



Social Security Governance:

A Practical Guide for Board Members
of Social Security Institutions
in Central and Eastern Europe



International
Labour
Organization

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TABLE OF CONTENTS

Foreword		vii
Contributors		xi
Development of the Handbook		xiii
Chapter 1	Introduction	1
Chapter 2	What Are You There to Do?	5
Chapter 3	The Legal Framework for the Board Member's Role	17
Chapter 4	The Board's Activities	27
Chapter 5	Management Structures	41
Chapter 6	Setting Objectives and Measuring Performance	51
Chapter 7	Financial Governance Issues	63
Chapter 8	Ensuring Transparency and Fairness	81
Chapter 9	Communications Strategy	95
Chapter 10	Record-keeping in a Social Security Institution	107
Chapter 11	Enforcement and Compliance	115
Chapter 12	Investment of Social Security Funds	123
Chapter 13	Planning for the Future	137
Chapter 14	Summing Up	153
Appendix A	ILO Definition of Social Security and Basic Requirements of ILO Convention 102	155
Appendix B	ILO Conventions on Social Security	157
Appendix C	The Myth, That Funding Resolves Adverse Demographics <i>by Nicholas Barr</i>	159
Appendix D	Some Keys to Being a Successful Board Member <i>by Warren McGillivray</i>	165
Appendix E	Composition of Social Security Boards in Selected CEE Countries	173
Appendix F	Self-assessment for Board Members	175
Appendix G	Other Useful Books, Publications, and Websites	181
Appendix H	Abbreviations and Acronyms	187

FOREWORD

This Handbook is intended as a practical guide for representatives of workers and employers who serve on the governing boards of social security institutions. It reflects the recent experiences of Central and Eastern Europe (CEE) and is designed to be of use in those countries, where the establishment of social security boards is a part of a larger effort to decentralize state power and create more diverse forms of interest mediation. While their exact structure and mandate varies from country to country, the region's new social security boards have important responsibilities: they are charged with ensuring that social security contributions are used judiciously for intended purposes, providing inputs to policymakers on the scheme's recent experiences, creating transparency in its operations, and assuring that its policies and practices comply with law. As such, they are vital institutions for strengthening democratic governance and representing the interests of workers, employers, pensioners, and other scheme constituents in the national pension administration.

The ILO has been closely involved in the creation and training of tripartite governing boards, as part of its general efforts to promote good governance of social security schemes in the region. This publication is one of several with this goal.¹ The Handbook was produced as part of the ILO technical cooperation project, *Strengthening Social Security Governance in Central and Eastern Europe*, which is being carried out with financial support from the Government of France. The project aims to promote social dialogue on social security reform and to encourage reforms that are well

¹ See also Cichon, M. and L. Samuel (eds.). 1995. *Making Social Protection Work: The Challenge of Tripartism in Social Governance for Countries in Transition*, Geneva: ILO.

matched to national conditions while consistent with the standards for minimum adequacy, inclusiveness, and democratic governance embodied in the ILO social security conventions. The project has three components: (i) promotion of tools and good practices for strengthening the governance of social security schemes; (ii) training and technical support to the social partners in their roles in social policymaking; and (iii) monitoring of early experience with various social security reform strategies. This Handbook was produced under the second component, which supports the social partners. Their need for such a reference guide is rooted in several regional conditions.

First, while tripartite boards have now been established in most countries of the region, their impact to date has not been as consistently fruitful as originally expected. This results partly from uncertainties on the part of board members themselves as to how best to fulfil their roles, and partly from general weaknesses in the governance of the transitional economies of these countries that make such fulfilment more difficult and challenging. Board members may therefore find it useful to refer to models of scheme governance in countries with more settled practices and longer traditions. Thus, drawing primarily on Western European experience, the Handbook lays out what we hope will be useful guidance for the operation of social security boards both generally and on a range of specific issues.

Second, some recent reforms that are particular to the CEE context have complicated the governance of social security institutions, confronting board members with new and complex challenges. Pension and/or health insurance schemes have been partially privatized in most countries, and the new second-tier arrangements interact with public schemes in ways that are sometimes burdensome and unpredictable. With the diversion of contribution revenues to individual accounts, the public scheme may be called on to maintain records for the new private providers. In the alternative, the record-keeping functions of the public scheme may be transferred to a new agency that maintains records for both tiers. Furthermore, in many countries the collection of social security contribution has been unified under a single government agency, often the tax authority, making the social security institution dependent on the performance of a second agency for both revenues and information on the identity of contributors. These new arrangements require the close attention of board members and create a need for them to exercise a combination of diplomacy and persistence in order to influence actions that lie beyond their direct authority. Without prescribing precise rules for coping with these challenges, the Handbook identifies important issues and strategic lines of inquiry.

Third, not all is negative or problematic today in the governance of Central and Eastern European social security schemes. Some positive practices are emerging as policymakers and scheme administrators gain knowledge and experience in managing social security in their own transforming political and economic environments. The same is true of trade unionists and employers serving on tripartite governing boards. As part of the development of the Handbook, we asked for the views and experiences of a number of regional social security board members, sought their feedback on the Handbook in draft, and incorporated into its pages their perspectives and the concrete examples they provided. In this way, the Handbook captures an emerging set of good practices that are being “home grown” in Central and Eastern Europe. As they arise from and are well adapted to regional realities, we expect that these will be of special relevance to users.

The production of this Handbook was an unusually collaborative effort in which many individuals across Europe generously shared their time, knowledge, and perspectives. Those individuals who played the most major roles are recognized on the contributors’ page, and a fuller description of the process is provided in the following section. We at ILO Budapest are grateful to all those mentioned for their ideas and generosity in sharing their experiences. It is their contributions that will make this an important reference tool on the bookshelves of board members in this region.

We thank especially the French Ministry of Social Affairs, Labour, and Family for the financial support which made this project possible. The ILO appreciates the French Government’s commitment to the democratic governance of social security and the arrangements it has developed for giving scheme constituents a strong voice in management. Many of these arrangements find their place in the following pages.

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DEVELOPMENT OF THE HANDBOOK

The idea of this Handbook was first discussed at an ILO employer conference on social security in Bled, Slovenia in mid-2001 by three of its participants, Jean-Marie Standaert, the Specialist on Employer Activities at ILO Budapest; Warren McGilivray, then Chief of Operations at the International Social Security Association; and myself. Following up on these discussions, we developed an outline for a simple guide delineating the responsibilities and duties of a social security board member and providing basic information on the range of issues he or she must address. Emmanuel Reynaud, then director of the social security policy branch of the ILO Social Protection Sector in Geneva, helped to refine and sharpen this outline. After lengthy consideration of who would be best suited to give this outline life, we identified Sue Ward, an independent pension consultant in the UK.

Ms. Ward is the author of many books and articles on pensions and investment and was formerly a pension specialist for a large UK trade union and for the Trades Union Congress. She was also a member of the government-appointed Committee on Pension Law Reform in 1991–2 and served on the Board of the Occupational Pensions Regulatory Authority from its establishment in 1996 to 2002. It is Ms. Ward's deep understanding of social security governance and lively, clear prose that give this Handbook its distinctiveness.

In the fall of 2004, Ms. Ward visited the ILO Budapest office to review our materials on social security and further develop the outline. She found much relevant information in the ILO training manuals produced by the Turin Centre, in ISSA training materials, and in the textbooks produced by the Financial, Actuarial, and Statistical Branch of the ILO Social Protection Sector. The Handbook relies heavily on these materials, many of which are cited throughout its pages and listed in the suggestions for further reading at the end of each chapter.

To provide regional perspectives and background, we arranged for pension specialists from the region to meet with Ms. Ward in Budapest, Bratislava, and Ljubljana. In Hungary, Mária Augusztinovics, a senior economist at the Hungarian Academy of Sciences, described recent issues and problems with pension scheme governance in Hungary. Ágnes Matits, an actuary, pension consultant, author, and trainer at the International Training Center for Bankers, added a perspective on the new Hungarian mandatory individual savings accounts. Dimitrina Dimitrova, the ILO Budapest Specialist on Worker Activities, helped inform the trade union perspective, as did Judit Czuglerné Iványi, a labour lawyer specializing in social security issues and deputy president of ILO National Council. Jean-Marie Standaert provided Ms. Ward with the CEE employers' perspective on social security issues.

In Bratislava, Mária Svoreňova, social policy adviser to the Trade Union Confederation of the Slovak Republic (KOZ SR), and Juraj Borgula of the Engineering Employers' Federation described Slovak social reform initiatives and their organizations' roles. In Ljubljana, Nataša Belopavlovič, then state secretary of the Ministry of Labour, Family, and Social Affairs; Peter Pogačar, of the Ministry staff; Jože Kuhelj, of the Institution for Pensions and Disability Insurance; Professor Tine Stanovnik of the Institute for Economic Research; Dušan Kidrič of the Macroeconomic Institute; and Lučka Bohm and Metka Rokсандič of the Association of Free Trade Unions shared their perspectives on the tripartite consensus on the 1999 pension reform and the mechanisms of Slovenian pension governance.

In November 2004, Warren McGillivray and I separately reviewed the first draft of the Handbook. Mr. McGillivray's review focused especially on the financial aspects of scheme management.

With the Handbook in its second draft, we again invited regional officials and specialists to meet with Ms. Ward, this time while attending an ILO pension conference in Budapest (December 2004). These individuals included: Agnieszka Chłoń-Domińczak, undersecretary of the Ministry of Social Affairs, Poland; Jiří Král, director of social insurance, Czech Ministry of Labour and Social Affairs; Lauri Leppik, an independent pension consultant from Estonia and former adviser to the Welfare Minister; Romas Lazutka of University of Vilnius, Lithuania; Inta Vanovska, director of pension forecasting at the Ministry of Welfare, Latvia; Cristian Toma, senior adviser at the Ministry of Labour and Social Protection, Romania; Jagoda Milidrag-Šmid, social policy advisor, UATUC, Croatia; Josef Suchel, social policy adviser, Confederation of Trade Unions, Czech Republic; and Ewa Tomaszewska, a member of the presidency of Solidarność and former board member of the Polish Social Secu-

rity Institution, ZUS. The perspectives they shared enhance the Handbook's relevance and authenticity.

To bring to bear the Western European perspective and to gather further examples of successful practices, two French officials contributed their experience and perspective to the new draft: Arnauld d'Yvoire, director of L'Observatoire des Retraites, and Michel Laroque, of the French Ministry of Social Affairs, Labour, and Family. Mr. d'Yvoire sought reactions to key parts of the draft from French social security organizations affiliated with L'Observatoire, while Mr. Laroque offered some glimpses into the evolution of social security in France.

Krzysztof Hagemeyer, economist and coordinator of pension policy at the ILO Social Security Department in Geneva and previously the ILO Budapest social security specialist, reviewed the several chapters of the Handbook and offered suggestions on a number of issues, including its treatment of social budgeting, social expenditure review, record-keeping, and the relevant parts of ILO Conventions.

In March 2005, as the Handbook moved toward completion, a group of former and current CEE social security board members provided written comments on the draft. In a one-day workshop in Budapest, we collectively reviewed these comments and obtained further regional examples. This group included Harri Taliga, social secretary of the Confederation of Trade Unions of Estonia (EAKL) and a member of the Estonian Health Insurance Board; Ewa Tomaszewska; Slavoljub Luković, Secretary of the Serbian Trade Union Confederation NEZAVISNOST and a current member of the Serbian Republic Fund for Pension and Disability Insurance for Workers; Marijan Zović, general secretary of the Serbian Employers Association and a member of the same board; Petru Dandea, vice president of CARTEL ALFA and a board member of the Romanian National House of Social Insurance; and Mária Svoreňova. Mária Augusztinovics also participated in this review as an independent expert.

In my final editing of the Handbook, I sought to deepen its ILO perspective and its focus on regional issues. I also contributed to chapter 10 on record-keeping, and I am the main author of chapter 11 on enforcement and compliance.

Mercedes Birck, the ILO social security project assistant, coordinated the numerous interactions of this entire network of contributors, facilitating communication, the logistics of meetings, and the exchange of information. Tom Bass, a freelance editor, formatted the Handbook, assuring consistency in form and usage. Judit Kovácsné Kiss typeset the final draft and in the process provided valuable help in polishing the final draft.

I thank Ms. Ward for her cooperative and fruitful collaboration in giving shape to this Handbook. On her behalf and my own, I thank all those who generously shared their time, ideas, and perspectives in the process of its development.

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September 2005

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*. p. 2.

This guide is intended to help you carry out your duties as a member of a supervisory body of a public social security institution in one of the states of Central and Eastern Europe (CEE). This institution might cover all aspects of social security, or it could be one of a number of separate bodies covering pensions, unemployment insurance, health insurance, or other benefits such as maternity or disability allowances. It is likely to deal with such functions as record-keeping, determining eligibility for particular benefits, and making benefit payments. In some CEE countries, it will also deal with the collection and recording of contributions (from employers, employees, self-employed, and other insured persons).² While the book is largely concerned with institutions running public, pay-as-you-go (PAYG) social security systems, much of the content is about the role of supervisory bodies more generally. So part of it

² However, in a growing number of CEE countries, there is a separate collection agency for social security contributions, linked with or part of the tax authority. See chapter 11.

will also be relevant to certain second-pillar funded arrangements, and indeed to the supervisory bodies of *any* public, not-for-profit, autonomous institution.

The supervisory body might be called a Board, Council, Assembly, or a 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 (perhaps called a Bureau) meeting more often.

For simplicity this book will refer to all such bodies as Boards and to their members as Board members. 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 institution, but rather holders of public offices. The Board as a whole has regular meetings with the Chief Executive Officer and senior staff of the institution also present, to oversee its work and consider its strategy and developments.³ Many of the nominated or elected members have other public roles as well, perhaps as the president of an employers' organization, a trade union federation, or an association of retired persons or persons with disabilities. Appendix E includes a number of examples of institutions of this sort, taken from different CEE 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.

Chapter 2 is a general introduction to social security and the Board member's role. It is followed by three chapters covering the legal framework for a social security Board's activities, with special reference to the countries of Central and Eastern Europe, the general structures of Boards, and their relationship with the staff of the institution. Following these, Chapter 6 looks at setting objectives and monitoring performance, and Chapter 7 considers financial governance. Chapter 8 focuses on ways to ensure that the institution is open and responsive to its clients and the outside world. Chapter 9 deals with communication with the public, and Chapter 10 discusses record-keeping and information and computer technology (ICT), both of which are of particular importance in CEE countries, given the regional trend toward more individualized benefits. Chapter 11 discusses the task of ensuring that employers, including government and parastatal bodies, comply with their obligations to pay

³ The CEO may or may not be an actual member of the Board. In the UK, for example, the CEO sits on the Board, while in France he/she generally does not.

social security contributions. Chapter 12 considers investment policy and advice. It will be of interest only to some Board members, since a number of institutions do not have cash balances or reserve funds to supervise. Finally, Chapter 13 looks at the important but often neglected issue of planning for the future. At the end of each chapter, there is a short summary of the main points, as well as a list of books, publications, and websites that you may find useful if you want to follow up any of the issues included in that chapter.

In the Appendices, there is a brief set of “rules of the road” that summarizes the main lessons and good practices that can be drawn from the book; a set of examples of social security institutions, their general authorities, and the structure of their governing bodies; a list of ILO social security conventions; and a self-assessment questionnaire for measuring your own performance and needs as a Board member. There is also a brief glossary, a list of abbreviations, and a complete list of the publications and websites referenced.

WHAT ARE YOU THERE TO DO?

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

The role of a trustee

Board members are in effect "trustees" for social security schemes.⁴ 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 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.

⁴ The term trustee is used in the English legal system, and others that have their roots in it, to refer to those managing and overseeing pension and investment funds, charities, and many other bodies.

From this, other principles follow for Board members:

- You are there to represent your constituency and to ensure that its members have a voice when decisions are taken that will affect them and the wider public. However, your constituency is wider than simply the organization with which you are associated. For example, a trade union representative would be expected to represent the interests of workers as a whole, not just those in his or her own federation. At the same time, you need to be balanced and fair in your approach, because you are part of a Board that is looking after the whole social security scheme, not just the part that affects your own constituency. So while your role is to speak up for them, the success of this form of governance depends critically on Board members taking a broader view of their responsibilities.
- In general, you are **not** there as a delegate – that is, you do not have to take instructions from your own organization’s executive body, or from the wider constituency. Instead, you have been entrusted by your constituency to argue and vote in line with its overall interests. From time to time, there will be controversial topics on which you will feel you will go back and 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. Many of the people you represent will know much less about the social security institution than you (that, after all, is why they have put you there). 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 all the different interests. So you may need to explain the true situation to them, and at times to tell them things they do not want to hear about what can and cannot be done. Social security is unique among government programmes in requiring 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 longer term. So one of your responsibilities is to help people understand the long-term perspective.
- There will be information that you receive as a Board member that you must keep confidential because it is about individuals or contracts with outside bod-

ies (see chapter 4). It is a good idea to make this clear to your own organization and to others in your constituency at an early stage, and to ensure that they understand: while you will be as open with them as possible, there will be issues on which you cannot share information that you are privileged to have.

- Outside the Board, there may be rivalries between different organizations in the same field – trade union federations that are trying to recruit members, for example. For the good of your constituency as a whole, you will need to suppress these rivalries and try to work in harmony on the Board. If there is a bitter conflict, this may not be easy. Bringing such quarrels into Board meetings will reduce your chances of representing your constituency effectively and make it harder for you to win debates over issues that are important to them. You may want to reach an informal understanding with your colleagues on this, or even draw up a formal memorandum, as a number of the trade union federations in Croatia have done. Their aim was to help to increase the influence of the *whole* trade union movement in the social security field. If there are other institutions in the social security field with tripartite boards, or your institution has a regional network, you might want to make contact with your fellow-representatives on those bodies, so you can discuss the problems that arise and work together on the solutions.
- Your role is supervisory, and you are there to take a view of the whole operation, not to get involved in the day-to-day management. That is what the Chief Executive and the staff are paid to do. Your task is to see that they are doing it properly, not to take a hand in it yourself. This becomes even more important if the Board itself has any responsibilities like those of an administrative court – penalizing people, hearing appeals, or making awards. People will not have faith that your judgments are fair, if you have intervened in making the original decision at an earlier administrative stage.
- In your normal day-to-day job, you may well have a “casework” function, dealing with queries from individual members of your union or association about decisions the institution has taken. It is important to establish from the beginning what you can and cannot properly do in response to these members’ queries. Asking a manager to check the file to ensure a case has been correctly dealt with, for example, may be acceptable, while asking for special treatment, such as seeing the file yourself or sitting in on discussions because you are a Board member, would not be proper.

- You are there to see that the law is upheld. If the institution has the power to waive its 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. Your role should rather be to draw the attention of policymakers to the problems with the law.
- The public does not want social security systems that lurch from one set of reforms to another in response to short-term problems. If this is what happens, they will lose faith in the system's ability to deliver benefits at all. It is important for Boards to work with their governments in looking strategically at future developments in the medium and long term, and to urge them also to look across the social security system as a whole, rather than at benefits individually.
- You are **not** expected to turn yourself into an expert, but you are expected to supervise the experts, and to make sure that they bear in mind the interests of those whom you represent. One very important role is simply to persuade the experts to talk in language that you, and a member of the general public, can understand, rather than in their own technical jargon. For this, you will need to be able to say at times, "I am sorry, but I don't understand you – please repeat the point in plain language." You also need to ensure, however, that you understand enough about the technicalities to be able to ask intelligent questions. The self-assessment in Appendix F can help you identify the areas where you need to build up your knowledge and skills.

One step that could facilitate your work is for the organizations that nominate or elect representatives to the Board to employ their own experts to assist them. For example, in France each body that nominates members for the Boards of the two associations of pensions institutions, the AGIRC and the ARRCO, is entitled to receive funds to pay a salaried "technical adviser" or expert.⁵

⁵ These organizations are the General Association of Pension Institutions for Workers and the General Association of Pension Institutions for Managerial Staff.

DOCUMENTS NEEDED BY BOARD MEMBERS

Board members will need a number of basic documents and other information. Of the list below, some will almost certainly exist already, while others may need to be drawn up, to ensure a well-run institution and Board. If there are gaps in the material available from your institution, you may want to raise the issue at a Board meeting, ask why the gaps exist, and press for the necessary documents to be created and made available over a period of time.

This basic collection of documents should be kept up to date. Most, if not all, should be included on the institution's website (if it exists). 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 should include:

- The statute under which the Board has been set up, and which defines your basic powers and duties;
- Regulations that go into more detail about the Board's powers and duties, including the procedures it must follow;
- The statutes and regulations setting out the details of the part of the social security system you are administering;
- More general codes of guidance 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 institution'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, you will also need copies of these;
- Any mission statement, client charter, or strategy or policy document, for example, on objectives and targets for performance (see chapter 6);
- Any long-term actuarial studies and projections that have been done for the institution and for the social security system as a whole (see chapter 12);

- Summaries of the organization's policy on human resource issues, such as the recruitment and training of its own staff;
- Codes of practice for dealing with outside consultants and contractors, tendering, and competitive bidding. These are likely to be laid down at the national level, perhaps with some specific guidance relating to your institution;
- Other publications, such as any internal or external newsletter, 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 go about their work.

OTHER INFORMATION YOU NEED

It is also useful for a new member to have information about the Chair of the Board, fellow-Board members, the Chief Executive Officer, and the senior staff. New members may want to arrange to meet informally with the Chair, Secretary, and CEO before their first Board meeting, in order to learn how the organization works in practice, what the current controversies are, and how the personalities and functions relate to each other. They should then make the effort to meet all the other senior directors, and to go round the offices. It will be useful to ask for an organizational chart, as suggested in chapter 4. However, often the formal structure of an organization and the way that it operates in reality are rather different. Therefore, after having made all these contacts, a Board member may want to draw a second organizational chart for him/herself, to lay out how the organization works in practice.

It will be important to find out who provides services for the Board – that is, who arranges the meetings, sends out the agendas and papers, takes the minutes, and deals with routine queries and correspondence for Board members. In the rest of this book, we are using the term Board Secretary, though the role might in fact 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. Nobody can be expected, however, to know everything about the relevant law or the institution's activities at the beginning of a term. It is good practice, therefore, for new Board members to be given

the chance to attend seminars about its work, and for existing members to have regular updating sessions. There will be areas where external experts should be brought in to explain overall principles, discuss the background, and offer an independent perspective on what is happening. There will be other areas where those working for the institution will be best equipped to take Board members step-by-step through the procedures they use, explaining the reasons for them and plans for the future.

One important element of this will be the structure of the benefits that are administered by the institution. In many cases, there will be different layers of benefits that originated at different times in the institution's history, as well as subgroups of the covered population with different entitlements. The public's focus may only be on the benefit structure as created by the most recent set of reforms, but for a real understanding of the scheme, the historical picture is necessary.

Training of Board members: An example⁶

Below is a summary of a two-day seminar organized and paid for by the General Association of Pensions Institutions for Managerial Staff (AGIRC) in France for new members of the *Administrateur*, the Board that supervises AGIRC. As it is a federation of smaller institutions, most of them are already members of their own Boards.

Day 1 of the seminar began with a short description by an existing member of his own experience on the Board. The Director of their Secretariat then gave a history and overview of this form of retirement provision, and how it fitted into the overall system of public pensions in France.

The Director of Regulation then explained the broad principles of regulation and the way the regime had evolved, in terms of legislation and judicial decisions.

After lunch, the Director of Institutional Relations explained the organization of AGIRC as an institution, and the responsibilities of the Board members. The Technical Director then explained the way how costings and estimates are done at AGIRC. This was followed by a session on the "social action" in which the institution is also involved.

The day ended with a round table with the senior executives, and then a dinner for participants and speakers.

⁶ In France, employers are obligated by law to give their employees who are on a social security Board a leave of absence to attend training sessions related to their role.

Day 2 started with an explanation by the Information Director of a pilot programme for providing information to members and simplifying administration. It then moved on to a session on auditing, given by the director of Audit and Control, and then a further session on quality controls and targets, by the Director in charge of that area.

After lunch there was a session on financial controls, followed by a final summing up by the Chair and Vice-chair, and the Chief Executive.

A seminar like this also provides a valuable opportunity to get to know fellow Board members and senior staff of the institution 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. (There is an example as part of the self-assessment exercise in Appendix F.) Following this, the Board Secretary could draw up a programme for each individual over the course of the year. Some of this could fit in with the cycle of work of the Board itself, so that training is provided at the point when it is most relevant. For example, in the month in which the audited accounts are due to be presented to the Board for approval, there could be a day or half-day session beforehand. This session would explain the methods used and what can be learned from a particular set of accounts. This could come from the national public auditing body, the institution's own staff, or an academic or other external consultant.

As an individual Board member, you may also want to think about more specific areas where you need further information. For example, you might wish to have a one-to-one session where an appropriate expert reviews the legal and constitutional framework for your institution, puts it into the overall context of the law, and discusses possible future developments.

It is often hard for busy people to make sure they set aside the time for 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 by which each member would keep a standardized record of his or activities could be an incentive to do this. A very simple example of this is included in Appendix F.

This record can be shared among Board members at an annual review session, as an item on the Board agenda, and perhaps also included in the annual report.

Key points from Chapter 2

- The primary duty of a tripartite Board of a social security institution is to see that the institution 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 institution, including the legal statutes, programme and operating statistics, budget and accounting documents, and protocols for the running of the Board meetings.
- It will be useful for a new Board member to meet the Chief Executive Officer 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.

MORE INFORMATION ON THESE TOPICS

If you want to follow up on any of the topics considered in this chapter, listed below are some books and other relevant resources.

ILO publications

Cichon, M. and L. Samuel. 1995. *Making Social Protection Work: The Challenge of Tripartism in Social Governance for Countries in Transition*. Budapest: ILO and Nicosia: Ministry of Labour and Social Insurance.

Gillion, C., J. Turner, C. Bailey, and D. Latulippe (eds.). 2000. *Social Security Pensions: Development and Reform*. Geneva: ILO.

ILO. 2001. *Social Security: A New Consensus*. Geneva.

ILO. 1984. *Introduction to Social Security*. Geneva.

Training manuals from the ILO's International Training Centre in Turin, Italy

- ILO. 1998a. *Social Security Principles*. Social Security Manual 1. Turin: ILO International Training Centre.
- ILO. 1998b. *Administration of Social Security*. Social Security Manual 2. Turin: ILO International Training Centre.
- ILO. 1998c. *Social Security Financing*. Social Security Manual 3. Turin: ILO International Training Centre.
- ILO. 1998. *Social Health Insurance*. Social Security Manual 5. Turin: ILO International Training Centre.

ILO/ISSA textbooks on Quantitative Methods in Social Security

- Cichon, M., W. Newbrander, et al. 1999. *Modelling in Health Care Finance*. Geneva: ILO/ISSA.
- Cichon M., W. Scholz, et al. 2004. *Financing Social Protection*. Geneva: ILO/ISSA.
- Iyer, S. 1999. *Actuarial Mathematics of Social Security Pensions*, Geneva: ILO/ISSA.
- Plamondon, P., et al. 2002. *Actuarial Practice in Social Security*. Geneva: ILO/ISSA.
- Scholz, W., et al. 2002. *Social Budgeting*. Geneva: ILO/ISSA.

