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The Investment of Social Insurance Funds

by

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Social insurance institutions, and in particular those for invalidity, old-age, and survivors' insurance, are the possessors of capital resources which in certain countries may amount to hundreds or even thousands of millions. The investment of these sums is not without its effect on the current rate of interest, and is of distinct importance not only for the insured but also for the whole economic system of the country and for the population in general.

As the investment problems of social insurance institutions have been the subject of particularly detailed discussion and study in Czechoslovakia, the Office has asked Dr. Klumpar, who is primarily responsible for all questions of investment of the funds of the Central Social Insurance Institution in Prague, to give an account of the principles underlying the investment policy of this Institution, which seems to have achieved a judicious compromise between the sometimes conflicting conditions of safety, yield, liquidity, social value, and economic value of investments.

THE steadily growing importance of social insurance is drawing public attention not only to the actual tasks of this branch of insurance but also to subsidiary aspects of its application, and in particular the question of the investment of the assets of social insurance institutions. A distinction must be drawn here according as these assets consist of capital in the sense of funds intended for permanent investment (invalidity, old-age, and accident insurance, if based on the principle of accumulation), or of reserves to be drawn on in case of a temporary increase of expenditure, as happens chiefly in connection with sickness insurance. From the point of view of national economy the funds of long-term insurance to be considered here are of much greater importance, even though the provisions concerning the investment of funds are often the same for both types of insurance.

In *Germany,* the first country to introduce public compulsory insurance, the question of the investment of funds was dealt with in section 76 of the Accident Insurance Act of 6 July 1884, according to which the funds of social insurance institutions could be deposited in public savings banks or invested as trust money. In the absence of special regulations concerning trust money, the funds could be invested in bonds of the Federal Government, a State, or a public body, or the credit institutions of these bodies, or could be deposited with the Federal Bank. The Invalidity Act supplemented this provision by adding that under certain conditions investment in other securities and in real estate could be declared admissible. When the Invalidity Act was amended on 13 July 1899, the sections concerning the investment of funds were also altered. The Federal Insurance Code of 19 July 1911 again supplemented the above provisions, and further amendments were introduced by the Act of 19 July 1923. Arranged systematically the various types of investment are as follows. First comes the acquisition of real property ; if the investment exceeds a certain amount the approval of the supervisory authority is necessary. This is followed by loans the security for which is a safe mortgage on land in Germany, and safe trusts on real estate or annuity bonds on land in Germany ; the loan may not exceed two-thirds of the value of the land. Loans may not be made on building plots or on new buildings which are not yet completed, or on land not yielding a permanent income. Investment is also allowed in bonds of the Federal Government or a State or of a Federal or State credit institution, in loans the interest on which is guaranteed by the Federal Government or a State or by a Federal or State credit institution, and in loans to public bodies provided that these loans can be called in by the creditor or that provision is made for their regular amortisation. Loans for which public bodies are security are also allowed, but only with the approval of the supervisory authority. Further, the purchase of securities of German public bodies or their credit institutions, securities authorised for the investment of trust funds, mortgages of German joint-stock mortgage banks, and loans on any of these securities are allowed. Funds may be deposited with a public savings bank, the Federal Bank, a State bank, or any other

German bank declared by law to be suitable for the purpose. A special form of investment allowed is short-term loans under bond for which sufficient security is given, and also loans for public utility purposes or shares in undertakings for such purposes ; in the latter case the approval of the supervisory authority is required. The Federal Government fixes the amount up to which the property must be invested in Federal and State securities, provided that this amount may not exceed 25 per cent. of the total.

In former *Austria,* where social legislation was modelled on that of Germany, accident insurance was introduced by the Act of 28 December 1887. This Act contained no special provisions on the investment of funds. But from the general provision that insurance institutions were subject to State supervision, it followed that the investment of the funds of the accident insurance institutions was covered by the provisions known as the " Insurance Regulations " (Ministerial Order of 5 March 1896). These provisions were also applied to the invalidity and old-age insurance scheme that was introduced by the Act of 16 December 1906 for certain salaried employees in higher positions under the name of pensions insurance. According to section 30 of the Insurance Regulations, the following are deemed to be securities suitable for covering the actuarial reserve :

