INTERNATIONAL SOCIAL SECURITY ASSOCIATION

Social Security Reserve Fund Monitor

Summary Report 2009–2011

International Social Security Association, Geneva, March 2014

The International Social Security Association (ISSA) is the world's leading international organization for social security institutions, government departments and agencies. The ISSA promotes excellence in social security administration through professional guidelines, expert knowledge, services and support to enable its members to develop dynamic social security systems and policy throughout the world.

Preface

Reserve funds are important for social security systems. Whilst aims vary, they often provide a financial buffer against future demographic changes, allowing the smoothing of cash flows and supporting the sustainability of systems. Many such funds are large and are attracting increasing scrutiny regarding how they are managed, the assets in which they invest, and the investment returns achieved. Best practice in governance is thus essential. The ISSA Reserve Fund Monitor project highlights the importance of these funds and aims to encourage the exchange of experiences to assist ISSA member organizations in the management of their funds.

This report is the first of a new series of ISSA publications and covers the three-year period ending 31 December 2011. The results set out here summarize the experiences of ISSA member organizations in all four ISSA regions in the investment of their reserve funds. Hereafter, ISSA Reserve Fund Monitor reports will be produced annually.

As part of the strategic objective to support excellence in social security administration, the ISSA Reserve Fund Monitor, together with the ISSA *Guidelines on Investment of Social Security Funds*, which set out the key elements, structures and processes for the management of reserve funds, aim to provide valuable and relevant information and practical experiences to assist ISSA member organizations.

This report was written by Simon Brimblecombe with input from Jaime Arevalo and comments provided by Edmundo Martinho. Jaime Arevalo was responsible for the analysis of data and the preparation of calculations, which were reviewed by Simon Brimblecombe. Additional input on the collection of data was provided by Ian Orton.

1. Executive summary

This Reserve Fund Monitor (2009–2011) report covers the performance of 22 reserve funds from 20 ISSA member organizations from all four ISSA regions who supplied information on returns on assets, asset allocation, use of external investment managers and other aspects of their operation. As at 31 December 2011, these 22 reserve funds managed USD 579 billion in assets.

The findings in this report cover the three-year period up to 31 December 2011. The situation facing the reserve funds surveyed are varied – for example, by size, cash flows, liability profile, domestic investment environment, regulatory framework and access to different investment instruments – therefore comparison between funds' practices should be considered in this broader context of the external environment.

1.1. Return on assets

The period covering the years 2009, 2010 and 2011 was a volatile one for investment returns. The average non-weighted real return on the funds over the three-year period was 4.6 per cent per annum, but there was large variation across funds and years. Reserve funds were particularly affected in 2011, with an average real return close to zero (Table 1). In all regions average returns were lower in 2011 than in 2010.

Table 1. ***Nominal and real rates of return in 2009, 2010 and 2011 (per cent)***

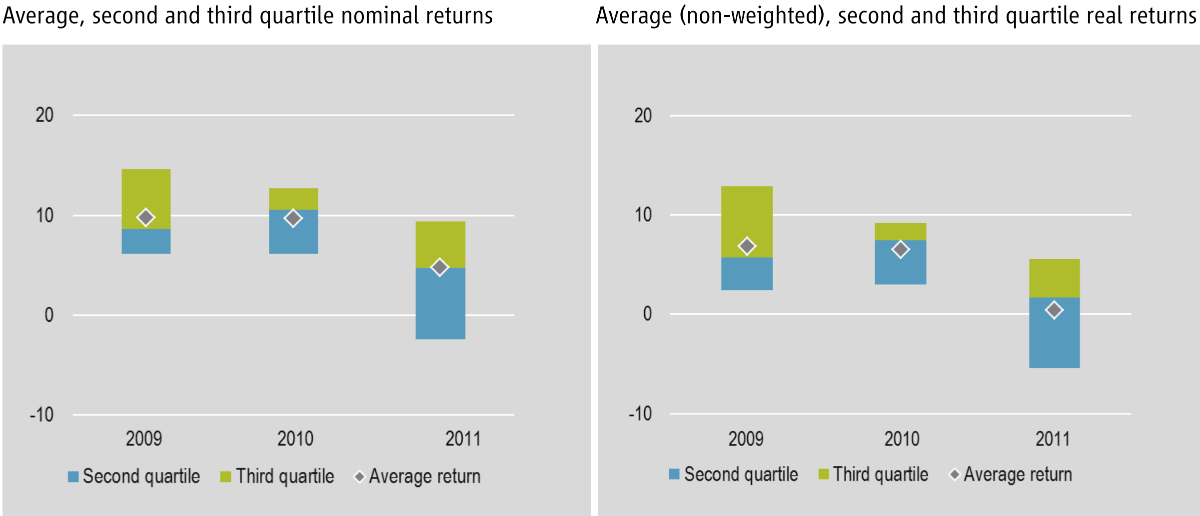
Year	Average* nominal return	Weighted average nominal return	Average* real return	Weighted average real return
2009	9.8	8.6	7.0	8.1
2010	9.7	10.0	6.5	6.9
2011	4.8	5.6	0.4	3.1
Average return*	8.1	8.1	4.6	6.0

* Annualized three-year return. Returns are those provided to the ISSA by the participant institution and assumed net of fees. Weighted return refers to average return weighted by fund size.