Websites

- International Labour Organization (ILO): www.ilo.org
- International Social Security Association (ISSA): www.issa.int
- University of Lausanne: www.unil.ch
- University of Maastricht: www.fdewb.unimaas.nl

Formal training opportunities

At its International Training Centre in Turin, the ILO organizes regular seminars aimed at managers of social security systems all over the world. Some courses are for those who manage and run the systems, while others are for people working directly with the technical models developed by the ILO for making projections of social protection benefits and financing.

In addition, the International Social Security Association (ISSA) organizes short executive development courses for Chief Executives and Board members of social security institutions.

The training manuals for the Turin courses have been heavily drawn upon in this handbook, as indicated above. The ILO and ISSA have jointly published the *Quantitative Methods in Social Security* series of textbooks, also listed above. Some of these are, however, more technical than a Board member would normally need.

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. It is designed to train specialists in social protection and in social protection financing for social security institutions, insurance companies, governments, research institutions, and consulting companies. Not everyone has the time to take the full one-year programme, so it is possible to take just one course or a block of courses. There are also plans to provide other courses for those with less advanced knowledge of mathematics and statistics.

The University of Lausanne is also setting up a two-year actuarial course specialising in social security, in conjunction with the ILO.

THE LEGAL FRAMEWORK FOR THE BOARD MEMBER'S ROLE

INTRODUCTION

Social security institutions and their governing Boards are set up by law to perform specific functions. Who sits on the Boards, how they are appointed, and what role they are expected to play is specified by the law. More detailed regulations and guidance may come from the relevant Government ministry or department.

In principle, autonomous social security institutions 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
- scheme financing, including the rate of contributions, the level of advance funding, and the allocation of contribution revenues among broad funding categories, within the framework of national economic plans.

On paper, this can look like a clear-cut division, but in reality the lines are somewhat blurred. One person's policy decision becomes the next person's set of requirements to be implemented. As the policy decision is implemented, the policy itself will change – vague commitments may harden into clear statements in an administration manual, or alternatively may be found to be too vague to be workable. The next time the issue is reviewed, the practical experience with implementation becomes the policy starting point. Therefore, whatever legal lines are drawn, for policies to be

successful there needs to be dialogue and feedback between the Government and the social security institution.

LEGAL STATUS

The degree of legal independence of a social security institution varies considerably from country to country. Some institutions 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 Finance Ministry.

The Board of the National Pension Scheme in Serbia

Under a statute passed in 2003, the Managing Board of the Pension and Disability Insurance Fund of Serbia has the following responsibilities:

- Develop and approve operating rules for the Fund, in accordance with the Fund's authorizing statute and other regulations applicable to it;
- Set contribution rates, with the approval of the Government;
- Adopt financial plans and annual financial statements of the Fund;
- Adopt annual and medium-term operating programmes;
- Follow a transparent public procedure in recruiting, selecting, and appointing the Fund director;
- Decide on other issues and discharge other functions in accordance with the statute and regulations of the Fund; and
- Report to the Government on the operation of the Fund.

The Board elects its Chair and Deputy for a two-year period of office. These offices rotate among Board members representing insured persons, employers, and beneficiaries.

The statutes covering the Board's role may be lengthy and technical, so it will be helpful both to Board members and the public if a brief summary in plain language is

produced and made available. If there is a controversy about the Board's powers, it is, of course, 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 to refer back to them whenever necessary. For this purpose, it is useful if, as a matter of routine, Board papers include extracts of the relevant part of the law, or references to it.

Practices may have been developed that are not in line with the strict wording of the law. For example, it might be laid down that the Board as a whole draws up and approves the annual budget, when in fact the Chair and Chief Executive do this, and only bring it to the Board for "rubber-stamping" – when it is too late for a meaningful review, deliberations, and changes. In such cases, though it might take some time to achieve, you may want to work with other Board members to return the power to the Board, and therefore insist on a fuller discussion.

Sometimes the terms of the statute that set up the institution may lead to frustration for Board members, because the institution does not have some powers that would make it easier to operate, or the statute may be unclear as to who has the powers it lacks. Equally, some requirements may be very inconvenient or difficult for some employers or individuals to meet. However, the institution ought to follow the law as it is, until it is changed. Taking legal shortcuts that are convenient in one instance will, over the longer term, 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.

OTHER LAWS

There may be other laws dealing with more general topics that you will need to be aware of and to refer to when necessary.

Examples include your country's:

- human rights legislation;
- legislation covering the ethics and behaviour of public servants, and anti-corruption legislation (see chapter 8 for more on this);
- legal requirements for auditing of public bodies, including the terms of reference of your national audit office or similar body;
- national requirements on freedom of information – that is, what documents from public bodies the general public is entitled to ask for and receive, and which are required to be published or made available on the bodies' websites; and

- international codes of guidance on relevant issues, such as the ISSA guidelines on the investment of social security funds (see chapter 12) and the International Actuarial Association (IAA) guidelines for social security actuaries (see chapter 13).

THE EUROPEAN UNION

For countries within the European Union, or candidates for membership, there are also Directives and Regulations relating to the field of social security (including any temporary or permanent abrogations your Government has arranged). The most important of these are:

- Regulation 1408/71, the detailed guideline which is intended to coordinate the various social security systems of the European Economic Area,
- Regulation 1612/88, which covers freedom of movement and equality of treatment for those defined as “workers”, and the rights they have to social security benefits as a consequence;
- Regulation 883/2004, on the coordination of social security systems (this will in due course replace 1408/71, but for the moment the two are operating in parallel); and
- Directive 79/7/EEC, on the progressive implementation of the principle of equal treatment of men and women in matters of social security.

RELATIONSHIP WITH OTHER BODIES

Within a tripartite Board, the Government will have its own representatives as members, and these often will be very senior people. On bipartite Boards, there will be no official Government representation; but senior Government delegates may nevertheless attend the meetings.⁷ Under either arrangement, the 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.

⁷ In France, full authority for the National Insurance Funds for Employees is left to the social partners. Nevertheless, two government delegates may attend the Board meetings, representing the Social Security Ministry and the Budget Ministry.

In most cases, the institution will also have relationships with other bodies, within or outside the Government. Generally, the most important of these is with the “sponsoring” ministry within the Government, e.g., the Ministry of Labour, Social Affairs, or Health.

At least as important in practice, though possibly not in the legal framework, is the Ministry of Finance, since this is responsible for the overall State budget. The contributions paid into social security funds, and the benefit payments made, have an important influence on the economy. So even though your institution is left to act autonomously in the way it carries out its administrative functions, the power of setting its operating budget will typically lie with the Government, as will decisions about what structure of benefits is optimal and level of benefits can be afforded. It is good practice, though, for the Board to be involved in drawing up the details of State budgets, as well as in consultations and negotiations before the final decisions are taken. A Government guarantee that any deficit will be covered from general taxpayers’ funds provides a further reason and need for the Ministry of Finance to oversee the activities. 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 a well-informed Board is a valuable asset to the Government in making these decisions; and making your presence felt is very much part of your job and in the public interest.

It is possible that, at times, a strong role for the Government, through the Ministry of Finance, may pose a threat to the social security system. This could happen, for example, if the party in power chose to try to win votes through popular benefit improvements with hidden costs that jeopardized longer-term financial solvency. 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 real needs and administrative costs of the institution, but which also takes account of the economic realities of the country;
- negotiate on this budget openly with the relevant ministries, rather than having the ministries’ representatives effectively dictate to the rest of 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 chapter 13);

- be formally consulted by politicians in advance on legislative changes that would have an impact on the Board's work or its finances, rather than being told after the changes are made;
- work with politicians on a realistic timetable to plan properly for the introduction of new technology or new requirements and make the necessary alterations in working practices that will be needed;
- make reports, and discuss or negotiate changes, dealing with 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 social security system of which the institution is a part, including consulting on the assumptions to be used in long-term actuarial projections of this larger system.

There will also be other bodies with which your Board will need to have a close relationship, such as:

- if your institution does not collect contributions, another agency does so, since the smooth running of the social insurance schemes will depend critically on the efficiency of collections. In Slovenia, for example, the Unified Tax Administration (part of the Ministry of Finance) collects both social contributions and personal income tax and controls, inspects, and enforces the contribution requirements; and the pension institution works closely with it on joint audits (ILO 2004: 253). For more suggestions for such collaboration, see chapter 11;
- your country's autonomous or semi-autonomous Government auditing office, responsible for monitoring the finances of all public institutions (see chapter 7);
- private sector institutions, such as individual savings funds, insurance companies, and banks, which employers use as intermediaries in paying contributions and which may receive contribution revenues from your institution. In Poland's privatized pension tier, for example, the social security institution ZUS is responsible for collecting pension contributions and must then allocate them to the individual savings fund chosen by each worker;
- in some cases, separate regulators: for example, health insurance funds may find it necessary to maintain a close relationship with whatever Government body licenses health providers and monitors quality standards; and

- in the medical and disability fields, professional bodies such as the medical practitioners' association or any associations of hospitals or organizations offering vocational rehabilitation.

The law may not always be clear about how responsibilities are divided between your institution and other bodies or whether, for example, one body has the power to *veto* actions by another, or only *recommend* that certain actions are not taken. In practice, these issues can be resolved best through working in partnership, 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 in which these partnerships can be formalized. Copies of these should be available to Board members, and to the public.

In general, an institution should try to maintain a good but not too close relationship with all these 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, in case the issue comes up again.

Key points from Chapter 3

- In principle, autonomous social security institutions deal with administration, while the Government takes decisions on policy matters. However, this is not a clear-cut division, and for policies to be successfully implemented there needs to be dialogue and cooperation.
- The degree of a social security institution's independence from Government ministries will vary from country to country. In some countries, practices may also have evolved which are not in line with 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 institution must conform, both national and international. Board members need to familiarize themselves with these.
- The Board's aim should be that the institution acts as an "independent but responsible" body in its relations with the Government.

With other public or private institutions with which the institution must work, the aim should be to maintain a good but relatively formal relationship. A Memorandum of Understanding between or among the different parties may be useful for this.

MORE INFORMATION ON THESE TOPICS

If you want to follow up on any of these topics, listed below are some books and other resources that could help.

The structure of social security institutions in CEE countries

GVG. 2003a. *Social Protection in the Candidate Countries. Country Study 40, Estonia, Latvia, Lithuania*. Berlin: AKA.

GVG. 2003b. *Social Protection in the Candidate Countries. Country Study 41, Czech Republic, Slovakia, Poland*. Berlin: AKA.

GVG. 2003c. *Social Protection in the Candidate Countries. Country Study 42, Bulgaria, Hungary, Romania, Slovenia*. Berlin: AKA.

European Union regulations and directives

www.europa.eu.int , via “Documents”

Other international standards and codes of practice

International Actuarial Association (IAA). 2002. *Final IAA Guidelines of Actuarial Practice for Social Security Programmes*, adopted by Council of IAA. 21 October 2002.

International Social Security Association (ISSA). 2004. *Guidelines for the Investment of Social Security Funds*. ISSA Study Group on the Investment of Social Security Funds. Paper for meeting. Porto, Portugal. 1–2 April 2004.

For ILO Conventions and Recommendations, see www.ilo.org/ilolex.

Social security institutions around the world

The ISSA website (www.issa.int) has links to a large number of the websites run by its member institutions, via “Other sites”. Many, though by no means all, have versions in English or in other languages.

THE BOARD'S ACTIVITIES

INTRODUCTION

There are variations in the way that Boards in different countries conduct their business. However, some points are common to all, and this chapter is intended to cover these.

TIME COMMITMENT

The frequency of Board meetings depends on the scope and volume of the Board's responsibilities, but in general meetings should be 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 institution and holds discussions with the external auditor each year, or an Investment Committee that deals with the management of investments. Other temporary committees may be set up for various purposes – for example, to draft a report to the Minister on a particular topic or to oversee an information technology project.

While Board meetings are usually held in the headquarters of the institution, holding some of them in regional or local offices each year will help Board members to 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 of the institution. Board members should arrange to tour the 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 people who may be doing routine jobs to understand how their contributions serve the institution's broader purposes.⁸

Boards should have responsibility for developing strategy, planning, and looking ahead to the future. A single meeting with routine business on the agenda may not leave enough time for an in-depth debate on strategy and the future programme. So a Board may need an extended review meeting perhaps once a year, taking a whole day or two days, often in a venue away from the main offices so that there are fewer distractions. A key element of this meeting will be establishing and reviewing the institution's objectives – what it is there for, what has been achieved, and what can be achieved over the next time period. (See chapter 6.)

Before you accept appointment as a Board member, it is a good idea to find out the full extent of the time commitment and decide whether you can meet it. As well as reserving time for the formal meetings, you will also need to read all the meeting documents, which can be very bulky, in advance. One experienced CEE Board member who was interviewed for this project commented that it takes her nearly as long to go through all the documents properly as to attend the meeting itself. For a less experienced member, it could take substantially longer.

There may also be other preparatory work. For example, the members representing workers might find it necessary to meet separately before a general 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 that require detailed study. It may also be necessary to report back and discuss together after each meeting, especially when there are plans to make changes that you know are needed but will be unpopular.

In Croatia, as described previously, the trade union representatives meet the day before the main meeting of the Board to discuss the issues and the problems that will be coming to them. Following the meetings, they report back to their confederations, providing whatever back-up material is needed to explain the problems. Similarly in Slovakia, until a recent re-organization, the vice-president of the Board of the Social Insurance Agency (SIA), who was also vice-president of the trade union confederation, would invite other members of the Board representing insured workers and

⁸ It is of course necessary that such office tours be undertaken with the full knowledge and cooperation of the CEO.

beneficiaries to have separate discussions before Board meetings. The staff of the trade union confederation would assist by providing briefing materials.

Anyone who is representing a particular constituency on an institution's Board needs to be a *real* and not a *nominal* member. Otherwise, the constituency will 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 the Board meetings continually clash with others that you also have to attend, you ought to consider whether you should remain a member of the Board. Taking up a seat without attending the meetings regularly, or attending without doing the advance preparation and follow-up, serves neither your constituency nor the Board's broader purposes.

MEETING PROCEDURES

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 for all tripartite bodies, 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 use their influence to ensure that they are formulated.

Topics that should be covered include:

- The *quorum* – That is, how many members from each grouping need to be present before the Board can take valid decisions?
- The *rules for taking decisions* – If there is a vote, is the outcome determined by simple majority, a majority of each group, or some other rule? Does the Chair have a decisive vote if the vote is split? Who can call a vote?
- The *position of committees* – Whenever a committee is appointed, its terms of reference should be set down clearly in writing. Perhaps the most important point is whether the group is making *recommendations* to the Board, or *decisions* that need only to be reported to the Board.
- The *rules for putting items on the agenda and proposing formal resolutions* – What is the procedure for a Board member other than the Chair or Chief Executive 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/participation in the meetings* – Are they only observers or also 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 and what is closed? It is good practice to hold as much as possible of the Board meeting in public. The 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* – Both are covered in separate sections in this chapter.

The Estonian Health Insurance Fund

The legislation covering the Fund's operations specifies that:

- Meetings shall be held at least every three months, and the procedure for announcing meetings shall be laid out in the internal statutes of the Fund.
- The Chair or Deputy Chair normally calls the meetings, but a meeting must also be held if requested by a member of the supervisory board or the management board, or by the auditor.
- A meeting of the Supervisory Board has a quorum if at least two-thirds of the members are present, including the Chair or Deputy Chair. If there is no quorum, another meeting must be held within seven days.
- Minutes must be taken at each meeting, including all decisions; and these must be held at the headquarters offices.
- Any member has a right to have a dissenting opinion recorded in the minutes.

It is good practice for these protocols to be put together in a short printed document and made available to Board members and the public. This helps people

understand how the Board conducts its business and provides reassurance that it is acting properly.

THE CYCLE OF WORK AT MEETINGS

It is normally the responsibility of the Board Secretary to organize the Board's programme of work, but it is good practice for the Secretary to share the details of this with the Board in advance. Most Board agendas will have a mix of regular and specific items.

Regular items might include:

- management accounts,
- operational reports, including details of various work loads, progress on meeting targets, etc.,
- the Chair's and Chief Executive's reports on ongoing activities,
- a report on communications and publicity, and
- an investment report (if relevant).

Other items may appear regularly on the agenda for a period, and then drop out – for instance, a report on the progress of a computerization project. Still others will be part of a regular cycle, annual or perhaps longer, e.g., every three or five years. These might include actuarial valuations or reviews of external contractors.

Over time, each aspect of the institution'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 then be resumed when there are fewer urgent demands.

If not already in the regulations, standard requirements should be set 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. If any documents have

to be sent late, this should be clearly noted and the reasons explained. The secretariat may wish to make use of e-mail or the institution's own intranet for this purpose, but while this is convenient for many, it will not be convenient for all, perhaps because of the limitations of their own technology. If anyone asks for the meeting documents to be sent by post or courier, this should be done.

- 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 those minutes should then 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.

TIMELY ISSUE OF DOCUMENTS

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

Similarly, new issues for decision – unless they are very minor – should not be brought to the Board without advance notice. Chairs and Chief Executives sometimes develop a habit of raising important issues in their reports, or under "Any Other Business", and asking 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 in fact urgent, the memorandum should be treated as notice of the item for the next meeting; and a proper report should then be prepared.

It is, however, a frequent problem for many committees that the deadlines for sending out agendas tend to drift, becoming later and later, while papers are sent separately afterwards or only provided 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 because of a lack of proper organization, but it can also be a sign that the institution's officials are taking the Board for granted and not giving sufficient priority to its business. Providing the documents late has the effect – accidentally or deliberately – of sidelining the Board and concentrating the power in the hands of those who have prepared them.

Just as there is a “natural” drift in the direction of sending material out late, so it is the “natural” role of a Board member to fight against it! It is important to notice and complain whenever this happens, and to insist that the agreed deadlines are observed in the future.

CONFIDENTIALITY

The rules and conventions about what should be public knowledge and what should be kept confidential will vary among organizations and countries. Much will depend on the laws on freedom of information. If these are rather limited, the Board might wish to go beyond them in the interests of transparency and building public trust. Openness needs to be balanced, however, 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; and
- information about the personal situation of individuals, whether employees or clients, should not be made public without their consent.

The same guidelines would generally apply to Board members discussing the affairs of the Board elsewhere, even if it is with colleagues or experts within the constituency that you represent. Relationships with commercial providers are particularly sensitive, since very large sums of money may be involved.

There will also be cases where, as a Board member, you will be given information that could be damaging to a firm if it were divulged. Failure to pay owed contributions to your institution is a case in point, and some might argue on this basis that such failures should be treated with confidentiality. A better approach, however, would be to make the institution's operations so transparent that there is very little that *can* leak out. For example, in Slovakia, the SIA website includes a list of debtors owing more than 250,000 SKK, and there are plans to extend this list to all those owing more than 100,000 SKK. So at least for the larger debtors, non-payment of contributions is public knowledge; and it is the enterprise's own fault if the information damages it. Keeping the facts secret means that you cannot use them as tools to enforce compliance, and also that you are denying information to others who have a real interest in it – in this case, the individual workers whose benefit entitlements may be affected.

It is *always* worth asking your fellow Board members to discuss *why* secrecy is needed in the first place. If it is agreed that secrecy is appropriate, however, loyalty to the Board and the institution would need to come before your wish to tell others, if you received information as a member of that Board.

In this regard, a particularly difficult issue is negotiations on political issues, where the media and opposition parties are likely to be deeply interested, and where you may or may not support the approach that the majority of the Board, or the Chair, is taking. What you do depends on the particular circumstances at the time, but if it is decided that a matter should be kept confidential, or if it is clear within the general policy guidelines that it should be, your decision to break confidence could have serious ramifications. Of course, different levels of confidentiality are appropriate for different events: for example, having an informal discussion with a limited group within your own organization, on whom you could rely to keep the matter secret, versus making a statement in public, or to a journalist, which would bring a confidential matter into the public limelight.

It may be possible to arrange for other bodies, such as your Government's tripartite economic and social council, to receive documents in draft so that they too can take part in the discussions of controversial issues. Moreover, on some occasions, and without breaching confidence, you might be able to suggest to an interested outsider the relevant questions to ask your institution about particular points.

However, there could be controversies in which you feel that you *have* to make a statement that breaches confidence. In general, you would then expect to resign – or

be dismissed – as a consequence. So you would need to balance the possible results of your departure from the Board against the consequences of failing to bring this particular point to the public's attention.⁹

CONFLICTS OF INTEREST

Linked to the question of confidentiality is that of conflicting interests – the question of what you should do if you have a personal or business interest in a body which is dealing with the institution. You might, for instance, be (or be related to) a director of an organization that is bidding for business from the institution. At best, this will make it difficult for you to make an objective decision, and at worst it may put you under pressure to help those with whom you are associated (corruption), or to lead others to allege corruption even if it does not exist.

Most countries will have codes of guidance or statutes about conflicts of interest. These may require declaring the conflicting interests, prohibit those with conflicts of interest from taking part in particular decisions, or both.¹⁰

Guidance from Transparency International (TI)

TI is an international, non-governmental body dedicated to combating corruption in business and public life throughout the world. It has published a detailed working paper (Carney 1998) covering all aspects of this question, and providing examples from a number of countries of what can or should be included in a code on conflicts of interest. As this paper puts it:

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

⁹ See chapter 9 for a discussion of “whistleblowing” – providing information about someone who is acting against the law or outside normal ethical standards.

¹⁰ Some governments also enact laws to prevent conflicts of interest from arising. In France, an individual who serves as Board member of a company that is awarded contracts by a social security institution is barred by law from becoming the administrator of that institution.

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.

Source: Carney 1998: chapter 1.

Even if the legislation governing your institution does not require a declaration of interests, it is good practice for the Board itself to require members to make one. If the legal requirements are rather limited, the Board may also want to develop more specific and comprehensive standards.

The register should be made available to all members of the Board, so that everyone is aware of the interests of his/her colleagues. Where a particular issue is being debated on which a Board member has a conflict of interest, he/she should declare this at the time as well. If the interest is at all significant, he/she should take no part in the debate and leave the meeting during the discussion. The principle of “declare, then take no part” should extend beyond simple financial interests and should apply to indirect interests as well as direct ones.

For example:

- A Board member might 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, but has shareholdings in a private health company, will be affected by decisions relating to such companies whether or not his/her own firm has direct dealings with the institution at that time.

You may feel that you are perfectly capable of being dispassionate and not allowing your interest to affect your judgment. You may well be right, but this is not the point. The important question is: “What would the person in the street – someone who was neither a friend nor an enemy – think if he or she heard about this?”

If it could lead this person to feel that there was anything dubious about the decision or the process that led to it, then you should take no part in that decision, or in the discussion of it.

LOBBYING

A far more subtle behaviour than actual corruption is lobbying by outside companies or institutions for business that benefits them or, more subtly, for ideas or policies that would eventually lead to further business. For example, moving some elements of the social security system from public to private provision can provide very large gains for banks, insurance companies, and private savings funds. Board members may well find that they are the target of lobbying by such institutions, including provision of information; invitations to meals, corporate entertainment, seminars, or study visits; or offers of equipment or software free of charge or at a reduced cost.

Such offers can be very attractive, especially since the lobbyists will probably be well trained in public relations and communications skills. One defence against them is to remember the American phrase, “There is no such thing as a free lunch.” In other words, people who seem to offer gifts usually have an ulterior motive. It would be good practice for your Board to agree to decline all gifts from individuals or companies with a financial interest in its operations and to make this a formal rule. As a second best alternative, you might require public disclosure of all gifts accepted by Board members in the register of interests, suggested above.

Key points from Chapter 4

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

MORE INFORMATION ON THESE TOPICS

If you want to follow up any of the topics considered in this chapter, some books and other resources that could help you are listed below.

Conflicts of interest

Carney, G. 1998. *Conflicts of Interest; Legislators, Ministers and Public Officials*. Online: www.transparency.org/working_papers/carney.

Czaputowicz, J. 2000. *Ethics of the Corps of Civil Service in Poland*. Paper presented at the International Institute for Public Ethics conference “Ethics in the New Millennium – Bridging the Public and Private Sectors”. 24–28 September 2000, Ottawa.

Estonian Government. *Anti-corruption Act*. Passed 27 January 1999, consolidated 2003.

European Institute of Public Administration. 2004. *Ethics in the Public Services of the European Union Members States*. Survey for the 42nd meeting of the Directors-General of the Public Service of the European Union Member States. 27–28 May 2004. Dublin, Ireland. Online: www.eipa.nl.

Open Society Institute. 2002. *Corruption and Anti-corruption Policy in Lithuania*. Online: <http://unpan1.un.org/intradoc/groups/public/documents/UNTC/UNPAN01831.pdf>.

Transparency International. Online: www.transparency.org.

MANAGEMENT STRUCTURES

INTRODUCTION

As discussed in chapter 1, the Board's role is supervisory, and it is there to oversee the whole operation, not to get involved in day-to-day management. That is what the formal head of the organization and its staff are paid to do. Posts will have different names in various institutions, but for convenience we are going to use the terms "Chief Executive Officer" (CEO) and "senior directors". The Board member's task is to see that they are doing their jobs properly. This chapter, therefore, considers the relationship that Board members have with these individuals.

The legal statute or regulations setting up the institution should include a statement of the different responsibilities of the Board and the CEO, and new members will need to make themselves familiar with this. If, in reality, the relationship does not seem to be working as laid down in the law, it is important to work to bring practice into accord with the legal requirements. Strategies could be discussed with Board members who have held their positions longer or perhaps be raised formally at a Board meeting.

THE SENIOR MANAGEMENT TEAM

Senior directors will probably include, at a minimum:

- a Director of Finance, with the ultimate responsibility for all matters relating to budgets, accounts, and internal audit;

- if the institution collects contributions, a Director of the Contributions Division, who is responsible for all contributions issues, such as registration, collection, compliance, and maintenance of records;
- a Director of the Benefits Division, responsible for all aspects of providing benefits, such as application and payment procedures, adjudication, and appeals; and
- a Director responsible for information and communications technology.

There may also be a senior Medical Officer, advising on medical matters and organizing the medical examination of people claiming disability benefits or employment injury benefits, and a senior Legal Officer advising on the law and dealing with prosecutions, reviews, and appeals.

