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Social and economic investment policies and practices in social security organizations

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The International Social Security Association (ISSA) is the world's leading international organization bringing together national social security administrations and agencies. The ISSA provides information, research, expert advice and platforms for members to build and promote dynamic social security systems and policy worldwide. An important part of ISSA's activities in promoting good practice are carried out by its Technical Commissions, which comprise and are managed by committed member organizations with support from the ISSA Secretariat.

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Summary

The investment of social security funds has traditionally focused on balancing risk and return and assessing performance in economic terms. In recent years, the focus has expanded to include environmental, social, ethical and governance issues, and investments are no longer viewed exclusively from a financial or economic perspective. Social and economic investments take into account non-financial factors. Asset allocation strategies for social security funds which are based on social as well as economic factors can result in ancillary benefits for the entire nation. A report on Social and economic investment policies and practices in social security schemes will be presented and discussed by leading investors of social security funds.

1. Introduction

Social security organizations are vital for economic growth and development because they encourage entrepreneurship, generate employment and reduce poverty through their investment activities. In some countries, their net assets amount to 65 per cent of the gross domestic product (GDP).

Traditionally, the investments of these organizations have focused on balancing risks and returns and assessing performance on purely financial and economic grounds. However, in recent years, these concepts have been expanded to include non-financial issues such as environmental, social and governance issues.

This study was undertaken under the auspices of the International Social Security Association (ISSA) Technical Commission on Actuarial, Statistical and Financial Studies with a view to obtaining information on worldwide trends regarding this phenomenon. The issues that were considered included but were not limited to social and economic investment policies were: asset allocations to social and economic investments; commitments to invest in social ventures in the future.

The study distinguishes between two types of social investments namely Socially Responsible Investing (SRI) and Economically Targeted Investment (ETI).

SRI incorporates investing in companies that meet certain basic standards of environmental, social and governance responsibility; actively engaging investee companies to become better, more responsible corporate citizens, and dedicating a portion of assets to community economic development (G. Yaron, 2005). SRI is undertaken not just because it is deemed ethical but also the investor believes that the underlying non-financial factors can affect the

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performance of the investment and therefore must be managed (Mercer Investing Consulting, 2006). SRI criteria may be predetermined and consistently applied to the selection of individual investments irrespective of whether they are equities, fixed income, real estate or any other investments and could be designated as an asset class on its own.

ETI delivers development oriented projects aimed at providing certain infrastructure for the nation. They are expected to return some ancillary or collateral benefits to the economy as a whole and not exclusively to members of the scheme. ETI may be either financially and economically viable; or economically but not financially viable. Examples include mass or affordable housing projects, road construction and job creation. ETI criteria may be predetermined and consistently applied to the selection of individual projects irrespective of whether they are equities, fixed income, real estate or any other investments and could be designated as an asset class on its own.

The findings of the study largely confirm, extend and integrate the perceived knowledge on these subjects in new ways.

The report also provides some of the views on the subject, describes the study's research objectives and approach, presents the questionnaire and discusses the findings. The reporters conclude with the salient policy issues and state the limitations of the study and some hypotheses that may be tested in future studies.

2. Perspectives on social and economic investments

In 1970 Walter Reuther of United Auto Workers argued unsuccessfully for a sufficient relaxation of United States Federal Standards to allow pension funds to invest a portion of their funds in high social priority projects (J.D. Hutchinson and C.G. Cole, 1980). In the mid 1990s the then US Secretary of Labour Robert Reich debated a similar issue but to no avail. But now, the issue of social investments is not taken lightly. After years of investing on purely financial and economic grounds, pension funds and other investors are now rethinking their strategies.

J.K. Glassman (2003) has indicated that the monitoring of corporate ethical and environmental performance has now become a growth industry. For instance the asset base of the Domini 400 Social Index (an index which tracks the performance of companies that pass certain ethical tests) increased from (United States dollars)USD69 million in 1995 to USD1.4 billion by 2006.

The proponents claim that because pension funds are long-term investors, they must consider the risks and opportunities that political, social, environmental and ethical practices could have on their investments (P.S. Sethi, 2005). These factors can affect the performance of the underlying assets and therefore must be duly considered and managed (Mercer Investment Consulting, 2006). Therefore, an evolution in thinking is required to transcend the traditional reading of fiduciary law that is increasingly out-of-step with common institutional investment

practices (G. Yaron, 2005). The best interests of members and beneficiaries of pension schemes must remain paramount but other socio-politico-economic interests may be considered in the investment decision process provided they do not infringe on the interests of the schemes' participants (United Nations Environment Programme - UNEP Finance Initiative, 2005).

But the critics insist that the overarching goal of pension fund managers should be the reduction of unfunded liabilities through the building up of assets to meet obligations. Social investments have no place in such a strategy especially given the under-funding of many pension schemes. If social investments generate competitive returns, the "invisible hand" will guide entrepreneurs to undertake them (E.A. Zelinsky, 1994). To use social investments to justify the funding of projects that are questionable to make it on their own is an interference with the operations of market forces. This creates the risk, if not the probability, of suboptimal returns for those whose funds are being used (C.C. Moore, 1995).