An important finding is the variation in returns (Figure 1) with a greater variation between upper and lower quartile figures observed in 2009 and 2011 than in 2010 (however, average, median and upper and lower quartile figures should be considered in the context of a sample size of 22 funds).

Section 3 provides more details of investment performance.

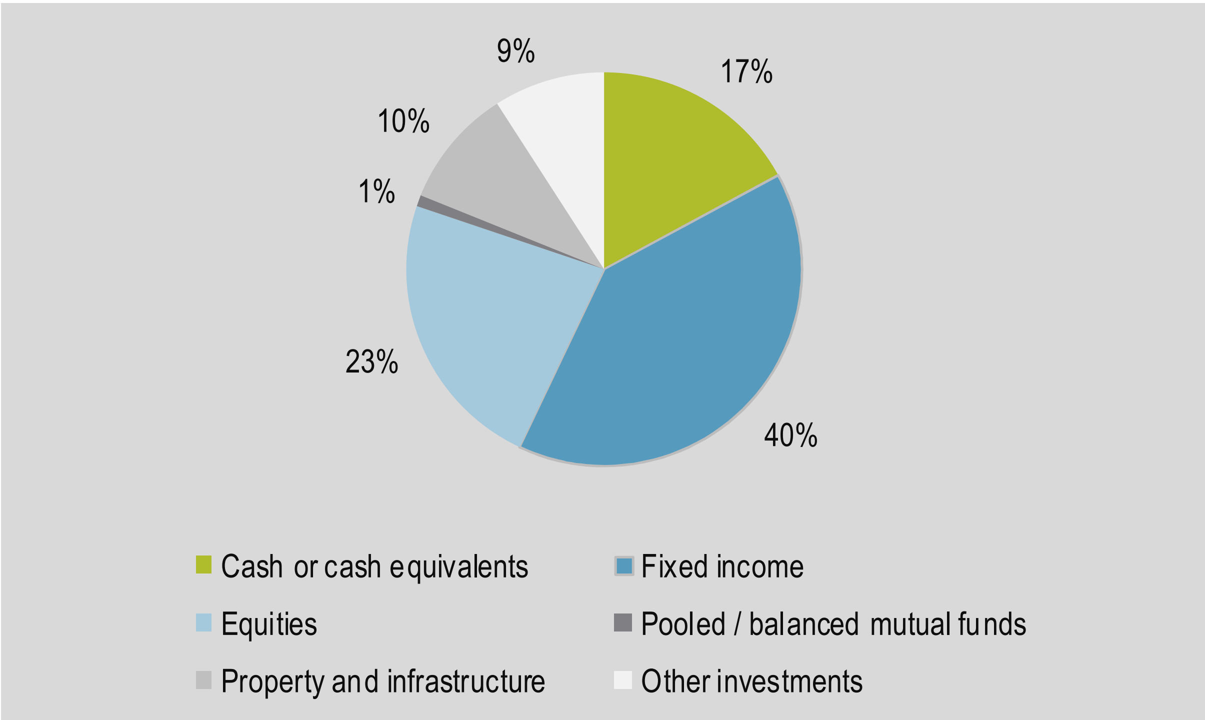
Figure 1. ***Variations in nominal and real rates of return***



1.2. Asset allocation

One of the key drivers of performance was asset allocation choice. The proportion of reserve funds devoted to different asset classes has varied over the three-year period reflecting changing attitudes to different investment choices, changes in the cash flow levels of systems and the relative performance of the different asset classes (Figure 2).

Figure 2. ***Average (non-weighted) asset allocation, as at 31 December 2011***



The average (weighted) figure masks a wide variation by region and size of fund. The larger funds surveyed tend to have a greater proportion of assets in fixed income investment and a smaller proportion in cash or cash equivalent investments and property (Figure 3).