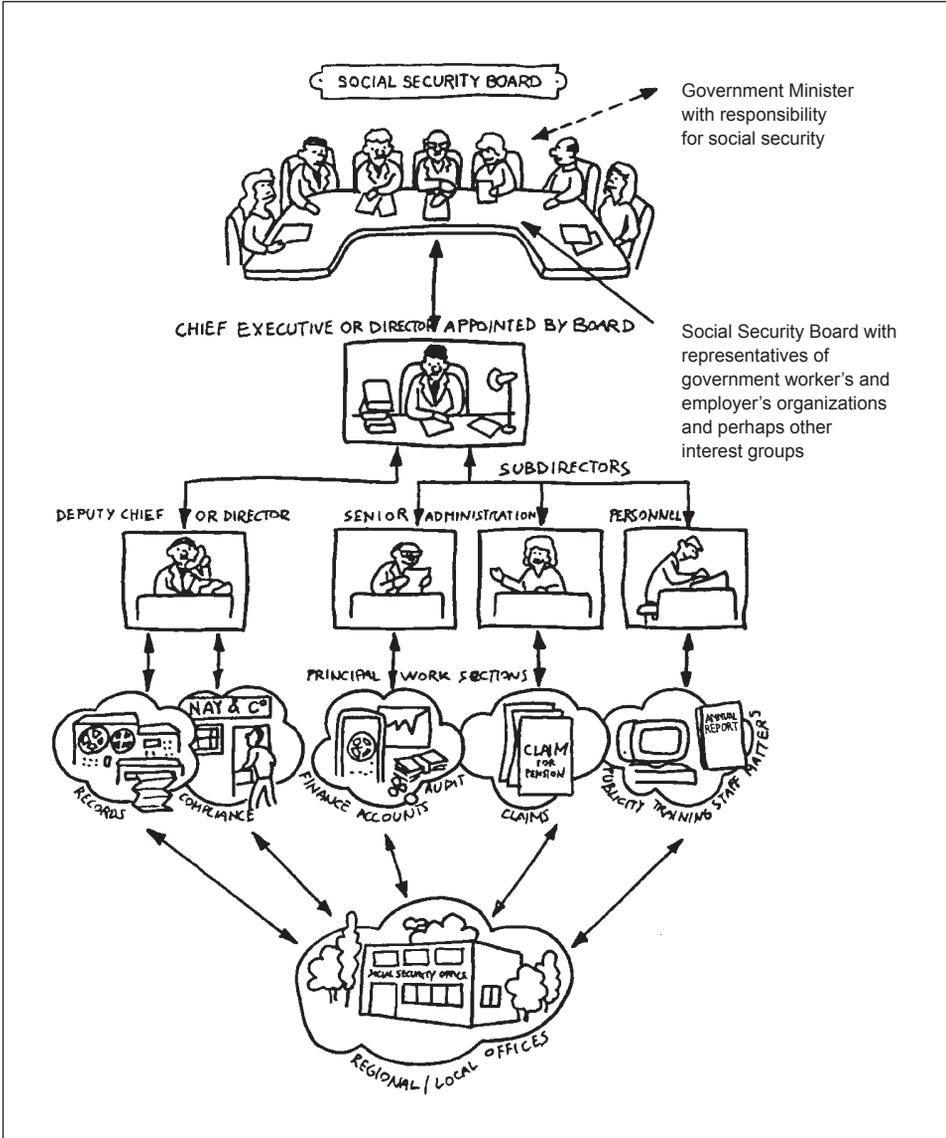
Someone at a senior level should also be specifically responsible for issues of security, such as computer security and data protection, and for risk management across the whole organization.

Other functions that are likely to be dealt with at headquarters level include:

- research;
- communications, public relations, and public information;
- advice to ministers, particularly on policy formulation and development;
- technical and procedural advice to regional/local offices; and
- collection, collation, and analysis of statistics from the regional/local offices, for example, on the intake of new claims, the flow of work, and backlogs.

Board members will find it helpful to have an organizational chart showing the management structure, resumés for key persons, and a statement of responsibilities for each of the senior staff. These all need to be kept up to date, and new versions circulated to Board members at regular intervals.

The following diagram from an ILO training manual illustrates a typical organizational structure.



Source: ILO. 1998b. *Administration of Social Security*. Social Security Manual 2. Geneva: ILO. p. 10.

RELATIONS WITH SENIOR MANAGEMENT

In general, Board members are likely to build a closer relationship 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 Chair of the Board is likely to have the closest working relationship with the CEO. As he or she will be operating at a level of greater detail than the ordinary Board member, the Chair is likely to have many meetings and discussions with the CEO that do not involve the Board members.¹¹ Generally, it is good practice for these discussions to be reported at a full Board meeting or, in the alternative, for the major points to be described to the Board in the reports of the Chair or CEO – though this may need to be after the event, if the matter is delicate. The aim should be for all members to be equally knowledgeable about what is going on. It is not a good idea for there to be an “inner circle” of people who understand what is happening and an “outer circle” of people who are only there to formalize decisions taken by the insiders. In some cases, the Chair or CEO may develop the habit of meeting individually with Board members to go over points before the main formal meeting. Though it may not be intended that way, such meetings can create suspicion that there are deals being made behind the backs of others, and so should be discouraged. If such meetings do occur, a written note of what was covered and any conclusions reached could be prepared and circulated. The Board member concerned could do this him- or herself.

Some Boards may have a smaller Executive Committee or Board of Directors (also called a “Bureau”) that meets more regularly and handles certain more detailed issues. This body should be formalized and have clear reporting lines so as to avoid its becoming a clique or an informal or “unofficial” entity.

¹¹ There may be good reasons for individual Board members also to be involved in discussions with senior staff of the institution outside Board or committee meetings – perhaps because of special concerns about particular issues. For example, government officials who sit on the Board may have meetings to discuss the annual budget in draft as part of their job at the relevant ministry, and then they will discuss it again as a Board member when it is a finished product.

SELECTION OF THE CEO

In many cases, the CEO will be appointed by the Minister or a committee of the legislature rather than the Board. It is good practice, however, for the Board to have some involvement also in the process, since it will be working closely with the appointee, even though the final appointment will be made at a higher level. In Poland, for example, the President of Social Insurance Institution, or ZUS (*Zakład Ubezpieczeń Społecznych*), is appointed and dismissed by the Prime Minister, based on the advice of the Minister responsible for social security, while members of the Board of Directors are appointed and dismissed by the Supervisory Board on the application of the President of ZUS. The ZUS President manages its activities and is at the head of a four-member Board of Directors.

If the Board itself is making the appointment, it may be useful to create a committee to do the detailed selection work; normally, the whole Board would ratify the final appointment. It is important that the committee's terms of reference are clear from the start, so that its members know what they can do on their own and what they must refer back to the main Board. If the Board is only being consulted about the appointment, it may select a representative to participate in a Ministerial committee or one set up by the legislature. Again, this individual would need to have clear terms of reference.

Since the CEO is the public face of the organization, it is essential that his or her appointment be made openly and fairly. It is also important that anyone who is qualified to do the job has an equal opportunity to be considered for it, whatever his/her gender, marital status, race, religion, or possible disabilities. It is good practice to advertise the job publicly, 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 – be made available to anyone who requests it. Short-listing of applicants should consist of individuals who meet the criteria laid down in this specification, and the final appointment should be made on an objective basis after a fair interview of all those who have been short-listed.

Only a fairly small number of people will be really qualified for the job, so it is very likely that at least some of them will be known to Board members. The points discussed in chapter 4 on conflicts of interest are therefore highly important. In addition, if an applicant lobbies Board members for the appointment or others put pressure on the Board on his/her behalf, this should lead to disqualification of that

applicant. In many cases, legal codes or the codes of practice for civil servants will state this. Where they do not, the Board may want to adopt the principle anyway.

For other senior staff within the top management team, normally the CEO would be in charge of the appointment, although in some countries the whole Board is involved. Again, the same principles of openness, fairness, and equal opportunities should apply.

A newly appointed CEO or senior manager will often have an understanding of managing a large organization within or outside the public sector, but little detailed knowledge of social security in particular. He or she will then need to build knowledge and skills for the specific details of the job, in much the same way as Board members themselves do.

REMUNERATION

The pay scales for the CEO and senior staff may be laid down by the Minister, the legislature, the Board, or some combination of these. In any case, the scales should be set according to some clearly defined criteria that can be publicly defended. For example, in Slovenia the salary of the social security institution's CEO is 90 percent of the Minister's, and the Minister's own salary is open to scrutiny in the legislature.

Sometimes part of the overall pay package is related to performance, with the Board responsible for judging whether the performance targets have been met. The clearer and more objective these targets are, the easier it is to measure performance against them. While the targets for the CEO will probably be unique to him or her, they will only be realistic if they are related to the targets for the institution and its staff as a whole. Even if none of the CEO's remuneration depends on performance, the setting of targets, and an annual review of whether they can be achieved, is useful. If targets have not been met, there may still be a case for paying all or part of the performance-related elements – if there were circumstances beyond the CEO's control, for example. However, the reasons for doing so should be clearly spelt out and documented. This will be especially important if the issue comes to the attention of the media, as well may happen.

The appointment and remuneration of senior staff is an area where a Board may feel the need for outside advice, possibly from “head-hunters” – consulting firms specializing in personnel recruitment. These can provide a very useful service, but it is important for both the Board and the recruiting organization to target properly the

segment of the job market where qualified candidates will be found. Generally, you will be competing in the local market for top managers or administrators, not the international one, because it will be essential to understand the national context and, of course, the language in which the institution is working. Setting the appointee's remuneration package at a level competitive on the international market – which could be well above local rates – is likely to be a waste of money. The Board needs to ensure that outside consultants, especially those with international perspectives, appreciate this.

MANAGEMENT AND REPORTING CHANNELS

In general, one would expect the entire senior management team to attend Board meetings when items relevant to it are on the agenda (which is likely to mean most meetings), rather than the CEO presenting reports on behalf of the team. Thus, the Finance Director would report on the budget process and discuss its details with the Board, while the Administrative Director would report on the institution's performance of its core tasks. These Directors, of course, will be relying on information prepared for them by more junior staff. Though opinions can differ on this, it does generally make sense for those more junior people to be brought into the meetings, at least for the item of business with which they are involved. Without their presence, it can be very inefficient and frustrating for the Board, since its members may ask questions that can only be answered after the meeting, when the particular director has obtained the necessary information from the relevant person.

In general, Board members should not seek information from more junior staff without the knowledge of the CEO or senior directors. This does not mean that the senior director has to be present at every discussion between a Board member and other staff, which is potentially very inhibiting. Rather, they simply should be kept fully informed about such discussions.

Board members should not interfere with individual appointments, promotions, or disciplinary actions unless they have a very good reason. As stressed earlier, it is the Board's role to set down the parameters and procedures, and then to leave the CEO to manage the day-to-day operations and report back to it. If the Board has set the right benchmarks for monitoring the performance of the institution, its members should be able to identify any disturbing trends that need more investigation. A report showing a rising level of staff turnover in one regional office or one section,

for example, could be a symptom of management problems; and the Board might therefore ask for a fuller report on this.

One useful practice is for the Board to have time set aside, perhaps at the beginning or end of their meetings, for a private discussion among themselves without any of the institution's staff present. This allows members to raise concerns with colleagues, and to discuss whether to take matters further, without creating unnecessary ill will, tensions, or problems in the working relationship. A longer private session might be useful during the annual strategy meetings or before the CEO's performance review.

If there is dissatisfaction with the CEO's performance, it is better to deal with the problem openly rather than leaving it to fester, which could allow rumours to circulate and factions to develop. Private discussions within the Board, in particular with the Chair, may be the first step. Another possibility is confidential discussions with the Minister or relevant senior civil servants. If the issues involve the CEO's style, the problems can be explained and an opportunity for improvement given. The same applies to questions of competence, though this can be a much more difficult issue to address. If the problems involve fraud or mismanagement (see chapter 7), then swift action may be needed. In some cases, initial secrecy may be necessary to avoid destruction of relevant evidence.

Even if the appointment of the CEO is not made by politicians, disciplining or dismissal of such a high-profile official is likely to have political implications. While allegations must always be backed by hard evidence, it may be necessary to suspend the CEO first – on full pay if that is in the terms of his or her contract – and then undertake a full investigation if there are suggestions of serious misconduct.

Key points from Chapter 5

- The Board's role is supervisory, and it is for the institution's senior management team to look after the day-to-day running of the institution.
- It is not a good idea to have an "inner circle" of people who understand what is happening and an "outer circle" whose only real function is to "rubber stamp" decisions. Discussions between particular Board members and senior managers outside the formal meetings should be fully reported to the entire Board whenever possible.
- Appointment of a Chief Executive Officer should be done openly and based on objective criteria, and remuneration policies should be clearly established.
- The senior management team will generally report to the CEO, and the junior staff will in turn report to senior management. In general, Board members should not bypass the CEO without his/her knowledge to seek information from more junior staff, nor should they 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 probably have political implications.

MORE INFORMATION ON THESE TOPICS

Further information on management structures can be found in:

ILO. 1998b. *Administration of Social Security*. Social Security Manual 2. Geneva: ILO. pp. 1–18.

SETTING OBJECTIVES AND MEASURING PERFORMANCE

INTRODUCTION

Since a social security institution exists for the benefit of its clients, and not the other way round, it is fulfilling its mission if it:

- pays out the correct benefits to the correct people at the correct time;
- collects the correct amount of contributions when due (or, if contributions are collected by another institution, monitors the process attentively to ensure that the amounts it receives are correct); and
- achieves all this with a reasonable level of administrative costs.

In its day-to-day work, the institution must have the administrative machinery to achieve these three purposes. In its supervisory role, the Board needs to have the information to judge whether they are being achieved, so that it can take or recommend corrective action when necessary.

OPERATIONAL PERFORMANCE AND SPENDING

The Board will be concerned with setting targets for, measuring, and reporting on the twin elements of:

- administrative performance, and
- the costs of achieving that performance.

Both form important parts of the Board's work. When scrutinizing the institution's budget, the *outcomes* of spending are as important as the spending items themselves. Getting the balance right, in terms of spending enough on administration to keep the system running well, but no more than is needed, is not easy:

- At one extreme, administration may be low-cost because controls are loose. However, this can lead to spiralling benefit expenditures due to, for example, inadequate standards of medical assessment of disability claims or outright fraud.
- At the other extreme, in a system where controls are very tight and every item of spending is checked and re-checked, clients may feel uncomfortable being so closely scrutinized; and some individuals may decline to apply for benefits which are due them under the law or to appeal wrongful denials of benefits by the institution.

Your constituency and the general public want the institution to carry out its role efficiently and effectively. The difference between those two words is important. For example, the institution might be very efficient in recouping erroneous payments of benefits. To be effective, though, it would also need to look at the causes of such incorrect payments and create a strategy to reduce them.

It is also important to ask the question: efficient and effective for whom? An action that leads to greater internal efficiencies for an institution, by reducing the work of its staff, may work very badly for its clients. Opening the offices to the public only for limited hours, or requiring everyone to travel to the offices rather than making contact by phone, may make the institution's internal processes less costly and in this sense more efficient, but these approaches would be very *inefficient* for the general public.

OBJECTIVES AND TARGETS

The Board has an important role in setting institutional objectives and targets, and then working with management to monitor the extent to which they are being achieved, as well as identifying the reasons for any shortfall.

Many institutions begin with a “mission statement” or “vision statement” setting out some broad principles. They then complement this with more concrete “objectives”. These terms are used widely in management and business training, but there is no single agreed definition of them. The difference between “mission” and “vision” statements is often fuzzy, and the difference between an “objective” and a “target” not always clear-cut.

A working set of definitions of the first two would be:

- the *vision* is “what the future will look like if the mission is achieved”;
- the *mission statement* is there to define the long-term, far-reaching goals of the organization in three different ways:
 - What does it do for its clients?
 - What does it do for its employees? and
 - What do the “owners” want?¹²

For a social security institution, the “owners” are typically the same groups as those represented on the Board – the Government, the different categories of contributors (workers, employers, self-employed), and the beneficiaries. Ideas about the long-term goals of the institution may, in fact, differ among these various groups, and it is generally healthy for the institution to bring out these differences and establish where there is common ground. In this way, the process of drawing up the mission statement and the objectives can be almost as important as their content.

The following example of a mission statement is drawn from the website of the Social Insurance Bank of the Netherlands.

¹² The material is taken from a paper available from www.allbusiness.com/business_advice, but an Internet search will provide much similar information.

Mission Statement of the Social Insurance Bank (SVB), the Netherlands¹³

Service-oriented and socially aware, the SVB aims to be the best implementer of state financial schemes for individuals.

The best

The SVB wants to carry out its core responsibilities well and be the best in its field. Legitimacy, efficiency and effectiveness are key terms here. In a word: the SVB's clients receive the payments to which they are entitled on time.

Service-oriented

With regard to implementation of the schemes, the SVB remains open and flexible towards its clients, both governmental and individual. Not only must the work be done as accurately as possible, it is also essential to be service-oriented and customer-friendly.

Socially aware

The SVB strives to be socially aware. That means having an open attitude towards developments in society, and adjusting one's working methods as and when necessary. The SVB avoids stagnation and obsolescence by staying open to new schemes.

Personal financial schemes

In carrying out its responsibilities, the SVB recognizes the importance of taking account of each individual client. After all, a client's personal circumstances have a bearing on his or her entitlement.

Source: Online: SVB website. English language version at:
www.svb.nl/uk

Objectives and targets are more specific. Broadly, one might say that the objective is a quantified aim or result to be achieved, usually within a specified period of time; and the target is a measurement indicating its fulfilment. Workable targets

¹³ Sociale Verzekeringsbank.

need to be quantifiable, defined as precisely as possible, and include a time element. For example, it is not enough simply to decide that “improvement is needed in the processing time for benefit claims.” A more precise aim would be for 75 percent of all claims to be cleared within 10 days of receipt, and the remainder within 14 days. There should then be a target date for achieving this improved service – say, over the next six months. On the way to achieving it, some intermediate targets may be helpful, say, 50 percent by the end of the first month, 65 percent by the end of the second, and so on. (These intermediate targets are sometimes called milestones.) Failure to reach a target should trigger questions by the Board about the source of the problems encountered and what corrective action is required.

PERFORMANCE INDICATORS (PIs)

Performance indicators are the ongoing measures that will show whether the institution is hitting its targets or not. They are useful tools for supporting the institution’s decision-making, as well as providing a clearer picture of current performance and the direction of trends. It is important, though, that the right ones are chosen. Unfortunately, the cliché that “what gets measured gets done” is usually true. For example, if you decide to measure “how many letters get answered within 14 days of arrival” then you will find that those keen to keep up their performance ratings respond to all their outstanding correspondence by day 14, regardless of whether the response is correct. A better indicator would be, “how many letters get answered *correctly* within 14 days.” At the time of drawing up performance indicators, a decision on how they are to be reported, in what format, and how often, should also be made.

A recent study carried out for ISSA by the consultant Accenture (see More Information at the end of this chapter for details) has pointed out the important distinction between managing *activities* and managing *service processes*. To quote the study: Institutions that manage service processes think in terms of end-to-end workflows rather than tasks. They design their processes to produce the services they are obligated to provide, and they aim for fast, consistent, high quality, cost-effective flows. An organization which manages activities might track, for example, the number of pension applications processed per hour; an agency managing service processes will look at the number of hours to complete its pension application process (Linder et al., 2004: 11).

WHAT ARE THE RIGHT INDICATORS?

The performance of the institution can be looked at, and measured, in two ways:

- its *technical or administrative efficiency*, which involves assessing the process by which *inputs* (resources used by the scheme) are converted into direct *outputs* (goods or services delivered to the beneficiaries). These indicators focus mainly on the human and other resources used to provide services – e.g., scheme personnel and administrative costs; and
- its *allocative efficiency*, which involves assessing *outcomes*, that is, economic or social changes resulting from a given policy or programme. These focus on the resources used to finance particular social security schemes or the system as a whole, such as social security contributions and taxes. They are considered in chapter 13, in the discussion of Social Protection and Expenditure Reviews (SPERs).

This chapter concentrates on the issues of technical and administrative efficiency.¹⁴

Establishing performance indicators can be a lengthy process, but the discussion itself can enhance the governance of the scheme considerably. Indicators should be:

- *comprehensive* – their scope should be as wide as possible;
- *consistent* – they must be consistent both with each other and over time;
- *relevant* – absolute numbers become more relevant in comparison, for example, the number of pensions could be set against the number of contributors; and
- *quantifiable* – it must be possible to express indicators in numbers.

As well as measuring the internal processes, performance indicators should cover the way that clients view the work of the institution. The perceptions of staff members who already understand the institution's workings may be very different from those of poorly informed clients who depend critically on the institution to

¹⁴ It should not be forgotten, however, that the two levels of performance are closely linked. A social insurance programme may appear very well targeted in theory, but if clients are unable to get access to the benefits because of a particular institution's procedures, the *outcomes* will be poor.

provide an income on which to live month by month. Thus, it is essential to examine performance from the point of view of the target population.

An annual survey of client satisfaction is a useful instrument for obtaining this perspective. When done on a regular basis, such surveys can be compared year by year to track the agency's performance. In a number of CEE countries, regular surveys are carried out by or on behalf of social insurance institutions. For example, in Latvia a survey in 1998 showed 81 percent of the clients of the state social insurance agency were satisfied with the quality of consultations, staff competency, speed of service, accessibility, provision of information, and related areas. The methodology for this survey drew on data from independent sociological and market research firms. In 2003 a questionnaire prepared in-house (not directly comparable to the previous one) found a 92 percent satisfaction rate.¹⁵

PUBLICIZING THE TARGETS AND INDICATORS

The institution should publish whatever targets and indicators have been developed, so that the general public can judge whether it is succeeding in meeting these and can see what they have a right to expect. Some of the targets may be included in a "public service agreement" between the relevant Ministry and the institution. There may also be a "client charter" or an equivalent which is made widely available, and allows individuals to know what they have a right to expect: for example, the time that a person should expect to wait for payment of a newly awarded benefit, or the time he/she should expect to wait to receive a response to a query.

¹⁵ World Bank. 2004. *Implementation Completion Report on a Loan in the Amount of DM30.4m to the Republic of Latvia for a Welfare Reform Project*. World Bank Report No. 29347. Online: www-wds.worldbank.org.

Client service standards in Latvia

The Latvian social insurance agency publicizes a set of client service standards:

1. We address our customers within five minutes; at peak times – within 20 minutes.
2. In standard cases, we serve our customers within 15 minutes.
3. We answer phone calls within three to four rings.
4. In our communication with customers on the phone, in writing, or face-to-face, our employees are not anonymous.
5. We treat every person we serve with courtesy and respect.
6. We provide clear, precise information on services and give substantial answers to our customers' questions.
7. We provide at least one free call phone number for our customers.
8. We inform our customers about granting or rejection of a service in writing in all cases.
9. We inform customers about the review procedure of their application upon their first request.

Source: Online: VSAA website at www.vsaa.lv.

COLLECTING AND PUBLISHING STATISTICS

Once targets and indicators have been set, the institution will have the continuing task of collecting the statistics to show whether they are being met or not; and the Board will need to monitor them.

It is very easy to introduce a new set of statistics on a particular aspect of the institution's operation without considering the difficulty of gathering these and the impact on the involved staff. The key questions to ask are:

- Is there a specific need that can only be met by collecting this additional data?
- Will this data in fact cast light on whether the institution is fulfilling its targets?

The staff involved in collecting statistics must understand *why* they are being asked for particular data, and *how* it will be used. Statistics are often carelessly or

inaccurately recorded, and poorly maintained, which makes them unreliable. This affects the long-term estimates (see chapter 12) as well as the short-term operations. Thus, forms and spreadsheets need to be well-designed and easy to use, and the staff should be trained so that they know the reasons for asking for the information as well as how to collect it.

There should be regular reports to the Board on the institution's performance, as measured in the collected statistics, compared with the chosen indicators; and these reports should be made available to the public. This practice should be regular, not limited to instances in which performance is positive. Measurements that are embarrassing for the institution, such as those showing backlogs of work or arrears of contribution payments, must also be reported. The further behind any organization falls in its activities, the more difficult it is to catch up again, so quick preventive action may be needed. If it is known that delays are going to occur – perhaps because of the introduction of a new benefit or administrative system – then this should be announced. At the same time, alternative arrangements should be found for handling the most urgent work, and these should be publicized.¹⁶

It is also necessary to exercise care to avoid any perverse effects of statistical measurement. What is not measured is often neglected. If staff members are rewarded based on performance statistics, it is important to monitor this process to ensure that the selected statistics measure important behaviour and are not subject to manipulation.

The interviews carried out for this Handbook suggested that performance measurement is limited in many CEE countries. This situation can be a good target for action by Board members seeking to raise the transparency of their institution's operations and to improve its administrative efficiency. Without openness about the problems being experienced and the effects they are having on individual clients, it is hard to be open about the recovery plans, and thus to take the necessary action to put matters right.

The institution may not always be in a position to take corrective action by itself. For example, if the bulk of the contribution arrears are due to non-payment by large state-owned companies, the decision on whether or how they pay what

¹⁶ In Slovakia, for example, when the new Social Insurance Act came into force in January 2004, the media were told there were likely to be delays of up to five months before any benefits for new pensioners could be paid. The Ministry of Labour, Social Affairs, and the Family also announced that those who had to wait could apply for social assistance.

they owe will, in the end, be a matter for the politicians. However, without transparency about what is happening, there will be no pressure on these companies or the politicians to put things right, or to face up to the implications of continuing inaction.

Key points from Chapter 6

- To fulfil its supervisory role, the Board needs information to show whether the institution is taking in and paying out the correct sums and whether its level of administrative costs is reasonable. This is at the heart of the Board's role, since both the Board members' constituents and the general public want the institution to perform efficiently and effectively, and their support for the institution is dependent on this.
- It is helpful to have an institutional mission statement setting out some broad principles, and then to set more concrete objectives and specific targets.
- Performance indicators should be simple, widely accepted, and meaningful measures of the service being provided to clients.
- It is useful to measure the institution's performance in terms of clients' satisfaction, as well as in terms of outputs such as the number of benefits paid or services provided.
- The institution should publish targets and indicators, possibly in a "client charter".
- Staff must understand the reasons for collecting statistics, and it must be made easy for them to do so. The statistics should be regularly publicized, bad news as well as good.

MORE INFORMATION ON THESE TOPICS

If you want to follow up any of the topics considered in this chapter, some books and other resources that could help you are listed below.

- ILO. 1998b. *Administration of Social Security*. Social Security Manual 2. Geneva: ILO, pp. 171–4.
- Financial Times. 2004. “Understanding Performance Management” supplement to *Financial Times*. 6 October 2004. London.
- International Social Security Association. 1997. *Re-engineering of Social Security Institutions*. Papers from the joint conference of ISSA and Inter American Conference on Social Security. 3–6 June 1997. Washington, D.C.
- International Social Security Association. 2000. *Re-engineering in Social Security Institutions: Guidance Manual Based on Experience*. Taormina: ISSA.
- International Social Security Association. 2001. *Measuring Performance in Social Security Institutions: Outcome Oriented Management, Compendium of Conference Reports*. Taormina: ISSA.
- Linder, J., R. Wheeler, and T. Wiley. 2004. *Creating Value through Performance Management in Social Security Administrations*. Taormina: ISSA Technical Commission on Information Technology.

FINANCIAL GOVERNANCE ISSUES

INTRODUCTION

Ensuring good financial governance of the institution is a key role of the Board. The annual cash flow of a social security institution equals that of a very large enterprise, sometimes the largest in the national economy. It requires controls that are commensurate with its importance.

Therefore, this chapter deals with:

- monitoring of administrative expenses;
- the institution's budgets, accounts, and financial controls;
- risk management;
- fraudulent claims or payments; and
- audits.

MONITORING OF ADMINISTRATIVE EXPENSES

It is important to distinguish between, firstly, spending on benefit payments authorized by law and paid to individuals who are found eligible, and secondly, the administration (or operating) expenditure of the institution.

While benefit spending should be reviewed regularly, the Board cannot generally reduce it, since an individual who qualifies for a benefit is generally *entitled* to it. A Board can and should warn of benefit expenditure trends that have implications for the scheme's financial solvency and/or effectiveness in achieving its objectives. This

kind of review is dealt with in chapter 13 on “Planning for the Future”, while the current chapter deals only with the second type, administrative expenses.