A careful review of the literature however seems to indicate that in the last decade, there appears to be some consensus regarding the need to pay attention to environmental, social and governance issues (ESG). Therefore SRI appears to be gaining wide currency. Opinion is however still divided sharply over the merits and demerits of ETL.

3. Research objective and methodology

The main objective of the study was to obtain information on the investment trends of social security organizations worldwide with special emphasis on Social and Economic Investments. This issue was considered in four broad ways:

- investment policies and asset allocation to social and economic investments;
- trends in social and economic investments;
- return expectations regarding (social) investments;
- what factors (if any) explain the empirical observations?

The approach to the study comprised a two-phase survey, i.e. a pilot study followed by an extensive survey. The pilot study involved seven ISSA member organizations selected from different parts of the world to enable 'representative' views from around the world to be compared even at the initial stage of the study.

The findings of the pilot study were presented at the ISSA Working Group Meeting on Investments in June 2006 in Amsterdam. Participants highlighted certain important issues which were noted and incorporated in a revised questionnaire that was used for the extensive survey. The results of the survey were presented as a draft report, which benefited from comments by participants of another ISSA Working Group Meeting in Dar es Salaam in March 2007. These proposals were included in the present final version.

In all, responses were received from 31 ISSA member organizations in the extensive survey.

The analyses of the responses were based on the grounded theory coding protocols of open, axial and selective coding (A. Strauss and J. Corbin, 1990).

Table 3. Respondent organizations

Albania	Social Insurance Institute	Indonesia	Employees Social Security System - <i>PT Jamsostek</i>
Algeria	National Retirement Fund	Islamic Republic of Iran	Social Security Organization
Andorra	Andorra Social Security Fund	Ireland	National Pension Reserve Fund*
Armenia	State Fund of Social Insurance	Japan	Government Pension Investment Fund
The Kingdom of Bahrain	General Organization for Social Insurance	Jordan	Social Security Corporation
Belize	Belize Social Security Board	Mexico	Mexican Social Security Institute
British Virgin Islands	Social Security Board	Philippines	Social Security System
Cameroon	National Social Insurance Fund	Portugal	Social Security Capitalization Funds Management Institute
Canada	Canada Pension Plan Investment Board	Sweden	<i>AP1 - Första AP-fonden*</i>
Cape Verde	National Social Insurance Institute		Local Authorities Pension Fund
Denmark	Labour Market Supplementary Pensions Institution - <i>ATP</i>	United Republic of Tanzania	National Social Security Fund
Fiji	Fiji National Provident Fund		Public Service Pension Fund
France	French Reserve Fund - <i>Fonds de Réserve pour les Retraites*</i>	Turks and Caicos Islands	Turks and Caicos Islands National Insurance Board
Gambia	Social Security and Housing Finance Corporation	Uruguay	República AFAP
Ghana	Social Security and National Insurance Trust	Zambia	Zambia Workers' Compensation Fund Control Board
Guernsey	Social Security Department		

* Non ISSA members. Information gathered with the assistance of ISSA member organizations in the country.

4. The questionnaire

The questionnaire had six main sections:

- respondent background;
- investment and asset allocation policies;
- corporate governance;
- investment policies regarding SRI;
- investment policies regarding ETI; and
- return expectations on social investments.

Respondent background

The key information sought in this section included the type of organization and the level within the organization at which the questionnaire was handled.

Investment and asset allocation policies

The key issues addressed in this section included, but were not limited to, the investment culture of the organization (strategic asset allocation policy setting and tactical investment selection process), their asset classes, and other relevant investment statistics.

Corporate governance

Corporate conventions and behaviour as well as governance structures increasingly determine stakeholder value. Among other aspects, stakeholders are interested in board independence, accountability, disclosure and internal controls and the implications of these for the investment process. The questions were structured to elicit information on these issues.

Current social investments regarding SRI

This section was devoted exclusively to SRI. The issues covered included the socio-political-economic dimensions of SRI. Reasons why organizations undertake or refrain from undertaking SRI were sought. From a list of points, respondents were requested to rank the importance of certain decision factors in their SRI activities.

Current social investments regarding ETI

This section was devoted exclusively to ETI. The issues covered included the socio-political-economic dimensions of ETI. Reasons why organizations undertake or refrain from undertaking ETI were sought. Respondents were requested to rank the order of importance of certain decision factors in their ETI activities.

Returns and valuations on (social) investments

One of the key issues that was addressed in this section was how social security organizations balance their risk and return expectations. The trends of return on different asset classes in the last five years were also considered. Further, information was sought on valuation methods and how the expected returns are benchmarked, with emphasis on the benchmarking for SRI and ETI.

5. Findings of the study

Out of the thirty-one replies received, the four largest respondents, from OECD (Organization for Economic Co-operation and Development) countries, accounted for 96 per cent of total assets with the largest among them accounting for 77 per cent of total investments.

Consequently and when considered pertinent, data has been divided into two categories: four largest OECD respondents and other respondents.