(1) Austrian securities suitable for the investment of trust money ;

(2) Loans of the State, and of the Kingdoms and Provinces represented on the Imperial Council ;

(3) Productive real property in Austria, provided that the charges on it were not more than one-third of the purchase price ;

(4) Mortgages, recognised as trustee securities, on Austrian property ;

(5) Deposits with Austrian savings banks ;

(6) The discounting of such bills as were suitable for discounting with the Austro-Hungarian Bank ;

(7) Loans on the insurance institution's own life insurance policies, but in no case exceeding the surrender value ;

(8) Loans on the securities mentioned under (1), but only up to 80 per cent. of their market value on the Exchange,

provided that in the case of lottery bonds the amount might not exceed the minimum sum payable at the draw, less expenses ;

(9) Loans to Austrian commercial and industrial companies whose rules provided that loans might not exceed the amount of the paid-up capital subject to liability ;

(10) Loans on security to insured persons, provided that special arrangements were made for guaranteeing such investments, in particular by the establishment of special reserves ;

(11) Deposits on current account or deposit warrant with approved Austrian credit institutions, but only to the extent that funds had to be readily available for carrying on the business of the insurance institution.

In practice, however, the types of investment mentioned under (7) and (10) were of no importance for the social insurance institutions, nor did they discount bills or make loans against securities.

Before the war, invalidity insurance was also introduced in *Great Britain,* together with sickness insurance, by the Act of 1911. This Act contains the following provisions on the investment of funds. All sums received in respect of contributions under the Act, and all sums paid out of moneys provided by Parliament on account of benefits and administration expenses, are paid into a fund called the National Health Insurance Fund. The Minister of Health ascertains periodically what sums are available for investment. So far as these are not paid over direct to the approved societies, they are carried to a separate account called the Investment Account, which is administered by the National Debt Commissioners. These Commissioners are five persons in positions of high standing, including the Chancellor of the Exchequer and the Governor and Deputy-Governor of the Bank of England. The 1924 Act provides that the National Debt Commissioners shall invest half the moneys of the National Health Insurance Fund in Government securities or stocks of local authorities ; the other half, which is invested by the approved societies, may be invested in trustee securities, local loans, or other securities approved by the Minister of Health.

It is an interesting fact that in the *Swedish* national insurance scheme, which is administered by a special State department, an autonomous committee of experts is responsible for questions of the investment of funds.

This brief survey of the legislation in force in the principal countries that had already introduced social insurance before the war shows that a rough distinction can be made between two systems of investment. Under the first, the social insurance institutions have the right to decide for themselves on the best way of investing their funds, even though they must observe detailed legislative provisions and are obliged to invest a specified proportion of their assets in State securities. The other method, on the contrary, imposes considerable restrictions on their freedom of action, since the administration of the assets, or a large part of them, is in the hands of the State administrative authorities and the sums in question are for the most part at the disposal of the national Treasury.

After the war, invalidity and old-age insurance was introduced in *Italy* by the Act of 21 April 1919, which was amended by the Acts of 27 October 1922 and 30 December 1923. In the matter of the investment of funds, these Acts refer to the corresponding provisions of section 12 of the Act of 30 May 1907, according to which the assets in question may be invested as follows :

(1) In stock of the Public Debt of the Kingdom of Italy ;

(2) In any other stock issued or guaranteed by the State ;

(3) In railway bonds issued by the State in respect of the annuities due from it ;

(4) In securities issued by the institutions authorised by the State to negotiate loans on landed security ;

(5) In securities issued by the autonomous section for communal and provincial loans attached to the Deposit and Loan Fund ;

(6) In loans to provinces, communes, and consortiums of communes, and to consortiums for land development and irrigation and for promoting hydraulic works of the third category, with the guarantees enjoyed by the ordinary savings banks under section 16 of the Act of 24 April 1898 (No. 132), even when these loans are made through the Deposit and Loan Fund in accordance with its own rules ;

(7) As income-bearing deposits with the Deposit and Loan Fund ;

(8) In urban real property ;

(9) In interest-bearing loans for the construction of working-class dwellings under the Act of 31 May 1903 (No. 254), or in bonds provided with the mortgage security specified in that Act.

