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Philippines
An Agenda for the Reform of the Social Security Institutions

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CURRENCY EQUIVALENTS

Average 1994	-	Pesos 27.5	(Jan-May)
Average 1993	-	Pesos 27.1	
Average 1992	-	Pesos 25.5	
Average 1991	-	Pesos 27.5	
Average 1990	-	Pesos 24.3	
Average 1989	-	Pesos 21.7	
Average 1988	-	Pesos 21.1	
Average 1987	-	Pesos 20.6	

ABBREVIATIONS AND ACRONYMS

ADB	-	Asian Development Bank
AFP	-	Armed Forces of the Philippines
ASEAN	-	Association of Southeast Asian Nations
BIR	-	Bureau of Internal Revenue
BOI	-	Board of Investments
BOO	-	Build-Operate-Own
BOT	-	Build-Operate-Transfer
BSP	-	Bangko Sentral ng Pilipinas
BTO	-	Build-Transfer-Operate
CBP	-	Central Bank of the Philippines
COA	-	Commission on Audit
COP	-	Committees on Privatization
CPF	-	Central Provident Fund
CPI	-	Consumer Price Index
CSS	-	Contractual Savings Sector
DBM	-	Department of Budget and Management
DOF	-	Department of Finance
ECC	-	Employee Compensation Commission
EPF	-	Employees Provident Fund
ERISA	-	Employment Retirement Security Act
FERS	-	Federal Employment Retirement System
FRN	-	Floating Rate Note
FRTN	-	Floating Rate Treasury Note
GDP	-	Gross Domestic Product
GOP	-	Government of the Philippines
GSD	-	Government Securities Department
GSIS	-	Government Security Insurance System
IMF	-	International Monetary Fund
IPO	-	Initial Public Offering
MCC	-	Medical Care Commission
NG	-	National Government
NHFMC	-	National Home Mortgage Finance Corporation
PFI	-	Participating Financial Institution
SSC	-	Social Security Commission
SSS	-	Social Security System

PHILIPPINES

AN AGENDA FOR THE REFORM OF THE SOCIAL SECURITY INSTITUTIONS

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This report is based on the findings of a Bank mission which visited Philippines from April 25 to May 11, 1994, consisting of Messrs. Ismail Dalla (Task Manager), Asad Alam (Young Professional), Aldo Baietti (CFSPS), and Peter Kyle (LEGPS), and Anand Chandavarkar, Louis D. Enoff, and Subramanian Sundaresan (Consultants). Mmes. Hamideh Keyhani, Amalia Mendez, Mercedes Pendleton and Mr. Martin Edmonds (EA1IE) assisted in the preparation of this report.

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EXECUTIVE SUMMARY

Introduction

1. In 1992, the World Bank conducted a study of the capital market in the Philippines.[1] The study highlighted the importance of the contractual savings sector (CSS) in capital market development, identified weaknesses and problems in the CSS, and made several recommendations for enhancing its efficiency. The study also recommended a comprehensive reform of the country's two social security institutions — the Social Security System (SSS) and the Government Service Insurance System (GSIS). The prospect of merging the two social security institutions was raised but not examined at that time, as it was beyond the scope of the study.

2. This current study of the CSS was undertaken in response to a subsequent request by the Government of the Philippines (GOP) in November 1993 for a detailed examination of the SSS and the GSIS (including the option of merging the two institutions). The study of the CSS continues Bank work on capital market development and focuses, in particular, on developing sources of institutional funds outside the stock market. In so doing, it complements other financial sector work carried out by the Bank over the last three years — starting with the reform of the banking system, the restructuring of the central bank[2], and improvements in the government securities market. It also reinforces financial sector work undertaken by the Asian Development Bank (ADB) on the equity market, including the unification of the two stock exchanges, the strengthening of the Securities and Exchange Commission (SEC), and the improvement of the clearing and settlement system.

3. The study is based on the findings of a Bank mission which visited the Philippines in April-May, 1994 and the subsequent visit in February 1995 to discuss the Green Cover Report. It also builds on the findings and recommendations of the 1992 Capital Market Study. This study begins by describing the macroeconomic background, identifying recent developments in the capital market, and discussing the CSS in the Philippines. It then provides a detailed diagnosis of the problems of the social security institutions in terms of their actuarial soundness, administrative arrangements, and their operational and financial performance. Consideration of some options for restructuring or redesigning the programs are presented in Chapter 6. The merger of the SSS and GSIS and its rationale is discussed in an annex followed by a specific plan to manage the transition.

4. **Macroeconomic Background.** The Philippine economy is now in the second year of an economic recovery following three years of stagnation. The increase in real output of 4.3 percent in 1994, and the maintenance of inflation at single digit levels, reflect the success of the stabilization efforts and the structural reforms undertaken by the GOP. These stabilization efforts have helped to reduce macroeconomic imbalances. The consolidated public sector deficit was reduced from 5.1 percent of GNP

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1 *Philippines: Capital Market Study*, World Bank, Report No. 10053-PH, February 24, 1992.

2 Financial restructuring the CBP was completed in December 1993 in connection with the second tranche release of the Financial Sector Adjustment Loan (Loan No. 3049-PH).

in 1990 to 0.5 percent in 1994. Inflation has also declined from about 16 percent in 1990 to 9.0 percent in 1994. Gross official reserves, while still low, increased from US$2.0 billion in 1990 (equivalent to 1.5 months of imports) to US$7.0 billion in 1994 (equivalent to about 3 months of imports). The structural reforms enacted to date have spanned a wide range of policy areas, including trade, exchange rates, agriculture, privatization, and energy.

5. These stabilization efforts and structural reforms will contribute to modest economic growth in the near term. However, additional efforts will be required if an adequate level of growth is to be sustained. Savings remain low at less than 18 percent of GDP, substantially less than the historical level of 26 percent achieved during 1973-80 and comparably worse than neighboring countries. The savings rate is more than 30 percent of GDP in Indonesia, Malaysia, and Thailand, and more than 40 percent of GDP in Singapore. This low savings rate may reflect, in part, the low level of financial intermediation. A major cause of financial disintermediation in recent years has been the large operating losses of the Central Bank of the Philippines (CBP) and the financing of these losses through the banking system in the form of excessive reserve requirements (25 percent).

6. **Recent Developments in the Capital Market.** The growth of the capital market has been constrained in recent years by several factors, including political uncertainty, the power crisis, and the distortion caused by the insolvency of the central bank. During the 1980s, balance of payment difficulties and an overvalued exchange rate led to a decline in the holding of financial assets as measured by the ratio of M2 to GDP. Although this ratio rose from 34 percent in 1990 to 44 percent in 1994, it is still less than half the comparable figures for Malaysia and Thailand. With the election of President Ramos in December 1992, the restructuring of the CBP in December 1993, and the return to normal power supply conditions in late 1993, financial markets have rebounded on all fronts. The interest rate on government securities plummeted from a level of 24 percent in 1992 to around 13 percent in 1994. The Philippine stock market was one of the best performing in the world in 1993, evidenced by a rise in the ratio of stock market capitalization to GDP from 15.1 percent in 1990 to 69.6 percent in 1993. Foreign portfolio investment has increased sharply, and indications are that foreign direct investment almost doubled between 1993 and 1994. Although the Philippine capital market experienced remarkable growth in 1993 and 1994, it is still very small in relation to other ASEAN countries such as Thailand and Malaysia. Therefore, tremendous potential exists for the capital market to act as the engine of growth for the economy. The CSS has a major role to play in this respect.

7. The government securities market was profoundly affected by the passage of Republic Act No. 7653 on July 3, 1993, which created the new Bangko Sentral ng Pilipinas (BSP), later established on December 23, 1993. During the previous four years, monetary policy management had been rendered ineffective. Since the CBP did not have a portfolio of government securities to conduct open market operations, it had to rely on the GOP to raise resources through the issuance of Treasury bills to cover its operating losses and additional funds required to meet monetary targets. The excess amount raised through this action was deposited with the CBP for conducting open market operations. With the restructuring which took place in December 1993, the BSP acquired a large amount of T-Bills (₱ 280 billion) on its books which could then be used for open market operations. The BSP has performed very well since its restructuring and has provided a stable monetary policy framework for the financial markets.

8. Most government securities carry maturities of less than one year. In an effort to create a larger pool of long-term capital, the Government Securities Department began issuing Floating Rate Notes (FRNs) in 1991, and the program has been highly successful. As of May 31, 1995, the amount of the FRNs amounted to ₱ 123 billion, or 31 percent of outstanding Treasury bills. Starting October 1994 the GOP began issuing fixed rate notes, starting with ₱ 10 billion of two year notes and in June 1995

issuing ₱ 3 billion of five year notes. Given more stable macroeconomic conditions and financial markets, it is recommended that the GOP consider lengthening fixed interest long-term securities. However, to facilitate the success of this auction, the GOP should consider removing the stamp duty, clarifying the tax on income and capital gains from fixed interest rate long-term securities, improving the clearing and settlement systems, and providing information to market participants on a timely basis. These measures are discussed in the Capital Market Study[3]. The CSS, especially the two social security institutions, can play an important role in contributing to the growth of a robust government securities market (Chapter 2).

9. Among the notable recent developments relating to the stock market were the unification of the Manila and Makati Stock Exchanges at the end of March 1994 and the ratification by the Senate of the Stock Transactions Tax Bill on April 28, 1994. The latter provides for a graduated three-tiered tax on initial public offerings (IPOs) that aims to encourage greater public ownership of closely held firms. The equity market continues to experience rapid growth and market capitalization increased from US$13.7 billion in 1992 to US$40.3 billion in 1993 and US$55.5 billion in 1994. The turnover ratio also increased during the same period. At the end of 1994, the Philippine constituents comprised about 3.9 percent of the total investable market capitalization of the 10 Asian markets followed by the IFC. Daily trading value averaged US$60 million in 1994, a sharp increase from the past, but still modest compared with a daily trading volume of US$500 million in Thailand. The buoyancy of the market is also borne out by the rise in the number of listed companies from 153 (1990) to 180 (1994).

The Contractual Savings Sector

10. **Profile.** The CSS consists of the two social security institutions (SSS and GSIS), the occupational pension funds, and the insurance industry, both life and non-life. At the end of 1993, total assets of the sector were estimated at ₱ 256 billion (US$9.4 billion). This represents a sizable pool of long-term resources, equal to more than one-quarter of the market capitalization of the listed issues on the two stock exchanges, 27 percent of the assets of the banking system, or 17.4 percent of the GDP.

11. The two social security institutions account for 60.2 percent of the total assets of the CSS. At the end of 1993, the total assets of these two institutions totaled ₱ 154 billion, 11 percent of GDP. The total assets for the SSS amounted to ₱ 103.8 billion in 1993, compared with ₱ 50.3 billion for the GSIS.

12. The occupational pension funds consist of private pension funds, the Armed Forces of the Philippines Retirement and Separation Benefits System (AFP), the Home Development Mutual Fund (Pag-ibig), and several multi-employer plans. These occupational pension funds are voluntary and consist largely of single employer occupational schemes (pag.-ibig) was made mandatory in 1995). They are supplementary to the social security system. However, data on their actual number and the size of their total assets is not fully known. It is estimated that the total value of the assets of all the occupational pension plans in 1993 was about ₱ 40 billion.[4]

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[3] For details please see the study on the Asian Bond Market, Dalla, June 19, 1995.

[4] The Wyatt Company's annual survey of 168 pension funds in the Philippines reveals that the assets of these funds have doubled between 1990 and 1993. This growth rate of 100 per cent was used as a proxy for the growth rate of the aggregated assets of occupational pension plans. The 1993 estimate was obtained by applying this rate of growth to the ₱ 20 bn value that was estimated by the 1992 Capital Market Study.

13. The size of CSS assets is substantial, and asset growth has been significant. CSS assets increased at an average annual rate of 18.1 percent during the period 1980-1993. As a percentage of GDP, the share of the CSS rose from 10.7 percent in 1985 to 17.6 percent in 1993.

14. **Savings Potential of the Social Security Institutions.** The CSS has generated substantial savings. Contributions to savings by the constituent social security institutions can be measured by their annual additions to reserves — the excess of current revenues from contributions and investment income over current expenditures on benefit payments and operating expenses. In 1993, the additions to reserves of the SSS and the GSIS were close to ₱ 21 billion, equivalent to 1.4 percent of the GDP and 7.8 percent of gross domestic savings. A better sense of the magnitude of these savings can be gauged by comparing the additions to reserves with the value of IPOs in the stock market. The aggregate addition to reserves was 1.6 times larger than the total value of IPOs in 1993; those of the SSS alone almost equalled the IPOs that year.[5] Although the level of savings mobilized is substantial, the social security institutions have not yet realized their full potential. As discussed in Chapters 3 and 4, the SSS suffers from low compliance with contribution payments while the GSIS has large overdues. There are also indications that present resources may not be able to fully cover the generous increases in benefits approved during the last four years. There is a clear need to improve asset management functions at both institutions to increase the risk adjusted returns so that future obligations could be met without recourse to the GOP. These inefficiencies on the revenue side have constrained the ability of these institutions to generate additional surpluses.

15. **Role of CSS in Capital Market Development.** The CSS is an ideal source for term financing, and potentially a substantial one, owing to its assured cash inflows and long-term liabilities. Even if aggregate savings are unaffected, contractual savings will cause a shift in favor of long-term finance used to promote the equity and bond market. <u>A major gap in the capital market in the Philippines is the shortage of long-term finance; and the contractual savings sector, as the most sizeable and dynamic source of non-inflationary long-term capital, is best suited to fill it</u>, if proper corrective measures are taken in a timely manner.

16. Given the nature of their liabilities, both the SSS and the GSIS should be investing in long-term assets. Instead, they have chosen to invest mainly in short-term government securities and in below market member loans (GSIS). Their asset structure is in part explained by the fact that there are currently no long-term fixed income debt instruments in the Philippines and further by constraints in their charters on making equity investments. The SSS and the GSIS could play a much more active role in developing the domestic capital market by lengthening the maturity structure of government securities and by promoting the equity market through appropriate policy changes (para. 45). A more diversified investment portfolio and prudent investment policy would also enable both institutions to earn a higher risk adjusted return without compromising their fiduciary obligations or disrupting financial markets.

17. The present asset and maturity mismatch between long-term liabilities and predominantly short-term assets could be redressed through an integrated reform and policy package which should include: (i) reducing below market member loans (salary, policy and housing); (ii) issuing long-term fixed rate government securities on a competitive basis; and (iii) providing for full or partial privatization of fund management. The mission's findings suggest that there is an adequate fund management expertise in the private sector available at competitive rates, a fact borne out by the experience of private pension funds.

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[5] Lack of disaggregated data for the occupational pension plans precludes estimation of their contribution to savings.

18. **Tax Status of the CSS.** Although both the SSS and the GSIS are tax exempt by law, there are some tax practices which need to be addressed to facilitate the growth of an active secondary market in government securities. Currently, the SSS and the GSIS are required to pay a withholding tax of 25 percent at source. This tax is expected to be refunded to the respective institution; however, the process takes up to one year or more, and the refunds are given in the form of tax credits which have no value for tax exempt organizations. This increases the carrying cost of government securities and creates disincentives for both institutions to participate in the secondary markets. Therefore, it is recommended that the present practice of withholding at source for both institutions be immediately discontinued.

19. The insurance industry is heavily taxed. The taxes on the industry include: (i) the tax of five percent on all premium income; (ii) the normal corporate tax on net income; (iii) the 25 percent withholding tax on interest income; (iv) the stamp tax on life policies; (v) examination and license fees; and (vi) municipal taxes on insurance premiums which vary with individual municipal jurisdictions. The total tax burden on the industry represents a tax rate of about 36 percent. The high taxes imposed on the insurance industry put it at a disadvantage relative to competing sectors such as the Pre-need, trust and private pension fund industries. It is recommended that the GOP consider rectifying this anomaly, especially the five percent tax on premium income.

20. The tax status of private pensions discriminates against self-employed or other individuals who do not participate in a qualified plan, limits the portability of benefits and constrains the mobility of labor. While the incentives for employers are adequate and generally in line with those offered in other countries, the contributions of plan participants are not tax-deductible and pre-retirement benefits cannot be rolled into a personal account to maintain its tax-exempt status. Such deductions should be viewed as part of an integrated tax incentive structure for saving.

Social Security Sector

21. **Current Structure of the Social Security Sector.** The current social security sector is essentially two-tiered; the first tier provides mandatory basic universal coverage while the second tier provides voluntary supplementary coverage. The first tier consists of the SSS, the GSIS, and a special retirement benefit scheme for government employees which is administered by the Department of Budget Management (DBM). The second tier comprises the occupational pension plans, the Pag-ibig and the housing fund.

22. **Nature of the Programs.** All the social security programs in the Philippines are of the defined benefit type (i.e., benefits are provided at a stated level, based on pay and contributory service, and contribution levels are set to provide adequate income to provide for these benefits and administrative expenses.) These two plans have been in place for more than 40 years. Though statutory provisions call for eventual universal coverage, these 2 programs currently cover about 60% of the work force. The Government has assumed responsibility for maintaining the solvency of these funds and for guaranteeing the benefit levels prescribed. Because of the inflationary climate, there is a strong tendency to raise benefit levels annually in order to offset, at least partly, any diminution in the real value of the benefits. Because of demographics there is an increasing % of retirees in relation to the number of workers.

23. There are several anomalies in the current structure which make a strong case for restructuring or rationalization. First, the actuarial assessment shows the need for revision to the programs to maintain actuarial soundness. There is an artificial dichotomy between public and private sector employees in the first tier. The SSS administers the program for persons working in the private sector while the GSIS administers the programs for persons employed by all levels of government (except the armed forces and the judiciary) and those in government corporations. Second, there is duplicate

coverage of some government employees. The GSIS also provides insurance, both life and non-life. While there may have been a justified rationale for GSIS' participation in the insurance business in the past due to the lack of a viable private insurance industry, this is no longer the case. The captive nature of its market is a source of distortion in the market, particularly in view of its tax-exempt status. Finally, the structure is characterized by a lack of portability between institutions.

24. **Operational Performance of SSS.** In March 1994, the SSS was serving over 14.6 million members and about 500,000 pensioners. The SSS provides three types of benefits: (i) social benefits; (ii) medicare benefits; and (iii) employee compensation benefits. A list of benefits is given in Table 4.1 in Chapter IV. In 1993, the SSS collected total contributions of ₱ 13.4 billion and paid out ₱ 14.0 billion in benefits, leaving a gap of ₱ 0.6 billion to be covered by investment income. A breakdown of total benefits payments shows that 84.9 percent were for social benefits (retirement and related), followed by Medicare (12.33 percent) and employee compensation (2.8 percent).

25. The amount of benefits paid for 1993 amounted to an increase of 34.7 percent over 1992, and an increase of 223.7 percent since 1989. In terms of the number of claims for 1992, the increase was about 2.5 percent for a total of 1,944,715 claims processed. About 59 percent of the claims are for social security (SS) benefits while 37 percent were for medical compensation (MC) and 3 percent for employees compensation (EC). Within the SS claims for sickness payments were by far the largest volume (over 550,000), but retirement benefits continue to be the major share of expenditures. Processing times for benefit claims have continued to show a significant improvement. Data from the first quarter of 1994 show processing pension claims down from 44 days to 2 days, MC from 20 days to 15 days, and Sickness/Maternity down from 30 to 19 days. Overall, the operating cost for SSS in 1993 was ₱ 1.0 billion, 3.8 percent of the total revenue and 1 percent of total assets, which is reasonable.

26. One of the disturbing features of SSS operation is the rapidly rising level of benefit payments. During 1980-86, contribution income increased at a compound annual rate of 6.4 percent, benefit payments by 18 percent p.a., and operating expenses by 13.1 percent p.a. Despite this pattern, the SSS was able to accumulate substantial reserves, since contributions were still higher than total benefit payments and operating expenses. Therefore, all earnings from investments were being added to reserves. However, during 1987-93, benefit payments increased at a much higher rate of 34 percent p.a., compared with 30 percent p.a. for contribution income and 27 percent for operating expenses. The combination of benefit payments and operating expenses exceeded income from contributions in 1992, and benefit payments alone exceeded contribution income by over ₱ 500 million in 1993. Consequently, the SSS has had to use investment income to cover current expenses over the last two years.

27. This development represents a serious concern when viewed in the context of anticipated demographic developments in the Philippines (see Chapter 5, para. 5.14 and 5.15 and Annex B, Charts B.10 and B.11). Chart B.10 in Annex B illustrates how the age distribution of the Philippine population is expected to evolve over the next 50 years. It shows a very young workforce which will age significantly over the next 50 years. In just over 25 years, by the year 2020, the percentage of persons age 60 and over will increase from 5.3 percent to over 10 percent. The ratio of the population between age 25 and 60 to the population above age 60 is an indicator of the number of potential workers to retirees. This ratio is currently close to six and is expected to stay level for another 15 years and then drop to close to three by the year 2040. As more employees reach retirement, the cost of pension and related benefits will be expected to increase, especially under a partially funded system such as the Philippines. This expected demographic change calls for a closer analysis of the various individual programs (retirements, disability, etc.) which are driving the benefits increases. At a minimum, it would

be prudent for the GOP to exercise restraint in legislating annual benefit increases across the board. The continued rapid increase in SSS disability claims is also cause for further analysis.

28. Levels of benefits have increased at a rapid rate because of generous increases in SSS benefits granted by legislators, who perceive that the SSS has a very large pool of funds which have to be utilized to increase the benefits for the members. The GSIS provides a pension at retirement of close to 80 percent of final salary for those with a full career of 35 years for those within the wage base ceiling. The SSS also provides a very generous pension, aiming at a salary replacement rate at retirement of close to 70 percent for a full career of 35 years, with higher wage base ceilings. The dependent's pension, in this case, is at the level of 100 percent of the member's pension. There seems to be less appreciation of the fact that these obligations are on longer terms and the level of benefits have to be kept at a realistic level so that the system will remain solvent.

29. The other possible contributing factor for this mismatch is the low level of compliance and possible abuse in medical claims. There is a need to review the claims process to correct the abuses. As far as compliance is concerned, it is recommended that the SSS consider crediting service on the basis of contributions made rather than years of participation. This will act as a deterrent to the contributors who are contributing solely to meet the minimum eligibility criteria.

30. **Operational Performance of GSIS.** In 1993, the GSIS was providing service to over 1.4 million members. A total of 691,560 persons received benefits of some sort from its Social Insurance Fund. This is by far the largest GSIS fund, with expenditures over 5 times more than the amount paid in the second highest category, Medicare. Payments for Employee Compensation claims ranked third in monetary value, but were just about one-half as much as Medicare payments. Property Replacement, General Insurance, Optional Life Insurance, and Barrio Officials Insurance round out the benefit categories administered through GSIS.

31. During 1989-93, member contributions rose from ₱ 4.85 billion to ₱ 10.85 billion, an average annual increase of 22.3 percent. Benefit payments rose at an annual rate of 25.8 percent, with the sharpest increase in medical expenses which rose fourfold during the period. While these numbers may indicate the financial performance of the GSIS is superior to the SSS, a further analysis of the situation paints a different picture. DBM still covers pension payments for some pre-1977 government employees. While GSIS benefits have been historically low, they are expected to double in the future, and its policy holders are aging (see Chapter 5). Furthermore, the return on investment has been subpar. Finally, its operating expenses are higher than those of the SSS. In 1993, total operating costs for the GSIS were ₱ 886 million or 5.6 percent of the total revenue and 1.5 percent of total assets, compared with the ratio of 3.8 percent and 1.0 percent, respectively, for the SSS.

Compliance

32. Compliance refers to the accuracy and timeliness of contributions made to the system in accordance with statutory mandates. Contributions can come completely from employers when they withhold an employee's share of contributions through payroll deductions or when there is no employee contribution. In some cases, employees or the self-employed may contribute directly. In the Philippines, the employer is responsible for deducting the employee contribution from payroll and is therefore liable for submitting both the employer and employee contributions to the proper institution. The issue of employer compliance with reporting and contribution requirements is a concern in many social security systems, especially when coverage of groups of workers is expanding. This is a matter of particular concern because of the low rate of compliance experienced in the Philippines. While it is not possible to arrive at an exact figure, estimates of employer compliance with SSS contribution requirements range

about 35-55 percent. This is a very low rate. While not out of line with other countries in similar coverage situations, it is a cause for concerted attention. It rewards non-compliant companies by giving them a competitive advantage over companies making regular contributions, and reduces benefits for many — usually those at the lowest end of the earnings scale. These effects combine to generate an overall lack of faith in the viability of the social security system.

33. The SSS has recognized the seriousness of this problem and has devised an ambitious program to increase compliance. This program calls for an increase in the number of SSS inspectors and greater cooperation with Department of Labor and Employment inspectors, as well as the more aggressive prosecution of employers in the courts. It is recommended that SSS accelerate the implementation of these measures.

34. There are currently over 500,000 employers in the Philippines and the number is growing. At current staffing levels, each SSS inspector is responsible for over 1,500 employers. Redeployment of staff and close cooperation with labor inspectors who are visiting many of these same employers will alert them to when compliance is a priority. The litigation strategy employed by the SSS in the past has been to prosecute employers only under the *civil* code for failure to comply with reporting and contribution requirements of the SSS. Under their new campaign, SSS lawyers are attempting not only to prosecute more cases but also to invoke *criminal* penalties for lack of compliance.

35. In addition to these efforts, it is recommended that five additional measures should be considered. First, a single person with a high level of authority should be designated at SSS headquarters to coordinate the compliance strategies. This person could also be a communications point for disseminating information about particular successes being achieved by the different branch offices in their compliance efforts, thereby spreading word of "best practices". Second, awareness of compliance lapses should be increased through data exchanges with other entities. Third, a review of the soundness of the present formula should be a matter of priority since employees receive credit for a full year of work after making contributions for only six months — providing a disincentive to contribute each month. Fourth, an aggressive public relations campaign should be undertaken to inform workers of the benefits that they may be losing due to the lack of reporting. Finally and most critically, there must be some firmer statutory base to assist SSS in collection of contributions. It is recommended that municipalities be required to verify compliance with SSS prior to renewing licenses for business establishments. This is particularly useful, because there is no tax compliance data base for SSS to rely on. We would propose that SS devise an automatic process for the municipalities to use so that this verification would take no longer than 2 or 3 weeks.

36. Compliance is not a problem for the GSIS since the Government as employer withholds employee contributions from payroll deductions and can submit full contributions to GSIS. While there are no compliance problems, there is a dispute about how to deal with payment of contributions by DBM for those employees who opt to retire under R.A. 1616. See Chapter 5 for a full discussion of this issue. It is recommended that NG settle its outstanding overdues with GSIS as soon as possible.

37. **Fraud Potential.** Because of the disproportionate growth of claims and benefit payments in the disability and Medicare programs, a thorough analysis needs to be made to uncover the cause and status of any potentially fraudulent activities. Appropriate prevention and detection measures should be developed.

Financial Performance

38. As mentioned both social security institutions in the Philippines are *defined benefit* plans. The provision for defined benefit coverage impacts upon financial operations in two ways. First, it requires the institutions to meet contractual obligations in the future. This means that existing assets and future contributions less benefit payments have to be managed in such a way that contractual obligations are met in full. The soundness of the plans is normally assessed periodically through actuarial assessments (see Chapter 5). Second, it is common practice for social security institutions not to record future liabilities as contingent liabilities on their published accounts but to reflect them in separate actuarial assessment reports.

39. The financial performance of the two institutions is discussed in Chapter 4 and summarized here. Both funds have grown substantially during the 1989-1993 period. GSIS reserves more than doubled, while the SSS fund in 1993 was slightly less than twice the 1989 total. The combined assets of the two funds in 1993 were ₱ 163.1 billion (US$6 billion). Both the SSS and the GSIS have been able to generate net income and accumulate relatively large reserves during each of the last five years. Although the share of contributions in total income for the SSS has been declining, the SSS added more than ₱ 57 billion to reserves since 1989 due to investment income. It would have been able to add substantially more reserves had it followed a different asset allocation strategy (para. 46). During the same period, the GSIS was able to add almost ₱ 33 billion, mainly because its contribution levels were higher and exceeded benefit payments, and due to partial coverage of pension payments for some government employees by the DBM (para. 35). The reserve level of the GSIS would have been substantially higher if it did not have a large carrying cost because of non-payment by DBM of the government contributions to GSIS funds (about ₱ 4.6 billion), and had it followed a more prudent investment policy.

Asset Management

40. The two social security institutions generate large amounts of long-term funds that need to be managed effectively to obtain the highest risk adjusted return so that the income plus capital gains will be adequate to meet future obligations. Recent trends in financial indicators of both institutions make a strong case for strengthening their asset management capabilities.

41. **Asset Allocation and Fund Management.** The investment of reserve funds is a critical function of both the SSS and the GSIS. Both institutions have a fiduciary responsibility to ensure that funds are managed prudently and invested in a diversified portfolio which will generate the highest risk adjusted returns, enabling them to meet future obligations in full.

42. **Investment Policy and Guidelines — SSS.** SSS investment policies are set forth in RA 6111, as amended. Specifically, the institution is required to accumulate all funds in excess of its administrative and operating expenses and benefit obligations in an Investment Reserve Fund, with fund investments mandated to earn at least 9 percent. The law allows the SSS to invest in a wide array of instruments, including a variety of types of loans to members, real estate loans, government securities and private listed equity and marketable securities. It also specifies ceilings for each investment category, most of which may not exceed 10 percent of the Reserve Fund. Investments in direct housing loans, however, may account for up to 30 percent of the Reserve Fund and no ceilings are mandated for government securities. Beyond these legal provisions, the SSS has issued written guidelines governing its fund management decisions. These guidelines provide overriding principles and objectives for investing, stressing sound criteria for maximizing returns consistent with maintaining the safety of principal and liquidity. The SSS stresses prudence and sound business/financial principles as well as the

importance of benefiting as many members as possible and supporting the social and economic development programs of the GOP. Although these guidelines are quite sound, they are now less appropriate for a pension fund such as the SSS. Given the nature of its obligations, SSS has a long-term investment horizon and should be allowed to engage in more equity investments. Worries that government ownership of equities might lead to greater government interference in private activities could be met by restraints on ownership in particular companies and sectors and on voting rights as well as keeping asset management at arms length from government. Capital gains are tax exempt in the Philippines. The investment limits which are prescribed in the law will need to be replaced by general principles such as prudent man rules, diversification, and risk adjusted returns. Policies regarding asset allocation (i.e., ceilings for each class of asset and investment limits on individual issues) should be left to the Trustees. A revised investment policy should be prepared with the assistance of a well-recognized investment advisor. Such a policy should be constructed with adequate safeguards to ensure sound management of the assets.

43. **Investment Policy and Guidelines — GSIS.** The Charter of the GSIS provides managers with some investment guidelines, but to a much lesser extent than the SSS. In PD 1146, the law grants full authority to the Board in determining fund allocation among different instruments. There appears to be little else issued formally in terms of specific guidelines governing asset allocation and investment policies. There is a clear need for the GSIS to devise a written policy with external assistance along the lines suggested for the SSS (para. 42).

44. **Asset Mix and Portfolio.** Both the SSS and the GSIS have a somewhat different portfolio composition from either the private pension funds or the AFP. The major differences lie in the greater allocations to government securities and member loans by both the SSS and the GSIS, and the lesser emphasis on marketable securities. The other major features of their portfolios are: (i) large member loans at below market rates; (ii) large exposure in housing loans through the NMHFC, which is reportedly in financial distress; (iii) poor accounting of portfolio quality. The accounting standards used for reporting SSS and GSIS portfolios are not in accordance with generally accepted accounting principles; and (iv) underallocation to equity investments.

45. As of the end of 1993, the SSS and the GSIS combined had allocated more than ₱ 25.8 billion (US$956 million) to NHMFC's housing program. While these investments are collateralized by mortgages and guaranteed to an extent by the NG, they have a high carrying cost and potential for loss because of the NHMFC's poor financial condition. Given the NG's commitment to the unified housing program, the SSS and the GSIS have been asked to allocate an additional ₱ 10 billion to the program in 1994. However, these measures can only erode further the capital of these institutions if structural remedies are not made with the program. Financing housing is a viable activity if it is done correctly. Given that the Philippines has a vibrant banking system and the established pattern of wholesale financing through government financial institutions, it is recommended that the SSS and GSIS create wholesale lending facilities for housing to be made available to eligible participating financial institutions at market rates. The participating financial institutions (PFIs) would be responsible for the credit risk. In the meantime, an independent assessment of the NHMFC will need to be carried out.

46. The historical experience of most countries has confirmed that equity investments generate much higher risk adjusted returns over time than other classes of assets, although such investments are more volatile in the short-term. Because of these experiences, most pension funds should allocate between 40-70 percent of their assets in equity investments with internal diversification. The present limit of 10 percent was appropriate in the past because of the very small size of the domestic equity market. However, the domestic market is now much larger, making a strong case for revising this limit upward. This would be consistent with maximizing the risk-adjusted return on the portfolio. As discussed earlier,

asset allocation ranges should not be prescribed in law, but should be decided upon by the Trustees. The increased allocation in equity investment will also foster the development of the domestic capital market as it will increase the pool of funds for equity investment.

47. **Investment Performance.** During 1989-93, both institutions realized returns less than the Treasury bill rates. The SSS fund outperformed the T-Bill yields in only two years and barely kept pace with inflation, while the GSIS fund never did. The GSIS performance was particularly poor since its investments yielded an average return of only 11.8 percent, and the annual yield on total assets was only 8 percent — below the inflation rate during the same period. When adjusted for inflation over the period, the real rate of return for the SSS portfolio was only 5.0 percent, and the return for the GSIS was actually negative, with a -0.6 percent real rate of return. Low yields result from asset allocation decisions under which the majority of assets are allocated to those programs which offer below market returns with potential credit risks and a lower allocation is made to those programs providing higher risk adjusted returns. There is clearly room for further improvement through a better mix of assets and improved asset management. It is, therefore, recommended that the institutions consider appointing private fund mangers to manage a major part of their assets starting with a pilot project. In the meantime, in-house asset allocation capability should be strengthened to improve returns and enhance ability to monitor performance of fund managers.

Actuarial Assessments of the SSS and the GSIS

48. Given the long-term nature and complexity of many of the commitments undertaken to provide for benefits to contributing members, a comprehensive detailed actuarial assessment is essential. The internal actuarial departments of both the GSIS and the SSS carry out actuarial studies of their various funds, annually in the case of the GSIS and once every five years in the case of the SSS (the last one having being performed as of January 1, 1990). These investigations have some limitations for the following reasons. The available figures do not fully reflect the current situation. In the case of the SSS, much has happened since the last valuation some four years ago by way of pension increases, changes in wage base ceilings, general increases in benefits, and changes in compliance. For the GSIS, the internal valuations are limited by the data that are made available to them and no adjustments are made to reflect the inadequacies. The actuarial methodology used differs for the two systems, thus making comparisons of limited value. The method of valuation used by the GSIS does not call for the long-term projection of benefits and contributions. The valuations are carried out for internal purposes and do not make explicit allowance in the assumptions for certain important elements of the programs which are crucial to the current study.

49. **Funding Method Used by the SSS.** For its main social security benefits, the SSS has adopted a system known as the scaled premium method. This method of funding is recommended for developing countries by the ILO. It involves a long-term projection of cash flows. Items of income (contributions and investment earnings) are compared year-by-year with items of expenditure (expected benefit payments and expenses). The current level of contributions would be considered to be satisfactory if, for a sufficiently long period in the future, income is expected to exceed expenditures.

50. **Funding Method Used by the GSIS.** For its Social Insurance Fund, the GSIS has adopted a method which would appear to be one that aims towards full funding, in common with many private occupational plans. Instead of evaluating future cash flow projections, past service liabilities (i.e., the present value of benefits that have accrued with respect to past service rendered) are determined and compared with the value of assets as of the measurement date. This follows a more traditional accounting style of presentation which employs an actuarial balance sheet. In determining past service liabilities, assumptions are made for future pay increases.

51. It should be noted, however, that the membership data used by the GSIS for its valuations do not reflect updated salary information and no adjustments are made on account of this. Salary data, in most cases, are several years out-of-date. Moreover, no future pension increases are anticipated and the wage base ceiling is assumed to remain at current levels. The liabilities calculated by the GSIS are therefore significantly understated. Thus, although the GSIS uses what at first glance appears to be a full funding method (assets held by the GSIS are approximately equal to the liabilities calculated by the GSIS), the method as it is applied results in the accumulation of assets that more closely resembles a partially funded program.

52. The scaled premium method was used by the actuary which carried out the independent assessment for this study. The SSS funding method involves the projection of future cash flows, and an analysis of long-term cash flow trends is essential to a proper understanding of the actuarial status of these funds.

53. In connection with this study, an independent actuarial assessment was carried out for the social benefit programs by a well-known actuarial firm in the USA. Chapter 5 discusses the findings and additional information is provided in Annex B. Main points are highlighted below.

54. **GSIS**. The actuarial assessment shows that the GSIS's reserves will be fully depleted by the year 2015 (Chart B.2, Annex B) unless corrective measures such as higher contribution rates, improvements in returns, or a reduction in benefits or a combination of these measures are taken in time. Two main conclusions can be drawn with relation to the GSIS Social Benefit programs. First, the current level of funding of the GSIS (after removal of the assets needed to cover the life insurance liabilities) is very inadequate; assets are only some 10 percent of the projected past service liabilities with allowances for future pay increases. This inadequacy, despite the substantial contributions made in past years, is the result of the low returns on invested funds. The internal appraisal of the GSIS as of January 1, 1994, reveals a close balance between assets and liabilities only because of the overly optimistic assumptions and the use of out-of-date data which led to an understatement of liabilities. Second, again, despite substantial contributions, the net cash flow and the funding level both display an unsatisfactory trend over future years.

55. **SSS**. The actuarial assessment shows that the SSS's reserves will run out by year 2021 unless corrective measures are taken in time. Regarding the Social Benefit programs of SSS, both the current level of funding and the trends in future net cash flow and funding levels indicate the adverse financial position of this system. With respect to funding levels, the rapid increases which have occurred recently in the wage compensation base have led to significant increases in liabilities without comparable increases in available funds. Although there is no internal valuation current enough to provide a basis for valid comparisons, the valuation of four years ago appears to suggest that the scaled premium structure would be adequate in the intermediate future only through the use of an exceptionally optimistic set of valuation assumptions. The present assessment shows a rapidly worsening cash flow situation and an imperative need to adjust the scaled premiums within the next few years.

Objectives of the Reform

56. Recognizing that a study of the social security sector could focus very narrowly on just the effect on capital markets or might be so broad as to challenge the basic objectives of the programs, the mission team developed objectives for framing the study. The following four objectives guided the formulation of the recommendations for the study:

- **Assisting the Social Security Institutions in Achieving their Objectives.** The objectives of the social security institutions have been developed over a long period of time and are consonant with well-established social objectives in the country. However, some of these objectives like universal coverage and long-term financial security for all workers and their dependents will not be achievable without substantial action.

- **Enhancing the Role of the Social Security Institutions in Capital Market Development.** As noted in Chapter 2, the social security institutions are the single largest mobilizer of long-term funds in the country. However, the short-term nature of their current investments, in many instances at below market rates, has constrained the development of the capital market.

- **Helping the Government Improve the Efficiency of the Social Security Sector.** Inefficient program administration contributes to the lack of public confidence in any program. Improving the efficiency of the SSS and the GSIS will not only improve public confidence, but also lead to better service and financial savings.

- **Improving the Legal and Regulatory Framework.** The myriad laws and amendments to the laws that govern the SSS and GSIS inhibit public understanding, obscure transparency, and expose the institutions to potential misuse and mismanagement.

