public health or defence.

Implicit pension debt is a prospective concept, the result of summing expected future deficits. Implicit social security pension debt can be calculated in two ways:

Implicit social security pension debt =	
<i>Closed group calculation</i>	the present value of all future benefits to present pensioners and all accrued rights of current insured persons
less	the amount of the initial reserve of the pension scheme;
or	
<i>Open group calculation</i>	the present value of all future benefits to present and future pensioners
less	the amount of the initial reserve of the scheme
less	the present value of all expected future contributions of present and future insured persons at a constant initial contribution rate.

Present value at a specific time means the value of future payments discounted at an assumed rate of interest to that time. The closed group calculation follows an occupational pension scheme concept, while the open group calculation follows a public finance approach.

Under the closed group calculation, the calculated amount is the termination reserve – the reserve that would be needed in order to discharge all financial obligations to present pensioners and present insured persons with accrued rights according to the present rules of the scheme. This ‘full funding’ reserve level is the amount which would be required to terminate the public pension scheme and honour all scheme commitments at that time. Since public pension schemes are secured by intergenerational societal commitments and contracts, not by financial resources, this level of funding is unnecessary. Implicit debt calculated in this

manner may be useful for generational accounting, but it has little relevance as an indicator for the overall financial status of a social security pension scheme.

For a contributory scheme, the open group calculation assumes that the intergenerational social contract will be honoured by present and future generations of pensioners and contributors, and that future contributors will pay their contributions at the currently legislated rates to finance the scheme. The calculated amount is the difference between expected future expenditures and revenues.

Implicit pension debt is not a sovereign debt of the government. It is a notional debt which purports to indicate the financial risk for the government. Provided sound governance is practiced, and contribution rates and/or benefit levels are adjusted in the future, the implicit debt will not occur.

A large implicit pension debt under the closed group calculation is sometimes cited as a reason to reform the public pension scheme. This is true only if there is also a large implicit debt under the open group calculation where contribution rates and/or benefit levels are subject to future adjustments.

## 5.3 THE ACTUARIAL REPORT

The actuarial report should be submitted in the same manner as the external auditor's report, to the board or to the responsible ministry. It is useful if the actuary presents the report to the board so that he/she can reply to questions. The actuarial report should be available to the public. A summary of it should be prepared for the media.

The actuarial report will normally contain:

- financial and demographic projections of the development of the scheme,
- analysis of the sustainability of the scheme under the financial system applied,
- estimated future replacement rates (average benefits/average earnings),
- comparison with the results of the previous actuarial valuation,
- projections under alternative assumptions (sensitivity analysis) and
- results of alternative provisions which the actuary was asked to investigate.

The results of the demographic and financial projections are not predictions. They are the outcomes if all the assumptions were to come true in the future. Since the assumptions cannot be selected with confidence over a long projection period, it is important to remember that (long-term) actuarial projections are not (short-term) budgets. Rather, they estimate the demographic and financial trends of a social security scheme.

The actuarial report compares the results of the current valuation with those in the previous actuarial report, and provides explanations of differences between the two reports. This analysis is an important part of the report.

Adequate and stable financing of social security schemes is essential to provide the protection of persons covered by the schemes and for the national economy. Changes in contribution rates or in benefits in order to adjust social spending to funds expected to be available have far-reaching political and economic consequences. The actuarial report gives board members a perspective on the projected future development and sustainability of the scheme for which they are responsible. It is a powerful governance tool, and board members should take account of conclusions and recommendations in the report. If there are unclear parts of the report, board members should seek clarification from the actuary.

The board and management must alert the government, board members' constituents and the general public to any emerging financing problems. Board members must expect to be questioned, and to find themselves criticized about financing problems over which neither they nor management have control, for example, future pension scheme deficits due to ageing of the population.

In the actuarial report, the actuary describes the data used and comments on its sufficiency and reliability. The board should pay attention to any recommendations by the actuary for improvements in data collection which are necessary before the next valuation. The recommendations may cover not only data deficiencies, but also ways to improve the collection or storing of data.

## KEY POINTS

- There are various methods of financing social security benefits. The system of finance does not affect the amount of a benefit; rather the financial system determines how funds are made available to pay benefits.
- The appropriate system depends on the nature of the benefit (short-term, pensions or employment injury). Board members should be aware of the systems which are applied to finance the scheme's benefits.
- If a scheme provides several social security benefits, the administering organization should keep separate accounts and records for each benefit.
- Actuarial valuations assess the current and future financial status of a social security scheme. They involve projecting the demographic and financial development of the scheme under various assumptions and alternative scenarios. Actuarial valuations should be undertaken every three years.
- The key to an actuarial valuation is the availability of data about the scheme. Incomplete or inaccurate data introduces uncertainty and result in a less reliable valuation. The board should take into account the actuary's proposals for improvement in data collection.
- The demographic and financial projections in the actuarial report are not predictions. Actuarial projections estimate the demographic and financial trends of a social security scheme if all the assumptions were to come true in the future.
- The actuarial report is a powerful governance tool. Board members should take account of conclusions and recommendations in the report.

# CHAPTER 6:

## GOVERNANCE OF INVESTMENTS

In general, public social security pension schemes which are partially funded have substantial funds to invest. Social security schemes that are PAYG financed usually have contingency reserves which are invested for short terms.

The investment of social security funds is a topic which demands the attention of board members, CEOs and other persons in the organization with investment responsibilities, since it is an area fraught with peril for them. Many social security board members and officials have been dismissed for real or alleged investment failures. If an investment has been authorized under undue (although sometimes irresistible) external pressure or for personal gain, this is understandable; however if an investment which was made in good faith turns out to be unsuccessful, it is not.

A study group of practitioners set up by the International Social Security Association (ISSA) developed *Guidelines for the Investment of Social Security Funds*, which set out the prerequisites and mechanisms for proper governance of investments of social security funds and good practice in the investment process. This chapter draws on the ISSA Guidelines.

The chapter first outlines the principal aspects of investment: objectives and investment policy and strategy including asset allocation. Then, it deals with governance issues: structures, accountability, measuring performance and control systems.

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### 6.1 INVESTMENT OBJECTIVES

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Social security funds must be invested prudently and responsibly. The introduction to the *Guidelines for the Investment of Social Security Funds* states:

“...the investment of these funds can make a critical contribution to the financial sustainability of...social security systems. However, experience has also shown that the investment of reserve funds is not without risk. Imprudently or improperly invested reserve funds can yield negative real rates of return, or can disappear altogether.”

The generally accepted objectives for the investment of social security funds are security, yield and social and economic utility.

### Investment objectives

There are two primary objectives for the investment of social security funds:

- Security - the investments should assist the social security scheme to meet its commitments in a cost-effective way;
- Profitability - the investments should achieve maximum returns, subject to acceptable risk.

Investments of social security funds should be made with a view to achieving a reasonable balance between these objectives.

A subsidiary objective is:

- Social and economic utility - investments which contribute to long-term national economic growth, for example, investments in human resources, health care or transportation infrastructure.

In the case of contingency reserves which are held to guard against unexpected events, or buffer funds whose purpose is to ensure the cash flow of the social security organization, liquidity – how quickly and successfully investments can be sold – is also an objective.

While investment of social security may ‘deepen’ national capital markets (i.e. increase market capitalization and transactions), this is an indirect positive result, not an objective of the investment of social security funds.

A difficult and politically sensitive issue is investment in projects with social and economic utility, for example, projects enhancing human resources, health or transportation infrastructure, low-cost housing, old-age facilities, tourism, state-owned enterprises and student loans. These investments can make substantial contributions to long-term national economic growth, although this indirect return is not reflected in the monetary rates of return. Ultimately, the sustainability of any social security scheme depends on economic growth. By contributing to economic growth, investments with substantial social and economic utility can improve the financial status of a social security scheme by increasing the number of members and their earnings, and the rates of return on the scheme’s other investments.

The ISSA Investment Guidelines recommend that there should be clear criteria for deciding when the social or economic utility of an investment is taken into account, and that this objective should be subsidiary to security and profitability. Investing in a socially or economically important project which is going to pay below-market returns means that the contributors and beneficiaries will subsidize the project. Where investment in such a project is considered desirable by the government and/or by the board but the returns are likely to be below market rates, the investment should be structured so that the subsidy is made from government resources.

## 6.2 INVESTMENT POLICY AND STRATEGY

The investment of social security funds should take into account the commitments of the scheme and the scheme's financial system, and it should be consistent with the scheme's short-, medium- and long-term financing objectives. The investment policy and strategy should include appropriate rules about the allocation of investments to specific asset classes, taking into account:

- risk management (a quantified likelihood of loss or less than expected returns) and risk tolerance;
- diversification and dispersion (thereby reducing risk by spreading investments among different asset classes and different investments within each class);
- matching assets and liabilities (taking into account duration and maturity, for example, pension scheme liabilities are long-term);
- currency matching; and
- performance measurement and monitoring.

The principal investment risks are market risk (decrease in the value of an asset), credit risk (the failure of a counterparty to an agreement or default by a bond issuer) and liquidity risk (inability to sell an asset for an acceptable price at a desired time). Other risks include inflation which will erode the real value of invested funds (which applies whether the funds are invested or not), and the currency (exchange rate) risk when investments made in foreign currencies are sold and converted to the national currency. The board must assess the investment risks, and after appropriate analysis determine the level of investment risk which can be tolerated by the organization.

In many countries, investments of social security funds comprise (or will comprise) a major share of the domestic capital market. The national economic, social and financial importance of these investments means that investment policy and strategy must be drawn up taking into account the national objectives and economic policies of financial authorities such as the Ministry of Finance and the Central Bank. However, these authorities (or other government bodies) should not be involved in implementation of the strategy (i.e. tactical investment decisions – choosing specific investments).

The investment policy should be reviewed at least every three years, the strategy more frequently and both should be widely publicized. The following box shows a selection of the beliefs which underpin the investment policy and strategy of the Canada Pension Plan Investment Board ([www.cppib.ca](http://www.cppib.ca)), an independent body with broad investment powers which was set up by legislation to invest the reserves of the Canada Pension Plan. The Board has the following mission:

- To manage the assets entrusted to the Board in the best interests of Canada Pension Plan contributors and beneficiaries;
- To invest in ways that over the long term will maximize returns without undue risk while having regard to factors that may affect the Canada Pension Plan's funding and its ability to meet its obligations; and
- To help Canadians understand what the Board is doing with their money through communications and stakeholder relations that exceed statutory reporting obligations.

The investment beliefs of the Canada Pension Plan Investment Board illustrate the sort of issues board members should consider in the context of their national circumstances.

### **Investment Beliefs of the Canada Pension Plan Investment Board**

The Canada Pension Plan Investment Board Investment Beliefs provide a framework for considering portfolio management issues and making informed decisions in a holistic and consistent manner. The management of the Board is guided by the Investment Beliefs.

- The major stakeholder risk is that the current Canada Pension Plan provisions will not be sustainable in the future (recognizing that investment returns are one of many factors which will contribute, positively or negatively, towards sustainability).
- Large positions in a single asset or asset class generally lead to lower expected returns.
- Markets are very efficient at pricing securities relative to one another, but are not perfectly efficient due to information and execution costs.
- Overall market direction exhibits some predictability in the long term, but is very nearly random in the short term.
- While a structural advantage (e.g. liquidity, size, time horizon) may be helpful, an investor must have skill to add value from active/tactical management.
- Because investors are risk averse, they expect a return premium for bearing risk and expect higher return premiums for bearing larger risks.
- Portfolio costs are more predictable than portfolio risks and these risks are more predictable than returns.
- Constraints never increase expected risk-adjusted returns.
- Certain illiquid assets (e.g. private equity and real estate) have characteristics which are similar to those of certain publicly traded assets, except that they are less easily converted to cash and cannot replicate passive benchmarks.

*Source: Viola, V. An innovative foundation for a sustainable future.*

### 6.2.1 Socially responsible investing (SRI)

Socially responsible investing (or sustainable investing or ethical investing) refers to an investment strategy which seeks to maximize both financial return and social good. Socially responsible investments are those which encourage ethical corporate behaviour, and support protection of the environment, consumer protection, human rights and a diverse workforce. Investments in businesses involved in alcohol, tobacco, gambling or armaments are normally avoided.

Some public pension funds have adopted SRI. For example, the Norwegian Government Pension Fund is mandated to avoid 'investments which constitute an unacceptable risk that the Fund may contribute to unethical acts or omissions, such as violations of fundamental humanitarian principles, serious violations of human rights, gross corruption or severe environmental damages.'

An international group of institutional investors has developed the United Nations Principles for Responsible Investment (see box). The principles take into account the increasing importance of environmental, social and corporate governance (ESG) issues to investment practices. The Principles aim to help investors integrate ESG issues into investment decision-making and ownership practices, and thereby improve long-term returns to beneficiaries.

#### United Nations Principles for Responsible Investment

Institutional investors following the United Nations Principles for Responsible Investment take into account environmental, social and corporate governance (ESG) issues, and commit themselves as follows:

- We will incorporate ESG issues into investment analysis and decision-making processes.
- We will be active owners and incorporate ESG issues into our ownership policies and practices.
- We will seek appropriate disclosure on ESG issues by the entities in which we invest.
- We will promote acceptance and implementation of the Principles within the investment industry.
- We will work together to enhance our effectiveness in implementing the Principles.

Source: <http://www.unpri.org/principles/>

Taking into account their duty to act in the best long-term interests of their beneficiaries, and that environmental, social and corporate governance issues can affect the performance of investment portfolios, institutional investors commit to the Principles in order to better align the investors with the broader objectives of society. Institutional investors signing the Principles publicly commit to adopt and implement them, where consistent with their fiduciary responsibilities. Most major public and occupational pension funds have committed to the Principles.

## 6.3 ALLOCATION OF INVESTMENTS

The most important investment decision is not whether to invest in company A or company B, but the allocation of investments among different asset classes. The basic asset classes are equities (stocks), fixed income (bonds), property and cash. Precious metals and collectibles can also be included.

The ISSA Investment Guidelines caution strongly against asset allocation being dictated from outside, for example, by the government. The Guidelines state that:

- There should be no minimum level of investment in any asset, in particular in government debt. Social security funds should not be a means for governments to finance deficits.
- The investment strategy should set quantitative restrictions on the maximum levels of investments in different asset classes.
- The investment strategy should not permit holding more than a specific proportion of the total market value of the assets of a particular industry or enterprise.
- Investments in some types of assets may be forbidden, for example unguaranteed loans or unquoted shares.
- A list of admitted (or recommended) assets could be applied based on the investment quality of the assets.

A partially funded pension scheme normally accumulates substantial reserves which must be invested. These reserves are often invested in government securities, either because the legislation requires this or due to the lack of a sufficiently deep domestic capital market where the reserves can be invested. Too often these investments have been devalued due to inflation, or have earned below-market interest rates, and sometimes the government has simply required that the scheme write off the government debt. These types of transfers from the scheme to the government are simply another form of taxation. A partially funded pension scheme can reduce the possibility of such a situation occurring if the contribution rate is chosen with reference to the level of reserves which will be generated and can be productively invested.

In Africa, as in most developing countries, there are insufficient appropriate domestic financial market investment opportunities for social security funds. Consequently, the funds overwhelm domestic capital markets, and social security organizations have often invested in projects such as hotels, shopping centres and housing estates. Experience has shown that everywhere social security organizations are inept managers of these projects, and that they divert the attention of the board and management from their core responsibility, the social security scheme. Rather than investing in projects, social security organizations should be 'wholesalers' of funds, and lend them (usually with a government

guarantee) to institutions which are competent to implement and manage such projects.

The lack of domestic investment outlets also raises the question of investing social security funds abroad. While this appears to be a solution, it means the funds are not used for national development and increasing national output. Since, in addition to a currency risk, foreign investment has serious macro-economic implications (e.g. regarding trade balances and the exchange rate), the Ministry of Finance and Central Bank must be involved before a foreign investment strategy can be implemented.

If the board has sufficient confidence in the organization's investment management, quantitative restrictions on investments can be eased by applying the 'prudent person' principle. This refers to behaviour which requires a person to exercise the same care, diligence and skill in discharging his/her duties as a reasonably prudent person would exercise in comparable circumstances.

## 6.4 GOVERNANCE STRUCTURES

It is necessary to distinguish between social security schemes where the organization administering the scheme is responsible for investments and those where a separate, generally independent, body is responsible. If the social security scheme is run by a government department (or closely supervised by one), a separate body responsible for investments can reduce the chances of actual or perceived political interference with the investment of social security funds. If the investments are made by a separate body, its legal status and its relationship to the social security organization must be defined.

In the following, the board refers to the board of the body which is responsible for the investment of social security funds.

### 6.4.1 Investment committee

The board should have an investment committee that is responsible for drafting the investment policy and strategy and monitoring its implementation. Given the importance of investments, the chairperson of the board is sometimes also chairperson of the investment committee. The CEO is usually a member of the committee. The rest of the committee is drawn from the board and outside experts with appropriate investment skills and experience. The investment committee reports to the board.

There should be standards of suitability for investment committee members in order to ensure the integrity and professionalism of the investment process. Conflicts of interest must be avoided (see Section 2.3.4). Since the board receives the investment committee's reports, it may be desirable for board members to receive some training on investing. The board needs sufficient knowledge to understand the investment statement and ask relevant questions, while, with the help of advisers, investment committee members need to be able to draw it up.

The board should have a sound understanding of the scheme's obligations, the system of financing the scheme, the investment objectives and the degree of risk and risk tolerance the scheme is able to sustain. Variations in the amount of contributions and in asset values should be considered along with the financial objectives. Taking all these factors into account, the investment committee establishes an investment policy and strategy for presentation to the board for approval. Once approved, the investment committee oversees the implementation of the policy and strategy, evaluates their effectiveness and reports regularly to the board on these matters. A sound basic principle to bear in mind is 'Do not invest in anything you do not understand'. The investment policy should be reviewed regularly by the board (at least once every three years). The investment strategy should be subject to ongoing review and evaluation.