Investments in real property (8) may not exceed one-fifth of the total amount of the assets to be invested.

In *Czechoslovakia,* invalidity and old-age insurance was introduced by the Act of 9 October 1924, which came into operation on 1 July 1926, and the Act of 21 February 1929 reorganised the pensions insurance scheme for employees. These two Acts have in principle the same provisions concerning the investment of funds. At least 20 per cent. must be invested in Czechoslovak State securities and 10 per cent. in other securities suitable for the investment of trust moneys, as specified by the Minister of Social Welfare in agreement with the Minister of Finance. This group includes in particular securities of provincial credit institutions, loans to provinces and communes, and electrification loans, provided they are suitable for the investment of trust money. The remainder of the assets may be invested in productive loans of the State, provinces, districts, or communes, or in loans guaranteed by them, and in productive loans of other public bodies entitled to levy taxes. Investment in Czechoslovak mortgages specified as suitable for the investment of trust money is also authorised. Finally, the assets may be invested in Czechoslovak financial institutions whose total liabilities are guaranteed by the State or by a province, district, or commune. In addition to these forms of investment, the Act also offers the possibility of utilising the assets for specified welfare purposes, but only under certain conditions and with the approval of the ministries concerned.

In *Hungary,* invalidity and old-age insurance was introduced by Act No. XL of 28 July 1928. The investment of funds is dealt with in section 133, according to which the moneys of the Institution's contribution reserve fund may be invested only in :

(1) Hungarian State Bonds ;

(2) Fixed-interest-bearing securities suitable for the investment of trust money :

(3) Houses for letting, wage-earners' and officials' houses which are the property of the Institution, produce a suitable yield, and are free of charges, and buildings suitable for the

reception and maintenance of persons in receipt of a pension under the provisions of the Act; also interest-bearing loans raised for the erection of such buildings and registered as first mortgages.

Not more than 30 per cent. of the fund in question, however, may be invested in the manner specified under (3).

The sums required for the regular discharge of current insurance obligations may be placed in a deposit or current account or on deposit warrant with the Hungarian Post Office Savings Bank, the Central Financial Institution, and its branches, with the consent of the Minister of Finance and in the manner prescribed by him.

In *France* the legislation embodied the second of the two systems mentioned above until quite recently, the greater part of the assets being invested in State securities and sometimes in other public loans. This method of investing funds was described as follows by the Reporter to the French Chamber of Deputies, Mr. Grinda, quoting from a speech by Mr. Ribot: " We do not admire these systems, which consist in placing in the State Treasury the securities of its debt or of bonds guaranteed by it, thus artificially raising their market value. "

The system was fundamentally altered by the Social Insurance Act of 30 April 1930, according to which the insurance funds may invest their available moneys as follows:

(1) In State securities or securities guaranteed by the State, in land bonds or communal bonds issued by the Land Bank *(Crédit foncier)*, and in bonds of the principal public railway companies;

(2) Up to half the total:

(*a*) in loans to departments, communes, colonies, protectorates, public institutions, and chambers of commerce, or in securities guaranteed by these bodies;

(*b*) in loans to the institutions specified by the Act of 5 December 1922 on cheap dwellings and smallholdings and by the Act of 5 August 1920 on mutual credit and co-operation in agriculture, and to provident and public health institutions recognised as being of public utility;

(*c*) in mortage loans on workers' dwellings or allotments;

(*d*) for the purchase of land or buildings for the construction or installation of preventive or curative institutions, or, subject to approval by the General Guarantee Fund, for the operations of the insurance fund.

The above survey of the provisions in force in the principal countries on the investment of funds does not claim to be complete, but it should at least give an idea of how the matter is dealt with in the legislation of the different countries. It will also serve as a sufficient basis for discussing the principles that should be observed in investing these funds.