57. In light of these objectives, a diagnosis of the problems affecting these two institutions suggests a package of reforms which include a restructuring of the social security sector. Although some reforms in the existing structural arrangements of each of the institutions can address some of the problems identified, it is our view that a thorough review of both programs should be undertaken.

58. Financial viability of both institutions can be immediately enhanced through better asset management and adjustment of the contribution rates. However, a thorough analysis of the effect of these actions on the currently separate SSS and GSIS programs was not done in this study. We did project the effect of increased asset returns and increased contributions on a merged fund. The results are summarized in para. 61 below. If these increases were to be applied to the separate SSS and GSIS programs several variations should be explored to determine the best and most acceptable increases. Suggestions for this type of review are contained in Chapter 6. It is recommended that this GOP proceed with actuarial analysis of each of the two programs.

59. **Merged Social Benefits Program.** We examined several options for merging the SSS and GSIS. Annex D describes the options considered and a recommended course for merger. A transition plan is also included.

60. In addition, Annex D discusses the actuarial assessment of a merged system. The assessment shows that, by including current and future government employees in the SSS contribution and benefit structure, net income of the fund will become negative by year 2007, or about seven years earlier than the projected level of SSS without the merger. Similarly, the merged fund would be fully depleted by 2014, about seven years ahead of SSS. The reason for this is that SSS will have to bear the burden of the GSIS funds which will run out earlier.

61. An analysis demonstrates that the financial soundness of a merged social benefits program can be strengthened considerably by improving the investment performance and increasing the current rate of contribution. By achieving investment returns that are three percent higher on average than what is assumed under the base scenario, and by raising the contribution rate from 8.4 percent to 11.4 percent

of covered salary, the life of the merged fund would be extended to 2026, an increase of 12 years. Other measures such as raising retirement ages or reducing replacement rates could also be used to further strengthen the position of each institution or the merged institution. For a discussion of some considerations for revising the social benefits system see Chapter 6.

62. The Social Benefit Fund of the GSIS is projected to plateau by 1996 and to actually begin decreasing between 2007 and 2010. The SSS Social Benefit Fund on the other hand will continue to increase until at least 2007 (see Table 5.1). By merging the SSS and the GSIS Social Benefit Funds the decrease in fund build-up would not begin until around the year 2000 (see Chart 6.2). If immediate measures are taken to improve investment return this timeframe could be extended another 6 to 10 years (see Chart 6.3). This would enable basic policy changes in the programs to be analyzed and debated and even phased in beginning in the 1996-1998 timeframe. All of this could be accomplished in time to prevent the assets of the funds from beginning an irreversible decline.

63. Since both the SSS and the GSIS are expected to face increasing financial pressures in the coming years, it will be advisable to begin appropriate actions now. Aside from policy changes in the design of the overall system, the contribution structure of each will need to be reappraised, and it will be easier to do this for one system than for two, assuming equity in treatment of workers is a desirable goal. Moreover, the demographic situation is still favorable, with heavy infusions of young workers to support future benefits; it would be preferable to begin the reform as soon as possible since, as the covered population matures, the costs associated with system change will increase.

CHAPTER 1

INTRODUCTION

A. Macroeconomic Background

1.1 The Philippine economy is now beginning to experience an economic recovery after two years of recession. Table 1.1 presents some of the key economic indicators for the country over the last five years. The increase in real output by 4.3 percent in 1994, and the maintenance of inflation at single digit levels, reflect the success of the stabilization efforts and structural reforms undertaken by the Government.

Table 1.1: Philippines - Key Macroeconomic Indicators, 1990-94

	1990	1991	1992	1993	1994
Growth Rates (%)					
Real GNP	4.5	0.7	1.4	2.6	5.1
Real GDP	2.7	-0.2	0.3	2.1	4.3
Key Prices					
Nominal Exchange Rate[a]	24.3	27.5	25.5	27.1	26.4
Real Effective Exchange Rate	100.0	98.8	109.6	106.9	114.1
Inflation Rate (CPI)	16.2	13.1	8.1	8.4	9.0
Interest Rate, Deposits	19.5	18.8	14.3	9.6	10.5
Interest Rate, 91-day T-Bills	23.7	21.5	16.0	12.4	12.7
Macro Aggregates (% of GNP)					
Gross Domestic Investment	24.0	19.9	20.8	23.8	24.4
Gross National Savings	18.6	17.7	19.0	17.9	19.8
Current Account Balance	-6.1	-2.2	-1.8	-5.9	-4.6
Consolidated Public Sector Deficit	-5.1	-2.1	-2.0	-2.1	-0.5
Domestic Public Debt	27.3	26.2	37.6	43.6	35.7
Total External Debt	64.5	65.2	57.0	61.2	58.8
Money and Credit (% of GNP)					
M2[b]	33.9	34.0	36.3	40.9	44.1
Reserve Money	10.4	10.7	11.1	12.0	10.4
Net Domestic Credit	23.1	19.3	20.7	43.6	45.1
Of which: Private Sector Credit	19.2	17.6	20.1	25.6	28.1

Notes:

a/ peso/US$, period average.

b/ equals sum of currency outside banks, and demand, time, savings, and foreign currency deposits of resident sectors other than the central government (IFS lines 34+35).

Sources: IMF, IFS, Central Bank.

1.2 The stabilization effort has helped in reducing macroeconomic imbalances. The consolidated public sector deficit was reduced from 5.1 percent of GNP in 1990 to 0.5 percent of GNP in 1994. The inflation rate has declined to 9.0 percent in 1994 from about 16 percent in 1990. Gross official reserves, while still low, have increased from US$2.0 billion (equivalent to 1.5 months of imports) to US$7.0 billion in 1994 (equivalent to about 3 months of imports).

1.3 Structural reform has spanned a wide range of policy areas. Trade policy has been significantly liberalized with a reduction in tariffs and quantitative restrictions. Restrictions on foreign ownership have been loosened and approval procedures have been simplified in an attempt to attract foreign direct investment. Exchange controls have been almost completely relaxed with virtual convertibility on the current account, including full repatriation of profits, dividends and capital on registered foreign investments. Marketing monopolies in the agricultural sector were abolished and most controls on producer prices were eliminated. A comprehensive agricultural reform program for acquiring and redistributing land was been introduced. An ambitious privatization program has also been underway with 301 public corporations targeted for divestment. Over 80 companies have already been privatized so far, including the national airline. Finally, in response to the severe electricity shortages which plagued the country in 1991-92, the Government opened up the power sector to private participation. The resultant surge of private investment effectively eliminated the shortages.

1.4 These stabilization efforts and structural reforms will contribute to modest economic growth in the near term. However, additional efforts will be required if an adequate level of growth is to be sustained. Savings remain low at less than 20 percent of GNP, substantially less than the historical level of 26 percent achieved during 1973-80 and comparably worse than neighboring countries. The savings rate is more than 30 percent of GDP in Indonesia, Malaysia, and Thailand, and more than 40 percent of GDP in Singapore. This low savings rate may reflect, in part, the low level of financial intermediation. The ratio of M2 to GNP at 44 percent is about half that of Malaysia and Thailand, and around 40 percent of that in Singapore. A major cause of financial disintermediation in the early 1990s was the large operating losses of the Central Bank of the Philippines (CBP) and the financing of these losses through the banking system in the form of excessive reserve requirements (25 percent).

1.5 Domestic savings are also depressed by the high level of consolidated public debt which keeps real interest rates very high. The interest rate on 91-day Treasury bills was close to 24 percent in 1990. Measures such as the major financial restructuring of the CBP in December 1993 in connection with the Financial Sector Adjustment Loan (para. 1.7) have contributed to the sharp decline in the T-bill rate to average 12.7 percent for 1994. The absence of continuous borrowing by the CBP to meet its cash flow requirements and monetary targets have also provided a more stable environment for financial markets in general and the banking system in particular. One of the major sources of long-term savings in the Philippines is the Contractual Savings Sector (CSS), which has only partly invested in productive investments.

B. Developments in the Capital Market

Overview

1.6 The growth of the capital market has been constrained in recent years by several factors, including political uncertainty, the power crisis, and the distortion caused by the insolvency of the central bank. During the 1980s, balance of payment difficulties and an overvalued exchange rate led to a decline in the holding of financial assets as measured by the ratio of M2 to GDP. Although this ratio rose from 33 percent in 1989 to 44 percent in 1994, it is still only half the comparable figures for Malaysia and Thailand. With the election of President Ramos in December 1992, the restructuring of the CBP in December 1993, and the return to normal power supply conditions in late 1993, financial markets have rebounded on all fronts. The interest rate on government securities plummeted below 13 percent for 1994. The Philippine stock market was one of the best performing in the world in 1993, evidenced by a rise in the ratio of stock market capitalization to GDP from 15.1 percent in 1990 to 69.6 percent in 1993. Foreign portfolio investment has increased sharply, and foreign direct investment almost doubled in 1994. Although the Philippine capital market experienced remarkable growth in 1993 and 1994, it is still very small in relation to other ASEAN countries such as Thailand and Malaysia. Therefore, tremendous potential exists for the capital market to act as the engine of growth for the economy. This report argues that the CSS has a major role to play in this respect.

Government Securities Market

1.7 The government securities market was profoundly affected by the passage of Republic Act No. 7653 on July 3, 1993, which created the new Bangko Sentral ng Pilipinas (BSP), later established on December 23, 1993. During the previous four years, monetary policy management had been rendered ineffective. Since the CBP did not have a portfolio of government securities to conduct open market operations, it had to rely on the GOP to raise resources through the issuance of Treasury bills to cover its operating losses and additional funds required to meet monetary targets. The excess amount raised through this action was deposited with the CBP for conducting open market operations. With the restructuring which took place in December 1993, the BSP (the new central bank) acquired a large amount of T-Bills (₱ 280 billion) on its books which could then be used for open market operations.

1.8 The volume and magnitude of BSP-administered issuances and transactions continued to expand and total government securities issued through the BSP increased by about ₱ 140.7 billion (or 27 percent) in 1993 to ₱ 655.3 billion, with a reduced weighted average rate of 15.0 percent as against 16.6 percent in 1992. The surge in the primary market was also reflected in secondary market sales and the consolidated sales and purchases of Treasury bills and floating rate treasury notes (FRTNs) within the dealer network was reported at ₱ 2.04 billion. The issuance of the T-bills is carried out through a book-entry system, which accounted for about 96 percent of the gross issues. The scope of coverage by the book-entry system was expanded to include BSP Bills aside from T-Bills (auctioned, top, GOCC/Special Series) and FRTN issues. Likewise, the range of institutional participants was broadened to cover all thrift-banks, nonbanks with quasi-banking licenses and special trust accounts. The custodianship facility, established in conjunction with the book-entry system, held about ₱ 39.9 billion in securities.

1.9 To keep pace with the growing volume and complexity of the market, it is vitally important to ensure the continuous efficient administration of the market and its smooth transfer of the fiscal agency function to the DOF. To this end, a prime pre-requisite is to develop high-grade and well-motivated GSD staff with the professional expertise to keep abreast of market developments. At the same time, high priority should be accorded to the full computerization of GSD operations, both hard and software systems.

1.10 Most government securities carry maturities of less than one year. In an effort to create a larger pool of long-term capital, the GSD began issuing Floating Rate Notes (FRNs) in 1991, and the program has been highly successful. As of May 31, 1995, the amount of the FRNs amounted to ₱ 123 billion, or 31 percent of outstanding Treasury bills. Since October 1994, the NG has been issuing two year fixed rate notes, and in June 1995 issued five years fixed rate notes, thereby providing a benchmark for pricing long-term corporate securities. Given more stable macroeconomic conditions and financial markets, it is recommended that the GOP consider auctioning additional fixed interest long-term securities. To facilitate the success of these notes, the GOP should consider removing the stamp duty, clarifying the taxation regulations both on interest income and capital gains from fixed interest rate long-term securities, improving the clearing and settlement systems, and providing information to market participants on a timely basis. These measures are discussed in the Capital Market Study. The CSS, especially the two social securities institutions, can play an important role in contributing to the growth of a robust government securities market (Chapter 2).

The Stock Market

1.11 There have a been a number of notable developments recently affecting the stock market. The first was the unification of the Manila and Makati Stock Exchanges at the end of March 1994, and their consequent functioning under a one-price system. Another major development was the unanimous ratification by the Senate on April 28, 1994, of the Stock Transactions Tax Bill, which provides for a graduated three-tiered tax on initial public offerings (IPOs) and aims to encourage broader public ownership of closely held firms. A "closely held" corporation is defined as one in which at least 50 percent of the outstanding capital stock or at least 50 percent of the total combined voting power of all classes of stock entitled to vote is owned directly or individually by 20 individuals.

1.12 Tax rates will be based on the proportion of the stock sold, bartered or exchanged or disposed, to the total outstanding shares of stock after the listing on the stock exchange. The tax will be paid by the issuing firm in the case of primary offerings or by the seller in the second offering. This year, more than a dozen firms have reportedly lined-up ₱ 30 billion worth of IPOs. The same Bill increases to one-half of one percent the prevailing one-fourth of one percent transfer tax on the gross selling price of publicly-listed shares. Given the modest increase in the tax rate, it is unlikely to have a major impact on the volume of public issues or stock exchange activity. The equity market continues to experience rapid growth and market capitalization increased from US$13.7 billion in 1992 to US$40.3 billion in 1993. The turnover ratio also increased during the same period. At the end of February 1994, the Philippine constituents comprised about 5.6 percent of the total investable market capitalization of the 10 Asian markets followed by the IFC. Daily trading value averaged US$40 million in February 1994, a sharp increase from the past, but still modest compared with a daily trading volume of US$500 million in Thailand. The buoyancy of the market is also borne out by the rise in the number of listed issues from 254 (1990) to 284 (1993).

1.13 A final noteworthy development concerns Congressional ratification (April 29) of the amendment to the Build-Operate-Transfer (BOT) Law, sections of RA No. 6957 ("An Act Authorizing the Financing, Construction, Operation, and Maintenance of Infrastructure Projects by the Private Sector, And For Other Purposes") which, among other provisions, permits negotiations instead of bidding for award of contracts for infrastructure projects. The amendment would also allow companies conducting pre-feasibility and feasibility studies on major infrastructure projects a first "crack" at securing the contract. The amendments are aimed at speeding up execution of infrastructure projects. Reportedly, five Malaysian conglomerates (Penang Group, Malaysian Airlines, Diversified Resources, Country Heights, and the Landmark Group) are awaiting Presidential approval of the amended law. The prospective BOT projects include toll roads, housing projects, resorts, and airports.

C. Objectives of the Study

1.14 In 1992, the World Bank conducted a study of the capital market in the Philippines.[1] The study highlighted the importance of the contractual savings sector (CSS) in capital market development, identified weaknesses and problems in the CSS, and made several recommendations for enhancing its efficiency. The study also recommended a comprehensive reform of the country's two social security institutions — the Social Security System (SSS) and the Government Service Insurance System (GSIS). The prospect of merging the two social security institutions was raised but not examined at that time, as it was beyond the scope of the study. Subsequently, in early 1994, the GOP formally requested the Bank to study this major institutional issue, which led to a Bank mission visiting the Philippines in April-May 1994.

1.15 The paucity of long-term domestic funds in the Philippines brought this issue to the forefront. The CSS and the fast growing stock market are the only major sources of such funds. The CSS is a particularly appropriate source of long-term funds because of its assured cash flows and long-term liabilities. To the extent that the assets of the social security institutions comprise more than 60 percent of the assets of the CSS (see Chapter 2), they are the primary players in the CSS. In principle, by mobilizing these long-term savings, the social security institutions can make non-inflationary long-term finance available to those who can use it most efficiently. The long-term maturity structure of their liabilities also creates a demand for matching financial assets, in the nature of equities and fixed income securities. This is particularly relevant as the size of the resources available to them, and to the CSS in general, can provide an effective primary and secondary market for government and private securities, expand the capital market, and generate demand for professional investment and fund managers which will help establish a funds management industry.

1.16 The social security institutions, in particular, have thus far played only a limited role in capital market development. This has been due to several reasons. Regulatory constraints have meant that both the SSS and the GSIS have allocated only limited amounts of their assets to long-term securities such as equity. The lending policies of these institutions have also favored consumption loans to members at subsidized interest rates. The weaknesses in the operational performance and in the institutional structures of the social security systems have also undermined their potential importance to the CSS. In addition, the continuing volatility of interest rates has made even the private pension system and the insurance sector fairly myopic in the conduct of their investments.

1.17 The need for a comprehensive package of reforms for the social security institutions is, therefore, clear. Such a strategy would also complement other financial sector work carried out by the

[1] *Philippines: Capital Market Study*, World Bank, Report No. 10053-PH, February 24, 1992.

Bank over the last three years — starting with the reform of the banking system, the restructuring of the central bank, and improvements in the government securities market. It would also reinforce financial sector work undertaken by the Asian Development Bank on the equity market, including unifying the two stock exchanges, strengthening of the Securities and Exchange Commission (SEC), and improving the clearing and settlement system.

D. Structure of the Study

1.18 The study is based on the findings of a Bank mission which visited the Philippines in April-May 1994. It also builds on the findings and recommendations of the 1992 Capital Market Study. Following this Introduction, Chapter 2 discusses the contractual savings sector in the context of examining the social security institutions. Chapter 3 examines the current status of the social security sector and the organization and administration of the SSS and the GSIS. Chapter 4 discusses the operational and financial performance of the SSS and the GSIS. Chapter 5 provides an actuarial assessment of the two institutions. Chapter 6 presents the various options to be considered when restructuring the social security sector. The annexes contain various actuarial and statistical notes and a plan for merger of the two social security institutions.

CHAPTER 2

THE CONTRACTUAL SAVINGS SECTOR

2.1 Contractual savings refer to any transaction whereby economic agents enter into a binding arrangement with institutions, whether public or private, to trade current consumption for future income. The prospective future income could be in many forms — for instance, as lump sum payments, annuities, or medical benefits. The nature of these contractual arrangements can be compulsory (e.g., social security schemes, provident funds) or voluntary (e.g., private life insurance and pension funds). In some countries in East Asia, such as Singapore and Malaysia, there is a pronounced policy towards compulsory or 'forced' savings, and national provident funds constitute the only major source of contractual savings.[2] In some others, like Indonesia and Thailand, compulsory contractual savings schemes are rudimentary and the major sources of contractual savings continue to be voluntary in nature.

2.2 This chapter presents a profile of the CSS in the Philippines, discusses its potential for generating savings, identifies key linkages with capital market development, examines the tax status of the sector, and concludes with a discussion of the legal and regulatory framework of the CSS.

A. Profile of the Contractual Savings Sector

An Overview

2.3 Table 2.1 presents the profile of the CSS in the Philippines as of 1993. The CSS consists of the two social security institutions (SSS and GSIS), the occupational pension funds, and the insurance industry, both life and non-life. At the end of 1993, the total assets of the sector were estimated at ₱ 256 billion. This represented a sizable pool of long-term resources, equal to more than one-quarter of the market capitalization of the listed issues on the two stock exchanges, 27 percent of the assets of the banking system, or 17.4 percent of the GDP.

2.4 The two social security institutions (SSS and GSIS) account for 60.2 percent of the assets of the CSS. At the end of 1993, the total assets of the social security programs were ₱ 154 billion, 11 per cent of GDP. An accurate assessment of the asset size of these schemes depends on several factors, the most important of which are the age of the fund, its funding method, its level of contributions and benefits, its coverage, the demographic characteristics of its members, and the efficiency of investment of its surplus funds.

2.5 The occupational pension funds consist of private pension funds, the Armed Forces of the Philippines Retirement and Separation Benefits System (AFP), the Home Development Mutual Fund (Pag-ibig), and several multi-employer plans. These occupational pension funds are voluntary and consist largely of single employer occupational schemes. They are supplementary to the social security system.

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[2] In Singapore, the total assets of the Central Provident Fund alone were 72 per cent of GDP in 1987. Adding the assets of life insurance companies raises the ratio to 78 percent. In Malaysia, the corresponding figures were 41 per cent and 48 per cent, respectively. For more details, see D. Vittas and M. Skully (1991), "Overview of Contractual Savings Institutions," Working Paper Series No. 605, The World Bank.

However, neither their actual number nor the size of their total assets is fully known. The AFP is not yet paying benefits. The Government provides for the benefits directly from the budget. The fund is currently used as an investment vehicle, but current plans will have it assume the payment of benefits at the point in time when the annual income from contributions and earnings on investments become sufficient to sustain ongoing operations. In 1993, the total assets of the AFP were close to ₱ 7 billion. As the assets of the AFP grow, they will provide a growing source of long-term funds. The Pag-ibig offers supplementary schemes for both public and private sector employees and is now compulsory. Bank staff estimates put the total value of the assets of all the occupational pension plans at about ₱ 40 billion in 1993.[3]

Table 2.1: Profile of the Contractual Savings Sector, 1993

	Social Security	Occupational Pensions[a]	Insurance[b]	Total
Total Assets (₱ bn)	154.1	40.0	62.0	256.1
As % of CSS	60.2	15.6	24.2	100.0
As % of GDP	10.5	2.7	4.2	17.4
Assets of the Banking System[c]				957.5
Assets of the Financial System[d]				1,859.6
Stock Market Capitalization				1,009.1

Notes:
a/ estimate.
b/ estimate, assuming a growth rate of 10% in 1993.
c/ data for September 1993; covers all banks - commercial, thrift, rural, and specialized government.
d/ data for September 1993; sum of the assets of the banking system, central bank, and non-bank financial institutions.

Sources: SSS, GSIS, Commission of Insurance, Central Bank, Philippine Stock Exchange, and staff estimates.

2.6 As of December 31, 1993, the total assets of the insurance industry, both life and non-life, amounted to ₱ 62 billion. Much of it is in the private sector, but there are public corporations which also provide insurance. The most important public agent in this field is the GSIS, whose insurance business was worth ₱ 9 billion in 1993.[4] Other public institutions provide specialized insurance, including the Philippine Deposit Insurance Corporation, The Home Insurance and Guaranty Corporation, and the Philippine Crop Insurance Corporation. While the role of the Government in providing

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[3] The Wyatt Company's annual survey of 168 pension funds in the Philippines reveals that the assets of these funds have doubled between 1990 and 1993. This growth rate of 100 per cent was used as a proxy for the growth rate of the aggregated assets of occupational pension plans. The 1993 estimate was obtained by applying this rate of growth to the ₱ 20 billion value that was estimated by the 1992 Capital Market Study.

[4] This is the sum of the total assets of the General Insurance Fund, the Optional Life Insurance Fund, and the property Replacement Fund.

specialized insurance can be justified, the commercial insurance provided by the GSIS should clearly be in the private domain and it is recommended that the NG consider divesting this business to the private sector as a part of the overall restructuring of the two social security institutions (para. 2.11).

2.7 The size of CSS assets is substantial, and asset growth has been significant. CSS assets increased at an average annual rate of 18.1 percent during the period 1980-1993. This growth is largely attributable to the surge in SSS assets, which grew at an average annual rate of 20.5 percent during the same period. The GSIS grew at a slower rate of 14.0 percent, as did the insurance industry. Table 2.2 shows the growth rate of the CSS and its various components over this period.

Table 2.2: Assets of the Contractual Savings Sector
(in billions of pesos)

	1980	**1985**	**1990**	**1993**	**Average Annual Growth Rate (%)**
Social Security	18.4	43.1	98.6	154.1	17.8
SSS	(9.2)	(26.3)	(62.5)	(103.8)	(20.5)
GSIS	(9.2)	(16.8)	(36.1)	(50.3)	(14.0)
Occupational Pensions	n.a.	n.a.	20.0	40.0	n.a.
Insurance	11.1	18.1	45.5	62.0	14.1
TOTAL CSS	**29.5**	**61.2**	**164.0**	**256.1**	**18.1**
GDP (Peso billion)	**243.7**	**571.9**	**1,073.1**	**1,456.6**	**14.7**
CSS/GDP	**12.1%**	**10.7%**	**15.3%**	**17.6%**	-

Sources: SSS, GSIS, Commission of Insurance, staff estimates, and IMF.

2.8 While a detailed study of the social security institutions is presented in Chapters 3 and 4, the following two sections provide a brief description and analysis of the life insurance industry and the private pension funds, which are the other significant components of the CSS.

The Life Insurance Industry

2.9 The life insurance industry comprises almost two-thirds of the assets of the insurance industry. It is principally owned and operated by the private sector, except for the GSIS which offers compulsory and optional life insurance for government employees. The bulk of the total assets of the industry (about 84 percent) are held by domestic insurers.

2.10 The growth of the life insurance industry during the last decade has been impressive and has kept pace with domestic inflation and with the growth of the Philippine financial sector as a whole. (Tables 2.3 and Annex Table C.1). This is all the more remarkable considering that the industry operates on an uneven playing field because of constraints such as higher discriminatory taxation relative to other segments of the financial sector. In fact, the growth of the life insurance sector has been faster than indicated by the published data, which exclude the so-called Pre-need sector in the Philippines. The Pre-need industry, which provides for specific benefits relating to education, cremation and internment, and pension fund accumulation, is essentially a form of insurance, and is recognized as such in other countries and offered by insurance companies. The Pre-need industry in the Philippines, which is a recent development, has been growing fast, with assets already estimated to be about ₱ 1 billion. Its rapid growth is principally attributable to tax concessions which are not granted to the life insurance industry and to the differential standards of regulation imposed by the Securities and Exchange Commission. The Insurance Commission has no jurisdiction over the Pre-need industry.

Table 2.3: Profile of the Life Insurance Industry

	1988	1989	1990	1991	1992
Life Insurance	23	23	23	22	23
Domestic Philippine National	19	19	19	18	19
Domestic Non-Philippine National	2	2	2	2	2
Foreign	2	2	2	2	2
Per Capita Exp. on Insurance)	126.55	146.93	164.79	185.29	210.92
Life Sum insured as % of GNP	21.16%	21.93%	21.55%	20.82%	24.60%
Premiums (life and non-life including professional reinsures) as % of GNP	0.94%	0.96%	0.94%	0.94%	0.99%
Composite (Life & Non-Life)	2	2	2	2	2
Memo:					
Number of Authorized Insurance Companies (Life & Non-Life)	131	128	130	127	127

Source: Key Data, Insurance Industry 1989-1992, Insurance Commission, Department of Finance, Department of Finance, Republic of the Philippines.

2.11 The growth and profitability of the insurance industry, however, has been affected adversely by (i) the very high commission rates relative to elsewhere in the world; (ii) onerous discriminatory taxation (discussed later); (iii) overly conservative investment policies; and (iv) a failure to develop attractive new product lines. The industry, while financially sound, has played a marginal role in capital market development. Given the strong growth and the proven capabilities of the private life insurance industry, and the need for reform and rationalization of the GSIS, there is a strong case for early divestiture of its life insurance business.

2.12 The asset mix of the industry shows a relatively high proportion of short-term government securities (about 35 to 37 percent), which is explained in part by the very high yields on short-term Treasury bills. Stocks and property represent only about 20 percent of the assets. The prevailing composition of insurance industry investments results in a mismatch between the maturities of its assets (mostly short-term) and its liabilities (long-term), with a concomitant over-emphasis on short-term cash income rather than accumulation of capital and reserves.

2.13 If the industry is to maximize its contribution to capital market development, it will need to adopt an agenda to act concurrently in four areas: regulatory environment, institutional development, taxation, and the Insurance Commission. The recommendations relating to the regulatory and developmental aspects as well as the reorganization of the scope and structure of the Insurance Commission have been set out in detail in the Philippines Capital Market Study.[5]

The Private Pension System

2.14 The private pension system in the Philippines is comprised primarily of voluntary single-employer occupational pension plans. This sector, while still relatively young, is an important source of retirement benefits for Philippine workers and one of the very few sources of long-term capital. Most of these employer sponsored formal retirement plans have tailored their benefit schemes to satisfy the minimum requirements established by the labor code (i.e., a specific multiple of salary per year of service with the company). The average benefit is roughly 1.5 times the member's final monthly salary times years of service, and is typically paid as a lump sum at separation.

2.15 Comprehensive data are not available on the total size or growth of pension fund assets, but a useful sample survey of 168 pension funds by The Wyatt Company gives representative orders of magnitude (Annex Table C.2). The median fund size as of end-year 1993 was ₱ 26.2 billion. The portfolio composition of the average fund was about 50 percent in corporate loans, 24 percent in fixed interest investments, about 12 percent in stock, with barely 3 percent in real estate or direct equity participation, and the remainder largely in Treasury bills. The focus seems to be mostly on short-term gains in fixed income securities (1-3 years) with equities being traded more as speculative issues. Surprisingly, few investments are allocated to the stock market, despite its higher rate of return over the long-run. Nevertheless, the private pension system is contributing to the development of the capital market through the involvement of financial intermediaries and external fund managers.

2.16 However, while occupational pension schemes are becoming more important in terms of the total assets invested in the various segments of the capital market, there is no agency to supervise and safeguard the quality and value of the investment portfolios. The Bureau of Internal Revenue is at present the principal government agency overseeing the registration and performance of employer sponsored retirement plans, but its perspective is purely oriented towards the tax aspects. Further steps are recommended along the lines indicated in the previous report on the Philippines Capital Market Study.[6] These are, broadly, as follows:

(a) There is a pressing case for the early creation of a regulatory unit within the Ministry of Labor to enforce current regulations for financial disclosure and compliance with generally accepted accounting principles to perform pension fund audits.

(b) The Bureau of Internal Revenue should improve compliance with the tax code and develop the expertise to evaluate actuarial studies and contribution plans.

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[5] Report No. 10053-PH, February 24, 1992, Vol. II, Annex 2, pp. 139-143.

[6] Ibid., Annex 3, p. 149.

(c) Formulation of investment guidelines to diversify investments, provide incentives for greater participation in the equities market, reduce related party transactions, and restrict investments in the employer stock and related transactions to a ceiling of 10 percent of the total portfolio.

(d) Representatives of employees on the board of trustees should be appropriately trained and oriented in pension fund management issues.

(e) Individuals and the self-employed should be allowed to set up personal pension accounts with the same tax status as that accorded to occupational pension sectors.

B. Savings Potential of the Social Security Institutions

2.17 The CSS has generated substantial savings. Contributions to savings by the constituent social security institutions can be measured by their annual additions to reserves — the excess of current revenues from contributions and investment income over current expenditures on benefit payments and operating expenses. In 1993, the additions to reserves of the SSS and the GSIS were close to ₱ 21 billion, equivalent to 1.4 percent of the GDP and 7.8 percent of gross domestic savings (Table 2.4). A better sense of the magnitude of these savings can be gauged by comparing the additions to reserves with the value of IPOs in the stock market. The aggregate addition to reserves was 1.6 times larger than the total value of IPOs in 1993; those of the SSS alone almost equalled the IPOs that year.[7] Although the level of savings mobilized is substantial, the social security institutions have not yet realized their full potential. As discussed in Chapters 3 and 4, the SSS suffers from low compliance with contribution payments while the GSIS has large overdues. There are also indications that present resources may not be able to fully cover the generous increases in benefits approved during the last four years. There is further a need to improve asset management functions at both institutions to increase the risk adjusted returns so that future obligations could be met without recourse to the NG. These inefficiencies on the revenue side have constrained the ability of these institutions to generate additional surpluses.

[7] Lack of disaggregated data for the occupational pension plans precludes estimation of their contribution to savings.

Table 2.4: Additions to Reserves of SSS and GSIS, 1993

	SSS	GSIS	TOTAL
Additions to Reserves (₱ bn)	13.0	7.8	20.8
As % of GDP[a]	0.9	0.5	1.4
As % of Gross Domestic Savings[b]	4.9	2.9	7.8
As % of Initial Public Offerings	99.5	59.7	160.2

a/ In 1993, nominal GDP = ₱ 1,501 billion.
b/ In 1993, gross domestic savings = 17.7% of GDP or ₱ 265.7 billion.

Source: SSS; GSIS; IMF; the mission's estimates.

2.18 The empirical evidence on the effect of social security on aggregate savings is not conclusive. However, there are two general points which can be made about the CSS. First, the fact that voluntary private pension schemes have shown rapid growth along with the compulsory schemes administered by the SSS seems to suggest that the effect on aggregate private savings may well be salutary. Second, contractual savings, whether compulsory or voluntary, generate significant positive externalities from their potential use for term finance.[8]

C. Role of Contractual Savings in Capital Market Development

2.19 The CSS is an ideal source for term financing, and potentially a substantial one as well, owing to its assured cash inflows and long-term liabilities, which can be reasonably estimated through actuarial methods. Even if aggregate savings are unaffected, contractual savings will cause a shift in favor of long-term finance used to promote capital market development.[9] A major gap in the capital market in the Philippines is the shortage of long-term finance, and the CSS is in a position to a play a major role in filling this gap without compromising its fiduciary responsibilities.

2.20 Although the liabilities of both the SSS and the GSIS are predominantly long-term, their assets are largely short-term (see Chapter 4). This stems from several factors, the primary ones being the high short-term rates on Treasury bills (between 15 to 28 percent during the nineties) and the very small size of the equity market (due to the crowding out of the private sector by the NG and lack of political stability). The skewed pattern of interest rates and the high real short-term rates (over 10 percent in recent years) inhibit the development of the market for long-term capital. As mentioned earlier, these high real rates were caused by very large consolidated budget deficits and operating losses

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8 A. Chandavarkar, (1993), "Saving Behaviour in the Asian-Pacific Region," *Asian-Pacific Economic Literature*, Vol.7, No. 1.

9 Dimitri Vittas, "Economic and Regulatory Issues of Contractual Savings Institutions," 1990, World Bank, CECFP, Processed, p. 11; "Overview of Contractual Savings Institutions," 1991, World Bank, WPS. 605, March, pp. 50-56.

of the CBP (para. 1.5). As a result, there have been no long-term instruments available to local investors. Furthermore, both the SSS and the GSIS have played a very limited role in secondary market trading due to a withholding tax of 25 percent at source imposed on both these institutions — despite their tax-exempt status. Technically, they are entitled to receive a tax refund from the BIR. However, the claim period is too long (over a year) and the refund is generally given in the form of tax credits, which are meaningless to tax exempt institutions.

2.21 Given appropriate fiscal and monetary policies, the SSS and the GSIS could play a much more active role in developing a long-term government securities market in the Philippines and, in so doing, lengthen the maturity structure of government securities. Moreover, investing in long-term government securities by the SSS and the GSIS would further benefit the members of these institutions, since such investments hold out the promise of higher rates of returns. (Both the SSS and the GSIS have been providing loans at below market rates to members for consumer and housing loans in recent years.) Table 2.5 shows the distribution of holders of government securities in recent years. The holdings of government securities by semi-government entities, which include contractual savings institutions such as the SSS and the GSIS, have increased steadily, from 12.1 percent of the total outstanding in 1986 to 27.7 percent in 1992, while the holdings of private investors have declined from 51.8 percent to 39.4 percent during the same period. Although considerable progress is noticeable, much remains to be done to enhance the role of the SSS and the GSIS in fostering the development of a long-term government securities market.

2.22 In this respect, it is instructive to draw upon the Malaysian experience. Table 2.6 compares the performance of the SSS and the GSIS in the Philippines with the Employees Provident Fund (EPF) in Malaysia. Two lessons can be learned from this comparison. First, with high contributions from both employers (11 percent) and employees (9 percent), the total resources of the EPF available for investment have been much larger than those of the SSS and the GSIS. Second, Malaysian law requires that 75 percent of the EPF's resources be invested in government securities; consequently, government securities constitute the main component of EPF investments. In 1990, for instance, government securities accounted for 73 percent of EPF investments, while they accounted for about 50 percent and 28 percent of SSS and GSIS investments, respectively. Likewise, the government securities held by EPF accounted for 52 percent of total government domestic debt outstanding, while the SSS and the GSIS held substantially less (17 percent).

Table 2.5: Outstanding Public Sector Domestic Debt by Holder, 1986-93
(percent)

	1986	1987	1988	1989	1990	1991	1992	1993
(As a percentage of total outstanding)	100.0	100.0	100.0	100.0	100.0	100.0	100.0	n.a.
Central Bank	8.9	6.1	3.7	4.6	3.4	3.0	8.9	n.a.
Commercial banks	19.4	12.9	16.1	23.4	23.2	24.2	17.0	n.a.
Thrift banks	1.5	1.2	1.5	1.4	0.9	0.9	1.5	n.a.
Trust funds	6.3	6.6	5.8	4.4	3.2	3.1	5.5	n.a.
Semi-Government entities /a	12.1	13.6	13.1	11.9	22.7	25.2	27.7	n.a.
Other private sector	51.8	59.7	59.8	54.3	46.7	43.5	39.4	n.a.

a/ includes SSS and GSIS.

Sources: Government Securities Department, BSP; World Bank, *The Philippines: Capital Market Study, 1992*; and mission's estimates.

Table 2.6: Performance of SSS, GSIS, and EPF (Malaysia), 1990
(percent)

	Philippines		Malaysia
	SSS	GSIS	EPF
Total assets as percent of GDP	5.5	3.2	41.0
Portfolio structure (as % of total)	100.0	100.0	100.0
Loans	21.7	51.0	0.0
Government securities	50.9	28.0	73.6
Other	27.4	21.0	26.4
Holding of government securities (as a % of government domestic debt)	13.0	3.5	51.8

Sources: Malaysia, Employees Provident Fund, 1991 Annual Report; World Bank, *Philippines: Capital Market Study*, 1992.

2.23 There have been some notable developments in the lending programs of the SSS and the GSIS, such as the ₱ 4 billion fund for power loans (GSIS), the Stock Investment Loan Program (SSS), and the Stock Purchase Financing Program (GSIS). The latter is no doubt devised to promote equity participation by small investors, but this may not necessarily be the most feasible channel, considering the lack of expertise in such groups, who may be better served by entities like mutual funds.

2.24 The present asset and maturity mismatch between long-term liabilities and predominantly short-term assets could be redressed through an integrated reform and policy package designed with the following features:

(a) A reduction in subsidized member loans (salary, policy and housing) while pricing them more nearly to market levels, coupled with a phased divestiture of the insurance business of the GSIS. These steps would together release more resources for long-term assets as well as higher-yielding bonds and equities. Such loans currently account for a disproportionate share (about 32 percent) of the SSS portfolio. The SSS is also the largest source for low-cost housing funds, but the provision of housing finance is better suited for a specialized agency. This is a subject which merits a separate study.

(b) Partial linkage of contributions and benefits which would make the public more conscious of the long-term nature of social security. To this end, the benefit formulas should be rationalized and made more transparent.

(c) A well-orchestrated public relations campaign to inform opinion makers and the public about how the viability and adequacy of social security arrangements depends critically on the ability of the SSS and the GSIS to effectively discharge their fiduciary responsibilities.

(d) The SSS and the GSIS could create a window for longer-term government securities, provided the NG introduces such securities on a competitive basis.

(e) Provide for full or partial privatization of fund management. The mission's findings suggest that there is an adequate pool of fund management expertise in the private sector available at competitive rates, which is also borne out by the experience of private pensions. This would also facilitate larger equity investments (currently about 11 percent) and provide valuable support to the privatization program.

Should the CSS Sector Invest Abroad or in Foreign Currency Denominated Assets?