Figure 3. ***Weighted average of asset allocation by fund size, as at 31 December 2011***

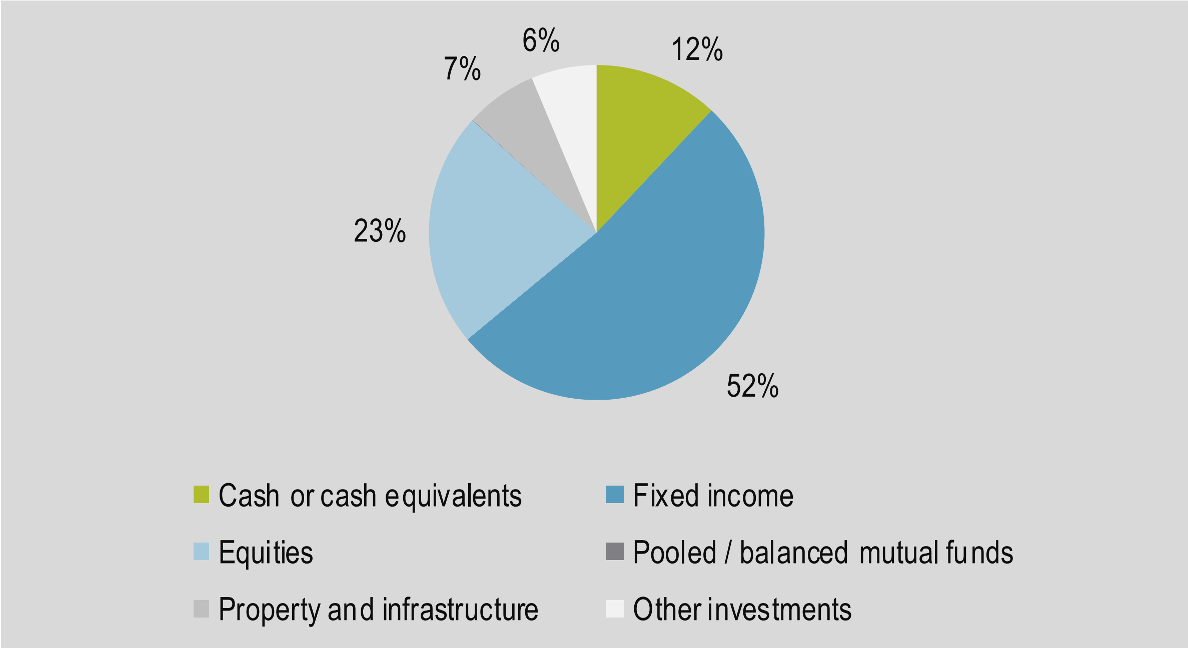
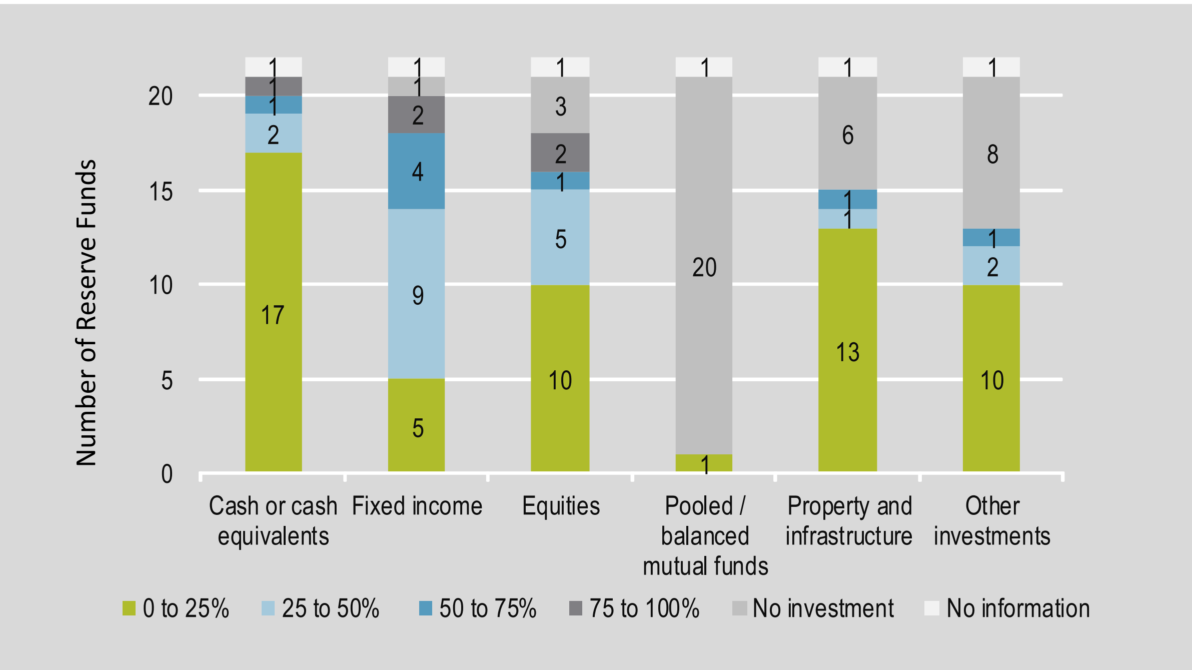


Figure 4 shows a representation of asset allocation by tranche of investment. Whilst 17 of the 21 funds who responded have between 0 per cent and 25 per cent in cash or cash equivalent, just five of the 21 funds have between 0 per cent and 25 per cent in fixed income investment, showing a wider variation of investment positions.