It is very difficult to make an absolute choice between the two systems mentioned above, for the development of social insurance as part of public administration is closely connected with the economic and political traditions of each country. Even in the case of private insurance, which is much less affected by political circumstances and has developed on much more uniform lines, there is a great difference in the methods of investment in the different countries. The writer is personally of the opinion that the former of the two systems mentioned is to be preferred, since it gives the social insurance institutions some possibility of keeping the objects of social insurance in view when investing their funds, and also makes it easier to utilise these funds for productive purposes. The system is also much more elastic, and the interests of State credit are surely sufficiently protected by providing that part of the capital must be invested in State securities. It should be remembered that in the event of repeated fluctuations, and especially of a persistent fall in value, investment in State securities has serious disadvantages ; the larger the amount invested in these securities, the worse, naturally, is the effect on the financial situation of the insurance institutions. This question, however, is a special problem, which has frequently been discussed in the literature on the subject and cannot be further examined here. For these reasons Mr. Grinda's remarks may be endorsed, to the effect that the system recently adopted in France " happily combines investment in State funds with economic and social investments, in the interests of the insured persons themselves and to the advantage of the national economy." It also seems desirable that the administration of the assets of social insurance institutions should be entrusted to autonomous bodies, as the responsibility for this side of their financial policy is thus spread over a larger number of bodies and persons. It is of course a necessary condition that the bodies entrusted with these important duties should be so composed that they can carry out their task in a systematic way, and that their conscientiousness, combined with the general provisions of the law and State supervision, should provide a sufficient safeguard against any misuse of the large sums accumulated by the institutions.

The question now to be considered is the principles to be observed in investing the funds of social insurance institutions.[1]

The first and most essential point is the safety of the investments, for the property involved has to meet the possible claims of hundreds of thousands, or even millions, of persons belonging to the socially weakest class. A number of legislative measures, as shown above, are intended precisely to achieve this safety of investments. The only securities considered suitable for the purpose are as a rule securities of the State or of public bodies and railway bonds ; with a few rare exceptions, investment in shares or bonds of private companies is not allowed. Loans are granted only to communes, departments, colonies, and public institutions, or must at least be guaranteed by these bodies. Special precautions are also demanded in the case of mortgage loans, for which it is specified that they must be suitable for the investment of trust money. There are in addition a number of other regulations in this connection, in particular on the valuation of property, etc.

Another point of equal importance is the return on investments, since the actuarial basis of the individual laws is the assumption that a specified rate of interest is earned on the total assets. A more favourable investment may lead to higher pensions if contributions remain unchanged, or enable the same pensions to be granted for lower rates of contributions. But the effort to earn a better rate of interest must not be allowed to jeopardise the safety of the investments, a consideration which may even make it necessary to accept a lower yield.

The question of the rate of interest on the loans granted by the social insurance institutions is also of great importance in another connection. In several States these institutions hold an important position on the capital market and exert great influence on its movements. The rate of interest charged by the institutions is as a rule very low, for they do not profit by

[1] Cf. in particular Dr. Rudolf MUELLER : "Anlage und Verwaltung der Kapitalien privater Versicherungsunternehmungen", and Dr. Friedrich SCHACK : "Die Kapitalanlagen der Versicherungssanstalten ".

the passing fluctuations of the money market that would sometimes enable them to earn a much higher rate on at least part of their capital. On the other hand, it would not be right to require the social insurance institutions to fix a much lower rate of interest than other financial institutions whose investments have to have the standing of trustee securities. Such a demand would not be in harmony with a reasonable investment policy, though this does not mean that the social insurance institutions could not and should not grant credit on more favourable terms for purposes closely connected with their own aims.

The question of liquidity is of comparatively less importance for social insurance institutions, since their future needs of ready money can be estimated with considerable accuracy. For this reason the institutions can and should as a rule place their funds in long-term investments. The sums temporarily deposited with financial institutions on deposit warrants, or possibly lent against collateral, are small compared with the long-term investments.

As the sums handled by many social insurance institutions are large, it is possible to use this money, within the terms of the law and subject to the necessary conditions of safety and yield, for important public utility undertakings. In Czechoslovakia, for instance, part of the funds of the Central Social Insurance Institution are placed at the disposal of the State Road Fund in the form of a loan. The function of the Road Fund is to facilitate the systematic reconstruction of the roads. Its resources consist of the motor vehicle tax and part of the import duties on mineral oil and on pneumatic, solid rubber, and cushion tyres, and the interest on the loan is paid out of this revenue.