2.25 Although Section 26 of its Charter does not prohibit the SSS from investing abroad, it also does not expressly provide for such investments. This, however, is a complex conflict-of-interest issue (between members and overall public policy) which merits careful consideration in the event that the SSS and the GSIS find it more remunerative to invest abroad. The GSIS was recently barred from investing in higher yielding foreign securities which would have been in keeping with their fiduciary responsibility for maximizing returns on their investment portfolio. This prohibition was probably prompted by the desire to prevent the export of domestic savings and to forestall public criticism of starving the domestic capital market for sectoral interests. It is not unusual for national contractual savings institutions to be permitted to invest abroad to overcome the constraints of the domestic capital market, e.g., as in the case of the Central Provident Fund (CPF) of Singapore or in Chile, where a 1990 authorization permits investment in foreign assets with a ceiling increasing from 1 percent to 10 percent from 1991-1996.[10]

[10] Carmelo Mesa-Lago, Changing Social Security in Latin America, Lynne Rienner Publishers, Boulder, Colorado, 1994, p. 126. In Singapore, "due to budgetary surpluses of the government, CPF balances are largely invested abroad, but the probably higher real rate on those investments is not channelled back to the CPF members", Mukul G. Asher, "Some Aspects of the Role of State in Singapore," The Economic and Political Weekly, April 2, 1994, p. 802.

This measure in Chile was announced despite the opposition from some quarters over the export of workers' savings abroad.[11] There is no reason why the CSS in the Philippines should not be permitted to invest abroad or in foreign currency instruments such as Philippine Brady bonds, as long as such investments are consistent with their fiduciary obligations and are subject to specified limits and prudential regulation. However, this would require a much higher level of investment expertise than is currently available in-house at either the SSS or the GSIS, and provides added incentive for privatizing the fund management activities of these institutions. The SSS is expected to have liabilities in foreign currencies in the future as reciprocal agreements with various countries become effective and since foreign currency denominated assets would diversify risk and offer some protection against a depreciating peso. It would further be consistent with the philosophy of liberalizing the capital account which would operate as a two way street, permitting outflows as well as inflows of capital.

D. Tax Status of the Contractual Savings Sector

2.26 Currently, both the SSS and the GSIS are exempt by law from any taxes, fees, or charges on: (i) all contributions; (ii) all benefits paid; (iii) income from investments; (iv) all supplies, equipment, papers or documents needed to operate the systems; and (v) assets and properties. Moreover, the benefits they pay are not liable to attachment, levy or seizure, unless the obligation is either to the SSS or to the GSIS. Under prevailing law, the tax exemptions are not to be affected by any subsequent legislation to the contrary.

2.27 During the Martial Law regime, the SSS was taxed for a time, but it is not clear whether a ₱ 191.2 million tax refund pending from the BIR, mentioned in the "Operating Highlights for the Year 1992" of the SSS, refers to this period or whether it was part of the pending refunds normally due on account of the withholding tax of 20 percent at source for all financial instruments.

2.28 Many countries exempt contractual savings from taxes to provide an incentive for savings. For instance, in Malaysia and Singapore, all contributions to and benefits from the provident funds are exempt from taxes, as are accumulated interest and any capital gains from permissible withdrawals for purchase of real estate and stocks. There are, however, some anomalies in the current tax status of contractual savings in the Philippines which merit amendment and reform, as these impair the cash flows and investment capabilities of the SSS and the GSIS, and the savings incentives for private contractual savings. The first of these is the levy of the withholding tax of 25 percent on interest income at source on both the SSS and the GSIS which is inconsistent with the tax-exempt status of both these institutions. On the other hand, the presumptive exemption of these institutions from the amended VAT is not justifiable. Much more onerous is the continued levy of the five percent tax on life insurance premiums, which, in conjunction with the varied municipal taxes on such premiums, puts private insurance at a serious disadvantage and undermines the concept of a level playing field. These issues merit close examination with a view to speedy reform.

2.29 The current withholding tax of 25 percent at source also poses problems for both the SSS and the GSIS since this tax is embedded in the price of the financial instruments which are bought by these institutions. Although this tax is refunded to the respective institution, the refund process is

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[11] International Labor Office, Report of the Director-General, (Appendix on the Experiences of a Number of Countries in the Area of Social Security), Geneva, 1992, p. 22.

excessively prolonged — as long as one year or more. This adversely affects their cash flows and investment potential, all the more so should the SSS and the GSIS increase their bill and note trading activities. There are two possible solutions to this problem. One is to allow "netting" of withholding tax payables and receivables by the two institutions as suggested by the Capital Market Study.[12] But it would be administratively simpler and more in keeping with the tax-exempt status of the SSS and the GSIS to instead exempt both these entities from the withholding tax. Such a step would greatly enhance their cash flow and investment potential and contribute to the enlargement of the capital market generally.

2.30 The insurance industry is heavily taxed. The taxes on the industry include: (i) the tax of five percent on all premium income; (ii) the normal corporate tax on net income; (iii) the 25 percent withholding tax on interest income; (iv) the stamp tax on life policies; (v) examination and license fees; and (vi) municipal taxes on insurance premiums which vary with individual municipal jurisdictions. The total tax burden on the industry represents a tax rate of about 36 percent on the sum of net income plus capital gains (staff estimate for 1988). The high taxes imposed on the insurance industry put it at a disadvantage relative to competing sectors such as the Pre-need, trust and private pension fund industries. The tax status of the private life insurance sector raises some important issues for policy and fiscal equity. Albeit, the main burden is the five percent tax levied on all premium income, which is effectively a direct tax on long-term planned savings as it is the premium paid by the policy holder which is taxed (and not the income from those savings).

2.31 Consistent with the recommendation of the 1992 Capital Market Study, the present mission recommends the following:

(a) The premium tax should be replaced with a structured investment tax on insurance policies which would also apply to Pre-need and trust investments. This will ensure that savings, on which tax is already collected as original income tax, are not taxed again.

(b) Concurrently, tax rates on Pre-need and Trust investment should be brought directly into line with life insurance in order to ensure that the overall changes are revenue neutral.

(c) Premiums on life insurance policies should be allowed as income tax deductions, up to a limit of, say, ₱ 2,000 p.a.

(d) Deductions should also apply to the Pre-need and trust industries to ensure a level playing field within an overall ceiling covering all voluntary contractual savings.

2.32 The tax status of private pensions discriminates against self-employed or other individuals who do not participate in a qualified plan, limits the portability of benefits, and constrains the mobility of labor. While the incentives for employers are adequate and generally in line with those offered in other countries, the contributions of plan participants are not tax-deductible and pre-retirement benefits cannot be rolled into a personal account to maintain its tax-exempt status. Such deductions should be viewed as part of an integrated tax incentive structure for saving, and should also incorporate deductions for interest on housing loans, subject to an overall ceiling of, say, 15 to 20 percent of gross income (under Section 28 (g) of the Internal Revenue Code) to cover deductions on account of voluntary contractual savings.

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[12] Ibid., Vol. II, Annex 1, Section, 3.14.

E. Regulatory Framework of Contractual Savings Sector

SSS and GSIS

2.33 The legal and regulatory arrangements relating to the public sector (SSS, GSIS and Employees' Compensation (EC) and Medical Care (MC)) and the private sector (pension and retirement funds) have to be evaluated in terms of the relevant objectives and criteria of regulation, which broadly comprise the following:

(a) Providing a requisite degree of operational and financial autonomy to fulfill fiduciary responsibilities to members.

(b) Ensuring adequate oversight, surveillance, accountability and transparency.

(c) Minimizing the moral hazard inherent in government guarantee of benefits to members (SSS and GSIS).

(d) Providing prudential safeguards for private funds to minimize risk of loss to participants in private pension plans.

2.34 The legal and regulatory arrangements must serve and reconcile the interests of:

(a) The participants, staff and management.

(b) The Office of the President, whose interest is to ensure maximum possible support for the economic, social and political priorities of the administration.

(c) The Department of Finance and the BSP, whose interest lies in efficient management of the public debt.

(d) Macroeconomic objectives such as the development of the capital market consistent with the fiduciary responsibilities of the social security institutions.

2.35 The SSS and the GSIS are governed by their respective Charters, which can be amended by Congress. Oversight of the SSS Commission and GSIS Board of Trustees is exercised by the Executive Secretary to the President but, in practice, the two institutions have enjoyed a great deal of operational autonomy since the regime of President Aquino. The Commission on Audit (COA) has auditing jurisdiction over the two institutions.

2.36 While the present regulatory arrangements have worked reasonably well, there are specific areas of improvement which merit attention and action, particularly the following:

- The need for professional appointments to the various Commissions and the Board of Trustees, together with greater accountability and transparency, and coupled with due safeguards against the politicization of the SSS and the GSIS or any attempts to impair their authority and independence. Individual members of Congress may be tempted to pressure the SSS and the GSIS in accordance with the economic priorities of their constituents and to suit their political objectives.

- Through public dissemination of the annual reports of the COA, of which the annual reports of the SSS and the GSIS are an integral part. In line with SSS practice, the GSIS annual report, which is forwarded to the Executive Secretary to the President and members of Congress, should also be made publicly available.

- There should be periodic independent actuarial evaluations of both the SSS and the GSIS, encompassing both financial and economic aspects, and such evaluations should be published. This task should be assigned to an independent office along the lines of the Public Actuary in Australia, but with the provision for contracting out actuarial services.

- There is a need to strengthen the regulations concerning employer registration for the SSS and for the reporting of earnings of the self-employed by making the employer's consent on SS Form R-1 obligatory, whereupon he would be assigned an identification number.[13]

- The use of the social security identification number for various purposes such as paying taxes, opening a bank account, and applying for passports and labor permits, would greatly increase compliance and heighten public awareness of the social security system.

Private Pension Systems

2.37 In most countries, the responsibility for regulating the private pension sector is typically divided between the labor organizations and the pension sector. Although the focus of regulation and supervision is on several aspects of pension fund administration and management, it is principally on the appropriations and legitimacy of financing, contributions, administration expenses and the management of the fund's investment portfolio. In the Philippines, there is no unified formal regulatory framework. The BIR is virtually the only institution involved in regulating the sector, but its focus is confined to tax related aspects and. even in that sphere, its role and performance fall short of comparable international standards. There is no single agency that monitors possible conflicts of interest in the management and administration of pension funds and oversees the system as a whole.

2.38 The major areas of weakness in the BIR's oversight of pension systems include:

- Inadequate enforcement of compliance with tax code; it only verifies deduction claims.

- A lack of actuarial expertise to evaluate pension funds prior to approval and when they are periodically updated, for which there is no legal requirement.

- A lack of guidelines to ensure adequate security for plan participants and for the investment of funds.

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[13] D. Zoellner, *Report of a Preliminary Advisory Mission to the Philippines*, Geneva, ILO Social Security Department, 1988.

2.39 In the absence of a formal regulatory system, the actuarial firms, the fund managers and, to some extent, the auditing and accounting firms have created a self-policing mechanism, which is also buttressed by employee representatives on a fund's board of trustees. While these efforts are welcome and laudable, they are no substitute for an effective formal system for collecting information, receiving complaints, and generally supervising the prudential aspects, which can serve to protect participants in the event of mismanagement or loss.

2.40 The regulatory framework of private pensions could be developed and strengthened by suitably adapting the framework prevalent in the U.S. and other developed countries as follows:

- Creating a central bureau to act as a registering, regulatory and statistical agency.

- Enacting a comprehensive law to regulate private pension funds; ensuring payment of pensions to employees in the event of employer bankruptcies along the lines of the U.S. Employee Retirement Security Act (1974) (ERISA), and providing prudential investment guidelines, reporting and disclosure provisions.

- Creating a Pension Benefit Guarantee Corporation to insure retirement benefits.

2.41 **Life Insurance Industry**. The growth and development of life insurance in the Philippines has outstripped the capacity of its governing regulations embodied in the Insurance Code (1978) and administered by the Office of the Insurance Commission, which falls under the DOF. While the regulatory focus has been quite rightly on prudential aspects, this has meant control of specific processes and transactions with a rather conservative and narrow application of the regulations rather than the direction and health of the industry as a whole. Private insurers also feel that the playing field is not equal relative to the treatment accorded the GSIS.

2.42 The Insurance Code should be revised to provide for:

(a) Clear guidelines for prudential as well as a developmental role for the Insurance Commission.

(b) Flexibility in regulatory controls to keep pace with changing market conditions, although their emphasis should be on prudential surveillance rather than on direct control of activity.

2.43 The Commission should continue its process of industry consultation to address all current issues, including the level of commission charges to agents, which are reportedly higher than comparable international levels. This is, however, a somewhat complex and thorny issue since it raises the question of whether any attempt to guide and regulate market-determined commission charges would be consistent with the process and philosophy of financial deregulation and liberalization. In any event, the Commission should ensure a level playing field between private life insurance and the GSIS pending divestiture of the latter's life insurance business.

F. Conclusions and Recommendations

2.44 The CSS is the most sizeable source of long-term resources (about ₱ 256 billion in 1993), equal to almost one-seventh of the total assets of the financial system and more than one-sixth of GDP. The sector has grown rapidly, averaging 18 percent annually during 1980 to 1993. Growth in the SSS (about 20 percent p.a.) and the GSIS (about 14 percent p.a.) has also been accompanied by the steady growth of both private life insurance and private pensions. Although the CSS has generated substantial flows of savings (about 7.8 percent of gross domestic savings or about 1.4 percent of GDP in 1993), the social security institutions have not yet realized their savings potential due to low compliance (SSS), large receivables from the national government (GSIS), relatively low risk adjusted returns on its assets caused by the investment policy constraints, and poor asset allocation decisions. Although the liabilities of the CSS are predominantly long-term, their assets are largely short-term, reflecting high average Treasury bill rates (15 to 25 percent during the nineties). Their role in the government securities market, especially the secondary market, has been constrained due to the withholding tax of 20 percent, despite their tax-exempt status.

2.45 The enhancement of the role and efficacy of the CSS in capital market development would require an integrated reform and policy package designed along the following lines:

(a) Changing the asset management strategy which would entail an increase in allocation to equity, a reduction in below market member loans (salary, policy and housing), and coupled with divestiture of the life insurance business of the GSIS.

(b) Creating a trading window for long-term government securities in the SSS and the GSIS.

(c) Fully or partially privatizing asset management, with provision for investing abroad, other things being equal, if it is remunerative and prudent.

(d) Exempting the SSS and the GSIS from the withholding tax with appropriate implementation.

(e) Abolishing the five percent premium taxes on the life insurance industry and allowing tax deductions for contributions to private pensions, subject to an overall ceiling.

2.46 While present regulatory arrangements have worked reasonably well, the following considerations should also be considered to improve the regulatory framework:

(a) The need for appointing qualified professionals to the various commissions and Boards of Trustees along with greater transparency and accountability.

(b) Periodic independent actuarial evaluations.

(c) Strengthening the regulations concerning employer registration for the SSS.

(d) Use of the Social Security identification number for various other purposes (e.g., taxes, bank accounts, issue of labor permits).

(e) Creation of a Central Bureau to act as a registration, regulatory, and statistical agency to regulate private pensions, enactment of a comprehensive law to regulate private pensions on the lines of the U.S. Employee Retirement Security Act (1974); creation of a Pension Benefit Guarantee Corporation to insure retirement benefits.

(f) The Insurance Code should be revised to provide a level playing field, clear prudential and developmental guidelines for the Insurance Commission, and flexible regulatory controls focused more on prudential surveillance than on direct control of activity.

(g) Feasibility of reducing high commission charges to insurance agents.

CHAPTER 3

ORGANIZATION AND ADMINISTRATION

3.1 This chapter discusses the organization and administration of the SSS and the GSIS. It begins with an overview and analysis of the current structure of the social security sector. This is followed by an examination of the different aspects of the SSS and the GSIS — the scope and nature of these programs, their objectives, organization, interfaces, operations, data gathering and management, legislative and regulatory framework — and, finally, conclusions and recommendations.

A. Structure of the Social Security Sector in the Philippines

3.2 Chart 3.1 presents the current structure of the social security sector. The sector is essentially two-tiered; the first tier provides mandatory basic universal coverage while the second tier provides voluntary supplementary coverage. The first tier consists of the SSS, the GSIS, and a special retirement benefit scheme for government employees which is administered by the DBM[14] (herein referred to as the DBM). The second tier comprises the occupational pension plans and the Pag-ibig.

3.3 There are several anomalies in the current structure which make a strong case for restructuring or rationalization. First, there is an artificial dichotomy between public and private sector employees in the first tier. The SSS administers programs for persons working in the private sector, while the GSIS administers programs for persons employed by all levels of government (except the armed forces and the judiciary) and those in government corporations. Armed forces personnel (including the police) are covered by AFP, which is administered separately. Judges and constitutionally designated positions are also covered by a separate retirement system. These separate systems are small and tailored to unique sections of government employees and, therefore, will not be further analyzed in this study.

3.4 Second, there is duplicate coverage of some government employees. The DBM provides lump sum gratuity benefits to public sector employees hired before May 1977. Since these employees are also covered by the GSIS, they may opt for either benefit at retirement.

3.5 Third, there are a multitude of public bodies providing similar first tier benefits and, in some cases, not fully capable of performing this function. For instance, as has been noted in Chapter 2, the AFP does not yet provide any benefits, although it collects mandatory contributions from members.

3.6 Fourth, there is an asymmetry in the arrangements governing the SSS and the GSIS, the two primary institutions in the sector. The social security programs of the SSS and the GSIS are governed by the Social Security Commission (SSC) and the Board of Trustees, respectively, while the Employee Compensation (EC) and the Medical Care (MC) programs of each are governed by the unified Employee Compensation Commission (ECC) and the Medical Care Commission (MCC).

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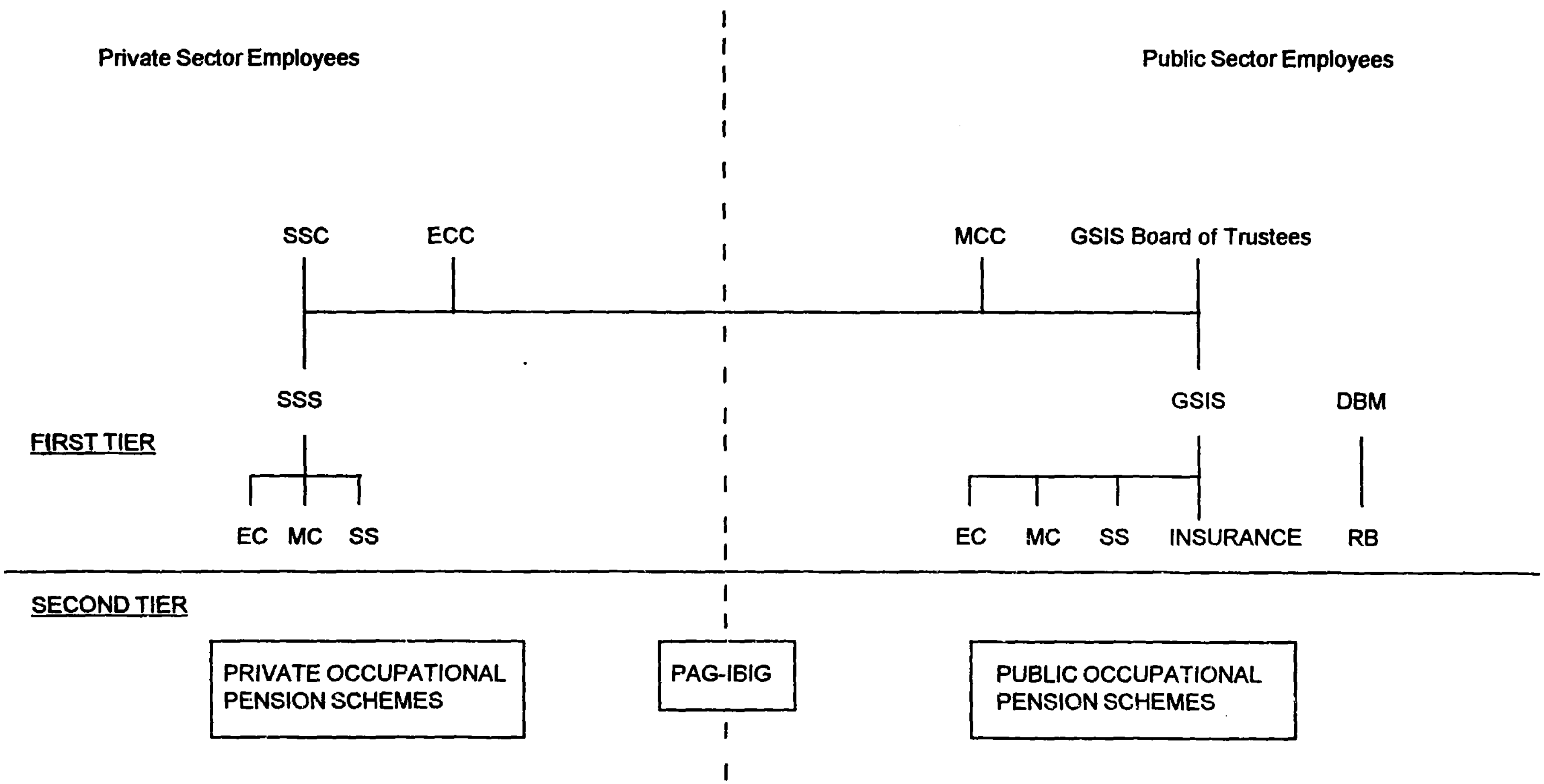
[14] For government employees with service prior to May 1977, only.

CHART 3.1: PHILIPPINES - CURRENT STRUCTURE OF THE SOCIAL SECURITY SECTOR



SSS = Social Security Commission
ECC = Employee Compensation Commission
MCC = Medical Care Commission
DBM = Department of Budget & Management
PAG-IBIG = Home Development Mutual Fund

SS = Social Security Program
EC = Employee Compensation Program
MC = Medical Care Program
RB = Retirement Benefits

3.7 Fifth, the GSIS also provides insurance, both life and non-life. While there may have been a justified rationale for GSIS participation in the insurance business in the past due to the lack of a viable private insurance industry, this is no longer the case. The captive nature of its market is a source of distortion in the market, particularly in view of its tax-exempt status, as has been discussed in Chapter 2.

3.8 Sixth, the structure is characterized by a lack of portability between institutions, particularly the SSS and the GSIS. Although a portability law was enacted in the spring of 1994, this is in reality only a totalization scheme. Members moving from one system to another cannot carry their contributions with them and they must build their contributions in the system that they join over time in order to be eligible for benefits through that system. Eligibility for benefits under each system is governed solely by contributions made to that system. Moreover, the benefit left behind after a member leaves that system is based on covered salary levels at the time of retirement (see Chapter 4 for a discussion of the behavioral and actuarial problems of this aspect).

3.9 A final anomaly related to the structure involves the current ability for disabled persons to "double dip" and receive benefits under both the employee compensation program and the social security programs.

B. Scope and Nature of Programs of SSS and GSIS

3.10 Among the developing countries of Asia, the Philippines has the oldest social security program, and is among those with the widest coverage and range of products.[15] The current programs provide for old age, disability, survivor, pension, employee compensation, maternity, sickness, disability, and funeral payments. However, there is no program of family allowances or for unemployment compensation, although legislation to create an unemployment benefit scheme has been under discussion.

3.11 All the social security programs in the Philippines are of the defined benefit type, i.e., benefits are provided at a stated level, based on pay and contributory service, and contribution levels are set to provide adequate income to provide for these benefits and to cover administrative expenses. The Government has assumed responsibility for maintaining the solvency of these funds and for guaranteeing the benefit levels prescribed. Because of the inflationary climate, there is a strong tendency to raise benefit levels periodically in order to offset, at least partly, any diminution in the real value of the benefits. Such increases in benefits are almost routine. These increases are made by Congress and signed into law by the President. These annual adjustments in benefits, along with the changes in contribution rates and the policy for investment of the reserve funds, have kept the social security programs continually within the public and political policy arena. A discussion of the effects of these changes is presented in Chapter 5.

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[15] The earliest social security arrangements among all the developing countries were in Latin America and Caribbean. By 1945, 11 of the 21 countries in this group had social security programs covering old age, disability, or death, but none of the 19 Asian and 54 African and Middle Eastern countries had such programs at the time. By 1955, all 21 Latin America and Caribbean countries had the above coverage while only 10 Asian and 41 African and Middle Eastern countries had them. Moreover, even by 1985, only 5 out of 14 countries in Asia (including the Philippines) provided sickness or maternity coverage. (D.J. Pfeffert, 1988, *Social Security Finance in the Developing Countries*, Working Paper Series No. 36, The World Bank).

Box 3.1: What is Social Security?

Social security, in general, connotes a set of programs, designed to protect people from a loss of income, or change in family status, that causes an increase in expenditure for daily needs. These programs usually provide protection for contingencies like health care, maternity, birth of children, sickness, accident, disability, old age, death, and unemployment. Cash benefits are paid to offset these occurrences and full or partial payment is made for medical treatment and/or medicines.

These social security benefits can be grouped into three categories: social insurance, allowances, and welfare, which are distinguishable by their different eligibility criteria. Social insurance entitlement is based on a record of work and of payments made by either the employer or employee, or both. Allowance payments are usually based on some demographic entitlement factor such as the age of minor children, or number of children in the care of a caretaker. Welfare is determined by the 'need' for the benefit, based on income or other resources. Payments under any of these categories can either be long-term or short-term. Long-term benefits may last for life or for the duration of a disability while short-term benefits could be anything from a one-time funeral benefit to a defined period for maternity benefits.

While most Western European social security systems tend to offer the complete menu of social security programs, including unemployment compensation, they belong to the more mature systems and are a legacy of Kaiser Wilhelm in Germany and William Beveridge in the United Kingdom. Around the world, however, social security programs, if any, differ considerably in the scope of their provisions.

3.12 While the programs are far from identical, it is apparent that the social security programs of the United States have heavily influenced the creation of and the modifications to the social security programs in the Philippines. The GSIS was, in fact, created in 1936 when the Philippines was under U.S. rule. This was only a few years after the U.S. itself had instituted its Social Security Administration during the Roosevelt Administration.

C. History of SSS and GSIS

SSS

3.13 The SSS was created in 1954 to implement the provisions of the Social Security Act of 1954, Republic Act 1161. It actually began operating in September of 1957. The original Act provided for (i) old age pensions; (ii) lump sum payments in case of sickness, death, and disability; and (iii) unemployment benefits. The unemployment benefits were deleted before implementation of the program in 1957. Coverage of this initial program was limited to employees working in companies with 50 or more employees and several categories of employment were excluded. In 1969, the SSS was charged with administering medical care benefits for non-government employees under the Philippine Medical Care Act and these provisions were later extended to include retirees and dependents as well as workers. The Employee Compensation Act of 1972 designated the SSS to administer the new program for work-related illnesses and for injuries to non-government employees. The initial goal of the original social security legislation was for eventual universal coverage of all workers. Coverage in the private sector gradually expanded to all employees and was extended to the self-employed in 1980. Coverage was extended to farmers and fisherman in 1992 and to domestic workers in 1993. Because of minimum income requirements for coverage and a poor compliance program, it is likely that only about half of non-government workers are paying into the system, although all workers are eligible for benefits if they meet specified income levels.

3.14 Currently, the SSS is responsible for the administration of the full range of social security benefits available to non-government employees in the Philippines and is further charged with handling a variety of employee loans — a practice unique to the Philippines. These loans are similar to loans made against life insurance policies in other countries since they make loans at an interest rate lower than the market rate. Their scope is varied and loans may be made for educational, calamity, separation or unemployment, housing, stock purchase, or for any other general purposes.

3.15 Except for the loan for employees' aspects, the objectives of the SSS resemble those of social security institutions in many other countries, and are provided in the Statement of Mission: "To promote meaningful protection to the members and their families against contingencies resulting in loss of income or financial burden and to contribute to the socio-economic development of the country through a viable social insurance program."

GSIS

3.16 The GSIS was created in 1936 by Commonwealth Act No. 186 to look after the needs of the nation's public servants when they could no longer look after themselves or their families. This system replaced what had been known as the Constabulary, Health and Teachers Pension Fund. This was basically an insurance program and that remained the function of the GSIS until 1946, when the GSIS began granting loans to employees based on their salary levels. In 1951, Congress passed Republic Act 660, which provided compulsory retirement benefits to government employees. In that same year, Congress also enacted Republic Act No. 656, which expanded GSIS coverage to protect government properties. In 1960, the responsibilities of GSIS were expanded under Republic Act No. 1616 into the retirement, insurance, housing and loan areas. The Philippine Medical Care Act of 1969 designated the GSIS to administer the medical care program for government employees. In 1975, Presidential Decree 626 created the Employee Compensation Commission and the GSIS was charged with administering the benefits of this program for all government employees. This program provides for income and medical benefits for employees in case of work-related accidents. In 1977, Presidential Decree 1146 expanded and increased the life and retirement insurance programs available to government employees and introduced survivorship and sickness income benefits. The General Appropriations Act of 1989 instituted the concept of government self-insurance with the GSIS responsible for administering the funds allocated annually for this purpose.

3.17 Consequently, the GSIS is currently responsible for the full range of social security benefits available to government employees in the Philippines, as well as additional programs of life and non-life insurance for members and the self-insurance program for government properties. A variety of loan programs that have come to be seen as salary supplements for government employees are also administered by the GSIS. Because of the chronic need for housing, the GSIS has also ventured into some arrangements with private developers to construct affordable housing for members. The GSIS has also been given the responsibility for administering life insurance, employee compensation, medical care, and special pension benefits for judicial and constitutional employees, along with the life insurance, medical care, and employee compensation program for the military.

3.18 With such a variety of different programs to administer, the objectives of the GSIS are perhaps best described in a statement made to the mission by the GSIS President when he said that he saw their function as "maximizing" the benefits available to their membership.

D. Organization

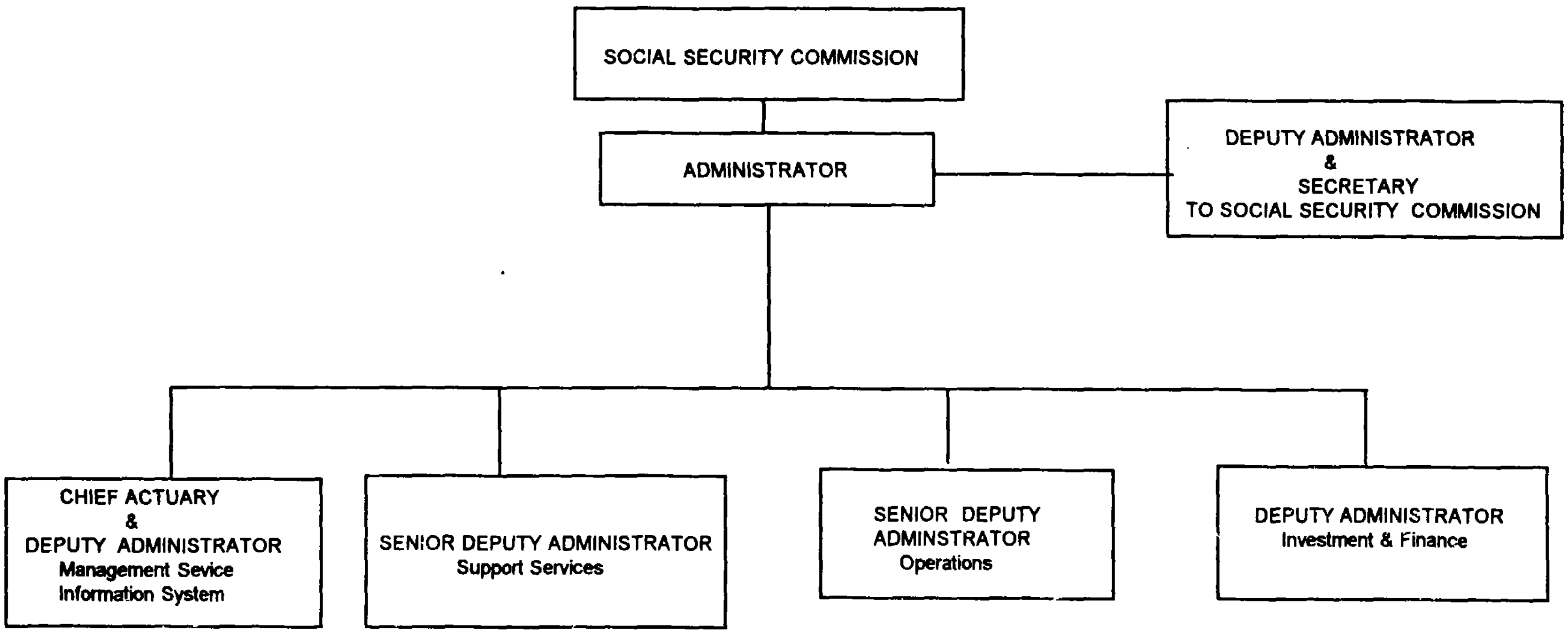
SSS

3.19 **Social Security Commission**. The policy making authority of the SSS is vested in a Social Security Commission composed of eight members. The members of the Commission include the Secretary of Labor and Employment, the Administrator of the SSS, and six other members appointed by the President of the Philippines. These six individuals are to include two each from labor, management, and the general public. The Chairman of the Commission is appointed by the President from among the members. The Commission has full authority to direct the implementation of programs under the Social Security Act. The Commission also directs the preparation of an annual report of the social security programs and an actuarial review every five years. The Commission has the authority to modify the organizational structure of the SSS to enable it to carry out its mission. It also acts as a quasi-judicial body in deciding disputes arising under the social security laws. Commission decisions may be appealed to the Court of Appeals or the Supreme Court. Direct staff support for the Commission is provided by a staff of 60 to 80 persons headed by a Secretary who is also a Deputy Administrator of the SSS. This staff consists of a Secretariat and a legal support unit.

3.20 **Administration**. The head of the SSS is an Administrator appointed by the President of the Philippines. Reporting directly to the Administrator are two Senior Deputy Administrators (SDAs), one for Operations and one for Support Services. A Deputy Administrator (DA) for Management Services and Information Systems (who is also the Chief Actuary for SSS) and a Deputy Administrator for Investment and Finance also report directly to the Administrator. An Assistant Administrator for Internal Audit also has direct reporting responsibility. A simplified organizational chart for the SSS is shown in Chart 3.2. (A complete organizational chart for the SSS is found in Annex Chart 3.1.)

3.21 **Member Services**. The field offices of the SSS employ about one-half of the institution's 3,600 total employees, with the remainder at the headquarters in Quezon City. The field structure is presently being devolved from 10 to 40 full service Branch Offices, with over 100 smaller Representative Offices in less populous areas. The branch offices are computerized on local area networks with 10 of the branches serving as hub locations. Each of the front-line employees who interface directly with the public in the Branches is equipped with a terminal to directly access information in member files and to perform calculations and computations. These Branch Offices are able to perform all member services without recourse to the central office. The complete implementation of the 40 full service branches is expected to be finished by 1995.

CHART 3.2: PHILIPPINES - SSS - SUMMARY ORGANIZATIONAL CHART



GSIS

3.22 **Board of Trustees**. The policy making authority of the GSIS is vested in a Board of Trustees appointed by the President of the Philippines. This Board is composed of nine members and is supported by an Executive Secretariat of 25 to 30 persons. In addition to policy making, the Board serves as a semi-judicial body resolving disputed claims up to the level where they can be appealed to the Court of Appeals or the Supreme Court. The President of the GSIS is, by statute, a member of the Board along with three persons who represent three leading organizations or associations of government employees. The members of the Board elect their own Chairman and Vice Chairman. The Board has broad authority, including the ability to approve changes in the organizational structure of the GSIS.

3.23 **Administration**. The operation of the GSIS is directed by a President and General Manager who is appointed by the President of the Philippines. Staff support to the President is provided by four Vice Presidential groups organized along general functional lines. There are three front-line operational units that interface directly with GSIS members. These units are headed by Senior Vice Presidents for Social Insurance, Housing Business Acquired Assets and Administration, and Branches. These three Senior Vice Presidents report through the Executive Vice President. There are also four Senior Vice Presidents who direct support staff units in the following areas: Corporate Planning and Information Systems, Finance and Investments, Administration, and General Insurance. These four Senior Vice Presidents report directly to the President. A simplified organizational chart of the GSIS is shown in Chart 3.3. (A complete organizational chart for the GSIS is shown in Annex Chart C.2.)

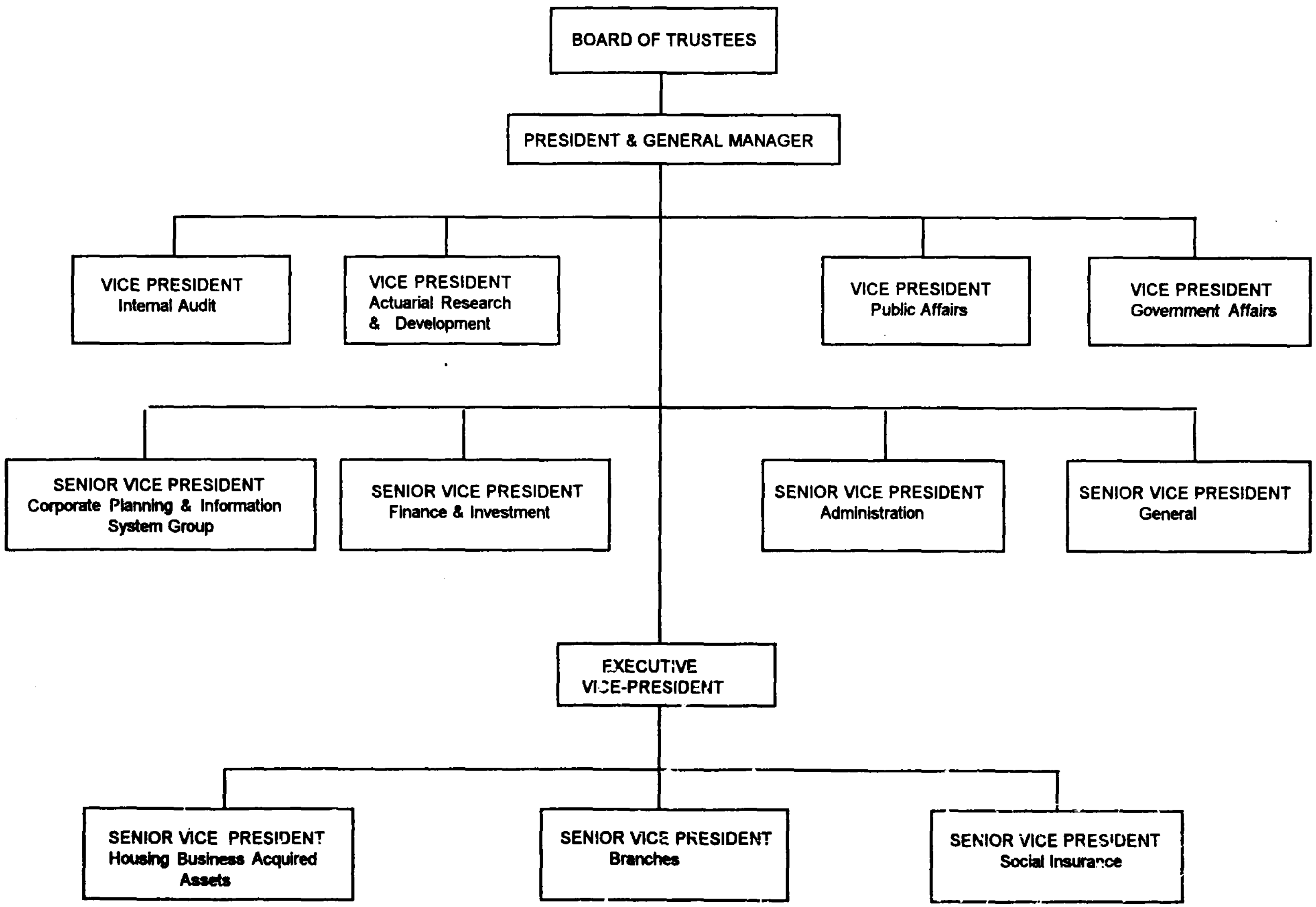
3.24 **Member Services**. GSIS members are served by 27 branch offices under the direction of the Senior Vice President, Branches. These offices employ about one-half of the approximately 3,800 employees of the GSIS. The branch offices have a basic computer system with a few terminals. Because the terminals are sparse and old, they are confined to "backroom" operations, while the "front-line" staff who deal directly with the public must rely on paper files or written requests to answer questions or process claims. Although some actions can be processed to completion in the branch offices, Medicare claims are still processed centrally at the GSIS headquarters.