Within an accepted investment policy and strategy and allocation of assets, the investment staff should take tactical investment decisions (i.e. which specific investments to make) up to specific limits without referring to the investment committee or the board.

## 6.5 ACCOUNTABILITY

The board is accountable for the investments to contributors, beneficiaries and other stakeholders of the social security scheme.

However competent the investment committee may be, it cannot have expert knowledge in all aspects of investment. Since the board and the investment committee must provide detailed oversight, they have the responsibility to have outside experts brought in to assist them whenever necessary. To obtain expert advice and alternative views, the investment committee should be able to obtain outside investment advice.

Investment management can be done in-house, or it may be done by external investment managers. The board may agree to assign a portion of the assets (tranche) to outside managers to invest in accordance with the investment strategy adopted by the board. This avoids criticism that in-house managers dominate investments, and it

can counter the inevitable criticism that investments made in-house are under-performing. The results of external investment managers, and whether they are complying with the investment strategy, are monitored by the investment committee, and regular reports on performance of external managers and in-house investments are made to the committee. Contracts for external management and advice should be open to competition. They should be reviewed periodically, and in the case of external investment managers, renewal depends on performance.

The board remains responsible for services it assigns to external providers. It is the board's responsibility to monitor the performance of these services.

The board must appoint a custodian for the assets, an agent who physically holds the documents proving that the organization owns the assets. This may be a government body, such as the Central Bank or the Ministry of Finance, or an independent firm. In the latter case, the custodian should be required to re-tender for the work at regular intervals.

Depending on how the investment function is organized, additional auditing and actuarial advice may be required.

## 6.6 MEASURING PERFORMANCE

Assets should be valued in accordance with accepted accounting principles.

Periodic analyses of the performance of the entire investment portfolio and of each asset class should be made to determine changes in asset values, and nominal, risk-adjusted and inflation-adjusted (real) rates of return. The analysis should include comparisons with target rates of return and with appropriate benchmarks. This analysis is undertaken separately for in-house investment managers and each external manager. The board assesses investment performance, and makes any necessary adjustments to the investment policy and strategy, and to the asset allocation. The analysis of investment performance should be published.

Investment managers, as well as the specialist firms who do performance measurement, tend to concentrate on whether a particular manager has done better or worse than others following the same strategy. While this may demonstrate their skill, it reveals nothing about whether the investment strategy is achieving its objectives. The performance assessment of social security investments should include a comparison with target rates of return, which are based on the assumptions in the actuarial valuation. The rates of return assumed in an actuarial valuation are the minimum rates necessary to sustain a pension scheme which follows a partially funded financial system.

The investment committee needs to receive and discuss performance reports regularly, and consider whether the investment policy and strategy should be modified. It is not usual to make frequent changes, but monitoring and periodic updating are essential.

## 6.7 CONTROL SYSTEMS

The board should ensure that the investment policy and strategy adopted are being followed, and that control systems are in place that cover all organizational and administrative procedures, including performance assessment, compensation for investment advice, investment information systems, processes and risk management procedures and regular reviews of advisers and contractual arrangements with investment institutions.

The board should receive regular reports on all these matters. Inefficiency, excessive costs, lack of transparency and under-performance in investments will lead to criticism of the organization. Relevant information on investments: the objectives, policies and strategy, and the performance of investments should be publicized in the organization's annual report and throughout the year in press releases and on the organization's website.

### KEY POINTS

- The primary investment objectives for social security funds are that they should be invested securely and profitably. Investments with social and economic utility are a subsidiary objective.
- The national economic, social and financial importance of social security investments means that investment policy and strategy must be drawn up taking into account the national objectives and economic policies of financial authorities such as the Ministry of Finance and the Central Bank.
- The board should adopt a statement of investment policy and strategy which includes rules for asset allocation.
- The board should appoint an appropriately qualified investment committee which oversees the implementation of the investment policy and strategy, evaluates their effectiveness, monitors performance and reports regularly to the board.
- While the board is responsible for all aspects of investments, the investment committee should be able to add experts to assist it, and external investment managers may be contracted to invest part of the social security funds.
- The investment committee controls the investment process, and should receive periodic analyses of the performance of investments including comparisons with target rates of return and appropriate benchmarks, which it reports to the board.

## CHAPTER 7:

# FINANCIAL GOVERNANCE OF NON-CONTRIBUTORY SCHEMES

The preceding chapters have dealt with governance of the operations and financing of contributory social insurance schemes. This chapter focuses on non-contributory schemes. Aside from references to contributions and contributors, many aspects of the administrative operations of non-contributory schemes are similar to those of contributory schemes. The concept of governance and governance responsibilities are the same no matter how a scheme is designed. The governing authority of a non-contributory social security scheme – whether it is a board or the legislative body itself – has a duty to ensure that it acts in the interests of all constituents. It will be dealing with legal frameworks, organizations, administration and information that are similar to those for a contributory scheme.

Generally, authority for governance of non-contributory social security schemes lies with the legislature, with decision-making power resting with the minister responsible for the department administering the scheme. Consequently, there are few examples of governing boards of non-contributory schemes. An exception is Mauritius, where a board is responsible for both the contributory and non-contributory pension schemes.

The legislation establishing a non-contributory scheme may call for an advisory board to advise the government on the management and effectiveness of the scheme, but an advisory board would not have decision-making power. An advisory board can also be established at the discretion of the minister responsible for the scheme even though it is not provided for in the legislation.

Advisory boards are desirable. They serve as stabilizing influences throughout changes of government and they can restrain imprudent election promises. Board members bring the perspective of the scheme's participants to the scheme's administration, particularly if a tripartite board includes beneficiaries' representatives and experts in the field. It requires effort on both sides to make this arrangement work well, as politicians and government officials will not enjoy criticism by the advisory board, and board members will be resentful when their advice is ignored. Nevertheless, the benefits of having an independent advisory board can much outweigh the effort to make the arrangement work.

## 7.1 TYPES OF NON-CONTRIBUTORY SOCIAL PROTECTION

Non-contributory schemes can be part of a comprehensive national social protection system, or they can be a step in the development of the system. Unlike contributory schemes, non-contributory schemes are not based on a person's formal sector wage and salaried employment; hence they can be effective anti-poverty measures. They can be established for all types of social protection. Non-contributory scheme cash transfers are unconditional or conditional.

### 7.1.1 Unconditional benefits

Unconditional (universal) cash transfers are directed at a segment of the population, for example, a universal old-age pension – sometimes called a social pension or a basic pension – for all persons over a specified age, or a benefit for all children under a certain age. Old-age pensions, basic health care, support for people with disabilities and financial assistance for families with children are the most common types of universal benefits.

An example is the old-age pension in Mauritius, which is payable to residents after age 60 regardless of income. There are no conditions placed on receipt of the pension except a residence requirement (see box). Financing is provided by the government from its general tax revenues. The benefit was established in recognition of the contribution aged persons made to the social and economic life of Mauritius during their younger years.

In many ways, a universal, non-contributory social security scheme is the easiest to set up and to manage. Universal schemes should have low administrative costs in relation to the cost of administering targeted schemes, and they are not as dependent on having well-developed records and strong institutional capacity. Universal pensions are effective in combating poverty and ensuring that the elderly receive a basic income.

### Mauritius: Universal Pension

Universal, non-contributory income support for the elderly in Mauritius was established in 1950. Subject only to minimum residence requirements (12 years from age 18 for citizens, 15 years from age 40 for non-citizens), every resident aged 60 or over is eligible for a monthly pension, the amount of which is increased at age 90 and again at age 100. Those who are totally blind or paralyzed receive an additional benefit, and all pensioners receive a thirteenth month bonus at the end of each year. The value of the pensions ranges from approximately 18 percent of per capita GDP for the most common pension, to 92 percent for the pension of a person aged 100 years or more and severely disabled. The result of the pension has been a considerable lessening of poverty, not just among the elderly but within their extended families.

The pension was first introduced with a means test, which was highly unpopular and was abolished in 1958. Pensions are now neither income tested nor retirement tested. They are taxable as ordinary income, however, so those who continue to work or who have other sources of income, return some of their pension income to the government in the form of taxes.

The pension is governed by the National Pensions Board, which also has responsibility for contributory pensions covered under the Act. The Board is tripartite, consisting of a chairperson, a representative from each of the Ministry of Finance, the Ministry of Health, the Ministry of Labour and Industrial Relations and the Ministry of Social Security, National Solidarity and Senior Citizens Welfare and Reform Institutions, four representatives of employers (two of whom are from the sugar industry), and four representatives of employees (two of whom are from the sugar industry). Appointments are made by the Minister, in the case of those representing employees, in consultation with unions.

The role of the board is left very broad in the legislation: 'the Board may of its own accord advise the Minister on any matter relating to this Act; the Board shall advise the Minister on any matter referred to it by the Minister'.

### Lesotho: Old Age Pension

In November 2004, the Government of Lesotho instituted an Old Age Pension for all resident Basotho over 70 years of age. Lesotho and Nepal are the only least developed countries to operate a universal non-contributory pension for all their older citizens. Lesotho's universal social pension is similar to those in Namibia and Botswana, however it is payable from a higher age.

Of about 75,000 Basotho who qualify for the pension based on their age, 65,000 are registered for the scheme. Setting the age criterion at 70 years reduces the cost of the scheme, which is important from the fiscal point of view, given Lesotho's low GDP. The total cost of the benefit is 1.43 per cent of GDP or about seven per cent of the government's recurring budget. This is in line with the cost of social pensions in other countries in southern Africa. The benefit level is more or less equivalent to the official national poverty line, one objective of the pension being to lift older people out of poverty.

*Source: HelpAge International: Making Cash Count.*

### 7.1.2 Conditional benefits

Conditional benefits are cash transfers that are paid on condition that the recipients do certain things, such as school attendance in order for a family to receive a benefit for children, or the requirement to look for work in order to receive an unemployment benefit. Non-contributory (social assistance) benefits can be targeted to reach a part of the population that is to some extent excluded from the economic and social life of the country. Targeting benefits may be more politically acceptable, since persons who do not need the benefit do not receive it. Benefits may also be targeted because a government must limit its financial commitment and therefore target benefits to those most in need.

Means tests measure the need of an individual or a family for benefits. Eligibility for benefits is determined by assessing the level and potential sources of income of a family (usually including support from family members and sometimes potential revenue from the sale of assets). Means tests let a government direct benefits to the poor.

In the case of old-age pensions, means tests have been shown to discourage people from saving for retirement, and they can discourage older people from part-time work. Means tested schemes often have lower take-up of the benefit by those in need, which may be due to the stigma of welfare, the difficulty of finding and identifying recipients and/or a complicated application procedure that potential recipients often face. Many of these difficulties can be avoided, or at least minimized, if they are borne in mind when the scheme is designed and the methods used by the administration to serve beneficiaries are set up.

An example of a targeted non-contributory scheme is the old-age pension in South Africa, which is one of a set of targeted benefits which have been designed to reduce poverty among the most vulnerable persons. Receipt of the pension is dependent on a means test which excludes only about 12 percent of the elderly population (see box).

A means test for schemes directed at the poor is generally designed with reference to the poverty line. The usual way to define the poverty line is to establish the cost to purchase a basket of goods and services that an individual or a family needs in order to maintain a minimum standard of living. Those whose income (or whose household income) falls below the level needed to purchase this basket are eligible for a benefit. The benefit may vary if the cost of food and services is more expensive in parts of the country, and the scheme may include a formula for benefit increases based on inflation.

The base line for income-tested schemes might be set at the poverty line, at the median standard of living for the country, or higher if the aim is to exclude only

### Means tested benefits in South Africa

South Africa has a number of means tested benefits for foster or other children needing support, dependents in care, people with disabilities, the elderly and war veterans - a basket of benefits that have been carefully chosen to move the most disadvantaged out of poverty.

The old age pension was originally established in the 1920s. In its current form, it is subject to a means test, and the full benefit is worth about 33 percent of per capita GDP. It reaches about 88 percent of South Africa's 1.8 million elderly, and is a significant source of income for many families, having lifted most of the poorest elderly out of absolute poverty. It has had important redistributive effects; for example, it has led to better school attendance by children in these households.

The pensions have achieved relatively good coverage, reaching isolated rural areas that have very few other services.

Despite the scheme's obvious benefits, a recent government discussion document mentions high administration costs and persistent problems with coverage as well as a degree of over-coverage (payments to ineligible persons).

the most wealthy persons from benefits. Decisions must be taken about how an applicant's means and hence his/her eligibility will be determined. In countries where there is a broad and efficient tax system that can provide reliable information on most persons' income, using taxable income as a measure is the simplest approach. Otherwise, for example, if a country has a large informal sector, determining eligibility is more difficult and open to errors – the inclusion of people who do not need the benefit, and the exclusion of others who are truly in need. In South Africa, where means tested benefits are carefully designed and well-established, it is nevertheless reported that there can be problems of wrong inclusion and exclusion.

### Establishing a poverty base line in Lesotho

According to the Kingdom of Lesotho Poverty Reduction Strategy 2004-2007, establishing a poverty base line involved converting expenditures on 30 items of food and ten own-produced consumption items into quantities and calories. The minimum expenditure on food necessary to meet the internationally accepted threshold of 2,200 kilo-calories required for a healthy and active life was then calculated, based on the cost per calorie actually incurred by Basotho families. By including an amount based on actual expenditure incurred on non-food items by households from the more deprived segments of the population, a per capita poverty line in constant 2002 prices was calculated.

### 7.1.3 Basic social protection package

The ILO recommends a non-contributory basic social protection package for low-income countries consisting of universal old-age and disability pensions, child benefits, universal access to essential health care and social assistance in the form of an employment guarantee scheme. A basic non-contributory scheme expands the economy of a country since it raises people out of poverty and increases their capacity to buy goods and services, which in turn creates jobs. If the 'fiscal space' (room in the Government's budget that allows it to provide resources for a desired purpose without jeopardizing the sustainability of its financial position or the stability of the economy) does not permit a complete package to be implemented at once, a sequential approach can generate immediate benefits in terms of poverty reduction, pro-poor growth and social development. As countries achieve higher levels of economic development, their social security systems can also expand, extending the scope, level and quality of benefits and services provided. The ILO estimates that basic means tested benefits can be provided for about two percent of GDP, while a partial set of basic universal benefits can be designed for between two and five percent of GDP.

#### KEY POINTS

- Non-contributory schemes are financed by the government, usually from general revenues. They can be conditional or unconditional.
- Unconditional (universal) benefits are available to all members of the recipient population, for example, a universal old-age pension.
- Receipt of a conditional benefit is subject to means testing or other conditions which must be met in order to receive the benefit. Targeting can be designed to achieve specific objectives, for example, lifting people out of poverty. While targeting reduces the cost of the benefits, a targeted scheme is more difficult to administer.
- A non-contributory basic social protection package can raise people out of poverty and contribute to national social and economic development.
- Governance of non-contributory social security schemes usually rests with the legislature.
- An advisory board can provide useful input to the government on the management and efficacy of the scheme.

## 7.2 FINANCING NON-CONTRIBUTORY BENEFITS

The financing of non-contributory benefits usually comes from government's general revenues – direct taxes levied on personal or household income, corporate taxes and property taxes, and indirect taxes such as taxes on goods and services. General revenues may also include income from government-owned assets. The funding of a non-contributory scheme is therefore on a pay-as-you-go-basis, and the annual budget is set during the government's budget process. This may be at a national level, or the funding and provision of benefits may be at a state or local level. There are instances where a government has established a special tax to finance a scheme, such as a tax on tobacco to fund a portion of health care, or has increased a particular tax and earmarked the increase to fund benefits.

It is essential to have actuarial projections of expected benefit expenditures to assess whether a non-contributory scheme can be sustained over the long run, and to have regular actuarial projections in the same way as for a contributory scheme. When expenditures of a non-contributory scheme exceed budgeted amounts, the government must be prepared to make up the short-fall from general revenue.

For a low income country wishing to establish a non-contributory scheme, it may be tempting to consider raising a specific tax. The government must consider the cost of collecting a special tax and whether it can do this efficiently. Additional taxes can have adverse economic effects. However, basic non-contributory schemes expand the economy of a country since they raise people out of poverty and increase their capacity to buy goods and services. An example of a scheme that was designed to be funded by special taxes is the means tested basic pension in Canada. A decision was soon taken to drop means testing, and later to change the financing formula and make the financing part of general government revenues. How the scheme was designed and why the design did not work provide a useful illustration of the difficulty of depending on an allocated tax (see box).

### Universal old-age pensions in Canada

In 1927, Canada established a means tested pension payable to persons age 70 and over. It was financed through an Old Age Security Fund, an account in the government's general revenues, and funded by a special levy composed of three taxes: a tax on the manufacturer's selling price of items covered by federal sales tax, a tax on personal income and a tax on corporate income. The rate was initially set at two percent for each component, and became known as the '2-2-2 formula'. The government was to make up any deficit.

A series of changes made the pensions more generous, lowered the pensionable age and removed the means test, and in 1952 the original legislation was replaced by the Old Age Security Act which provided for a new universal pension. The original fund was maintained, and the funding was increased to a 3-3-3 formula in 1959. Over the next 15 years, the revenue increased from personal income tax, but sales tax revenue eroded because of changes in the tax regime. In addition, costs were rapidly increasing due to the introduction of an income tested supplement for low income pensioners. In 1972 the old-age security tax was eliminated. The Fund was abolished in 1975, and since then the pension has been paid from general revenues.

The Fund was in surplus for only nine of its 20 years of operation. Increases in funding did not keep up with the increasing generosity of benefits. The funding formula was not sustainable in the long term without a considerable increase in income tax and/or more sustainable sales or corporation taxes. In addition, since 1967 workers and employers had been contributing to an obligatory pension scheme, the Canada Pension Plan, hence the tax for the universal pension was a burden, particularly on the working poor.

