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**Managing risks in the portfolio**

***Jordan's social security investment engine:  
A strategic partner in economic development***

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Director General  
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Jordan

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# Managing risks in the portfolio

## Jordan's social security investment engine: A strategic partner in economic development

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### Jordan in the global economy

Over the past five years, the Jordanian economy has succeeded in overcoming the effects of the unstable conditions that affected the Middle East. The real growth rate reached 7.6 per cent in 2004 reflecting the high growth and sound economic conditions the Jordanian economy enjoys. These include highly skilled human resources, a stable political climate, investment incentives and preferential free trade agreements with the United States, Europe and all Arab States. The main economic indicators for 2004 are:

Gross domestic product (GDP)	JOD <sup>1</sup> 8,164 million
Per capita income	JOD 1,534 at current market price
Real GDP growth	7.6 per cent
Discount rate	4.25 per cent

### The Jordan Social Security Corporation

Jordan's social security scheme started operating in early 1980. When the military and the civil service schemes cease operations in the coming twenty years, the scheme will be the sole public pension scheme for the Kingdom. The scheme is operated and managed by the Social Security Corporation of Jordan (SSC), which was established in accordance with the provisional Social Security Law No. 30 of 1978 and commenced its activities in January 1980. The SSC is an independent body that is run by a tripartite board which undertakes its activities in managing and controlling both the insurance and investment activities of the scheme through the power vested in it by the Law. Among the successful policies the Corporation has implemented during its operation is the board decision to create a semi-independent investment arm that, with the help of the private sector, could take more aggressive investment decisions in the economy. The Investment Unit of the social security scheme (IUSS) was established in early 2002 with a board of seven commissioners, four of whom are from the private sector. The other three commissioners are from the Board of Directors of the SSC – the Director General and employee and employer representatives. The Chairman of IUSS is among the four members who represent the private sector and is

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<sup>1</sup> JOD = Jordanian dinar. USD 1.00 = JOD 0.71 in August 2005.

appointed by the Prime Minister on the recommendation of the Chairman of SSC, who is by law the Minister of Labour.

## **Investments of the Social Security Corporation**

The SSC investment fund has increased from JOD 4.2 million (around USD 6.5 million) in 1980 to more than JOD 3.5 billion (around USD 4.9 billion) at present, which amounts to almost 42.2 per cent of Jordan's GDP. The SSC places great importance on expanding and diversifying its investments as a way to obtain sufficient returns to ensure its ability to meet its obligations. At the same time, the Corporation strives to make investments which provide social and economic benefits to support its goals for the national economy by creating new job opportunities, increasing production and strengthening the economic foundation of the country. Investment decision-making by the SSC is made in accordance with strategic guidelines approved by the Board of Directors.

### **Social Security Corporation Investment Commission Mission Statement**

"Preserve the real value of assets and generate, at all times, liquidity necessary to meet the liabilities of the SSC. This is to be achieved while taking into consideration the national interests of Jordan and the implementation and observation of investment standards and ethical codes according to best international practices related to the management of pension funds."

The IUSS adopted the following strategic guidelines which were issued by the Board of Directors in 2002:

- investment at national level, and international level only in cases of limited national investment opportunities;
- diversify investments in a way that minimizes risk and maximizes profit, pay close attention to economic transformation and the general investment climate and adopt international and regional investment standards;
- avoid speculation in the derivatives market and foreign exchange and concentrate on applying basic principals of investment;
- preserve the real value of assets;
- improve the investment decision process by drawing from international experiences and best practices, and by extensive professional training of employees.

These strategies are carried out through the following investment principles and objectives:

- a conservative approach in order to preserve the assets and reserves of the SSC;
- maintain the real value of assets;
- achieve maximum possible profitability to extend the actuarial equilibrium period;
- provide the necessary liquidity to meet current and short-run obligations and liabilities;
- participate in projects that have a positive influence on the national economy and a development effect as well.

To achieve its targets, the SSC uses the following financial instruments:

- Money market instruments.
- Bonds (sovereign and corporate).
- Loans.

- Traded equities (publicly listed).
- Private equities (unlisted).
- Mutual funds.
- Real estate.

The SSC is allowed to diversify into international markets subject to coordination with the Central Bank of Jordan and approval of guidelines by the Cabinet.