E. Interface

Interface with Other Governmental Bodies

3.25 Both the SSS and the GSIS have a multitude of day-to-day responsibilities which require interaction with other governmental entities in the Philippines. Both organizations must liaise with Congress to keep abreast of related legislative or oversight questions as well as to keep the legislators informed of current activities. The legal staffs of both organizations maintain regular communications with various judicial bodies in conducting appellate and litigation activities. The Commission on Audit of the Philippines has staff located in various facilities of both organizations in order to carry out its mandated audit function. Also, since both organizations report to the President of the Philippines, there is regular communication with the President's management staff about ongoing operations and activities.

CHART 3.3: PHILIPPINES - GSIS - SUMMARY ORGANIZATIONAL CHART



3.26 In addition to interfaces with these organizations, the SSS and the GSIS have a statutory responsibility to the Employee Compensation Commission and the Philippine Medical Care Commission. These two Commissions have overall responsibility for the Employee Compensation and Medicare programs similar to the Social Security Commission and the Board of Trustees of the GSIS. Since these programs are fully administered by the SSS and the GSIS, the relationship with these two Commissions is direct and contact frequent. Other statutory provisions require both organizations to have a close relationship with the National Home Mortgage Finance Corporation (NHMFC). Due to these requirements, the GSIS and SSS supply about 90 percent of the funds for NHMFC programs. Though the SSS and the GSIS are required to supply funding for these housing programs, they have no effective control over the funds once they are transferred to NHMFC. A further discussion of this relationship can be found in Chapter 5.

3.27 The SSS maintains a close working relationship with the Department of Labor and Employment (DOLE). Since DOLE has teams of inspectors located throughout the country who are responsible for ensuring employer compliance with safety, minimum wage, and child labor regulations, they are able to exchange information with the inspectorate staff of the SSS branch offices. In an effort to improve compliance, the SSS and the DOLE have signed a memorandum of cooperation in this area. This is a positive relationship which should be fully developed and utilized. Likewise, the Bureau of Internal Revenue (BIR) has substantial information about wage levels and employer payrolls. The SSS maintains a data exchange program with the BIR to take advantage of this information in compliance administration.

3.28 The GSIS is required to maintain a close working relationship with the DBM in fulfilling its duties for administering funds for the Government's self-insurance program. The DBM acts as payer of the employer share of contributions to GSIS programs. In addition, there is a need to coordinate between GSIS pensions and previous government pension systems which remain in effect as an option for some persons employed in government service in 1977 or earlier. Since the GSIS administers portions of some benefits for the military, judicial, and constitutionally created positions, it must maintain some degree of coordination with administrative staff of the judiciary and the AFP.

F. Compliance

3.29 Compliance refers to the accuracy and timeliness of contributions made to the system in accordance with statutory mandates. Contributions can come completely from employers when they withhold an employee's share of contributions through payroll deductions or when there is no employee contribution. In some cases, employees or the self-employed may contribute directly. In the Philippines, the employer is responsible for deducting the employee contribution from payroll and is therefore liable for submitting both the employer and employee contributions to the proper institution. The issue of employer compliance with reporting and contribution requirements is a concern in many social security systems, especially when coverage of groups of workers is expanding. This is a matter of particular concern because of the low rate of compliance experienced in the Philippines. While it is not possible to arrive at an exact figure, estimates of employer compliance with SSS contribution requirements range from about 35 to 55 percent. This is a very low rate, and works to erode confidence in the entire social security system. It further rewards non-compliant companies by giving them a competitive advantages over companies making regular contributions, and reduces benefits for many — usually those at the lowest end of the earnings scale. These effects combine to generate an overall lack of faith in the viability of the social security system, and contribute to its financial problems. While the compliance rate is low, this is not unusual for a developing country striving to broaden social security coverage. Despite similar experiences in other developing countries, this is a problem which warrants serious attention.

3.30 The SSS has recognized the seriousness of this problem and has devised an ambitious program to increase compliance to 80 percent over the next three years. This program calls for an increase in the number of SSS inspectors and greater cooperation with DOLE inspectors, as well as the more aggressive prosecution of employers in the courts. It is recommended that SSS accelerate the implementation of these measures.

3.31 There are currently over 500,000 employers in the Philippines and the number is growing. At current staffing levels, each SSS inspector is responsible for over 1,500 employers. Redeployment of staff and close cooperation with labor inspectors who are visiting many of these same employers will alert them to when compliance is a priority. The litigation strategy employed by the SSS in the past has been to prosecute employers only under the *civil* code for failure to comply with reporting and contribution requirements of the SSS. Under their new campaign, SSS lawyers are attempting not only to prosecute more cases but also to invoke *criminal* penalties for lack of compliance.

3.32 In addition to these efforts, the mission would suggest five items for consideration in this critical area. First, a single person should be designated at SSS headquarters to coordinate compliance strategies. This should be a position with high visibility and with the authority to mobilize all necessary resources. This person could also serve as a communications point for disseminating information about particular successes being achieved by the different branch offices in their compliance efforts, thereby spreading word of "best practices".

3.33 Second, awareness of compliance lapses should be increased through data exchanges with other entities. While it is important to maintain the public's confidence in the security of data held by the SSS, there may be some data available through other government sources such as the Bureau of Trade (which licenses businesses), that could help the inspectorate staff in prioritizing their visits. In this same vein, the SSS should maintain communication with the BIR to determine if its currently planned tax automation could be helpful in SSS compliance activities. At a minimum, some efforts at coordinating data definitions or adopting a single number for each person's tax and payroll records should be pursued. This number could also be used for passport and labor records, barring the opposition to accumulating such comprehensive data in one location. While the SSS cannot accomplish these activities on its own, it should be a catalyst for prompting the appropriate agencies to take action.

3.34 Another area that bears further analysis is the benefit formula, which does not provide adequate incentives for employees to ensure that contributions are made for each month of work. From our review, it would appear that once contributions are made for six months, an employee is given credit for a full year. This anomaly is discussed in the actuarial analysis (Chapter 5) and some financial implications are highlighted in Chapter 4. A revision of this anomaly in the benefit formula should be addressed in the very near future.

3.35 Fourth, an aggressive public relations campaign should be undertaken to inform workers of the benefits that they may be losing because of the lack of compliance. At the same time, the SSS must somehow ensure that any employee reporting a lack of compliance on the part of the employer does not endanger his employment status. While the public relations campaigns to enroll newly covered groups have been very professional and quite successful (see Annex Chart C.3 for a sample of the poster used to inform household workers of their coverage), it may be necessary to use specially targeted efforts such as radio advertisements in a particular time slot and language to reach certain groups. This type of public relations effort could be especially useful if and when Medicare coverage is expanded. Since it appears that there is almost a universal desire on the part of every citizen to receive medical care coverage, some special efforts should be designed to capitalize on the opportunity to communicate with persons newly enrolling in Medicare.

3.36 Finally, and most importantly, some statutory relief should be employed to assist SSS in ensuring compliance. In countries where compliance is most successful, there is some statutory authority which heavily penalizes employers for non-compliance, usually through the tax agency. Since no such help is available in the Philippines, another approach is recommended. All employers/businesses are required to be registered/licensed by the municipality in which they do business. A statutory requirement should be implemented which causes the municipality to seek SSS approval prior to issuing or renewing a business license. This would cause businesses to take their SSS reporting seriously Safeguards should be included in the law, so that SSS would be required to respond to municipality requests within 10 to 15 workdays so as not to impede the business licensing process. With the current state of computerization in SSS, some automated process could be devised to ensure a rapid review process.

3.37 Compliance is not a problem for the GSIS since the Government as employer withholds employee contributions from payroll deductions and can submit full contributions to GSIS. While there are no compliance problems, there is a dispute about how to deal with payment of contributions by DBM for those employees who opt to retire under R.A. 1616. See Chapter 5 for a full discussion of this issue.

G. Data Gathering and Management Information Systems

SSS

3.38 The SSS maintains information and processes many of its operations with the help of an IBM ES 9000 mainframe computer. Each participant is given a social security number which serves as the basis for identification. Records are collected from employers and fed into the data storage system. Two databases are maintained:

- **Registration Database**, which stores information that usually does not change (e.g., name, social security number, address, sex, date of birth, names of beneficiaries, employer name, address, identity number and business code).

- **Members' Contribution Database**, which stores such information as dates of employment, credited years of service, monthly contributions (number of months contributed and total amounts), monthly salary credits over the six-year period prior to the last contribution, and total monthly salary credits. The SSS keeps information on monthly salary credits but not on actual salaries, since both contributions and benefits are based on monthly salary credits. Monthly salary credits are computed by reference to salary bands and are subject to a ceiling (currently ₱ 7,000 per month).

3.39 In addition, personal computers and super-microcomputers are used for routine applications, short-term benefits and member loan processing. There is also a move towards increased decentralization of services. The hub branches maintain their own databases of which the Head Office keeps identical copies.

3.40 Aside from the problem of compliance discussed earlier, there are two other major data problems relating to the "non-contributing" population and the "unpostable" population. The non-contributing population consists of those active members who have failed to contribute during the last 12 months but have contributed for at least one month at some time in the past. Naturally, the records for this population cannot be kept current with respect to salary credits and other information. The unpostable population refers to those active members with information that is defective or missing so that these members cannot be transferred to the main databases. A major undertaking would be needed to correct these records. As of year-end 1993, there were some 3.9 million currently contributing members (i.e., those who have made at least one month's contribution during 1993) and an additional 5.7 million non-contributing members (Table 3.1). Based on some very broad averaging, the SSS estimates that these headcounts would rise to 5.1 million and 9.5 million, respectively, if they included the unpostable population. These estimates are likely to be slightly overstated due to the presence of participants with multiple social security numbers. The SSS has noted this and is taking corrective measures.

Table 3.1: SSS - Breakdown of Active Participant Information

	Contributing Population (millions)	Non-Contributing Population (millions)	Total
Postable	3.9	5.7	9.6
Unpostable	1.2	3.8	5.0
Total	5.1	9.5	14.6

3.41 The GSIS operates an IBM ES 9000 mainframe computer at Headquarters to process and keep records of the insurance and member loan programs. The other programs are handled through personal computers by the respective departments (Social Insurance, Medicare, Employees' Compensation, Optional Life, Property). Records for these programs are kept on diskettes. The branch offices do some processing through personal computers. The administration of the various programs is not yet fully computerized and there is still some reliance on manual recordkeeping.

3.42 The extensive membership information stored in the mainframe computer for the insurance programs forms the main database for the active employees that is used for various purposes, including accounting, compilation of statistics, and the annual actuarial status investigations (of all of the benefits under Social Insurance) carried out internally. As life insurance is a compulsory part of the benefits provided, this database should cover all of the active employees.

3.43 The data received for the independent actuarial assessment suggest that the individual employee records are not updated regularly for salary changes. Updating is only carried out whenever there are changes made to the life insurance policy. In principle, a salary increase at any time should trigger a change to the policy, since there is a change in both the face amount of insurance as well as the calculated policy reserve value. In practice, however, the records are updated only when a claim is made or when a policy loan is taken out, or when a change in the term or type of policy takes place. An example of the latter occurs when a government employee who entered service at age 30 or below claims the proceeds on his compulsory life policy at age 45. At such time, the employee usually submits his salary history so that the GSIS can compute the actual amount of insurance to be paid. His salary at that time would then become the basis for the initial amount of insurance on his renewed policy. Actual premiums paid should also reflect current salary levels, as they are collected automatically through payroll deductions.

3.44 The lack of up-to-date records in the main employee database can pose serious problems. For instance, the data provided for the independent actuarial assessment, plus other information collected by the GSIS actuarial staff, indicate that the salaries in the main database are, on average, only about 50 percent of what they should be. Unless adjustments are made to account for this, the actuarial liabilities calculated for pay-related benefits, including the actuarial reserves for life insurance, will be very significantly understated. Furthermore, any private insurance company that has an interest in bidding for some or all of the existing insurance policies will want up-to-date information in order to price those policies it would assume. Until an automatic updating procedure is in operation, the process of bringing each record up-to-date is likely to take considerable time and effort.

3.45 The emphasis and reliance placed by the GSIS on the insurance database has meant that certain other areas of recordkeeping have not been given sufficient attention. No records are kept, for example, of members who have left the public sector with deferred vested retirement benefits under GSIS programs. The actuarial liabilities under the Social Insurance program are understated on account of this. This is likely to develop into an area of increased concern with the eventual implementation of portability provisions between the public and private sectors. Steps, therefore, need to be taken to address this issue.

H. Legislative and Regulatory Framework

3.46 The social security legislation in the Philippines is comprised of the following four major enactments:

(a) the Social Security Law — Republic Act No. 1161, as amended.

(b) the Revised Government Service Insurance Act of 1977 — Presidential Decree No. 1146.

(c) the Philippine Medical Care Act of 1969 — Republic Act No. 6111.

(d) Titles II and III, Book 4 of the Labor Code of the Philippines — Presidential Decree No. 442, as amended.

3.47 The following paragraphs summarize these key legislative enactments.

(a) **SSS**. The SSS Law, which entered into force in 1954, seeks to "establish, develop, promote and perfect a sound and viable tax-exempt social security service suitable to the needs of the people throughout the Philippines which shall provide to covered employees and their families protection against hazards of disability, sickness, old age and death, with a view to promoting their well-being in the spirit of social justice". To carry out this objective, a Social Security System was created which is directed and controlled by a Social Security Commission composed of the Secretary of Labor and Employment, the SSS Administrator and seven appointed members, three of whom represent the labor group, three representing the management group and one representing the general public—all appointed by the President. The general conduct of the operations and management of the SSS is vested in an Administrator who serves as the chief executive officer and is also appointed by the President of the Philippines. The SSS Commission has reasonably wide powers and duties, but the adoption, amendment and rescission of rules and regulations is subject to the approval of the President of the Philippines. The Law contains a mechanism for the settlement of disputes and provides for actuarial and other such reports on a regular basis. Coverage in the SSS is compulsory for all employees not over 60 years of age and their employers and upon certain self-employed persons. Benefits include monthly and dependent's pensions, and benefits for retirement, death, permanent disability, funeral, sickness, and maternity leave. The Government provides funds necessary to meet the estimated expenses of the system and accepts general responsibility for the solvency of the system. The investment criteria for reserves not required to meet ongoing benefit, administrative and operational expenses are prescribed in some detail. Funds may be invested within prescribed limits in interest bearing bonds or securities of the Government of the Philippines, loans or interest bearing advances to the Government, interest bearing deposits or securities in any domestic bank doing business in the Philippines, direct housing loans to covered employees, short- and medium-term loans to covered employees such as salary, educational, calamity and emergency loans, and other income earning projects secured by first mortgage, bonds, debentures and preferred and common stocks.

(b) **GSIS**. The provision of social security and insurance benefits to Government employees dates from 1939. The current law provides that membership is compulsory for all permanent and non-permanent employees of the Government. The Government is defined to include local and regional government entities and government-controlled corporations. The level of contribution and the amounts of the benefits differ from those applicable under the SSS Law, but the provision of benefits is also subject to a Government guarantee. In addition to all SSS benefits, the GSIS Law also provides for life and non-life insurance benefits. The Law is administered by the Government Service Insurance System, which is governed by a Board of Trustees comprised of the President and General Manager and seven other members appointed by the President of the Philippines. Three of these members represent associations of government employees. The Law further provides for the appointment, powers and duties of the President and General Manager and other senior executives. The Law also provides for the adjudication of claims and disputes and gives broad discretion to the Board of Trustees to invest revenue not required for operational purposes on such terms and conditions as it may determine.

(c) **Medical Care**. The Medical Care Act governs the provision of medical care benefits. This Act created the Philippine Medical Care Commission, which is composed of the Secretary of Health as Chairman, the Administrator of the Social Security System, the President and General Manager of the Government Service Insurance System, three other Government representatives and four non-Government members representing, respectively, the beneficiaries, private employers, physicians and hospitals. The Commission is responsible for formulating policies and administering and implementing the Philippine Medical Care

Plan consistent with the National Health Plan. The implementation of the Commission's policies is entrusted to the SSS in respect of SSS members and to the GSIS in respect of GSIS members. Contributions from employees and employers are made to a Health Insurance Fund which, after deducting operating expenses, is invested on such terms as the Commission may determine. All members of the SSS and the GSIS and their legal dependents are provided with medical care benefits.

(d) **Employee Compensation**. The employee compensation fund provisions are enshrined in the Labor Code. This Act extends to all private and public sector employers and employees with limited exceptions. It provides for the creation of an Employees Compensation Commission, which is obliged to "initiate, rationalize and coordinate" the policies of the employee's compensation program. The Commission consists of four ex-officio members, comprising the Secretary of Labor as Chairman, the GSIS General Manager, the SSS Administrator, the Chairman of the Philippine Medical Care Commission and two appointed members representing, respectively, employees and employers. As with the provision of medical care, the implementation of the Employees Compensation Commission policies is vested in the SSS and the GSIS. The Commission has the power to assess and fix rates of contribution and to perform such other acts as it may deem appropriate for attaining its purposes. Funds received from contributors are accumulated in a State Insurance Fund administered separately by the SSS and the GSIS and used to meet operating expenses. Decisions of the Commission may be appealed to the Supreme Court. The Act provides for medical, disability and death benefits and the payment of all benefits is guaranteed by the Republic of the Philippines.

3.48 Social security legislation has been amended on numerous occasions. The tendency to expand programs and to increase benefits has resulted in frequent amendments to legislation that should be immutable, except where really necessary, as is illustrated by reference to the number and scope of bills impacting on social security issues that are currently under consideration by one or other of the Houses of the Congress (see Box 3.2). It seems likely that some of these bills will be passed by the Congress this year or in the near future.

I. Conclusions and Recommendations

3.49 Although the social security program in the Philippines is the oldest in Asia and its goals are consistent with generally accepted social security objectives, many problems exist. The current organization of social security delivery in the Philippines is overlapping and inefficient. There are two public organizations performing essentially the same functions for two different populations. There is no sound rationale for this arrangement, which further leads to the lack of portability and consequent disincentives for participation by both employers and employees. These problems, along with operational and financial shortcomings, contribute to a lack of confidence in the system and are depriving the Philippines of an opportunity to provide long-term resources for the economy. Continuation of the current systems without reform will likely lead to a further lack of confidence and result in a potential financial burden for the Government.

3.50 The recommendations arising from this chapter can be grouped into two categories: general and compliance.

Box 3.2: Proposed Amendments Affecting SSS and GSIS

(i) Proposed Social Security Law - House Bill No. 11122
This Bill seeks to introduce numerous amendments to the current Social Security Law including a provision that the Social Security System... "contribute to the socio-economic development of the country".

(ii) Proposed Revised GSIS Law - Senate Bill No. 234
This Bill provides for the introduction of new and increased benefits and a streamlining of the procedures for the administration of such benefits.

(iii) Proposed Revised Medical Care Law - House Bill No. 6976
The creation of a non-profit National Health Maintenance Organization System will be created under this Bill in order to coordinate the work of existing medical care agencies.

(iv) Proposed Unemployment Welfare Law - Senate Bill No. 1123
This measure would institute an unemployment welfare program for dismissed, terminated or separated employees from the private sector.

(v) Proposed Unemployment Insurance Act, Senate Bill No. 492
This Bill seeks to adopt and implement an unemployment insurance program which would provide ample protection to workers and their families in the event of dismissal or of separation from their employment.

General

(a) Divest the GSIS insurance business.

(b) Delay creation of an unemployment program until the recommendations in this study are implemented and the basic inefficiencies in the system are corrected.

(c) Revise Employee Compensation and/or disability program to remove current opportunity for "double-dipping".

(d) Resolve dispute between the GSIS and DBM over payment of employer contributions.

Compliance

(a) Continue current SSS initiatives to improve compliance.

(b) Designate single compliance 'Czar' at SSS headquarters.

(c) Further develop coordination with DOLE inspectors.

(d) Further develop data exchanges with BIR, Department of Trade, and other agencies.

(e) Standardize data elements between government agencies and adopt a single identification number for tax and social security record-keeping purposes.

(f) Revise benefit formulas to remove disincentives for full reporting.

(g) Devise an aggressive public relations program to educate employees and employers about the benefits of compliance and the risks of non-compliance.

(h) Develop a legislative proposal to require municipalities to receive SSA approval before registering or renewing the license of an organization to conduct business.

CHAPTER 4

SSS AND GSIS: OPERATIONAL AND FINANCIAL PERFORMANCE

4.1 This Chapter discusses important operational aspects of the SSS and the GSIS and reviews their financial performance during the last five years (1989-93).

A. Operational Performance

4.2 The types of benefits provided by the SSS and the GSIS are listed in Table 4.1. Except for insurance benefits provided by the GSIS, the benefits provided by both institutions are virtually the same. However, there are some differences with respect to benefit levels. In general, benefits provided by the SSS are much higher relative to the premiums paid (Tables 4.2 and 4.3).

Table 4.1: Division of Benefit Provisions

	GSIS	SSS
Social Benefits	Retirement/Separation* Death* Disability - short-term Disability - long-term* Sickness Compulsory life ins.*	Retirement* Death* Disability - short-term Disability - long-term* Sickness Maternity
Medicare	Hospitalization and medical care	Hospitalization and medical care
Employees' Compensation	Benefits related to work injury, including: Medical Disability - short-term Disability - long-term* Death*	Benefits related to work injury, including: Medical Disability - short-term Disability - long-term* Death*
Optional Life Insurance	Additional life insurance	None
General Insurance	Property insurance	None

4.3 **Benefit and Contribution Levels.** The level of benefits paid out and the level of contributions collected have an obvious impact on the cash flow situation of a fund and the funded levels. Table 4.3 shows a summary of current contribution requirements for both the GSIS and the SSS. GSIS contributions are at a higher rate, but a portion is subject to a lower wage base ceiling than the SSS. Table 4.2 summarizes pension related benefits, the most expensive part of the Social Benefits program.

The GSIS provides a pension at retirement of close to 80 percent of final salary for those with a full career of 35 years for those within the wage base ceiling. The wage base ceiling is currently at a relatively low level of ₱ 3,000 per month, but is expected to rise to ₱ 6,000 in the near future, at which time, the salary of most GSIS participants will be fully covered. Certain existing provisions, in which there is no salary cap, apply to older GSIS participants. The most expensive ancillary benefit related to the member's pension is the dependent's pension on death of the member, which in the case of the GSIS is 50 percent of the member's pension. The SSS also provides a very generous pension, aiming at a salary replacement rate at retirement of close to 70 percent for a full career of 35 years, with higher wage base ceilings. The dependent's pension, in this case, is at the level of 100 percent of the member's pension.

Table 4.2: Summary of Principal Pension Benefits

Type of Pension Benefit	GSIS	SSS
1. Monthly retirement pension for members with more than minimum number of credited years and earning more than stipulated wage minimums.	2.5% x Credited Years x RAMC Revalued Average Monthly Compensation is 36-month average of compensation, plus ₱ 140, subject to a maximum of ₱ 3,140.	2% x Credited Years x 60-month average of Monthly Salary Credit. Monthly Salary Credit is monthly salary up to a wage base ceiling which is ₱ 7,000 per month at 1/1/94, increasing to 12,000 per month at 1/1/99.
2. Post-retirement spouse's pension	50% of monthly pension.	100% of monthly pension
3. Pre-retirement spouse's pension	50% of accrued monthly pension based on service completed and compensation history at death.	100% of accrued monthly pension based on service completed and compensation history at death.
4. Permanent disability pension	100% of accrued monthly pension based on service pension based on serviced completed and compensation history at death.	100% of accrued monthly pension based on service completed and compensation history at death.

Table 4.3: Summary of Current Contribution Requirements for Participants Earning Over Minimum Level
(Amounts shown are expressed as percentages of covered salary)

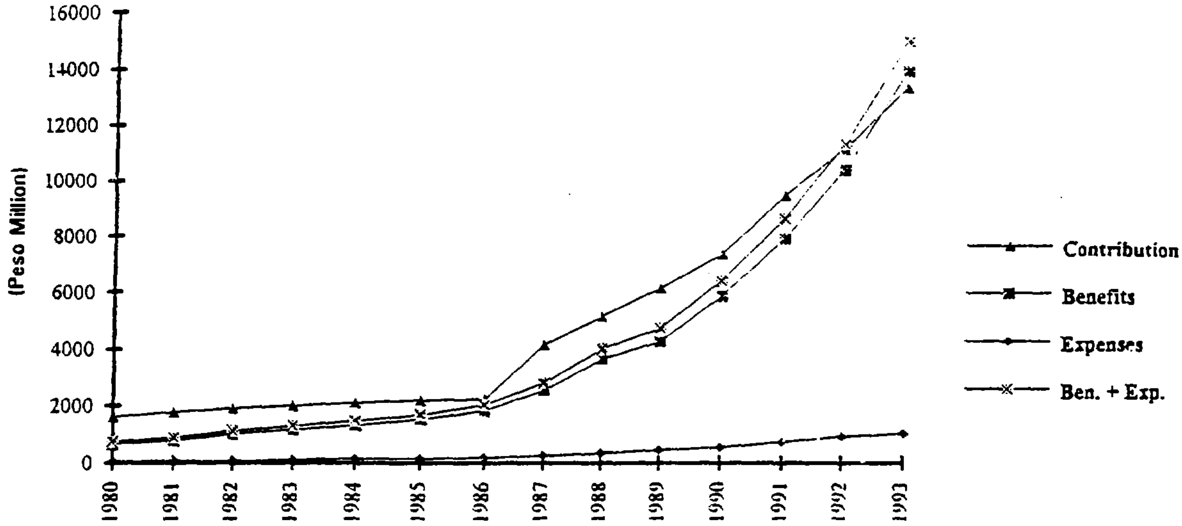
Programs	GSIS			SSS		
	Employee	Employer	Total	Employee	Employer	Total
Social Benefits						
- Retirement and related	5.50 [2] plus 1.00 [3]	7.50 [3]	14.00	3.33 [1]	5.07 [1]	8.40
- Life insurance	2.00 [3]	2.00 [3]	4.00			
Medicare	1.25	1.25 [4]	2.50	1.25 [4]	1.25 [4]	2.50
Employee's Compensation	----	1.00 [5]	1.00		1.00 [5]	1.00
TOTAL	9.75	11.75	21.50	4.58	7.32	11.90

[1] Maximum covered monthly salary of ₱ 7,000 in 1994, ₱ 8,000 in 1995, ₱ 9,000 in 1996, ₱ 10,000 in 1997, ₱ 11,000 in 1998 and ₱ 12,000 in 1999.
[2] Maximum covered monthly salary of ₱ 3,000.
[3] No maximum covered monthly salary.
[4] Maximum covered monthly salary of ₱ 3,000.
[5] Maximum covered monthly salary of ₱ 1,000.

4.4 **SSS.** In March 1994, the SSS was serving over 14.6 million members and about 500,000 pensioners. The SSS provides three types of coverage: (i) social benefits; (ii) medicare benefits, and (iii) employee compensation benefits. In 1993, the SSS had total contributions of ₱ 13.4 billion and paid out a total of ₱ 14.0 billion in benefits, leaving a gap of ₱ 0.6 billion to be funded from investment income. Out of the total benefits paid 84.9 percent was for social benefits (retirement and related), followed by Medicare (12.3 percent) and employee compensation (2.8 percent).

4.5 The amount of benefits paid in 1993 amounted to an increase of 34.6 percent over 1992, and an increase of 223.7 percent since 1989. The total number of claims processed in 1993 was 1,994,715, a 2.5 percent increase from a year earlier. About 59 percent of these claims were for social benefits, while 37 percent were for Medicare and 3 percent for employee compensation. Within social benefits, claims for sickness payments were by far the largest in number (over 550,000), but retirement benefits accounted for the biggest share of expenditures (₱ 3.5 million). Processing times for benefit claims have continued to show significant improvement. Data from the first quarter of 1994 shows processing pension claims down from 44 days to two days, Medicare from 20 days to 15 days, and Sickness/Maternity down from 30 to 19 days. Overall, the operating cost for the SSS in 1993 were ₱ 1.0 billion, equal to 3.8 percent of total revenues and 1 percent of total assets, which is reasonable.

Chart 4.1: SSS - Consolidated Operations, 1980-93



4.6 The rising level of benefits paid out by SSS is a disturbing development. Chart 4.1 shows the relationship between contributions, benefits and expenses. During 1980-86, contribution income increased at a compound annual rate of 6.4 percent, benefit payments by 18 percent, and operating expenses by 13.1 percent. Despite this increasing burden of benefits, the SSS has been able to accumulate substantial reserves, since contributions were still higher than the total of benefit payments plus operating expenses. Consequently, all earnings from investments were being added to reserves. However, benefit payments have been accelerating rapidly. During 1987-93, benefit payments increased by 34 percent p.a., compared with 30 percent p.a. for contribution income and 27 percent for operating expenses (see Table 4.4 for a comparison of trends since 1989). As a result, the combination of benefit payments and operating expenses exceeded income from contributions in 1992, and benefit payments alone exceeded contribution income by over ₱ 500 million in 1993. This means that the SSS has had to use investment income to cover current expenses over the last two years. A graphical representation of the developments is provided in Chart 4.1. These developments are further compounded by demographic considerations (Chapter 5), and demand a closer analysis of the growth in the various individual programs (retirement, disability, etc.) to identify those factors contributing to the rising level of benefits. At a minimum, the Government needs to exercise restraint when considering across-the-board benefit increases. The continued rapid increase in disability claims is also cause for further analysis.

Table 4.4: Currents Trends in Contributions, Benefits and Expenses, 1989-93
(annual growth, in percent)

Year	Contributions	Benefits	Expenses	Ben. + Exp.
1989	18.94	16.7	32.7	18.1
1990	19.67	37.6	20.1	25.9
1991	28.67	34.6	32.6	24.4
1992	17.9	31.2	26.4	30.8
1993	19.8	34.6	11.8	32.7

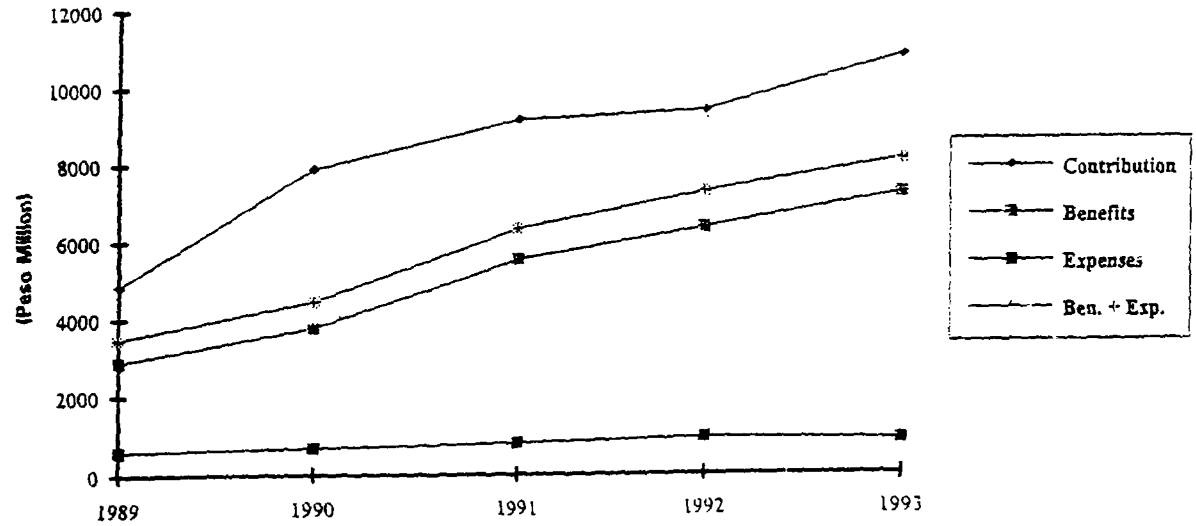
4.7 Benefit levels have been increasing at such a rapid rate because legislators have been operating under the perception that the SSS has a very large pool of funds which must be utilized to increase the benefits for the members. An independent actuarial assessment would have provided the legislators with more accurate information. There seems to be less appreciation of the fact that SSS obligations are on longer terms or that benefit levels must be realistic so that the system will remain solvent. Low compliance levels and possible medical claims abuses compound the problem.

4.8 The mission was presented with anecdotal evidence of fraud in disability and medical claims. Time and data constraints did not permit a careful analysis of these assertions. A subsequent review of claim and benefit data indicate a need for future analysis. Both the number of claims and the percentage of payments in these categories seem to be rising disproportionately, and these are areas highly susceptible to fraudulent activity. A thorough analysis needs to be made and appropriate corrective actions taken.

4.9 **GSIS**. In 1993, the GSIS was providing service to over 1.4 million members. A total of 691,560 persons received benefits of some sort from its Social Insurance Fund. This fund is by far the largest GSIS fund, with expenditures over five times greater than the next largest category, Medicare. Payments for Employee Compensation claims ranked third in monetary value, but were just about one-half as much as Medicare payments. Property Replacement, General Insurance, Optional Life Insurance, and Barrio Officials Insurance round out the benefit categories administered through the GSIS.

4.10 The GSIS has grown steadily over the past five years. Chart 4.2 illustrates GSIS consolidated operations for 1989-93. During this period, member contributions rose from ₱ 4.85 billion to ₱ 10.85 billion, an increase of 22.3 percent p.a. Benefit payments rose at an annual rate of 25.8 percent, with the sharpest increase in medical expenses, which rose four-fold during the period. While these numbers seem to support the contention that the GSIS has been outperforming the SSS, further analysis disputes this conclusion. DBM still covers pension payments for some pre-1977 government employees. Moreover, while GSIS benefits have been historically low, they are expected to double in the future and its policy holders are aging (see Chapter 5). Furthermore, investment returns have been subpar. Finally, its operating costs are higher than those of the SSS. In 1993, the total operating costs for the GSIS were ₱ 886 million, representing 5.6 percent of total revenues and 1.5 percent of total assets, compared with 3.8 percent and 1.0 percent, respectively, for the SSS.

Chart 4.2: GSIS - Consolidated Operations, 1989-93



4.11 **Areas for Further Analysis**. Other areas of SSS and GSIS operations need further analysis. In particular, the workload/staff ratios of these two organizations need to be examined. While it appears that some of the difference in administrative costs can be explained by the presence of the insurance function in the GSIS, this explanation alone is not sufficient. Increased automation and streamlining by the SSS have helped to increase its efficiency substantially, and further efforts in these areas will continue to reduce costs and increase efficiency. There is a need to consider how automation and delayering would affect the operational performance of the GSIS. One area of SSS operations requiring special attention is employer contribution compliance.

B. Financial Performance

4.12 Both social security institutions in the Philippines are **defined benefit**. The provision for defined benefit coverage impacts upon financial operations in two ways. First, it requires that they meet future contractual obligations. Therefore, the existing assets and prospective contributions less benefit payments must be managed in such a way that contractual obligations are met in full when they are due. The soundness of defined benefit plans is periodically determined through actuarial assessments (see Chapter 5). Second, it is common practice that the future liabilities of social security institutions are not recorded as contingent liabilities on their published accounts, but are reflected instead in separate actuarial assessment reports.

4.13 The financial performance of both the SSS and the GSIS (including asset allocation and fund management) are discussed below for the period 1989-1993. Chapter 5 covers future financial performance as a part of the actuarial assessment.

4.14 The financial performance information for the two institutions is summarized in Table 4.5. (Tables in Annex C present five year comparative income statements and balance sheets for the SSS and GSIS.) Both funds have roughly doubled from 1989 to 1993. The combined assets of the two funds in 1993 were ₱ 163.1 billion or US$6 billion. The SSS fund is the larger of the two, with assets of ₱ 103.7 billion and almost 15 million members. The assets of the GSIS in 1993 were ₱ 59.4 billion, covering roughly 1.5 million members.

4.15 Both the SSS and the GSIS have been able to generate net income and accumulate relatively large reserves in each of the last five years. Although the share of contributions to total income has been declining for the SSS, its investment income has added more than ₱ 57 billion to reserves since 1989. It would have been able to add even more to its reserves had it followed a different asset allocation strategy. During the same period, the GSIS was able to add almost ₱ 33 billion, mainly because its contributions levels increased and exceeded its benefit payments, and it received partial coverage of pension payments for some government employees by the DBM. The reserve level of the GSIS would have been substantially higher without the large carrying cost from the non-payment by DBM of the government contributions to GSIS funds (about ₱ 4.6 billion), and had it followed a more prudent investment policy.

Table 4.5: Summary of Financial Performance, 1989-93
(in millions of pesos)

	1989	1990	1991	1992	1993
Social Security System					
REVENUES	12,969	16,987	22,238	23,963	27,558
Members' Contributions	6,151	7,354	9,467	11,151	13,364
Investment Income	6,786	9,602	12,713	12,733	14,113
Other Income	32	31	58	79	81
EXPENSES	4,732	6,430	8,640	11,306	15,004
Benefits Payments	4,267	5,872	7,903	10,371	13,960
Operating Expenses	465	558	737	935	1,044
NET INCOME	8,237	10,557	13,598	12,657	12,554
ASSETS	51,940	62,567	76,419	90,756	103,751
Current Assets	29,683	34,677	14,958	22,845	30,368
Investments	21,569	27,176	60,342	66,668	71,977
Property & Other	688	714	1,119	1,243	1,406
LIABILITIES & RESERVES	51,940	62,567	76,419	90,756	103,751
Current Liabilities	139	168	612	2,090	2,182
Reserves	51,801	62,399	75,807	88,666	101,569
Government Service Insurance System					
REVENUES	6,990	10,790	13,014	14,101	15,837
Members' Contributions	4,856	7,893	9,159	9,402	10,854
Investment Income	1,810	2,640	3,567	3,863	4,318
Other Income	324	257	288	836	665
EXPENSES	3,482	4,466	6,346	7,294	8,140
Benefits Payments	2,893	3,779	5,536	6,361	7,254
Operating Expenses	589	687	810	933	886
GAIN ON SALE OF ASSETS	37	7	345	209	1,041
NET INCOME	3,545	6,331	7,013	7,016	8,738
ASSETS	28,859	36,068	43,207	50,794	59,351
Current Assets	4,259	5,563	6,063	12,033	18,350
Investments	21,052	26,871	33,284	34,920	36,968
Fixed & Other	3,548	3,634	3,860	3,841	4,033
LIABILITIES & RESERVES	28,859	36,068	43,207	50,794	59,351
Current Liabilities	2,114	2,748	2,728	2,968	3,026
Reserves	26,745	33,320	40,207	47,826	56,325

Sources: SSS and GSIS.

Asset Management

4.16 Social security institutions generate large amounts of long-term funds which need to be managed effectively to obtain the highest risk-adjusted return, so that the income plus capital gains can meet future obligations. Recent trends in the financial indicators of both the SSS and the GSIS show that their asset management functions could be substantially strengthened. The key points are highlighted below:

- **Compliance Problems for the SSS**. The SSS is experiencing compliance problems (see Chapter 3). As mentioned earlier, benefit payments in 1993 surpassed total contributions. This means that, for the first time in its history, the SSS had to apply earnings from investment to pay for benefits.