## 7.2.1 Financial Planning

Preparing the government's annual budget is a complex task, and usually a difficult exercise in balancing competing demands. Ensuring stable financing for social security programmes financed by general revenues requires long-term actuarial projections of expenditures and a social budget. A social budget, combined with a Social Protection Expenditure and Performance Review (SPER), allows the government to calculate what percentage of its total budget will be needed, now and in the long term, so that the non-contributory schemes provide the desired level and quality of social protection (see Chapter 8). With a social budget, the government can identify the funds needed for social security before making the necessary trade-offs with other budget demands.

There is no guide as to exactly what percentage of a country's budget should be spent on social security. As mentioned above, the ILO has calculated the cost of starting with non-contributory universal basic benefits at between two and five percent of GDP. South Africa's means tested benefits, which are reported to have reduced poverty by 48 percent and destitution by 67 percent, cost about three percent of

GDP. While social protection schemes in industrialized countries have much higher expenditures as percentages of their GDPs, it is important to remember that these countries began with modest benefits that addressed the greatest needs at the time.

To fulfil its governance role, the board or legislature must find out from the government what data is available about the scheme's costs and ensure it receives an explanation of how the government is arriving at its budget projections for social security. It should also ensure that the government has a plan for ongoing data collection and analysis, and consistent assessment of the outcomes of the schemes.

### **7.2.2 Budgeting and accounts**

If there is a board of a non-contributory scheme which only has an advisory role, it may have difficulty inserting itself into the government budget process in order to ensure that funding will be available to meet the objectives of the scheme. When the scheme is funded from the government's general revenues and the board has no role to play in government budget decisions – which is frequently the case – the board will have to find ways to ensure that sufficient funds are set aside in the annual budget to cover expected benefit payments and the administration of the scheme.

Although the payment of benefits is legislated, if a scheme has inadequate coverage or the benefits are based on means or other tests, there is a danger that under-budgeting will lead the government to delay efforts to expand coverage, or to ask the administration to be tougher in its targeting decisions, thereby defeating the purpose of the scheme. Changes in the interpretation of assessing such matters as the degree of disability for disability payments, or in the leniency applied to difficult decisions concerning a means test can significantly reduce benefit payments. Even taking a longer time to make decisions on applications or delaying payments can reduce the amount of benefit payments. This behaviour is counter to the spirit of social protection, but since these actions happen it is important to ensure that sufficient funds are in the budget at the outset.

The board of a non-contributory scheme should discuss its role in the budget process, and at least obtain agreement from the government that it can make recommendations on the amounts needed. As government budget processes are often secret, it is unlikely that the board will be able to review and discuss the budget in advance of public announcements of the government's overall budget, but at least the board should be involved in the preliminary discussions during the budget planning phase.

If governance of the scheme lies with the legislature, then discussions and explanations of the budget for non-contributory benefits will take place during the passage of the budget bill in the legislature. Legislators should have access not

only to the budget details, but also actuarial reports on the scheme and a social budget and Social Protection Expenditure and Performance Review.

Both the presentation of the budget and the accounts for the previous year's expenditures, should account for each non-contributory scheme as a separate budget line. Sometimes the enabling legislation calls for the funds for a non-contributory social security scheme to be held in a separate account, while still forming part of the government's overall budget. In both cases, it is important that the total cost of the scheme be accounted for clearly and that administrative costs be accounted for separately from the cost of benefits. If the scheme pays several benefits, the different components should be budgeted and accounted for separately.

Administrative costs depend a great deal on the design of a scheme and the ease of reaching beneficiaries. There are great variations in administrative costs of schemes depending on national infrastructures. Administrative costs of non-contributory schemes are two to three percent of benefits for the Mauritius universal pension, about 4.5 percent in Botswana and 15 percent in Namibia due to the widely dispersed beneficiaries.

Government budget expenditure reports normally aggregate expenditures. Details of a scheme's expenditures should be set out in an annual report on the operations of the scheme which should be presented to the legislature and to the public. The report should include a description of the scheme and detailed accounts of expenditures on benefits and administration, along with comparisons of expenditures over time, actuarial projections of the scheme, information on coverage and major initiatives that the administration has undertaken and the results of the initiatives. It should include the administration's plans for the following budget period. If these reports are presented for the legislature's approval, they provide a sound basis for governance of the scheme.

When non-contributory schemes are administered by a government department, it is simpler for the department to combine the reporting of administrative costs for all its responsibilities. This does not allow for proper governance or evaluation of the non-contributory schemes. It is not necessary to overdo the administration reporting (e.g. having employees fill out time sheets showing how much time is spent on the administration of each scheme or benefit), or otherwise complicate the work by keeping records detailing each small cost attributable to each scheme. A formula should be devised that will closely approximate the percentage time of the administration's personnel and the percentage of recurring costs needed to administer each scheme. This should be prepared by tracking how much employee time is spent on the various schemes for set periods of time – for example, tracking carefully one week a month for enough months to get a

statistically valid estimate that can be transformed into an annual amount. In this way, the administration can track costs and update them when processes change. This documentation is also useful when requesting additional funds for administration, as well as for reports on the schemes.

### KEY POINTS

- Budgeting non-contributory scheme expenditures should be done using actuarial projections of expenditures, a social budget and a Social Protection Expenditure and Performance Review.
- It is necessary to ensure that sufficient funds are allocated in the government's annual budget to permit a non-contributory scheme to operate in such a manner that it can meet its objectives.
- The government should list each non-contributory scheme as a separate budget line and should account for the benefits and the administrative costs separately.
- Annual reports on the operations of non-contributory schemes should be prepared and submitted for approval to the legislature and to the board where there is a board.

## 7.3 ADMINISTRATION OF NON-CONTRIBUTORY SCHEMES

Certain administrative functions require special attention in non-contributory schemes. These include public communications, coverage and controlling benefit fraud. In some ways, the areas are linked, and the level of difficulty that the administration faces is related to whether the design of the scheme is simple and straightforward, and whether any means testing or other targeting is sufficiently fair and easy to understand while still meeting its objectives.

### 7.3.1 Communications

Schemes that are well-managed and effective in meeting their objectives deserve broad public and political support. However, if the public and politicians do not understand a non-contributory scheme and its benefits, it can be in danger of being cut when the government is looking for funds for another project. Consequently, it is necessary to review the administration's communications and communications strategy, and ensure that it is informing the public regularly, in clear and simple language, about the scheme, the reasons for it and the impact that the scheme is having on society. Ensuring public understanding of a scheme requires using many forms of communication.

It is especially important to communicate a targeted scheme's objectives and benefits – the reasons for expenditures, the broad societal benefits of the scheme

and the need to take a long term view if the scheme requires time to have an impact. If, in order to achieve its objectives, the scheme is complex, it must be explained in very simple terms.

### 7.3.2 Coverage

When workers pay contributions in order to receive benefits under certain circumstances, they generally know about the possibility of the benefits and apply for them. In a non-contributory scheme, there will be many persons who have no knowledge of the benefit or how to apply for it, and who have never had dealings with the government.

No government wants to see money spent where it is not needed, but neither does a government want to promise coverage and then find that people who should be receiving benefits are not. The full coverage of the eligible population by a non-contributory social security scheme is more difficult to manage than in a contributory scheme. Countries with well-developed social protection, which are managing both contributory and non-contributory schemes, invariably find more complete coverage in the contributory scheme than in the non-contributory one.

In a contributory scheme, the administering organization should be able to match the records of contributions with the person claiming benefits, and it may be able to follow up with employers if its records are deficient. In the case of non-contributory schemes, it is not as easy to identify the beneficiaries. If the scheme is universal, for example an old-age pension, the administration could rely on vital statistics (birth and death records) or government registration of citizens or voter lists to offer the benefit to individuals directly. However, these lists are often incomplete, and miss some of the most destitute. The administration may have access to income tax data if privacy laws allow, but where there is a significant informal economy, tax records miss a large portion of the population, and if the benefit is means tested tax records can be inaccurate about income.

Consequently, the administering organization or department must advertise widely and communicate information about the benefit in a variety of ways. When dealing with a population that has a low level of literacy or many different languages and dialects, the use of printed matter that gives the information in picture form is more useful than standard government information. Announcements via radio or television can be useful. In isolated rural areas, leaders in the local communities can spread information.

Once they learn about the benefit, many people will not have documentation to prove their eligibility. The administration can partner with community workers, and train them on the basic information about the benefit and how to identify potential beneficiaries. For example, in Botswana, lack of birth records led the

government to establish Age Assessment Committees in each district to conduct interviews and collect affidavits from community leaders, peers and relatives of applicants. While there are problems with this method, it is preferable to not attempting to establish eligibility in the absence of records. No approach is foolproof, and the administration should try to find one that is appropriate for the local culture and circumstances and convenient for potential beneficiaries, while still allowing a reasonable level of control against fraud.

Some schemes require people to travel to distribution centres to collect their benefits. If the benefit is small, the distance is far or the beneficiary too destitute or ill to travel, this contributes to lack of coverage. To ensure delivery of benefits, the use of trusted third parties is possible.

Payment of non-contributory benefits to beneficiaries through post offices or the banking system is not feasible where the national infrastructure, especially in rural areas, is limited. In addition, many beneficiaries do not have bank accounts and/or are unfamiliar with banks. In countries such as Botswana, Namibia and South Africa where the rural population is dispersed over wide areas, cash benefits are delivered to rural beneficiaries.

If there is a board, it should learn from the administration what steps it is taking to extend coverage while maintaining the integrity of the scheme. Otherwise, it will fall to the legislature to ask these questions, and legislators should insist that a report on coverage, and what the administration is doing to extend coverage, is included in the scheme's annual report.

### **7.3.3 Fraud**

A financially attractive benefit inevitably leads to benefit fraud. The usual fraud is non-reporting of deaths of beneficiaries of old-age or invalidity pensions. This can distort coverage statistics and can lead to apparent over-coverage, even though there may be many people who are not covered and who should be. While the fraud may be understandable, as the family of the beneficiary has often become dependent on the extra household income, if such frauds are allowed to continue the overpayment of benefits has serious implications for the cost of the scheme. Mauritius has a well-designed universal pension, yet statistics in the past indicated that there were about four thousand more people collecting it than there were elderly people living in the country. The statistics also showed a rather unlikely population over 100 years of age, indicating non-reporting of deaths.

## KEY POINTS

- Good public understanding of the objectives and benefits of non-contributory schemes is essential for their continued operation and success.
- Achieving coverage is more difficult in non-contributory schemes because they are frequently aimed at persons who are the most difficult to reach, and who often have little understanding of government programmes and procedures.
- The administration of the scheme should make it easy for clients to learn about the scheme and apply for and receive benefits.
- The administration must deal with benefit fraud, otherwise it can have a serious affect on the cost of the scheme.

## CHAPTER 8: PLANNING

Planning of social protection should have a long-term perspective and take into account the package of protection provided by all social protection schemes. However, in most areas of public policy, political leaders everywhere tend to think and act with relatively short time horizons. Social protection schemes, in particular social insurance pensions, are ill-suited to short-term policymaking. They require an approach where problems are anticipated and dealt with well in advance of when they will occur. This avoids crises and ensures that the systems are able to meet their obligations to those who count on them.

Social security schemes have a major impact on the well-being of a country's population and the national economy. They affect people in various ways at different times in their lives, and what happens in one scheme often has an effect on others. From the perspective of governance, projecting the status of one social security scheme in isolation, though important, is not enough. Each individual social security scheme which delivers benefits that cover specific risks and needs is part of an overall national social protection system. Individual schemes have their own roles to play and objectives to meet, but as components of the national system they also serve the objectives of an overall national social protection policy.

Individual schemes interact with each other, and these interactions have a major impact on the economy and public finance. It is the design of the social protection system as a whole, with individual schemes playing different roles in the coverage of population groups for different contingencies and needs that determines the ultimate outcomes of the overall national social protection policy. Decisions as to what resources are allocated to different social protection functions and how particular schemes are financed have a major impact not only on the effectiveness of the entire system but also on the financial sustainability of the national system and each of its components. Decisions concerning individual schemes should never be taken without assessing their impact on the system as a whole.

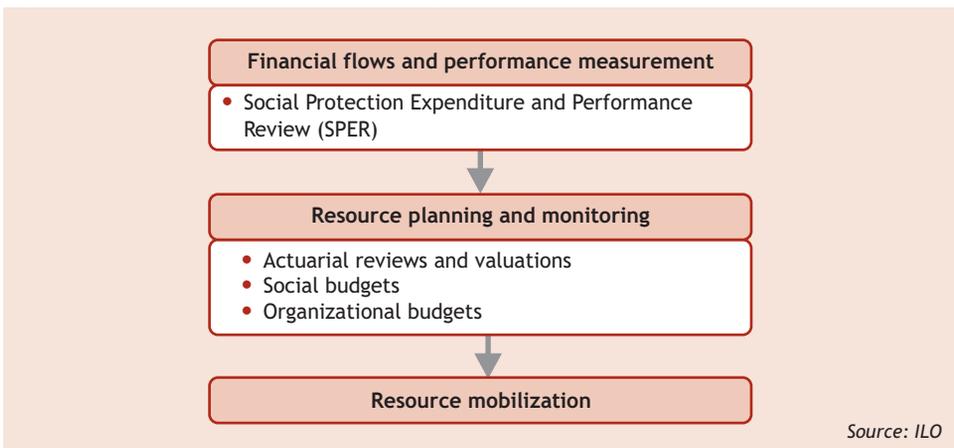
The amount of resources available to finance social protection is limited. The mobilization of resources has to take into account the fiscal system's overall capacity to raise revenue. The total potential amounts of contributions paid by employees, employers or other protected persons, direct taxes levied on income, and indirect taxes levied on consumption is finite. High contribution rates resulting from the expansion of a scheme serving one sector of the population, may significantly limit the possibility of mobilizing resources to finance the social protection coverage of another population group.

The board of each social security organization should press for overall planning of social protection, and ensure that it is involved in policy debates. Board members should be aware of the contents of the national Poverty Reduction Strategy Paper (PRSP). A PRSP describes a country's macroeconomic, structural and social policies and programmes to promote broad-based growth and reduce poverty, as well as external financing needs and major sources of financing. PRSPs are prepared by governments through a participatory process involving civil society and development partners. (See <http://www.imf.org/external/NP/prsp/prsp.asp>.) The board should be in a position to provide constituents and politicians with their viewpoints on the requirements of the national social protection system. If there is a national economic and social council the board should share its perspectives with members of the council.

Are overall national social policy objectives being achieved effectively and efficiently? Are the various schemes operating in a coordinated fashion? What groups are not covered? To what extent does the system succeed in preventing poverty? How well does it help families to cope with social risks? Does it encourage work or discourage it? Does it achieve the desired goals of equity and social justice? These are questions that must be addressed if social protection is to be provided in an optimal way.

The ILO has developed tools to help governments plan social protection policy and strategy: Social Budget Modelling and Social Protection Expenditure and Performance Reviews (SPERs). The models are described in two joint technical publications of the ILO and the ISSA, *Social Budgeting* (2000) and *Financing Social Protection* (2004). They assess the overall financial and fiscal size of the social sector, and project future developments under alternative simulations and policies. The models provide guidance to policies which will assure efficiency, effectiveness and financial transparency and avoid waste of resources, while maintaining the long-term fiscal and economic sustainability of social protection measures.

**Figure 8.1: Tools of social resource management**



## 8.1 SOCIAL BUDGETS

Key planning instruments used to monitor present and likely future performance of a social security system are actuarial valuations and social budgets.

For a specific social security scheme, an actuarial valuation (see Section 5.2) provides:

- projections of how a scheme's income and expenditure will develop under certain assumptions;
- whether, under the current legislation and regulations and selected assumptions, the scheme is in actuarial equilibrium in the medium- to long-term;
- if not, what measures affecting the income or expenditure could produce financial equilibrium; and
- how alternative scheme provisions would affect the actuarial equilibrium.

For the national social protection system, a social budget shows:

- the development of all revenue earmarked for social protection and all social expenditure under certain assumptions in the medium-term future;
- whether measures are needed to maintain the financial equilibrium of the system as a whole; and
- how alternative income and expenditure measures would affect the financial equilibrium.

Social budgets normally contain explicit population, economic and labour market modules as well as explicit modules for all major social transfer systems such as pensions, short-term cash benefits (maternity, sickness, death, employment injury and unemployment benefits), social assistance and medical care. Alternatively the expenditure of individual schemes can be projected by actuarial models based on the same demographic and economic scenarios for all schemes in the national social protection system. The results of projections of the individual schemes are aggregated into an overall national social expenditure and financing account and links are created to the government budget.

Any major change in the benefit provisions of a scheme should be accompanied by an actuarial valuation and social budget analysis. The results of such analyses should be part of the justification accompanying social protection bills submitted to national legislatures. The actuarial valuation will show the impact of the change on a specific scheme, and the social budget will show the financial impact on the social protection system as a whole.

For example, an increase in the retirement age should strengthen the financial equilibrium of a pension scheme. It could allow a reduction in the contribution rate, or extend the equilibrium period during which the present contribution rate can be maintained. But individual social security schemes do not operate in isolation. An

increase in the retirement age could result in increased invalidity benefits and/or increased social assistance payments to support persons who are unable to find employment until the higher retirement age. A social budget uses appropriate assumptions to show the effect of an increase in the retirement age on the entire national social protection system, not just on the pension scheme. Decision-makers should take the overall financial impact of any change into account.