Respondents' background and age distribution of organizations

The responses were provided by senior investment managers, directors and chief executive officers of the organizations that were surveyed. These organizations were established between 1924 and 2003. The period during which most of the organizations were established (modal class) is 1970 to 1980. During this period, some 25 per cent of the organizations in the sample were established. Approximately one half of the organizations in the sample were founded between 1960 and 1980.

Investment policies and guidelines

Eighty per cent of respondents have asset allocation policies. However, for most of them these policies were put in place by the Board several years after the establishment of the organization. The asset allocation policies of one-third of the respondents were put in place by the law that established these organizations. Where the policies were put in place by the law, they tend to give broad guidelines without specific allocations to asset classes. In putting in place asset allocation policies, law makers and boards of trustees/directors usually consult investment professionals and hold consultations with stakeholders.

Most organizations prefer to either review their asset allocation policies annually or review them as and when required, but in any case not beyond three years.

Table 5.1. Review frequencies for asset allocation policies (in percentage)

Reviewed annually	33
Reviewed once in 2 years	6
Reviewed once in 3 years	22
Reviewed once in 4 years	0
Reviewed once in 5 years and beyond	0
Reviewed as and when required	39

The most preferred approach of respondents to managing their assets is contracting them out to private sector organizations. But a significant number of them manage their assets in-house either from one department or various departments headed by different portfolio managers:

Table 5.2. Fund management approaches (in percentage)

One departmental head	28
Separate portfolio managers	20
Contracted out to private institutions	40
Other	12

Asset allocation

Almost all respondents make allocations to cash and cash equivalents, fixed income, and equities. Real estate, also receives considerable investments but index linked bonds (recently available in some markets) and the other non-traditional assets do not appear to be heavily targeted in asset allocations.

Table 5.3. Allocations to the various asset classes (in percentage)

Asset class	Percentage of respondents
Cash and cash-equivalents	94
Fixed income	94
Equities	89
Real estate (property)	67
Index-linked securities	39
SRI	33
ETI	28
Alternative assets	44
Other	33

Tables 5.4 and 5.5 show that the funds under the management of the respondents increased significantly between 2000 and 2005. In Table 5.4 the funds increased from USD263 billion to USD767 billion (192 per cent growth). The corresponding increases in Table 5.5 were 191 per cent and 223 per cent for the largest four OECD respondents and other respondents respectively. It was however not possible, on the basis of the responses, to segregate the growth into capital gains and pension contributions.

As a percentage of total investments, cash declined considerably between 2000 and 2005 in all three tables. For the four largest OECD respondents (Table 5.5) the combined cash position as a percentage of total investments dropped from 1.7 per cent to 0.15 per cent over the period. Generally these OECD organizations keep over 90 per cent of their assets in equities and fixed income and hold insignificant amounts of cash. On the other hand other respondents (mostly from developing countries - Table 5.5) keep significant amounts of cash although this is a declining trend. This situation seems to reflect the investment opportunities available to the various organizations in their respective markets.

Over the same period, fixed income increased in absolute terms but fell as a percentage of total assets for all respondents. However, equities increased significantly during the same period both in absolute and percentage terms.

The four largest OECD respondents have virtually no exposure to SRI and ETI (at least as defined in this study) but have some minimal exposure to real estate and index linked bonds. The opposite holds true for respondents from developing countries who invest in real estate, SRI and ETI though they seem to be reducing these investments in favour of index linked bonds.

Table 5.4. Investment of all respondents (in millions and percentages)

	2000		2005	
	USD	%	USD	%
Cash deposits	7,857	2.99	6,841	0.89
Fixed income	159,437	60.73	403,706	52.64
Equities	91,391	34.81	340,188	44.36
Real estate (property)	317	0.12	1,086	0.14
Index-linked securities	1,277	0.49	2,722	0.35
SRI	1,330	0.51	1,223	0.16
ETI	292	0.11	167	0.02
Alternative assets	557	0.21	1,070	0.14
Others *	67	0.03	9,951	1.30
Total portfolio	262,525	100.00	766,954	100.00

* Others includes investments in commodities, foreign exchange exposures and other special purpose joint ventures.

Table 5.5. Investment breakdown by respondents (in millions and percentages)

	4 largest OECD respondents				Other respondents			
	2000		2005		2000		2005	
	USD	%	USD	%	USD	%	USD	%
Cash deposits	4,287	1.7	1,106	0.15	3,570	34.3	5,735	17.1
Fixed income	156,463	62.1	394,133	53.74	2,974	28.6	9,573	28.5
Equities	89,679	35.5	328,772	44.83	1,712	16.5	11,416	34.0
Real estate (property)	-	-	157	0.02	317	3.0	929	2.8
Index-linked securities	1,273	0.5	1,839	0.25	4	0.0	883	2.6
SRI	-	-	-	-	1,330	12.8	1,223	3.6
ETI	-	-	-	-	292	2.8	167	0.5
Alternative assets	425	0.2	552	0.08	132	1.4	518	1.6
Others	-	-	6,841	0.93	67	0.6	3,110	9.3
Total portfolio	252,127	100	733,400	100	10,398	100	33,554	100

(See Figures 1 to 4 in Appendix.)