Figure 4. ***Asset allocation by tranche of investment, as at 31 December 2011***



Note: Pooled/balanced mutual funds: Mutual or pooled funds investing solely in or overwhelmingly in one asset class are included under the relevant asset category.

For more details of asset allocation practices, see section 4.

1.3. Cash flow constraints

The period under review is characterized by a challenging external environment with financing constraints from fiscal tightening, a fall in revenues due to a stagnation and reduction in the salary base and an increase in benefit payouts. For 60 per cent of the funds, this resulted in a deterioration of cash flows over the three-year period. Given that this is a driver of decisions on asset allocation and rates of return, this is an important consideration when judging investment performance.

1.4. What other factors affect investment performance?

The Reserve Fund Monitor collates information on the factors impacting investment management and general investment practices. Some of the key findings were:

- 59 per cent of participants stated that they used at least one external investment manager, with 60 per cent of those doing so using three or more managers.
- 91 per cent of reserve funds stated that their investment management was subject to a regulatory framework.
- 70 per cent of those responding stated that they had a Socially Responsible Investment policy.

The remainder of this report sets out in more detail responses pertaining to issues of investment performance and management.

2. Survey participants

The results presented in this report reflect the responses of 20 institutions from all four ISSA regions representing 22 reserve funds. The funds participating include ten from Europe, four from the Americas, four from Africa and four from Asia and the Pacific. Total assets under management amounted to USD 579 billion as at 31 December 2011.

The project surveyed participants regarding asset performance and asset allocation, but also asked questions on how assets are managed and the external constraints impacting on management.

The results reflect the experiences, policies and approaches of reserve funds with very different profiles. Whilst seven of the funds managed less than USD 1 billion in assets, six managed between USD 1 billion and USD 10 billion in assets, five manage between USD 10 billion and USD 50 billion and four manage USD 50 billion or more.

3. Performance of reserve funds

The three-year period 2009, 2010 and 2011 was a volatile one for investment returns. The average non-weighted real return on the funds was 4.6 per cent per annum with returns of 7 per cent and 6.5 per cent per annum in 2009 and 2010, respectively, and 0.4 per cent in 2011 (see Table 2). When weighted by fund size, the results change slightly, with an average real return of 6.0 per cent per annum. The trend in weighted real returns is similar to the non-weighted returns with a slight fall from 2009 to 2010 and a larger fall in 2011.

3.1. Benchmarks and general market performance

The performance of assets for different reserve funds is heavily dependent on the domestic situation in each country. Some of the biggest drivers of performance are local regulation, local capital market opportunities and the liability profile – including cash flow levels. The performance of other reserve funds and asset classes in general can provide interesting pointers to ISSA member organizations.

The OECD survey of public pension reserve funds[1] recorded an average real rate of return of 7.3 per cent in 2009 and 3.9 per cent in 2010, in line with the results of the Reserve Fund Monitor and in particular the reducing trend from 2009 to 2010.

When looking at portfolio returns on defined benefit, supplementary employer-sponsored, pension plans (Table 2), although such returns cannot be used as a benchmark due to different operating environments (e.g. different investment mandates, investment freedom and liability profiles), the trends in nominal returns over the three years also matches the trend observed in the results of the Reserve Fund Monitor.

Table 2. ***Defined benefit portfolio returns (nominal) in selected countries/regions (per cent)***

	2009	2010	2011	Average 2009–2011
Brazil	23.4	8.2	6.7	12.5
Canada	15.6	9.6	0.5	8.4
Euro Zone	17.0	6.2	-2.1	6.7
Japan	10.2	0.3	-8.1	0.5
Switzerland	10.9	3.0	-0.9	4.2
United Kingdom	13.8	12.9	7.6	11.4
United States	19.4	12.2	2.4	11.1
Non-weighted average	15.8	7.5	0.9	7.8

Sources: Towers Watson Global Finance Pension Watch; Credit Suisse Swiss Pension Fund Index.