- **Allocation of Cost between DBM and the GSIS**. Some GSIS members have an option to retire under a separate system, by which DBM is committed to pay a lump sum gratuity payment. A high proportion of those eligible are exercising this option.[16] As a result, the GSIS is absolved from paying pensions for which it was previously obligated, but is required to return member contributions. This situation has led to a dispute between DBM and the GSIS as to whether DBM should continue to make full contributions to the GSIS for members who are eligible under this option. As a result, DBM recently started to delay payments to the GSIS, which the GSIS now records as receivables. These receivables are substantial and amounted to ₱ 4.6 billion at the end of 1993. This ongoing dispute has several implications. First, there is clearly a problem with respect to the financial practice of a system which allows one institution to discharge the obligations of another without commensurate consideration from the benefiting institution. Second, it is now somewhat difficult to ascertain the true past performance of the GSIS since this practice has been ongoing for many years. Consequently, its financial condition and performance is worse than what current financial statements portray.

- **Receivables**. One striking finding concerns the situation with receivables at the GSIS. Since 1989, the GSIS has consistently tied up considerable resources in non-revenue earning assets, thus reducing total yield. During 1993, revenue earning investments comprised only 62.3 percent of total assets. The remainder of these assets were tied up in receivables in one form or another, and in property and acquired assets. By comparison, more than 97 percent of SSS total assets were allocated to revenue yielding investments — a primary reason for the difference in the percentage of revenue that is sourced from investments. The receivable problem of the GSIS has two features: (i) there is a continuing debate with DBM as to whether that institution should remit full contributions to the GSIS when it is in fact paying the retirement benefits to the members; and (ii) there seems to be a growing amount of accrued income receivable relating to past dues which should be heavily scrutinized. The problem is costly, and is tying up almost ₱ 10 billion which could alternatively be invested. Moreover, the agency is holding more than ₱ 1 billion in receivables from reinsurers of its insurance operations.

- **Utilization of Assets**. Since 1992, the GSIS has reclassified certain liquid assets at the request of the Commission on Audit (COA) from the "Investments" to "Current Assets". This was done in order to more properly reflect the short-term nature of these assets on the balance sheet (and to apply the practices of the SSS). However, it appears that the GSIS is earning very little from these short-term instruments, whereas the SSS has most of these

[16] Under CA 186 and RA 1616. It should be noted that some retirees exercising these option also have the option of revoking it within a year and thus reverting to GSIS pension eligibility.

funds invested in short-term Treasury bills. There is a need to assess true market value of GSIS assets and to make the appropriate provisions for future policy.

C. Asset Allocation and Fund Management

4.17 The proper investment of reserve funds is a critical function for both the SSS and the GSIS. Both institutions have a fiduciary responsibility to ensure that these funds are managed prudently and invested in a diversified portfolio which will generate the highest risk-adjusted returns to enable them to meet their future obligations in full.

Investment Policies and Guidelines

4.18 **SSS**. SSS investment policies are set forth in RA 6111, as amended. Specifically, the institution is required to accumulate all funds in excess of its administrative and operating expenses and benefit obligations in an Investment Reserve Fund, with fund investments mandated to earn at least 9 percent. The law allows the SSS to invest in a wide array of instruments, including a variety of types of loans to members, real estate loans, government securities and bonds and private listed equity and marketable securities. It also specifies ceilings for each investment category, most of which may not exceed 10 percent of the Reserve Fund. Investments in direct housing loans, however, may account for up to 30 percent of the Reserve Fund and no ceilings are mandated for government securities. Beyond these legal provisions, the SSS has issued written guidelines governing its fund management decisions. These guidelines provide overriding principles and objectives for investing, stressing sound criteria for maximizing returns consistent with maintaining the safety of principal and liquidity. The SSS stresses prudence and sound business/financial principles as well as the importance of benefiting as many members as possible and supporting the social and economic development programs of the Government. Although these guidelines are quite sound, they are not appropriate for a pension fund such as the SSS. Given the nature of its obligations, SSS has a long-term investment horizon and should be allowed to engage in more equity investments. Capital gains are tax exempt in the Philippines. Therefore, the investment limits which are prescribed in the law will need to be replaced by general principles such as prudent man rules, diversification, and risk adjusted returns. Policies regarding asset allocation should be left to the Trustees.

4.19 **GSIS**. The Charter of the GSIS provides managers with some investment guidelines, but to a much lesser extent than the SSS. In PD 1146, the law grants full authority to the Board in determining fund allocation among different instruments. There appears to be little else issued formally in terms of specific guidelines governing asset allocation and investment policies. There is a clear need for the GSIS to devise a written policy along the lines suggested for the SSS (para. 4.18).

Asset Mix and Portfolio

4.20 Table 4.6 presents the portfolio make-up of the SSS and the GSIS compared to the average portfolio of private pension funds and to the fund of the Armed Forces of the Philippines (AFP) as of the end of 1993. Both institutions have a somewhat different portfolio composition than either the private pension funds or the AFP. The major difference is marked by a greater emphasis on government securities and member loans by both the SSS and the GSIS and a lesser emphasis on marketable securities. In addition, because the Government has a strong affordable housing policy, both the SSS and the GSIS have been requested by the Government to invest heavily in the unified housing program of the NHFMC. In response, the SSS has reduced its member loans over the past five years in support of the unified lending program.

Table 4.6: Asset Allocation as a Percentage of Total Portfolio, 1993

	SSS	GSIS	AFP	Private Pension Funds
Govt. Securities	56.3	16.9	-	3.2
NHMFC	17.6	8.2	-	-
Member Loans	14.3	42.7	-	-
Stocks	7.2	12.3	31.9	27.2
Private Placements	-	-	34.6	46.9
Other Investments	4.6	19.9	33.7	22.7
Total	**100.0**	**100.0**	**100.0**	**100.0**

4.21 The portfolio composition of the SSS and the GSIS :

- **Member Loans**. Both institutions provide an array of loans to members for a variety of purposes, including consumption, housing, education and disaster relief. Most of these loans are made available on soft terms and at subsidized rates, clearly reducing returns. Moreover, many loans are currently past due, so repayment is doubtful. In addition, both the GSIS and the SSS are now forced to repossess securitized property on non-performing accounts or to reschedule outstanding obligations of past due accounts. Given the need to meet future contracted obligations, it is recommended that both institutions, especially the GSIS, consider reducing the share of these loans in their portfolio mix by freezing these loans at present levels. If there are good reasons to extend some member loans, then these should be done at a rate no less than that for Treasury bills.

- **Housing Loans**. Exposure to the NHFMC is extremely troublesome, especially for the SSS. As of the end of 1993, the SSS and the GSIS combined had allocated more than ₱ 25.8 billion (US$956 million) to NHMFC's housing program. While these investments are collateralized by mortgages and guaranteed to an extent by the NG, they have a high carrying cost and a potential for loss given the NHMFC's poor financial condition. Given the NG's commitment to the unified housing program, the SSS and the GSIS have been asked to allocate an additional ₱ 10 billion to the program in 1994. However, these measures can only erode further the capital of these institutions if structural remedies are not made with the program. Financing housing is a viable activity if it is done correctly. Given that the Philippines has a vibrant banking system and an established pattern of wholesale financing through government financial institutions, it is recommended that the SSS and the GSIS create wholesale lending facilities for housing to be made available to eligible participating financial institutions at market rates. The participating financial institutions (PFIs) would be responsible for the credit risk. In the meantime, an independent assessment of the NHMFC will need to be carried out.

- **Poor Accounting of Portfolio Quality**. The accounting principles used to reflect the portfolio quality of the SSS and the GSIS are not fully in accordance with generally accepted accounting principles. Presently, investment losses and gains are reflected only when an asset is sold or disposed of. Accordingly, both institutions show nonperforming investments for which no return is anticipated. Moreover, there are no established principles for the determination of doubtful loan portfolios or to make provisions for anticipated losses arising from nonperforming accounts. General and specific provisions for doubtful accounts should normally be made to reflect the true financial condition of the institution.

- **Underallocation to Equity Investments**. The historical experience of most countries has confirmed that equity investments generate much higher risk adjusted returns over time than other classes of assets, although such investments are more volatile in the short-term. Because of these experiences, most pension funds should allocate between 40-70 percent of their assets in equity investments with internal diversification. The present limit of 10 percent was appropriate in the past because of the very small size of the domestic equity market. However, the domestic market is now much larger, making a strong case for revising this limit upward. This would be consistent with maximizing the risk-adjusted return on the portfolio.

Investment Performance

4.22 Table 4.7 and Chart 4.3 summarize the investment performance of the SSS and the GSIS over the last five years as compared to the performance of the AFP fund and the median performing private pension fund from a survey of 168 private funds in the country. The performance of these funds is compared to Treasury bill returns over the same period. The Treasury bills approximate a risk-free passive investment.

4.23 Before reviewing performance among the different funds, two points should be noted on the comparability of yields. First, the method of investment valuation differs among the various funds. For example, investments for both the SSS and the GSIS are valued at cost until sold. As such, the yields may be somewhat understated vis-a-vis the other funds to the extent that unrealized gains can be recorded for marketable securities. Private pension funds value marketable securities at current value. However, on average, the yields still should approximate each other, given that over the five-year period, gains would likely be realized from the actual sale of these securities.

4.24 Second, the denominator used in yield calculations also differs among the various funds. For example, the GSIS adheres to a strict definition of 'investments' and thus excludes a substantial amount of assets which are tied up in current assets. Since this amount is substantial, it will tend to overstate actual returns. In addition, as was discussed in the previous section, member loan accounts which are considered doubtful are not converted to a cash basis and, as such, actual income accrued as receivables from these accounts would again tend to overstate investment yields.

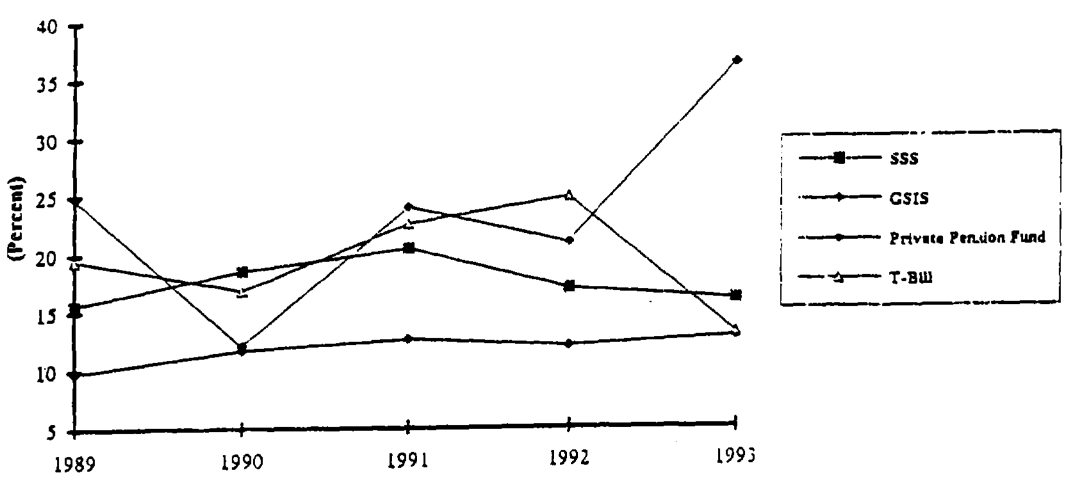
Table 4.7: Rate of Return on Investment Portfolio, 1989-93
(percent)

Year	SSS[a]	GSIS	AFP	Private Pension Funds	T-Bill	Inflation Rate	RR - T Bill Rate		RR - Inflation Rate	
							SSS	GSIS	SSS	GSIS
1993	16.0	12.8	24.7	36.4	13.1	8.0	2.9	-0.3	8.0	4.8
1992	17.0	12.0	16.2	21.0	24.9	8.9	-7.9	-12.9	8.1	3.1
1991	20.5	12.6	17.9	24.0	22.6	18.7	-2.1	-10.0	1.8	-6.1
1990	18.6	11.7	24.6	12.1	16.9	14.2	1.7	-5.2	4.4	-2.5
1989	15.6	9.8	16.8	24.8	19.5	12.2	-3.9	-9.7	3.4	2 4
5-year average	17.4	11.8	20.4	23.7	19.4	12.4	-2.0	-7.6	5.0	-0.6

Sources: SSS and GSIS; Bank staff estimates.

Notes: a/ Rates of returns on a market to market basis for SSS, were 1989-20.2; 1990-12.4; 1991-25.9; 1992-16.8: 1993-44.9; for a 5-yr. Aug. of 24.1 GSIS numbers were not available.

Chart 4.3: Rate of Return on Investment Portfolio, 1989-93



4.25 The investment performance of the SSS and the GSIS over the last five years has been mixed. During 1989-93, both institutions realized returns less than Treasury bill rates. The SSS fund outperformed the T-Bill yields in only two years, while the GSIS fund never did. The GSIS performance was particularly poor since its investments yielded an average return of only 11.8 percent, and the annual yield on total assets was only 8 percent — below the inflation rate during the same period. When adjusted for inflation over the period, the real rate of return for the SSS portfolio was only 5.0 percent, and the return for the GSIS was actually negative, with a -0.6 percent real rate of return.

4.26 Low yields result from asset allocation decisions under which the majority of assets are allocated to those programs which offer below market returns with potential credit risks and a lower allocation is made to those programs providing higher risk adjusted returns. There is clearly room for further improvement through a better mix of assets and improved asset management. It is, therefore, recommended that the institutions consider appointing private fund mangers to manage a major part of assets on a pilot basis. In the meantime, in-house asset allocation capabilities should be strengthened to improve returns and to enhance the ability to monitor fund manager performance.

D. Conclusions and Recommendations

4.27 The social security system in the Philippines is one of the more mature in the developing world. It has been able to mobilize a large amount of long-term resources and has thus far generated returns which have been adequate to meet current obligations and to accumulate substantial reserves. However, there is a need to rationalize the structure of the system, adjust contribution and benefit levels, and allocate mobilized funds efficiently to ensure that the future obligations of members can be met in full. In addition, there is a need to fully legitimize the fiduciary responsibilities that the social security institutions have towards their members. The primary obligation of the SSS and the GSIS should be towards their members by providing social security benefits to them. It would be desirable if this objective could be accomplished while at the same time fulfilling other national and socio-economic priorities of the Government, through the use of scarce long-term funds. There are no underlying problems with this as long as the integrity of the system is not compromised and the institutions remain actuarially sound.

4.28 The review undertaken points out the need to improve aspects of both institutions. The SSS is facing severe compliance problems which will necessitate a major and concerted effort on the part of its management and staff to resolve. Outside help in the form of statutory relief is also recommended. Another area which requires attention is the change to the method of computing the benefit level by crediting service on the basis of contributions made rather than years of participation. In the case of the GSIS, there is a need to clear up the outstanding overdues by the NG, reduce the carrying costs and divest its insurance function to the private sector. The asset allocation policies of both institutions could be substantially improved, especially in the case of the GSIS. Investment restrictions in the legislation governing the SSS need to be removed and replaced with a general statement of objectives, and asset mix decisions should be delegated to the Trustees. The assistance of outside fund managers should be initiated. Investment policies should be modified to reflect new market conditions and be flexible to adjust to the changing environment. The portfolio allocation to equity should be raised above the present level of 10 percent to realize higher long-term risk adjusted returns. Furthermore, asset allocations to below market programs should be reduced by freezing them at existing levels. Both institutions should move to wholesale operations for providing housing finance, i.e., through eligible financial intermediaries who will bear the credit risk.

CHAPTER 5

ACTUARIAL ASSESSMENTS OF THE SSS AND THE GSIS

A. Purpose and Scope

5.1 Any study of social security programs requires a proper understanding and evaluation of the financial obligations assumed. The long-term nature and complexity of many of the commitments undertaken to provide benefits to contributing members require detailed actuarial investigations, including projections of income and expenditure, as well as assets and liabilities, well into the future.

5.2 To this end, the internal actuarial departments of both the GSIS and the SSS carry out studies on the actuarial status of their various funds, annually in the case of the GSIS and once every five years in the case of the SSS (the last one having been performed as of January 1, 1990). These investigations are, however, not suitable for the purposes of this study for a variety of reasons:

- The available figures do not fully reflect the current situation. In the case of the SSS, much has happened since the last valuation some four years ago by way of pension increases, changes in wage base ceilings, general increases in benefits, and changes in compliance. For the GSIS, the internal valuations are limited by the data that are made available to them and no adjustments are made to account for inadequacies.

- The actuarial methodology used differs for the two systems, thus making comparisons of limited value.

- The method of valuation used by the GSIS does not call for long-term projections of benefits and contributions.

- The valuations are carried out for internal purposes and do not make explicit allowances in the assumptions for certain important elements of the programs which are crucial to the current study.

5.3 In a 1991 review of the internal actuarial valuations, the ILO made some suggestions for modifying the valuation techniques and recommended that an actuarial assessment be carried out by an independent firm of actuaries. The World Bank selected The Wyatt Company to perform an actuarial assessment of the two systems for the purposes of this study. Pertinent suggestions by the ILO have been taken into account in this assessment.

5.4 This chapter of the report presents and discusses, in summary form, the principal results of the actuarial assessment of the SSS and the GSIS in their current form. The full details of the assessment have been elaborated in a separate actuarial report entitled: *The Philippine Social Security Systems: Actuarial Assessment of the Social Security System and the Government Service Insurance System as of January 1, 1994.* A description of the actuarial concepts and terminology used in the assessment appears in Annex A to the report, while Annex B gives more details on the results of the assessment.

5.5 Both the GSIS and the SSS incorporate three separately identifiable programs - Social Benefits, Medicare and Employees' Compensation. Each of these has its own fund for which detailed accounts are kept and contribution requirements separately determined. A summary of the benefits provided under the programs appears in Table 4.1.

5.6 All of these programs provide benefits with short-term liabilities; in addition, the Social Benefits and Employees' Compensation programs incorporate certain benefits with long-term liabilities. The assessment treats long-term and short-term liabilities differently (as explained in Annex A).

5.7 In addition, the GSIS offers optional programs of life and property insurance which are available to systems participants at their own expense. These GSIS insurance programs have been excluded from the scope of the assessment.

5.8 Wyatt was instructed to assume that all life insurance benefits will be transferred to the private sector, including the compulsory life insurance coverage provided under the GSIS. Hence, benefits under this compulsory life insurance component of the GSIS Social Benefits program, and the assets attributable to those benefits, have also been excluded from the assessment.

5.9 The Medicare and Employees' Compensation programs of the GSIS provide certain benefits to the judiciary and to members of the armed forces, and these benefits have been considered in the assessment.

5.10 Section B of this Chapter summarizes the results of the assessment and presents the conclusions arising therefrom, including certain recommendations for future actions (which are recapitulated in the Actuarial Plan in Annex D).

B. Summary and Findings

5.11 The actuarial assessment of the SSS and the GSIS has revealed that <u>the Social Benefits programs of both institutions are not financially viable in the long-term under the current structure of benefits and contributions and with current operating practices</u>. While the funds relating to these programs may experience positive cash flows in the near-term, the long-term outlook is that both will experience very steep increases in benefit payments requiring significant increases in contribution levels. The SSS Medicare program is also not financially viable. The Employees' Compensation program of the SSS is overfunded. Both the Medicare and Employees' Compensation programs of the GSIS, on the other hand, are underfunded, suggesting over-utilization and inefficiencies in the operation of these programs. This section of the report discusses the actuarial position of each of these programs and the reasons for their financial status.

5.12 The main results of the actuarial assessment are shown in Table 5.1. Annex A explains certain actuarial concepts and terminology which are necessary to understand the amounts shown in Table 5.1, while Annex B presents the results and a discussion of the factors influencing them.

TABLE 5.1

Main Results of Actuarial Assessment as of January 1, 1994

(Amounts are shown in millions of Pesos)

SOCIAL BENEFITS PROGRAM	GSIS			SSS		
	Best Estimate Assumptions	Optimistic Assumptions	Pessimistic Assumptions	Best Estimate Assumptions	Optimistic Assumptions	Pessimistic Assumptions
A. Actuarial Position as of December 31, 1993						
1. Actuarial Value of Assets	36,969.67	36,969.67	36,969.67	101,800.86	101,800.86	101,800.86
2. Past Service Liability-Current	79,693	51,106	81,937	301,852	228,315	391,294
3. Past Service Liability-Projected	264,827	144,343	400,889	524,919	310,150	864,800
4. Total Expected Benefit Payments and Expenses in 1994	37,952	38,357	37,683	11,445	10,881	11,221
5. Asset Coverage %s:						
a. Assets/PSL-Current	46.4	72.3	45.1	33.7	44.6	26.0
b. Assets/PSL-Projected	14.0	25.6	9.2	19.4	32.8	11.8
c. Assets/(Ben. Pmnts + Expenses)	9.7	9.6	9.8	8.9	9.4	9.1
B. Key Projection Results						
1. Year Net Fund Income Ceases to Increase	1996	1996	1996	2007	2008	2007
2. Year Net Fund Income Becomes Negative	2008	2010	2007	2014	2017	2013
3. Year Fund Runs Out	2016	2019	2014	2022	2026	2020

	MEDICARE BENEFITS PROGRAM Best Estimate		EMPLOYEES' COMPENSATION Best Estimate	
	GSIS	SSS	GSIS	SSS
A. Actuarial Value of Assets as of December 31, 1993	847.17	8,480.72	431.09	11,038.58
B. Key Projection Results				
1. Year Net Fund Income Ceases to Increase	1994 or before	1994 or before	1994 or before	stays level
2. Year Net Fund Income Becomes Negative	1997	1998	1997	--
3. Year Fund Runs Out	2001	--	2002	--

5.13 The most important conclusion that emerges from the actuarial assessment is that now is a very appropriate time to consider a revision of the two systems. Both the GSIS and the SSS are inadequately financed, and will face increasing financial pressures in the coming years. The social benefit funds for the programs become negative in 2008 and 2014 respectively, and the funds run out in 2016 and 2022 respectively. Aside from possible changes in the design of the systems, the contribution structure of each must be reappraised. Moreover, the demographic situation is still favorable, with heavy infusions of younger workers to support future benefits; as the covered populations mature, the short-term costs associated with system change will increase (the GSIS already shows signs of this).

Demographics

5.14 The demographics of the Philippines are such an important factor to the future of these social security schemes that it is worth while to elaborate briefly on why the situation is timely now to do restructuring to prepare for the future. Currently, the Philippine population is relatively young with only about 7.6% of the population 55 years and older and only about 5.3% who are 60 years and older. By the year 2020 those 55 and older will comprise 14.5% of the population and those 60 and older will comprise more than 10%. Perhaps more importantly the population 70 years and older will more than double in that timeframe, from 1.2 million to over 2.5 million persons. This eldest age group is the one which will receive pension benefits for 15 or more years. These demographic trends continue on into the 21st century and will only exacerbate the financial status of these programs unless fundamental changes are made, and the sooner they are made the less drastic they need to be. (See Chart B10 in Annex B for a further age distribution of the Philippine population.)

5.15 While improvements in compliance can help to alleviate problems in the SSS, these improvements will be marginal at best (see para. 5.20). Changes in the replacement rates for some or all categories of members, increasing the retirement age, and increasing contribution levels can all have a significant impact on the future sustainability of these programs. Projections of these changes with the future demographic projections need to be made so that some change or combination of changes can be found which will be politically and socially acceptable as well as sufficient to meet the objectives of the social security programs. Since decisions about the basic policies of the programs were not a part of our review, no projections incorporating a combination of such basic changes were made as a part of this report. The important point here is that the SSS fund has already begun to use interest income to pay current benefits even with these very favorable demographic conditions when one might want to be building an especially large reserve to prepare for the aging of the population. If this trend is not reversed soon the spend-down will continue and changes will have to be more dramatic and more sudden. Chapter 6 presents an outline of some considerations for restructuring the social security sector.

SSS

Social Benefits

5.16 The Social Benefits program is the main program of the SSS. It includes the long-term pension, death and disability benefits that represent the largest open-ended commitments of the SSS. Although the nominal rate of contribution is 8.4 percent of covered pay, the effective rate is 5.3 percent of total pay for contributing members, as a result of non-compliance and the application of a maximum wage base. Benefits, as a percentage of total pay is currently some 5.4 percent, but is projected to rise to 7.4 percent in 20 years. The results of the actuarial assessment show that it is potentially a very expensive program which has been inadequately financed and which, in the absence of corrective measures, will face the likelihood of "financial ruin" in the future. Many factors contribute towards the projected worsening of the financial situation and include problems with respect to investment performance, current benefit design, compliance, benefit increases, and level of funding.

5.17 **Investment Performance.** Investment performance has not been as good as it could have been. Undoubtedly, the relatively low level of investment in equities and equity-type securities has contributed to the fund not having accumulated as rapidly as would have been otherwise possible. In addition, the high percentage of funds tied up in loans has restricted the availability of funds that could otherwise be more profitably invested. Although loans are generally viewed as socially beneficial, the cost of lost opportunities for higher-yielding investments and the resultant long-term impact on the fund must be taken into account.

5.18 **Benefit Design.** Several elements of benefit design contribute towards making the program a very expensive one. First, the current structure provides a high salary replacement rate at retirement for most employees. This reduces the need for private plan coverage for the general workforce to a greater degree than perhaps appropriate or desirable. The SSS should therefore study the question of whether it is properly fulfilling its role as a social insurance system. Social and economic aspects need to be taken into account, but a study of the actuarial aspects is a logical place to begin; hence, these are referred to in the Actuarial Plan in Annex D.

5.19 Second, ancillary benefits, such as the pension payable to a survivor on the death of a participant, are set at a very high level (100% of the participant's pension). While such a high level of benefits may be appropriate for lower paid participants, it seems excessive when applied uniformly at all levels.

5.20 **Compliance.** The low level of compliance (i.e., the making of contributions) can also have an adverse influence on the funding. It is important to note, however, that low compliance takes two forms: (a) a low <u>percentage of participation</u> (number of participants contributing); and (b) a low <u>intensity of participation</u> (number of contributions during the year). The actuarial assessment indicates that reducing the number of non-participants will not necessarily improve the long-term funding position of the SSS so long as the non-participants are older than the average, since the older the participants are, the greater is the extent to which the cost of benefit accruals exceeds the contributions. From the funding point of view, increasing the percentage of participants is helpful if the participants are young, but increasing the degree of participation is always helpful.

5.21 Although many of the steps towards improving participation lie within the sphere of administration, certain changes could be made in the SSS benefit design to increase compliance. These include increasing the rather low 10-year eligibility requirements for the minimum benefit (so as to prevent persons dropping out for many years, only to recommence contributions just in time to qualify for a minimum) and basing the crediting of service directly on the actual number of contributions made (so as to provide some leverage on "uninterested" employers and employees). Although changes in these areas must be appraised from social and economic viewpoints, an actuarial study of the implications for system finances is also needed and is referred to in the Actuarial Plan.

5.22 **Benefit Increases.** Significant increases in benefits have occurred recently. These have happened in two ways.

5.23 First, the wage base ceiling, on which both contributions and benefits are based, has increased rapidly in the recent past (and is scheduled to increase rapidly up to year 1999). This has led to significant increases in the liabilities without comparable increases in available funds.

5.24 Second, in the recent past, increases have been made across the board to SSS pension payments, and at levels far in excess of cost-of-living increases. One justification given for this practice is that pensioners who retired several years ago are receiving inadequate benefits. If this were the case, the rates of increase should be selective rather than uniform. It is imperative to avoid setting a precedent that can be extremely costly to the system.

5.25 **Funding**. The level of contributions currently being made is not adequate to support the benefits promised in the long-term. The internal valuation carried out four years ago by the SSS suggested that the scaled premium structure would be adequate into the intermediate term future. The current assessment indicates that this would be possible only through the use of an exceptionally optimistic set of valuation assumptions; it shows a rapidly worsening cash flow situation and an imperative need to adjust the scaled premiums within the next few years.

Medicare

5.26 At first glance, the Medicare program presently appears adequately funded — current assets equal about three years of expenditures (benefit payments and administrative expenses), which is within the normal range for a program such as this. However, the fund is likely to run out shortly before the end of the ten-year projection period. A likely reason for this is that the contributions are applied to a fixed base and so cannot support the increasing benefit levels (since the end of 1993, benefits have increased by some 40%).

Employees' Compensation

5.27 The very strong financial position (currently, assets cover some 30 years of benefit and expense payments), despite the low contribution requirement, suggests that the system is not achieving its objectives. This may be due to a lack of awareness of the program and its benefits.

GSIS

Social Benefits

5.28 Like the SSS, the Social Benefits program of the GSIS is potentially a very expensive program. The nominal rate of contribution is 14.0 percent of pay, but the effective rate is 12.0 percent, as a result of the application of a minimum wage base to a proportion of the contribution rate. Benefits, as a percentage of total pay is currently some 5.2 percent, but is projected to rise rapidly to 25.2 percent over the next 20 years. In spite of a total rate of contributions (from employer and employee) higher than that of the SSS, the program is inadequately financed and is likely to face severe financial strains in the future. As the population covered is more mature than that of the SSS, financial strains are likely to appear sooner than with the SSS. The reasons for the inadequate financing can again be traced to adverse investment performance, benefit design, benefit changes, and level of funding.

5.29 **Investment Performance**. The investment performance has lagged even further behind the expected norm than is the case with the SSS. Very significant portions of the assets are either nonearning (e.g., contributions receivable from the DBM) or attributable to member and non-member loans. The comments made with respect to the SSS apply equally well here.

5.30 **Benefit Design**. The pension benefits are very generous, with an accrual rate which is even higher than that of the SSS for covered salary levels.

5.31 **Benefit Increases**. Currently, there is a wage base ceiling of ₱ 3,000 per month that applies to a portion of the contributions, and to benefits for members who joined the system after May 31, 1977. This ceiling is widely expected to increase in the near future to ₱ 6,000 per month, at which level it would cover the full salary of most governmental employees. The pension related liabilities will increase significantly when this takes place. This expectation has been taken into account in this actuarial assessment.

5.32 The level of pension increases that have been granted in the recent past have not been as high as under the SSS but nevertheless have been above the rate of inflation.

5.33 **Funding**. The current level of contributions is not adequate to support the benefits being promised. Being an older group, equivalent pension benefits will cost the GSIS more than the SSS. The abrupt increases in wage base ceilings contemplated under the GSIS will cause greater financial strains than would more gradual increases; the increases will rapidly affect benefit calculations but affect contribution accumulations only gradually.

5.34 The internal appraisal of the GSIS as of January 1, 1994 shows a close balance between assets and liabilities only because of overly optimistic assumptions and the use of out-of-date data which led to an understatement of liabilities, including the reserves for compulsory life insurance.

Medicare

5.35 The GSIS Medicare program is financially weak. Assets cover less than one year's worth of benefit payments and expenses and the projections indicate that coverage will worsen, unless adequate measures are taken to correct inefficiencies in the system.

Employees' Compensation

5.36 With current utilization rates, the weak financial situation of the Employees' Compensation Program is likely to worsen. It will be important to remove the current inefficiencies in this system (such as duplication of benefits) in order to make the program financially more sound.

CHAPTER 6

OPTIONS FOR RESTRUCTURING

6.1 The previous chapters have analyzed the structure and the current state of the social security sector in the Philippines. Although this sector is long-established, its fragmented and overlapping administrative coverage, poor actuarial and financial performance and lack of well-defined and understood objectives have reached a point where the adequate provision of social security services is now in jeopardy. Just as important, the country is missing out on an extremely important opportunity to capitalize on the resources accumulating in the social security institutions to develop a vibrant capital market. Fortunately, the demographic and the economic situation are such that it is still possible not only to achieve this goal, but also to improve the social security programs so that long-term social protection becomes a reality. However, this requires strong and immediate action at the highest levels of government.

6.2 While a package of operational and financial reforms can obviate many of the problems identified earlier, the maximum benefits can be achieved only through restructuring the social security programs and structures into a coherent framework. Due recognition has been given to the natural inertia inherent in any proposal to change large, established organizations and the political realities involved, but the opportunity cost for maintaining the status quo is so high that a restructuring is the desired course to follow.

6.3 The following four objectives guided the formulation of the recommendations for the study:

- **Assisting the Social Security Institutions in Achieving their Objectives.** The objectives of the social security institutions have been developed over a long period of time and are consonant with well-established social objectives in the country. However, some of these objectives like universal coverage and long-term financial security for all workers and their dependents will not be achievable without substantial action.

- **Enhancing the Role of the Social Security Institutions in Capital Market Development.** As noted in Chapter 2, the social security institutions are the single largest mobilizer of long-term funds in the country. However, the short-term nature of their current investments, in many instances at below market rates, has constrained the development of the capital market.

- **Helping the Government Improve the Efficiency of the Social Security Sector.** Inefficient program administration contributes to the lack of public confidence in any program. Improving the efficiency of the SSS and the GSIS will not only improve public confidence, but also lead to better service and financial savings.

- **Improving the Legal and Regulatory Framework.** The myriad laws and amendments to the laws that govern the SSS and GSIS inhibit public understanding, obscure transparency, and expose the institutions to potential misuse and mismanagement.

6.4 As stated in the previous paragraph, one of the primary objectives of this study is to assist the social security institutions in meeting their objectives. Primary objectives of both the SSS and GSIS are to provide security against the loss of income through old age, death, or disability of their members. Based on the actuarial review summarized in the previous chapter, it will be necessary to modify the benefit or contribution structure of both programs in the near future to avoid serious financial shortfalls.

6.5 Both the GSIS and SSS social benefit programs are of the defined benefit type. That is, they promise to provide a specified benefit level to each eligible person based on age, disability, or death. These benefits are funded through contributions from members during their working life which are used to pay benefits to current eligibles as well as to build an investment fund which will be used to defray some of the benefit costs of the programs in the future. This method of funding is commonly referred to as a "partially funded" system.

6.6 One of the reasons for the coming shortfall of funds for these two programs is the demographic make-up of the Philippines. The birth rate is declining and longevity of persons at all ages is increasing. This means that in the years ahead there will be a substantial increase in the percentage of persons beyond retirement age and a decreasing percentage of those persons of working age. The ratio of contributors to recipients will decrease sharply. This demographic phenomena is not unique to the Philippines but is rather common in most developed countries. A comprehensive discussion of the effects of this aging of the population on pension funds can be found in the recent World Bank publication "Averting the Old Age Crisis."

6.7 Several countries having defined benefit pension programs have had to refine benefit and/or contribution schemes supporting these pension programs to avoid financial shortfalls. Since the Republic of Philippines will be reviewing the financial viability of the GSIS and SSS programs in the near future, it would be an opportune time to consider the longer term fiscal impacts of the current programs and how effective they will be in meeting their goals. In that regard, there are several elements of the programs that can have significant impact on benefit and funding levels. Also, as a result of the recent ILO report on Social Security in the Philippines, the government is in the process of reviewing the broader social sector with a view toward developing a comprehensive social sector plan that could include the social security programs of the GSIS and SSS. All of these factors along with the very positive economic situation in the Philippines make this an opportune time to review the social pension programs of the GSIS and SSS with a view toward reform.

6.8 In designing or restructuring social security programs there are several factors to be considered: (1) Meeting the goals of financial security for members of the program and the population in general; (2) the fiscal sustainability of the programs; (3) effect of the programs on labor markets and capital markets; (4) effect of the programs on savings; (5) the congruity of the social security programs with other related programs, e.g. welfare programs, private pensions, insurance, or provident funds.

6.9 Looking at these factors in the Philippines in reverse order of their listing above, we see:

(i) **Congruity** - Currently there are over 1700 employer pension plans, the mandatory Pag Ibig Provident Fund, and several government corporation Provident Funds available beyond the social pension programs of the SSS and GSIS. While this represents a broad spectrum of opportunities for supplemental savings there is not a rationalization of how all of these programs interact and there are broad groups of workers not covered by any pension plan. Portability between plans is also a concern.

The insurance industry is growing but hampered by some inconsistencies mentioned in Chapter 2. The need to remove the government from insurance competition with the private sector is also discussed in that chapter.

The welfare system is growing but still needs substantial expansion if the entire population is to be served,. The current social pension programs are designed to cover only contributing workers and their families. The minimum benefit provisions provide for a welfare type transfer to lower level workers from higher earning members. These principles are inherent in the program but social security laws project a gradual coverage of all workers. This is a valid goal but will not be achievable for some time recognizing the difficulties in compliance with the current coverage groups. Some suggestions for improvements in compliance are contained in Chapter 3.

(ii) **Savings** - The overall effect of social security pension plans on savings is often difficult to determine. A discussion of the potential savings from the social security sector in the Philippines is included in Chapter 2. The overall effect of changes to these programs should bear in mind the likely effects on savings.

(iii) **Labor and Capital Markets** - The existing social security programs in the Philippines do not seem to have negatively impacted the labor market. Of course, coverage is still far from universal and as mentioned earlier, compliance is a problem. The goal of universal coverage and the need to create vehicles to ensure compliance must be considered in any effort at restructuring. A thorough discussion of likely capital market effects of increasing long-term pension funds is also contained in Chapter 1.

(iv) **Financial Security and Fiscal Sustainability** - In order to ensure financial security for its members a social security pension system must be fiscally sustainable. Otherwise the plan will fail or the government will be faced with finding revenues from another source to deliver promised benefits. As discussed in Chapter 5 there are various provisions in the current benefit formulas which should be reexamined for fairness and fiscal sustainability. The following Box 6.1 provides a basic decision logic format for redesigning a social security pension program.

Box 6.1: A DECISION FLOW CHART FOR REDESIGNING AN OLD AGE PENSION SYSTEM

1. What is the desired rate of wage replacement?

2. What will be the age of retirement eligibility?

3. What supplemental programs will exist to alleviate poverty or provide employer or individual pension savings.

4. Will the system continue to be a defined benefit plan or other will it include other systems such as defined contribution, or a combination of the two systems. If defined benefit:

   A. Will the system be fully funded, partially funded, or pay as you go?

   B. Will the benefit rate be flat or will it be related to wage levels or years of work or both?

   C. Will the benefit level be indexed?

   D. What will be the extent of transfer, if any, between generations or between high and low wage earners?

   E. Will there be minimum or maximum benefits?

5. What will be level of contribution from employers/employees.

6. Will the accumulated funds continue to be managed centrally by the government with the assistance of private fund mangers or managed privately?

6.10 In redesigning these programs we believe it is important to consider the likely costs and benefits over a long-term period. A period of 75 years provides a span that will likely cover the lifetime of all persons contributing to the system. Using two or three sets of economic and demographic projections, designers of a pension system should model the various possible outcomes before finalizing such an important effort.

6.11 In addition to these various considerations, the mission explored the benefits to be derived from merging the GSIS and SSS. These findings are discussed in Annex D along with a transitional plan for accomplishing the merger.

ANNEXES

ACTUARIAL CONCEPTS AND TERMINOLOGY

1. This annex explains certain key fundamental actuarial concepts and terminology that are useful for understanding the evaluation of the actuarial status of the benefit programs.

2. **Funding versus Pay-as-you-go.** Funding a benefit plan entails making financial provisions to meet future benefit payments and administration costs. Funding objectives of benefit plans will vary between full-funding and no-funding (or pay-as-you-go). Under the latter, sufficient resources are raised to meet benefit and expense payments as they arise, and there is no accumulation of reserves except perhaps for a requirement to keep a contingency reserve sufficient to cover a few months of benefit payments. Under fully or partially funded programs, the contributions collected are greater than the current benefit payments and administrative costs, and the excess is invested to finance part or all of future program costs.