To implement the above-mentioned strategies, IUSS operates the investment fund using the following investment tools:

- Shares in new and existing public companies through direct investment or through the Amman Stock Exchange (ASE).
- Long-term fixed income investments such as loans and bonds as well as BOT (build, operate and transfer) contracts.
- Short-term investments such as deposits, treasury bills and bonds, and deposit certificates.
- Developing and buying land, investment buildings, hotels, etc.
- Any financial tools approved by the Board of Directors.

The Corporation has a specific interest in strategic projects that influence the national economy. Table 1 shows the distribution of SSC investments during the period 2000-2004. Table 2 shows the strategic target allocation of invested assets.

**Table 1. Social Security Corporation invested assets 2000-2004**

**In JOD million:**

Year	Equity assets class	Fixed income assets	Real estate	Bank accounts	Total invested assets	Total return	Average annual return (%)
2000	346.6	281.1	63.6	756.4	1,447.7	85.5	6.2
2001	475.7	232.6	84.3	789.8	1,582.5	72.6	4.8
2002	503.0	369.7	92.4	690.3	1,674.1	68.9	4.4
2003	698.5	648.7	108.9	471.4	1,927.5	56.4	3.0
2004	1,265.3	729.3	134.2	409.4	2,538.2	84.9	3.8

**In percentages:**

Year	Equity assets class	Fixed income assets	Real estate	Bank accounts	Total invested assets
2000	23.9	19.4	4.3	52.2	100
2001	30.1	14.6	5.3	50.0	100
2002	30.2	22.3	5.5	42.0	100
2003	36.2	33.6	5.6	24.4	100
2004	49.8	28.7	5.2	16.1	100

**Table 2. Social Security Corporation invested assets strategic target allocation**

Type of investment	Short-term (%)	Long-term (%)
<b>Monetary</b>	<b>20-50</b>	<b>10-20</b>
<b>Bonds:</b>	<b>7-40</b>	<b>20-45</b>
Government	6-20	10-25
Company	1-10	5-10
International	0-10	5-10
<b>Equities:</b>	<b>25-52</b>	<b>35-65</b>
Public	17-30	25-40
Private	8-20	10-20
International	0-2	0-5
<b>Loans</b>	<b>7-15</b>	<b>10-20</b>
<b>Real estate</b>	<b>3-15</b>	<b>10-20</b>

## Social Security Corporation Investment Commission Main Investment Guidelines

In accordance with best practices and with the help of international experts, the following investment guidelines were endorsed by the IUSS Board of Commissioners.

- **"National Investment:** priority is for national viable investments within parameters and standards that ensure safety of investments and meet liquidity requirements.
- **Investment Diversity:** diversifying investments with a focus on medium and long term investments to reduce risks and ensure highest possible returns.
- **Fundamental Investments:** avoiding speculative instruments and basing investment decisions on economic fundamentals.
- **Protection against Inflation:** investing in instruments that secure the real value of the fund.
- **Code of Ethics:** preventing any conflicts between fund management and individual interests."

## Evaluation Guidelines

General standards have been adopted for reviewing the pension fund risks. A top to down standard has also been used to review investment risks in the portfolio. This standard defines the main risks first and then the minor risks.

## Reviewing the pension fund risk according to the current situation

- Assets support liabilities: The aim of pension funds is to provide current and future benefits for their members and beneficiaries. This indicates the importance of actuarial reviews.
- Expected behaviour of assets compared to risks: A risk results from the inability to achieve the required returns to satisfy liabilities due to unexpected behaviour of invested funds. This unexpected behaviour can be a result of many internal and external risks. To avoid market risk IUSS does the following:
  - periodic revision of asset allocations to control market risks and confirm assumptions and quantitative measures of asset diversification;
  - measuring long-term performance – The study of long-term performance concentrates on asset levels and the whole fund level to define the return on

different types of assets during past periods when the market risk coefficient has raised risk;

- to avoid internal risk, the IUSS adopts asset diversification since the Jordanian financial market is relatively small and suffers from sector concentration (banking sector) and concentration within the sector itself;
- currently, the IUSS reviews its investment policy and is considering investing abroad to reduce risk and adhere to sound international diversification practices.