Administrative expenses are generally only a small proportion of the total budget of a social security institution. Great economies of scale are possible in national benefit administration, so that public schemes generally have much lower administrative costs than private institutions, e.g., individual savings schemes and insurance companies. However, whatever is spent on administration is not available for benefits, which is the key reason that administrative costs must be monitored and controlled.

Moreover, while small in relation to the overall budget of the scheme, administrative expenses may nevertheless have a major impact on the institution’s public image. It is important for the Board to ensure that administrative budgets are frugal, and thus contribute to a public image of frugality in the institution’s use of revenues from scheme contributors.

However, it is not possible to point to a clear benchmark for evaluating whether a particular institution’s administrative expenses are too high. This is partly because it is not easy to obtain comparable figures for administrative expenses of social security schemes in different countries. Moreover, even in the same country, social security institutions may deal with different types of benefits or combinations of these; and/or their administrative expenses may have been computed in different ways. An institution that provides social assistance, for example, is almost bound to have higher administrative expenses than one that deals only with social insurance benefits because, with means- or income-tested benefits, much more detailed work must be done to establish which applicants are eligible and to monitor beneficiaries’ continuing eligibility.

In order to monitor the cost of performing various administrative tasks, it is necessary to allocate administrative expenses across the different benefits being paid by it – e.g., short-term, long-term, employment injury, medical care, and so on. Detailed record-keeping is needed for a highly precise allocation, but this may itself add to administrative expenses. More simply, the scheme actuary can analyze the general ratio of administrative expenses to contribution and benefit expenditures in each branch of the scheme as part of the actuarial valuation (explained in chapter 13). These ratios can then be reviewed again in future valuations and readjusted.

Costs per transaction (unit costs) should then be analyzed, to obtain a more detailed picture of the institution’s cost structure. However, careful interpretation of such cost figures is required. If the cost of a particular transaction is rising over time,

this may be because the office is becoming less efficient, or it may be because it is providing a better service to the clients. If, for example, staff have been inadequately trained so that there are many mistakes in computations of benefit payments and people have to appeal or complain to get the payments put right, the cost per transaction may be low – but the cost to the client, and to the institution in putting things right, could be high. “Spending to save” – that is, spending more on resources and training – may raise the initial transaction cost but at the same time raise the quality of that transaction by considerably more.

The relationship between short-term decisions and long-term spending also needs to be borne in mind. Today’s decisions granting disability benefits, for example, could affect overall scheme expenditures for four decades or more.

EXCEPTIONAL COSTS

“Exceptional” costs should be budgeted for separately from normal administrative expenses and must be monitored carefully. Examples of such costs include:

- institutional start-up costs, such as spending on building offices or purchasing equipment, and
- recalculations of benefits following a reform that changes entitlements.

One would normally expect that after the initial start-up period for an institution, administrative costs will be reduced due the curtailment of these “exceptionals”. It is important to keep an eye on them to ensure that they do not include items that are really part of normal operating costs but would be “inconvenient” to report as such.

Coordinating spending decisions among different parts of the organization, as well as with other agencies with which the institution interrelates, is also important. The equipment that regional or local offices buy must be compatible with that used in the head office – if it is not, much time and money will be wasted trying to set up proper communications. Similarly, a decision to buy computer software which is or is not compatible with that used by other agencies could affect not just your institution, but the way those other agencies have to organize themselves, perhaps for the next decade or more.

THE INSTITUTION'S BUDGET, ACCOUNTS, AND FINANCIAL CONTROLS

Approving and monitoring an institution's budget and accounts is a very important area of a Board's work. However, those who control the process of drawing up these documents have a great deal of power, and there may be tension among the Board, CEO, and Ministry of Finance over this. One practice reported by some Board members who were interviewed for this project is for them to receive the budget documents, and the final accounts for the year, only at a very late stage. This may be after all the negotiations have been completed by the Ministry of Finance and the institution's officials, and with little or no time for the Board to digest the contents. Discussion and scope for change may also be very limited. This diminishes the influence of the Board and thwarts its objectives. Board members should do their best to ensure that the documents come to them in good time and while they are still in draft.

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

Annual budgets have three main purposes:

- *Planning* – quantification of the financial impact of actions required to achieve both immediate and long-term objectives. This also allows you to see which objectives can be achieved in the coming year and which have to be postponed;
- *Authorization* – the approved budget brings authority to incur expenditure; and
- *Control* – the budget is the basis for monitoring and control of income and spending. It provides a standard against which financial performance can be measured.

It must be clear which parts of the organization, and which officials, are responsible for spending in which areas, and for the monitoring of such expenditure. It is useful to have information on the organizational chart (see chapter 4) about which officials, and at which levels, control budgets. Can the head of a regional office, for example, purchase new equipment for his office without authorization from a supe-

rior? It is, of course, the person who has the authority who should be blamed for cost overruns (or praised for items coming in below cost!), not those who carry out others' spending directives.

For a budgetary control system to operate successfully, there need to be reports on the actual position throughout the year, compared to a *budget profile*. To create a profile, the annual budget must be broken down into monthly or quarterly figures. Generally, this does not mean simply dividing the budget by 12 or 4, as spending will be higher at some parts of the year than others (for example, because sickness is more common in winter, spending on sickness benefits will be relatively higher). Taking into account such seasonal fluctuations, the budget profile provides an estimate of the proportion of the budget that will be used up by the end of each accounting period.

This is then compared with the actual accounts at the end of each month or quarter, and the *variances* are reported, whether positive or negative – that is, the difference between the budget profile and actual spending. These variances should be considered significant if they exceed a fixed amount of money, or a percentage level, that is beyond the range of normal variation. When this occurs, the cause should be investigated. It might be found at either end of the process: the profiling might have been inaccurate, or an unexpected condition or problem may have caused the actual spending in a particular area to exceed expectations.

The Board should expect to receive progress reports on the budget position at each meeting. There may also be a formal budget review process, perhaps at the mid-year point. This enables action to be taken where the circumstances have changed and budget revisions need to be made. The procedure for agreeing to changes should be similar to that for preparing the budget at the beginning of the year. However, this review should not be used as an opportunity to gain agreement to policy changes or new activities. The review should *only* focus on changed circumstances.

The specific details of a budget will depend on national conventions and regulations. It is common, though, for some flexibility to be allowed in a budget through the use of *virement* – transferring a savings under one spending category to another. Any *virement* should be authorized at an appropriate level, depending on the type and size of the transfer. Formal rules are essential, so that it is clear where a *virement* can be applied, who can authorize it, and what the limits are.

THE ACCOUNTS

Sets of accounts have two parts: a balance sheet and an income and expenditure statement. As the example below shows, the balance sheet is a statement of what an institution owns at a particular point in time, i.e., what the assets are and how they are financed. Liabilities indicate what sums of money have been made available to finance the assets, and total assets always equal total liabilities. The balance sheet is supported by the income and expenditure account, which shows the revenue and spending of the institution over the last financial period, and consequently, the surplus or deficit generated.

Where the institution deals with a number of different social security benefits, separate accounts and records should be maintained for each benefit, and reported to the Board. Some benefits will be short term, such as sickness and maternity benefits and the payment of medical costs. Others will be long term, like old age, invalidity, and survivors' pensions. The actuarial methods for estimating future spending differ (see chapter 13). In principle, the contribution rate for each benefit should be adequate to make it self-supporting. A deficit in one benefit branch should not be covered by allocating money across from another branch (*virement*, explained above), *unless* there is a clear and transparent process, with full understanding of the implications.

In particular, if a long-term benefit scheme is building up reserves in anticipation of future growth in the number of beneficiaries, this strategy cannot be successful if the reserves are diverted to make up for short-term deficits elsewhere. In countries where this has happened, it has often been a matter of considerable political controversy, discussed at length in the legislature and in the relevant consultative bodies. While the administering institution will not have a choice if it is required by law to make such a transfer, the Board should make it clear to the public that this will have major long-term implications, i.e., that it is not simply a minor accounting adjustment.

The budget may also be subject to a *cash limit*. This means that once the budget has been approved by the relevant body – which may be the legislature or the Ministry of Finance – there is an upper limit which cannot be exceeded in that financial year. Under a cash-limited budget, if the amount estimated in the budget for a particular expenditure category (for benefit awards, for example) is less than the amount required, the institution may have to find savings or meet the cost from reserves. Alternatively, it may be allowed to carry forward deficits to future years, though pos-

sibly only up to a certain limit or with special permission from the relevant Ministry. This, however, postpones the problem of having a spending level above budget, rather than solving it.

Typical balance sheet of a social security institution

ASSETS		LIABILITIES	
Cash	95	Payables	675
Receivables	521	Bank borrowing	987
Investments	23,456		
Fixed assets	1,456	Reserves	23,866
Total assets	25,528	Total liabilities	25,528

Typical income statement of a social security scheme

INCOME	
Contributions	
Employees	5,000
Employers	5,000
Government subsidy	1,000
Investment earnings	1,000
Other income	50
Total income	12,050
EXPENDITURE	
Benefits	10,000
Administrative expenses	1,000
Total expenditure	11,000
Excess of income over expenditures	1,050
Reserve at the beginning of the year	15,000
Reserve at the end of the year	16,050

Source: ILO/ISSA. 2002. *Actuarial Practice in Social Security*. Geneva: ILO/ISSA. p. 92.

BUDGET REPORTS TO THE BOARD

The level of detail in reports to the Board will depend on the size of the institution, the legal framework within which it is operating, and the Board's mandate. An assembly meeting every quarter, for example, may be given only a very broad report, while a bureau meeting each month would receive a more detailed set of figures. In both cases, though, budget reports would be considerably less detailed than those going to the Finance Director and the CEO, since they are expected to monitor all aspects of the institution. A report to the Board would bring together a number of sub-headings into a smaller number of main headings, for instance, on different benefit categories or types of administrative expenditures.

In general, people tend to find large figures difficult to grasp, while smaller ones tend to grab their attention. Probably everyone involved in public affairs has had experience of attending a meeting where the spending of millions in the budget is accepted without comment while there is a fierce argument about a trivial amount for travel expenses. While this kind of scrutiny is understandable in some sense and even tempting, it is important that *all* the figures are scrutinized if the institution is going to be fully accountable.

The accounting reports throughout the year will be consolidated into the Annual Report, (see chapter 8) after the internal and external audits, described below.

The institution's property assets

Social security institutions must own or rent large amounts of real property, including offices and shop-front premises where the public can go with queries. Board members should ensure that there is a full register of this property, and that it is kept up to date and included in the balance sheet at realistic values. Some Boards will find they need to carry out an exercise to establish what exactly is owned by the institution and how it is being used.

TYPES OF RISKS

Risk management is a fundamental part of corporate governance. The International Social Security Association (ISSA) has recently developed some guidelines on implementing a risk management policy (see More Information, at the end of this chapter). This section provides some key points from these guidelines.

Risk can be defined simply as the possibility of something going wrong which will have negative consequences. Social security institutions are at risk that certain events or conditions could undermine their plans and make it less likely that they can achieve their objectives. These risks fall into several broad categories.

One is *operational* risk, which would include such contingencies as computer failure, mistakes in record-keeping, poor compliance by scheme members with requirements that they declare earnings and make contributions, inadequate staffing to maintain operations satisfactorily, fraudulent transactions, and unexpected fiscal liabilities resulting from political or legal decisions.

There is also *liquidity* risk – the danger that available funds will not be sufficient to cover the payments due at some points in the financial year. This can be dealt with by establishing a buffer fund to cover a few weeks' or months' payments, invested in a way that allows it to be accessed very quickly when needed.

Yet a third category is *investment* risk. Chapter 12 covers these risks and what can be done to limit them.

Particularly important from the long-term, actuarial viewpoint are *longevity* risk and *economic* risk. *Longevity risk* refers to the risk of people living longer than expected. *Economic risk* refers to a range of factors, including negative impacts of the business cycle on employment levels and contribution collections, as well as the effects of inflation on a scheme where benefits are fully indexed but contributions are not. It might also include the risk of a rise in new incapacity and work injury claims in response to an economic downturn.

Finally, there is *political* risk – that is, the risk that the politicians will change their minds or change the rules about social security benefits in ways that are very disruptive for the institution.

Social security institutions should establish a formal process for identifying, quantifying, and managing these various kinds of risks. Generally this will best be carried out under the control of a Chief Risk Officer or another senior official with clear responsibility and accountability for risk management. It would be good prac-

tice for the Board to include a summary of the risk evaluation and a report on the steps being taken to manage the risks on a regular basis in its public documents.

SAFEGUARDING AGAINST FRAUD OR THEFT

Fraud and theft are particular risks for all social security systems. Not every country has a banking system that can cope with direct payment from the social security institution into individuals' accounts, though this is the quickest and most secure method. Even where direct payment is the standard, some people will still need to be paid through post offices or other local institutions, or even in cash over the counter. However, the more cash is handled, the greater the opportunities for fraud and theft.

There will generally be a section of the institution's staff that deals specifically with fraud. It should be headed by a senior official, and this unit needs to work closely with the auditors (see below), and at times with the legal authorities and police. Awareness of potential fraud and ways to protect against it should be raised throughout the organization. The Board should receive regular reports on detection and prevention.

However, the Board needs to ensure that there is a balance between caution against fraud and responsiveness to clients in all the procedures related to benefit payments. On the one hand, there is a need for speed and efficiency, especially since most beneficiaries depend on regular payments by the institution to meet basic needs. On the other hand, public funds have to be safeguarded from abuse. Eligibility determination procedures should therefore allow that straightforward benefit claims – generally, the vast majority – be processed routinely with a minimum of checks, while unusual claims are more carefully scrutinized. For the lower-risk group, it would be usual to have a post-payment review for a sample of cases.

Safeguards can be built into the system by strong security requirements. Cheques and order books can be designed and printed so that they are difficult to forge, and then moved around the country by secure methods. (See chapter 10 for computer security.) The staff involved in the preparation and issue of payments should be different from those responsible for claims processing and calculation of benefit amounts. This both reduces the risk of collusion and increases the chances of discovery of any internal fraud. 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 a computerized system, there are usually inbuilt security devices to restrict access to the system

and identify any individual who has had access to it, and these should be part of the specification for any new system. With manual systems, this involves signatures to acknowledge receipt, for instance, of a batch of order books to prepare for sending out to clients.

Safeguarding against fraud and theft in France

The classic French approach to preventive oversight involves establishing a separate auditing branch to certify management actions. Thus, an accountant must be appointed to work along side the director of every basic social security fund. While this individual is under the director's formal authority, he/she is functionally independent and reports directly to the Board. Any financial decision made by the director must be checked by the accountant before payment is made. This applies not only to budgetary decisions, but also to social benefit payments. Decisions made by the director's delegates are supervised by the accountant's delegates, thus imposing close scrutiny and accountability on management decisions.

In addition to this traditional form of supervision, the social security organizations of today also have auditing procedures and a number of internal controls.

RECOVERING AFTER FRAUD

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

AUDITING

An important part of the Board's activities is supervision of the audit process for the institution. An independent audit protects scheme resources, lends credibility to the institution's financial statements, and helps protect everyone who has an interest in the operations. It is thus useful in achieving and maintaining the public confidence, essential to the scheme's success.

There is sometimes quite a negative attitude towards auditors, internal and external, within an institution. A positive approach from Board members will help counteract this, and a discussion with the auditors and the relevant managers about the aims of the audit should help to dispel any misunderstandings.

There are in fact two types of audits – internal and external. In most countries, the authorizing statute or regulation for the social security institution will require an external audit, independent of the institution, usually by the official Government auditor. However, social security schemes are technically complex, and the institutions have a very high volume of transactions. This makes external audit insufficient unless it is also supported by *internal* audit. Usually, the internal auditors are employees of the social security institution, but it is important that they have autonomy and be perceived this way.

The aim of the internal audit is to meet the basic informational requirements of the external auditors before they start their inspection. The *external* audit will then be able to concentrate on its priority areas without having to start from scratch. The Board's Audit Committee should go through their report in detail, and in particular any recommendations for improvement that they offer.

The internal audit

Internal auditors generally audit all aspects of the operation of:

- the offices dealing with the receipt of contributions (if the institution is involved in collections) and the authorization and payment of benefit claims;
- the various sections that deal with setting up and maintaining records; and
- personnel administration, so far as the costs of staffing are concerned.

Usually the audit of benefit claims will involve examining a random sample to determine the level of accuracy of eligibility decisions and benefit calculations. Much of this part of the auditors' work will be carried out in the regional or local offices. This will not be a matter, however, of questioning the decisions of experts such as the doctors who decide if medical conditions are disabling. Rather, it is to check that the proper procedures have been followed, and the correct amount of money paid, for the circumstances outlined in the file. If a particular problem is identified, the auditors may then require a much higher level of checking for that office or that group of offices.

Key points to safeguard internal auditors' independence

- The scope of the auditors' work should not be restricted. They should be free to examine and report on the work of any department or part of it. The decision to include or exclude any area of activity must rest only with the audit manager.
- The internal auditor must have an unchallengeable right of access, at all reasonable times and without having to give notice, to all the financial and associated records of the organization; and he/she must be able to require any explanations considered necessary.
- The audit manager should be free to report to all levels of the organization. His/her line manager should be the Finance Director or the CEO.
- Auditors should never become involved in the operation of any system they will have to report on later. If they do, their independence will be compromised and the audit will lose its effectiveness. The temptation to "borrow" specialist staff to help with peak workloads must be resisted.
- Independence of mind is an important quality to look for and treasure in your auditors.

It is vital that the Board stand up for the principle of auditors' independence. Even if after investigation the auditor's concerns turn out not to be justified, they would still be right to raise such concerns, and should not be penalized if they have done so in good faith.

Internal auditing can seem like another layer of bureaucracy, but it has some major advantages for the smooth running of the institution:

- The auditor provides an expert opinion on issues of accounting judgment. There are a number of areas where particular accounting conventions will have to be followed for the treatment of particular items in the accounts. Internationally, there is a series of International Public Sector Accounting Standards (IPSASs; see More Information at the end of this chapter). Having an expert in-house can clarify what should be done at an early stage, and thus avoid having to recompute figures later.
- The internal audit helps to ensure that the accounting system which is used to record transactions and safeguard funds is working properly. If there are significant weaknesses, the auditor will point these out and suggest ways of improving the system. If there are material errors in the accounts, the auditor will draw management's attention to them so that corrective action can be taken, and the reasons for them investigated.
- The auditor will also draw management's attention to any staff inefficiency, incompetence, or fraud discovered in the course of the audit. This should help to deter anyone from consideration of taking the risk.

The external audit

The national or Government audit office in general has a special position under the law, with a guarantee of independence.

If the external auditor is not satisfied with what he/she finds, the published accounts can be "qualified". This means that a statement is included indicating that a particular point is not satisfactory, along with an explanation of why. The institution then needs to take corrective action, or at least improve the situation, in time for next year's annual report on the accounts. The auditors may also detect weaknesses that they do not consider serious enough for the accounts to be qualified, but do still give them some concerns. They would generally point these out in a letter to management. Again, the auditor would expect the institution to take corrective action before the next audit. He/she would then report on what has been done.

Once complete, each year's audited accounts should be published, normally as part of the institution's annual report, and put on its website where one exists.

THE AUDIT COMMITTEE

It is good practice for a Board to have an audit committee that meets regularly. It should be made up, wholly or mainly, of Board members who do not have other positions within the institution, including people with strong financial and risk management expertise. If the Board is weak in this area, it might wish to ask the Minister to appoint people with the necessary skills, or alternatively it could bring people with the right expertise onto the Audit Committee without them becoming members of the Board as a whole.

This Committee has the main responsibility, on behalf of the Board as a whole, for ensuring that the internal audit programme is effectively testing the adequacy of systems of internal control – both financial and non-financial. It should set the timetable for the audit, approve the areas of activity selected for special study by the internal auditors, and receive their reports. It then needs to ensure that the lessons arising from internal audit studies are effectively learnt and appropriate action implemented.

The Audit Committee should also receive the management letter from the external auditors and satisfy itself that management is responding adequately to any specific recommendations from the auditors. Though sometimes it may be impractical to carry out their recommendations, in general an audit committee and a Board should think seriously before rejecting any of them. Both the recommendations and the response should be made public.

While the Audit Committee plays the leading role, however, this does not absolve the other members of the Board from taking an interest in the accounts and their audit. The proper financial management of the organization, as assessed by the auditors, is a matter for the whole Board.

VALUE FOR MONEY

The link between monitoring management performance (covered in chapter 6) and monitoring finance (covered in this chapter) is the constant search for ways to provide service to the client that is both *good quality* and *reasonable cost*, that is, “Value for Money” (VFM).

One part of this search will be the “survey function” which concentrates on organizational and procedural, rather than financial, aspects of the institution’s work.

Most large institutions will have in-house department responsible for this. By close monitoring of the institution's organization and procedures, this department will seek to identify gaps in knowledge or weaknesses in procedures, and training needs that arise as a result. Most such departments work through providing suggestions and encouragement rather than undertaking disciplinary measures. Their aim is not only to ensure that correct procedures are being followed, but to develop, encourage, and make known "best practices" throughout the institution.

When they widen their scope to look at value for money, external auditors also have a great deal to offer in terms of improving efficiency and effectiveness. The Board should encourage them to provide comments on this aspect. If the Government auditing office is unable to undertake VFM analysis, it might consider hiring an outside body from time to time to study this area. A VFM audit can be a taxing but worthwhile process, since it challenges assumptions that Board and managers may have held for a long time.

If regular reports on value for money are not being made to the Board, members might request such analysis from top management and to help set the parameters for this programme of work.

Key points from Chapter 7

- Ensuring good financial governance of the institution is a key part of the Board's role.
- Administrative costs should be only a small part of the overall spending of the institution, but they need to be properly budgeted for, monitored, and controlled.
- *Virement* (moving money among spending categories) is acceptable for administrative costs, but is a bad practice for benefit spending, except perhaps to even out short-term cash flows. If done, there should be a transparent process, with a clear understanding of the implications.
- Risk management is a fundamental part of corporate governance, and the institution needs to develop formal procedures for evaluating, monitoring, and limiting risk, set out in published documents.
- There must be safeguards against fraud and abuse, though they should not be so tight that they discourage honest claimants.
- An important part of the Board's activities is supervision of the audit process. Auditors' independence should be safeguarded. The Audit Committee should supervise the process and ensure that auditors' recommendations are considered and acted on.
- Value for money studies should be carried out regularly.

MORE INFORMATION ON THESE TOPICS

If you want to follow up any of the topics considered in this chapter, some books and other resources that could help you are listed below.

Cichon, M., W. Scholz et al. 2004. *Financing Social Protection*. Geneva: ILO/ISSA. Chapter 7.

ILO. 1998b. *Administration of Social Security*. Social Security Manual 2. Geneva: ILO. pp. 26–31.

ILO. 1998c. *Social Security Financing*. Social Security Manual 3. Geneva: ILO. pp. 61–62.

Plamondon, P. et al. 2002. *Actuarial Practice in Social Security*. Geneva: ILO/ISSA. Chapter 8.

Risk Management

Daykin, C. 2004. *Financial Governance and Risk Management of Social Security*. Presentation to ISSA General Assembly. Online: www.issa.int.org. September 2004.

Safeguarding against fraud or theft

ILO. 1998b. *Administration of Social Security*. Social Security Manual 2. Geneva: ILO. pp. 32–36.

Auditing

Chartered Institute of Public Finance and Accounting (CIPFA) (2001), *Accounting & Auditing Standards – A Public Services Perspective*. London: CIPFA. Online: www.cipfa.org.uk. (Also see <http://www.cipfa.org.uk/international/> for details of CIPFA's international work.)

ILO. 1998b. *Administration of Social Security*, Social Security Manual 2. Geneva: ILO. pp. 29–31.

International Public Accounting Standards (IPSASs) are maintained by the International Organization of Supreme Accounting Bodies (INTOSAI) to which most government audit offices will belong. Its central document is the *Lima Declaration of Guidelines on Auditing Precepts*, which provides the philosophical and conceptual framework, and is particularly strong on the need for independence. Online: www.intosai.org.

National Audit Office (NAO). 1997. *Value for Money Handbook*. London: NAO.

ENSURING TRANSPARENCY AND FAIRNESS

INTRODUCTION

As stressed throughout this guide, social security institutions are there to ensure the well-being of the citizens who depend on them. Yet many people distrust the institutions, along with other public service bodies, and suspect those who run them of looking after their own interests and having little regard for the welfare of their clients. Tripartite governing boards have an important role to play in combating this distrust. Their fundamental role is to ensure that the institution acts in an open and honest way, putting its clients first. This means, among other things, that the amount invested in administration and staffing costs is adequate for doing the job, but not excessive. Such frugality in the use of resources needs to be real and visible to everyone.

Therefore, the institution needs to be open about:

- its pay structures,
- its recruitment and promotion policies, and the number of people it employs,
- how it assesses staff performance and provides promotions,
- what training it offers, and to whom (including who travels abroad, for such things as study visits), and
- how it makes decisions on capital investments, for instance, new offices or new computer systems.

The institution also needs to lead by example, that is, it must follow the policies it wishes others to follow. It should be open about issues where it is in disagreement with individuals (see below, for more about appeals of the institution's decisions), and it should be willing to admit mistakes publicly.

This does not mean that questions of “why X got the job rather than Y”, or “why Z got paid this amount when A only received this amount”, should be discussed in a Board meeting or on the institution's website. But it does mean that the procedures adopted, and the rules or codes of guidance followed, should be open to discussion. Making such procedures and rules publicly available improves accountability to the public and to the legislature.

Some important policies will be beyond the scope of any one institution to devise or change, though your institution may be able to exert some influence. For example, staff may be covered by a law or code of guidance that lays down the policy for all civil servants' conduct and conditions of employment. The Board should be transparent about what this larger policy is and how it affects the institution, and it should support and affirm these policies.

In some countries, some of these broader policies may be under development or may be in need of improvement. In such cases, there is a key role for the Board to play in working cooperatively with counterparts in other institutions and in government to improve standards overall.

On other issues, the institution may have considerable autonomy, so that the CEO and Board can play the lead role in deciding many matters that make a difference to the quality of administration and the way that the institution is perceived by the public.

Evaluating staffing policy: Important questions for Board members to ask

Here is a quick check list that Board members can use to establish what staffing policies and procedures exist in their institution 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 – in particular, can they look at their own personnel files?
- What is the grading structure of staff, and how are decisions taken about who is given which grade?
- Is there any evidence that grades are creeping upwards, to get round 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 an appropriate 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.

KEEPING AN IMAGE OF FRUGALITY

Spending by the institution should be “fit for the purpose” but not extravagant. Where the line is drawn will depend on the particular item in question, but generally you as a Board member should exercise your sense of what will lead to public criticism of the institution. Some examples of excess include:

- locating offices in a newly refurbished building 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 places that are comfortable but less opulent are available; and
- providing foreign trips for large numbers of staff, or for poorly defined or unsatisfactory reasons.

If the institution is to maintain its standards of service, there must be investment. It is not sensible to be stingy over this. It can be more expensive in the long run to buy something cheap that does not work well than it is to buy the right product.

Similarly, having public offices that are dirty, with broken furniture and located in neighbourhoods that are daunting for people to visit, may produce short-term savings in rent and maintenance. But this is likely to lead to more confrontations between staff and clients, and higher levels of vandalism that will increase the costs in the long term.