As a percentage of GDP, the net assets of the respondents ranged from 1 to 64.6 per cent. Some respondents have limits regarding the level of foreign investments that can be made but such limits usually relate only to certain aspects. For most respondents, the foreign investment limitation relates to foreign exchange exposure.

The data further indicates that respondents in the two categories, "advanced" and "small-island countries", generally tend to have very significant foreign investments in their investment portfolios. For these respondents, current foreign investments as a percentage of the total portfolio show values of up to 98 per cent.

Corporate governance

Ninety-five per cent of respondents have Boards of Directors/Trustees. However, only 27 per cent of them have boards independently constituted and 65 per cent have certain board positions reserved for workers' representatives, government appointees and other public sector organizations. Seventy-eight per cent of respondents indicated that their chairpersons are appointed by Government and 65 per cent also have their director generals or chief executive officers appointed by Government. This holds true regardless of whether the organization is in an OECD or a developing country.

The boards of 33 per cent of respondents are reconstituted whenever there is a change in government. Seventy-eight per cent report to a superior body with the commonly cited bodies being government ministries. In a couple of countries they report directly either to the Head of State or to parliament.

Board members are usually appointed for a limited period with the most preferred tenures being either two or five years. In a few cases board members are appointed for an unspecified period.

Table 5.6. Tenure of office for board members (in percentage)

One year	5
Two years	24
Three years	19
Four years	14
Five years	24
Six years	5
Unspecified/Unlimited	9

The most preferred frequency for board meetings is monthly.

Table 5.7. Frequency of board meetings (in percentage)

Weekly	5
Fortnightly	10
Monthly	50
Every two months	5
Quarterly	20
Twice a year	10
Once a year	0

Seventy one per cent of the organizations have investment committees but only 29 per cent state that such committees are independently constituted. Twenty-four per cent state that certain positions are reserved for certain worker, employer and public sector representatives on the investment committee.

Table 5.8. Constitution of investment committees (in percentage)

Members are selected independently	29
Positions reserved for worker representatives	24
Positions reserved for employer representatives	24
Positions reserved for public stakeholders	10
Positions reserved for private stakeholders	14
CEO/DG is a member of the Committee	43
Other	24

Seventy-one per cent of respondents indicate that in the event of a conflict of interest, the affected board member must disclose it and be subsequently disqualified from participating in the ensuing deliberations with 18 per cent stating that non-disclosure will lead to the affected board member being removed from the Board.

Table 5.9. Actual or potential conflict of interest (in percentage)

Disclosure required and disqualification necessary	71
Disclosure required but disqualification not necessarily	35
Disclosure not required	12
Non-disclosure leads to removal of member	18
Other	6

Socially responsible investments

Thirty-three per cent of the respondents make specific allocations to SRI but only 14 per cent of them either highlight this in their annual reports or have specific policies regarding SRI. Allocations made to SRI are generally small compared with the size of the total portfolios of respondents.

Table 5.10. Allocations to SRI in both USD amounts and percentages

	2000	2005
USD allocations to SRI (millions)	1,330	1,223
SRI allocations as a % of total portfolio (all respondents)	0.51	0.16
SRI allocations as a % of portfolio (respondents from developing countries)	12.8	3.6
SRI allocations as a % of portfolio (4 largest OECD respondents)	-	-

(See Figure 5 in Appendix.)

Respondents that undertake SRI commonly cite "alignment with organizational mission/vision" as the reason for doing so. Risk mitigation and demand by stakeholders to pursue SRI also contribute to this decision but to a lesser extent.

Most respondents that do not undertake SRI at the present time generally have no plans to introduce this concept in the foreseeable future. Only 14 per cent of them state that they will consider undertaking SRI in the next five years and the reason given for doing so is impending legislation and demand from stakeholders.

The main reasons cited by those that refrain from undertaking SRI mostly are because they are not obliged or under any pressure to do so. Also they are of the view that SRIs tend to pose problems for corporate governance.

Respondents indicated that the most important factor they take into consideration in their social investment decisions is sustainable investment. The next most important set of issues they consider are environmental and regulatory issues followed by governance and transparency considerations. All these come before job creation impact is taken into account.

The responses regarding HIV/AIDS may be split into two: one-half of respondents are of the view that the disease is not important now for their investment decisions but it may be in five years. The others informed that it will never be important in the investment decision process.

Economically targeted investments

Twenty-eight per cent of the respondents make allocations to ETI but only 10 per cent of them either highlight this in their annual reports or have specific policies regarding ETI. Not only are the allocations to ETI insignificant compared with the size of the total portfolio, but also the actual amounts involved have reduced over time.

Table 5.11. Allocations to ETI in both USD amounts and percentages

	2000	2005
US dollar allocations to ETI (millions)	292	167
ETI allocations as a % of total portfolio (all respondents)	0.11	0.02
ETI allocations as a % of portfolio (respondents from developing countries)	2.8	0.5
ETI allocations as a % of portfolio (4 largest OECD respondents)	-	-

(See Figure 5 in Appendix.)