3. **Short-term Benefits.** It is generally accepted practice to provide short-term benefits under a pay-as-you-go system. These benefits do not represent open-ended commitments involving substantial amounts of capital and so are susceptible to simpler methods of evaluation such as tracking the progression of yearly costs expressed as a percentage of covered earnings. The costs of these programs are easier to control, and the impact on the costs resulting from changes in the level or structure of benefits, or from changing economic and social conditions, is more transparent.

4. **Long-term Benefits.** Benefits such as those payable for retirement, survivorship and disability are generally referred to as "long-term" since the benefits accrue over a long time period (usually over the working life-time of the employee) and are typically payable for an extended period of time (usually during the remaining lifetime of the recipient). The pattern and shape of increases in long-term benefits are sensitive to economic and social conditions, demographic influences, and changes in the benefit structure of the programs. Annual benefit payments are likely to rise rapidly over time as:

- more workers reach retirement age;
- benefits for retirees increase because of longer service with the system and higher final average pay levels;
- improvements are added to the benefit formula (e.g., increasing the wage base ceiling);
- pensions in payment are increased on a regular or ad hoc basis; and
- longevity increases.

5. **Advantages of Funding.** The proper funding of long-term benefits requires the accurate anticipation of the future levels of benefit payments. Contribution levels under funded programs are initially higher than required in order to meet current payments over many years. Even so, funding offers the following advantages with respect to meeting the costs of the program:

- The costs of pension and related obligations are recognized as they are earned or accrued (usually over an employees' working life time).

- Funding reduces the deferment of costs. In an unfunded plan, the cost of benefits is met at the time of payment even though the benefit entitlement might have been earned many years earlier.

- The payment of higher than necessary contributions in the early years of an individual's participation helps to even out the pattern of increasing costs, which makes financial planning easier.

- Inter-generational transfer of responsibility for meeting the financial commitments is reduced; each group of participants meets its own liabilities.

- Assets are earmarked and separated from the assets of the plan sponsors; this segregation reinforces the security of the benefits, especially in the case of employer-sponsored programs.

6. The desired level of funding depends on the importance of the above considerations to the plan sponsor. Full-funding aims at having sufficient assets to cover all benefits accrued with respect to past service, including allowances for future increases in benefits due to future increase in pay, wage base ceilings, and pensions. At the other extreme, pay-as-you-go schemes assume that costs will be met at the time of occurrence, so there is no advance funding. There are a host of intermediate positions. Different considerations apply in determining the desired level of funding, depending on whether the plan sponsor is the Government or a private employer.

7. **Funding of Private Employer Programs.** Where the plan sponsor is a private employer, security is a very important consideration, as is the ability to even out the cost of the program. Hence, funding is desirable. However, the actual level of funding will also be influenced by legislation governing occupational pension plans, tax and accounting implications, and the availability of the necessary finance.

8. **Funding of Social Security Programs.** For government-sponsored social security programs, the security of benefits is less of a concern, as the benefits are usually guaranteed by the Government's ability (at least in theory) to collect and allocate sufficient tax revenue to meet its needs. Also, high levels of funding of social security benefits require the accumulation and investment of vast resources by the Government, with potential adverse consequences from a market economy perspective — the crowding out of private investment, the threat of nationalization, the danger that demand for investment could exceed supply, thereby pressuring yields. Most social security programs around the world, such as the SSS and the GSIS, are of the defined benefit type (as opposed to defined contribution plans), and are in fact unfunded or minimally funded.

9. In developing countries with low levels of capital formation, a strong argument can be made for encouraging the funding of social security benefits. The accumulated assets can form a valuable and significant source of capital for investments. Furthermore, with a generally younger population, developing countries can expect a more rapid increase in the level of benefits to be paid, which would, in the absence of advance funding, mean frequent revisions to the contribution rates. It is encouraging to note that the Government of the Philippines has taken a leading role in this area by deciding to fund both the SSS and the GSIS. While the SSS and the GSIS have adopted funding methods that are different from one another, both methods are characterized by partial funding.

10. **Funding Method Used by the SSS.** In funding its main social security benefits, the SSS has adopted a system known as the scaled premium method. This method of funding is recommended for developing countries by the ILO. It involves a long-term projection of cash flows. Items of income (contributions and investment earnings) are compared year-by-year with items of expenditure (expected benefit payments and expenses). The current level of contributions would be considered to be satisfactory if, for a sufficiently long period in the future, income is expected to exceed expenditures.

11. **Funding Method Used by the GSIS.** For its Social Insurance Fund, the GSIS has adopted a method which would appear to be one that aims towards full funding, in common with many private occupational plans. Instead of evaluating future cash flow projections, past service liabilities (i.e., the present value of benefits that have accrued with respect to past service rendered) are determined and compared with the value of assets as of the measurement date. This follows a more traditional accounting style of presentation which employs an actuarial balance sheet. In determining past service liabilities, assumptions are made for future pay increases.

12. It should be noted, however, that the membership data used by the GSIS for its valuations do not reflect updated salary information and no adjustments are made on account of this. Salary data, in most cases, are several years out-of-date. Moreover, no future pension increases are anticipated and the wage base ceiling is assumed to remain at current levels. The liabilities calculated by the GSIS are therefore significantly understated.

13. Thus, although the GSIS uses what at first glance appears to be a full funding method (the assets held by the GSIS are intended to approximately equal the liabilities calculated by the GSIS), in its application the method results in the accumulation of assets appropriate for a partially funded program.

14. **Actuarial Assumptions.** The current and projected financial status of the various programs is crucially dependent on the various actuarial assumptions used in the actuarial assessment. Three assumption scenarios were used in order to produce optimistic, best estimate and pessimistic results. Table A.1 shows the assumptions used that have the most significance. It should also be noted that the yield on funds assumed under all three scenarios is set equal to the valuation interest rate. A full discussion of the assumptions appears in the detailed actuarial report. These assumptions have also been discussed with the actuarial staff of the GSIS and SSS. In comparing the assumptions included in the best estimate, optimistic, and pessimistic sets, it should be borne in mind that it is the interaction between the different assumptions that is important, more than the individual values.

15. **Approaches Used for the Independent Assessment.** The primary focus of the assessments has been directed towards the long-term benefits of the main social security component of the two systems as these represent, by far, the largest financial obligations. The scaled premium method is used for the independent assessment. Since the SSS is the predominant institution, any merger is likely to involve a move towards SSS procedures rather than towards those of the GSIS. The SSS funding method also involves the projection of future cash flows, and an analysis of long-term cash flow trends is essential to a proper understanding of the actuarial status of these funds.

16. The funding levels, or the extent to which the assets cover the liabilities, have been measured in three different ways:

- Assets have been compared with the Past Service Liability - Projected (PSL-Projected). This measures the liabilities accrued in respect of past service rendered at the measurement date, with an allowance for future increases in salaries. Fully funded plans aim to have sufficient assets to cover this measure of liability.

- Assets have also been compared with the Past Service Liability - Current (PSL-Current). This measures the liabilities accrued in respect of past service rendered at the measurement date, without any allowance for future increases in salaries. This is also a common measure of coverage used by funded plans.

- With social security programs, a common measure of coverage is to express the assets in terms of the number of years the assets would cover current benefit payments and expenses. This Ratio of Assets to Expenditures and its progression have also been determined.

17. The projections of cash flows and funding levels for the Social Benefit programs have been carried out for a period of 45 years. The evaluation of the Medicare and the Employees' Compensation programs have been carried out analyzing cash flows only, with a projection period of 10 years.

TABLE A.1

Key Assumptions Used for Actuarial Assessment as of January 1, 1994

	Best Estimate Scenario		Optimistic Scenario		Pessimistic Scenario	
GSIS						
1. Valuation Interest Rate/ Yield on Funds 1/	Initial:	10.50%	Initial:	12.50%	Initial:	9.20%
	Ultimate, from 1999:	8.00%	Ultimate, from 1999:	8.00%	Ultimate, from 1999:	8.70%
2. Salary Increases	Initial:	10.00%	Initial:	9.50%	Initial:	10.50%
	Ultimate, from 1999:	7.50%	Ultimate, from 1999:	5.00%	Ultimate, from 1999:	10.00%
3. Increases in Wage Base Ceiling 2/	Ultimate:	7.00%	Ultimate:	3.00%	Ultimate:	10.00%
4. Increases to Pensions in Payment	Initial:	8.50%	Initial:	6.50%	Initial:	9.50%
	Ultimate, from 1999:	6.00%	Ultimate, from 1999:	2.00%	Ultimate, from 1999:	9.00%
5. Increases in Medical Limits	Initial:	9.50%	Initial:	8.50%	Initial:	10.50%
	Ultimate, from 1999:	7.00%	Ultimate, from 1999:	4.00%	Ultimate, from 1999:	10.00%
SSS						
1. Valuation Interest Rate/ Yield on Funds 1/	Initial:	11.30%	Initial:	12.60%	Initial:	9.70%
	Ultimate, from 1999:	8.80%	Ultimate, from 1999:	8.10%	Ultimate, from 1999:	9.20%
2. Salary Increases	Initial:	10.50%	Initial:	9.50%	Initial:	11.00%
	Ultimate, from 1999:	8.00%	Ultimate, from 1999:	5.00%	Ultimate, from 1999:	10.50%
3. Increases in Wage Base Ceiling 3/	Ultimate:	7.00%	Ultimate:	3.00%	Ultimate:	10.00%
4. Increases to Pensions in Payment	Initial:	8.50%	Initial:	6.50%	Initial:	9.50%
	Ultimate, from 1999:	6.00%	Ultimate, from 1999:	2.00%	Ultimate, from 1999:	9.00%
5. Increases in Medical Limits	Initial:	9.50%	Initial:	8.50%	Initial:	10.50%
	Ultimate, from 1999:	7.00%	Ultimate, from 1999:	4.00%	Ultimate, from 1999:	10.00%

1/ The yields shown are for the Social Benefits funds. A slightly lower yield has been used for the Medicare and EC funds in order to reflect the shorter-term nature of the investments required for these programs.

2/ The current wage base ceiling for GSIS is P. 3,000 per month, but is expected to go up to p. 6,000 per month in the near future.

3/ The current wage base ceiling for SSS is P.7,000 per month and is scheduled to increase by P.1,000 annually until 1999 when it reach P. 12,000 per month.

RESULTS OF ACTUARIAL ASSESSMENT

Actuarial Position of Social Benefits Programs

1. Charts B.1 and B.3 show the projected net income for the funds of the Social Benefits programs of the GSIS and the SSS, respectively. Net income is defined as contributions plus investment returns (realized and unrealized), less benefit payments and expenses. The projected net income is shown under all three scenarios considered (best estimate, optimistic, and pessimistic), and until the year that the net becomes zero under the optimistic assumptions (2010 for the GSIS and 2016 for the SSS).

2. Under the best estimate assumptions, the net income is seen to rise gradually for just over 12 years for the SSS. It then begins to drop and becomes negative by the year 2014. Therefore, under the scaled-premium funding method used by the SSS, contributions will have to be raised sometime well before 2014 in order to maintain a reasonable level of funding.

3. Charts B.2 and B.4 show the projected funded position under the best estimate assumptions, using three different measures, as follows:

(i) Ratio of Assets to liabilities. Asset coverage percentage: PSL - Projected.
(ii) Asset Coverage Percentage: PSL - Current.
(iii) Past Service Liability - Current.

These measures are discussed in Annex A.

4. Chart B.2 indicates that although GSIS assets will initially cover ten years of expenditures at current levels, the fund is expected to be exhausted in the year 2015 - only 20 years into the future. As for the SSS, Chart B.4 shows a similar current expenditure coverage ratio, although the fund will not be depleted until 2021.

5. Chart B.5 shows the impact of improved compliance on the Social Benefits program of the SSS, using best estimate assumptions. Although improved compliance results in higher net income in the early years, the attendant increase in benefits payable (as the participation percentage increases, more employees will be eligible to receive benefits) will eventually cause serious strains on fund resources. Low compliance is not a problem under the GSIS.

Actuarial Position of Medicare Programs

6. Charts B.6 and B.7 show the projected status under the best estimate assumptions of the Medicare programs for the GSIS and the SSS, respectively, for a projection period of ten years. The charts show the assets to expenditures ratio (measured against the left-side vertical) and the net income to the funds (measured against the right-side vertical). Both Medicare funds are likely to run out of funds - by the year 2001 for both the GSIS and the SSS.

Actuarial Position of Employees' Compensation Programs

7. Charts B.8 and B.9 show the projected status of the Employees' Compensation programs for the GSIS and the SSS, respectively, for a projection period of ten years. The charts show the assets to expenditures ratio (measured against the left-side vertical) and the net income to the funds (measured against the right-side vertical). The GSIS program would exhaust in its funds by the year 2002, while the SSS program is likely to remain heavily overfunded (an assets to expenditures ratio of about 20 for the entire projection period).

Factors Influencing Actuarial Assessment

8. **Impact of Population Demographics.** Chart B.10 illustrates how the age distribution of the Philippine population is expected to progress over the next 50 years. It shows a very young workforce which will age significantly over the next fifty years. The ratio of the population age between 25 and 60 to the population above age 60 is an indicator of the number of potential workers to retirees. This ratio is currently close to 6 and is expected to stay level for another 15 years and drop to close to 3 by the year 2040. As more employees reach retirement, the cost of pension and related benefits will be expected to increase, especially under pay-as-you-go or partial methods of funding.

9. Chart B.11 shows the current age distribution of active SSS and GSIS participants, and it is readily apparent that GSIS participants are significantly older. Consequently, a harmonized benefit plan will likely cost more for GSIS members than for SSS members.

10. **Level of Benefits and Contributions.** The level of benefits provided and the contributions collected have an obvious impact on the cash flow situation of the program funds and funding levels. Table B.1 shows a summary of current contribution requirements under both the GSIS and the SSS. GSIS contributions are at a higher rate, but a portion is subject to a lower wage base ceiling than the SSS.

11. Table B.2 shows a summary of the pension related benefits, the most expensive part of the Social Benefits program. The GSIS provides a pension at retirement of close to 80% of final salary for those with a full career of 35 years whose earnings lie within the wage base ceiling. The wage base ceiling is currently at a relatively low level of ₱ 3,000 per month, but is expected to rise to ₱ 6,000 per month in the near future, at which time the salary of most GSIS participants will be fully covered. Certain alternative benefits, for which there is no salary cap, apply to older GSIS participants. The most expensive ancillary benefit related to the participant's pension is the surviving spouse's pension on the death of the participant, which in the case of the GSIS is 50% of the member's pension. The SSS also provides a very generous pension, aiming at a salary replacement rate at retirement of close to 70% for a full career of 35 years, with higher wage base ceilings. The surviving spouse's pension in this case is at the level of 100% of the participant's pension.

12. **Participant Data.** Naturally, the valuation results are directly affected by the data that are provided for valuation purposes. The mission made several adjustments and assumptions in the data provided. and these are detailed in the full actuarial report. These adjustments and assumptions were discussed with the staff of the actuarial departments of the GSIS and the SSS in the field during the mission. Table B.3 shows a brief summary of the data used for the actuarial assessment.

13. For the GSIS, the primary adjustments concerned updating the salaries in their database. These were adjusted for valuation purposes by examining the current salary distribution available from another source, also provided by the GSIS staff. On average, salaries had to be increased by about 75%. The impact of this is not only reflected in the actuarial liabilities and projected cash flows, but also on the value placed on the actuarial reserve for compulsory life insurance, which had to be increased significantly from the amounts shown in the financial statements.

14. With respect to the SSS, the adjustments mainly focused on compliance, including the average number of months of contributions for currently contributing members, and certain characteristics of the non-contributing population. Details are provided in the full actuarial report.

15. **Assets and Investment.** The amount of assets taken into account determines the future flow of investment income and the extent to which assets cover the liabilities. Table B.4 shows the assets under the two systems, as reported in their financial statements as of December 31, 1993, and the values taken into account for the actuarial assessment. Figures are given separately for the Social Benefits, Medicare and Employees' Compensation funds.

16. As the compulsory part of the GSIS's Life Insurance program was excluded from the assessment, the actuarial reserves held for this benefit were subtracted from the value of the fund to arrive at the amount of assets available for the rest of the program. The actuarial reserve for the compulsory life program shown in the financial statement as of December 31, 1993 was based on out-of-date information and had to be adjusted.

17. The investment mix of the asset portfolios and the past performance of assets in each type of investment were used to determine the valuation rate of interest used in the assessment.

CHART B.1

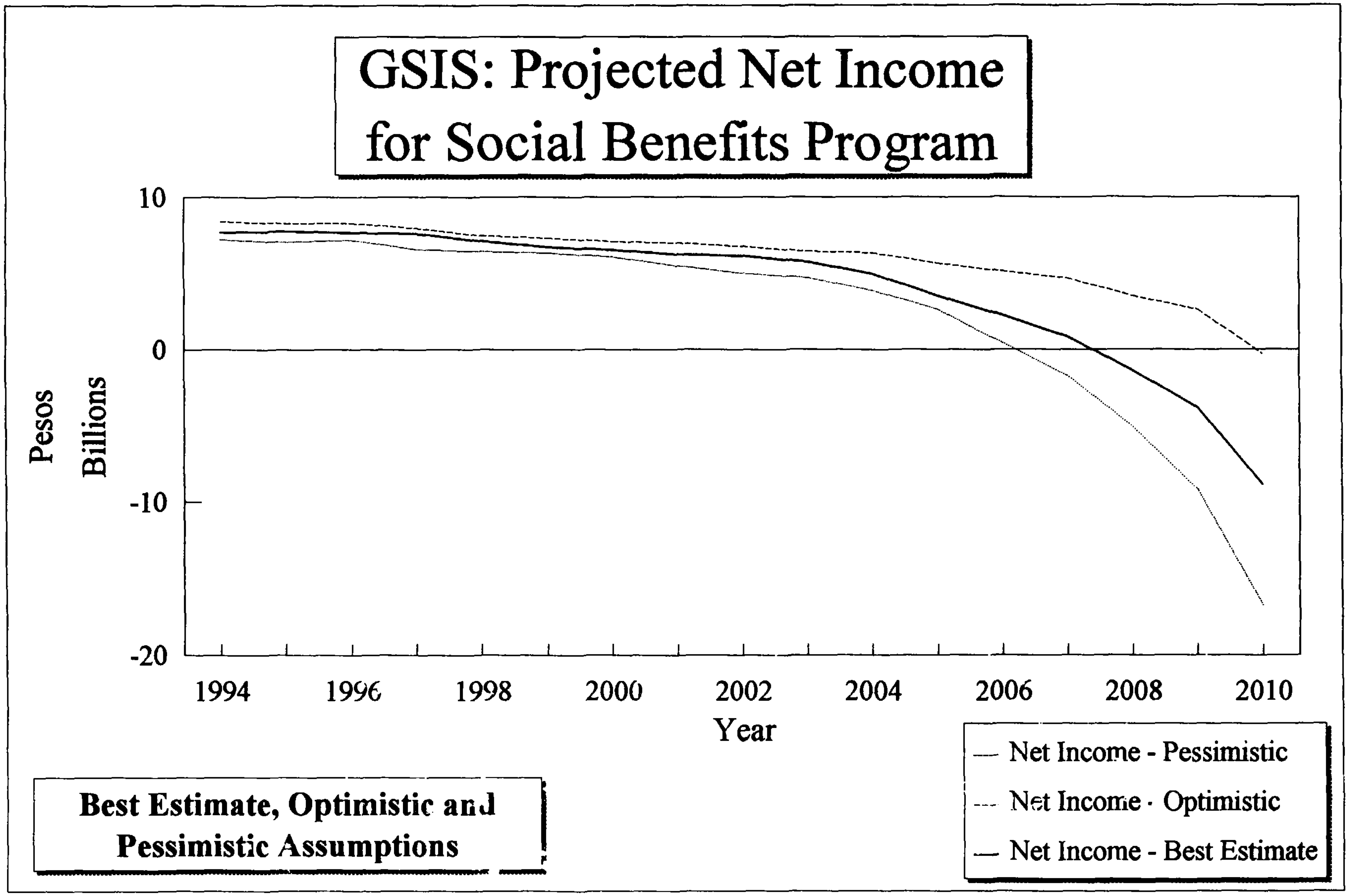
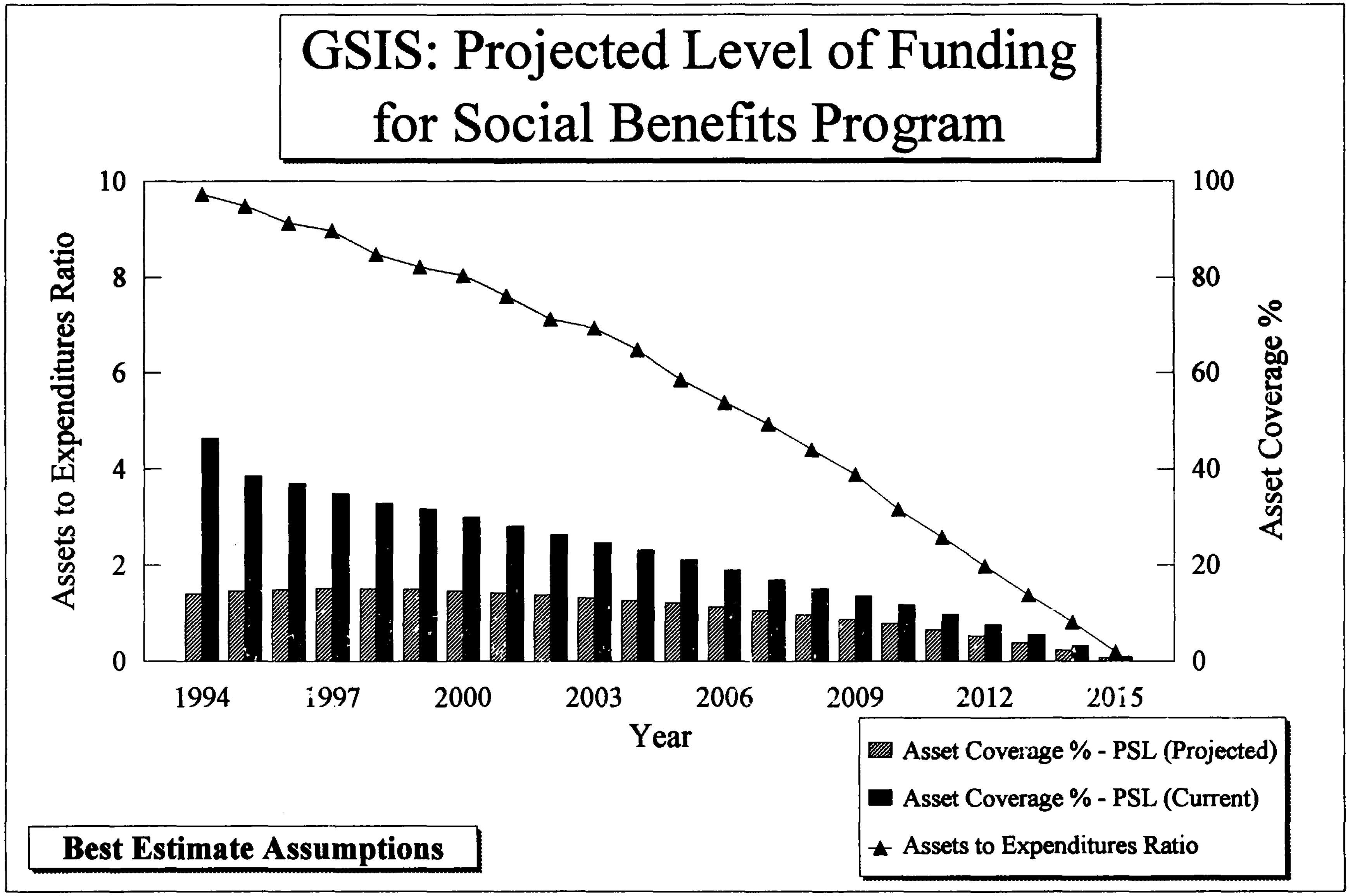

GSIS: Projected Net Income
for Social Benefits Program
10
0
-10
-20
Pesos
Billions
1994
1996
1998
2000
2002
2004
2006
2008
2010
Year
Net Income - Pessimistic
Net Income - Optimistic
Net Income - Best Estimate
Best Estimate, Optimistic and
Pessimistic Assumptions

CHART B.2



GSIS: Projected Level of Funding for Social Benefits Program
Assets to Expenditures Ratio
Asset Coverage %
0
2
4
6
8
10
0
20
40
60
80
100
1994
1997
2000
2003
2006
2009
2012
2015
Year
Asset Coverage % - PSL (Projected)
Asset Coverage % - PSL (Current)
Assets to Expenditures Ratio
Best Estimate Assumptions

CHART B.3

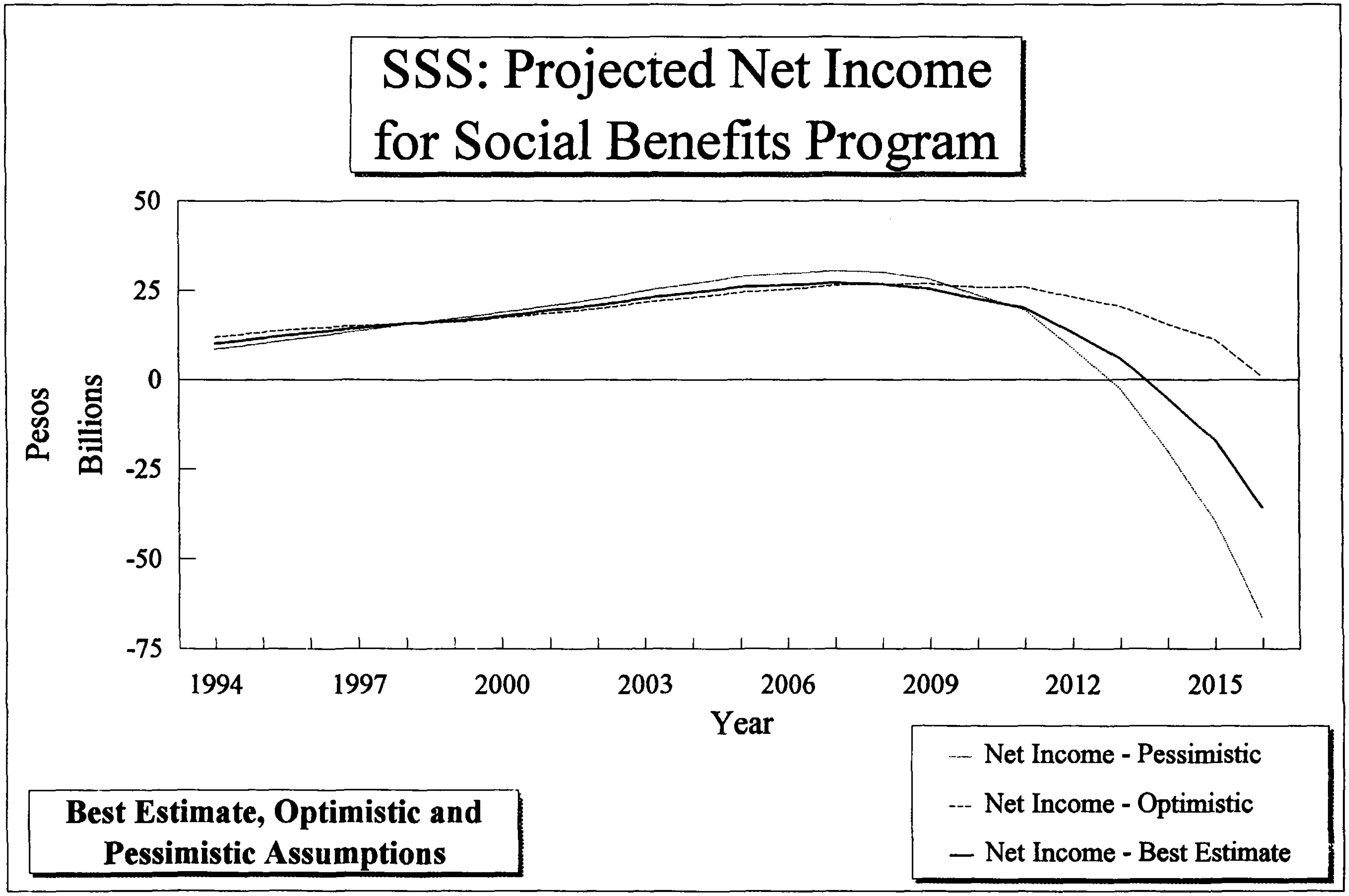

SSS: Projected Net Income
for Social Benefits Program
50
25
0
-25
-50
-75
Pesos
Billions
1994
1997
2000
2003
2006
2009
2012
2015
Year
Net Income - Pessimistic
Net Income - Optimistic
Net Income - Best Estimate
Best Estimate, Optimistic and
Pessimistic Assumptions

CHART B.4

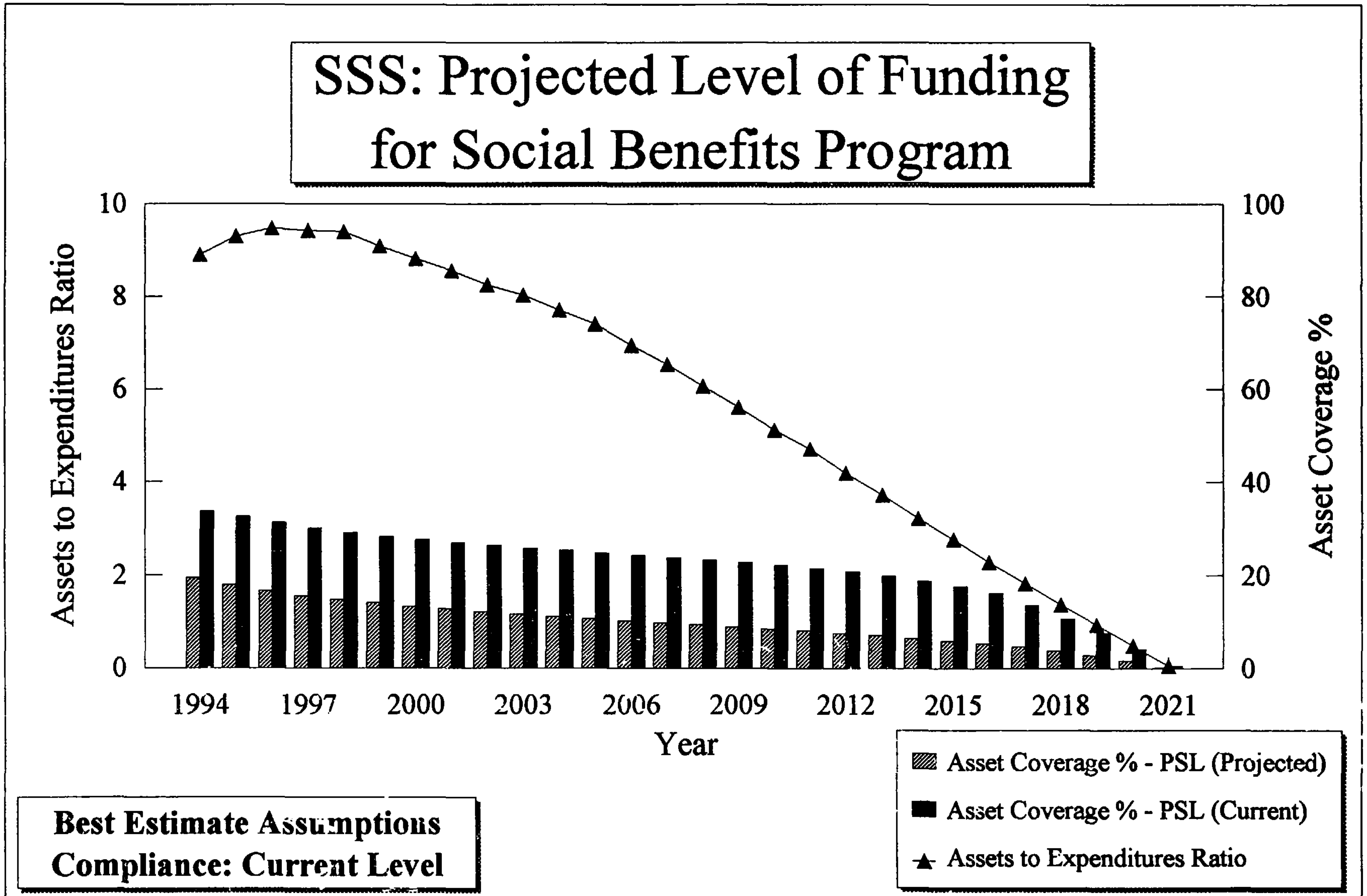

SSS: Projected Level of Funding
for Social Benefits Program
Assets to Expenditures Ratio
Asset Coverage %
Year
10
8
6
4
2
0
100
80
60
40
20
0
1994
1997
2000
2003
2006
2009
2012
2015
2018
2021
Asset Coverage % - PSL (Projected)
Asset Coverage % - PSL (Current)
Assets to Expenditures Ratio
Best Estimate Assumptions
Compliance: Current Level

CHART B.5

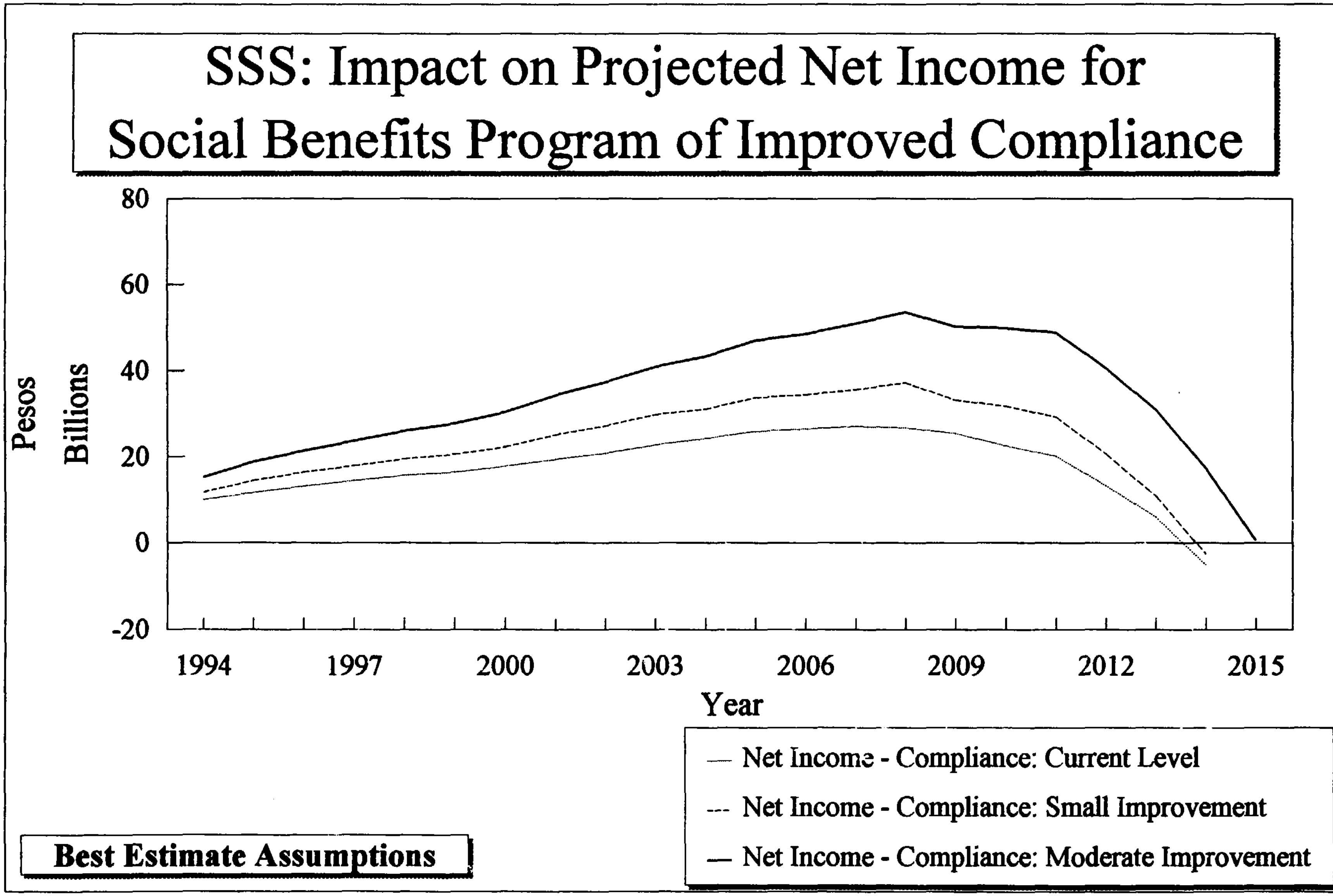
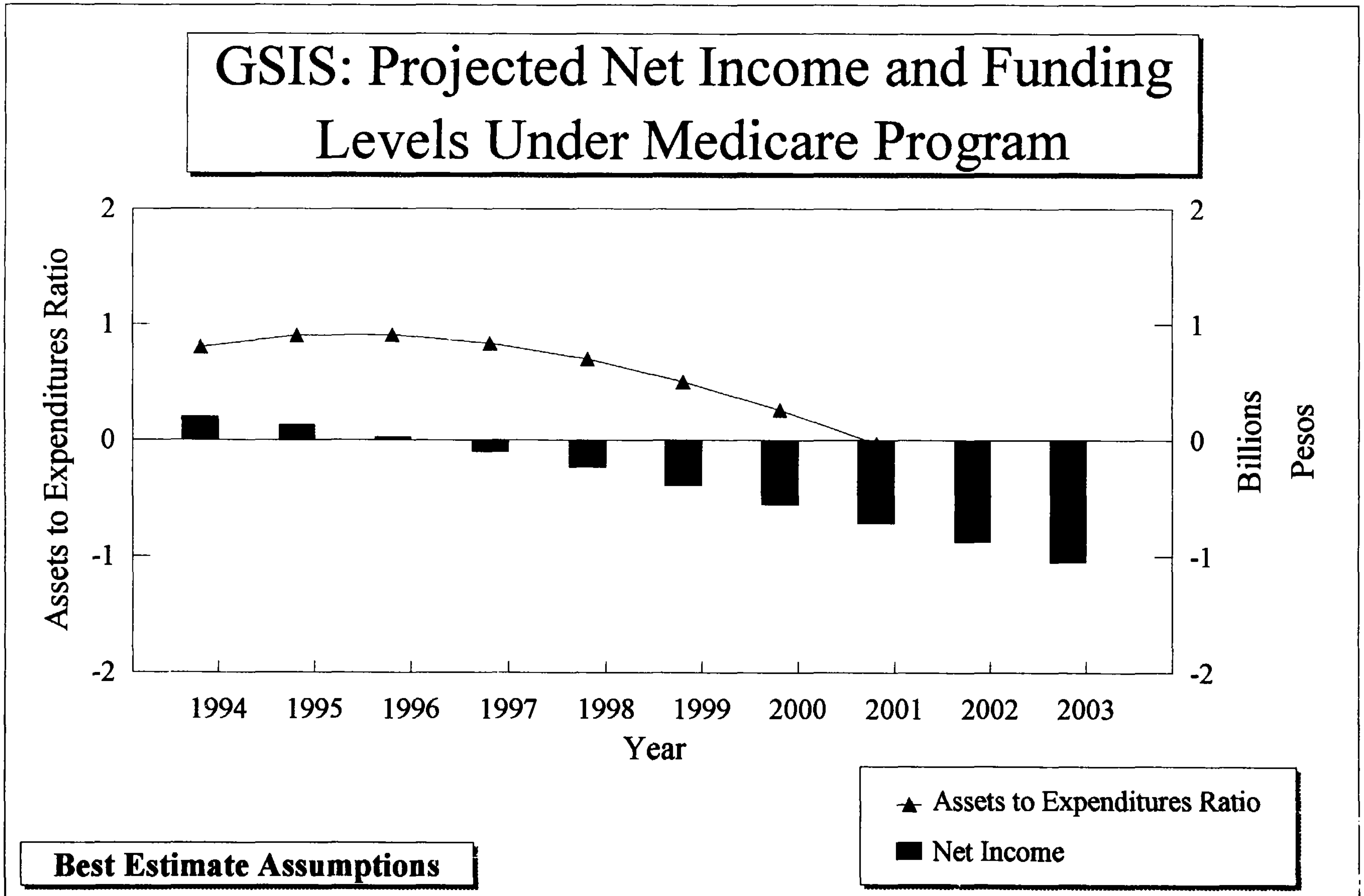