At the national level, a social budget models the entire system of social transfers in a country, and by applying selected assumptions, projects the way it is likely to perform under alternative economic, demographic, social and legislative scenarios. Social budgets can be used for periodical assessments of the present and probable future performance of an existing scheme or to simulate the financial and fiscal effects of new benefits. Simulations of this nature are key instruments in social policy planning. They help to avoid socially, economically, financially and fiscally expensive mistakes in the planning process.

A social budget requires a national social accounting system. A social accounting system reflects one aspect of the national social protection system, the flow of funds. A social accounting system and a social budget are governance tools for planning, monitoring and analysing national social policy decisions. For example, for a specific year, or over a period, they can provide information on:

- the national social protection system's financial flows;
- existing social security organizations' relative size in terms of their expenditures; and
- the structure of social protection expenditures and their financing (e.g. each scheme's share of total resources and the relative weight of different revenue sources).

A national social accounting system should be designed so that it has links to other information systems, in particular the United Nations System of National Accounts (SNA). It should include all mandatory national social revenues and expenditures. Private voluntary social protection provisions are not included. The system should be designed so that comparisons with the accounts of other national systems are possible.

## 8.2 SOCIAL PROTECTION EXPENDITURE AND PERFORMANCE REVIEWS

A social budget does not address questions such as the adequacy of benefit levels, the equity of benefit provisions, the equivalence between individual contributions paid and benefits received or the impact of social expenditures and their financing on the income distribution of individual private households. A Social Protection Expenditure and Performance Review (SPER) investigates these questions, and provides information about the structure and level of total social expenditure. It establishes indicators of performance with respect to the system's population coverage, effectiveness, efficiency and adequacy of benefit levels. Coverage is measured in terms of persons and by the range of contingencies covered. Other aspects of social protection coverage, such as access to health care, are taken into account. A SPER analyzes the distributional impact of public social expenditure.

A SPER assists the government in social policymaking and empowers the social partners to participate in the process. The review provides a broad picture of social protection expenditure trends, the extent of coverage and of exclusion from social protection and the adequacy of benefits. A detailed analysis focuses separately on each national social protection scheme, tracing income and expenditures, the size and characteristics of the population covered, benefit levels, inflation adjustments and administration costs. The box on the following page shows the key findings and the way forward from the Zambia SPER and Social Budget Report.

The scope of a SPER depends on the definition of social protection. ILO SPERs cover risks which cause a worker to be unable to earn a living (e.g. sickness, maternity, disability, old-age, unemployment, death) or meet basic family needs (e.g. housing, education). In many countries not only is coordination of the social protection system deficient, but there is no standardized information on all existing social protection schemes. Scheme based performance indicators require standardized data, and SPERs aim at establishing a framework permitting performance assessment of the social protection system as a whole.

The data and information requirements for a SPER are extensive. A complete list of all social protection programmes must be drawn up. This includes social insurance schemes, non-contributory schemes, other state and local government programmes, mutual and community-based activities, foreign aid (e.g. food), etc. Then for each programme the number of protected persons must be determined, and information on take-up rates obtained. Data on insured persons and beneficiaries (by sex, age, labour market status, type of employment), benefit levels and services delivered and on benefit and other expenditures must be

### **Zambia SPER and Social Budget Report: Key findings and the way forward**

The SPER and Social Budget Report provides a comprehensive picture of existing social protection in Zambia, and looks into the future on the basis of projections for the next twenty years. The Report deals with key issues concerning the objective of extending social protection coverage in Zambia. It identifies issues that require action, and investigates the possible provision of a minimum benefit package aimed at poverty alleviation: universal old-age pension, targeted social assistance and child benefit.

#### **Key Findings**

- Half of Zambia's population is extremely poor and programmes that are targeted to alleviate poverty are under-funded by the Government and highly donor dependent.
- The labour market is highly informalized.
- Zambia is entering a demographic transition in a period of sustained economic growth: the population almost doubles with a large increase in the working-age population.
- Coverage by both non-contributory and contributory schemes is low, and benefits inadequate. There is a lack of overall coordination.
- Zambia is highly dependent on donor funding for health care.
- Zambia's external debt was greatly reduced (2006) but at the same time donor aid was reduced so that very limited fiscal space was created.

#### **Way Forward**

- The Government needs to undertake a detailed public expenditure review with the aim of assessing the basis for, and redistributive impact of all kinds of existing transfers, subsidies and tax privileges in order to identify the fiscal space needed to finance priority social policies.
- The results of the work on informality of employment should feed into policy discussions on the extension of social protection coverage, together with a job creation strategy targeted at youth.
- There is scope to extend coverage by existing contributory and non-contributory schemes.
- A minimum package of universally acceptable benefits would be affordable - targeted social assistance and a universal pension would cost less than one percent of GDP. A universal but limited child benefit scheme (first child only) would have higher start-up costs (1.2 percent of GDP) but reduce over time.
- The next stage of the project needs to address the composition of a comprehensive social protection system and funding mechanisms.

*Source: International Labour Office, 2008; Zambia Social Protection Expenditure and Performance Review and Social Budget; Social Security Department, Geneva.*

obtained for all programmes. Background information which must be collected includes data (generally by age and sex) on the population and labour force, employment by type of employment, unemployment, earnings, etc

The main objectives of Social Protection Expenditure and Performance Reviews are:

- to identify the scope of social protection in terms of risks and needs covered, as well as existing gaps in coverage (risks and needs not covered or insufficiently covered);
- to establish the costs in terms of annual expenditure and the sources of finance (measured as a proportion of GDP and in the case of public expenditure as a proportion of overall government expenditure); and
- to analyse the effectiveness of the social protection system and its schemes in terms of policy objectives (high and equitable coverage, poverty and income inequality reduction, income security, etc).

Generally, the focus is on discovering vulnerable groups that are not covered or whose coverage is not sufficient to alleviate or prevent poverty.

A SPER first identifies the social protection needs of various broad population groups which have common needs for social protection. It then analyses current social protection measures and identifies the extent and quality of the protection provided in order to assess gaps in social protection in terms of persons not covered, unprotected social risks and the adequacy of the protection provided. A coverage matrix summarizes the extent to which different population groups receive social protection against the social risks which have been identified. When assessing the threshold for providing a minimum level of social protection, different definitions of the level of a minimum level are tested.

Scheme-based indicators can be used to assess performance of particular social protection functions and the national social protection system as a whole. They must be aggregated and compared to indicators of social context, status and cohesion. Selected indicators of effectiveness, coverage and the efficiency of financing and the allocation of expenditures are described in the following paragraphs.

### ***Effectiveness indicators***

It is difficult to identify the impact of the social protection system on different social indicators, since the indicators are affected by many other factors. Any analysis of the social protection system should begin with a detailed description of its overall context: the demographic situation and trends (age and sex distribution of the population, demographic dependency ratios, etc.), economic characteristics (economic growth, inflation, primary distribution of income, etc.) and the state of the labour market (employment, unemployment, transfer dependency ratio).

Demographic dependency ratios and transfer dependency ratios (the ratio of the number of people without any personal sources of primary income - children, unemployed, disabled and other non-active persons of working age and over the working age - to the number of primary income earners) are the main indicators showing the demand for public transfers and private transfers within and between families. If these ratios and the age structure of a population reveal, for example, a predominance of dependants below the working age and only a small proportion of elderly people, then if the only form of social protection is an old-age pension scheme, something may be wrong with the national social protection policy.

**Performance with respect to social outcomes** includes poverty rates, income inequality, health status, nutrition and social cohesion. Time-series analyses or comparison with other countries' experience can be used to estimate a social protection system's impact on social outcomes.

**Distributional performance** involves analysis of the coverage provided for the most vulnerable groups of society. This includes analysis of the horizontal distribution of coverage and benefits (gender distribution, formal/informal sector distribution and distribution among other vulnerable groups), the portion of cash benefits actually distributed to these groups and an assessment of their access to social protection and other basic social services. It also includes analysis of the vertical distribution of coverage and benefits to assess the effectiveness of the system in reaching the poor and closing the poverty gap.

**Administrative performance** is measured by the ratio of administrative costs to total expenditure. This ratio is determined for individual schemes, organizations and the social protection system as a whole. Other measures include the compliance rate, arrears and the time taken to process benefit claims accurately and to make the correct benefit payments.

### ***Coverage indicators***

Coverage has three dimensions which must be measured: scope, extent and level.

The **scope of coverage** is the range of contingencies and needs covered by existing schemes (e.g. old-age, survivorship, disability, sickness, maternity, health care, unemployment, family, poverty).

The **extent of coverage** is the percentage of persons covered in a specific population group (defined by sex, age, labour market status, etc.), or the percentage of persons protected (insured persons and their dependants) within the total population. The take-up (access) rates, which measure the proportion of persons subject to a given contingency and entitled to benefits who actually received benefits or used services are also measured.

The **level of coverage (depth/quality)** is the level of protection provided, for example, legal replacement rates; actual benefit levels relative to average earnings or average income; patients' co-payments as a percentage of total health expenditure (or private health expenditure as a percentage of total health expenditure); and shares of income from different social transfers in cash and in kind in total household income.

The social expenditure ratio (SER) – the ratio of total social protection expenditure to GDP – depends on coverage, and is an aggregate indicator of coverage. Another aggregate indicator of coverage is the proportion of income from social protection transfers (in cash and in kind) in total household income. Data for this indicator are normally available from the national accounts and/or from household budget surveys.

### ***Indicators of efficiency of financing and the allocation of expenditures***

The objective is to measure the efficiency of the financing arrangements and the allocation of overall expenditure among different social risks and needs. Transactions financing social protection schemes are grouped by type and source of revenue. Efficiency is analysed by comparing the social protection system's outcomes to its overall costs.

Expenditure (both overall and by function) can be analysed as a social expenditure ratio (SER) or as a ratio to consolidated general government revenue. In many developing countries, the SER is low, but the ratio to total public revenue collected through all forms of tax and social contributions is comparable to that in developed countries, due principally to the small size of the government in terms of the revenue collected. While the SER indicates the coverage of a social protection system, it does not reflect the level of effective social protection, nor does it indicate how efficiently social protection is provided. Benchmarks based on the experience of other countries can be used to compare social protection expenditure and poverty rates, income inequality, health status and other factors.

There is no generally accepted aggregate indicator of the level and efficiency of national social protection. A global indicator would take into account the scope of formal social protection (social security branches, social assistance and possibly education and housing); social protection coverage; the level (depth/quality) of coverage; social protection expenditure and the SER; the effectiveness of social protection; and the efficiency of social protection. Such an indicator of the level of social protection and the efficiency of provision would have a potentially powerful political impact, for example, if a country discovers that its social protection indicator is lower than that of a much poorer country, or that its level of protection is achieved by a much higher allocation of resources.

## 8.3 PRACTICAL CONSIDERATIONS

The history of social security is filled with examples of deficient system performance. Poor performance is usually the result of poor governance, in particular poor financial governance. Sound governance may be even more important than a flawless initial design of a scheme, since the need for corrections can be demonstrated through performance monitoring measures and design faults can be remedied by subsequent modifications of the law.

Legal and managerial instruments are necessary for sound social protection governance. Legal instruments define the objectives of national systems and schemes, and the monitoring, auditing and actuarial requirements, while managerial instruments set out how performance is to be monitored. Performance monitoring requires reliable statistical and accounting information, clear and verifiable objectives and a set of performance indicators and benchmarks. Without clear and quantifiable outcome indicators it is not possible to measure the performance of a social protection system and thereby justify the system.

The following table sets out the quantitative governance instruments available to monitor social security schemes and the national social protection system.

<b>Hierarchy of quantitative governance instruments</b>		
<b>Main purpose of instrument</b>	<b>Scheme level</b>	<b>National level</b>
Descriptive (statistics, accounts, reports)	Scheme statistics Scheme accounts Annual reports/reviews	National social protection statistics National social accounting system National social protection reports
Evaluation and planning (budgets, projections, simulations, resource mobilization)	Actuarial valuations	Social Budgets
Performance measurement, monitoring and analysis	Scheme based performance indicators	Social Protection Expenditure and Performance Reviews (SPERs)

Source: *Financing Social Protection*, ILO.

Gathering support to deal with potential social security scheme problems before they occur is difficult. This difficult situation has been faced by many social security boards. If the extent of the problems is quantified through actuarial valuations, social budgets and SPERs, and the cost of inaction is made clear, resistance of persons who oppose the necessary solution(s) can be reduced. It is a challenge for board members to rise to the occasion and advocate measures for the long-term good of a scheme, even though the measures may be unpopular among some individuals or groups.

## KEY POINTS

- Social security schemes have a major impact on the well-being of a country's population and its economy. Social security is typically provided by a number of national schemes delivering benefits to cover different risks and needs. Planning of social protection should have a long-term perspective and take into account the package of social protection provided by all schemes.
- Responsibility for planning of the national social protection system rests with the government. The board of a social security organization should support the planning process and contribute to it.
- Board members should ask questions about the scheme they are governing and the national social protection system of which it is a part, for example:
  - ➔ Does the legal system define:
    - Who is covered?
    - Who contributes?
    - Who provides what benefits?
    - Who supervises the functioning of:
      - the system as a whole?
      - the individual schemes?
  - ➔ Is there a regulatory system which provides for regular performance checks?
  - ➔ Do all schemes have comprehensive and mandatory statistical and accounting frameworks?
  - ➔ Does a system of national statistics and accounting which captures the full picture of the country's social situation exist?
  - ➔ Is there a system of scheme-based performance indicators?
  - ➔ Are actuarial valuations and Social Budget simulations carried out periodically? Are the resulting recommendations taken into account?
  - ➔ Has a Social Protection Expenditure and Performance Review been undertaken? Have the results been taken into account in planning social protection policy?
- While social security planning requires a long-term perspective, political leaders everywhere tend to operate with relatively short time horizons. Gathering political support to deal with potential social security problems is difficult. These are challenges which board members must face.



# GLOSSARY

<b>Active insured person (contributor)</b>	A person on whose behalf at least one contribution payment has been made to a social security scheme during a period, usually a year.
<b>Actuarial balance</b>	The present value of future income less future expenditure of a scheme over a projection period.
<b>Actuarial equilibrium</b>	The minimum level of funding in a social security scheme to be maintained over a defined period. The actuarial equilibrium is a discretionary concept. It is often stated in the form of a provision in the social security law that the scheme must maintain a level of funding of $k$ times annual expenditure (the reserve ratio) for a specified number of years $x$ (the period of equilibrium).
<b>Actuarial liability</b>	The present value at a given time of benefit entitlements accumulated under a scheme by insured persons and beneficiaries.
<b>Annuity</b>	A financial arrangement to provide an income for a specified number of years or for the remaining lifetime of an individual or an individual's survivors out of a lump sum.
<b>Asset price bubble</b>	A situation where the level of a market index is too high in comparison to the value of the companies included in the index as derived by other valuation methods. An asset price bubble is usually the result of speculation and ends with the implosion of the bubble.
<b>Basic Income (BI) or citizen's income</b>	A transfer income paid by the State to all residents or citizens, independent of need. BI is often seen as a substitute for social assistance or unemployment benefits.

<b>Beneficiary ratio</b>	The number of benefit recipients of a social security scheme at a given time divided by the number of contributors (or insured persons).
<b>Benefit replacement rate</b>	The amount of an individual's monthly or annual benefit divided by the amount of the individual's previous monthly or annual income subject to contributions, or the average benefit amount in a given year divided by the average income subject to contributions in the same year.
<b>Bond</b>	A debt instrument issued by borrowers (government, companies) promising to the holder periodic fixed interest payments and repayment of the face value at a maturity date.
<b>Capital market</b>	The market for financial claims, generally with a long-term time horizon.
<b>Capital stock</b>	The stock of all produced and non-produced assets in an economy. Along with labour, one of the two standard production factors.
<b>Catchment ratio</b>	The total amount of earnings subject to the payment of contributions divided by the total amount of earnings received by insured persons. The ratio equals one when all earnings are subject to contribution payment. It is less than one when there is a ceiling on insurable earnings or there are other exemptions from contribution payment.
<b>Claw-back ratio</b>	The proportion of a benefit that returns to the public budget through taxation of the benefit.
<b>Cohort</b>	A group of individuals with (a set of) identical characteristics, for example, all males born in the same year.
<b>Compliance rate</b>	The number of persons on whose behalf contributions are actually paid to a scheme divided by the number of persons who are legally obliged to contribute to the scheme.

<b>Contribution ceiling</b>	The maximum amount of individual wages that is subject to contributions to a scheme. The ceiling usually is the maximum amount of earnings on which benefits are calculated.
<b>Contribution rate</b>	The percentage of the covered insurable earnings that is to be collected by a scheme.
<b>Cost rate (PAYG cost rate)</b>	The total expenditure of a scheme divided by total insurable earnings in a period.
<b>Coverage rate</b>	The total number of registered insured persons (persons with an insurance record but not necessarily active) divided by a reference population, for example, the labour force.
<b>Defined benefit (DB) scheme</b>	A pension scheme with a benefit formula for calculating benefit amounts, such as a flat amount per year of service or a percentage of earnings or a percentage of earnings times years of service.
<b>Defined contribution (DC) scheme (Mandatory savings scheme)</b>	A pension scheme where contributions are paid to an individual account for each scheme member. The benefit depends on the account balance at the date the benefit is payable, i.e. on the amounts contributed, the interest earned and accumulated in the account as well as the administrative expenses incurred.
<b>Demographic ratio</b>	The dependent population divided by the active population. It can be subdivided into youth and old-age dependency ratios.
<b>Density of contributions</b>	The number of contributions actually paid during a period divided by the maximum potential number of contributions that could be paid during the period.
<b>Economically active population</b>	A collective term comprising all persons who furnish the supply of labour for the production of goods and services as defined by the United Nations System of National Accounts (SNA).