The commonly cited reason for undertaking ETI is "alignment with organizational mission/vision". Risk mitigation and demand by stakeholders to pursue ETI also receive attention but to a lesser extent.

Eighty-three per cent of organizations that undertake ETI state that it is profitable but 33 per cent of them explained that such ETI tends to generate political controversy and adverse public reaction. Only 16 per cent of those that undertake ETI have withdrawn from such investments.

The reasons given by respondents that do not undertake ETI are because they are not obliged or under any pressure to undertake ETI. Also, they are of the view that ETI increases investment risk without a corresponding reward of higher returns and also their investment policies have no room for such an investment strategy.

Respondents indicated that the most important factor they take into consideration in their ETI decisions is improvement of infrastructure especially in the health sector but generally HIV/AIDS prevention and/or treatment is not important to them. Affordable housing, job creation and development of general infrastructure rank in that order in terms of importance.

Returns and valuations regarding social investments

The most important investment objective of respondents is risk management. This is followed by diversification and liquidity management in that order. Social and economic investments are accorded low priority. The least important investment objective is national policy considerations. These findings are consistent with those described in previous sections.

Table 5.12. Ranking of investment objectives by respondents

Investment objective	Rank
Risk management	1
Diversification	2
Liquidity	3
Safety	4
Expected total return	5
Maintenance of assets value	6
High income yield	7
Avoidance of volatility	8
Social objective	9
Currency considerations	10
National policy	11

Table 5.13 shows the minimum and maximum returns for the asset classes in the sample. The maximum return was recorded for equities (50.2 per cent) followed by fixed income (48.8 per cent) and the minimum return was recorded for fixed income (-1.1 per cent). Table 5.14 also suggests that the current returns of respondents are better than their average returns in the last five years.

Table 5.13. Minimum - Maximum return profile for asset classes (in percentage)

	Minimum return	Maximum return	Range
Cash and cash equivalents	0.0	26.6	26.6
Fixed income	-1.1	48.8	49.9
Index-linked securities	5.8	7.1	1.3
Equities	3.3	50.2	46.9
Real estate (property)	4.8	18.7	13.9
SRI	0.0	15.0	15.0
ETI	0.0	14.4	14.4
Alternative assets	15.7	47.6	31.9

Table 5.14. Average return for five years ending 2005 and return for 2005 (in percentage)

	Minimum return	Maximum return
Total return for 2005	4.2	22.6
Average return for 2000 to 2005	3.7	10.2

We note that the minimum - maximum returns in Table 5.13 are nominal figures and they are also not weighted. Therefore, they do not lend themselves readily and easily to meaningful comparisons regarding the performance of SRI/ETI vis-à-vis the traditional asset classes.

However, a growing body of empirical studies of commercially available equity SRI products such as the Domini 400 Social Index and SRI mutual fund products indicate that investment performance over longer-time horizons are not statistically different from the non SRI comparators and that periods of under or over performance are often end-date sensitive.

6. Case study

Table 5.15 summarizes a case study on a respondent which shows that returns on SRI/ETI debt instruments are not inferior to investments in comparable assets and in most cases these SRI/ETI investments may outperform investments in traditional debt instruments.

Table 5.15. Case study – the experience of a respondent regarding social investments

Project description	Duration or year	Amount (USD)	SRI/ETI vs. the best alternative (percentage)		Performance of other asset classes (percentage)	
			Return on investment	10 year bond	Fixed deposit	Real estate
Investment statistics regarding Socially Responsible Investing						
Construction of 6 university hostels	2000/2002	13,333,333	7.6	7.5	2.5	3.1
Construction of 370 military quarters		17,666,667	15.0	11.4	9.0	5.2
Construction of debating chamber for parliament	2004/2006	27,500,000	12.9	11.4	6.7	5.2
Construction of 200 houses for civil servants	2004/2006	11,583,333	12.9	11.4	6.7	5.2
Construction of 195 houses for low income earners	2003/2004	2,166,667	8.5	7.5	6.7	5.2
Construction of 580 houses for low income earners	2005/2006	7,900,000	10.0	9.0	7.1	6.0
Investment statistics regarding Economically Targeted Investments						
Construction of a bridge to link two parts of the capital city		58,500,000	13.2	11.4	6.5	5.2
Construction of a business park for 10,000 small traders	2007	8,333,333	14.4	11.4	6.7	5.2
Financing plantation of estates and rehabilitation of a plant	2005	5,583,333	12.0	14.4	9.0	5.2
Loan syndication involving 6 lenders to finance a factory	2004	10,000,000	10.0	8.5	9.0	5.2

7. Implications of findings, conclusion and recommendations

Three key issues have been identified which require the attention of stakeholders and which have implications for the management of social security funds.

First, the funds under the management of social security organizations have increased significantly in recent years but in investing these funds they tend to stick to their traditional asset classes. This is in spite of the growing evidence that returns on social and economic investments are not necessarily inferior to returns on comparable asset classes.