SSS: Impact on Projected Net Income for
Social Benefits Program of Improved Compliance
80
60
40
20
0
-20
Pesos
Billions
1994
1997
2000
2003
2006
2009
2012
2015
Year
Net Income - Compliance: Current Level
Net Income - Compliance: Small Improvement
Net Income - Compliance: Moderate Improvement
Best Estimate Assumptions

CHART B.6



GSIS: Projected Net Income and Funding Levels Under Medicare Program
Assets to Expenditures Ratio
Billions Pesos
2
1
0
-1
-2
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
Year
Assets to Expenditures Ratio
Net Income
Best Estimate Assumptions

CHART B.7

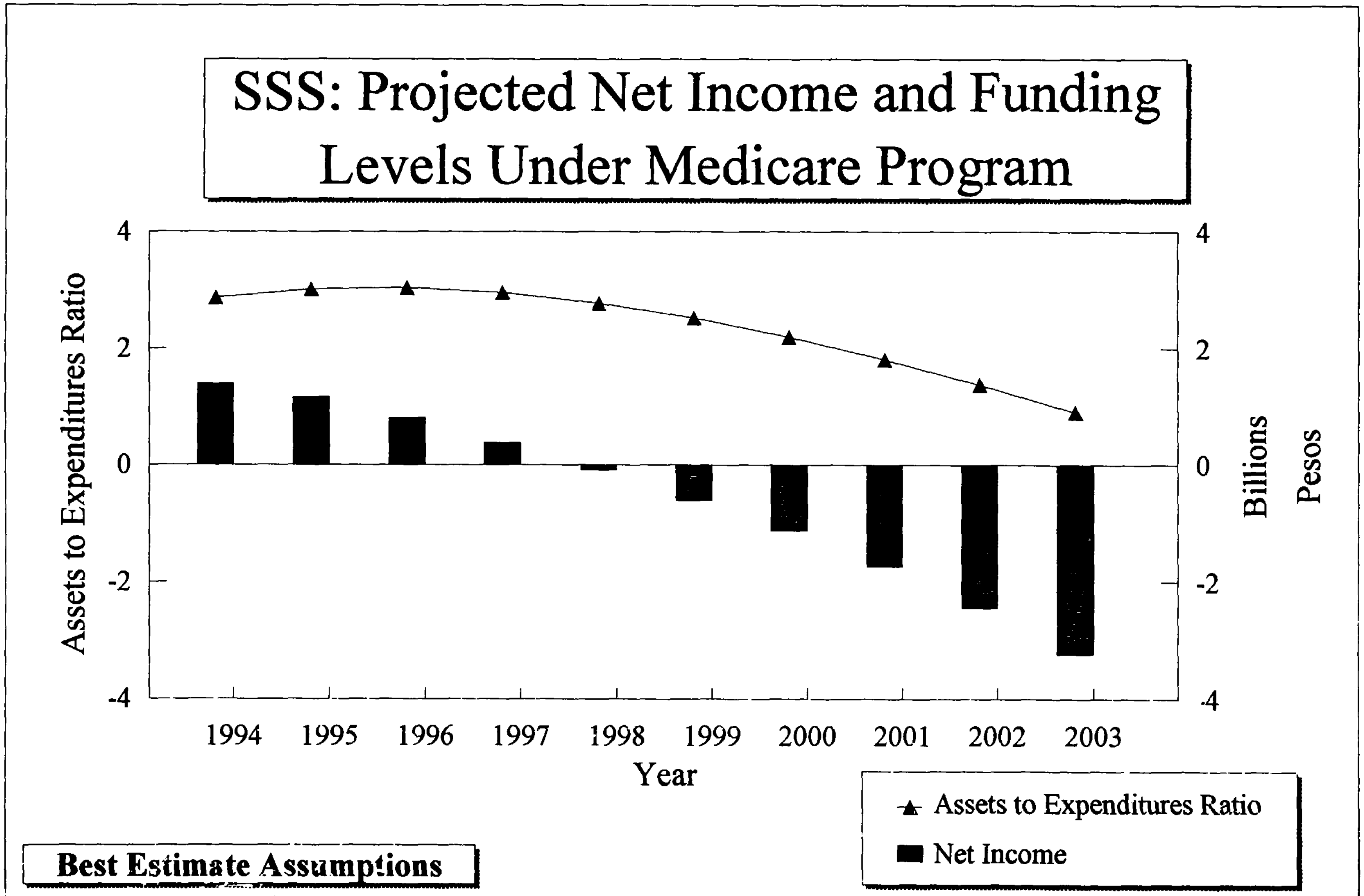

SSS: Projected Net Income and Funding Levels Under Medicare Program
Assets to Expenditures Ratio
4
2
0
-2
-4
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
Year
Billions Pesos
Assets to Expenditures Ratio
Net Income
Best Estimate Assumptions

CHART B.8

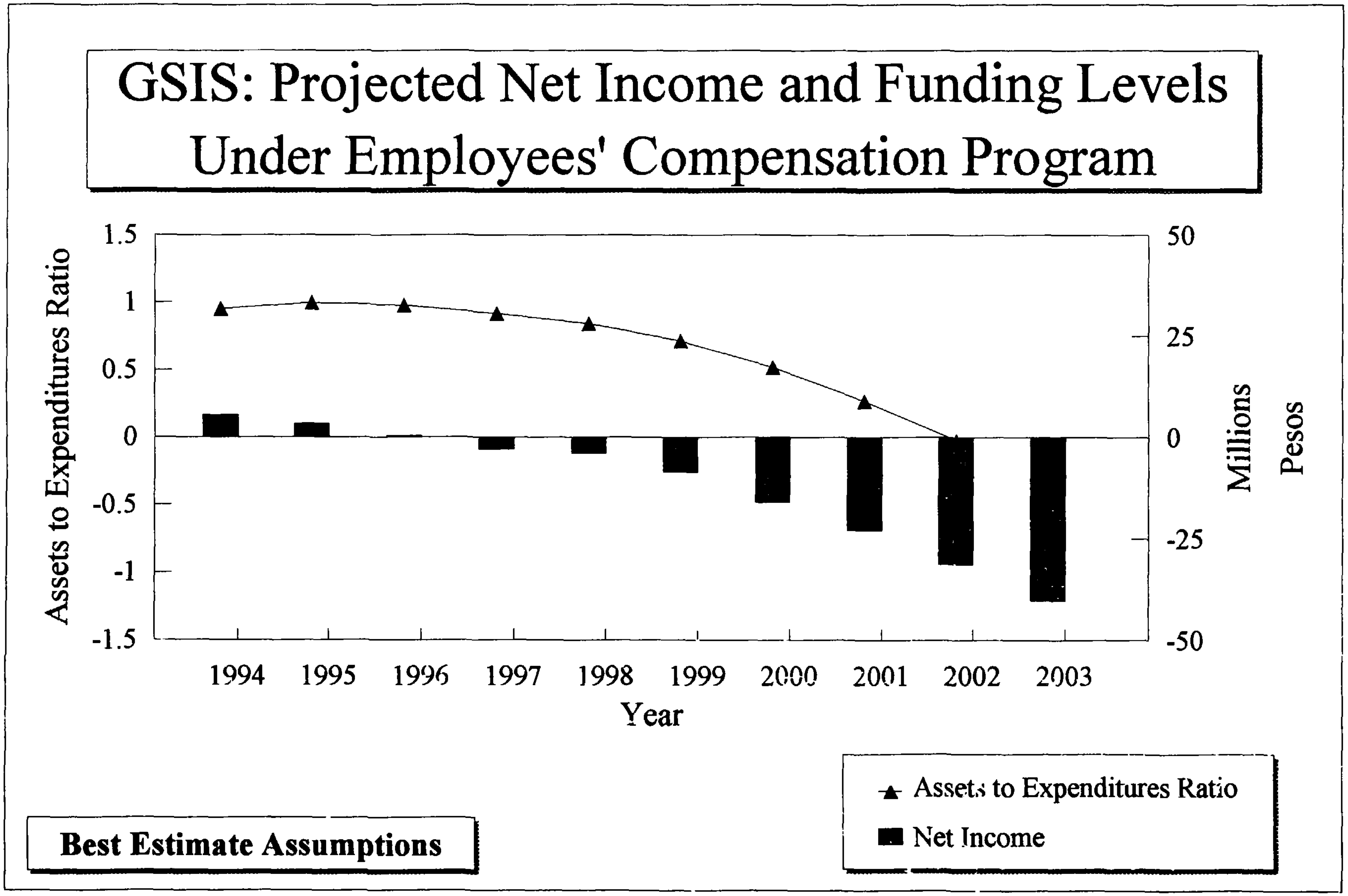
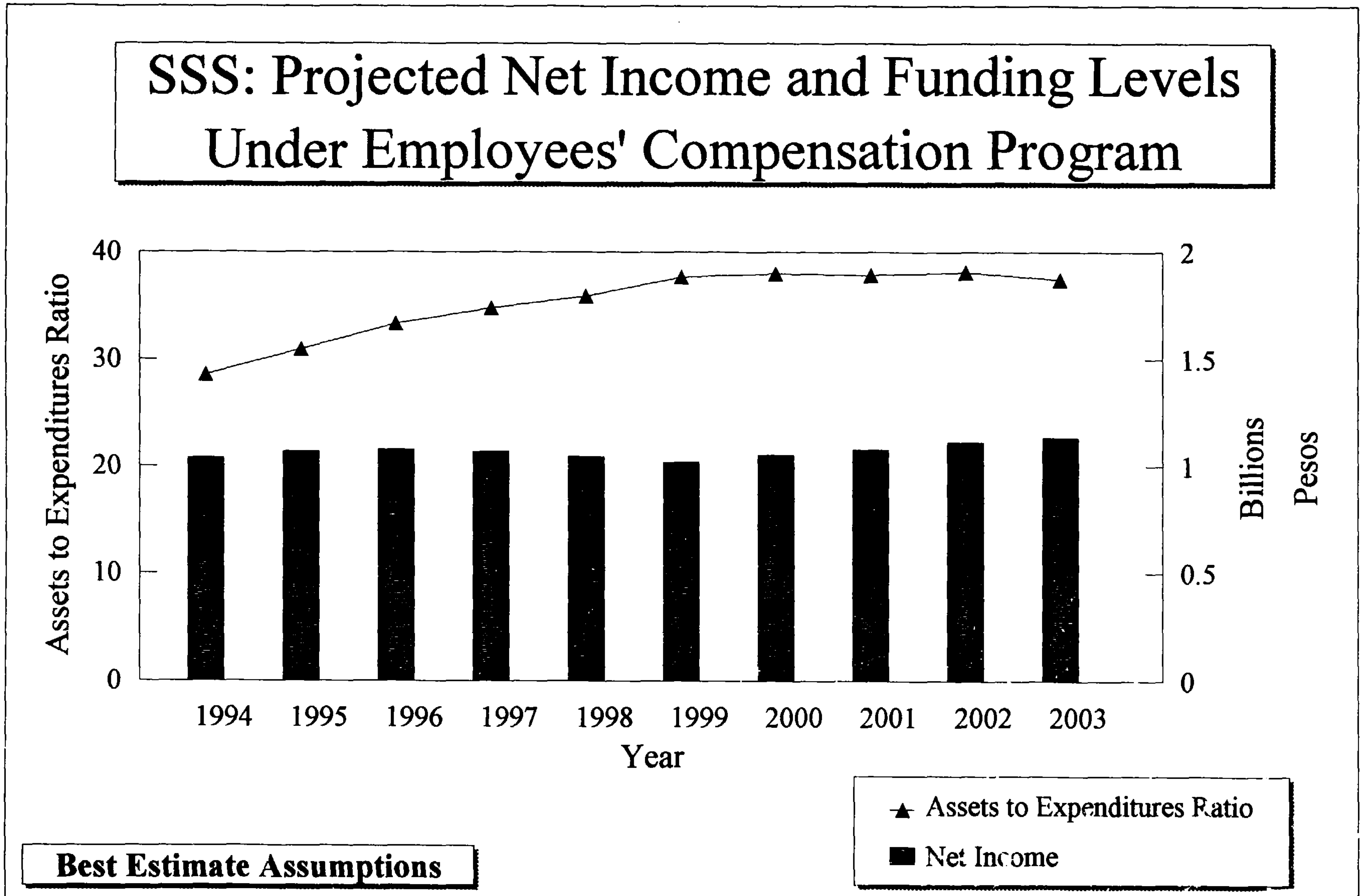
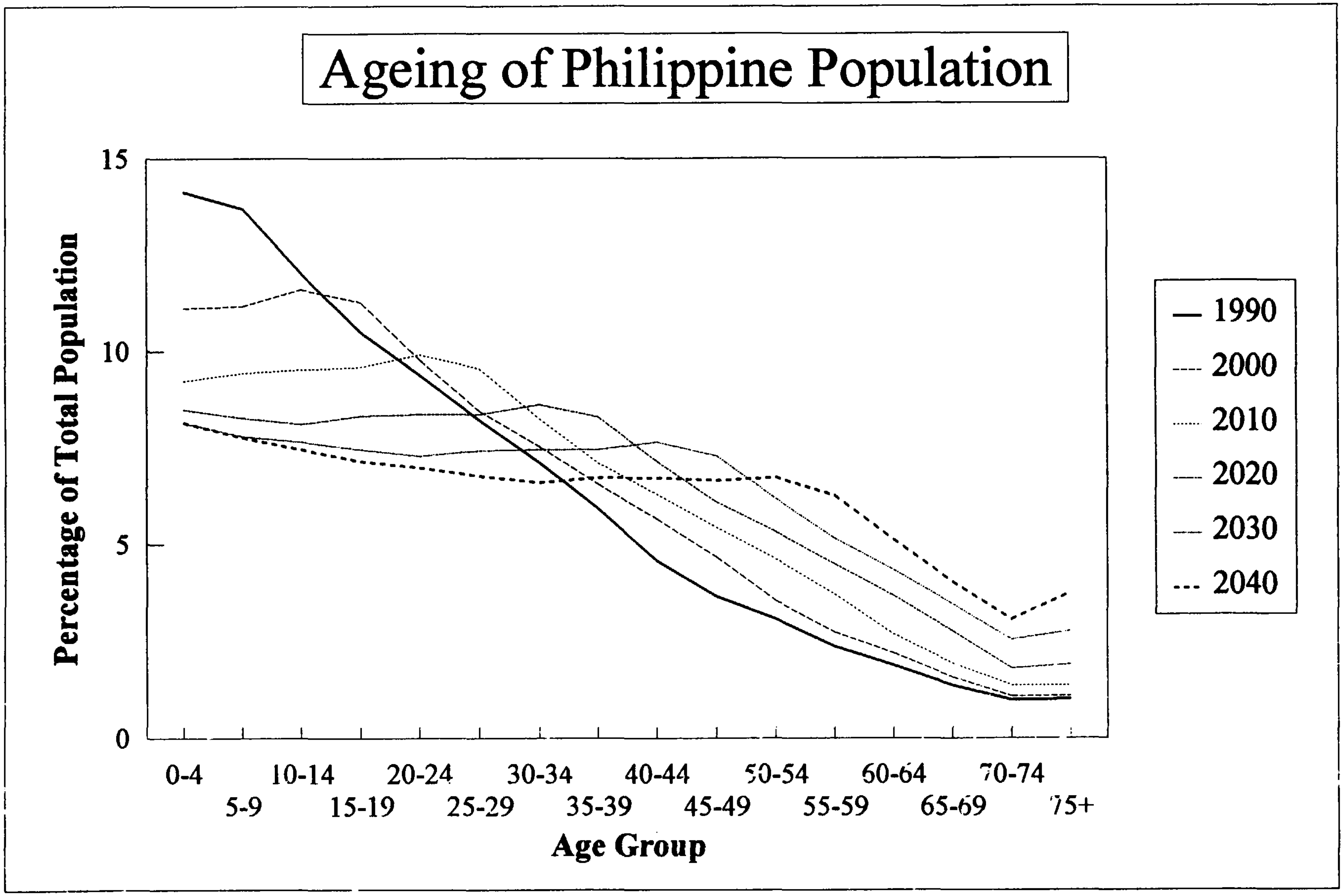

GSIS: Projected Net Income and Funding Levels
Under Employees' Compensation Program
Assets to Expenditures Ratio
1.5
1
0.5
0
-0.5
-1
-1.5
50
25
0
-25
-50
Millions Pesos
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
Year
Assets to Expenditures Ratio
Net Income
Best Estimate Assumptions

CHART B.9



SSS: Projected Net Income and Funding Levels
Under Employees' Compensation Program
Assets to Expenditures Ratio
40
30
20
10
0
2
1.5
1
0.5
0
Billions Pesos
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
Year
Assets to Expenditures Ratio
Net Income
Best Estimate Assumptions

CHART B.10



Ageing of Philippine Population
15
10
5
0
Percentage of Total Population
0-4
5-9
10-14
15-19
20-24
25-29
30-34
35-39
40-44
45-49
50-54
55-59
60-64
65-69
70-74
75+
Age Group
1990
2000
2010
2020
2030
2040

CHART B.11

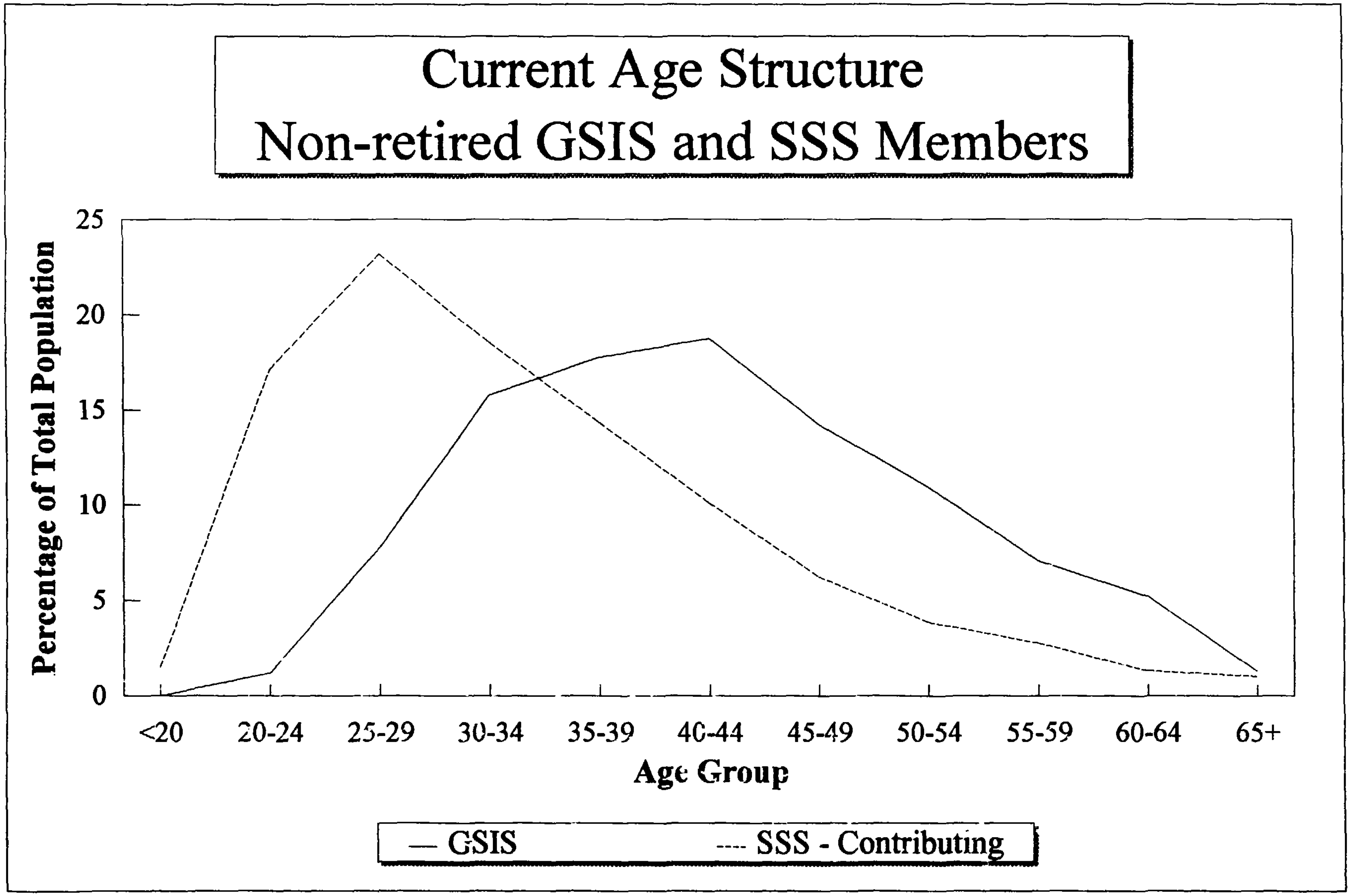

Current Age Structure
Non-retired GSIS and SSS Members
Percentage of Total Population
25
20
15
10
5
0
<20
20-24
25-29
30-34
35-39
40-44
45-49
50-54
55-59
60-64
65+
Age Group
— GSIS
---- SSS - Contributing

TABLE B.1

Summary of Current Contribution Requirements for Participants Earning Over Minimum Level

(Amounts shown are expressed as percentages of covered salary)

Programs	GSIS			SSS		
Social Benefits	Employee	Employer	Total	Employee	Employer	Total
- Retirement and related	5.50 [2] plus 1.00 [3]	7.50 [3]	14.00	3.33 [1]	5.07 [1]	8.40
- Life insurance	2.00 [3]	2.00 [3]	4.00			
Medicare	1.25	1.25 [4]	2.50	1.25 [4]	1.25 [4]	2.50
Employee's Compensation	----	1.00 [4]	1.00		1.00 [5]	1.00
TOTAL	9.75	11.75	21.50	4.58	7.32	11.90

1/ Maximum covered monthly salary of P.7,000 in 1994, P.8,000 in 1995, P.9,000 in 1996, P. 10,000 in 1997, P.11,000 in 1998 and P.12,000 in 1999.
2/ Maximum covered monthly salary of P.3,000.
3/ No maximum covered monthly salary.
4/ Maximum covered monthly salary of P.3,000.
5/ Maximum covered monthly salary of P.1,000.

TABLE B.2

Summary of Principal Pension Benefits

Type of Pension Benefit	GSIS	SSS
1. Monthly retirement pension for members with more than minimum number of credited years and earning more than stipulated wage minimums.	2.5% x Credited Years x RAMC Revalued Average Monthly Compensation is 36-month average of compensation, plus P.140, subject to a maximum of P.3,140.	2% x Credited Years x 60-month average of Monthly Salary Credit. Monthly Salary Credit is monthly salary up to a wage base ceiling which is P.7,000 per month at 1/1/94, increasing to P.12,000 per month at 1/1/99.
2. Post-retirement spouse's pension	50% of monthly pension.	100% of monthly pension
3. Pre-retirement spouse's pension	50% of accrued monthly pension based on service completed and compensation history at death.	100% of accrued monthly pension based on service completed and compensation history at death.
4. Permanent disability pension	100% of accrued monthly pension based on service pension based on serviced completed and compensation history at death.	100% of accrued monthly pension based on service completed and compensation history at death.

TABLE B-3

Summary of Participant Information as of January 1, 1994

(Amounts in millions of Pesos)

A. Active Participants	Headcount	Total Annual Pay	Average Age	Average Past Service
GSIS 1/	1,172,030	61,817.2	42.4	16.2
SSS - Contributing	3,960,536	190,434.0	33.7	11.6

1/ Excluding armed forces and judiciary personnel.

B. Inactive Participants	Headcount	Total Annual Pensions	Average Age
GSIS			
Retired	82,477	1,450.5	74.1
Survivors	53,993	297.2	49.0
Disabled	1,445	21.6	69.5
SSS			
Retired	208,588	2,118.2	69.0
Survivors	406,868	2,499.5	28.6
Disabled	59,712	901.8	53.7

TABLE B.4

Value of Assets Considered for Actuarial Assessment as of January1, 1994

(Amounts shown are in Millions of Pesos)

			Amount Shown in Financial Statement as of December 31, 1993 1/	Amount Considered for Actuarial Assessment as of January 1, 1994
GSIS				
A.	1.	Social Insurance Fund	47,554.93	49,239.66 2/
	2.	less Compulsory Life Insurance Reserve	(7,596.99)	(12,269.99) 3/
	3.	Amount Available for Social Benefits	39,957.94	36,969.67
B.		Medicare Fund	847.17	847.17
C.		Employees' Compensation Fund	431.09	431.09
SSS				
A.		Social Benefits Fund	82,017.22	101,800.86 2/ 4/
B.		Medicare Fund	8,480.72	8,480.72
C.		Employees' Compensation Fund	11,038.58	11,038.58

1/ Total assets less current liabilities.

2/ Adjusted to reflect market value of stocks, and write-off of 5% of Non-Member Loans and write-off of certain investments as recommended by GSIS for the GSIS Social Insurance Fund.

3/ After adjustment to reflect updating of participant records.

4/ Also excludes certain "non-admitted" assets such as furniture, fixtures and equipment, in order to be consistent with the GSIS valuation of assets.

Annex Table C.1: Life Insurance Industry - Key Data, 1988-1992

	1988	%	1989	%	1990	%	1991	%	1992	%
Investments	14,625.8		15,885.7		19,382.6		22,687.0		27,587.3	
Investments in government securities	4,284.1		4,423.1		5,885.0		5,856.9		8,221.1	
Percentage to total (life)	29.3		27.8		30.4		29.99		29.8	
Insurance in force at the end of the year	168,223.2	100.0	200,393.8	100.0	231,727.0	100.0	261,882.0	100.0	337,113.5	100.0
Ordinary	109,798.4	65.3	132,469.1	66.10	159,146.5	68.7	185,143.3	70.7	207,510.9	61.6
Group	57,098.2	34.0	66,761.2	33.32	71,607.8	30.9	75,944.4	29.0	128,948.8	38.3
Industrial	1,335.6	0.8	1,163.5	0.58	972.7	0.4	794.3	0.3	653.8	0.2
Number of policies	3,363,913	100.0	3,154,839	100.0	3,066,659	100.0	2,885,311	100.0	2,798,702	100.0
Ordinary	2,079,886	61.8	2,019,843	64.02	2,046,180	66.7	1,977,787	68.6	1,987,427	71.0
Group	503,592	15.0	468,458	14.85	463,893	15.1	456,613	15.8	451,523	16.1
Number of certificates issued under group policies	4,591,924		5,139,684		4,681,078		3,052,105		4,493,852	
industrial	780,435	23.2	66,538	21.13	556,586	18.2	450,911	15.6	359,752	12.9
Legal Policy Reserves	9,197.0		10,672.2		12,361.8		14,969.8		16,517.8	

***Source*: Key Data, Insurance Industry, 1988-1992, Insurance Commission, Department of Finance, Republic of the Philippines.**

Annex Table C.2: Survey Profile - Retirement Funds, 1993

	Quarter Ended 12/31/93
1. Number of Participants	
- Companies	128
- Retirement Funds	171
2. Funding Medium	
- Trusteed	
. Professional Investment Manager	166
. Other	4
- Non-Trusteed	1
3. Total Plan Assets Surveyed	
(in millions of Philippine Pesos)	
- Trusteed	
. Professional Investment Manager	11,111.0
. Other	71.6
- Non-Trusteed	3.2
- Total	11,185.8
4. Average Plan Asset Size	
(in millions of Philippine Pesos)	
- Trusteed	65.8
- Non-Trusteed	3.2
- Total	65.4
5. Plan Assets Movement	
(in millions of Philippine Pesos)	
- Total Market Value of Plan Assets as of 9/30/93	9,587.0
. Contributions during the quarter	400.6
. Benefit payments during the quarter	(337.9)
. Investment income (including unrealized appreciation/depreciation of stocks)	1,536.1
- Total Market Value of Plan Assets as of 12/31/93	11,185.8
6. Number of Investment Managers	
- Banks	12
- Investment Houses	3
- Insurance Companies	1
7. Number of Funds per Manager Type	
- Banks	159
- Investment Houses	7
- Self-Managed	4
- Insurance Companies	1

***Source*: The Wyatt Company (Philippines) Inc. (1994), *36th Survey on Investment Performance of Retirement Funds in the Philippines*, March.**

Annex Table C.3: Executive Summary - Retirement Funds

Retirement Fund Investment Performance (All Trusteed Funds)						
	Fourth Quarter 1993 (%p.a.)	**Third Quarter 1993 (% p.a.)**	**Full Year 1993 (%p.a.)**	**Full Year 1992 (%p.a.)**	**1/1/91 to 12/31/93 (% p.a.)**	**1/1/89 to 12/31/93 (% p.a.)**
Best Performing	448.99	358.88	143.13	196.77	106.44	35.48
Upper Quartile	104.06	34.87	42.04	20.15	29.02	25.18
Median	74.67	27.83	35.22	18.38	25.58	22.52
Average	82.28	32.56	36.40	20.98	26.59	22.60
Lower Quartile	39.63	17.86	23.31	16.84	21.34	19.73
Worst Performing	6.49	-13.71	1.78	5.91	12.32	13.02
Asset Composition as of December 31, 1993 (All Trusteed Funds)						
	Treasury Bills (%)	**Corporate Loans (%)**	**Other Fixed Interest (%)**	**Stocks (%)**	**Real Estate (%)**	**Others (%)**
Best Performing Fund (Quarter ending 12/31/93)	-	5.05	-	94.12	-	0.83
Average Fund	3.17	46.86	19.70	27.22	0.64	2.41
Worst Performing Fund (Quarter ending 12/31/92)	-	-	8.72	4.30	11.60	-
Economic Indicators						
	Fourth Quarter 1993 (%p.a.)	**Third Quarter 1993 (%p.a.)**	**Full Year 1993 (%p.a.)**	**Full Year 1992 (%p.a.)**	**1/1/91 to 12/31/93 (%p.a.)**	**1/1/89 to 12/31/93 (%p.a.)**
Inflation Rate	5.82	14.58	8.44	8.11	9.87	12.21
Nominal WAIR (All maturities)						
-Treasury Bills		11.33	13.10	16.90	17.47	19.32
-Time Deposits		7.98	10.07	14.08	14.22	15.75

***Source*: The Wyatt Company (Philippines) Inc. (1994), 36th Survey on Investment Performance of Retirement Funds in the Philippines, March.**

<u>Annex Table C.4</u>: **SSS - Consolidated Income Statements, 1989-1993**
(in million pesos)

	1989	Percent	1990	Percent	1991	Percent	1992	Percent	1993	Percent
INCOME										
Investment Income	6,786	52.3	9,602	56.5	12,713	57.2	12,733	53.1	14,113	51.2
Members' Contribution	6,151	47.4	7,354	43.3	9,467	42.6	11,151	46.5	13,364	48.5
Other Income	32	0.2	31	0.2	58	0.3	79	0.3	81	0.3
Total Income	**12,969**	**100.0**	**16,987**	**100.0**	**22,238**	**100.0**	**23,963**	**100.0**	**27,558**	**100.0**
EXPENSES										
Benefit Payments										
Death & Funeral Grant	1,434	11.1	1,985	11.7	2,710	12.2	3,415	14.3	n.a.	n.a.
Retirement	1,403	10.8	1,883	11.1	2,593	11.7	3,539	14.8	n.a.	n.a.
Medical & Hospitalization	473	3.6	737	4.3	1,060	4.8	1,316	5.5	n.a.	n.a.
Disability, Sickness & Maternity	943	7.3	1,266	7.5	1,528	6.9	2,094	8.7	n.a.	n.a.
Refunds & Rehabilitation Services	14	0.1	1	0.0	12	0.1	7	0.0	n.a.	n.a.
Total Benefit Payments	**4,267**	**32.9**	**5,872**	**34.6**	**7,903**	**35.5**	**10,371**	**43.3**	**13,960**	**50.7**
Operating Expenses										
Personnel Related Expenses	285	2.2	316	1.9	408	1.8	432	1.8	n.a.	n.a.
Maintenance & Repairs	24	0.2	43	0.3	51	0.2	90	0.4	n.a.	n.a.
Depreciation	36	0.3	53	0.3	61	0.3	130	0.5	n.a.	n.a.
Supplies & Materials	18	0.1	20	0.1	25	0.1	31	0.1	n.a.	n.a.
Communications	15	0.1	18	0.1	25	0.1	46	0.2	n.a.	n.a.
Light & Water	14	0.1	17	0.1	22	0.1	26	0.1	n.a.	n.a.
Other Expenses	73	0.6	91	0.5	145	0.7	180	0.8	n.a.	n.a.
Total Operating Expenses	**465**	**3.6**	**558**	**3.3**	**737**	**3.3**	**935**	**3.9**	**1,044**	**3.8**
Total Benefit & Operating Expenses	**4,732**	**36.5**	**6,430**	**37.9**	**8,640**	**38.9**	**11,306**	**47.2**	**15,004**	**54.4**
NET INCOME	**8,237**	**63.5**	**10,557**	**62.1**	**13,598**	**61.1**	**12,657**	**52.8**	**12,554**	**45.6**

Annex Table C.5: SSS - Consolidated Balance Sheets as of December 31st, 1989-1993
(in million pesos)

	1989	Percent	1990	Percent	1991	Percent	1992	Percent	1993	Percent
ASSETS										
Current Assets										
Cash & T-Bills	14,599	28.1	21,415	34.2	8,591	11.2	12,670	14.0	19,722	19.0
Bonds & Securities	2,440	4.7	2,777	4.4	4,154	5.4	7,732	8.5	7,742	7.5
Receivables	12,615	24.3	10,458	16.7	2,178	2.9	2,401	2.6	2,577	2.5
Contingent Assets	0	0.0	7	0.0	22	0.0	16	0.0	296	0.3
Other Current Assets	29	0.1	20	0.0	13	0.0	26	0.0	31	0.0
Total Current Assets	**29,683**	**57.1**	**34,677**	**55.4**	**14,958**	**19.6**	**22,845**	**25.2**	**30,368**	**29.3**
Investments										
Notes	6,290	12.1	9,515	15.2	33,816	44.3	33,760	37.2	33,235	32.0
Government Bonds & Securities	123	0.2	447	0.7	851	1.1	1,051	1.2	1,776	1.7
Corporate Notes & Bonds	3	0.0	38	0.1	3	0.0	3	0.0	4,219	4.1
Loans to Members	12,410	23.9	12,805	20.5	18,418	24.1	20,454	22.5	14,794	14.3
Preferred & Common Stocks	383	0.7	483	0.8	326	0.4	227	0.3	334	0.3
Loans to Other Government Units	2,266	4.4	3,758	6.0	6,717	8.8	10,912	12.0	17,306	16.7
Other Investments	94	0.2	130	0.2	211	0.3	261	0.3	313	0.3
Total Investments	**21,569**	**41.5**	**27,176**	**43.4**	**60,342**	**79.0**	**66,668**	**73.5**	**71,977**	**69.4**
Net Property & Equipment	688	1.3	714	1.1	1,074	1.4	1,150	1.3	1,312	1.3
Other Assets	0	0.0	0	0.0	45	0.1	93	0.1	94	0.1
TOTAL ASSETS	**51,940**	**100.0**	**62,567**	**100.0**	**76,419**	**100.0**	**90,756**	**100.0**	**103,751**	**100.0**
LIABILITIES & RESERVES										
Current Liabilities										
Accounts Payable	10	0.0	30	0.0	390	0.5	1,839	2.0	1,879	1.8
Other Current Liabilities	129	0.2	138	0.2	222	0.3	251	0.3	303	0.3
Total Liabilities	**139**	**0.3**	**168**	**0.3**	**612**	**0.8**	**2,090**	**2.3**	**2,182**	**2.1**
Reserves										
Reserve Funds										
SSS Reserve Funds	45,520	81.9	51,040	81.6	61,982	81.1	71,776	79.1	81,406	78.5
Health Insurance Fund	3,738	7.2	4,584	7.3	5,721	7.5	7,107	7.8	8,480	8.2
State Insurance Fund	5,227	10.1	6,451	10.3	7,768	10.2	9,427	10.4	11,039	10.6
Valuation, Surplus & Other Reserves	316	0.6	324	0.5	336	0.4	356	0.4	644	0.6
Total Reserves	**51,801**	**99.7**	**62,399**	**99.7**	**75,807**	**99.2**	**88,666**	**97.7**	**101,569**	**97.9**
TOTAL LIABILITIES & RESERVES	**51,940**	**100.0**	**62,567**	**100.0**	**76,419**	**100.0**	**90,756**	**100.0**	**103,751**	**100.0**

Annex Table C.6: SSS - Summary of Asset Allocation, 1989-1993
(in million pesos)

	1989	%	1990	%	1991	%	1992	%	1993	%
Government Securities	33,200	65.5%	41,169	67.5%	45,133	61.1%	49,493	57.4%	56,425	56.3%
Member Loans	12,166	24.0%	13,256	21.7%	19,581	26.5%	25,532	29.6%	31,984	31.9%
Private Securities	5,316	10.5%	6,595	10.8%	9,142	12.4%	11,239	13.0%	11,842	11.8%
Total	**50,682**	**10.0%**	**61,020**	**100.0%**	**73,856**	**100.0%**	**86,264**	**100.0%**	**100,251**	**100.0%**

Annex Table C.7: SSS - Summary of Income Yields From Asset Categories, 1989-1993
(in million pesos)

	1989	%	1990	%	1991	%	1992	%	1993	%
Government Securities	5,391	18.6%	7,978	23.8%	9,476	23.7%	9,700	22.3%	9,880	20.0%
Member Loans	950	9.2%	987	7.9%	2,079	14.1%	1,778	8.2%	2,508	9.2%
Private Securities	444	10.4%	836	11.2%	1,159	16.1%	1,254	13.1%	1,725	14.9%
Total	**6,785**	**15.6%**	**9,801**	**18.6%**	**12,714**	**20.5%**	**12,732**	**17.0%**	**14,113**	**16.0%**

Annex Table C.8: SSS - Distribution of Investments
Consolidated
December 31, 1993 vs. December 31, 1992
(In millions pesos)

	As of Dec. 31, 1993		As of Dec. 31, 1992		Investment Income Jan-Dec.	Aggrega ROI
	Amount	% Dist.	Amount	% Dist.		
TOTAL INVESTMENTS	**100,251.674**	**100.00**	**86,264.674**	**100.00**	**14,112.771**	**16.01**
1. GOVERNMENT SECURITIES	**56,424.762**	**56.28**	**49,493.876**	**57.37**	**9,879.583**	**19.95**
T-Notes & T-Bills	46,294.704	46.18	44,825.923	51.96	9,275.909	20
PNB/LBP Savings/Time Deposits	7,388.973	7.37	2,453.873	2.84	265.421	16
Government Bonds & Securities	2,526.435	2.52	1,999.430	2.32	314.253	16
PGH & National Orthopedic Hospital	200.150	0.20	200.150	0.23	24.000	12
Common & Preferred Stocks	14.500	0.01	14.500	0.02	0.000	0.
2. MEMBER LOANS	**31,984.390**	**31.90**	**25,532.381**	**29.60**	**2,509.523**	**9.**
National Home Mortgage Finance Corp.	17,105.523	17.06	10,711.352	12.42	1,573.910	11
Salary/Educational Calamity Loans	7,911.224	7.89	8,376.716	9.71	374.288	4.
Housing Loans (Non-ULP)	6,046.811	6.03	5,921.770	6.86	543.977	9.
Separated member Loans/IIL	330.301	0.33	330.353	0.38	0.016	0.
Student Assistance Loans - SNPL	67.104	0.07	70.095	0.08	1.607	2.
Acquired Assets	64.078	0.06	49.527	0.06	9.916	20
Stock Investment Loan	119.908	0.12	46.474	0.05	4.426	6.
Land for Development	18.000	0.02	18.000	0.02	0.000	0.
Community Hospital/Hospital Assist.	6.926	0.01	8.094	0.01	0.383	5.
Emergency Loans	314.515	0.31	0.000	0.00	0.000	0.
3. PRIVATE SECURITIES & LOANS	**11,842.522**	**11.81**	**11,238.417**	**13.03**	**1,724.665**	**14.**
Marketable Sec. & Other Common Stocks	7,189.791	7.17	5,225.940	6.06	986.837	14.87 /a
KASAPI Lending Program	1,624.321	1.62	2,716.068	3.15	287.601	14
IMELP	1,145.603	1.14	1,562.110	1.81	227.497	18
SMILP/Small Scale Industry	315.313	0.31	511.974	0.59	52.411	13
Hospital Financing Program	389.796	0.39	314.912	0.37	53.768	16
Educational Institution	415.658	0.41	276.498	0.32	50.016	16
SSS-NHA Apartment/Dormitory Loan Program	256.749	0.26	212.151	0.25	25.682	11
SSS Employees Housing Loan Program	130.144	0.13	129.413	0.15	11.905	9.
UBP Savings/Time Deposits	84.802	0.08	71.802	0.08	3.446	4.
Commercial Loans	37.783	0.04	63.736	0.07	9.277	21
Program MADE (PBSP)	93.301	0.09	56.019	0.06	7.825	10
Preferred Stocks	120.352	0.12	42.264	0.05	0.220	0.
Bus Acquisition Financing Program	2.877	0.00	33.741	0.04	3.598	21
Developmental Loan - SSS Corporate Housing	3.899	0.00	9.492	0.01	2.977	55.89 /b
Development in Progress	5.407	0.01	9.471	0.01	0.000	0.
Corporate Notes & Bonds	2.826	0.00	2.826	0.00	0.000	0.
Vocational/Technical School	7.000	0.01	0.000	0.00	0.627	13
Financing Assistance program	16.000	0.02	0.000	0.00	0.963	12
Power Generation Program	0.900	0.00	0.000	0.00	0.015	14

/a If unrealized gains on stocks were included and using market value of stocks, Marketable Securities ROI would be 179.54%, Private Securities ROI wou be 142.12%, and Over-all ROI would be 44.95%.
/b If ₱ 2.067 million commitment fee is excluded, ROI would be 14.74%.