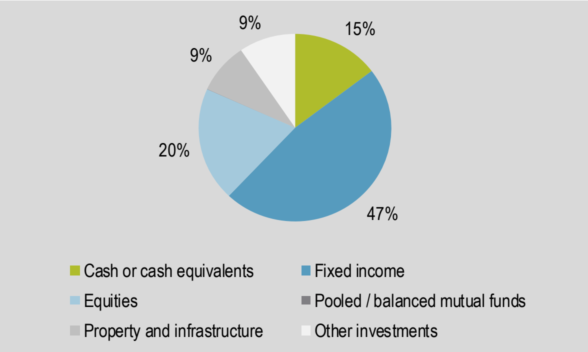
4. Asset allocation

Supplementing the asset allocation figures presented in the executive summary, this section *sets* out in greater detail historic asset allocation figures, demonstrating trends over time, and the split between domestic and foreign investment in respect of fixed income and equities (Figures 5A to 5E).

1. See OECD. 2011. *Pensions Markets in Focus*, No. 8.

Figure 5A. ***Asset allocation, as at 1 January 2009***

1. Simple average



2. Weighted average

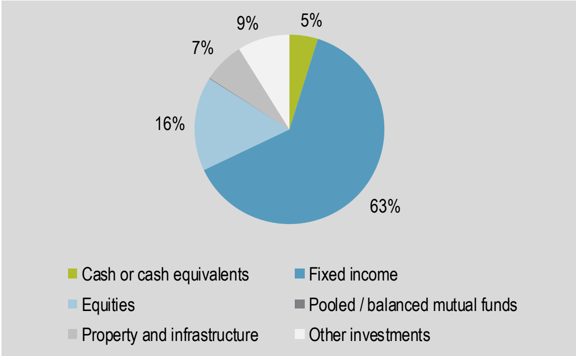
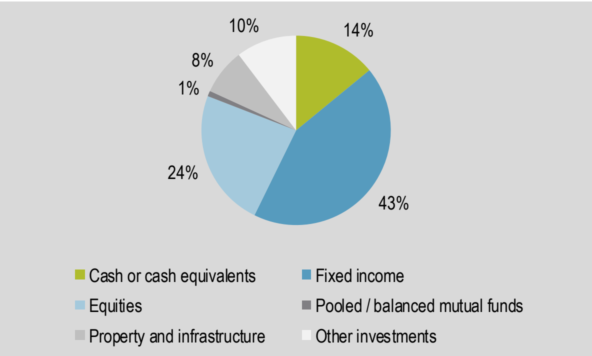


Figure 5B. ***Asset allocation, as at 1 January 2010***

1. Simple average



2. Weighted average

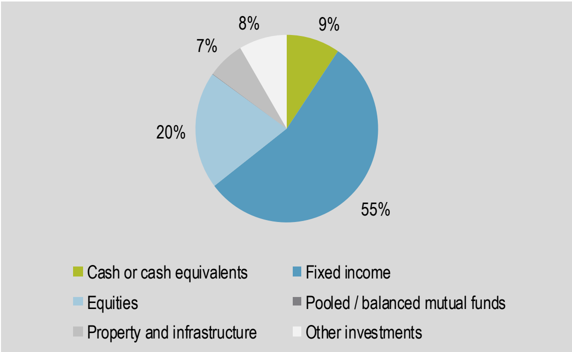
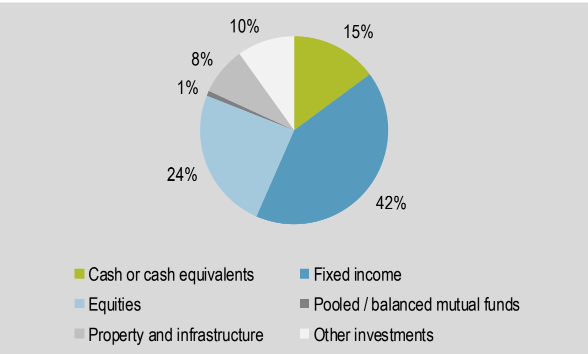