RECRUITMENT POLICY

Transparency and fairness are essential in the recruitment of new staff. The institution's image is reinforced not only through job advertisements but also in how those doing the recruiting, usually the Personnel Department, treat applicants. People who are treated well when they seek employment with an institution will probably speak well of it afterwards, even if they are not successful in their applications. Those who are treated badly during the recruitment process will probably be quick to spread their criticism.

Recruitment policy should be laid down in a published document. It is good practice to:

- search for possible candidates 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 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 decisional criteria during the selection process. In addition to providing details about the institution, the remuneration, and the working conditions, an advertisement should clearly state:

- the *essential* personal requirements, including academic qualifications, where needed; and
- the *desirable* personal qualities or requirements.

Interviews and tests should be conducted with an objective marking system and on the same basis for all candidates. If, at the end of the process, a candidate is appointed who does not meet the original specification, those making the appointment should be prepared to explain and justify the departure.

It is good practice for the Board to receive a regular report on recruitment, as part of the CEO's report, with comments on any exceptional cases and on lessons learnt.

SETTING A GOOD EXAMPLE

Since public institutions will have credibility only to the extent that they follow the policies that they wish others to follow, they should be model employers in the hiring and promoting of members of minority groups, including people with disabilities. In this way, private employers as well as the general public become more accustomed to seeing such individuals in the work force. That, in turn, provides opportunities to observe their competency and reliability, all of which leads to diminished attitudinal barriers to their employment in society.

Institutions should also act as a model in terms of the accessibility to persons with disabilities to their offices, leaflets, websites, and so on.

ILO Convention 168 Employment Promotion and Protection against Unemployment Convention, (1988) includes:

Article 6.1. Each Member shall ensure equality of treatment for all persons protected, without discrimination on the basis of race, colour, sex, religion, political opinion, national extraction, nationality, ethnic or social origin, disability or age.

6.2. The provisions of paragraph 1 shall not prevent the adoption of special measures which are justified by the circumstances of identified groups under the schemes referred to in Article 12, paragraph 2, or are designed to meet the specific needs of categories of persons who have particular problems in the labour market, in particular disadvantaged groups, or the conclusion between States of bilateral or multilateral agreements relating to unemployment benefits on the basis of reciprocity.

Article 8.1. Each Member shall endeavour to establish, subject to national law and practice, special programmes to promote additional job opportunities and employment assistance and to encourage freely chosen and productive employment for identified categories of disadvantaged persons having or liable to have difficulties in finding lasting employment such as women, young workers, disabled persons, older workers, the long-term unemployed, migrant workers lawfully resident in the country and workers affected by structural change.

EXTERNAL CONTRACTORS OR CONSULTANTS

These same principles apply to the recruitment of external contractors or consultants, whether for large contracts or short assignments. In most countries, there is a law or a code of practice for government bodies entering into contracts. Board members should be given the details of this, put in place a procedure for monitoring them, and receive regular reports on what has been done.

In general, with any sort of contract, “what you get out depends on what you put in”. The more care that goes into the specification of work at the beginning, the more likely it is that the contractor will produce the desired product. What happens when things go wrong also needs to be specified. Imposing large penalties is not

always the right approach, because these may make it cheaper for the contractor to abandon the project with the problems unsolved than to agree with the institution on how to put things right.

One 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 client receives the completed work in a nice package. In real life very few projects work this way. There are always problems, issues, and extra questions. A collaborative approach, with continuing dialogue between the contractor and consultant, tends to work very much better.

STAFF ETHICAL CODES

These issues were considered in chapter 4 as part of the role of Board members. The same points apply equally to staff and to the institution's dealings with the outside world. In a recent survey of *Ethics in the Public Services of EU Member States*, by the European Institute of Public Administration, it was reported that European citizens do not have very much confidence in national civil services. This report stated:

Several countries responded to the questionnaire by saying that there is a clear link between the image of the civil service and ethical behaviour. For example, according to the Italian contribution to this survey, "this link is bilateral: high ethical standards improve the image of public administration and employment, and the diffusion of a good image stimulates higher ethical performance..." (EIPA 2004: 5, para. 12).

The obligations of civil servants regarding ethical behaviour, the requirements laid down in laws, and disciplinary legislation, are similar in all 25 national public services of the enlarged EU. However, the report found that the traditional values of the civil service are coming under some pressure because of privatizations and the need to work in partnership with the private sector. Civil servants today often face dilemmas where values are in conflict – in particular, the rule of law as against demands for efficiency.

One particular practice that poses a danger for social security institutions is that of staff accepting *gratuities* from clients, in the form of cash or gifts, for providing services that they are supposed to provide anyway, as part of their regular jobs. This

effectively means that the client is paying twice for the same service, once with his or her contributions, and once with a bribe. Public bodies should take a strong stance against this.

Combating corruption and unethical behaviour effectively requires a whole range of weapons. Ethical behaviour starts at the top, and good leadership is essential. Codes of conduct are now widespread but, as emphasized by the EIPA, they:

... make little sense unless they are accepted by the personnel, and maintained, cultivated and implemented with vigour. In addition, codes of ethics are useless if staff are not reminded of them on a regular basis and given continuous training on ethics. Codes are only effective if they are impressed upon the hearts and minds of employees (EIPA 2004: 7, para 25).

Key instruments to minimize the risks of unethical behaviour include:

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

Any instance of corruption must be dealt with firmly and openly, even if the institution's management is confident that it is only an isolated instance. Otherwise, the public credibility of the entire institution will suffer.

"WHISTLEBLOWING"

This term refers to the reporting of wrongdoing by a colleague or superior in the institution. It is important that such reporting is made possible, and that the whistleblower is protected from victimization as a consequence. At the same time, caution is necessary in implementing such procedures in order to avoid making staff feel that they are under suspicion. For those CEE countries that are EU members or candi-

dates for membership, whistleblowing legislation is part of the *acquis communautaire*. Even without this requirement, it is in the interest of any institution to have clear procedures for protecting those who report wrongdoing – not only to act as a deterrent, but also because the only alternative may be for an individual who observes a serious problem to inform the media, and this could be much more damaging. There should be a special mechanism outside the normal chain of command under which individuals can report evidence of possible wrongdoing. This might involve, for example, a special integrity officer or ombudsman, an independent commission, or the top management. A “Charter of Value” with an independent overseer can also protect staff from reprisals or retaliatory measures and, in this way, promote ethical behaviour.¹⁷

If such a mechanism is in place, any Board member approached by potential whistleblowers should refer them on to the appropriate person. One does need to be a little wary, since disgruntled staff members occasionally try to exploit Board members by providing inside information that is incorrect, incomplete, or contrived in the expectation that a Board member will raise the matter at a meeting and thereby embarrass senior management. But such possibilities are only a reason for caution and care in handling such complaints, not for inaction.

As a Board member, you may wish to raise this issue for discussion and possible action in your own institution. You might ask:

- if national whistleblowing legislation exists in your country, are the staff of your institution fully informed about it, and how effectively is it being implemented?
- if there is no legislation, could your institution adopt a code (perhaps borrowed from another country) voluntarily, and urge the sponsoring Ministry to encourage broader adoption of it?

There would need, of course, to be full staff consultation and debate before the introduction of new procedures, with much tact exercised so as to avoid any negative effects on the general work climate.

¹⁷ Such a charter has been adopted by the European Space Agency.

TRANSPARENCY IN BENEFIT DECISIONS

The way social security institutions make and monitor decisions must also be transparent and open to question. Some mistakes are inevitable, so there must be a willingness to admit when this happens and put things right.

Ideally, the laws and regulations under which your institution operates should allow it to verify whether or not someone meets the qualifying conditions for a benefit without a lot of time-consuming correspondence. When new benefit arrangements are being set up, or existing ones revised, these operational aspects should be considered at an early stage. It is useful, therefore, to include operational staff – those actually making eligibility determinations – at the planning stage. There should then be feedback on implementation from those who actually deal with the clients, and from the clients themselves through opinion polling and focus groups. This feedback should lead to adjustments in the rules if necessary.

There should be formal rules for deciding favourably or unfavourably on each individual claim to benefit. The internal procedures should make it clear which level or grade of staff can make a decision on each individual type of case. More complex cases will generally need to be referred upwards, to more senior staff with specialist training.

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

All decisions should be given in writing, and thus permanently recorded. If not provided in legislation, reasonable time limits on resolving cases need to be set, and then compliance with these should be monitored. Without such limits, there is a danger that unsuccessful or unresolved claims will be left in the pending tray, without claimants being told of what has happened, or of their right to appeal. If the time limits are too short, however, there is a danger of rushed, incorrect decisions being made simply to meet the deadline. So it is useful to have a formal procedure for overriding those limits, with notification of the person concerned, where there are good reasons for delay.

Beneficiaries are entitled to know not only what they are getting, but how the benefit calculation was made. So the written notification should provide these details, as well as explaining a claimant's right to have the decision reviewed.

Generally, there are two levels of appeal in a social security institution: one internal where a senior officer or co-worker who was not originally involved in the decision reviews it, and one external where the denial is reviewed by a court or a less formal social security tribunal.

It is important that, at both levels, the processes work quickly and efficiently, so that justice is not denied by complex appeal rules that ordinary individuals cannot understand or use. Though providing advice and representation is an important part of the work of trade unions and pensioner associations in many countries, it should not be an effective *requirement* that claimants must have the help of such bodies to be properly heard. It will be useful, therefore, for the Board to review the processes from the point of view of the “person on the street”.

As important as the procedures are the attitudes of the institution’s staff towards claimants who raise questions. All institutions make mistakes, and there can be honest differences in the way that two people interpret the same facts. So an overly defensive attitude on the part of staff is not helpful, and it can prevent the institution from learning lessons from its dissatisfied clients. Even where a claimant has no case, it could be that the information provided was misleading, or that there was misinformation from the staff in the past.

Key points from Chapter 8

- A fundamental job of the Board member is to ensure that the institution 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 new staff and in dealing with contractors and external consultants. The institution should lead by example on issues such as positive action in recruiting from disadvantaged groups.
- The Board should ensure that the institution spends what is needed for its activities without being extravagant, thus projecting an image of frugality.
- The Board should establish and monitor a code of ethics for the staff of the institution, and make sure that there are adequate protections for "whistleblowers".
- All decisions on eligibility should be provided in writing and, when negative, should include a clear rationale. The Board should strive to create an institutional culture in which staff members are willing to admit when mistakes have been made.

MORE INFORMATION ON THESE TOPICS

If you want to follow up any of the topics considered in this chapter, some books and other resources that could help you are listed below.

Policy of the institution

European Commission. 2001. Round Table Conference on "Discrimination by Design". 3 December 2001.

European Institute of Public Administration. 2004. *Ethics in the Public Services of EU Member States*. Online: www.eipa.nl.

Fultz, E, and M. Ruck. 2002. *Reforming Worker Protections: Disability Pensions in Transformation*. Budapest: ILO-CEET.

ILO Conventions and Recommendations, see www.ilo.org/ilolex.

ILO. 1998b. *Administration of Social Security*. Social Security Manual 2. Geneva: ILO. pp. 153–159.

Nunberg, B. 2000. *Ready for Europe: Public Administration Reform and European Union Accession on Central and Eastern Europe*. Washington, D.C.: World Bank.

Dealing with benefit claims

ILO. 1998b. *Administration of Social Security*. Social Security Manual 2. Geneva: ILO. pp. 105–124.

COMMUNICATIONS STRATEGY

INTRODUCTION

Good communication and public relations are essential in building public confidence in a social security institution. Communication 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 institution’s main messages. This is especially important in the launching of a new scheme or in undertaking reforms to an existing one. However, having a communications strategy and people in post to carry it out should also be a *permanent* aspect of the institution’s work.

The key points in developing a communications strategy are:

- identifying your audience (or audiences, as there will probably be several);
- formulating the message you want to get across to them; and
- putting yourself in their place, thinking about what they need to know, deciding how much they will understand already (often very little in a technical field), and then designing your communication of the institution’s important messages round this.

If you give too much information, or information that seems irrelevant, people will lose interest and will not take in the message. If you give too little, you run the risk of 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 Prices Index between November 2003 and 2004, and this increase will be included in pensioners' payments in week x of the financial year.

That may make sense to the lawyers in the institution, but not to the pensioners. What they need to know is:

- Your pension is being increased by 2.5 percent. This is in line with the rise in the cost of living (or in average wages). You will see the increase in your benefit payments from 3rd March onwards.

WORKING WITH THE MEDIA

The press, radio, and television are all powerful media for getting a message across, positive or negative. Most institutions will at one time or another receive some “bad press”, as a result of scandals and blatant examples of incompetence. Sometimes the reporting is exaggerated for other reasons and used to hold the institution up for scorn. To ignore the negative reports, or to use them as a reason for not working actively with the media, is self-defeating. The media are there, and it is through them that most of the public get information. Therefore, anyone who has a message to get across must work with the media.

Ideally, a fairly senior staff member should be assigned this task. He/she should be responsible not only for responding to queries but also for taking the lead in providing news and information. This person should develop an overall strategy for raising public awareness of the institution and its activities.

Bad news, such as delays in benefit payments or computer breakdowns, should be openly admitted. This is better than waiting for discovery by the media, and allows the institution to tell its own story about what is being done to deal with the problems.

The institution should also have media contacts in its local offices, responsible to the media officer at the head office. He/she can then give advice and support concerning the message to put across at the local level and how to do it. The head office and local offices need to work together as a team, so that a consistent message is conveyed.

If the institution operates very openly with its media contacts, whilst paying due regard to the need for confidentiality about individuals, it is far less likely that there will be sustained media criticism of the scheme's operations.

A relationship with the media is always two-way. Many newspapers and radio stations run inquiry services or “helplines” where their readers or audiences can ask for information or air grievances. It is good practice to encourage those who run these to come to the institution with these queries and grievances *before* publication, and to respond swiftly and helpfully. This posture provides a chance to correct misunderstandings, reduces the opportunities for journalists to attack the institution's competence, and gives the institution some valuable feedback about the sorts of things that can go wrong, or are perceived as going wrong, for clients. Board members may well have contacts with the media and thus be in a position to act as “ambassadors” for the institution, but you need to be well informed to perform this role effectively.

For example, Board members of the Unemployment Fund in Estonia receive a regular pack of information from the Secretariat, including copies of press releases at the same time as they go out to the media, regular reports on press contacts and coverage, and copies of press cuttings or transcripts of programmes. This allows the Board to see what is being said, and so be forewarned about what is likely to be repeated by their own contacts who read or listen to this coverage – all of which will make them better ambassadors for the institution.

When there are controversial questions in the air, Board members may well be contacted individually by journalists, perhaps with the hope of obtaining damaging quotes or comments that contradict the official statements. So you will need to insist that you are briefed well in such situations, and in some cases the Board may find it useful to agree that only one person – probably the Chair – should speak to the media.

THE INSTITUTION'S OWN COMMUNICATIONS

As part of its rolling programme of work, the Board from time to time should consider all of the public relations material produced by the institution. Forms, leaflets, and standard letters should all be looked at from the point of view of the reader. Will the reader understand what is being said? Is he/she told what steps to take next? For those who do need to know the finer details of the regulations, perhaps to prepare an appeal, does the document explain where to find those details?

It is worth carrying out opinion polls, and also testing such material out on small groups of the people at whom it is aimed, to find out whether they receive the message that is intended. Changes such as writing shorter sentences, and using concrete examples rather than abstract terms, can make a great difference in interpretability and user-friendliness. If the institution itself does not test material in this way, then Board members could do so with their own constituencies. Organizations of scheme beneficiaries could be invited to help with the drafting of material from an early stage.

Forms for collecting information from contributors or beneficiaries can be particularly difficult to design well. They must be clear and easy to understand, while at the same time being legally correct and unambiguous, always informing persons of their rights and options. They must also be “customer friendly” and not alienating for the reader, but it should still be clear that they come from an official body. The individual should not be asked to fill in again and again details that the institution already has on record, and should not be asked to fill in several different forms for payments that come under one umbrella. Nor should people have to produce repeatedly documents that staff of the institution has already reviewed and verified.

All these bad habits are part of what one might call “externalizing trouble”. That is, instead of the institution operating an efficient and accessible filing system in which these items can be stored and looked up as required, it is treating the individual clients as human filing systems, to be called upon at will and for its own convenience. This transfers costs to individuals that should rightly be borne by the institution, because it means they have to travel, perhaps take time off work, and then queue up in an office when they have other things to do.

Two noteworthy regional examples of efforts to improve communication are:

- *The Slovenian “anti-bureaucracy” programme of 2002.* The idea here was to have all government departments linked to a central register, so that people would not need to give the same information several times to different bureaucracies. This does of course raise important questions of privacy and data security that need taking seriously (as indeed the Slovenian Government has done).
- *The Czech Social Security Administration’s (SSA) new computer programme, being implemented in 2004–5.* This major initiative is reshaping SSA’s network of offices into district and regional tiers, and putting the records onto a central electronic database. Any individual with a query will be able to go into any office, and the staff will be able to view the complete file electronically, together with centralized guidance on how the law is to be interpreted.

Even without such major innovations, however, it is possible to make incremental improvements each time a form is revised or a procedure is changed. The same would apply to leaflets and posters explaining benefits or procedures.

Providing annual statements for individual contributors is likely to help boost confidence in the system, and also allows the institution to correct mistakes or misinformation early, before a worker applies for a benefit.¹⁸

METHODS OF COMMUNICATION

In the past, the main methods of communication were paper and face to face, and this is still very much the case in many social security institutions. Increasingly, however, electronic means and telephone call-centres are being used. They can be very helpful, but should not be allowed to totally take over, as some individuals with whom the individual must conduct business will not be able to use them readily. Rather, the new methods should supplement the traditional ones, which may be streamlined and trimmed to fit the reduced demand but not totally eliminated.

The clients of most social security institutions will include many elderly and disabled people (indeed, for some institutions the great majority of clients will fall into these groups). Communication material and methods need to take this into account. For example, the institution may provide leaflets in large print, or at least make a large print version easily available on request, and also Braille and tape versions.

An institution's offices are also a form of communication. Thus, the public areas should be physically accessible to people with disabilities. The height and design of counters is important, as is provision of loops for hearing aids. Making it easy for people with disabilities to manage will help all other clients as well.

Internet usage is growing fast in most countries, but is uneven. Older and poorer people, and those in rural areas, are far less likely to be connected than young city-dwellers. The time will come when all social security information will be accessible to everyone on the Web, and letters can be replaced by e-mails. However, we are not

¹⁸ For example, under a law enacted in 2004, the Slovakian Social Insurance Agency is now obligated to inform each insured person annually about the working years it has recorded for pension purposes and the wages on which his/her pension will be calculated. This obligation is being phased in, so that in 2004 only insured persons born before 1951 received a statement, while in 2005 all those born before 1961 will do so, and in 2007 all those born before 1970.

there yet. For example, a recent survey in Slovakia showed that only 10 percent of all households had computers with access to the Internet.

Interactive use of the Internet for filling in forms or making claims is also growing, but still more unevenly. This trend raises questions of security as well as accessibility. While the computer site itself may be secure, will people be accessing it in public places where others can look over their shoulders? Designers also need to be aware that the computers that people have at home will often be far slower, and have far less memory, than the state-of-the-art ones that may be in use in the social security institution's offices. Graphics that take a long time to download or require sophisticated software will be at worst useless, at best frustrating, for many clients. The design should allow individual users to save and print out any forms that they have filled in online, however antiquated their software may be.

Expecting people to make claims or query decisions by telephone also has its dangers. Though usage is high, it is still patchy, and older and poorer people may have less confidence about using a phone as well as less access to one. They may also be hard of hearing, and not mentally or physically agile enough to make notes at the same time as taking part in a telephone conversation. So employees engaging in telephone or face-to-face conversations with clients should make a record of these as soon as possible afterwards, and the note should then be retained on the person's file.

Call-centre systems should be set up using fully trained staff who are knowledgeable about the institution's benefits and eligibility conditions. They also need access to the clients' records. Setting up a system that uses under-trained staff in a "factory"-type environment is frustrating for both callers and staff. It is also likely to be a false economy, because of the time that has to be spent to correct problems that should never have occurred initially.

WEBSITES

Most social security institutions today have websites, and they can provide great opportunities for making information available to the public. Their particular advantage is that they can provide information at several levels. So, for example, the first page can give a summary of the general eligibility conditions for receiving a benefit. One or two clicks of the mouse can bring more detailed guidance, and then even the text of the legislation itself. The Web also allows for a wealth of statistical information, case studies, and so on to be provided.

As stated before, though, the issue is to design and maintain the site so that it is useful to the ordinary user – perhaps elderly or disabled, with poor eyesight – and not just to the well-educated and technically sophisticated person.

This is an area where Board members can be extremely useful to their constituents in pressing for realism and simplicity when the website is being designed. You might want to test it out on your own home computer, or ask your friends or relatives to do so. There is often a huge gap between the technical expert's approach (which tends to be, "Oh look, the site will support this clever bit of graphics, let's use it") and what the ordinary client needs.

Website accessibility for people with disabilities

Basic tools for improving accessibility include:

- a button on the home page that enables users to enlarge the print size, and
- voice-reading programmes, in which the text on a web page is read out loud to the user free of charge.

The World Wide Web Consortium has a Web Access Initiative (www.w3c.org/WAI). It has produced guidelines for web access and detailed explanations of how to make a web page accessible. (See More Information at the end of this chapter for more details on web addresses.)

THE INSTITUTION'S ANNUAL REPORT

The Board members of a social security institution should aim to ensure not only that administration is efficient, but also that it is perceived as such by the general public. For this, the annual report – an account of the stewardship and activities of the institution over each financial year – is a key document. It serves as a permanent record, while many of the institution's other publications will be more short-lived.

Usually the report will be formally addressed to the relevant Minister, or to the national legislature. The total audience, however, is considerably wider than that and includes contributors and beneficiaries, the media, and researchers on social security and related topics. In some cases, the Minister will present the report to the legislature

so that there can be a discussion about it among policymakers. In other cases, there may instead (or in addition) be a press conference, a public meeting, or a meeting between the head of the institution and a committee of members of the legislature.

The annual report should also be put on the institution's website and provided to research bodies and libraries as a printed document. Anyone who wants to trace the history of what happened on a particular issue, or how spending on a group of beneficiaries has changed over the years, should be able to do so by referring to the past reports.

It is worthwhile for the institution to take the time and trouble to design the report well, making it user-friendly and hence more accessible to non-specialists.

WHAT SHOULD THE ANNUAL REPORT CONTAIN?

Four basic elements should be included:

- a narrative of activities during the year, along with top management's expectations for the future. This should explain what has changed and why. For example, if districts have been re-organized or a new software system brought in, details would be included together with a note of how the institution coped (or will cope) with the change;
- operational statistics, including such matters as staff and office costs, training activities, public relations material sent out, and performance against the standards and targets set (see chapter 6);
- statistics on contributors and beneficiaries, amounts of contributions collected and benefits paid, and any arrears or backlogs of work. It is also useful to have a description of trends over time, showing how the numbers have changed over the last five or ten years; and
- the audited accounts (see chapter 7) with explanatory comments to help non-accountants understand them.

Most of this material can be drawn from the regular reports to the Board each month or calendar quarter. If the institution has a regular bulletin or journal, some of the needed information will be published in the course of the year. In Slovenia, for example, the Institute for Pension and Disability Insurance publishes a regular bulletin giving running totals of beneficiaries, amounts payable, average ages at retirement,

and so on. Its annual report includes more analysis, and also graphs and charts which make the material much easier to understand.

The annual reports are likely to be used as “source material” by researchers and analysts over the long term. So it is important to ensure that the statistics are clearly laid out and explained, and that full definitions are given. In some CEE countries – for example, Poland, Croatia, and Serbia and Montenegro – those who have received disability pensions prior to reaching retirement age are allowed to continue to receive them if this is more beneficial; and those who exercise this option are classified as disabled pensioners in the social security institution statistics. This makes the statistics on the retired population misleadingly small and the disabled population misleadingly large.

It is good practice for the Board to make a public presentation of the annual report at which questions can be asked and to invite members of the press. This can be stressful for the people from the institution who take part, however, so the Board may need to emphasize the importance they place on such open exchanges and resist pressure to delay or drop this practice.

REPORTING TO YOUR CONSTITUENCIES

Publication of the annual report provides an excellent opportunity for Board member to report back to their constituencies (in the sense used in chapter 2 – that is, not only to your own union or employers’ federation but others whom you also represent indirectly on the Board). As a Board member, you could arrange special meetings for this purpose. You could also request a briefing beforehand from the Board’s secretariat, or the appropriate officials from the institution, to ensure that you are able to answer difficult questions. Indeed, it could be helpful to have officials with you at the meeting for technical back-up – but it should be clear that it is your report, and they are present only to assist. A competent chair will be needed for the meeting, so that it is not sidetracked into discussion of individual cases.¹⁹ General feedback from your meeting could be given to the Board the next

¹⁹ Individual cases, or specific questions, should be referred to the appropriate officials, and the answers passed back to the person who raised them originally. It is common to find that, if someone airs a grievance at a public meeting, there is more to it than meets the eye, and the part of the story that is *not* told may later change your view!

time it meets, and to others such as the representatives of your constituency on the national social and economic council, where one exists.

INFORMATION CAMPAIGNS

At times when there are major developments in a social security scheme, it is useful to mount a coordinated public information campaign. This will generally involve a series of activities in the press, radio, and TV – as well as advertising and presentations to various groups at both the local and national levels. The Chair and Board members, as well as the institution's staff, should be involved in these activities if the message is to be effectively conveyed. All the involved staff, at whatever level, also need to be briefed on the campaign and its objectives, so that they can answer enquiries from members of the press and public.

Any 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 in several different ways. 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 contributors and beneficiaries and raise confidence in the institution among the public at large.

Key points from Chapter 9

- A good communications strategy is critically important to the institution, since it will influence how both it and the scheme it administers are seen by contributors and beneficiaries.
- A fairly senior staff member should be designated to work actively with the media, as well as to respond to queries from the public, and there should also be media contacts at the local level.
- The institution's own communications should be consistent, appealing, and easy to understand by those at whom they are aimed.
- E-mail, the Internet, and telephone call-centres all have a role to play, but they should be designed recognizing that the institution's clients will in many cases be elderly, disabled, or disadvantaged.
- The institution's annual report is an important tool for communication and can be used for informing the public, politicians, and the constituencies of Board members.
- It is usual to mount a coordinated public information campaign when there are major developments in a social security scheme. This should have a realistic timetable, as it will take time for the messages to penetrate.

MORE INFORMATION ON THESE TOPICS

If you want to follow up any of the topics considered in this chapter, some books and other resources that could help you are listed below.

ILO. 1998b. *Administration of Social Security*. Social Security Manual 2. Geneva: ILO. pp 131–148.

Fultz, E. and T. Stanovnik. "A Comparative Review". In: E. Fultz and T. Stanovnik (eds.). 2004. *Collection of Pension Contributions: Trends, Issues, and Problems in Central and Eastern Europe*. Budapest: ILO-CEET.

Websites for people with disabilities

Go to www.w3c.org/WAI/ for the World Wide Web Consortium (W3C) Web Access Initiative Home Page. Within this you will find www.w3.org/WAI/getting-started/ Getting Started: Making a Web Site Accessible. Other pages include www.w3.org/WAI/EO/Drafts/PWD-Use-Web/ How People with Disabilities Use the Web.