Secondly, those that undertake social and economic investments do not usually highlight these in their annual reports and if an organization is not currently undertaking social investments it is most likely it will not consider undertaking it in the foreseeable future.

Thirdly, even though social security organizations make efforts to make their investment processes transparent, there is significant "government influence" in their operations; evidenced by the government's direct appointment of the people occupying key positions of accountability in these organizations.

Therefore in order to enhance the take-up rate of SRI on one the hand and ETI on the other and to ensure that appropriate governance procedures are put in place to safeguard these investments, the following must be noted:

Socially responsible investing

- SRI may mean deliberately avoiding investing in enterprises whose activities are deemed to be socially irresponsible or contradictory to the objectives and goals of the social security institution. It could also mean paying attention to the governance of entities in which investments are made and playing an active and responsible part in normal governance structures (such as shareholder voting).
- Regarding this, it is important for Social and Economic Investment Policies to be considered as an integral part of the investment guidelines of the investing institution and make good governance a fundamental feature of the decision-making process. Clear criteria for SRI should be agreed and disclosed. In particular, the institution's attitude towards, and policy regarding, Social and Economic Investment policies should be publicly disclosed to all stakeholders.
- SRI can be an appropriate response to demonstrate good citizenship. SRI does not mean abandoning any of the normal criteria for deciding whether or not to invest, but requires an additional level of screening to exclude those investments that do not

conform to the SRI investment criteria adopted. SRI does not need to imply foregoing return relative to other opportunities.

Economically targeted investment

- ETI involves selecting investments not just on purely financial criteria but according to broader criteria relating to the expected social and economic impact of the investment. Social security institutions are an obvious source of capital for ETI in many developing countries, as they are frequently the largest institutional investor in the country and have explicit public interest responsibilities. In deciding on whether to invest in ETI, consideration may be given to the expected impact of the investment on the economy and to the 'social rate of return'. Consideration may also be given to the economic costs and social implications of not undertaking ETI.
- ETI does not need to imply foregoing return relative to other opportunities. ETI should still be required to offer a reasonable financial return to the institution. To ensure this ETI should be subject to the full rigors of investment appraisal in accordance with the institution's investment criteria and may require even more rigorous evaluation than usual, in so far as the investment opportunity is not subject to market disciplines. It must be noted that broader economic impact and the 'social rate of return' may not be straightforward to evaluate but best endeavours should be undertaken to make a rigorous assessment.
- Investing in an ETI should, where possible, be shielded from potential subsidies (implying less than satisfactory financial returns) by the use of intermediate financing vehicles to act as a risk buffer, with subsidies being supported explicitly by the government or other appropriate agencies. Clear criteria for ETI should be agreed upon and disclosed. Special care is needed to ensure that ETI results in an efficient allocation, since market disciplines may be suspended. Finally ETI should not be seen as having negative political effects if due process is followed.

The foregoing findings do not necessarily hold true for all social security organizations taken together since the findings are based on a sample. However, some of these findings may be used as hypotheses in large and more representative samples of all social security organizations. A couple of the hypotheses are indicated below:

- Either social security organizations are already carrying out SRI or they are not. Those that are not undertaking SRI already will not do so in the near future (a similar hypothesis may be tested for ETI).
- Good disclosure practices and clearly defined social investment criteria reduces investment risk perception.

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Appendix

Figure 1. Frequency distribution of the age structure of organizations

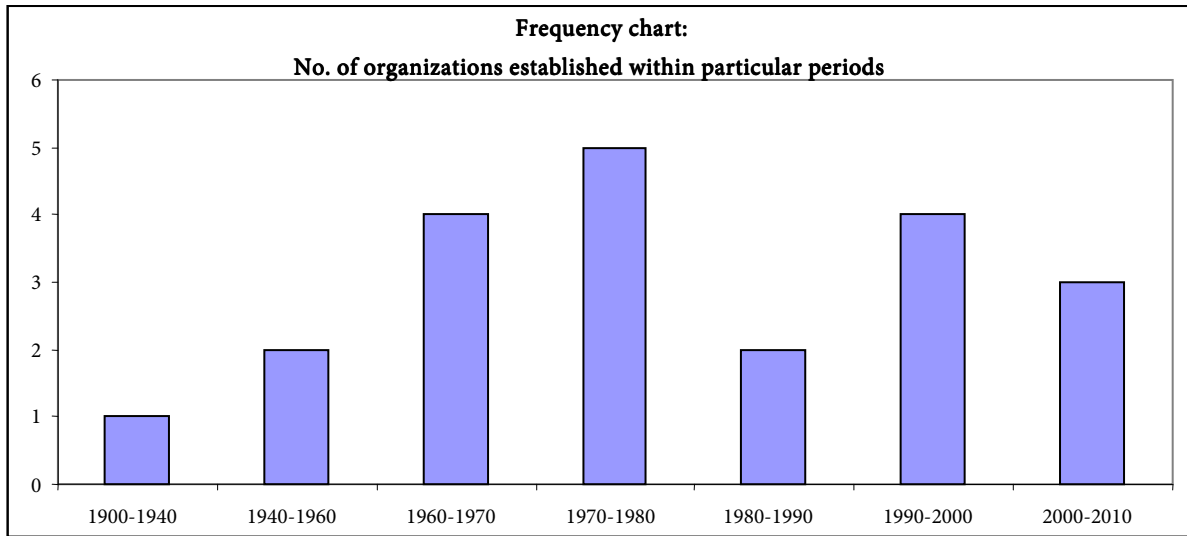


Figure 2. Comparison of asset classes between 2000 and 2005 (all respondents)