In their financial policy the social insurance institutions observe another and equally important principle, which distinguishes them from most of the financial institutions that are run for profit. This is the effort to take into account not only safety and the return on investments, but also the aims for which the loans are granted. Two factors have to be considered here : the objects of social insurance and the principle of productivity. In investing their funds the social insurance institutions promote their own objects by supporting undertakings that bear a close relation to those objects. In the domain of local loans, these investments take the form of loans to provinces, districts, and communes for the construction of hospitals and other curative institutions, for homes for the aged, and for various other schemes in the interest of public health (e.g. water mains, drainage, etc.).

The promotion of the construction of small dwellings for insured persons forms a chapter of its own. When invalidity and old-age insurance was being set up in Germany, the idea found expression that the money taken from the workers by the introduction of compulsory insurance should be returned to them in another form, as for instance, by the building of workers' dwellings and similar welfare institutions. This idea was also influenced by the fact that the introduction of invalidity and old-age insurance coincided in Germany with a period of industrialisation when the housing question was very much to the fore, since the concentration of the population in large and medium-sized towns had led to a perceptible housing shortage and an unprecedented demand for dwellings. The investments specified in the Act opened up a very wide field of activity to the invalidity insurance carriers in promoting the construction of small dwellings. During the war there was not so much scope in this direction, but in the subsequent period of inflation the insurance carriers again began to finance building. Owing to the depreciation of the currency, however, the sums granted lost their value; but once the institutions were again well on the way to consolidating their financial position, they immediately set to work to promote the building of dwellings for insured persons and steadily developed this side of their activity. In Czechoslovakia, too, the two principal social insurance carriers devoted large sums to granting mortgage loans for the construction of small dwellings. The French legislation, as explained above, goes so far as to confine the mortgage loans of the social insurance institutions to the building of workers' dwellings.

In granting their loans the social insurance carriers have two primary aims: to relieve the housing shortage in general and to combat certain diseases in particular. They have been quick to realise that by providing good, healthy, and cheap dwellings for the workers they are at the same time protecting them against disease and premature invalidity.

There are also cases in which the social insurance institutions have acquired real property on their own account. Some of the accident insurance institutions in Austria, for instance, did so, though even then it was pointed out that it was wrong for these institutions to assume the burden of administering large real property, a task that is distinctly difficult and essentially foreign to the aims of the institutions. After the war, therefore, another system was adopted, which consisted in giving special support to public utility associations engaged in house building.

Towards the end of the war, on the initiative of the trade unions and with the support of the Federal Insurance Institution for Salaried Employees, a scheme was prepared in Germany for setting up a special central body to construct dwellings for salaried employees; the employees' trade unions were to carry out this programme, which was to be financed by the Federal Insurance Institution. In 1918 the scheme was put into effect by the formation of the Public Utility Company for Salaried Employees' Homesteads *(Gemeinnützige Aktiengesellschaft für Angestelltenheimstätten,* or *Gagfah),* with an initial capital of 2,000,000 marks. Its sole aim was and still is the providing of cheap and healthy dwellings for persons of small means, and especially for persons insured under the Salaried Employees' Insurance Act. The building undertaken by this company is financed primarily out of the mortgage loans granted by the Federal Insurance Institution for Salaried Employees on terms that are extremely favourable for Germany. The Institution grants loans on first mortgage up to 40 per cent. of the building costs, and loans on second mortage guaranteed by the municipality in which the dwellings are erected.

In Czechoslovakia, too, the Central Social Insurance Institution, after acquiring a number of building sites from the municipality of Prague on which small dwellings were to be erected, decided to form a public utility company to undertake the building and administer the houses. The share capital was subscribed by the Institution, which will also grant the necessary credits. If the experience gained in Prague proves satisfactory, the company will extend its activities to other localities in the Republic.

Besides the functions that are connected with the aims of social insurance, stress is also rightly laid on the productivity of the investments. It is difficult to give an exact definition of a productive investment, but the principle is certainly correct. As a former Czechoslovak Minister of Finance, Dr. Engliš, has said, the underlying idea is that if social insurance or its pensions are not to become a burden on production and consumption, it is essential that the social insurance funds shall be so used as to increase the economic productivity of the country. The money capital must be turned into fixed capital, due regard being paid to its economic yield, so that future pensioners may live on the surplus production obtained by proper investment of the accumulated capital. It should be mentioned here that the principle of accumulation in insurance is ultimately justified by such a way of using the capital.