Web Content Accessibility Guidelines are at www.w3.org/TR/1999/WAI-WEB-CONTENT-19990505/

RECORD-KEEPING IN A SOCIAL SECURITY INSTITUTION

INTRODUCTION

Record-keeping is often regarded as a dry subject, one considered necessary for good social security administration but not the stuff of interesting policy deliberations. Yet in Central Europe today, there is hardly a more important or neglected topic. Across the region, governments have enacted reforms to individualize social security benefits, making the level of payment to each beneficiary much more dependent on his or her own past contributions. While such reforms pose major new record-keeping requirements, they have often been undertaken with little consideration of the new demands and little advance planning concerning the nuts and bolts of administration. This neglect has led to many administrative problems and, sometimes, to major administrative breakdowns. Ensuring that the needed record-keeping systems are in place *before* a reform is launched is a key role and challenge for social security Board members.

THE NEED FOR RECORDS

Most individuals have their main contact with the social security institution at the time when a benefit is claimed. So the credibility of the scheme, so far as they are concerned, depends on the quality, efficiency, and accuracy of the service they receive at that point. This, in turn, depends on whether the scheme maintains accurate and up-to-date records that can be retrieved quickly.

The records kept by a social security institution, and their form, will depend on the type of benefit being administered, as well as on whether the institution is responsible for collecting contributions (see chapter 11), or transferring revenues elsewhere – i.e., to finance other benefits paid by other schemes.

Though the procedures will be different in each case, reconciliation between the records of incoming contributions and each individual's own entitlement record is always likely to be needed. Some institutions still rely on the individual workers and employers to keep the records and provide the information to the institution, as with the old “workbook” systems used in many CEE countries under state socialism. While this may be necessary as an interim measure, such a strategy is unlikely to be satisfactory for long, given the increasing mobility of both labour and capital. A worker's employer may go out of business long before he/she applies for benefits, and some firms may not retain records even though they are required to do so. For all these reasons, keeping the records needed for calculating benefits should be the responsibility of the social security institution.

The need to retrieve and analyze records arises not just when a benefit becomes payable but for other purposes. For example, the internal and external auditors will need to check at least a sample of them for accounting purposes (see chapter 7); and the actuary will need records for statistical analyses done as part of scheme valuations. In order to produce reliable projections, actuaries will need not only good quality records but also databases that allow access to information contributors, contribution payments, beneficiaries, and benefit payments by age and sex of the recipient. Without records so organized, solid actuarial projections are not possible.

The basic records need to be maintained for as long as the individual is a contributor or a beneficiary of the scheme, and then throughout the period that surviving dependents are beneficiaries also. Obviously this can be many decades. Certain source documents, such as initial registration forms or the employer's contribution/payroll schedules, may also need to be kept for long periods in case of a query, or for legal and/or accounting reasons.

Consequently, secure storage of very large amounts of data is a primary need for all social security institutions. Nowadays, this may be on microfilm or electronic. Keeping data storage systems up to date, secure, and properly backed up, and ensuring that backlogs of material held in previous formats are transferred when a new system is installed, are all vital requirements. The Czech Republic's modernization project, mentioned in chapter 9, involved transferring 30 million pieces of paper into electronic form in just 10 weeks.

Safeguarding data from being transferred to others without authority is also important, especially for the EU member states, where data protection standards are strict.

INFORMATION TECHNOLOGY

Most CEE social security institutions are by now either fully computerized or in the process of becoming so. Without computers, the ever-growing flow of data would simply be unmanageable. However, computer projects in the social security field (perhaps even more than with other areas of government) tend to be very large and complex. Whether setting up a new scheme or enhancing an existing one, such projects need to be preceded by work on the existing system and data to ensure that the input is right to start with.

There should also be a system of checks on the input data to make it difficult to enter erroneous information into the system. For example, with earnings-related contributions, systems should reconcile contribution payments with wage/salary figures and identify underpaid or overpaid contributions, perhaps with tolerance factors built in. In addition to the reconciliation of individual contributor data, programmes should be able to reconcile total employer remittances with aggregated deductions, and to flag incorrect or duplicate record numbers.

GETTING A COMPUTER PROJECT RIGHT

Information technology (IT) and computer projects are notorious for going wrong, both in the commercial and non-commercial worlds. According to a recent report on IBM's Global Social Security Practice, social security projects managed in the traditional way are now more likely to be partial failures than they were 30 or 40 years ago. The new risks come from:

... the complexity that arises from the need to import legacy data, frequent needs for prolonged co-existence with inflexible ... applications, and the growing complexity of leading-edge technology needed to support more complex, distributed, and collaborative service models (ISSA/IBM 2004: 9).

This study offers some advice for senior managers that is equally relevant for Board members: namely, that they should not try to take over the work of the ICT managers and project managers, but should keep on questioning them to identify weak points and determine where more attention and planning are needed.

The study also suggests a series of questions that Board members might wish to ask their project managers at the start:

- Why is new technology being considered?
- Are there clear, formally documented descriptions of the project objectives, how the project will begin and end, and how it will be evaluated?
- Is there a concise formal statement in a form that stakeholders can readily understand of expected achievable and measurable outcomes?
- What is the real attitude of the project team to the stakeholders? Are they part of the problem or part of the solution?
- If a [Board member] suggests that the stakeholder list is not complete, can the project team quickly identify another stakeholder group?
- Are [Board members] on the project communications distribution list? Do they read the communications and seek clarifications?
- Who made the decision whether to buy or build the new ICT system? Do [Board members] know why the particular decision was made? What were the risks under each alternative? Is the ICT project supporting the organization, or is the organization supporting an ambitious ICT showcase project?
- Have tolerance levels for project risks been set? Is there a clear statement of acceptable consequences under such headings as cost, timing, impact on the public, and adverse publicity?
- Are [Board members] aware of the milestones, and will they be kept informed of progress towards each one?
- Before problems arise, have well-defined procedures for project review been set up?

Source: ISSA/IBM 2004: 11–12.²⁰

²⁰ Slightly edited to replace “Senior Executives” with “Board members”. The term “stakeholders” covers all the groups of people who will use the new system, including insured persons, employers, beneficiaries, banks, suppliers, the institution’s internal managers and users of the system, legislators, pressure groups, and so on. “Milestones” are the intermediate targets on the road to the conclusion of the project.

Recovering from a computer crisis

In Poland, reforms adopted in 1999 made individual contribution records necessary for both the first and second tiers of the pension system, but there was little advance planning time and many delays in the creation of a new computer system. Moreover, the old system was discontinued before the new one was ready, leaving the social security institution, ZUS, temporarily without capacity to monitor contributions payments. When employers recognized this, contribution payments dropped. ZUS implemented a crisis plan, including:

- reinstating the old software, with some updating,
- revamping its plan for implementing its new system with clearly defined stages,
- requiring employers to send additional annual reports summarizing their obligations and payments, and
- requiring individual savings funds and employers to use two identification numbers, thus facilitating the assignment of contributions to the correct individuals.
- Gradually over the next three years a series of improvements were made.

In 2001, ZUS adopted a new "100 percent plan" aimed at achieving 100 percent accuracy in information processing, and made major jumps in efficiency in the following 18 months, bringing overall accuracy from 71 percent to 96 percent. In June 2002, the processing of contributions was finally transferred to the new IT platform.

The cost of this crisis was considerable, however. The legislature has authorized the issuance of government bonds to make up for the contributions revenues that were not transferred to the private savings funds by ZUS during the crisis period and its aftermath.

Source: Fultz and Stanovnik 2004: 168–170.

COMPUTER SECURITY

Maintaining the integrity and security of computer systems is not easy, but there is no point in an institution spending money on a state-of-the-art system if it does not also spend money on state-of-the-art security for it. So the Board needs to ensure that the institution 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 instance, on opening attachments to e-mails – along with an explanation of the reasons. Many viruses are spread by the innocent actions of individuals who simply do not understand the effects of what they are doing; and
- a robust disaster recovery plan, which is frequently tested.

One regional institution where security has received considerable attention is REGOS in Croatia, which uses special algorithms to encrypt documents, including some issued by the US National Institute of Standards and Technology (Fultz and Stanovnik 2004: 80).

Reports on computer failures and breaches of security, and on what has been done to prevent recurrence, should be provided to the Board regularly at its meetings.

Key points from Chapter 10

- Across Central and Eastern Europe, recent social security reforms have tended to relate social security benefit amounts much more closely to each worker's own past earnings and contributions. However, the resulting demands for more detailed record-keeping have often been neglected, leading to major administrative problems and, sometimes, to breakdowns.
- Computers are needed to handle the recording and flow of data, but before the start of a new information technology (IT) project there must be work on the existing system and data to ensure that the input is right.
- IT projects are notorious for going wrong, and recent guidance from the computer firm IBM and the International Social Security Association will assist Board members asking the right 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 disasters.

MORE INFORMATION ON THESE TOPICS

If you want to follow up any of the topics considered in this chapter, some books and other resources that could help you are listed below.

Augusztinovics et al. 2002. "The Hungarian Pension System before and after the 1998 Reform." In: E. Fultz (ed.). *Pension Reform in Central and Eastern Europe*. Budapest: ILO-CEET.

Barrand P., S. Ross, and G. Harrison. 2004. *Integrating a Unified Revenue Administration for Tax and Social Contribution Collections*. IMF Working Paper. Washington, D.C.: IMF. p 12.

ILO. 1998b. *Administration of Social Security*. Social Security Manual 2. Geneva: ILO pp. 61–77.

- ISSA/IBM. 2004. *Information and Communications Technology (ICT) Social Security Project Management: Ten Issues on ICT Management in Social Security Organizations*. Geneva: ISSA. Online: www.issa.int.
- National Audit Office (NAO). 2004. *Improving IT Procurement: Report by The Comptroller And Auditor General*, HC 877 Session 2003–2004: 5 November 2004. London: NAO. Online: www.nao.gov.uk.
- Scholz, W. et al. 2000. *Social Budgeting*. Geneva: ILO/ISSA.
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ENFORCEMENT AND COMPLIANCE

INTRODUCTION

Improving the collection of social security contributions is a major challenge today across Central and Eastern Europe. This challenge arises because most social security schemes are “missing” significant amounts of contribution revenue that are owed by law but allude enforcement efforts. The losses result from several factors, all associated with economic and political transformation: (i) the informalization of economic activity that occurred in the early 1990s, (ii) widespread collusion between workers and employers in the formal economy to conceal a portion of wages paid (so-called “envelope” salaries), and (iii) government laxity in enforcing the contribution requirement on large firms in financial difficulty that are closely associated with the state.²¹

These missing revenues place social security schemes in a tight financial bind. The problem is particularly acute for pension systems, which have obligations to a large cohort of pensioners who earned their benefit entitlements during an earlier period of full employment under state socialism, but which today must meet these obligations from a revenue base that is significantly eroded. Many governments have found it impossible to adjust pension benefits fully for inflation, and over time this has reduced the living standard of pensioners and, in some countries, increased poverty rates. This imbalance also creates pressures to raise contribution rates. For most countries in the region, weak enforcement of the contribution requirement is a

²¹ All these problems have their roots in the early years of transition. In recent years, modest improvements in collections have been achieved in some countries, but in others compliance rates continue to decline year after year.

major national problem, but, remarkably, one that receives relatively little high-level attention.

Recent regional efforts to improve the collections have focused mainly on the adoption of so-called unified collection systems.²² Under this arrangement, a single enforcement agency collects contributions to fund several social insurance schemes (e.g., pensions, health care, unemployment, sickness, employment injury) and may collect income taxes as well. In principal, this approach can achieve economies of scale in enforcement and can give the enforcement agency access to information on enterprises from multiple government sources. However, it is difficult to document the usefulness of this shift in practical terms. Rather, the problematic results are more obvious.

One problem is that unified systems are of limited use in reaching those in the informal economy for whom no government agency has identifying records. A second is that unified systems may divide responsibilities in ways that may create difficulties in administering social security.²³ In some CEE countries with weak institutional arrangements for collections, this major reshuffling of responsibilities has been disruptive; and the same weaknesses that plagued the social security institution have recurred under the new arrangement.²⁴

In some sense, weak contribution compliance is a natural problem for social security Boards to tackle, since they have close relations with the major groups of contribution payers, workers and employers. In those countries where the Board retains authority for collections, this issue merits its close attention and active involvement. However, even where authority has been shifted to another institution, social security Boards have an active role to play on collection issues. At a minimum, they will need to ensure that:

- the amounts transferred to their institution correspond with its records of what is due;²⁵

²² Such systems have been established in Latvia (1996), Slovenia (1996), Estonia (1999), Hungary (1999), Bulgaria (2002), Albania (2004), and Romania (2004). In the Slovak Republic, a proposal for unified collections has been under consideration for several years.

²³ For example, in Hungary the Pension Insurance Fund is charged with recording each worker's contributions to an individual account but does not have access to information on collections, which fall under the purview of the tax authority.

²⁴ See Barrant et al (2004), Appendix of regional case studies.

²⁵ Such a role was played successfully by the National Office of Social Insurance in Moldova following the unification of collections under the tax agency.

- the collection agency continues to receive and make available information on contributors that is needed for administration of social security scheme(s).

These tasks present a challenge for Board members whose institutions have lost authority for collections, and a skilled combination of concern, tact, and persistence will be required. However, the perspective of a well-informed social security Board is a valuable asset to the Government in its efforts to improve collections; and making your presence felt is very much part of your job and in the public interest.

A recent ILO study offers some guidelines for those who are interested in becoming involved in improving collections.²⁶ These are relevant for Board members whether or not their institution has direct collection responsibility.

REDEFINE NON-COMPLIANCE AS A SOCIAL ISSUE

Non-compliance is often viewed as a dry, technical, or purely financial issue that is quite divorced from pension coverage. Thus, raising public awareness of the social consequences of failing to pay contributions is another crucial first step. Board members can use their offices to speak out on these consequences – i.e., the problems facing workers in the informal sector when they need social security, the drain on scheme revenues that result from non-compliance by formal sector firms, and the absolute loss of benefits to workers in the region's new individual savings schemes. They can also encourage governments to make compliance a focus of high-level social dialogue and engage the social partners' in devising solutions.²⁷ To facilitate their own role in improving collections, Board members might support the establishment of a high-level body to monitor the collection agency, including representatives of the social partners and affected social security schemes.

²⁶ Fultz and Stanovnik. 2004. Chapter 2. Points have been adapted slightly to the perspective of a Board member.

²⁷ For example, Bulgaria's minimum contribution thresholds are the direct result of such cooperation. These thresholds apply to approximately 50 industries and were signed as collective agreements with the social partners.

LEAD BY EXAMPLE

Even-handed enforcement by governments is an essential first step in improving compliance, without which other initiatives cannot be expected to succeed. Board members should seek to ensure that contributions are collected from large firms as well as small ones and, in particular, from state firms as well as private ones. Such even-handedness is necessary to rebuild public trust in pension governance. For uncompetitive firms, enforcement of contribution liabilities may pose a risk of job loss. Yet hidden subsidies in the form of lax collections may not be the most effective tool for supporting shaky industries, and such policies delay economic restructuring and job creation in sectors where long-term employment prospects are brighter. What is needed is a two-pronged approach that combines even-handed collections with strong transitional support for workers in affected industries.²⁸ EU membership, actual and prospective, provides a new foundation for such policies.²⁹

SUPPORT INVESTMENTS IN ENFORCEMENT

Compliance is facilitated when those who are liable for contributions know that they are being monitored, and any lapse on their part will be met with a quick response. The costs of providing such monitoring can be greatly reduced by automated information systems that match the flow of funds with a master list of those who are liable for contributions. Boards can support funding for a large enough team of collection agents to make auditing and enforcement real threats, as well as for training these agents in professional auditing methods. They can also support adequate levels of compensation for the agents, thus reducing their susceptibility to financial temptations. They can call for penalties or fines, and other sanctions for non-compliance can be set to make the probable costs of cheating exceed the benefits that it might yield – but not so high as to make enforcement predatory.

²⁸ Such a strategy is provided in the “flexicurity” approach, which points to the potential gains of a loosening of job protections and a strengthening of social protection. See: S. Cazes and A. Nesporova. 2003. *Balancing Flexibility and Security in Central and Eastern Europe*. Geneva: ILO.

²⁹ Government policies of allowing and forgiving contribution arrears for particular companies constitutes illegal state aid under EU law.

PIGGYBACK ON EXISTING RULES AND PROCEDURES

The burden of enforcing compliance can be reduced by relying on indirect methods that require employers to prove that they are up-to-date on their contributions in order to gain access to certain government benefits. For example, such a demonstration could be required in order to obtain an import or export license, to participate in a government tender, to obtain loans or subsidies for small business, or even to be listed on the stock market. Collection institutions can develop cooperative agreements with other agencies to impose such requirements, contribute to their costs of enforcement, and assist them in monitoring employers and workers. Such indirect enforcement methods should be reviewed regularly to ensure that they remain in place only so long as required.

REDUCE THE COMPLIANCE BURDEN

Social security systems that are user-friendly promote trust and encourage compliance. A number of actions suggested previously in this Handbook can contribute to this outcome, including:

- Provision of clear, timely, and complete information to employers and workers on their obligations to pay contributions;
- Streamlining the paperwork associated with paying contributions and creating options for electronic filing. (Duplicative reporting can be eliminated by unifying the collections within a single agency, but also by cooperation among separate agencies.) It is also useful to create a special unit to offer assistance to contribution payers, including a toll-free number, website, and e-mail address through which information can be provided rapidly.³⁰
- Holding public meetings with employers to explain collection procedures and elicit feedback and recommendations.

³⁰ That is, telephone lines that are not blocked by continuous busy signals and rapid turnaround time on e-mail inquiries.

TACKLE THE SHADOW ECONOMY STEP BY STEP

The recommendation offered previously for even-handed enforcement of the contribution requirement cannot, unfortunately, be extended to the shadow economy. This sector is too vast to be brought into compliance by a single initiative. Moreover, the shadow economy is not a single entity but an array of heterogeneous firms and individuals with different legal status (formal, grey, or black economy), who have varying sensitivities to positive incentives versus sanctions, and who have quite different capacities to pay contributions. In this situation, it is best to proceed incrementally, identifying those industries and sectors where workers and employers have a clear capacity to pay and where there is a clearly defined salary stream that makes enforcement cost-effective. Board members can set priorities for action and devise projects to target specific problems, or encourage the collection agency to take such actions.³¹ It is important that these initiatives not follow a predetermined model or recipe but be devised to match particular conditions and problems in the country, in short, that they be “homegrown”.

In the final analysis, promoting compliance involves building confidence in the pension system. No amount of policing can force compliance on the part of a population determined to evade. Moreover, it is easier and less costly to collect contributions from a population that acknowledges the benefits of protection than from one that lacks confidence in the government’s ability or commitment to deliver on its promises. Building such public trust is at the core of your job as a Board member. Where contributions are collected by another agency, both institutions are dependent on each other for success, making this an area where Board members will need to take an active interest and lead role.

³¹ Such projects might involve, for example, increased monitoring and inspections; public information campaigns that stress the importance of compliance and the social consequences of non-compliance; or a minimum contribution threshold for all workers, regardless of reported wages.

Key points from Chapter 11

- In most CEE countries, there is an urgent need to achieve better compliance with the law on the collection of contributions. This is a matter of great importance for social security Boards, even if contributions are collected by another agency, and they have a key role to play in raising the visibility of this issue.
- A key guiding principle is to make compliance easy, and then take swift and straightforward action when something goes wrong.
- It is also important to change the public perception, so that people understand that non-payment of contributions has a direct effect on their benefits at a later date. At the same time, employers need to be made to see payment of contributions as a sign of good corporate citizenship.
- A strategy with many elements – a multidisciplinary approach – is far more likely to be successful than one that focuses on only a few points. Important elements in such an approach include “piggybacking” (making contribution compliance a prerequisite for other government programmes and benefits), information sharing among government agencies, and public information campaigns, as well as boosting resources for inspectors, training, on-site visits, legal recovery procedures, and prosecutions.

MORE INFORMATION ON THESE TOPICS

If you want to follow up any of the topics considered in this chapter, some books and other resources that could help you are listed below.

Barrand P., S. Ross, and G. Harrison. 2004. “Integrating a Unified Revenue Administration for Tax and Social Contribution Collections.” IMF Working Paper. Dec. 2004. Washington, D.C.: IMF.

Fultz, E. and T. Stanovnik (eds). 2004. *Collection of Pension Contributions: Trends, Issues, and Problems in Central and Eastern Europe*. Geneva: ILO.

- Gillion, C. et al. 2000. *Social Security Pensions: Development and Reform*. Geneva: ILO. Chapter 10.
- ILO. 1998b. *Administration of Social Security*. Social Security Manual 2. Geneva: ILO. pp. 89–101.
- McGillivray, W. 2001. “Contribution Evasion: Implications for Social Security Pension Schemes.” *International Social Security Review*. Vol. 54, No. 4.
- Stanovnik, T. 2004. Contribution Compliance in Central and Eastern European Countries: Some Relevant Issues.” *International Social Security Review*. Vol. 57, No. 4.

INVESTMENT OF SOCIAL SECURITY FUNDS

INTRODUCTION

Although first-tier social security systems are mostly “pay-as-you-go”, increasingly they also do have funds to invest. These may be simply short-term buffer funds, held to tide over the institution should there be some crisis that interrupts the flow of contribution revenues. Other schemes are partially funded, with substantial funds intended to ease demographic pressures for the future. For example, in Slovenia 1.9 percent of the revenue comes from the investment fund (*Kapitalska Druzba*) set up with part of the proceeds from the privatization of State enterprises. In Poland, there is a Demographic Reserve Fund, which currently contributes only a tiny percentage of total revenue for first-tier pensions, but is projected to build up to around 40 percent of GDP by 2050.³²

Two examples of much more significant levels of partial funding exist in North America. The Canada Pension Plan (CPP) is pursuing a so-called “steady-state financing” approach. The contribution rates set for 2001–2020 are higher than are needed to cover benefit obligations in this period. The excess revenues are transferred to the Investment Board. The aim is to create a large enough reserve over time to help pay the benefits expected as the population ages, without having to increase contribu-

³² ILO. 2003. *Statistical Trends in Social Protection Coverage and Public Social Protection Expenditure in Poland*. p. 136. An ongoing Social Protection and Expenditure Performance Review. Online: www-ilo-mirror.cornell.edu/public/english/protection/socfas/publ/country.htm.

tions. A second example of partial funding about which there is much controversy at present is the US. Though social security in the US is largely pay-as-you-go, the 1982 Social Security Amendments put in place a similar strategy to that being pursued in Canada. Contribution rates were set so that the Social Security Trust Fund receives more in payroll taxes than it pays out in benefits. The excess is invested in special-issue Treasury Bonds, so it is effectively being borrowed by the Treasury and must be repaid at the time the Baby Boom generation starts to retire. These bonds were valued at US\$ 1.5 trillion at the beginning of 2004, and the Social Security Trust Fund receives more than US\$ 80 billion annually in interest from them. However, these reserves are only a small percentage of future benefit obligations.³³

MANAGING THE INVESTMENTS

If social security investments are to fulfil the goals set for them, they need to be managed prudently and responsibly. The International Social Security Association has recently published guidelines on this, developed by a committee of practitioners. As it has pointed out:

... 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 (ISSA 2004: 1).

This chapter draws heavily on the ISSA materials to describe the manner in which investment bodies should be set up and governed, the expert advice that they need, the setting of investment objectives, and the measurement and reporting of results. However, there is considerable variation from country to country in financial markets, legal frameworks, and supervisory structures. So while the basic principles remain the same, the way they are put into practice has to vary.

³³ SSA website, available at www.ssa.gov/qa.htm.

GOVERNANCE STRUCTURES

In discussing investment policies, one major distinction to make at the outset is between those countries where the institution administering the social security scheme is also responsible for investing reserves, and those where a separate, and generally independent, institution performs this function. In both cases, responsibilities must be specified within the institution, and its objectives must be clear. Where the investing institution is a separate body, its own legal status and its relationship with the social security institution must also be defined.

Having a separate investment institution may help to reduce the chances of actual or perceived political interference. On the other hand, in a democracy where a range of interests are represented in the political system, the political system may offer the best protection of the social security system and its investments. And placing social security investments beyond political scrutiny and control could lead to other sorts of problems. In this chapter, we call the investing body the “investment arm”, regardless of whether it is a separate institution or a subsidiary of the main one.

Whatever the structure, the investment arm should have a committee that is responsible for drafting the investment policy and strategy and then monitoring its implementation. This committee should report to the Board of the main social security institution. In some cases, the same person will chair the Board and the investment committee, and the CEO may also sit on the committee. The rest of the committee is typically drawn partly from the Board itself, partly from outside experts with the appropriate skills and experience.

There should generally be minimum standards of suitability for the committee members. The selection process should be designed to ensure this, and to provide for a high level of integrity and professionalism in the way the investment arm is run. All the points made in chapter 4 about conflicts of interest also apply here, even more sharply given the amounts of money involved.

As the committee should be reporting regularly to the Board of the main social security institution, all the Board members should receive some investment training. Those members sitting on the committee itself may well need more training and in greater depth. A benchmark might be that the Board as a whole needs sufficient knowledge and skill to understand the investment statement and ask questions on it, while the investment committee needs enough to be able to draw it up, with the help of its advisers, and take an informed view on a statement of “investment beliefs”.

Investment objectives

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

- (i) *security* – the investments should assist the social security scheme to meet its commitments in a cost-effective way;
- (ii) *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.

Source: ISSA 2004: 7.

In the case of buffer funds whose purpose is to ease the cash flow of the social security institution, an eye also needs to be kept on *liquidity* – how quickly and successfully investments could be sold to meet benefit obligations. In this case, it would be a mistake to tie up all the reserves in property that could be very profitable in 10 years' time, but would be saleable only at a loss before then. The approach and strategy for the investments should be integrated with those for the social security scheme, and be consistent with its objectives, whether short, medium or long term. Factors to be taken into account are the scheme's commitments as established by legislation, its expected future cash flows, and the appropriateness of different types of investment for meeting the investment objectives.

DEFINING THE INVESTMENT POLICY AND STRATEGY

The investment policy should be based on the principle that the investor is acting as a “reasonably prudent” person would. It should include appropriate rules about the allocation of investments to specific assets or types of assets. In setting these, the points that need to be taken into account are:

- risk management;
- the need for diversification and dispersion – that is, spreading investments across different classes of assets, and different investments within each class;

- matching assets and liabilities, including consideration of when each will mature;
- currency matching; and
- performance measurement and monitoring.

Investment statement

One of the best ways of ensuring that investment policy and strategy are fully worked out, and that all legitimate considerations (but no others) have been taken into account, is to put them into a clear published statement. The ISSA guidelines suggest that policy should be reviewed at least every three years, while the strategy that comes out of it should be reviewed more regularly, perhaps once a year.

- A good example of one comes from the Canada Pension Plan Investment Board. (See More Information, at the end of this chapter.)
- One element in this statement is a list of "Investment Beliefs" approved by the CPP Investment Board. As they say, these are "... a framework for considering portfolio management issues and making informed decisions in a holistic and consistent manner." Below is a selection of them, but it would be worthwhile for members of investment committees to look at the full set of these on the CPP website and to decide whether or not they agree, as a self-training exercise.
- The major stakeholder risk is that the current CPP 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.