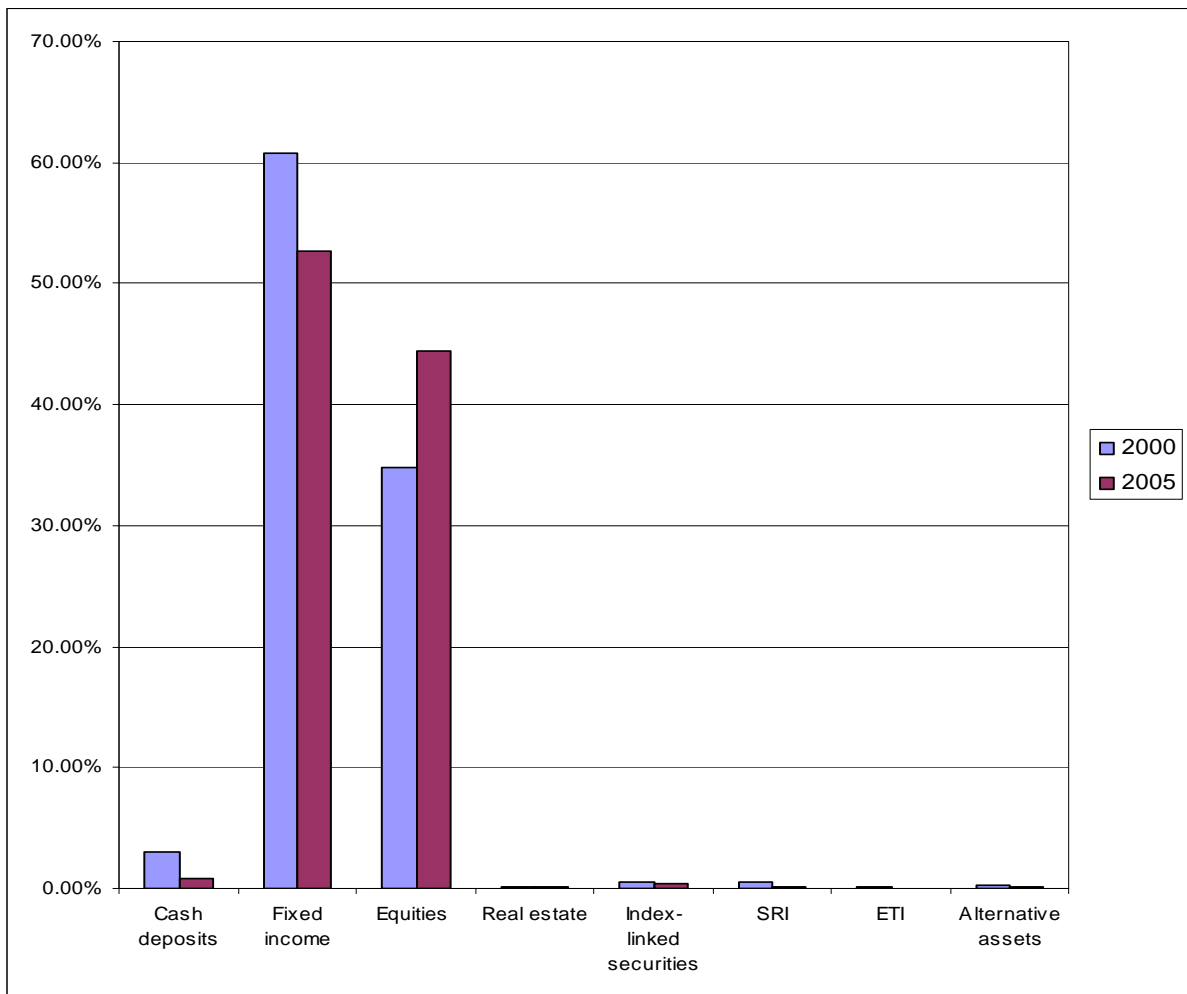


Figure 3. Asset class composition as at December 2005 (developing country respondents)

