



International Labour Office

Investment of Social Security Funds

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OBJECTIVES

Social Security Reserves

- Contingency vs technical reserves
- Level of funding may differ
→ DB vs DC pensions

Why invest social security reserves?

- To protect reserves against price inflation
- To generate supplemental income, and improve financial sustainability of scheme

INVESTMENT PRINCIPLES

- Safety → Preservation of capital paramount
- Return → earn interest or dividend
- Consider liquidity
Short-term vs long-term investment
- Investment Policy
→ reflects risk-tolerance, horizon, etc.
- Investment Strategy
→ more specific (asset classes etc.)

INVESTMENT VEHICLES

- Bank Deposits (savings account vs fixed-term)
- Government Bills & Bonds
- Corporate bonds
- Equity (Stock)
- Forex & Money Market
- Commodities (Gold, etc.)
- Property & Real Estate
- Mutual funds or
- Derivatives (Options, futures, CMOs, etc.)
- Other (Art, etc.)

INVESTMENT VEHICLES

Main considerations

- Risk versus Return
- Liquidity (→ investment horizon?)
- Transaction cost
- Custody & maintenance cost
- Ethical criteria (e.g. no arms, gambling, tobacco)
- Socially-responsible investment (SRI)?
- Other?

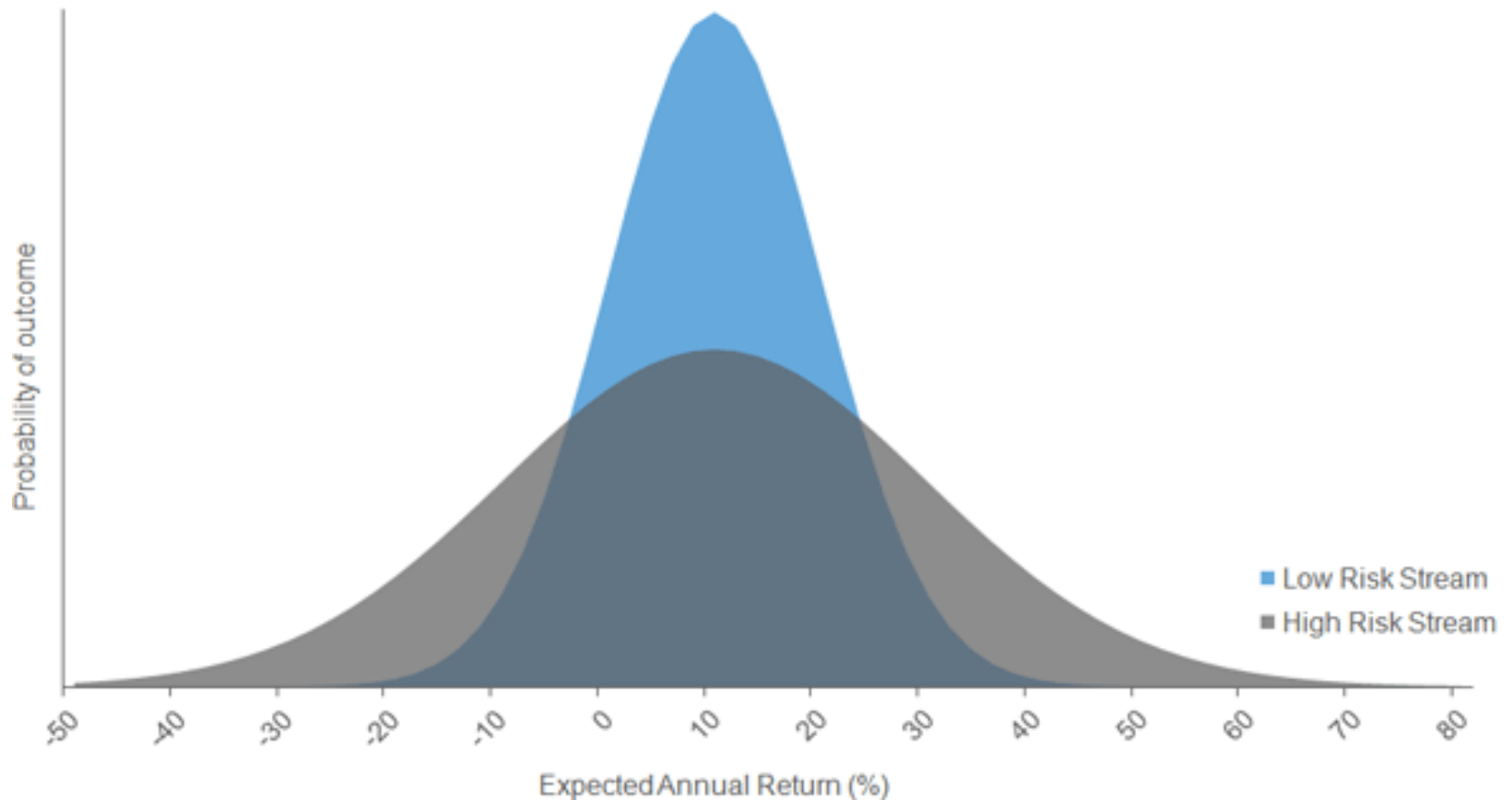
INVESTMENT RISK

Multiple Dimensions of risk:

- Market (Price-) Risk
- Exchange-rate (currency-) risk
- Interest-rate Risk
- Counterpart Risk
- Credit risk
- Country Risk
- Sovereign Risk
- Liquidity Risk
- Etc.