Figure 5C. ***Asset allocation, as at 1 January 2011***

1. Simple average



2. Weighted average

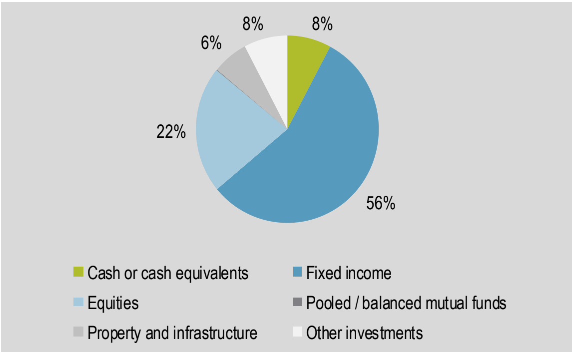
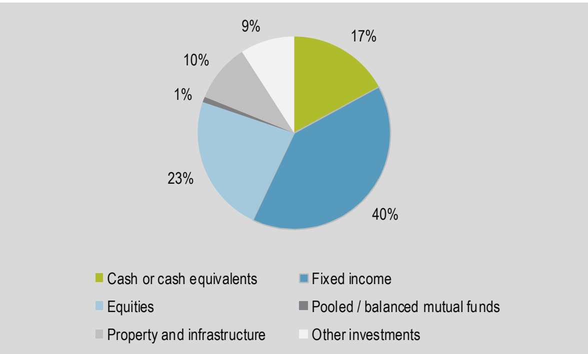
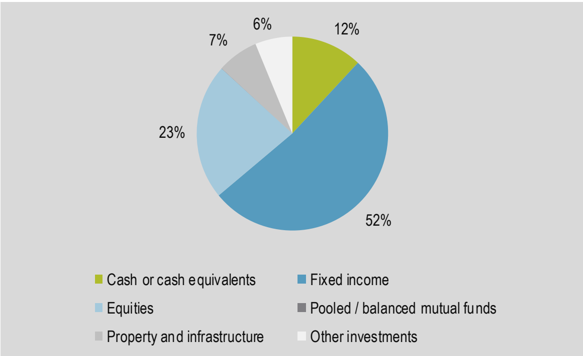


Figure 5D. ***Asset allocation, as at 31 December 2011***

1. Simple average



2. Weighted average

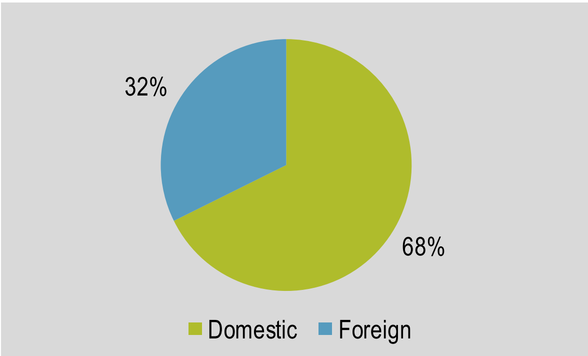


The key changes from 1 January 2009 to 31 December 2011 in the weighted average position have been:

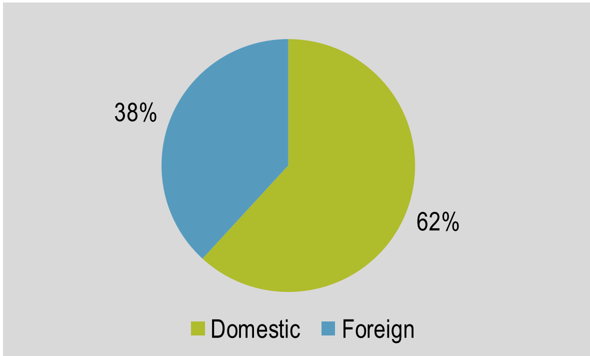
- A significant fall in fixed income allocation from 63 per cent to 52 per cent.
- An increase in equities from 16 per cent to 23 per cent.
- An increase in cash or cash equivalent investment from 5 per cent to 12 per cent.