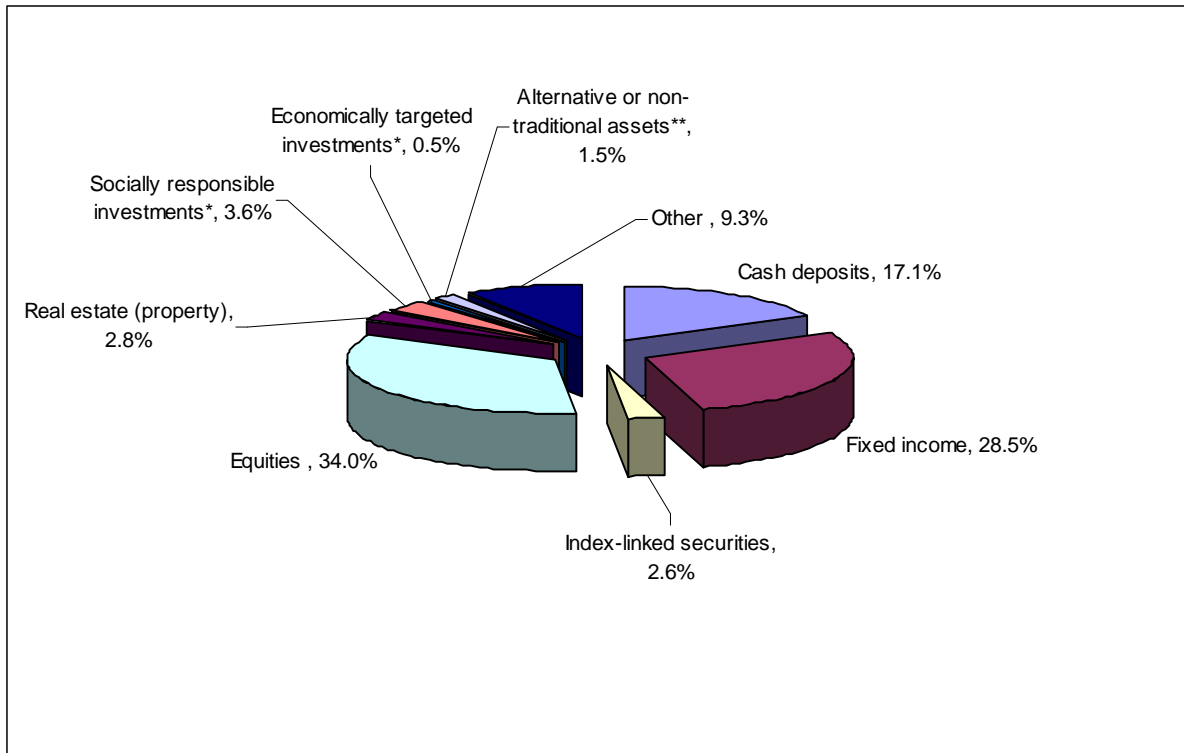


Figure 4. Asset class composition as at December 2005 (4 largest OECD respondents)

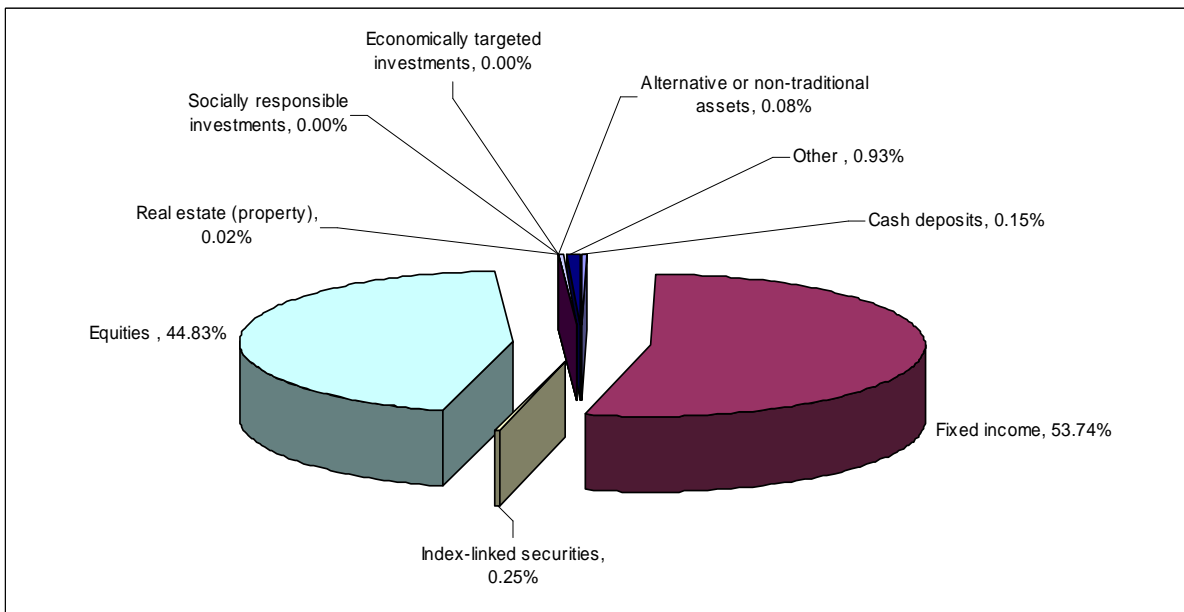


Figure 5. Comparison of levels of both SRI and ETI between 2000 and 2005