<b>Economic growth</b>	The change over time of the income produced by an economy; usually based on the growth of 'real' GDP, i.e. nominal GDP in constant prices of a base year.
<b>Eligibility conditions</b>	The set of legally defined conditions which stipulate if and when a person has the right to a benefit.
<b>Employed persons</b>	All persons above a specified age who, during a reference period, were: in paid employment; at work (persons who during the reference period performed some work for wage or salary, in cash or in kind); or with a job but not at work (persons who, having already worked in their present job, were temporarily not at work during the reference period but had a formal attachment to their job).
<b>Equities</b>	Shares in a business; a synonym for common stock of a publicly traded company.
<b>Financial assets</b>	Instruments traded on financial markets (e.g. equities, bonds and other debt instruments, options, futures).
<b>Financial equilibrium</b>	A scheme is in financial equilibrium at a given time if the present value of all future expenditure is equal to the present value of all future income of the scheme plus the initial reserve.
<b>Financial solidarity</b>	The principle that contributions or taxes for the financing of social benefits are charged on the basis of members' ability to pay, regardless of their risks or circumstances (e.g. health impairments or having eligible dependants). In social insurance schemes this principle is generally embodied by uniform contribution rates charged as a fixed percentage of an individual's insurable earnings. In the case of tax-financed benefits, the principle applies if income tax rates are progressive.

- Financial system** The arrangement for providing the resources necessary to meet the obligations of a social security scheme. A financial system is a set of legal provisions which ensure that the expected amount of a scheme's expenditures is always matched by equal and available financial resources, in other words, that the scheme is in financial equilibrium.
- Formal sector** The economic sector where workers' socio-economic activities are regulated and protected by formal societal institutions.
- Full funding** Financial system under which the reserves of a pension scheme are equal to the scheme's actuarial liability.
- Funding ratio** The reserves divided by the liability of a pension scheme.
- General average premium (GAP)** A constant contribution rate applicable indefinitely, which theoretically guarantees that a scheme's expenditure can always be covered by the contributions collected, investment income and funds accumulated in the reserve. It is equal to the present value of all future benefits less the reserve at the valuation date divided by the present value of all future insurable earnings.
- Governance** All consultative and decision-making processes, institutional arrangements and managerial and administrative actions whereby social protection policies are designed, agreed, implemented and supervised. The definition encompasses the first blueprints for a social protection system in government or other institutions, and then the consultation process, the legal enactment, the managerial and administrative implementation and national and lower-level supervision of social protection schemes.
- Grandfather clause** A provision exempting persons or other entities engaged in an activity from new rules or legislation affecting the activity, or granting special privileges when including such groups in new legislative provisions, for example, special credits (fictitious insurance years) granted to

older workers when a new benefit system is introduced in order to help them fulfil the benefit qualification conditions.

- Gross domestic product (GDP)** The aggregate measure of the production of goods and services in a country. Broadly, the amount of gross income available for distribution to the production factors labour and capital, which, after taxation, constitutes the basis for redistributive state interventions.
- Inactive insured person** A person who is registered in a scheme but has made no contributions during a given period.
- Informal sector** The economic sector where workers' socio-economic activities are not regulated or protected by formal societal institutions.
- Insurable earnings** The wages and salaries received for services rendered to an employer which are subject to the payment of social security contributions.
- Insurance credits** The number of contributions or periods of service that have been paid or credited to an insured person since his/her entry into a social security scheme.
- Insured person** A person who is registered under a social security scheme.
- Intergenerational equity** Refers to a 'fair' distribution of 'burdens' between generations, for example, members of successive generations should pay the same share of their disposable incomes during their active lives in order to earn benefit entitlements with equal replacement rates.
- Labour** The number of members of the labour force or the volume of hours worked. Along with capital stock, one of the two standard production factors.
- Labour force** See Economically active population.
- Liquidity ratio** Scheme income divided by expenditure.

<b>Maturity</b>	<p>The state reached by a social protection scheme when there is:</p> <ul style="list-style-type: none"> <li>demographic maturity - stable or almost stable ratios of the number of persons covered divided by the total active population and of the number of persons receiving benefits divided by the total inactive population;</li> <li>benefit maturity - a relatively stable ratio of the average amount of benefits divided by the average earnings subject to contributions. This can occur when all pensioners have contributed for a full career.</li> </ul>
<b>Moral hazard</b>	<p>An insurance risk that a person protected against a risk may behave differently from the way he/she would behave if he/she were fully exposed to the risk.</p>
<b>New entrant</b>	<p>A person who registers for the first time with a scheme as an insured person.</p>
<b>Notional defined contribution scheme (NDC)</b>	<p>A pay-as-you-go pension scheme where each member has an individual account in which benefit rights are accumulated in a similar manner to that in a funded defined contribution scheme. Contributions are credited to a member's account, but no funds are deposited in the account. The notional account balance is periodically revalued, just as a funded account is credited with interest. At retirement, the amount in the individual account is converted into periodic payments.</p>
<b>Old-age dependency ratio</b>	<p>See Demographic ratio.</p>
<b>Partial funding</b>	<p>Any system for financing pensions which accumulates lower reserves than a full funding system.</p>
<b>Pay-as-you-go (PAYG) rate</b>	<p>The total annual expenditure of a scheme divided by total insurable earnings. The PAYG rate is the annual contribution rate if a scheme is financed on an unfunded pure annual assessment (PAYG) system where no reserve is accumulated.</p>

<b>Performance indicators</b>	Quantitative measures of the administration, benefit delivery or financial performance of a social transfer scheme, either in absolute terms or in comparison to defined benchmarks.
<b>Period of equilibrium</b>	A period during which the contribution rate remains constant in a partially funded financial system.
<b>Poverty gap</b>	A measure of the 'depth' or 'intensity' of poverty, defined to be the average difference between the income of poor people and the poverty line. The aggregate poverty gap is the sum of all these differences. The relative aggregate poverty gap is the aggregate poverty gap divided by the GDP.
<b>Poverty line</b>	The level of income defining the borderline between the 'poor and 'non-poor' in a society. If a person or household has less than this amount to spend, the person or household is defined as being poor.
<b>Poverty rate (Poverty headcount index)</b>	The proportion of people in a group or a population with income under the poverty line.
<b>Present value</b>	The value at a given time of a future payment or series of future payments.
<b>Price index (Consumer price index, Cost of living index)</b>	A measure of the cost of a fixed basket of goods and services compared to the cost in a base year.
<b>Productivity</b>	The output produced per unit of factor input. Economic theory distinguishes between labour productivity, capital productivity and total factor productivity. A simple approach widely used for measuring labour productivity on a macroeconomic level is dividing real GDP by the total number of employed persons.
<b>Provident fund</b>	A fully funded, defined contribution scheme which is managed by a public institution.
<b>Public pension scheme</b>	Pension scheme administered by a public institution.

<b>Re-entrant</b>	A person resuming payment of contributions to a scheme after a break.
<b>Reference earnings</b>	The earnings used in the formula to calculate a benefit.
<b>Replacement rate</b>	The amount of an average (or individual) benefit in a period divided by the average (or individual) amount of insurable earnings in the same or another period. The replacement rate is calculated gross or net of taxation.
<b>Reserve</b>	The net result of the accumulation of contributions, investment and other income, less benefit payments, administrative expenses and other expenditures.
<b>Reserve ratio</b>	The reserve at a given time divided by the expenditures of a pension scheme during a period (usually the previous year).
<b>Salary scale</b>	A table showing the evolution over a career of member's salary by sex and age.
<b>Savings rate</b>	The share of disposable income not spent on consumption.
<b>Scaled premium system</b>	A partially funded financial system for pensions under which contribution rates are increased periodically on a 'step-by-step' basis (where the duration of a step is called the period of equilibrium). In practice the contribution rate is calculated for a defined period of years, often ranging from ten to 25, so that in the final year of the period of equilibrium the income from contributions and investments is equal to expenditures on benefits and administration.
<b>Social accounting system (SAS)</b>	A methodologically consistent compilation of the revenues and expenditures of a country's social protection system.
<b>Social budget</b>	A social budget is a social account encompassing social protection expenditure and income earmarked to cover social expenditures of the State and social security institutions, and to a lesser extent the private sector.

<b>Social expenditure</b>	Transfers paid by State or public organizations, or agreed through collective bargaining. Transfers include cash benefits such as pensions, employment injury benefits, short-term cash benefits (sickness, maternity and unemployment benefits) and benefits in kind such as health services and basic social assistance. Tax exemptions for social reasons are usually considered part of social expenditure.
<b>Social expenditure ratio (SER)</b>	Total social expenditure in a country as a proportion of GDP.
<b>Socially responsible investment (SRI)</b>	Investments where social, environmental and/or ethical considerations are taken into account in the selection, retention and sale of investments, and the responsible use of rights (such as voting rights) attaching to investments.
<b>Social Protection Expenditure and Performance Review (SPER)</b>	A report providing detailed analysis of the performance of a national social protection system, and the extent of coverage and exclusion from social protection. A SPER provides information about the structure and level of total social expenditure and establishes indicators of system performance with respect to effectiveness, efficiency and the adequacy of benefit levels.
<b>Social security</b>	All cash and in kind social transfers that are organized by the State or statutory bodies or are agreed to through collective bargaining. Benefits include cash transfers such as pensions, employment injury benefits, short-term cash benefits (sickness, maternity and unemployment benefits) as well as benefits in kind such as health care.
<b>System dependency ratio</b>	The number of beneficiaries divided by the number of contributors. In pension schemes this ratio can be quite different from the population old-age dependency ratio.
<b>Take-up ratio</b>	The number of persons receiving benefits divided by the number of persons who are legally entitled to them.

- Terminal funding** The financial system whereby at the time pension payments begin, an amount equal to the present value of all future pension payments is set aside in a reserve to finance them.
- Time horizon** Starting from the base period, the maximum time during which the results of a projection can be meaningfully interpreted. The time horizon varies according to the type of scheme and/or the national economy.
- Trickle-down effect** The indirect income effect of social transfers when individuals other than the recipient of a transfer benefit from it, for example, if grandparents receiving a pension finance the schooling of their grandchildren.
- Unemployed persons** All persons above a certain age who, during a reference period, were:  
without work (not in paid employment or self-employment);  
currently available for work (available for paid employment or self-employment); or  
seeking work (had taken specific steps to seek paid employment or self-employment).
- Unfunded liability** Actuarial liability less the amount of the reserve.
- Unit cost** The cost of a unit of service or a good in a given category of services, for example, the cost of one 'hospital day' per patient.
- Utilization frequency** The number of cases of treatment or units of care per protected person in a given category of social services.
- Universal benefits** Tax-financed benefits or transfers that are available to all citizens or residents falling in a specific category of the population, for example, people over a certain age or families with children).



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## APPENDIX A:

# Composition of social security boards in selected African countries

### COUNTRY/INSTITUTION COMPOSITION OF GOVERNING BODIES OF SOCIAL SECURITY SCHEMES

(multiple representation is noted in parentheses)

#### BURUNDI

##### National Social Security Institute

Institut national de sécurité sociale (INSS)

**Board** – 12 members

Chairperson, nominated by the President

Ministry of Public Services, Labour and Social Legislation

Ministry of Finance

Ministry of National Defence and Veterans

National Police

Trade unions (3)

Employers' organizations (3)

Managing Director

■ supervised by Ministry of the Public Service, Labour and Social Security

#### CAMEROON

##### National Social Insurance Fund

Caisse nationale de prévoyance sociale(CNPS)

<http://www.cnps.cm>

**Board** – 15 members

Chairperson, nominated by the President

Government (4)

Trade unions (4)

Employers' organizations (4)

Civil society (2)

Managing Director

■ supervised jointly by Ministry of Labour and Social Security and the Ministry of Finance

COUNTRY/INSTITUTION	COMPOSITION OF GOVERNING BODIES OF SOCIAL SECURITY SCHEMES (multiple representation is noted in parentheses)
<p><b>GHANA</b></p> <p><b>Social Security and National Insurance Trust (SSNIT)</b>  <a href="http://www.ssnit.com">http://www.ssnit.com</a>            Social Security Law, 1991 (PNDCL 247)</p>	<p><b>Board</b> – 14 members            Chairman nominated by Government            Members nominated by Government (3)            Ministry of Manpower Development &amp; Employment            Ministry of Finance &amp; Economic Planning            Bank of Ghana            Nominated by Ghana Employers' Association (2)            Nominated by Trades Union Congress (2)            Civil Servants Association            Ghana National Association of Teachers            Director General, SSNIT (appointed by the Government)</p>
<p><b>GUINEA</b></p> <p><b>National Social Security Fund</b>            Caisse nationale de sécurité sociale (CNSS)  <a href="http://www.cnss.org.gn">http://www.cnss.org.gn</a></p>	<p><b>Board</b> – 10 members appointed by the Ministry of Social Affairs and the Promotion of Women and Children            Ministry of Social Affairs and the Promotion of Women and Children (2)            Workers' representatives (3)            Employers' representatives (3)            Ministry of Finance            Ministry of Health</p>
<p><b>LESOTHO</b></p>	<p>N/A</p>

COUNTRY/INSTITUTION	COMPOSITION OF GOVERNING BODIES OF SOCIAL SECURITY SCHEMES
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(multiple representation is noted in parentheses)

### MAURITIUS

#### National Pensions Scheme

<http://www.gov.mu/portal/site/ssnssite>

**Board** – 18 members

Chairperson, appointed by the Minister of Social Security, National Solidarity & Senior Citizens Welfare and Reform Institutions

Ministry of Social Security

Ministry of Finance (2)

Ministry of Health and Quality of Life

Ministry of Labour and Employment

Sugar industry employers (2)

Non-sugar industry employers (2)

Sugar-industry workers (2)

Non-sugar industry workers (2)

Commissioner of Social Security + three officials (ex-officio members)

### MADAGASCAR

#### National Social Insurance Fund

Caisse nationale de prévoyance sociale (CNaPS)

<http://www.cnaps.mg>

**Board** – 20 members

Chairperson, nominated by the President from representatives of workers, employers and government

Ministry of Public Services, Labour and Social Legislation (2)

Ministry of Finance and Budget (2)

Trade unions (8)

Employers' organizations (8)

■ supervised jointly by the Ministry of the Public Service, Labour and Social Security and the Ministry of Finance and Budget.

### MOZAMBIQUE

#### National Social Security Institute

Instituto Nacional de Segurança Social (INSS)

**Board** – 7 members

Chairperson, nominated by the President

Ministry of Labour

Ministry of Finance

Workers' representatives (2)

Employers' organizations (2)

■ supervised by the Ministry of Labour

COUNTRY/INSTITUTION	COMPOSITION OF GOVERNING BODIES OF SOCIAL SECURITY SCHEMES (multiple representation is noted in parentheses)
<p><b>NAMIBIA</b></p> <p><b>Social Security Commission</b>  <a href="http://www.ssc.org.na/">http://www.ssc.org.na/</a></p>	<p><b>Board</b></p> <p>Chairperson, nominated by the Minister of Labour and Social Welfare</p> <p>Ministry of Labour and Social Welfare</p> <p>Ministry of Finance</p> <p>Ministry of Health</p> <p>Trade unions (3)</p> <p>Employers' organizations (3)</p>
<p><b>NIGERIA</b></p> <p><b>Nigeria Social Insurance Trust Fund (NSTIF)</b>  <a href="http://www.nsitf.net">http://www.nsitf.net</a></p>	<p><b>Board</b> – 11 members</p> <p>Chairperson, nominated by the President</p> <p>Executive Directors (3)</p> <p>Ministry of Labour</p> <p>Central Bank</p> <p>Trade unions (2)</p> <p>Employers' organizations (2)</p> <p>Managing Director</p>
<p><b>RWANDA</b></p> <p><b>Social Security Fund of Rwanda</b>                      Caisse sociale du Rwanda  <a href="http://www.csr.gov.rw">http://www.csr.gov.rw</a></p>	<p><b>Board</b> – 7 members; all appointed by the Council of Ministers which also designates the Chairperson</p> <p>Ministry of Labour</p> <p>Government (2)</p> <p>Workers' representatives (2)</p> <p>Employers' representatives (2)</p> <p>■ supervised by the Ministry of Finance and Economic Planning</p>

COUNTRY/INSTITUTION	COMPOSITION OF GOVERNING BODIES OF SOCIAL SECURITY SCHEMES
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(multiple representation is noted in parentheses)

## SENEGAL

### Social Security Fund

Caisse de sécurité sociale (CSS)

<http://www.secusociale.sn>

<http://www.fonctionpublique.gouv.sn/>

**Board** – 6 members

**Governing body** – 22 members

Chairperson, elected by the General Assembly

**General Assembly** – 32 members

Government (6)

Workers' representatives (16)

Employers' representatives (10)

■ supervised by the Ministry of Public Services, Employment, Labour and Professional Organizations

### Social Insurance Institute for Old-age Pensions in Senegal

Institution de prévoyance retraite du Sénégal (IPRES)

<http://www.ipres.sn>

**Board** – 8 members

**Governing body** – 22 members

Chairperson, nominated by the General Assembly

**General Assembly** – 32 members

Government (4)

Workers' representatives (16)

Employers' representatives (12)

■ supervised by the Ministry of Public Services, Employment, Labour and Professional Organizations

**COUNTRY/INSTITUTION      COMPOSITION OF GOVERNING BODIES OF SOCIAL SECURITY SCHEMES**

(multiple representation is noted in parentheses)

**SIERRA LEONE**

**National Social Security and Insurance Trust (NASSIT)**

<http://www.nassitsl.org>

National Social Security and Insurance Trust Act, 2001 - Section 8(2)

- Board of Trustees – 15 members
- Chairman appointed by the President
- Ministry of Labour and Social Security
- Ministry of Finance
- Ministry of Social Welfare, Gender & Children's Affairs
- Bank of Sierra Leone
- Uniformed services association
- Employers Federation (2)
- Sierra Leone Insurance Association
- Sierra Leone Labour Congress (2)
- National Union of Civil Servants
- Sierra Leone Teachers Union
- Social Security Pensioners Association
- Director General, NASSIT