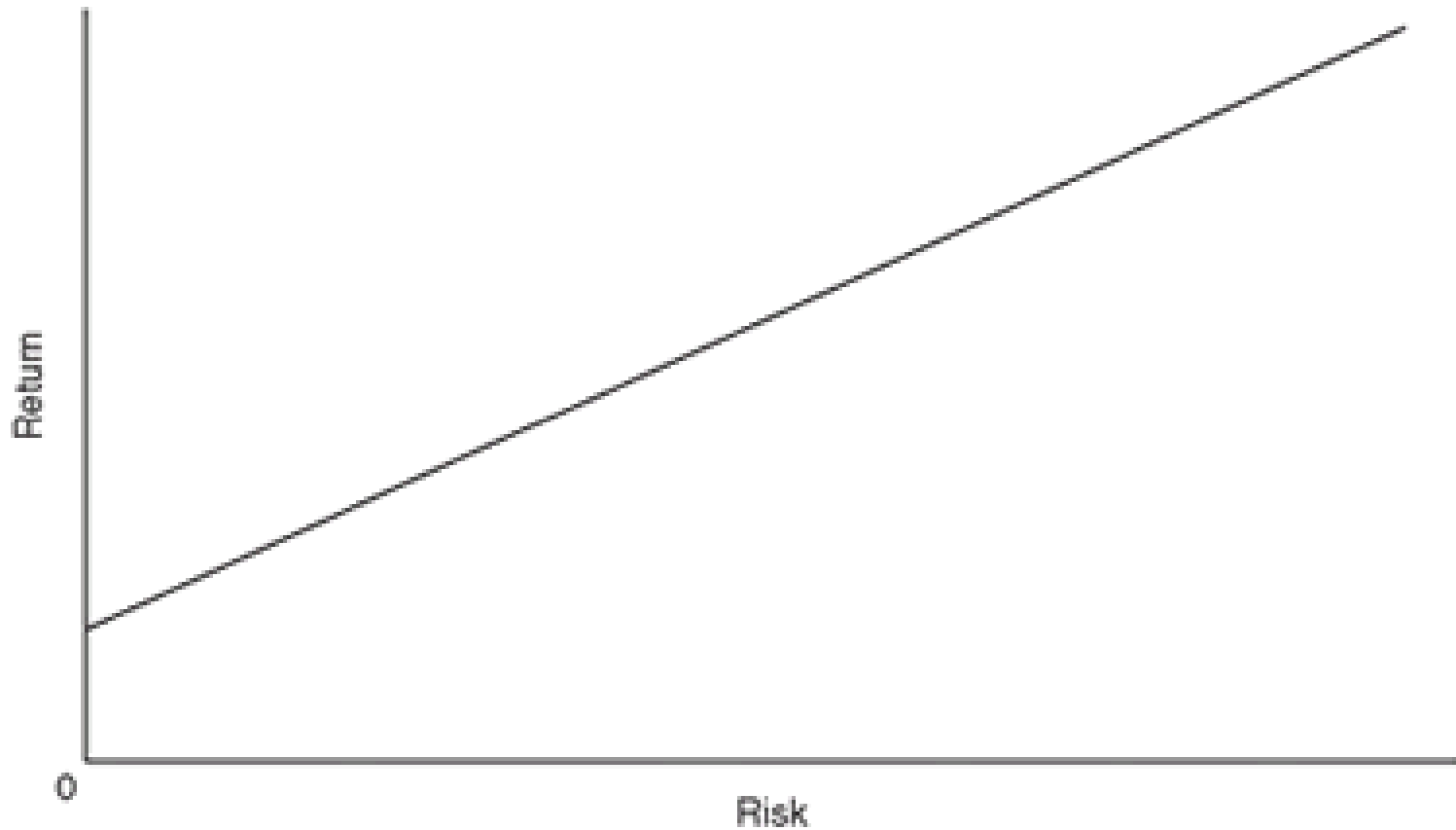
INVESTMENT RISK

Market Risk: variability of return



INVESTMENT RISK

Risk-return trade-off



RISK MANAGEMENT

How to manage risk?

- Avoid certain asset classes
- Limit exposure
(e.g. use % limits by asset class)
- Diversification
- Hedging
- Measure exposure (e.g. V.A.R.)
- Risk management policy

PRUDENTIAL REGULATION

Prudential Regulation

- Prudent-person rule
 - obligation for investment managers
- Separation of duties (policy / execution)
- Conflict-of-interest
 - disclosure rules etc.
- Other

Governance and Supervision

Governance principles

- Involve beneficiaries in governance of investment
→ tripartite investment board?
- Adopt investment 'regulation'
- Separate investment policy & execution
- Disclosure of policy and portfolio
- Outsourcing may be preferable to in-house management

Regional Issues

- Uneven Development of Capital Markets
 - limited choice of investment vehicles
 - Bank deposits?
 - Treasury bonds?
 - Equity & corporate bonds?
 - Property & Real estate?
- High price inflation
 - Need inflation hedge

Outlook

- Population ageing uneven
 - demographic dividend
 - Funding needs limited?
- Developing countries
 - High GDP growth rates
 - Capital market yet to develop
 - Limited technical capacity
- Pension funds
 - Public systems being established
 - Occupational & private pensions
 - high potential grow for next decades

THANK YOU !