Not all investment managers or advisers would agree with the complete list, but using it – or something similar – as a framework for discussion would help identify where the differences in view lie, and what effect they might have on the investment strategy adopted.

ACCOUNTABILITY

There should be clear accountability by the investment arm to the beneficiaries and other “stakeholders” in the social security scheme. One way to ensure this is to impose the principle of the “duty of care”. That is:

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) (ISSA 2004: 4).

The “prudent-person principle” refers to:

... 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 (ISSA 2004: 8).

In addition, anyone who has particular professional or business knowledge is expected to exercise it in carrying out his/her duties. This would be covered by the *prudent-expert* principle, which goes a stage further and is defined as:

Rules or principles which underline the need for genuine expertise as well as behaviour consistent with the prudent-person principle (ISSA 2004: 14).

However expert and well trained the investment committee is, it is unlikely that its members will have expert knowledge in all the different aspects of investment. Even if they do, having outside people giving an alternative view will often be useful. So the committee should have power to obtain outside investment advice, or to appoint professionals to carry out certain tasks. The contracts for these services should be open to competition, separately for each type of expert advice. There needs to be a regular review process so that these contracts come up for re-tender over a period of years.

The day-to-day work of investment management may be done in-house by people directly employed by the investment arm, or it may be done by outside investment managers. These may be local, associated with an international investment institution, or a combination of both. They will need constant monitoring, with reports to the investment committee's meetings not only about the results, but also to ensure that they are following the investment objectives and strategy set out by the Board. Costs also need to be monitored, including both direct fees and the underlying "transaction costs", for instance, commissions for buying and selling investments. These can amount to as much as the direct fees, and may provide an incentive to the investment managers to "churn" (buy and sell unnecessarily) the investment portfolio. Investment managers in the UK have adopted a voluntary "pension fund disclosure code" under which they disclose total investment costs and their components, and show how much each pension fund is paying. Board members might wish to consider a similar code for their investment managers.

If the investment arm is independent of the social security institution, it will also need an auditor (who could be the same as for the main activities of the institution), and possibly an actuary.

There will also need to be a *custodian* for the investment assets – that is, an agent which physically holds the documents or certificates proving that the institution owns X or Y. This may be a government body, such as the central bank or the Ministry of Finance, or an independent firm such as a large international bank. If the custodian is

independent, it should be formally appointed and required to re-tender for the work at regular intervals. A basic requirement is that the assets are legally separate from any other assets it is holding. The custodian should not be permitted to pass on any of the assets to a third party for safekeeping.

CONTROL SYSTEMS

The investment arm exists to serve the purposes of the client, not the other way round. In this case, the “client” is the main institution on whose behalf the funds are being invested. Inefficiency, excessive administrative costs, and lack of transparency in the investment arm’s activities will rebound on the main Board’s effectiveness and its reputation, just as much as if it was occurring within the main institution itself.

So the investment arm should be expected to have the same level of controls and standards as the main institution, and the investment committee should be expected to monitor and report on these.

A full financial statement should be published annually, and key documents such as statements on investment policy and strategy should also be readily available. What should not be disclosed until after the event, however, is anything that would prejudice a transaction, or compromise the investment institution’s responsibilities.

RESTRICTIONS ON INVESTMENTS

The most important investment decision is not whether to take shares in company A or company B, but how much to put into each particular category of investment, such as shares (equities), bonds, or property. In a scheme that is partly funded or even holds a substantial liquidity reserve, the size of the fund can be expected to grow quickly to the point where it is significant in the national capital market. So the national financial authorities – the Ministry of Finance or the central bank – are bound to take an interest, because of the effect that investment could have on the economy. There is a balance to be struck here, one that has been debated in detail at the international level. The ISSA guidelines state that:

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* [italics added] investments made by a social security scheme or its investing institution (ISSA 2004: 8–9).

Stated another way, the investments are not made in order to deepen capital markets, though they may have this indirect effect. Rather, they are held in trust by the institution in order to finance future benefits and maintain the stability of the social security system.

The decision on which precise equity or bond to invest in follows from that first “asset allocation” decision. The ISSA guidelines caution strongly against asset allocation being dictated from outside, such as by the government. In particular, they emphasize that it is not a good idea for the government to lay down any minimum level of investment in government debt. As the guidance puts it, “Social security funds should not become a means for governments to finance deficits and debts” (ISSA 2004: 9).

Rather, the investment committee, in setting its investment strategy, should decide for itself the prudent minimum and maximum levels of investment in the different categories. The maximum levels need to be set with reference to prudential rules – that is, rules promoting financial security, with provision for going above these ceilings only in exceptional circumstances.

It is also good practice to have ceilings on the proportion of the total market value of a particular industry or enterprise that can be held by the investing institution, regardless of the different forms it might take. Some types of investment may be limited or forbidden altogether. These could include loans without appropriate guarantees or on terms that would not be acceptable to the market, unquoted shares, and investments that raise major risks of conflicts of interest.

Social security institutions often face questions about investing outside the country. Doing so may be inevitable where the country’s capital market is small and/or underdeveloped – otherwise the weight of the social security institution’s reserves could simply overwhelm it within a few years. However, there need to be strict rules

about the *quality* of the investments made abroad, simply because they are further away and much more difficult to monitor. Currency risks also need to be considered, and discussion with the central bank or other financial authorities may well be needed before the investment committee develops its strategy on foreign investments.

Issues may also arise concerning investment in financial “derivatives” such as swaps and options, and in hedge funds. These can be extremely complex, and often rely heavily on borrowing money as part of the process. A number of public authorities – for example, county governments in the US – have lost heavily on investments in these instruments in the past. It is a good basic principle not to invest in anything you cannot understand. Any institution that invests in this field *must* have an appropriate risk management structure (covered in chapter 7), and very strict monitoring.

INVESTMENTS WITH SOCIAL AND ECONOMIC UTILITY

One difficult and politically sensitive issue that may confront social security board members is whether to invest in projects with social and economic utility – for example, state enterprises, student loans, low-cost housing, old-age facilities, health infrastructure, tourism, and projects enhancing human resources. Under the ISSA investment guidelines:

- the social or economic usefulness of an investment can be taken into account in deciding whether or not to make it; *but*
- these considerations should be subsidiary to the primary ones of security and profitability; and
- there must be clear criteria for deciding the circumstances in which, and to what extent, these secondary considerations will be taken into account.

Investing in projects of social or economic importance even though they are going to pay below-market returns means that the contributors or beneficiaries will be subsidizing that social purpose. Except in the extraordinary situation where they express their wish to do this clearly through a democratic process, this should not happen. Instead, the investment should be structured so that the government provides the subsidy, for example, by paying to the investment arm the difference between the market rate of return and the return actually being received. To quote the ISSA guidelines:

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 (ISSA 2004: 7).

Such investments will need very close monitoring by the social security institution. To quote ISSA:

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 (ISSA 2004: 7–8).

VALUING THE ASSETS AND MEASURING PERFORMANCE

The valuation of the assets should be in line with general accounting principles, whether national or international, and should be published as part of the annual report of the investment arm. The report also needs to include a regular analysis of each class of investment, to see what the rates of return have been. There are international standards for this “performance measurement”, which should be used unless there are particular reasons not to. (See More Information at the end of this chapter.)

Investment managers, as well as the specialist firms who do the performance measurement, tend to concentrate on whether the particular manager has done better or worse than others in the business, and then the market as a whole. This may demonstrate their skill (or luck), but it says nothing about whether the investment policy itself is achieving its objectives. So the performance assessment of social security investments needs to include a comparison with target rates of return, and with appropriate benchmarks. These would generally be linked to the assumptions made by the actuary, and the Government, in projecting the future obligations of the social security scheme.

The investment committee needs to discuss the performance analysis regularly, and consider whether the investment policy and strategy need altering. It is not

usually sensible to make frequent changes, but monitoring and periodic updating are both essential. The performance analysis should also be published.

A final point – one that was missed by many investors around the world in the last few years – is that “returns” on assets are only calculated figures. Unless you are drawing income from the assets, or are selling them at a particular time, these returns do not represent cash in the bank. If you bought something at 100, and are now selling it at 50, then the fact that at one time its value stood at 140 is irrelevant.

Key points to Chapter 12

- Although almost all first-tier social security systems are financed on a pay-as-you-go basis, increasingly they do have some funds to invest.
- The two primary objectives for investment of fund reserves are that they should assist the social security scheme to meet its commitments in a cost-effective way, and that they should achieve maximum returns subject to acceptable risks. Liquidity may also be important.
- An investment policy and strategy should be defined, taking account of risk management and the need for diversification. This should be incorporated in an investment statement.
- The financial authorities are likely to take an interest in investment policy, but social security funds are not there to deepen the capital market; they are held in trust for the payment of benefits to future pensioners.
- The principle of “duty of care” should be imposed on those who invest the funds, requiring them to act honestly and in good faith, and to exercise the care, diligence, and skill of a reasonably prudent person (called the “prudent person” principle).
- The investment committee should be expected to monitor and report on controls and standards, and a full financial statement should be published annually. Investment costs, both openly published fees and hidden costs, should be monitored.
- The most important investment decision is that on “asset allocation”, that is, the proportion of the funds to be put into different categories of investment, and whether at home or abroad. The financial authorities are bound

to take an interest in this, but the institution should decide on its own minimum and maximum levels of investment in the various categories.

- If there is a desire to make investments with social and economic utility, these considerations should be subsidiary to the primary ones of security and profitability, and there should be clear criteria for deciding what investments to make.
- There should be regular valuations of all the assets, in line with international principles, and measurement of performance. However, relative performance against other fund managers is less important than absolute performance against the obligations the fund is intended to meet.

MORE INFORMATION ON THESE TOPICS

If you want to follow up any of the topics considered in this chapter, some books and other resources that could help you are listed below.

Canada Pension Plan Investment Board. Online: www.cppib.ca.

Cichon M., W. Scholz et al. 2004. *Financing Social Protection*. Geneva: ILO/ISSA. Chapter 6.

International Social Security Association (ISSA). 2004. *Guidelines for the Investment of Social Security Funds*. ISSA Study Group on the Investment of Social Security Funds. Paper for meeting at Porto, Portugal. 1–2 April 2004.

Investment Management Association (IMA). 2002. *Pension Fund Disclosure Code*. Online: www.investmentuk.org/news/standards/pfdc2.pdf

PLANNING FOR THE FUTURE

INTRODUCTION

Social security schemes exert a major impact on a country's economy and the well-being of its population. For pension schemes, entitlements build up, and are paid out, over very long time-periods – from the beginning of a person's working life to his/her death or that of survivors, which could mean a span of 60 or 70 years or more. That is a far longer time than is affected by most other government activity. Moreover, social security schemes affect people in various ways at different points in their working lives, and what happens in one scheme often has a ripple effect on others. All this argues for planning, which is:

- *long-term* – looking ahead over the lifetimes of those affected; and
- *holistic* – looking at all the different social security schemes together.

However, in most areas of public policy, democratic leaders tend to think and act in a relatively short time horizon, drafting laws that win support from a coalition of those who are attentive to their actions. Social security, and pensions in particular, are ill suited to such short-term policymaking. These schemes require a different approach, one in which problems are anticipated and dealt with well in advance of their actual occurrence. This is necessary in order to avoid crises and ensure that the systems are able to meet their obligations to those who count on them.

Gathering political support to deal with problems before they occur always is difficult. Such support is facilitated when the extent of the problem is quantified and, very importantly, the costs of *inaction* are also made clear to those who will find the

needed solutions painful in the short-run. Making these problems and costs clear requires regular long-term projections of scheme financing.

ILO Convention 102, article 71, states that:

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.

While demographic problems are on the horizon in most CEE countries, only a few have created long-term models for projecting social security costs and benefits forward in the future. In addition, there is often no one with a responsibility to take a broad look across programmes, seeing how each one fits into the overall picture and which groups of the population are not covered, or not covered adequately. This can be extremely important for future coverage and spending.³⁴

This chapter focuses on actuarial valuations done for first-tier, defined-benefit social security systems. A “pure” defined-contribution second-tier system does not require an actuarial valuation in order to see whether it is going to meet its commitments, because by definition the only commitment is to the amount of money going in, not the level of the benefit that will eventually be paid. However, if the system has been set up on the assumption that it will provide a certain replacement rate – as is generally the case – then long-term projections are still needed to estimate whether the contribution rate is adequate for that purpose. Notional defined-contribution systems, as in Poland and Latvia, also require actuarial calculations, since they are financed on a pay-as-you-go basis and benefit levels are set based in part on the estimated life expectancy at retirement age of particular age cohorts.³⁵

³⁴ For example, increasing the retirement age, unless there is an increase in employment opportunities for older workers, may cause the unemployment and disability pension costs to increase.

³⁵ Similarly, in Sweden, the automatic balancing mechanism that is in place for the NDC system makes actuarial valuations less necessary for ensuring solid financing. However, constant monitoring of future benefit levels is needed to insure that they do not fall below acceptable levels – no automatic balancing mechanism has been devised for this purpose.

Regional examples of long-term planning capacity

In Latvia, the Ministry of Welfare has set up a model for making long-term social security projections, with the help of a team from the Swedish Social Security Board. This makes it possible to estimate how demographic changes will affect social security benefits overall. This model makes projections for as long as a century ahead – the length of time it takes for a pension system to develop “from the cradle to the grave”. It covers all social security benefits, though it is most detailed and precise with respect to pensions. To set life expectancy estimates, the Ministry holds an annual seminar with demographic and actuarial experts, and it publishes mortality tables from the information collected.

In Poland, the Government built a long-term model, beginning with a training seminar at the ILO’s centre in Turin and continuing with close cooperation. The model is now housed and operated in the Gdansk Institute for Market Economics. It is updated annually, and reports on its assessments are published regularly.

In Bulgaria, the National Social Security Institute has set up two models – short term and long term – with support from the ILO, the US Social Security Administration, and the US National Academy for Social Insurance. The NSSI actuarial staff has produced four annual reports on the short- and long-term benefit schemes and many specialized analyses. They frequently participate in government-wide working groups and assist other government agencies in making projections.

RESPONSIBILITY FOR PLANNING

Overall planning for social security is unlikely to be any one institution’s direct responsibility, and no single institution may have all the tools to do it anyway. A social security institution will, however, have at least some of the statistics that are needed, and all have a direct interest in seeing that it is carried out. So the Board of each institution needs to press for regular overall planning to be done, and to ensure that it is involved in the policy debates within such a project. The Board should be in a position to provide the politicians with their viewpoints on the requirements

for long-term, holistic projections, as well as to share these perspectives with colleagues on tripartite Economic and Social Councils.

WHAT HAS TO BE TAKEN INTO ACCOUNT?

There are a number of different methods of financing social security, and these differ between short- and long-term benefits. Employment injury arrangements are often a special case, as discussed above. The ILO textbooks and training manuals (see More Information, at the end of this chapter) go into the details fully, at both the technical and non-technical levels.

Short-term benefits

These are generally financed on a “pay as you go” (PAYG) basis, that is, contributions from current workers are used to pay benefits for current scheme beneficiaries. Looking ahead just a few years, estimates of the contributions needed to finance a given level of benefits can usually be fairly precise. The number of young adults entering the labour force after finishing their education can usually be estimated with good precision, and the effects of any recent change in eligibility conditions will be known. There can be, however, considerable uncertainty concerning the unemployment rate and consequent needs for unemployment benefit. To facilitate such estimates, good historical data on scheme contributors and beneficiaries is essential (see chapter 10).

Looking more than a few years ahead will require more assumptions: What will happen to the employment rate of married women? Or of older workers? Will workers move from the informal to the formal economy, or in the opposite direction? Will there be net immigration or net emigration? Will birth rates rise or fall, affecting the supply of workers two decades ahead? If cost-of-living increases in benefits are pegged to earnings or prices, then there also have to be estimates of these future trends. The same is true if the level of wages subject to contributions is so pegged.

Long-term benefits

Estimating the costs of long-term benefits, including retirement pensions, invalidity pensions, and survivors' pensions, is much more complex because of the long time horizons and the number of different factors that impinge on these schemes. In general, scheme costs will tend to rise over time, because:

- each year, a new group of people qualify for pensions which will be paid over many years;
- generally, pension entitlements increase with the number of years worked by a beneficiary, so as the system matures, individuals will be retiring with larger amounts due to them;
- pensions already being paid will generally increase in line with prices, with earnings, or by some formula that combines the two; and
- if life expectancy is increasing, new pensioners will be living longer. What matters here is not life expectancy *at birth* (though this affects the contributions side of the equation) but life expectancy *at retirement age*. If you have reached retirement, you have avoided some of the risks of life, and are one of the more robust ones!

So if the pension scheme is run on a PAYG financial system, as with the short-term benefits, the costs can be very low when a new system starts, but then rise steadily.

In some countries, as described earlier, the government has decided to charge more in contributions than the financing of a pure PAYG system would require at present.³⁶ The idea is then to set aside the excess in an actuarial or technical reserve, invest it, and use the investment income to pay all or part of benefit costs in the future.

Full funding, the typical mechanism for financing private pensions, is another possibility. The idea is that each year the contributions made by or on behalf of a worker are set aside in reserves, which are invested. In a fully funded defined-benefit (DB) system, the level of these reserves is set to cover the cost of providing

³⁶ As described in chapter 12, examples include Poland, Latvia, Canada, and the US.

the promised entitlements, including the expected income from the investments. In a defined-contribution (DC) system where there is no benefit promise, the worker simply receives his/her contributions plus investment earnings (or losses) and minus administrative expenses.

There are any number of intermediate positions between full PAYG and full funding. None of them affect the *cost* of financing a pension scheme. That is set by the number of pensioners, how long they live, and the level of pension they will be paid. What the type of financing system influences is rather the *timing* and the *source* of the payments into the system. A particular rate of contributions may be reached earlier or later, or more or less income may come out of companies' profits or the interest on their borrowings, rather than out of their payroll, depending on the combination of methods used.

In 1994, the World Bank published an influential study, *Averting the Old Age Crisis*, in which it claimed that a pension funding crisis could be prevented as populations age by changing the method of finance from pay-as-you-go to pre-funding. However, it is now widely recognized that this does not make economic sense. For the reasons why, see Appendix C, which provides a discussion of the issue by economist Nicholas Barr.

Employment injury insurance

Provision for employment injuries is a special category of social insurance. ILO conventions call for this to be financed exclusively by employers' contributions, and this is generally the practice around the world. Employment injury is frequently financed under the so-called "terminal funding financial system". This means that the contribution rate is set so that, in any period (usually a year at a time), the income of the scheme will be enough to meet all the future benefit payments in respect of injuries incurred during that period. The total value, in terms of today's money, of each new employment injury pension is calculated at the time it is awarded, and set aside in a technical reserve. This is then credited with interest and debited with the payments out, each year.

In some countries, rates differ according to industrial sector or the actual experience of different employers. These systems are generally called *differential rates* or *merit* or *experience rates*. Under *differential rates*, every

establishment is put into a category according to its activities, and those which are estimated to have higher risks of employment injury are charged more in contributions. Under the *merit* or *experience* rating system, the actual employment injury experience of that particular establishment is taken into account, according to whether it is higher or lower than average.

The argument for having different rates is that they will make employers more safety-conscious and keen to keep the employment injury rate down, as it affects their pocketbooks. However, the systems can be complex for both employer and social security institution to run. Statistical information needs to be collected regularly, and to be highly accurate, if the systems are to be fair.

In addition, steeply differentiated rates disadvantage workers in high-risk work environments. Firms may evade the requirements and start operating in the informal economy where the workers have no insurance at all. Other employers may put pressure on their employees not to report accidents, instead offering them compensation under the table, or threaten them with dismissal or other penalties if they report.

The best way to ensure that workers actually receive their injury compensation is to avoid making its cost burdensome on employers. This implies some degree of risk-sharing among all those in the system.

WHO DOES THE PROJECTIONS?

Long-term planning for a social security institution involves actuarial analysis, that is, projecting the financial balance of the scheme under various economic and demographic scenarios. The role of the scheme actuary is a very special and important one. As formulated by the ILO:

... It is the actuary who has to judge whether the vision of the future development of a given society and economy which underlies all these assumptions [for an actuarial analysis] 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.³⁷

The techniques used by actuaries are complex and technical. Some of them differ from those used by private pension funds or insurance companies, though the basic principles are similar.

In some countries, the social security institutions, and/or the government departments such as the ministry of labour or the ministry of social welfare have their own actuaries in-house. The Government of Poland is planning to set up a national actuary's office in 2007, with the aim of covering not just social security but other programmes that require long-term planning, such as education, health, and employment services. In other cases, especially in smaller countries, it is necessary to rely on actuarial expertise from outside the government.

The ILO has its own Financial and Actuarial Service (ILO FACTS) that carries out valuations, assessments, and audits as requested. It has also created a Social Budget Model, consisting of a "family" of interrelated spreadsheets that can be used by governments for all aspects of social budgeting – both short- and long-term benefit schemes and the social protection system considered as a whole (to be discussed subsequently). The ILO provides this model free-of-charge for use by those with the necessary skills – which the ILO will itself help to develop through training.

Actuarial training is quite specialized, but social security projections can also be made by other professionals, such as quantitative policy analysts with backgrounds in economics, public finance, and social policy. The ILO toolkit of textbooks and models for making projections in different areas is readily available for a team to work with in building the relevant skills. Demographic, economic, and statistical institutes within government ministries or universities are the most likely sources of suitable people for this.

There is a need for development of actuarial skills in CEE countries and elsewhere, if more long-term and holistic planning is to be done.

³⁷ ILO. 2002. *Actuarial Practice in Social Security*. Section 1.2.4.

Professional guidance for actuarial work

Actuaries generally follow the Guidelines of Actuarial Practice for Social Security Programs laid down by the International Actuarial Association, their professional body.³⁸ These guidelines can be regarded as good practice for anyone who is going to carry out a study in a professional way, whether they are certified actuaries or professionals with other quantitative specialties. The ILO Social Security Department (SOC FAS) also has a publication setting out the necessary contents of actuarial reports (see More Information, at the end of this chapter).

The IAA guidance call for actuaries to comply with the following principles:

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.

³⁸ IAA (2002). See further reading at the end of this chapter.

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: ISSA 2002: 2–3.

THE ROLE OF THE SOCIAL SECURITY INSTITUTION

Adequate and stable financing is important not only for social security schemes themselves, but also for the economy as a whole. Changes in the rates of contributions or taxes needed to finance benefit obligations, or in the benefits themselves in order to adjust social spending to what is available, will often have political and economic consequences. For these reasons, even the institutions with the greatest autonomy generally do not set their own contribution rates, and may have no formal responsibility for making the long-term actuarial estimates used in setting them.

Assuming that these functions are being performed elsewhere, it is still important for Board members to understand what is involved, for two reasons:

- the institution has a key role in providing many of the statistics on which the estimates are based, and the actuary needs to work with the staff and the Board to ensure that the relevant information is available and accurate; and
- whatever changes are made, the institution will have to administer them in future, and Board members' constituencies will want to understand the reasons for them. So Board members can expect to be questioned and perhaps find themselves on the receiving end of criticism.

At the least, the Board should ask to be kept informed, to be involved in the preliminary discussions, especially on the assumptions, and to be given an explanation of the process, the results, and changes being recommended.

CHOOSING THE ASSUMPTIONS

Making actuarial projections involves a whole series of assumptions about the future. The “projection period” – the time being looked at – will typically be at least five decades. The assumptions will be drawn from the experience of the scheme, national and international statistics, and discussions with Government officials. As indicated above in the IAA guidelines, where the assumptions are dictated by someone else, the actuary should be expected to say so and include a sensitivity analysis showing the effects of changing these. For example, the Government might insist on assuming an unrealistically high success-rate for collecting contributions, at a time when it is known that many large former State enterprises are effectively bankrupt.

Criteria for sound assumptions:

According to the IAA Code of Practice (see above), the assumptions should be:

- (a) Chosen on a realistic basis, as opposed to a conservative or a liberal basis, so as not to bias the financial projections. Each assumption should be realistic in its own right;
- (b) Stated explicitly, as opposed to implicitly, to the greatest extent possible;
- (c) Internally consistent, that is, all assumptions should be consistent with each other by virtue of their correlation or interrelationship; and
- (d) Consistent overall, e.g., the economic and demographic assumptions should be consistent with the long-term experience and the outlook for the economy.

Source: IAA 2002: 5.

One important issue that Board members may want to check is consistency between valuations used for first- and second-tier pension arrangements, especially if the level of second-tier pensions depends on future investment returns. It is not unknown for second-tier projections to use much more optimistic assumptions than are used for the first pillar. This can then make the first pillar look comparatively more expensive, difficult to finance, and disadvantageous for workers.

The assumptions made by the actuary are partly *demographic*, that is, they relate to the population of contributors and beneficiaries, and partly *economic*. The key economic ones involve the average rate at which employment and wages can be expected

to rise (or fall) over the period being looked at, the rates at which pensions and other benefits will increase (or decline), and – if there is, or there is planned to be, a reserve fund – what interest rates will be earned on these investments. Since assumptions should be based in part on past performance, much will depend on how good the programme statistics kept by, for example, the Ministry of Labour, really are.

It would be pure chance if the actuary managed to get all these assumptions right, and so come out with precisely the correct figures for even three years ahead, let alone 10, 15, or 25 years. What is possible, though, is to show the likely direction of trends, to include various scenarios, and to provide a sensitivity analysis showing how great an effect changing the assumptions has on the results. The projections should be repeated every three or five years – and even more often in a time of rapid change.

It is good practice for Board members to discuss the assumptions to be used, including the baseline, and alternatives that are more optimistic or pessimistic. A consensus among them can be of great help in ensuring the credibility of the projections and promoting the adoption of policy changes to address problems that they indicate are on the horizon. It is extremely useful to have non-specialists involved in this way, to provide a “reality check” on what the experts are doing.

ACTUARIAL VALUATION REPORTS

The actuary will begin work by pulling together statistics on the active insured population and scheme beneficiaries. The statistical material will generally be drawn from the institution’s own records, and will thus require the actuary to become familiar with the computer programmes and databases that exist. If the analysis reveals any gaps or inaccuracies, estimates will need to be made to address these, and the actuary will want to assess how consistent the statistics are with relevant information from other sources. In the final report, the actuary will describe the data used and comment on its sufficiency and reliability.

The Board should carefully consider this part of the actuary’s report and give special attention to proposals for improvement in data collection needed before the next valuation is due. These recommendations may cover not only outright data deficiencies but also ways to improve the collection or storing of data so as to increase the ease of the next valuation.

Using mathematical formulas or a computer model, the actuary will then use the assumptions and data to produce a set of projections. He/she is likely to repeat the

analysis for every year, but then roll these into five- or ten-year periods to make the final report manageable. By comparing estimates of the numbers of future contributors and their incomes with estimates of future pensioners and benefit levels, the actuary will calculate future contribution rates needed over time to keep the system solvent.

In countries that have mixed pension systems in which a portion of contribution revenues are being diverted to privately managed individual accounts, a key question for analysis by the actuary is that of transition costs. It is not enough simply to ask the actuary to look at the new system as if it has started “with a blank slate”, with the old system swept away. The public pension system is missing revenues with which to meet existing and future obligations. The actuary should be asked specifically to address the question of how big this “hole” in scheme financing is, how it is going to be filled, and who is going to bear the cost.