COUNTRY/INSTITUTION	COMPOSITION OF GOVERNING BODIES OF SOCIAL SECURITY SCHEMES
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(multiple representation is noted in parentheses)

### TANZANIA

#### National Social Security Fund (NSSF)

<http://www.nssf.or.tz>

National Social Security Fund Act, 1997

#### Board

Chairman, appointed by the President

Government (3)

Association of Tanzania Employers (3)

Tanzania Federation of Trade Unions (3)

Permanent Secretary of the Ministry responsible for social security (ex-officio)

#### National Health Insurance Fund (NHIF)

<http://www.nhif.or.tz>

National Health Insurance Fund Act, No. 8 of 1999

**Board** – 9 members appointed by the Minister for Health

Chairman

Ministry of Health (2)

Ministry of Finance

Attorney General's Chambers

Association of Private Hospitals

Tanzania Union of Government and Health Employees

Members with expertise in Business or Insurance (2)

Director General, NHIF

#### Public Service Pension Fund

<http://www.pspf-tz.org>

#### Board

Chairman - Permanent Secretary of the Treasury

Permanent Secretary of the Civil Service

Attorney General

Governor of the Bank of Tanzania

Secretary General of Tanzania Union of Government and Health Employees (TUGHE)

Treasury Registrar

Members appointed by the Minister of Finance (3), 2 (at least one woman) from TUGHE and 1 from the Civil Service

COUNTRY/INSTITUTION	COMPOSITION OF GOVERNING BODIES OF SOCIAL SECURITY SCHEMES
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(multiple representation is noted in parentheses)

### ZAMBIA

<p><b>National Pension Scheme Authority (NAPSA)</b>  <a href="http://www.napsa.co.zm">http://www.napsa.co.zm</a>            National Pension Scheme Act, No. 40 of 1996</p>	<p><b>Board of Trustees</b> – 10 members appointed by the Minister of Labour and Social Security            Minister of Labour and Social Security (Chairperson)            Ministry of Finance            Ministry of Labour and Social Security            Bank of Zambia            Employees' associations (2)            Employers' associations (2)            Bankers Association of Zambia            Pension Managers Association            NAPSA Director General (non-voting)</p>
<p><b>Workers' Compensation Fund Control Board</b>  <a href="http://www.workers.com.zm">http://www.workers.com.zm</a>            Workers' Compensation Act, No. 10 of 1999</p>	<p><b>Board</b> – 11 members appointed by the responsible Minister            Chairperson            Government (3)            Employers' associations (3)            Workers' associations (3)            Pensioners' association</p>

### SWAZILAND

<p><b>Public Service Pensions Fund</b>  <a href="http://www.pspf.co.sz">http://www.pspf.co.sz</a></p>	<p><b>Board</b>            Chairman            Employee representatives (4)            Employer representatives (4)            Independent experts (4)            Chief executive officer (ex officio)</p>
<p><b>National Provident Fund (SNPF)</b>  <a href="http://www.snpf.co.sz">www.snpf.co.sz</a>            King's Order-in-Council No. 23, 1974</p>	<p><b>Board</b> – 12 members            Government (3)            Employee representatives (3)            Employer representatives (3)            Swaziland National Council (2)            Chief executive officer (ex officio)</p>

## APPENDIX B:

# ILO SOCIAL SECURITY INSTRUMENTS

The ILO defines social security to be:

‘...the protection which society provides for its members, through a series of public measures, against the economic and social distress that otherwise would be caused by the stoppage or substantial reduction of earnings resulting from sickness, maternity, employment injury, unemployment, invalidity, old age and death; the provision of medical care; and the provision of subsidies for families with children.’

(ILO. 1984. *Introduction to Social Security*)

The adoption in 1952 of the Social Security (Minimum Standards) Convention (No. 102) was a landmark in the development of international social security legislation. It was based on the concepts of universal and comprehensive coverage, unification of social security schemes and guaranteed income security and medical care for the entire population. The objective is a basic level of social security that should be attained everywhere in the world, whatever the degree of economic development.

The Convention defines nine branches of social security that cover the contingencies which prevent workers from providing for themselves and their dependants or create additional expenses: the need for medical care, sickness, unemployment, old-age, employment injury, child maintenance, maternity, invalidity and death of the breadwinner.

Convention 102 requires that a specified percentage of the population be protected. A ratifying State is thus free to develop the scope of its system by extending coverage successively. Nor is a ratifying State obliged to accept all parts of the Convention; it can confine its ratification to just three of the nine branches of social security, provided they include at least one of unemployment, employment injury, old-age, invalidity or survivors’ benefit. The Convention provides for temporary exceptions for countries ‘whose economy and medical facilities are insufficiently developed’.

Convention 102 allows a variety of public social security administrative structures and financing, provided certain core requirements are met, including:

- cash benefits should be periodic payments provided throughout the contingency,

- a benefit should replace previous income to a specified extent,
- the cost of the benefits and administration should be borne collectively by insurance contributions or taxation,
- insured persons' contributions should not exceed 50 per cent of the total contributions payable,
- the State should assume general responsibility for the provision of benefits and proper administration and
- representatives of insured persons should participate in the management of a scheme (if only in a consultative capacity) in all cases where the administration is not entrusted to an institution regulated by the public authorities or to a government department.

In the following decades, Convention No. 102 was supplemented by a number of Conventions setting higher standards for the social security branches in order to offer better protection, and Recommendations that generally advocated stricter requirements.

- Equality of Treatment (Social Security) Convention, 1962 (No. 118)
- Employment Injury Benefits Convention, 1964 (No. 121)
- Invalidity, Old Age and Survivors' Benefits Convention, 1967 (No. 128)
- Medical Care and Sickness Benefits Convention, 1969 (No. 130)
- Maintenance of Social Security Rights Convention, 1982 (No. 157)
- Employment Promotion and Protection against Unemployment Convention, 1988 (No. 168)
- The Maternity Protection Convention, 2000, (No. 183)

The texts of these Conventions and Convention 102 are available at:  
<http://www.ilo.org/public/english/protection/secsoc/areas/legal/standard.htm>.

ILO Conventions have had a major influence on the development of social security throughout the world; indeed they are often regarded as containing an internationally accepted concept of social security. Social security schemes comprising all the branches covered by Convention No. 102 are now found in virtually all industrialized countries. Following independence, most developing countries implemented social security schemes which are generally more limited in scope.

ILO Conventions on social security have developed in line with commonly accepted principles concerning social security. They have become more flexible as regards the methods of protection, but they still contain core provisions such as those noted above which are considered essential in any social security scheme. These basic requirements are designed to ensure minimum coverage, levels of benefits and guarantees by the State. While the Conventions allow for a wide variety of methods for calculating benefits, they do not accept methods

which are unable to ensure that persons protected by a scheme receive adequate health care in the event of sickness, and an adequate replacement income in the event of loss of earnings due to specified contingencies. Accordingly, unless there is risk pooling, thus ensuring solidarity between those affected by a contingency and those not affected, the aims of the Conventions cannot be fully achieved. In particular, schemes providing for lump-sum benefits in the event of old-age, invalidity or survivorship do not meet the requirements of the Convention.

### **Social security: A new consensus**

In June 2001 the International Labour Conference held a general discussion on social security. The conclusions of the Committee on Social Security were presented in a resolution which was adopted by the Conference. The resolution set out several principles which are summarized below.

- Social security is very important for the well-being of workers, their families and the entire community. It is a basic human right and a fundamental means for creating social cohesion, thereby helping to ensure social peace and social inclusion. It is an indispensable part of government social policy and an important tool to prevent and alleviate poverty. It can, through national solidarity and fair burden sharing, contribute to human dignity, equity and social justice. It is also important for political inclusion, empowerment and the development of democracy.
- Social security, if properly managed, enhances productivity by providing health care, income security and social services. In conjunction with a growing economy and active labour market policies, it is an instrument for sustainable social and economic development. It facilitates structural and technological changes which require an adaptable and mobile labour force. With globalization and structural adjustment policies, social security becomes more necessary than ever.
- There is no single right model of social security. It grows and evolves over time. Each society must determine how best to ensure income security and access to health care. These choices will reflect their social and cultural values, their history, their institutions and their level of economic development. The State has a priority role in the facilitation, promotion and extension of coverage of social security. All systems should conform to certain basic principles. In particular, benefits should be secure and non-discriminatory; schemes should be managed in a sound and transparent manner, with administrative costs as low as practicable and a strong role for the social partners. Public confidence in social security systems is a key factor for their success. For confidence to exist, good governance is essential.
- In PAYG defined benefit pension systems, risk is borne collectively. On the other hand, in systems of individual savings accounts, risk is borne by the

individual. This option should not weaken solidarity systems which spread risks throughout the whole of the scheme membership. Statutory pension schemes must guarantee adequate benefit levels and ensure national solidarity. Supplementary pension schemes can be a valued addition to, but not a substitute for, statutory pension schemes. It is for each society to determine the appropriate mix of schemes.

The resolution included references to the extension of social security protection.

- Social security is not available to the majority of the world's people. Of highest priority are policies and initiatives which can bring social security to those who are not covered by existing systems.
- Each country should determine a national strategy for working towards social security for all. This should be closely linked to its employment strategy and to its other social policies. As government resources are limited in developing countries, there may be a need to broaden the sources of funding for social security through, for example, tripartite financing.
- Social security cannot always have the same range of provisions for all categories of the population. As social security systems evolve, they can become more comprehensive as national circumstances permit. Where there is limited capacity to finance social security, priority should be given to needs which are most pressing in the view of the groups concerned.
- The fundamental challenge posed by the informal economy is how to integrate it into the formal economy. This is a matter of equity and social solidarity. Policies must encourage movement away from the informal economy. Support for vulnerable groups in the informal economy should be financed by society as a whole.

Other issues dealt with in the resolution included:

- Ageing of the population has a significant effect on both advance-funded and PAYG pension systems and on the cost of health care. This is transparent in PAYG systems where a direct transfer takes place from contributors to pensioners, however, it is just as real in advance-funded pension systems where financial assets are sold to pay for pensions and purchased by the working generation. Solutions must be sought through measures to increase employment and ways to achieve higher economic growth.
- To be sustainable, the financial viability of pension systems must be guaranteed over the long term. It is therefore necessary to conduct regular actuarial valuations and to implement the necessary adjustments sooner rather than later. It is essential to have an actuarial evaluation of any proposed reform before adopting new legislation.

- For persons of working age, the best way to provide a secure income is through decent work. The provision of unemployment benefits should therefore be closely coordinated with training and retraining and other assistance they may require in order to find employment.
- Social security should promote and be based on the principle of gender equality. This implies not only equal treatment for men and women, but also measures to ensure equitable outcomes for women. As a result of increased participation of women in the labour force and the changing roles of men and women, social security systems originally based on the male breadwinner model correspond less and less to the needs in many societies. The form of survivors' benefits needs to be reviewed. Where either parent provides care for children, social security benefits for childcare purposes should be made available to the caregiver.
- In many developing countries, particularly in sub-Saharan Africa, the HIV/AIDS pandemic is having a catastrophic effect on every aspect of society. Its impact on the financial base of their social security systems is particularly acute, as the victims are concentrated among the working age population. This crisis calls for an urgent response through research and technical assistance by the ILO.

The resolution concludes with specific proposals for the work programme of the ILO. The report on the discussion including the text of the resolution are in *Social security: A new consensus* (International Labour Office, 2001). Available at: <http://www.ilo.org/public/english/protection/secsoc/downloads/353sp1.pdf>.



## APPENDIX C:

# KEYS TO BEING A SUCCESSFUL BOARD MEMBER

A broad definition of governance of a social security scheme comprises three levels: (1) the political body (legislature) which enacts the scheme, (2) the board of directors (or advisory board) of the scheme, and (3) the management and administration of the scheme. A sound governance structure is essential for any social security scheme to meet its objectives. These keys to being a successful board member refer to the second level of governance. They are based on observations of the actions (or inactions) of social security scheme board members in many countries.

At the first level of governance, governments enact legislation establishing or modifying social security schemes. Ensuring the social protection of the people whom they govern is a major responsibility of governments, and the resulting transfers of resources often comprise large shares of government budgets. Governments are explicitly or implicitly the ultimate guarantors of social security schemes, and they have a legitimate interest and responsibility for the schemes. They have a central role to play in social security by adopting policies that are responsive to the wishes and conditions of persons protected by the schemes who, incidentally, are also voters.

Ideally, legislation establishing a social security scheme should be enabling, leaving details to be determined by the board and technical staff of the scheme. Frequent recourse to the legislature for specific amendments inevitably brings the entire scheme under legislative review. Rather, a social security scheme should report annually to the legislature on its operations, and at specific intervals (e.g., every five years) there should be a thorough review of the scheme by the legislature.

There is a difference between the legitimate interest of a government in a social security scheme and political interference. The political risk is that legislators will seek to micro-manage the scheme (e.g., direct lower-level personnel appointments, direct the scheme to make specific investments, and/or modify the provisions of the scheme for short-term political gain). Under these circumstances, the board of directors of the scheme operates with insufficient authority and independence to direct the operations of the scheme in accordance with the legislation, and its advice to the government is apt to be ignored.

Board members are usually appointed by the government. If the board of directors is insufficiently independent, there is little point being a board member. The experience will be frustrating since important decisions about the scheme may be made on the basis of current political considerations regardless of the board's opinion. If the government can remove a board member at any time on a whim or if the member's position on an issue is contrary to the wishes of the government, being a board member may be personally gratifying, but the position is simply cosmetic.

Most boards have tripartite representation with worker, employer, and government representatives as set out in the ILO Convention 102. Unfortunately, even when boards have considerable independence, their governance has often been disappointing due to members' inadequate knowledge of social security principles and the scheme being governed, excessive turnover of board members, and/or board members' failure to appreciate their role. Increasingly, boards are being strengthened by the appointment of other representatives of civil society (e.g., pensioners) and persons with specific expertise. While board members are often appointed by the government for political reasons, this is neither a reason nor an excuse for them to fail to exercise their mandate. Board members should behave like parents – nurturing a social security scheme as it grows and matures so that the objectives of the scheme can be met.

Provided the board has real power to govern the operations of the social security scheme and direct and supervise the third level of governance, the management and administration of the scheme, appointment to the board is both an honour and an opportunity to influence an important national programme which provides important benefits to workers and their dependants.

These keys to being a board member apply to members who have real power to oversee the operations of the schemes on whose boards they serve and to guide and influence governments with their advice.

## **1. LEARN ABOUT SOCIAL SECURITY AND THE SCHEME YOU ARE GOVERNING**

Being a board member of a social security scheme is not the same as being on the board of a commercial or state enterprise. Of course, many management and accounting objectives and operations are the same, but a social security scheme has been established by statute and its ultimate governance is through the legislature. Rather than shareholders, it has stakeholders – worker and employer contributors, and workers and their dependants as beneficiaries. The operations of a social security scheme are quite different from those of a commercial enterprise. In social security, the emphasis is not on short-term 'shareholder value' and the

‘bottom line’, but on meeting the long-term social objectives of the scheme in a financially sustainable manner.

While business administration courses can equip potential board members of commercial enterprises with the accounting, financial, and management background they need, there is little academic training that deals with social security. In order to be an effective board member, it is necessary to learn about social security. An excellent start is the ILO’s *Introduction to Social Security*. The International Training Centre of the ILO offers courses on social security, and the International Social Security Association offers continuing education courses.

Board members should learn about the objectives of the scheme they are supervising. For example, the objectives of a social security pension scheme normally include income replacement throughout members’ retirement through consumption smoothing over the life cycle, poverty avoidance, income maintenance for disabled persons and dependent survivors, and ensuring the financial sustainability of the scheme. Board members should ask:

- Are the scheme’s objectives being met?
- What are the problems?
- Do the stakeholders appreciate the scheme – and if not, why not?

## 2. BE AWARE OF YOUR FIDUCIARY RESPONSIBILITIES

Appointment to the board of a social security scheme is an honour, but it is not a sinecure. Board members are the trustees/custodians of scheme members’ contributions and their interest in the scheme. Board members must recognize their fiduciary responsibility, exercise it with integrity and use sound judgment. They should be legally culpable for actions (or inactions) they take which harm the stakeholders of the social security scheme. Board members appointed to represent a constituency must rise above partisan and ideological issues and take decisions in the best interest of all current and future scheme members and beneficiaries.

Investments are a crucial fiduciary responsibility of board members. Investment failures have resulted in many terminations of chief executives’ and board members’ appointments. For a board which has appropriate investment independence, the International Social Security Association’s *Guidelines for the Investment of Social Security Funds* sets out the role and responsibility of board members and deals with setting investment objectives and strategy and the investment process. The guidelines formalize the investment process. Following them protects the interest of stakeholders and shields board members from recriminations over investments, some of which will inevitably fail to perform.

While the investment operations of a major financial organization are often considered to be more interesting than mundane social security matters such as the payment of adequate benefits on time or ensuring compliance with the contribution conditions of the scheme, board members and management must not focus on investments and neglect other aspects of the social security scheme.

### **3. FIND OUT HOW THE SCHEME TREATS ITS CLIENTS**

No matter how well designed and financed a social security scheme may be, contributors and beneficiaries will not appreciate it unless it is efficiently administered in a client-friendly manner. The only way a board member can personally assess client satisfaction with the scheme is by meeting worker and employer contributors and beneficiaries. While the impressions about the level of client satisfaction may be anecdotal, they provide the board member with input about public perception of the scheme and the quality of its administration, and a basis for raising issues with management.

Most social security schemes have field offices. It is in these branch offices where the interface between the scheme and its clients occurs. Board members should visit field offices, if possible, anonymously, in order to ascertain whether the offices are appropriately situated and designed and provide efficient and client-friendly service.