Figure 5E. ***Domestic-foreign split in investment (as at 31 December 2011)***

1. Fixed income



2. Equities



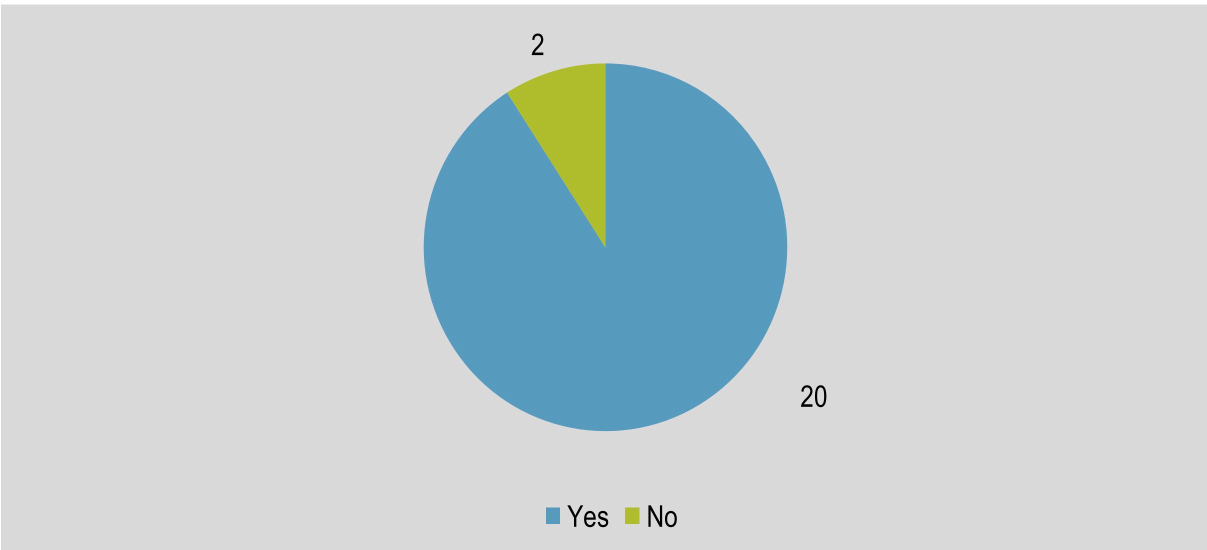
5. Other survey results

The responses to a number of questions regarding the context of investment management of the reserve funds provide additional information on other factors affecting performance.

5.1. Regulatory framework

The overwhelming majority of surveyed funds (twenty of the twenty two) are subject to a regulatory framework for the management of assets.

Figure 6. ***Is your fund subject to a regulatory framework?***

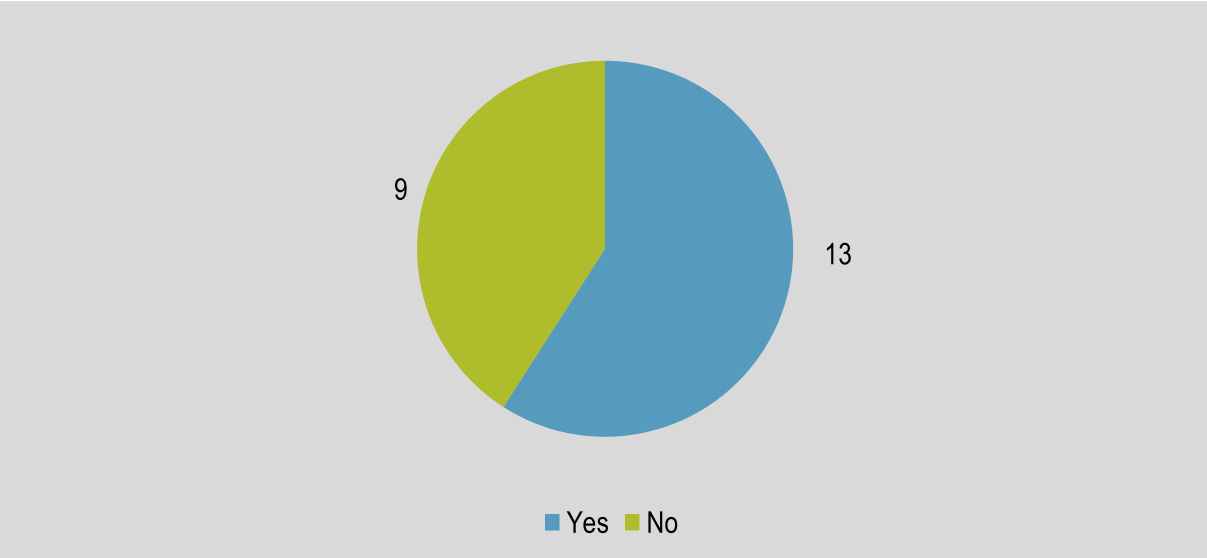


The ISSA Investment Guidelines set out the importance of an appropriate governance framework whether driven or not by an overriding regulatory structure.