The final product of the actuary’s work will be a report – perhaps to the Ministry or to the legislature. It should also be made available to the public.

The results should summarize the income, spending, and assets of the scheme over suitable intervals, for both the past period and the projection period. It will generally also show the effects of inflation on the purchasing power of benefits that are not fully inflation-indexed. The report might also include a section comparing current findings with those in the previous report, with explanations of significant changes in assumptions or results.

Though the more detailed parts of the report are also worth going through, this analysis and the conclusions will probably be the most useful part for Board members, and the areas most worth discussing with the actuaries.

TAKING THE WIDER PERSPECTIVE: SOCIAL PROTECTION EXPENDITURE AND PERFORMANCE REVIEWS (SPERS) AND GOVERNMENT-WIDE SOCIAL BUDGETING

From the perspective of the government as a whole, projecting the finances of one social security institution in isolation, though important, is not enough. Social security is typically provided by a number of different national institutions delivering benefits to cover different risks, including those of lost income due to old age, sickness, disability, death, and unemployment. Are the overall national social policy objectives being achieved effectively and efficiently? Are various schemes operating in a coordinated fashion or at cross-purposes? To what extent does the system succeed

in preventing and alleviating 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 all governments must face and address if public funds are spent in an optimal ways.

The ILO has developed two tools to help governments answer these questions. These are: (1) Social Protection Expenditure and Performance Reviews (SPERs); and (2) Social Budget Modelling, touched on earlier, which can be applied not only to separate schemes but to the social protection system as a whole. Full information about them is contained in two ILO textbooks, published jointly with the International Social Security Association, *Social Budgeting* and *Financing Social Protection* (see More Information, at the end of this chapter). They may be described very briefly as follows:

- A Social Protection Expenditure and Performance Review is a tool for taking stock of what social protection exists today and in the past. It provides a comprehensive picture of all social protection programmes, including their expenditure and financing, the scope, extent, and level of coverage, and other aspects of their performance in fulfilling national policy objectives. They can focus separately on each national social protection scheme, trace its income and expenditures, the size and characteristics of the population covered, benefit levels, inflation adjustments, and administrative costs. In this way, they can identify gaps and overlaps in coverage and provide a basis for evaluating scheme efficiency and effectiveness. In recent years, SPERs have been undertaken for two CEE countries, Poland and the Slovak Republic (see More Information at the end of this chapter).
- Social Budgeting is a tool for comprehensive planning of future social expenditures. A full social budgeting exercise looks across *all social programmes*, including social spending and income of independent social institutions as well as Government, whether or not it is legally earmarked to cover social expenditure. It also covers private sector transfers to private households, so long as they comply with certain characteristics – such as being required by law. Social Budgeting is built on a so-called *statistical* basis, a methodologically consistent compilation of the revenue and spending of the country's social protection system. This is termed the Social Accounting System (SAS). The SAS is incorporated in a mathematical model and used to make projections of future income and expenditure. It can also be used to simulate social spending and revenues under alterna-

tive economic, demographic, and/or legislative assumptions, thus revealing the likely impacts of future events on the entire social protection system.

Such analyses may not always make happy reading for government officials or those running social security institutions. However, they point to gaps in coverage and pressure points in the system, and show what could be done to address these, and so help to prevent a government lurching from crisis to crisis in social protection. Boards of social security institutions should press their governments to adopt such tools in their planning processes.

Key points from Chapter 13

- The impact of social security benefits and contributions on a country's economy and well-being is large, and entitlements build up over very long time-spans.
- However, only a few CEE countries have undertaken regular long-term projections for their social security systems.
- In general, responsibility for doing this will not lie with the institution, but it will develop and maintain the relevant statistics and will be in a position to press for planning to be done.
- What has to be taken into account varies between short- and long-term benefits. Employment injury insurance is usually a special case.
- Long-term planning for a social security institution involves actuarial analysis, that is, making projections based on demographic and economic modelling. The relevant actuarial skills, or training in them, are available from the ILO and various other sources.
- Actuaries have firm professional guidance that they generally follow. The Board should discuss their assumptions with them in advance and, if possible, reach a consensus that they are reasonable before the valuation proceeds. Their report should be a sort of "bible" for the Board – an important reference for all policy deliberations.
- To obtain the wider picture, social budgeting and social protection expenditure reviews are also needed, looking across multiple social programmes.

MORE INFORMATION ON THESE TOPICS

If you want to follow up any of the topics considered in this chapter, some books and other resources that could help you are listed below.

IAA. 2002. *Guidelines of Actuarial Practice for Social Security Programs*. International Actuarial Association. Online: www.actuaries.org/members/en/committees/SOCSEC/documents/SS_Guidelines_final_en.pdf.

ILO. 1998. *Internal Guidelines for the Actuarial Analysis of a National Social Security Pension Scheme*. Geneva: ILO FACTS.

McGillivray, W. 1996. "Actuarial Valuations of Social Security Schemes: Necessity, Utility and Misconceptions." *Social Security Financing: Issues and Perspectives*, Geneva: ISSA.

Svoreňova, M. and A. Petrášová. 2004. *Social Protection Expenditure and Performance Review of the Slovak Republic*. Budapest: ILO-CEET.

Hagemejer, K. 2002. *Social Protection Expenditure and Performance Review of Poland*. Geneva: ILO.

SUMMING UP

The advice offering in the preceding pages has been detailed and elaborate. Its main thrust can be captured in these “rules for the road” to guide decision-making and action by Board members:

1. The institution exists for the sake of the clients – beneficiaries and contributors – not the other way round. So the guiding question in assessing new ideas or plans always is: “What does this do for the clients?”
2. Today’s contributor is likely to be tomorrow’s beneficiary, or at least related to one. The two categories are not separate. They are the same people, at different points in their lives. So letting contributors break rules today could mean that their benefits are reduced or non-existent when they reappear as beneficiaries in the future.
3. People no longer believe it when a government body (or any other large organization) says, “Trust us, we know that what we are doing is what’s best for you.” Trust has to be replaced by clear rules, transparency about how they are being put into effect, and accountability. Rules, decisions, and procedures should be publicized, unless there is specific reason for them not to be.
4. If ordinary people cannot understand what the institution is telling them, that’s the *institution’s* fault, not the person’s, because they have not explained it clearly.
5. If something in a financial deal, software contract, or set of performance statistics looks too good to be true... it almost certainly is. A Board’s lay members should never hesitate to question the experts. Jargon and clever presentations are often used as ways of disguising poor performance or a lack of understanding by

- the experts themselves. The lay member who “asks a silly question” does a service for everyone. If experts *really* understand what they are talking about, they will be able to explain it clearly to someone who does not know the subject.
6. Turf wars – disputes between institutions over priorities – do not benefit the client. The more institutions that are working in a particular field, the more important it is that they cooperate. Just as important as the human beings communicating, the computer systems must do so too.
 7. Getting decisions and procedures right the first time is almost always cheaper and quicker than getting them wrong and having to correct them later – even if doing them right appears to take longer at the first stage.
 8. Good, accurate work, delivered on time, will not be praised in the media. It is simply what is expected of the institution. Bad work, delays, or corruption scandals will make headline news. This may be very annoying and unfair, but that’s the way it is.
 9. If a scandal erupts, it needs to be dealt with quickly, efficiently, and openly. Telling the truth is not only the right thing to do from a moral perspective, but also usually produces the best pragmatic outcome. Often it is the cover-up, not the original scandal, that does the real harm to reputations.
 10. Your youngest contributor may still be drawing a benefit in 60 or 80 years time. So estimating for the future, not just the next three or five years but for the next half-century, is vital if you (and the clients) are to know if the system you are running will be able to keep its promises to them. However, they are *only* projections, and none of us can know with any certainty what will happen tomorrow, let alone in five or 50 years time. So the projections need to be rolled forward regularly, and this means the computer models used to produce them must be kept up to date. Once a new set of projections has been done, it should be brought to the attention of policymakers.

ILO DEFINITION OF SOCIAL SECURITY AND BASIC REQUIREMENTS OF ILO CONVENTION 102

The ILO defines social security as:

... 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.

Source: ILO. 1984. Introduction to Social Security. p. 3.

The ILO social security conventions provide standards for the structuring of benefits, as well as for their administration and financing. ILO Convention 102, Minimum Standards of Social Security, provides a unified guideline for developing all branches of social security. While giving governments considerable flexibility to structure social security schemes to meet national needs and preferences, its key provisions require that:

- any benefit in cash should be a periodical payment provided “throughout the contingency” that it is designed to address;
- the benefit should replace previous income to a certain specified extent;
- the costs of the benefits and of administration should be borne collectively by way of insurance contributions or taxation;

- the insurance contributions to be borne by the employees should not exceed 50 percent of the total cost of the scheme;
- the State should assume at least general responsibility for the due provision of the benefits and for the proper administration of the scheme; and
- representatives of the persons protected should participate in the management of a scheme, or at least be associated with it in a consultative capacity.³⁹

³⁹ ILO and ISSA. “Social Security: Introductory Module.” In: *Pensions* training materials. Unit 3. p. 20.

ILO CONVENTIONS ON SOCIAL SECURITY

COMPREHENSIVE STANDARDS

Social Security (Minimum Standards) Convention, 1952 (No. 102)

Income Security Recommendation, 1944 (No. 67)

Instruments with interim status

Social Insurance (Agriculture) Recommendation, 1921 (No. 17)

Social Security (Armed Forces) Recommendation, 1944 (No. 68)

PROTECTION PROVIDED IN THE DIFFERENT BRANCHES OF SOCIAL SECURITY

Medical care and sickness benefit

Medical Care and Sickness Benefits Convention (No. 130) and Recommendation (No. 134), 1969

Instruments with interim status

Medical Care Recommendation, 1944 (No. 69)

Old-age, invalidity and survivors' benefit

Invalidity, Old Age and Survivors' Benefits Convention (No. 128) and Recommendation (No. 131), 1967

Employment injury benefit

Employment Injury Benefits Convention (No. 121) and Recommendation (No. 121), 1964

Instruments with interim status

Workmen's Compensation (Agriculture) Convention, 1921 (No. 12)

Unemployment benefit

Employment Promotion and Protection against Unemployment Convention (No. 168) and Recommendation (No. 176), 1988

Social security for migrant workers

Equality of Treatment (Social Security) Convention, 1962 (No. 118)

Maintenance of Social Security Rights Convention, 1982 (No. 157)

Maintenance of Social Security Rights Recommendation, 1983 (No. 167)

Instruments with interim status

Equality of Treatment (Accident Compensation) Convention (No. 19) and Recommendation (No. 25), 1925

THE MYTH THAT FUNDING RESOLVES ADVERSE DEMOGRAPHICS⁴⁰

Nicholas Barr

“Some degree of pre-funding is desirable in an old age security system. This helps to insulate the system from demographic shock” (James 2000: 1).

Consider a balanced PAYG scheme, where:

$$sWE = PR \quad (1)$$

where s = the PAYG social security contribution rate, W = the average nominal wage, E = the number of workers, P = the average nominal pension, and R = the number of pensioners. In such a scheme, current contributions of the workforce exactly cover current pension payments.

To show the effects of adverse demographics, suppose that a large generation of people of working age in period 1 is followed by a smaller generation in period 2 – broadly what is happening in most OECD and transition countries. As a result, the smaller period 2 workforce has to support the large generation of retired period 1 workers. It is helpful to consider separately the cases of static output and growing output.

⁴⁰ Barr, N. 2000. “Reforming Pensions: Myths, Truths, and Policy Choices.” IMF Working Paper 139. August 2000. Washington, D.C.: IMF. p. 8–11.

STATIC OUTPUT

Suppose that, because of a decline in the birth rate, E halves. Other things being equal, a PAYG scheme can remain in balance in various ways. One option is to halve the average pension, P , imposing the entire cost of the demographic shock on pensioners. This is problematical because it breaks the promise made to pensioners and because of its potential equity effects, including pensioner poverty. Another option is to double the contribution rate, s , thus imposing the entire cost on workers. This is problematical because of its potential adverse incentive effects on work effort. Other options are discussed shortly.

It is sometimes argued that funded schemes get round this problem: period 1 workers build up pension savings; the savings of a representative worker exactly cover his pension stream (i.e., the present value of his pension stream exactly equals the lump sum he has accumulated by the time he retires); if there is a large number of period 1 workers, this is not a problem, it is argued, because each worker accumulates enough to pay for his/her own pension. The problem with this argument is that though it is true in nominal terms, it is false in real terms, as demonstrated in Barr (1979). To see why, note that the underlying problem caused by demographic change is a fall in output. This affects a PAYG system by shrinking the contributions base, WE , correspondingly reducing the pensions bill which can be supported by a given contributions rate. With funding the mechanism is more subtle, but equally inescapable, operating through a mismatch between demand and supply in either the goods market or the assets market. The mechanism merits explanation. Discussion starts with a closed economy; subsequent extension to a global economy does not change the result.

If a large generation of workers is followed by a smaller generation, there will be a large accumulation of pension funds belonging to the older generation at a time when the workforce is declining. The large older generation will seek to draw down its accumulated savings to finance its desired level of consumption in retirement. That desired level of spending will exceed the desired pension contributions of the smaller, younger generation. If output does not rise, the resulting disequilibrium manifests itself in either of two ways.

- (a.) Suppose that pensioners seek power over future production by building up piles of money, for example, government bonds. In that case, desired pensioner consumption exceeds desired saving by workers. Excess demand in the good market causes price inflation, reducing the purchasing power of pensioners' annuities.

- (b.) Suppose, instead, that pensioners seek power over future production by accumulating non-money assets, for example, equities. In that case, pensioners' desired asset sales exceed desired asset purchases by workers. Excess supply in the assets market reduces asset prices, reducing pension accumulations and hence the resulting annuity.⁴¹

Under either outcome, pensioners do not get the real pension they expect. Funded pensions face similar problems to PAYG schemes, and for exactly the same reason – a shortage of output. The only difference is that with funding the process is less transparent and, for that reason, is perhaps preferable to politicians, who prefer bad news be seen to arise through market outcomes rather than political decision.

GROWING OUTPUT

Returning to equation (1), with static output the problems of PAYG could be resolved by halving P , by doubling the contribution rate, s , or by a combination of the two. An alternative solution arises where output, and hence the average wage, W , doubles, but P remains constant. Though this implies a fall in the replacement rate, P/W , pensioners – crucially – get the real pension they were promised. In that case, equation (1) holds, and the PAYG scheme remains in balance without the need for either a reduction in pensions or an increase in contributions.

Equally, increased output is a complete solution for funded schemes. Cases (a) and (b), above, now play out as follows.

- (a.) Goods market: a decline in the savings rate at full employment increases aggregate demand; but if aggregate supply has increased sufficiently, there is no excess demand for goods and hence no inflation. As with the PAYG case, though P/W falls, pensioners get the real pension they expect.
- (b.) Assets market: higher output generally implies that workers will have higher wages; if period 2 workers want a pension of (say) 50 percent of their previous wage, their demand for assets to hold in their pension accumulation will increase in proportion with their wages. At its simplest, E halves but W doubles,

⁴¹ Heller (1998) also makes this point. A simulation exercise by Brooks (2000) based on a stochastic overlapping generations model with stocks and bonds shows the general equilibrium effects on asset returns of demographic change, showing in detail how this result emerges.

so that the demand for assets equals desired sales by pensioners. Hence there is no deflation of asset prices. Again, period 2 pensioners get the real pension they expect.

POLICIES IN THE FACE OF DEMOGRAPHIC CHANGE

Thus the central question – and the reason for the earlier emphasis on output – is how to encourage growth, and the part which funding does (or does not) play in bringing this about. In principle, output can be increased in two ways. One approach is to increase the productivity of each worker, thus increasing W in equation (1). Policies to this end include: (a) more and better capital equipment, for example, robots, and (b) improving labor through more education and training. A second approach is to increase the number of workers from each age cohort, thus increasing E in equation (1). Such policies include: (c) policies to increase labour supply, for example, by married women by offering better child care facilities, (d) raising the age of retirement, (e) importing labour directly, for example, through more relaxed immigration rules,⁴² and (f) importing labour indirectly by exporting capital to countries with a young labour force.

What impact does funding have on these policies? It clearly has no bearing on policies (b)–(e). The evidence on the effect of funding on capital accumulation via policy (a) is controversial, a topic taken up in more detail in Section II.C. The effect of funding on (f) requires discussion. The emphasis on output is because what matters to pensioners is consumption, not money. However, pensioners are not restricted to consumption of domestically produced goods, but can consume goods made abroad so long as they can organize a claim on those goods. It does not help British pensioners to build piles of pound notes if there are no British workers producing anything. However, if British workers use some of their savings to buy Australian factories, they can in retirement sell their share of the factory's output for Australian money to buy Australian goods, which they then import to the United Kingdom. This is an example of policy (f).

⁴² Though this would have to be phased carefully to prevent another demographic crunch in 30–40 years time.

This approach can be effective, but is no panacea. The policy breaks down if Australian workers all emigrate to California; in that case Australian factories remain idle, and so both UK pounds and Australian dollars are useless. Thus, the age structure of the population in the destination of foreign investment is important. Second, if large numbers of British pensioners exchange Australian dollars for other currencies, the Australian exchange rate might fall, reducing the real value of the pension. Thus the ideal country in which to invest has a young population *and* products one is likely to want to buy. Accumulating assets in countries with younger populations can thus be a useful way to maintain claims on future output. Overseas investment by pension funds is one way to implement this policy. But there are other ways of doing so: I could, for example, hold part of my saving in Australian equities or mutual funds. Funding per se is not paramount – what is paramount is saving.

The conclusion to which this leads is threefold.

- In the face of demographic problems the key variable is output;
- Policy should consider the entire menu of policies which promote output growth directly;
- From a macroeconomic perspective the choice between PAYG and funding is secondary.

In sum, the argument that funding insulates pensioners from demographic change should not be overstated. The policy implication is that from an economic point of view demographic change is not a strong argument for a shift towards funding.

SOME KEYS TO BEING A SUCCESSFUL BOARD MEMBER

Warren McGillivray

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 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 dependents.

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 located in Turin 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 dependant 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’ contribu-

tions 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. (See <http://www.issa.int/pdf/GA2004/2guidelines.pdf>.) 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 institution 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 branch offices. It is in these branch offices where the interface between the scheme and its clients occurs. Board members should visit branch offices (anonymously, if possible) in order to ascertain whether they are appropriately situated and designed and providing 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 SKEPTICAL AND INDEPENDENT – BUT SEEK ADVICE

A sceptical approach is prudent on the part of persons responsible for supervision of any institution. 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 institution. 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.

COMPOSITION OF SOCIAL SECURITY BOARDS IN SELECTED CEE COUNTRIES

Country and institution	Composition of the Board
Albania <i>Instituti I Sigurimeve Shoqerore</i> , Social Security Institute (SII).	Administrative Council composed of 12 members; <ul style="list-style-type: none"> – 6 from Government Ministries (Finance, Economy, Labour and Social Affairs, Health, and Justice) and the SII (one member); – 2 from the largest workers' organizations, and 1 from beneficiaries' organizations – 3 from employers' organizations, one of whom represents farmers.
Estonia Health Insurance Fund	Supervisory Board of 15 members, including <ul style="list-style-type: none"> – the Minister of Social Affairs, Minister of Finance, and Chairman of Social Affairs Committee of legislature, – one official designated by the Ministry of Social Affairs, – one member of the legislature designated by the Social Affairs Committee, – five members from organizations representing the interests of insured persons, and – five members from employers' organizations. Minister of Social Affairs is Chair of the supervisory Board by virtue of office. A Management Board comprising 3–7 paid officials reports to the Supervisory Board.
Estonia Unemployment Insurance Fund	Supervisory Board of 6 members; <ul style="list-style-type: none"> – 2 appointed by the Government – 1 each appointed by the Estonian Confederation of Trade Unions and the Estonian Employees Confederation of Unions – 2 appointed by the Estonian Confederation of Employers and Industry A Management Board comprising 3 paid officials reports to the Supervisory Board.

<p>Poland</p> <p>Social Insurance Institution (ZUS)</p>	<p>Supervisory Board comprises of ten members:</p> <ul style="list-style-type: none"> – three are appointed by the Prime Minister on the nomination of the minister responsible for social security, acting in concert with the minister responsible for public finance. – three others are appointed from the nation-wide employers' organization, and – three from the trade union and pensioners' organizations, and – one from the beneficiaries' association.
<p>Serbia <i>Službeni glasnik RS</i> Employees Pension and Disability Insurance Fund of Serbia</p>	<p>The Managing Board has 15 members – five representatives each of insured persons, employers, and beneficiaries.</p> <p>Members of the Managing Board are appointed by the representative trade unions organized at the level of the Republic, representative employers' associations organized at the Republic level, pensioners' associations organized at the Republic level with more than 50,000 registered members (to represent beneficiaries). Two of the employers' representatives are appointed by the Government, in its role as a large employer.</p> <p>There is also a Supervisory Board, with 5 members, 2 representing insured persons, 1 representing employers, and 1 representing beneficiaries.</p> <p>There are similar boards for the Farmers' and Self-Employed Funds.</p>
<p>Slovakia</p> <p><i>Sociálna poisťovňa</i>, the Social Insurance Agency (SIA)</p>	<p>The tripartite Supervisory Board has 15 members;</p> <ul style="list-style-type: none"> – 5 designated by representative associations of trade unions and interest associations of citizens, representing beneficiaries of pension benefits, – 5 designated by associations of employers, and – 4 designated by the Government. <p>The President of the Supervisory Board is the Minister of Labour, Social Affairs, and Family.</p> <p>Except for the President, Members of the Supervisory Board are elected and removed by the National Council (the legislature).</p>

SELF-ASSESSMENT FOR BOARD MEMBERS

QUESTIONNAIRE

This is adapted from a questionnaire devised by the French association of pension institutions, AGIRC, and included in a Handbook for the Boards of their member-institutions. (See bibliography for details.) Going through it should help you appreciate your areas of knowledge and your strengths, and also the areas on which you are weak and so need to do more work or obtain more 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"> – the organization I represent, – my colleagues on the Board who had been in the role for a long time, – the Chief Executive and other senior staff of the institution, – any other sources. 		
I have copies of all the relevant documents about the institution 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 had 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 go carefully through the agenda and all the accompanying documents.		
I am in touch with experts who can assist with briefings on points which need specialist knowledge.		
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"> – a further explanation in lay person’s terms – background material as necessary. 		
I am aware of <ul style="list-style-type: none"> – the institution’s mission statement, objectives, and targets, and – the performance indicators being used. 		
When investment in future administrative or technological developments is being discussed, I determine whether the proposals: <ul style="list-style-type: none"> – will have a positive effect in terms of cost, the quality of the administration, and service to the clients; – are compatible, in the short and medium term, with the institution’s budget; – will improve the capacity to communicate with other government institutions and with our clients 		
I keep myself well informed about press and media comments on the institution and its activities.		
I am aware of the institution’s staffing policies, and I believe them to be fair and transparent. I believe we are leading by example in this field.		
The institution’s finances	Yes	No
I understand the public accounting rules followed by the institution.		
I have obtained briefings from specialists on aspects I did not understand.		
I understand what proportion of the institution’s total expenditure is devoted to administration, including: <ul style="list-style-type: none"> – what the main categories of this spending are, and – how it is divided by head office and regional/local office spending. 		
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 auditor's management letter.		
I check that any recommendations in those reports are being carried out.		
The Board member's right to information	Yes	No
The institution keeps Board members up to date on: <ul style="list-style-type: none"> – its activities, – current reviews and development programmes, – any relevant political or legal developments. 		
Board members are sent copies of any circulars, reports, or other publications issued by the institution.		
Board members receive regular reports on: <ul style="list-style-type: none"> – new benefit claims, current payments, benefit claims which have been terminated; – revenue and expenditure, both on benefits and on administration; – administrative costs; – performance against objectives and benchmarks; – recommendations by internal and external auditors; – action being taken to implement these. 		
I believe sufficient information is provided to allow Board members to take an active part in the governance of the institution.		
Communicating about the institution	Yes	No
In my role as a Board member of the institution, I consider I have a role in communicating about its activities to the constituency that I represent.		
I have regularly organized or participated in external meetings which provide information about the institution's activities: <ul style="list-style-type: none"> – within my own organization. – for a wider group, or the general public. 		
I feel I know and understand enough about the institution's activities to be able to take an active part in such a meeting.		
When this is not the case, I would be able to ask for a further briefing from: <ul style="list-style-type: none"> – people in my own organization, – people in the institution. 		
I believe I am informed well enough to participate actively in debates about social security policies in general, in particular, about future developments and possible reforms.		
I believe I am fulfilling my role as an ambassador for the institution.		

The institution's investment strategy	Yes	No
I understand: <ul style="list-style-type: none"> – the various categories of investment available to the institution, and – how their characteristics vary, for instance their level of risk, liquidity, and likely rate of return. 		
I take a full part in drawing up and reviewing the institution's investment strategy, and I understand the reasoning behind it.		
I understand the way in which investment performance is measured, including: <ul style="list-style-type: none"> – the benchmarks being used, – the reasons given by the investment managers when they report on any shortfall. 		
I understand the structure of fees and other charges made by the 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 institution. <ul style="list-style-type: none"> – These reports look forward..... years. – The Board has the chance to discuss the assumptions and the statistics with the experts carrying out the work. 		
There has been, or there is planned to be, a review of social protection expenditure across the whole economy, in my country.		

Knowledge and skills

	Topic	Rate your knowledge/skills (insert "good", "moderate", "weak" + any comments)
1	History and structure of the benefits provided	
2	Legal framework	
3	Structure of the institution	
4	Setting objectives and measuring performance	
5	Accounting and financial control	
6	Investment issues	
7	Longer-term actuarial issues	

EXAMPLE OF TRAINING RECORD

Objective: to devote a minimum of 2 hours a month to informal training (reading, discussion with experts, etc.), and 2 days' formal training per year.

Name of member:

Start date for period covered by record:

Date	Activity	Formal or informal? And any comments

OTHER USEFUL BOOKS, PUBLICATIONS, AND WEBSITES

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International Organization of Supreme Accounting Bodies	www.intosai.org
International Social Security Association (ISSA)	www.issa.int
University of Lausanne	www.unil.ch
University of Maastricht	www.fdewb.unimaas.nl
World Wide Web Consortium (W3C)	www.w3c.org

ABBREVIATIONS AND ACRONYMS

AGIRC	– General Association of Pension Institutions for Workers (France)
ARRCO	– General Association of Pension Institutions for Managerial Staff (France)
CEE	– Central and Eastern Europe
CEO	– Chief Executive Officer
CPP	– Canadian Pension Plan
DB	– Defined Benefit System
DC	– Defined Contribution System
EIPA	– European Institute of Public Administration
EU	– European Union
GDP	– Gross Domestic Product
IAA	– International Actuarial Association
ICT	– Information and Communications Technology
ILO FACTS	– ILO Financial and Administrative Service
IPSAS	– International Public Sector Accounting Standards
ISSA	– International Social Security Association
PAYG	– Pay-as-you-go
PI	– Performance Indicator
PIS	– Performance Indicators
SAS	– Social Accounting System
SIA	– Social Insurance Agency (Slovakia)
SNA	– System of National Accounts
SPER	– Social Policy and Expenditure Review
SSA	– Social Security Administration (Czech Republic)
VFM	– Value for Money
ZUS	– Social Insurance Institution (Poland)