### **4. BE PROACTIVE – THINK LONG TERM**

Board members must look ahead. Often, boards of public pension schemes simply react to demographic or financing problems in a hurried and unsatisfactory manner. Neither of these problems, nor most others, arises suddenly. Attention to actuarial reports on the scheme can alert board members to potential future problems and allow them to propose measured responses to government and obtain support for the solutions they propose. Otherwise, board members find themselves facing crises (sometimes inspired by the media), and reacting in a manner that may not be in the best interest of the stakeholders.

While board members do not need to be information and communications technology (ICT) experts, they must be aware of advances in ICT and their potential for improving the administration and client service of the scheme, and they must ensure that management exploits the potential of new ICT developments.

## 5. BE SCEPTICAL AND INDEPENDENT – BUT SEEK ADVICE

A sceptical approach is prudent on the part of persons responsible for supervision of any organization. The board is informed and advised by the management of the social security scheme, but sometimes the overall fiduciary responsibility of the board will differ from a narrower administrative perspective of the management of the scheme. Board members should seek the advice of outside experts, but they should bear in mind that the experts may have agendas that are not necessarily supportive of the scheme.

In addition to reports from the management of the scheme, boards receive reports from external auditors, periodic actuarial valuations, and reports on investment performance. These reports can be highly technical and board members are often reluctant to question them since they do not have the technical expertise. The reports are made to inform the board and aid it in taking decisions. If board members do not understand them there is little point producing the reports. Board members must overcome their natural reluctance to ask questions and their fear of possibly displaying ignorance about a topic. They should query the reports, bearing in mind that if the person presenting a report is indeed an expert, he/she will be able to explain complex matters in a manner that is comprehensible to those who are not experts.

Board members have the difficult job of seeking advice while at the same time remaining independent of external influences. Independence does not mean that the board members act without reference to the framework established by legislation, government policies or the constituencies they represent. The board should consult with and advise legislators and government officials and other government bodies, for example, the Central Bank which sometimes provides prudential supervision of the social security scheme.

Reappointment to the board should be a result of the excellence of a board member's performance, not his/her acquiescence to the wishes of those who originally made the appointment. The best relationship between social security board members and the government is that which normally applies between the board of a Central Bank and the government.

## 6. BE FOCUSED AND TRANSPARENT

A board member cannot become expert on all aspects of a social security scheme, but the member can focus on a particular area – adequacy of benefits, investments, financing, administration, etc. – and become expert in the chosen area. By applying sound and consistent principles to the area of specialization, a board member can gain the respect of his/her peers on the board and of

stakeholders and establish a reputation for his/her knowledge and rectitude in protecting their interests.

Except when confidentiality is required (e.g., in certain investment situations), a board member should be open about his/her approach to controversial issues. This may lead to criticism from those who do not agree with the approach, but it can also inspire respect. If criticism comes, take it in stride, as this is the price of being a principled board member.

It is difficult for a board member to be transparent if the operations of the scheme are not. As well as ensuring widespread dissemination of the scheme's annual report (or preferably a popular readable version of it), board members should strive to allay concerns and create the public support for the scheme by seeking stakeholder inputs and publicizing major board decisions. A board member representing a constituency should be accountable not only to the constituency but to the public at large for his/her individual actions and the collective actions of the board.

## **7. DO NOT TRY TO MICRO-MANAGE**

Just as legislators should leave the board to deal with matters within its competence, the board should provide direction and supervision but not interfere directly in the management of the social security organization. The chief executive and senior officers of the scheme have been hired to operate it efficiently in accordance with the wishes of the board. If they do not perform as expected, the solution is for the board to deal with these matters with the chief executive and senior officers, and if this is unsuccessful, to replace them. The board should resist the temptation to try to manage the daily operations of the scheme. This undermines the executives who are responsible, creates uncertainty and factions among the staff, and almost always produces a worse result than the situation the board was trying to correct.

Warren McGillivray, 2005  
(former Chief, Studies and Operations Branch,  
International Social Security Association)

## APPENDIX D: SELF-ASSESSMENT FOR BOARD MEMBERS

This questionnaire is adapted from one used by the General Association of Pensions Institutions for Managerial Staff (AGIRC) in France. Going through it will help you to appreciate your areas of competence, and identify areas which you need to strengthen, perhaps through some formal training.

Questions about my appointment as a board member	Yes	No
When I accepted my board appointment, I understood what my role would be and what was expected of me.		
To build up a detailed picture about what was required in my new role, I asked: <ul style="list-style-type: none"> <li>■ the organization I represent,</li> <li>■ my colleagues on the board who had been in the role for a long time,</li> <li>■ the Chief Executive and other senior staff of the organization,</li> <li>■ any other sources.</li> </ul>		
I have copies of all the relevant documents about the organization and its activities.		
(If the answer is no to the above, I have requested copies of the documents that are missing from my dossier.)		
I already had the chance to participate in seminars about the role of the Board member before I started.		
Board members are offered regular further help with updating the knowledge and skills they require.		
Questions about my ongoing involvement	Yes	No
I believe I fulfil my role as a board member within the spirit of the mandate entrusted to me.		
I take an active part in all the meetings of the board and the sub-committees on which I sit.		
Before each meeting, I carefully go through the agenda and all the accompanying documents.		
I am in touch with experts who can assist me with briefings on points where I need specialist advice.		

I can contact colleagues who sit on the board or on similar bodies, so that we can discuss matters of common interest.		
At the meetings, if the discussion is in terms which I do not understand, I insist that board members are given: <ul style="list-style-type: none"> <li>■ further explanation in lay persons terms,</li> <li>■ background material as necessary.</li> </ul>		
I am aware of <ul style="list-style-type: none"> <li>■ the organization’s mission statement, objectives and targets</li> <li>■ the performance indicators being used.</li> </ul>		
When investment in future administrative or technological developments is being discussed, I determine whether the proposals: <ul style="list-style-type: none"> <li>■ will have a positive effect in terms of cost, the quality of the administration and service to the clients;</li> <li>■ are compatible, in the short and medium term, with the organization’s budget;</li> <li>■ will improve the capacity to communicate with other government organizations and with our clients.</li> </ul>		
I keep myself well informed about press and media comments on the organization and its activities.		
I am aware of the organization’s staffing policies, and I believe them to be fair and transparent. I believe we are leading by example in this field.		
<b>The organization’s finances</b>	<b>Yes</b>	<b>No</b>
I understand the public accounting rules followed by the organization.		
I have obtained briefings from specialists on aspects I did not understand.		
I understand what proportion of the organization’s total expenditure is devoted to administration, including: <ul style="list-style-type: none"> <li>■ what the main categories of this spending are, and</li> <li>■ how it is divided between head office and field offices.</li> </ul>		
I scrutinize the budget figures and reports as they appear, and request further information on any aspects which are not clear.		
These reports arrive in sufficient time for proper scrutiny before the meeting at which they are discussed.		
I scrutinize the audit reports and the auditors’ management letter.		
I check that any recommendations in those reports are being carried out.		

<b>The board members' right to information</b>	<b>Yes</b>	<b>No</b>
<p>The organization keeps board members up to date on:</p> <ul style="list-style-type: none"> <li>■ its activities,</li> <li>■ current reviews and development programmes,</li> <li>■ any relevant political or legal developments.</li> </ul>		
<p>Board members are sent copies of any circulars, reports or other publications issued by the organization.</p>		
<p>Board members receive regular reports on:</p> <ul style="list-style-type: none"> <li>■ new benefit claims, current payments, terminated benefit claims;</li> <li>■ revenue and expenditure on benefits and administration;</li> <li>■ administrative costs;</li> <li>■ performance compared to objectives and benchmarks;</li> <li>■ recommendations by internal and external auditors;</li> <li>■ action being taken to implement auditors' recommendations.</li> </ul>		
<p>I believe sufficient information is provided to allow board members to take an active part in the governance of the organization.</p>		
<b>Communicating about the organization</b>	<b>Yes</b>	<b>No</b>
<p>In my role as a board member of the organization, I consider I have a role in communicating about its activities to the constituency that I represent.</p>		
<p>I have regularly organized or participated in external meetings which provide information about the organization's activities:</p> <ul style="list-style-type: none"> <li>■ within my own organization and</li> <li>■ for a wider group, or the general public.</li> </ul>		
<p>I feel I know and understand enough about the organization's activities to be able to take an active part in such a meeting.</p>		
<p>When this is not the case, I would be able to ask for a further briefing from:</p> <ul style="list-style-type: none"> <li>■ people in my own organization or</li> <li>■ people in the organization.</li> </ul>		
<p>I believe I am well enough informed to participate actively in debates about social security policies, in particular, about future developments and possible reforms.</p>		
<p>I believe I am fulfilling my role as an ambassador for the organization.</p>		

The organization's investment strategy	Yes	No
I understand: <ul style="list-style-type: none"> <li>■ the various categories of investment available to the organization,</li> <li>■ how their characteristics vary, for instance their levels of risk, liquidity, and rates of return.</li> </ul>		
I take a full part in drawing up and reviewing the organization's investment policy and strategy, and I understand the reasoning behind it.		
I understand how investment performance is measured, including: <ul style="list-style-type: none"> <li>■ the benchmarks being used,</li> <li>■ the reasons given by the investment managers when they report on any shortfall.</li> </ul>		
I understand the structure of fees and other charges made by investment managers.		
I scrutinize these fees and other charges when reports are provided		
Projections for the future	Yes	No
There are regular actuarial reports on the social security benefits being provided by my organization. <ul style="list-style-type: none"> <li>■ These reports look forward ... years.</li> <li>■ The board has the chance to discuss the assumptions and the statistics with the actuaries carrying out the work.</li> </ul>		
There has been, or there is planned to be, a review of social protection expenditure across the whole economy.		

**Knowledge and skills**

Topic	Rate your knowledge/skills (insert weak/moderate/good")
1 History and structure of the benefits provided	
2 Legal framework	
3 Structure of the organization	
4 Setting objectives and measuring performance	
5 Accounting and financial control	
6 Investment issues	
7 Long-term actuarial issues	

# APPENDIX E: ISSA GUIDELINES FOR THE INVESTMENT OF SOCIAL SECURITY FUNDS

Social Security Essentials

[www.issa.int](http://www.issa.int)



**issa**

INTERNATIONAL SOCIAL SECURITY ASSOCIATION

## Technical Report 13

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### Guidelines for the investment of social security funds

**ISSA Study Group on the  
Investment of Social Security Funds**

## **Guidelines for the investment of social security funds**

**ISSA Study Group on the Investment of Social Security Funds**

**Technical Commission on Statistical, Actuarial and Financial Studies  
– Investment of Social Security Funds  
ISSA 28<sup>th</sup> General Assembly, Beijing, 12-18 September 2004**

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The International Social Security Association (ISSA) is the world's leading international organization bringing together national social security administrations and agencies. The ISSA provides information, research, expert advice and platforms for members to build and promote dynamic social security systems and policy worldwide. An important part of ISSA's activities in promoting good practice are carried out by its Technical Commissions, which comprise and are managed by committed member organizations with support from the ISSA Secretariat.

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First published 2004.

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## ISSA - TECHNICAL REPORT 13

### Guidelines for the investment of social security funds

#### Introduction

Social security funds are held by social security schemes in order to safeguard the schemes' ability to pay benefits and provide services, to generate investment income that helps to finance benefits and services, and, in many instances, to ease transitory demographic pressures.

In recent years, the number of member organizations of the International Social Security Association with such funds has grown significantly. As their experience has shown, the investment of these funds can make a critical contribution to the financial sustainability of their social security systems. However, experience has also shown that the investment of social security funds is not without risk. Imprudently or improperly invested, such funds can yield negative real rates of return, or can disappear altogether.

These factors led the ISSA to create a Study Group on the Investment of Social Security Funds. The Study Group consisted of officials of ISSA member organizations directly involved in the investment of social security funds as well as outside experts from institutions engaged in similar investments and from international organizations.

At its first meeting, held in Paris in December 2002, the Study Group identified, as a priority, the development of guidelines which could assist social security institutions in the investment of their funds. At its second meeting, held in Porto in April 2004, the Study Group examined draft Guidelines drawn from several sources and adapted to the special circumstances of social security institutions. The present Guidelines are the result of the Study Group's reflection and of comments subsequently received from several of its members.

These Guidelines are intended to provide social security institutions – whether they be government ministries, statutory bodies or private bodies – with general principles and considerations for the investment of social security funds. The principles and considerations are supplemented with commentaries that provide background information, describe acceptable alternative approaches, or discuss other factors that should also be taken into account.

The Guidelines have been formulated to take into account two distinct situations. In the first instance the entity administering the social security scheme is also responsible for investing the social security funds. In the second instance the

entity responsible for investing the social security funds is distinct from the social security scheme.

There are many different models of social security around the world, comprising schemes in developing and industrialized countries. Financial markets, legal frameworks and regulatory and supervisory structures vary from country to country. In drafting the Guidelines, considerable attention has been given to providing the degree of flexibility required to respond to these differences. However, a practical consequence is that the Guidelines cannot reflect every possible circumstance. Therefore, in applying the Guidelines, they must be adapted, as appropriate, to the specific situation of each scheme and each country.

## 1. Governance prerequisites: Governance structure

A sound governance structure is essential for the effective investment of social security funds. The governance structure should ensure an appropriate division of operational and oversight responsibilities, and the suitability and accountability of those with such responsibilities.

**Governance**<sup>2</sup> is a complex subject, with many dimensions. It would not be possible, in Guidelines such as these, to address all aspects of good governance. This and the next section of the Guidelines describe the minimum governance principles and considerations that must be taken into account when a social security institution undertakes the investment of the funds entrusted to it.

### 1.1. Identification of responsibilities

There should be a clear identification and assignment of operational and oversight responsibilities in the governance of a social security scheme. This should be the case whether a scheme is administered by a government ministry or by an entity (e.g., a statutory body, such as an autonomous institution) established for this purpose. In the latter case, the legislation establishing the entity should set out the legal status of the entity, its main objectives and its internal governance structure.

### 1.2. Governing body

- If an entity other than a government ministry is established to administer a social security scheme, the ***governing body*** of that entity should be vested with the power to take the actions necessary for the scheme to fulfil its legislative

<sup>2</sup> Terms which appear in ***bold italics*** in the text of the Guidelines are defined in the glossary of terms found in the appendix.

mandate. The governing body should be subject to the least possible political interference or influence. The governing body is ultimately responsible for ensuring that the provisions of the legislation establishing the social security scheme are observed and that the interests of **scheme members**, beneficiaries and other **stakeholders** are protected. The governing body should not be able to absolve itself completely of its responsibilities by delegating certain functions to external service providers but should retain responsibility for monitoring and oversight of those service providers.

**Commentary:** *Independence from political interference or influence does not mean that the governing body should operate without reference to the legislative framework established by the national parliament or the policies of the government. Nor does it preclude appropriate consultations with parliamentary and government officials or other government agencies. However, it does mean that there should not be political interference in the decisions taken by the governing body within the legislative mandate given to it.*

*In establishing a governing body for a social security scheme, many countries require tripartite representation of workers, employers and government. The International Labour Organization, among others, has long advocated tripartite representation as a means of protecting against unwarranted political interference and ensuring input from those most affected by a social security scheme.*

- The responsibilities of the governing body should be consistent with the overriding objective of the social security scheme, which is to pay the benefits and provide the services promised. 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. Under the **financial system** adopted, the contribution level established and investment income should be sufficient to finance the benefits and services, and risk management should be applied in the assessment of the long-term sustainability of the scheme.

### 1.3. Investing institution and investment committee

- In accordance with the legislation establishing a social security scheme and/or the decision of a scheme's governing body, the **investing institution** may be either the entity administering the social security scheme or an entity established expressly for the purpose of investing the scheme's funds. In the latter case, there should be a clear statement of the legal status of the investing institution, its main objectives, and its internal governance structure (including its governing body). Moreover, in such a case, Guidelines 2, 4, 5,

and 6 should apply to the governing body of the investing institution, and guidelines 7, 9, 10, 11, 12 and 13 to the investing institution itself.

**Commentary:** *In some instances, there may be advantages to establishing an investing institution which is distinct from the entity administering the social security scheme. For example, when a government ministry is responsible for administering a social security scheme, the creation of an investing institution which is independent of that ministry may ensure protection against both political interference and the perception of political interference in the investment decisions which are taken.*

- The governing body (bodies) of the social security scheme and/or of the investing institution should appoint an investment committee responsible for developing the **investment policy** and the **investment strategy**, recommending them to the governing body (bodies), overseeing their implementation, and evaluating their effectiveness. The investment committee should meet regularly and report its activities to the governing body (bodies). The frequency of its meetings should take into account the responsibilities and tasks assigned to it.

**Commentary:** *It must be stressed that the investment committee is not the same as the investing institution or the governing body of the social security scheme. The investment committee reports to the governing body of the social security scheme or the governing body of the investing institution and is charged with recommending, overseeing and evaluating the application of the investment policy and investment strategy.*

*In some instances, the chairperson of the governing body of the investing institution chairs the investment committee. The chief executive officer of the entity administering the social security scheme may be a member of the investment committee. The other members of the committee should be chosen from among the members of the governing body (bodies) of the social security scheme and/or of the investing institution on the basis of their expertise and experience in the various key aspects of investment management. Outside experts should be asked to serve on the investment committee if the required expertise is not available among the members of the governing body (bodies).*

#### 1.4. Accountability

- The governing bodies of the social security scheme and of the investing institution should be accountable to the scheme members, beneficiaries, and other stakeholders of the social security scheme. In order to ensure the accountability of the governing bodies, their members should be liable for their actions and for their failure to act.