5.2. External investment managers

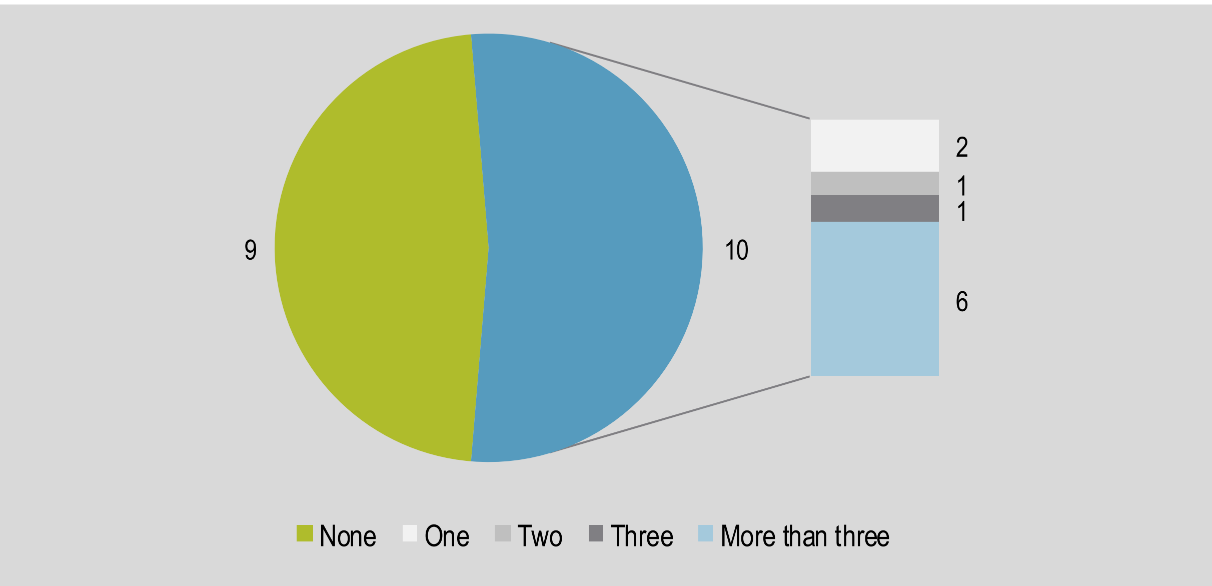
Thirteen of the twenty-two funds surveyed use external investment managers for a part or all of their investment.

Figure 7. ***Does your fund use external investment managers?***



Of these thirteen funds, ten provided more information on the number of managers used, with the majority using three or more managers.

Figure 8. ***How many external investment managers does your fund use?***

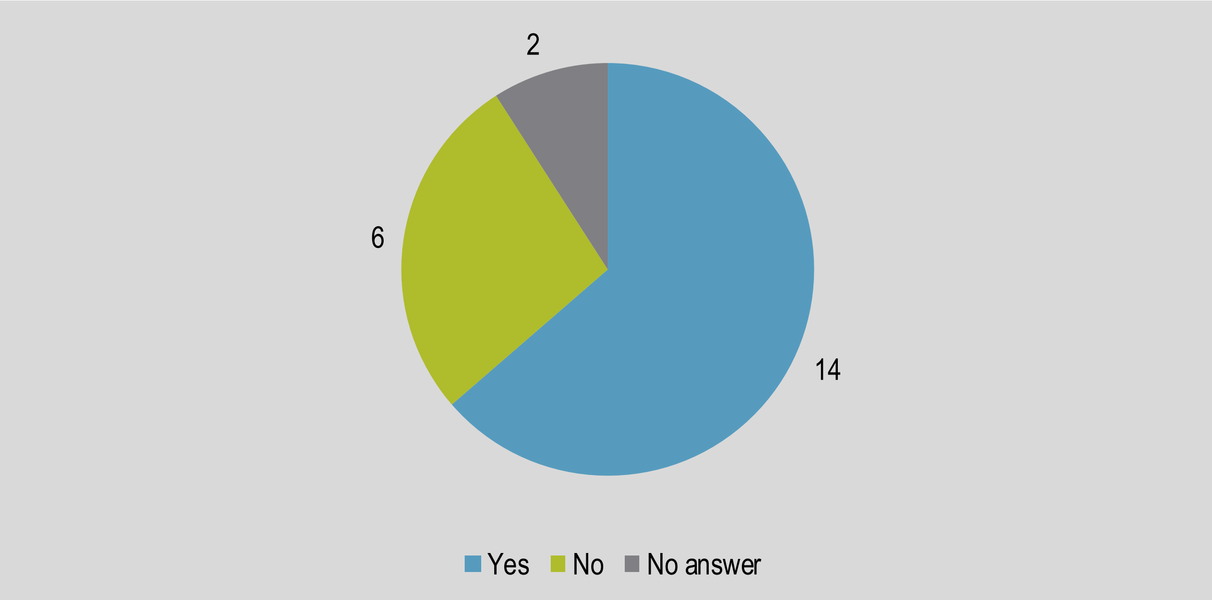


Note: An additional three reserve funds stated that they used external investment managers but did not specify a number and are excluded from Figure 8.

5.3. Socially Responsible Investment

Of the twenty-two funds, 14 declare having a Socially Responsible Investment policy.

Figure 9. ***Does your fund have a Socially Responsible Investment policy?***



6. Summary and next steps

The findings from the Reserve Fund Monitor show that despite the challenging operating environment, reserve funds managed to achieve positive real returns over the three-year period under consideration. The findings of subsequent Reserve Fund Monitor reports will ensure on-going analysis of the situation and a platform for the exchange of information. The next Reserve Fund Monitor report is scheduled for the second half of 2014.

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