## **Risk management of the Social Security Corporation portfolio**

### **Strategic equities and trade portfolio**

The diversification tool for strategic equities is based on international investment standards to determine the ideal diversification of equities for the SSC portfolio. Different alternatives have been applied to diversify equities within the sector portfolios (banks, industry, services, insurance) to maximize the returns at various levels of risks taking into account the following determinants: (1) restructuring the portfolio to fit international standards for public pension funds, and (2) determining previous shareholding ratios for certain companies.

The strategic equities and trade portfolio were determined as follows:

- restructuring the recent portfolio for each sector to assure the highest expected return given the different levels of risk;
- defining the ideal diversification for higher returns and low risks compared to the recent diversification method of the SSC portfolio;
- defining the highest and lowest level and targeted equity for each company to keep the return rate and risk within the range which achieves highest return at the lowest risk;
- the trade portfolio was determined on the basis of transferring 2 per cent of the portfolio value to the trade portfolio and maintaining the highest expected return for the strategic portfolio;
- the IUSS excluded unlisted companies and conducted an evaluation study for each company to assess its future financial performance.

Measures of risk for equity investments include (1) standard deviation, (2) Sharpe measure, (3) value at risk and (4) sensitivity. The implementation of these measures requires a financial database. The IUSS has started a project and the data for bank stocks is now available.

### **Bond portfolio**

The Jordanian Government bond market has the following characteristics: unstable issued bonds, low trading on the ASE, market prices for bonds are not available, bonds of different durations are not available, yields to maturity for bonds of different durations are not available, par value of bonds is high. The IUSS investment policy for bonds is to hold them until maturity (passive buy and hold strategy) taking into account the bond market circumstances and the liquid position of the SSC fund. The IUSS concentrates on the cash flow of bonds regardless of their market value. The portfolio risk depends on the cash flow at risk.

The bond market in Jordan is not very active and there is no yield curve, so risk measures depend on the market value of the bonds which are applicable to the portfolio. The study of risks should concentrate on the cash flow and the effect of changes in the interest rate and their effect on portfolio returns. The IUSS uses the traditional risk measures which are duration and value at risk. These measures need previous yield curve data on long-term bonds, and if the data is not available a proxy indicator can be applied as follows:

- The use of interest rates on bonds issued from 1999-2004 by the Central Bank of Jordan.
- The use of past interest rates on deposits and loans in commercial banks. The risks of deposits and bonds with similar durations are different, so we can take the distribution of loan interest rate changes instead of the distribution of deposit interest rates. The assumption is that the changes in the interest rate of loans apply to the changes in the interest rate of bonds.
- Assessing the relationship between the interest rate on US government bonds and the interest rate on Jordanian Government bonds of the same duration, and using this relationship to determine the potential distribution of Jordanian interest rates that depend on the distribution of US interest rates. This principal depends on a policy of connecting the Jordan diner to the US dollar.

## **Loan portfolio**

There is no specialized financial institution in Jordan to rate loans and there are no reports on the past financial performance of debtors. The IUSS is planning to build a database of financial reports on companies listed in the stock market to classify and price different loans according to their risks.

## **Real estate portfolio**

The IUSS depends on three evaluators to value real estate annually. The deviations of their valuations are used to calculate potential distributions of real estate prices and to measure the value at risk of the real estate portfolio. IAS 39 (International Accounting Standard) is applied to real estate investments. Most of SSC real estate investments are in five star hotels and resorts in Jordan.

## **Conclusion**

One can say that SSC has been one of the most successful stories in investment policies in its region. It is not an exaggeration to say that investment policies in the SSC proved the robustness of the decision-making process in the Corporation. Given that the SSC started operating with a JOD 50,000 loan from the Jordanian Government, and after twenty-five years of operation repaid its loan and built a portfolio of over JOD 3.5 billion (USD 4.9 billion), this shows with no doubt the effective investment policies and guidelines the Corporation follows.

Covering almost every economic sector in the Kingdom, the SSC is considered to be both the biggest and most important investor in the Jordanian economy. Foreign investors seek partnerships with the SSC whenever they decide to enter into new investment projects in the country, especially privatization projects. There is hardly an infrastructure project without a SSC investment. The soundness and effectiveness of SSC investment decisions is an example for social security schemes in developing and developed countries.