**Commentary:** *One means for determining whether a member of a governing body has properly carried out his/her responsibilities is to apply the principle of “duty of care”. Under this principle, a member, in exercising the powers of office or discharging the duties, is required to act honestly and in good faith, with a view to the best interests of the social security scheme and scheme members. As well, he or she is required to exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances (i.e. **prudent-person principles**). If the member, by reason of his/her profession or business, has a particular knowledge or skill relevant to his/her duties of office, he/she is expected to employ that particular knowledge or skill in exercising those duties.*

- Accountability of the governing bodies of the social security scheme and of the investing institution requires that there should be transparent processes for selecting members and for taking decisions as well as regular meetings and disclosure of decisions and information to scheme members, beneficiaries and other stakeholders, including information regarding the financing of the scheme and its financial status.

**Commentary:** *At the time of appointment to a governing body, a member should disclose all business interests and affiliations that may result, or appear to result, in a conflict of interest with the execution of his/her duties on the governing body. The member should be expected to disclose any business interest or affiliation that develops after his/her appointment and while he/she is on the governing body.*

*If the governing body is dealing with an issue in which the member has a business interest or could appear to have such an interest, the member should withdraw from the part of the meeting in which the issue is being discussed and not vote on the issue. It should be noted in the record of the meeting that the member removed himself/herself from consideration of this issue.*

### 1.5. Suitability

Membership of the governing bodies of the social security scheme and of the investing institution (as well as any specific investment committee) should be subject to minimum suitability standards, in order to ensure a high level of integrity and professionalism in the governance and administration of the social security scheme and of the investing institution.

### 1.6. Expert advice

Where they lack sufficient expertise to make fully informed decisions and fulfil their responsibilities, the governing bodies of the social security scheme and of the investing institution should seek expert advice or appoint professionals to

carry out certain functions. Contracts for the provision of expert advice should normally be open to competition, separately for each type of expert advice required. Experts should be appointed having regard to the quality of their expertise and not solely on the basis of the lowest tender.

**Commentary:** *In engaging external advisors, the governing body (bodies) of the social security scheme and/or of the investing institution must ensure that they have sufficient knowledge to define their investment requirements, to understand the implications of the proposals presented to them, and to evaluate those proposals within the framework of the social security scheme's overall objectives. If the governing body or bodies are uncertain whether they have the necessary knowledge, they should obtain independent advice from experts with no material interest in the outcome of the decisions taken.*

### 1.7. Auditor

■ An auditor, independent of the government, the governing body of the social security scheme, the entity administering the social security scheme and the investing institution, should be appointed by the government or the governing body of the social security scheme to carry out annual audits of the social security scheme. The auditor should be free from political interference.

**Commentary:** *If the investing institution is distinct from the entity administering the social security scheme, there should be independent audits of each.*

■ If as a result of carrying out his/her professional and/or statutory duties, the auditor becomes aware of information which could have a significant negative effect on the financial situation or the administrative and accounting organization of the scheme, or of significant weaknesses in the systems of control, the auditor should make a report to the government or governing body (whichever appointed him/her). If the auditor reports to the governing body and the governing body does not take appropriate remedial action in a specified time, the auditor should also make a report to the government.

■ An opinion from the auditor should be included in the annual financial statements of the social security scheme, which should be publicly available.

### 1.8. Actuary

■ An actuary should be appointed by the government or the governing body of the social security scheme to carry out periodic actuarial reviews of the scheme. The actuary should be free from political interference.

**Commentary:** *If the actuary is an employee of the government ministry overseeing the social security scheme, or of the governing body or the entity administering the scheme, the work of the actuary should be subject to independent peer review or actuarial audit.*

- If as a result of carrying out his/her professional and/or statutory duties, the actuary determines that the financial sustainability of the social security scheme is materially at risk to the extent that the scheme may not be fulfilling or is unlikely to be able to fulfil its obligations, or that it will not be able to comply with the statutory provisions of the scheme, or that it faces the possibility of material financial shortfalls of income relative to its expenditure in the future which will not be covered by reserves, the actuary should make a report to the government or the governing body of the social security scheme (whichever appointed him/her). If the actuary reports to the governing body of the social security scheme and the governing body does not take appropriate remedial action in a specified time, the actuary should also make a report to the government or directly to the parliament.

**Commentary:** *The process for determining the assumptions underlying the actuarial review should be transparent and based on objective considerations.*

- The report of the actuary on the actuarial review should promptly be made publicly available.

### 1.9. Custodian

Custody of the assets of the social security scheme can be carried out by the entity administering the scheme, by the investing institution, by a government entity such as the central bank or treasury, or by an independent **custodian**. If an independent custodian is appointed by the governing body of the social security scheme to hold and ensure the safekeeping of the assets of the scheme, the assets of the scheme should be legally separated from other assets of the custodian. The custodian should not be able to absolve itself of responsibility by entrusting to a third party all or some of the assets in its safekeeping.

**Commentary:** *The custodian should perform independent transaction and position reconciliations at specified intervals.*

## 2. Governance prerequisites: Governance mechanisms

In addition to an effective governance structure, there should also be suitable governance mechanisms. Social security schemes should have appropriate control, communication and incentive mechanisms that encourage good decision-making, proper and timely execution, transparency and regular review and assessment.

### 2.1. Systems of control

There should be appropriate systems of control in place to ensure that all persons or bodies with operational and oversight responsibilities act in accordance with the objectives set out in the legislation establishing the entity administering the social security scheme or the investing institution, when the investing institution is distinct from the entity administering the social security scheme. Such systems of control should cover all basic organizational and administrative procedures, including performance assessment, compensation mechanisms, information systems and processes, risk management procedures and regular review of expert advisers and of any contractual arrangements.

### 2.2. Internal reporting

Reporting channels between the entity administering the social security scheme, the governing body of the scheme, the investing institution, the government and other persons involved in administering the scheme should be established in order to ensure the effective and timely transmission of relevant and accurate information.

### 2.3. Public disclosure

The governing bodies of the social security scheme and of the investing institution should disclose relevant information to all parties involved, including scheme members, beneficiaries and other stakeholders, in a clear, accurate and timely fashion.

**Commentary:** *The information to be disclosed on an annual basis should include at least the following:*

- *the duties, objectives and mandate of the entity administering the social security scheme, its governing body, and the investing institution (if different from either of the previous two);*
- *the committees of the governing body of the social security scheme, as well as their composition, mandates and activities;*
- *a financial statement of the scheme for the previous year, including information on income, expenditures, assets and liabilities;*

- *the opinion of the auditor on the financial statement;*
- *the report of the actuary on the actuarial review (if such a report has been made since the previous disclosure of information).*

*Disclosure should not extend to information that would compromise fiduciary responsibilities or prejudice investment transactions.*

## 2.4. Redress

Scheme members, beneficiaries and other stakeholders should be granted access to prompt statutory redress mechanisms through a body established for this purpose or through the courts.

## 3. Investments

### 3.1. Objectives

There are two *primary* objectives for the investment of social security funds:

- *security*: the investments should assist the social security scheme to meet its commitments in a cost-effective way;
- *profitability*: the investments should achieve maximum returns, subject to acceptable risk.

Investments of social security funds should be made with a view to achieving a reasonable balance between the twin objectives.

***Commentary:*** *The importance of the security of the assets and the return on assets to maintain the financial sustainability of the social security scheme according to its financial system should always be considerations in making decisions on investments. The liabilities of the social security scheme should take into account the scheme's maturity and liquidity requirements.*

- The social and economic utility of investments may also be taken into account. In such a case, however, it should be subsidiary to the primary objectives of security and profitability. As well, there should be clear criteria for determining the circumstances and to what extent social and economic utility will be taken into account. Where investment in a particular venture of economic and social utility is considered desirable by the government and/or by the governing body of the social security scheme but the returns likely to be achieved are below market norms, the investment should be structured so that the subsidy is made from other government resources, in order to avoid compromising the fiduciary responsibilities of the social security scheme.

**Commentary:** Investments with social and economic utility include, for example, private-sector initiatives, state enterprises, student loans, low-cost housing, old-age facilities, health infrastructure, tourism, and projects enhancing human resources. In many countries, these types of investments may make a substantial contribution to long-term national growth rates even if the indirect rates of return may not always be fully reflected in the monetary rates of return. By contributing to long-term national economic growth, they can improve the financial status of the social security scheme in terms of the number of members, the amount of their insurable earnings, and the rate of return on the scheme's investments.

Investments that are made on the basis of social and economic utility should be continuously monitored. To enable the social security scheme to do this, it should have a seat on the board of directors of such projects whenever there is a substantial investment of social security funds.

### 3.2. Integrated approach

The investment of the funds of a social security scheme should take into account the financial system under which the scheme operates, and be consistent with its short-, medium- and long-term financing objectives. The commitments of the scheme established by legislation, expected future cash-flows and the appropriateness of different types of investments for meeting the scheme's investment objectives should be taken into account.

### 3.3. Investment policy and strategy

- The investment policy of a social security scheme should be based on prudent-person principles and appropriate **quantitative restrictions**. It should take into account the following concepts:
  - risk management;
  - diversification and dispersion;
  - matching assets and liabilities, including considerations of duration and maturity;
  - currency matching; and
  - performance measurement and monitoring.

**Commentary:** 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. Factors such as the volatility of contributions and assets should be considered along with the financial objectives. The governing bodies of the social security scheme and of the investing institution should have a sound understanding of the scheme's obligations, the purpose of the investments, and the appropriate mix of assets required to ensure the scheme's financial sustainability.

- The investment policy and investment strategy should be consistent with the financing objective of the social security scheme and its cash-flow requirements. The policy should require that the investing institution have in place appropriate systems of control to ensure that the five concepts noted above have been properly taken into account.
- The national economic, social and financial importance of the investment of social security funds requires that, within the context of these Guidelines, the investment policy of a social security scheme should be established taking into consideration the economic policies of national financial authorities such as the ministry of finance and/or central bank.

**Commentary:** *In many countries, social security funds comprise a major part of the capital market. Therefore, the investment of those funds should take into consideration long-term national objectives that may not be entirely reflected when pursuing a strategy based exclusively on maximizing returns. Ultimately, the sustainability of any social security scheme depends on national economic growth.*

*While the views of national financial authorities are a legitimate consideration in setting the investment policy and strategy, they should not be involved in the implementation of the strategy. In particular, those authorities should not be allowed to dictate the specific investments to be made by a social security scheme or its investing institution.*

- A statement of the investment policy and strategy should be formally articulated by the governing bodies of the social security scheme and of the investing institution and should be publicly available.

**Commentary:** *The investment policy should be reviewed by the governing body of the investing institution regularly (at least once every three years). The investment strategy should be subject to ongoing review and evaluation.*

### 3.4. Restrictions on investments

- No minimum level of investment should be prescribed for any given category of investment, except on an exceptional and temporary basis and for compelling prudential reasons.

**Commentary:** *The prescription against minimum levels of investments for given categories refers to rules that are externally imposed on a social security scheme or investing institution. It especially applies in regard to government debt. Social security funds should not become a means for governments to finance deficits and debt.*

*The prescription does not, however, preclude the governing body of a social security scheme or investing institution from setting minimum levels of investments as part of its investment policy.*

*Provision should, in particular, be made for a minimum level of cash and/or short-term money-market securities required to pay immediate benefits and meet other ongoing obligations as they become due.*

- Maximum levels of investment by category should be set with reference to **prudential rules**. The investing institution should be allowed to exceed such ceilings under certain conditions (e.g. time limits), and possibly subject to prior authorization by the governing body of the social security scheme and/or the government.
- Investments in a given individual asset or security, or in the assets or securities of a particular industry or entity other than the government itself, should be limited as a proportion of a social security scheme's total portfolio. The investing institution should not hold more than a specific proportion of the total **market value** of a given type of asset or of the assets of a particular industry or entity.
- A list of admitted/recommended assets can be drawn up by the government or by the governing body of the social security scheme. Such a list could either be exhaustive and compulsory or optional. In the latter case, the investing institution would have to justify any substantial deviation from the list.

**Commentary:** *Caution should be exercised before adopting a “list” approach which places tight constraints on strategic asset allocation. If a list approach is used, one of admitted assets is less problematic than a list of recommended assets.*

- Investment in certain categories of investments should be limited or prohibited – for instance, loans without appropriate guarantees or on terms which would not be acceptable to the market, unquoted shares, and investments which raise major risks of conflicts of interest. Individually placed and unquoted investments should be subject to particularly stringent disclosure and approval mechanisms, with a requirement to demonstrate that the terms of the investment are fair and not subject to improper influence or control. Measures should be in place to prevent unlawful appropriation of funds.
- International investments should normally be restricted to investment-grade securities appropriate for a social security scheme. Care should be taken to manage any currency risks.
- The use of financial **derivatives** as an investment management instrument may be useful and effective if it is carried out in a prudent fashion to manage and **hedge** risks (e.g., to reduce exposure to currency fluctuations). However, unhedged positions in derivatives can expose the investing institution to significant risk. Appropriate risk management structures should be set in place

to govern the use of derivatives, and compliance with these structures should be carefully monitored.

### 3.5. Prudent-person principles

- Application of prudent-person principles or the *prudent-expert* concept can make it possible to reduce quantitative restrictions on investments. This, however, requires the governing body of the social security scheme and the government to have confidence in the investing institution's internal systems for management and control of its investment portfolio. If prudent-person principles are applied to managing the investment of social security funds, they should be set out, with a minimum body of rules, by the governing body of the social security scheme or by the government.

*Commentary: Unless the modalities of application of prudent-person principles are sufficiently precise, imprudent attitudes may develop. These principles – or at least their interpretation – may vary substantially from one country to another.*

- Whatever principles the investing institution may adopt, there have to be competent and honest managers to apply them. It is, therefore, essential to ensure the competence and integrity of managers. The governing body of the social security scheme or of the investing institution should adopt criteria concerning the expertise that is required of investment managers and other advisers on investment policy and strategy and their implementation.
- Insofar as prudent-person principles are applied and quantitative restrictions eased, greater fiduciary responsibility should be placed on officials of the investing institution and members of its governing body in order to ensure the accountability of any who abuse the independence conferred by the application of these principles. The social security scheme should have an appropriate structure to control decisions taken on the basis of the prudent-person principles (for example, through the nomination of other qualified persons on the investment committee and the governing body of the investing institution or through a system of external and independent review).

### 3.6. Valuation

Assets should be valued in accordance with generally accepted accounting principles. The objective should be to ensure that information about investments is as transparent as possible. To achieve this goal, there should also be disclosure of the results that would have been obtained using the main alternative methodologies (for example, market value or *fair value* when assets are shown at *historical cost*).

### 3.7. Performance analysis

- Periodic analysis of each asset class and the portfolio as a whole should be carried out to determine nominal, risk-adjusted, and inflation-adjusted (real) rates of return. The analysis should include comparisons with target rates of return, and with appropriate benchmarks, to allow the governing body of the social security scheme to assess investment performance, to update the asset allocation strategy, and to make adjustments (as may be required) to the investment policy and strategy.
- The analysis of investments should be publicly disclosed.

# Glossary of terms

<b>Custodian</b>	The agent engaged by the governing body of the social security scheme or of the investing institution to hold and safeguard the assets of the social security scheme.
<b>Derivatives</b>	Synthetic financial market products based on other instruments such as shares, bonds, indices, or commodities.
<b>Dispersion</b>	The distribution of assets among different categories of assets.
<b>Diversification</b>	The distribution of specific assets within a given category of assets.
<b>Fair value</b>	Asset values based on the price that would be agreed upon in an arm's length transaction between knowledgeable, willing parties under no compulsion to act. This technique is often used for assets which are not traded/sold often enough to establish a market value.
<b>Financial system</b>	The method whereby funds are allocated in order to provide the expected benefits and services as they fall due, and the equilibrium between receipts and expenditures is maintained. Financial systems range from full-funding to pay-as-you-go.
<b>Governance</b>	The systems and processes by which an institution or government manages its affairs with the objective of maximizing the welfare of and resolving the conflicts of interest among its stakeholders.
<b>Governing body</b>	The group of persons who, under the legislation or by-laws establishing an entity, is given the responsibility for the governance of the entity.

<b>Hedge</b>	A form of risk compensation using a counter-trade or covering transaction designed to offset an existing or potential risk position by eliminating or diminishing the element of risk (in particular, price, interest rate or exchange rate risk).
<b>Historical cost</b>	Asset values based on the price paid in the past for the same or comparable assets.
<b>Investing institution</b>	The entity responsible for the investment of a social security scheme's funds. In accordance with legislation and/or the decision of the scheme's governing body, this can be either the entity administering the social security scheme or an entity established expressly for this purpose.
<b>Investment policy</b>	The investment principles and procedures established by the governing body of the investing institution.
<b>Investment strategy</b>	The plan approved by the governing body of the investing institution to implement the investment policy.
<b>Market value</b>	Asset values based on the price for the same or comparable assets on open markets at the time of valuation.
<b>Prudent-person</b>	Rules or principles which govern individual behaviour, and which require a person to exercise the same care, diligence and skill in discharging his/her duties of office as a reasonably prudent person would exercise in comparable circumstances.
<b>Prudent-expert</b>	Rules or principles which underline the need for genuine expertise as well as behaviour consistent with the prudent-person principles.
<b>Prudential rules</b>	Any rules (quantitative restrictions, prudent-person, prudent-expert, etc.) whose objectives are the promotion of the financial security of those concerned.

- Quantitative restrictions** Rules which prescribe either minimum or maximum allocation of investments in specific assets or classes of assets. Depending on the country concerned, such rules may be found in the legislation establishing the social security scheme, in directives of national financial authorities such as the ministry of finance or central bank, or in decisions of the scheme's governing body.
- Scheme members** The persons protected by a social security scheme by virtue of the contributions which they pay or which are paid on their behalf.
- Stakeholders** All individuals and organizations materially affected by the social security scheme, including (as may be appropriate under the legislation establishing the scheme) scheme members, beneficiaries, employers, workers, organizations representing any of these, and the government