When social insurance was introduced in the different countries the objection was raised that large sums would be withdrawn from the national resources. This was so, for instance, during the eighties, when insurance was introduced in Germany, and again recently in Czechoslovakia and in France. The accumulation of capital is also said to have been one of the reasons for the rejection of social insurance on a referendum in Switzerland.[1] The argument does not hold water. As shown above, the accumulated capital is invested in such a way as to benefit the national economy. The objection would be justified only if large sums were diverted from production and placed at the disposal of the State to be used to meet purely administrative expenses or to cover deficits, etc.

It is interesting to find that in Germany, at a time of severe unemployment, a proposal has been put forward for a compulsory saving scheme, according to which any person on full earnings would have to set aside 7 per cent. of his gross income to combat unemployment. These savings would be placed at the disposal of banks, which would lend them to undertakings at a low rate of interest. The author of this proposal, Dr. Schotte, was of opinion that in this way about 1½ million unemployed could be given work on the construction of dwellings, canals, railways, etc. This is not the place for a critical discussion of the proposal, which in practice would certainly meet with great difficulties. But it is of interest as showing that the accumulation of capital with which the insurance institutions are reproached has been proposed on an even greater scale as a means of combating unemployment.

Connected with this problem is the effort of certain groups of producers to obtain greater attention for their needs in the

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[1] Cf. *Industrial and Labour Information*, Vol. XLI, No. 1, 4 Jan. 1932, p. 18.

investment policy of the social insurance institutions. Agricultural production is not here in question, since in most States the law provides sufficiently for loans on agricultural property, but industrial production. It is recognised that social insurance funds are in part so used as also to promote production : for instance, municipal loans for important economic schemes are also of great indirect importance for commerce and industry. But direct loans for industrial operations, or chiefly for such a purpose, are not as a rule considered. Mortgage loans are granted primarily on houses for letting, to the extent allowed by law, and, as mentioned above, preference is given to houses containing small dwellings for insured persons.

As far as the writer is aware, this problem has been considered in detail only by the Czechoslovak Central Social Insurance Institution. The question was referred to a special committee, which noted all the difficulties involved in granting loans of this kind. In many cases the value of the subject of the loan depends chiefly on natural resources, and cannot as a rule be accurately assessed, quite apart from the fact that enquiries of this kind are very expensive. Instances of this are mines and quarries. In other cases the value depends wholly on the possibility of marketing a particular commodity, and if there is a crisis—even if it is only a local one—the property loses nearly all its value ; instances are lime kilns, brick works, blast furnaces, etc. The situation is more favourable when the subject of the loan is equally suitable, or nearly so, for several purposes ; for instance, buildings that can be equipped for a different form of production without excessive further investment, or buildings for industrial purposes that can be adapted for use as business premises, offices, or dwellings. The question has also been raised whether some allowance should also be made for the value of the machinery installed in the buildings, but this will depend on the law on mortgage loans in the country in question. Special stress has been laid on the important connection between the subject of the loan and the solvency of the debtor. For this kind of loan it is not sufficient to have the value of the undertaking assessed by a building expert, but the personal qualities of the debtor must also be considered ; not only the technical, but also the commercial aspects of the undertaking, its competitive power, etc., must be examined. In the Czechoslovak Institution the question was solved by deciding not to grant loans directly for industrial purposes, but to arrange with certain public mortgage establishments that they should make loans for industrial operations out of the funds of the Institution, which should be placed on deposit with them for that purpose. So far as it is yet possible to judge, this system has proved satisfactory. The individual loans are small compared with the security on which they are made. In this way and by a careful selection of applicants, the result has been achieved that in spite of the economic depression the institutions making loans of this kind have suffered no losses.

From what precedes it will be clear that the investment of the assets of social insurance institutions is a complicated problem, which has been solved in different ways in various States. The importance of the problem varies in the different countries according to the financial system adopted and the proportion of the total accumulated capital assigned to long-term insurance. Nevertheless, for the administration of the assets of social insurance it is possible to deduce certain general principles, which are not only of economic but also of social importance.