Annex Table C.9: GSIS - Consolidated Income Statements, 1989-1993
(in million pesos)

	1989	Percent	1990	Percent	1991	Percent	1992	Percent	1993	Percent
INCOME										
Investment Income	1,810	25.9	2,640	24.5	3,567	27.4	3,863	27.4	4,318	27.3
Members' Contribution	4,856	69.5	7,893	73.2	9,159	70.4	9,402	66.7	10,854	68.5
Other Income	324	4.6	257	2.4	288	2.2	836	5.9	665	4.2
Total Income	**6,990**	**100.0**	**10,790**	**100.0**	**13,014**	**100.0**	**14,101**	**100.0**	**15,837**	**100.0**
EXPENSES										
Benefit Payments										
Social Insurance	2,097	30.0	2,676	24.8	4,004	30.8	4,815	34.1	5,312	33.5
Optional Life & General Insurance	283	4.0	286	2.7	229	1.8	180	1.3	442	2.8
Medical Insurance	277	4.0	416	3.9	709	5.4	830	5.9	988	6.2
Employment Compensation Insurance	236	3.4	330	3.1	366	2.8	415	2.9	472	3.0
Other Benefits Paid	0	0.0	71	0.7	228	1.8	121	0.9	40	0.3
Total Benefit Payments	**2,893**	**41.4**	**3,779**	**35.0**	**5,536**	**42.5**	**6,361**	**45.1**	**7,254**	**45.8**
Operating Expenses										
Personnel Related Expenses	389	5.6	491	4.6	583	4.5	638	4.5	538	3.4
Furniture & Equipment	16	0.2	13	0.1	15	0.1	21	0.1	28	0.2
Depreciation	0	0.0	0	0.0	2	0.0	37	0.3	56	0.4
Supplies & Materials	24	0.3	25	0.2	29	0.2	32	0.2	37	0.2
Communications	10	0.1	10	0.1	12	0.1	18	0.1	21	0.1
Light & Water	23	0.3	25	0.2	31	0.2	32	0.2	32	0.2
Other Expenses	127	1.8	123	1.1	138	1.1	155	1.1	174	1.1
Total Operating Expenses	**589**	**8.4**	**687**	**6.4**	**810**	**6.2**	**933**	**6.6**	**886**	**5.6**
Total Benefit & Operating Expenses	**3,482**	**49.8**	**4,466**	**41.4**	**6,346**	**48.8**	**7,294**	**51.7**	**8,140**	**51.4**
Gain on Sale of Assets	**37**	**0.5**	**7**	**0.1**	**345**	**2.7**	**209**	**1.5**	**1,041**	**6.6**
NET INCOME	3,545	50.7	6,331	58.7	7,013	53.9	7,016	49.8	8,738	55.2

Annex Table C.10: GSIS - Consolidated Balance Sheets as of December 31st, 1989-1993
(in million pesos)

	1989	Percent	1990	Percent	1991	Percent	1992	Percent	1993	Percent
ASSETS										
Current Assets										
Cash & Advances	68	0.2	(236)	-0.7	(46)	-0.1	2,762	5.4	7,372	12.4
Contrib. & Premiums Receivables	1,376	4.8	2,852	7.9	3,237	7.5	5,175	10.2	6,762	11.4
Accrued Income Receivable	2,118	7.3	1,798	5.0	2,022	4.7	2,644	5.2	2,840	4.8
Other Receivables	85	0.3	642	1.8	83	0.2	86	0.2	279	0.5
Due from Reinsurers	612	2.1	507	1.4	767	1.8	1,366	2.7	1,097	1.8
Total Current Assets	**4,259**	**14.8**	**5,563**	**15.4**	**6,063**	**14.0**	**12,033**	**23.7**	**18,350**	**30.9**
Investments										
Loans to Members	10,401	36.0	12,301	34.1	13,281	30.7	13,978	27.5	15,800	26.6
Loans to Non-Members	1,469	5.1	2,116	5.9	3,122	7.2	4,075	8.0	4,622	7.8
Stocks & Bonds	4,364	15.1	4,837	13.4	4,252	9.8	4,789	9.4	5,685	9.6
Short & Medium-Term Investments	3,137	10.9	5,049	14.0	7,568	17.5	10,362	20.4	8,962	15.1
Time Deposits	1,133	3.9	2,063	5.7	3,897	9.0	263	0.5	642	1.1
Other Investments	548	1.9	505	1.4	1,164	2.7	1,453	2.9	1,257	2.1
Total Investments	**21,052**	**72.9**	**26,871**	**74.5**	**33,284**	**77.0**	**34,920**	**68.7**	**36,968**	**62.3**
Net Property & Equipment	2,906	10.1	2,929	8.1	2,955	6.8	2,648	5.2	2,652	4.5
Acquired Assets	558	1.9	614	1.7	862	2.0	892	1.8	1,065	1.8
Other Assets	84	0.3	91	0.3	43	0.1	301	0.6	316	0.5
TOTAL ASSETS	**28,859**	**100.0**	**36,068**	**100.0**	**43,207**	**100.0**	**50,794**	**100.0**	**59,351**	**100.0**
LIABILITIES & RESERVES										
Current Liabilities & Deferred Credits										
Accounts Payable	2,026	7.0	2,688	7.5	2,204	5.1	2.597	5.1	2,269	3.8
Deferred Credit	88	0.3	60	0.2	524	1.2	371	0.7	757	1.3
Total Liabilities	**2,114**	7.3	**2,748**	**7.6**	**2,728**	**6.3**	**2,968**	**5.8**	**3,026**	**5.1**
Reserves										
Reserve Funds										
SSS Reserve Funds	21,773	75.4	26,159	72.5	33,715	78.0	39,862	78.5	47,268	79.6
Optional & General Insurance Fund	1,750	6.1	2,185	6.1	2,444	5.7	2,668	5.3	3,059	5.2
Medicare Insurance Fund	542	1.9	598	1.7	824	1.9	826	1.6	847	1.4
Employment Compensation Fund	415	1.4	461	1.3	486	1.1	486	1.0	486	0.8
Valuation, Surplus & Other Reserves	2,265	7.8	3,917	10.9	3,001	6.9	3,984	7.8	4,665	7.9
Total Reserves	**26,745**	**92.7**	**33,320**	**92.4**	**40,470**	**93.7**	**47,826**	**94.2**	**56,325**	**94.9**
TOTAL LIABILITIES & RESERVES	**28,859**	**100.0**	**36,068**	**100.0**	**43,198**	**100.0**	**50,794**	**100.0**	**59,351**	**100.0**

Annex Table C.11: GSIS - Income from Loans and Investments, 1988-1993
(in million pesos)

	1988	1989	1990	1991	1992	1993	Growth Rate
Income from Loans:							
Interest on Policy Loans	85.51	117.62	110.07	126.14	156.54	189.51	14.18%
Interest on Salary Loan	512.09	433.57	559.21	595.05	660.35	741.07	6.35%
Interest on Flv PAL, Pay Later	0.93	2.08	0.53	1.49	1.76	1.57	9.14%
Interest on Real Estate Loans	197.09	115.40	68.84	110.69	199.04	157.34	-3.68%
Interest on Educ. Assist. Loan	1.49	3.43	0.26	1.91	1.84	1.74	2.57%
Interest on Deeds of Cond. Sale	204.26	252.27	294.02	315.56	463.31	538.66	17.54%
Interest on Government Loans	12.88	45.41	80.33	118.07	128.25	354.91	73.78%
Interest on Business Loans	6.05	60.77	15.51	46.71	203.12	235.97	84.16%
Interest on Lease Purchase	175.64	84.20	7.49	235.11	143.59	218.93	3.74%
Interest on Other Loans	0.33	0.44	0.71	0.75	0.81	0.95	19.06%
Total Income from Loans	**1,196.29**	**1,115.18**	**1,136.97**	**1,551.48**	**1,958.62**	**2,440.66**	**12.62%**
Income from Investments:							
Dividend on Stocks - Traded	52.19	84.04	107.25	121.05	32.72	61.82	2.86%
Dividend on Stocks - Subsidiary	-	-	-	-	50.00	-	-
Dividend on Stocks - Non-Traded	-	-	-	-	6.47	0.66	-
Interest on Bonds	15.01	34.91	62.84	77.12	88.93	48.51	21.60%
Interest on Time Deposits	38.88	118.32	302.82	635.98	2.80	9.63	-20.75%
Interest on Short-Time Inv.	390.69	280.12	700.12	333.95	696.76	763.13	11.80%
Interest on Medium-Term Inv.	37.34	170.90	321.97	844.89	832.73	796.11	36.03%
Other Investments Income	14.21	30.53	8.80	2.04	194.41	198.18	55.15%
Total Investment Income	**548.32**	**718.82**	**1,503.81**	**2,015.03**	**1,904.83**	**1,878.04**	**22.78%**
Less: Investment Expenses	-	-	-	-	-	-	-
Interest Expense on Loans	26.25	24.41	0.98	-	-	0.22	-54.92%
Total Investment Expenses	**26.25**	**24.41**	**0.98**	**-**	**-**	**0.22**	**-54.92%**
Net Income from Investments	**522.07**	**694.41**	**1,502.83**	**2,015.03**	**1,904.83**	**1,877.82**	**23.78%**
Net Income from Loans & Inv.	**1,718.36**	**1,809.59**	**2,639.80**	**3,566.51**	**3,863.44**	**4,318.48**	**16.60%**

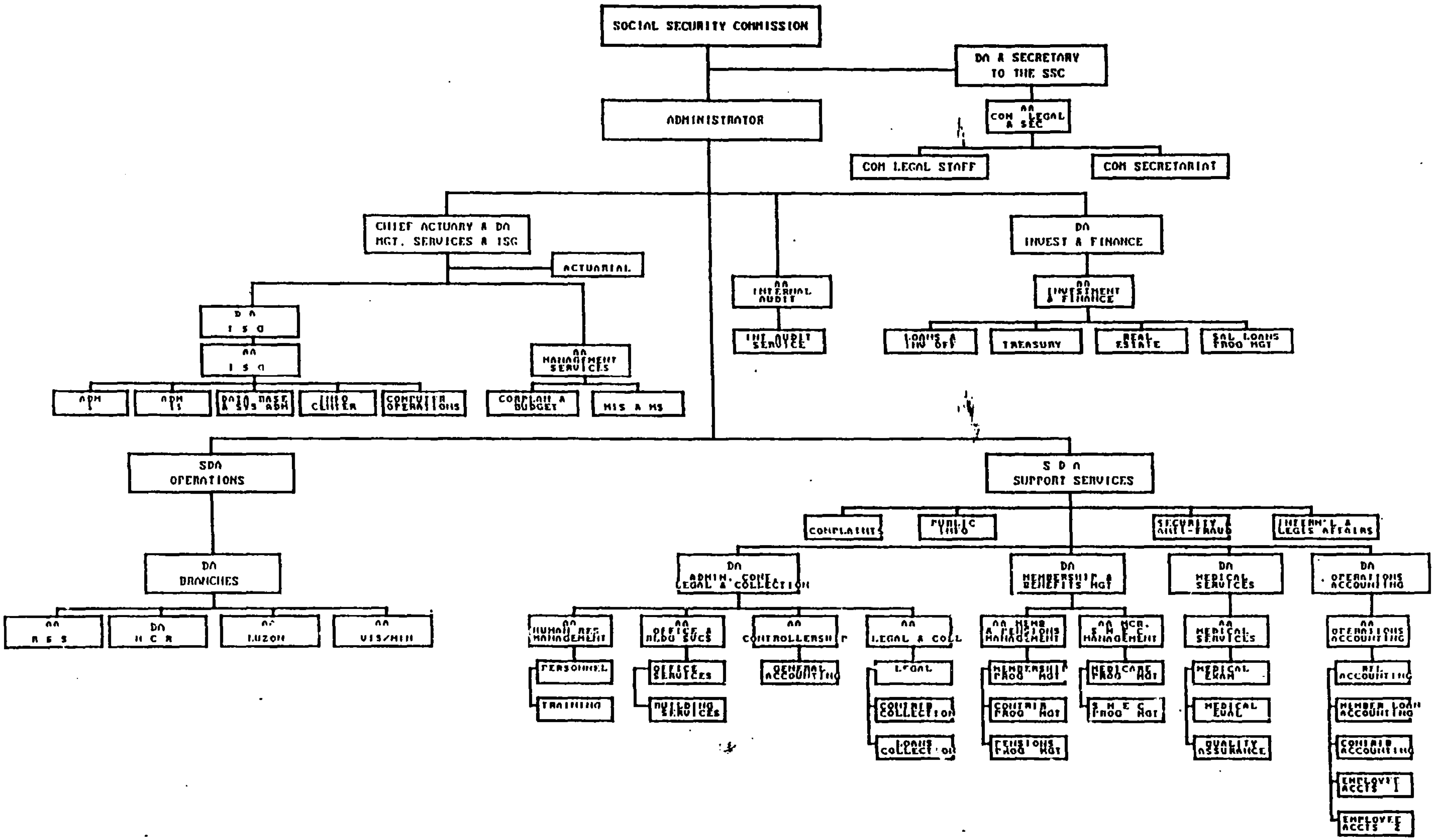
Annex Table C.12: GSIS - Yield Rates, 1988-1993

	1988	1989	1990	1991	1992	1993	Average
Income from Loans:							
Interest on Policy Loans	7.14%	9.18%	7.60%	7.40%	7.73%	7.85%	9.38%
Interest on Salary Loan	12.96%	7.85%	8.30%	7.86%	8.93%	10.10%	11.20%
Interest on Flv PAL, Pay Later	3.90%	8.75%	3.23%	16.83%	29.69%	38.33%	20.15%
Interest on Real Estate Loans	53.41%	50.64%	20.43%	15.59%	22.01%	13.81%	35.18%
Interest on Educ. Assist. Loan	2.42%	1.16%	0.09%	2.47%	2.44%	2.52%	2.22%
Interest on Deeds of Cond. Sale	11.83%	13.56%	14.78%	14.73%	18.69%	17.33%	18.18%
Interest on Government Loans	18.24%	9.76%	7.46%	7.97%	6.37%	13.77%	12.71%
Interest on Business Loans	0.13%	0.63%	0.14%	0.37%	1.50%	1.60%	0.87%
Interest on Lease Purchase	17.66%	11.33%	1.42%	52.66%	30.27%	49.34%	32.54%
Interest on Other Loans	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	0.00%
Total Income from Loans	**14.07%**	**20.74%**	**17.12%**	**20.89%**	**24.34%**	**27.15%**	**24.86%**
Income from Investments:							
Dividend on Stocks	1.90%	2.73%	2.96%	3.43%	2.52%	1.44%	3.00%
Interest on Bonds	2.06%	4.29%	7.07%	8.42%	9.99%	5.86%	7.54%
Interest on Time Deposits	11.37%	19.30%	20.94%	23.89%	0.13%	2.15%	15.56%
Interest on Short-Time Investment	14.83%	11.63%	38.14%	11.75%	15.41%	15.28%	21.41%
Interest on Medium-Term Investment	-	34.17%	18.43%	29.37%	22.64%	20.48%	31.27%
Other Investments Income	5.35%	6.68%	1.68%	0.25%	16.05%	15.78%	9.16%
Total Income from Investment	**4.69%**	**9.13%**	**14.94%**	**14.75%**	**11.96%**	**11,91%**	**13,48%**
Net Income from Loans & Inv.	**3.27%**	**9.82%**	**11.66%**	**12.61%**	**12.01%**	**12.78%**	**12.43%**

Annex Table C.13: **GSIS - Outstanding Balances on Loan and Investments, 1988 - 1993**
(in million pesos)

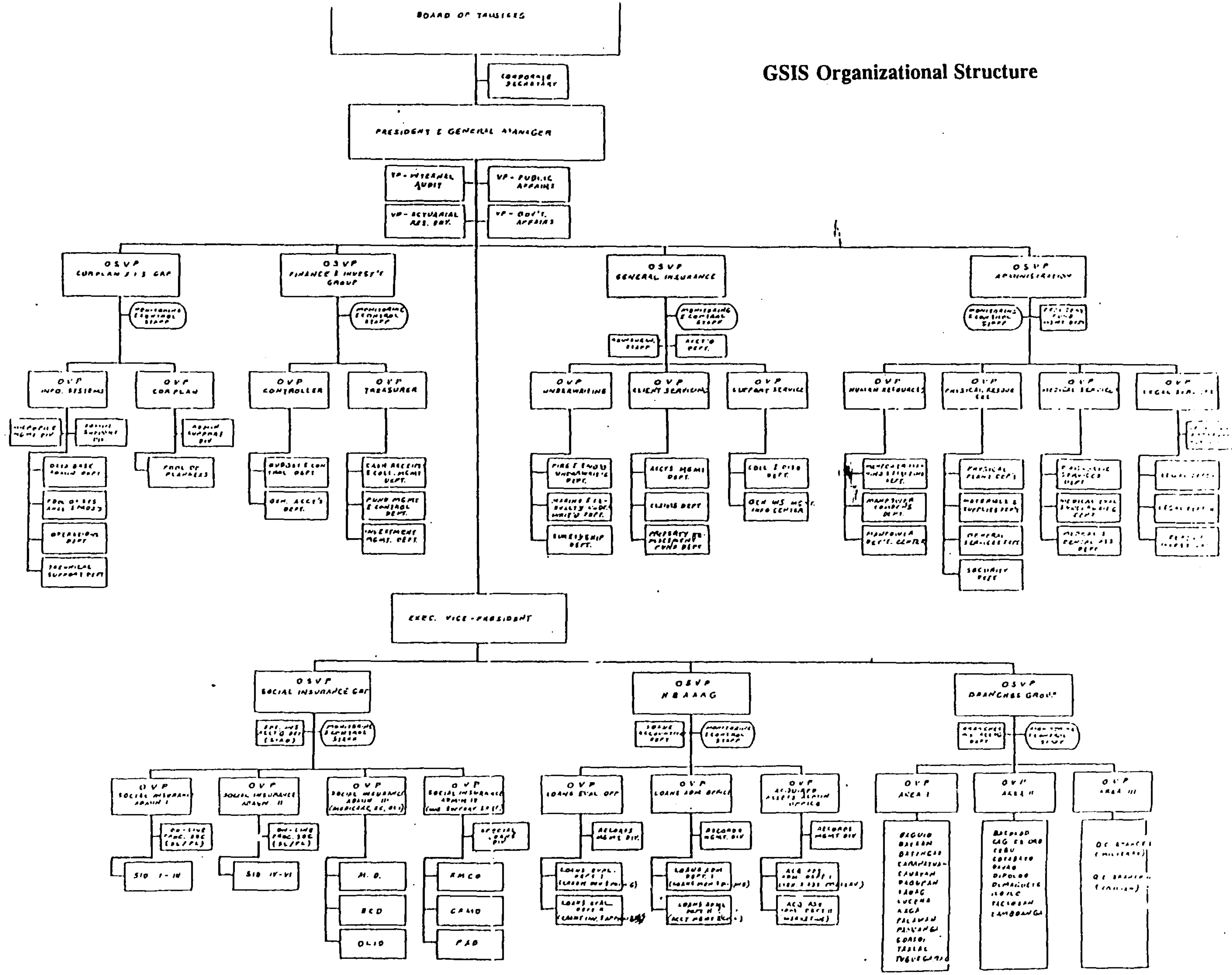
	1988	1989	1990	1991	1992	1993	Growth Rate
Loans							
To Members:							
Policy Loans	1,297.74	1,382.66	1,625.81	1,908.36	2,298.17	2,717.61	13.11%
Salary Loan	5,196.29	6,281.56	7,756.83	7,983.78	7,472.18	7,950.35	7.35%
Flv PAL Pay Later Plan	27.70	21.97	11.22	7.97	5.64	4.15	-27.13%
Real Estate Loans	505.14	65.99	676.67	854.27	1,153.58	1,282.45	16.80%
Educational Assistance Loan	62.25	530.83	74.25	82.05	70.92	68.95	1.72%
Deeds of Conditional Sale	1,856.69	2,117.78	2,155.97	2,444.94	2,977.26	3,776.41	12.56%
Total	**8,945.81**	**10,400.80**	**12,300.76**	**13,281.37**	**13,977.74**	**15,799.92**	**9.94%**
To Non-Members:							
Government Loans	136.94	838.80	1,396.24	1,685.51	2,469.43	3,039.29	67.64%
Business Loans	176.84	142.68	144.46	883.50	1,065.78	1,016.42	33.84%
Lease Purchase	1,083.50	487.55	575.46	552.52	539.65	566.70	-10.24%
Total	**1,397.28**	**1,469.04**	**2,116.17**	**3,121.53**	**4,074.87**	**4,622.41**	**22.07%**
Total Loans	**10,343.09**	**11,869.83**	**14,416.92**	**16,402.90**	**18,052.61**	**20,422.34**	**12.01%**
Investments							
Stocks	2,751.88	3,486.99	3,873.48	3,307.99	3,863.20	4,905.81	10.12%
Bonds	787.38	876.63	963.67	944.27	925.14	779.25	-0.17%
Time Deposits	211.77	1,132.91	2,062.47	3,897.17	263.81	642.23	20.31%
Short-Term Investments	3,132.42	1,966.58	2,404.67	3,613.75	6,127.22	4,624.58	6.71%
Medium-Term Investments	-	1,171.09	2,644.74	3,953.67	4,234.61	4,337.21	29.93%
Other Investments	396.48	548.14	505.10	1,164.46	1,453.12	1,257.12	21.21%
Total Investments	**7,279.94**	**9,182.34**	**12,454.12**	**16,881.32**	**16,867.11**	**16,546.19**	**14.66%**
Total Loans & Investments	**17,623.02**	**21,052.17**	**26,871.04**	**33,284.22**	**34,919.72**	**36,968.53**	**13.14%**

SSS Organization Chart
(As of August 1993)



Annex C

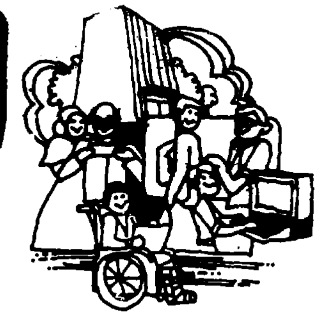
GSIS Organizational Structure



Annex C

Annex C

IKAW AT ANG SSS



Questions & Answers on Social Security

Guidelines on Social Security Coverage for Househelpers

1. HOW DID HOUSEHELPERS QUALIFY FOR MEMBERSHIP IN THE SSS?

The enactment of Republic Act 7655 effective Sept. 1, 1993 made it compulsory for househelpers 60 years old and below to be covered by the SSS.

Considered as househelpers are housemaids, houseboys, nannies, cooks, laundrywomen, family drivers, gardeners, or any individual rendering domestic or household services exclusively to a household employer.

To qualify for SSS membership, the househelper must be receiving a monthly pay of ₱1,000 or more.

2. WHAT SSS BENEFITS AND PRIVILEGES CAN BE ENJOYED BY HOUSEHELPERS?

Househelpers are entitled to the same benefits and privileges that are available to a regular covered employee e.g. sickness, maternity, disability, retirement, death and funeral, Medicare, etc. They can also borrow funds by applying for salary loans, calamity loans, housing loans and others.

3. HOW DOES THE HOUSEHELPER APPLY FOR SSS MEMBERSHIP?

Before starting to make contributions, a househelper must first secure an SS number by accomplishing Form E-1 at the nearest SSS branch. This form must be submitted together with a copy of his/her birth certificate, or in its absence, a baptismal certificate.

If birth or baptismal records are not available, a joint affidavit must be executed by two individuals personally known to the applicant, attesting to the correctness of his/her name and date of birth.

4. HOW MUCH IS THE MONTHLY CONTRIBUTION OF THE HOUSEHELPER AND THE EMPLOYER?

Monthly contributions of both househelper and employer are computed based on the househelper's monthly salary.

For example, a househelper earning ₱1,000 to ₱1,099 every month contributes ₱45.80 — divided into ₱33.30 for Social Security and ₱12.50 for Medicare. The employer's counterpart is ₱73.20 (₱50.70 for SS plus ₱12.50 for Medicare plus ₱10.00 for Employees' Compensation). Adding the househelper's and employer's shares, the total monthly contribution credited to the househelper adds up to ₱119.

For househelpers earning ₱1,100 to ₱1,399 a month, the combined dues add up to ₱146.30. For those with a monthly pay of ₱1,400 to ₱1,749, househelper (₱68.75) and employer (₱104.75) share a ₱173.50 contribution per month.

A table with a detailed Schedule of Monthly Contributions for both employer and househelper can be secured from the SSS.

5. HOW WILL SSS CONTRIBUTIONS BE PAID?

They must be paid on the 10th day of each month through banks accredited by SSS, using Form R-5 for the purpose. It is the employer or his/her representative who should make the payments, which include the contributions of both househelper and employer.

For records purposes, the employer must also submit a quarterly report of the househelper's monthly contributions by accomplishing SSS Form H-3. This form, along with the Special Bank Receipt (SBR) for the quarter, must be submitted to SSS on the 15th day following the end of each quarter (April 15, July 15, October 15 and January 15).

Note: In all the SSS forms, the household employer must indicate "HR" after his/her name and must indicate his SS number.

6. DOES A HOUSEHOLD EMPLOYER NEED TO BE A MEMBER OF THE SSS?

An employer must register if he/she is not yet a member of SSS. A household employer's SS number will be issued for this purpose.

But if previously registered or already an SSS member, the employer need not register anymore; instead his/her existing SS number can be used for transactions involving househelper contributions.

A minimal contribution truly goes a long way for both househelper and employer. For househelpers, their long-due social security benefits as employed and productive citizens are now within reach. On the other hand, household employers are relieved of a variety of expenses for maintaining househelpers. The higher the number of contributions made, the more benefits and privileges the househelper can enjoy.

Ikaw at ang SSS
Balikat ng Bayan!

SOCIAL SECURITY SYSTEM

SSS/10/E/94

INQ = 4/11/96 ISSUE

D. MERGER OF SSS AND GSIS

A. Introduction

1. One of the questions posed for this mission was whether it would be advisable to merge the SSS and GSIS organizations. After careful review of the existing situation the mission team believes that a merger of the two institutions should occur. While we recognize the potential disruption caused by merging, the team believes that the full benefit of the recommendations in this report will only occur if a merger is pursued. The timing for such a merger is best determined by those in authority in the GOP. The following sections spell out the rationale for merger, the options considered, a recommended structure, actuarial assessments of a merged institution, and a transition plan.

B. Rationale for the Merger

2. There are four primary reasons for merging the GSIS and the SSS:

- **Rationalizing the Social Security Sector.** As Chapter 3 has argued, the current structure is beset with an artificial segmentation of membership, a multitude of plans for the public provision of social security, differing contribution and benefit rates, the absence of portability, and a lack of transparency. Since the SSS and the GSIS are the major players in the sector, a merger between them would go a long way toward rationalizing the sector.

- **Easing of Problems of Portability.** Although recent legislation provides for portability, the specifics have not been worked out and might be complicated given the differences in contribution rates and benefits. It will also involve recurring administrative expenses. A merger and rationalization of the basic social security programs into a common contribution and benefits formula would help resolve these difficulties.

- **Improving Efficiency.** While specific financial and operational reforms can also contribute towards improving efficiency, efficiency gains can be achieved by economies of scale from merging branches. There are at least 27 locations where both the SSS and the GSIS maintain branches. Efficiency gains would also be achieved by pooling the human resources from the two institutions. Some of the skill requirements are job-specific and in scarce supply.

- **Improving Asset Management.** Through a comprehensive reform, it would be easier to pass new legislation which will cover all facets of social security including asset management and related policies. Changing asset allocation practices and adopting portfolio diversification principles would enable the social security system to play a more active role in developing the capital market. The privatization of the asset management function will further deepen the financial market.

C. Options Considered

3. The mission team examined three restructuring options. All options assume that the insurance operations of the GSIS be divested to the private sector for reasons discussed earlier.

- **Prospective Restructuring**

  Under this approach, each institution and its funds would remain intact and current GSIS members would continue to receive their present benefits until they exit the system. All new public sector employees would be required to join the SSS as a first tier of protection and additional employee and employer contributions would go into a new second tier fund to be administered by the GSIS.

  While this approach would eventually lead to a universal first tier of coverage, the deficiencies and duplications of the current system would remain.

- **Partial Restructuring**

  Under this approach, the Medical Care (MC) and Employee Compensation (EC) functions would be completely transferred to SSS jurisdiction. Appropriate funds and actuarial liabilities for these two programs would be transferred from the GSIS to the SSS and merged with the MC and EC funds currently managed by the SSS. The Social Insurance Fund currently managed by the GSIS would be transferred to the SSS along with the actuarial liabilities and responsibility for administration.

  All future government employees as of a certain date would be required to join the SSS. Current members of the GSIS would be given an option of either joining the SSS and a newly created second tier GSIS system or remaining in the current GSIS until retirement or departure from the system. Management of the remaining GSIS fund would be transferred to the SSS along with appropriate actuarial liabilities and responsibility for administration. The GSIS would be reorganized as an Occupational Pension Fund with a new charter and Board of Trustees.

- **Full Restructuring**

  Under this approach all programs and funds would be merged and there would be no second tier of benefits offered universally to government employees. The insurance component would be divested to the private sector and the benefit structures and contribution schedules would be rationalized into one.

  While this approach would seem to offer the most immediate move to a universal system, the dislocations resulting are likely to be overwhelming and could lead to a further deterioration of confidence in the system. Moreover, this approach does not offer the option of a second tier of protection for government workers.

D. Recommended Structure

4. It is recommended that a 'partial merger' approach be adopted. This approach meets all four of the objectives outlined in para. 2 above and achieves the maximum benefit within a realistic economic and political framework. The resulting program will be beneficial to all parties. The proposed system would benefit the members of the social security system by ensuring the safety of their social security provisions and by increasing the value of their contributions. The Government would also be a beneficiary since it will no longer have to expend annual budgetary allocations to pay retirement benefits for public sector employees. The enhanced generation of long-term resources that will result from these changes — both on account of the increased efficiency in operations and fund management and in the creation of the supplementary benefits — will provide a stimulus for the financial sector, promote capital market development, and facilitate economic growth. Consistent with this, therefore, the following structure is recommended for the social security sector (see Chart D.1 for a depiction of this structure).

(a) Establish a three-tier system wherein:

First Tier

- SSS would provide basic social security coverage to all employees in retirement, health, employee compensation and disability.

- GSIS would transfer its social insurance fund, the medical care fund, and the employee compensation fund to SSS, which will manage and administer these funds in accordance with its original terms and conditions with the consent of the GSIS Board of Trustees. All new entrants to the system would join SSS at a predetermined date at SSS contribution rates and benefits; any excess contributions would go towards the new supplementary government fund to be administered by GSIS (second tier).

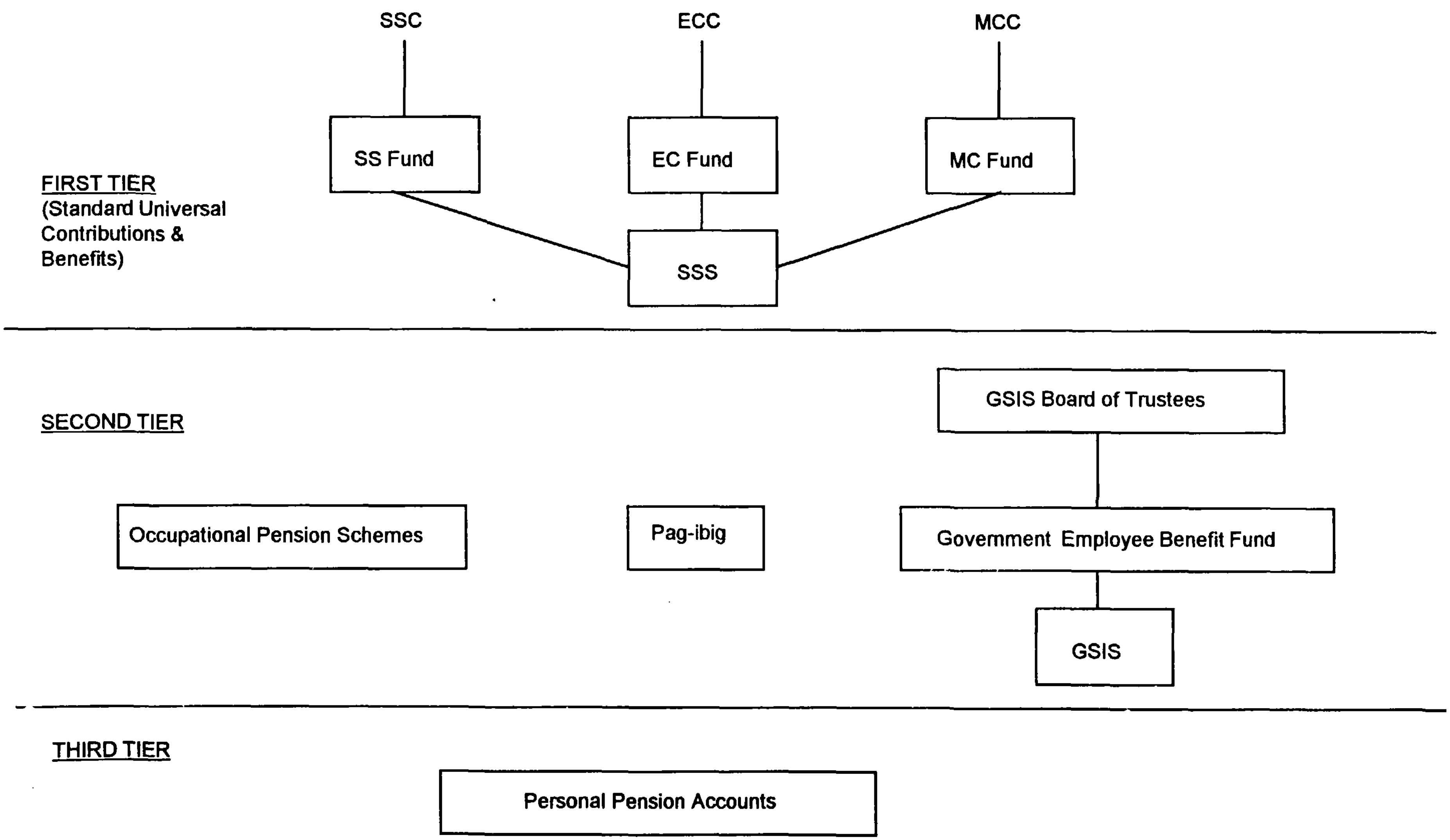
- GSIS would divest its insurance business. This recommendation has also been made by the Insurance Commission and is welcomed by the insurance industry. A detailed analysis will need to be carried out to assess the actuarial value of the insurance plans and the methods for divesting this function.

Second Tier

- GSIS would be restructured to become a second tier supplemental occupational pension scheme like other private pension funds in the country. It would be a defined contribution plan. The members would also be able to make additional voluntary contributions to this supplementary fund with matching government contributions subject to some ceilings. GSIS members would determine the investment policy of the second tier scheme.

CHART D.1: PHILIPPINES - RECOMMENDED STRUCTURE FOR THE SOCIAL SECURITY SECTOR

For All Private & Public Sector Employees



Third Tier

- Individuals would be allowed to set up a personal retirement account so that the integrity of pension benefits could be retained during an individual's working life. Pensions would become portable, which should facilitate easier movement from the public to the private sector and vice versa.

(b) Merge, at a later date, the Medical Care Program and the Employee Compensation Program of the two institutions to form a unified system to be governed by the current Medical Care Commission and the Employee Compensation Commission, respectively.

(c) Discontinue the retirement benefits being provided by the DBM to government employees and settle the outstanding overdue to the GSIS.

(d) Privatize, at least partly, the fund management functions of both institutions. There is adequate talent available to provide the necessary level of professional expertise. Fund managers should be selected based on their experience, qualified staff, and past track records. Separate custodial arrangements should be made to ensure the safety of funds. The capability to select fund managers and to monitor their performance is to be developed in-house with technical assistance.

5. This would provide for a universal first tier of protection with optional second tier coverage available to government and non-government employees alike. In addition, a new third tier would be created to allow for workers to transfer second tier benefit credits to a new plan or to retain them in a tax exempt account until they reached retirement age. This third tier could also be used to encourage the growing body of self-employed to initiate retirement funds and thus increase available long-term capital for investment.

6. As an incentive for increasing the time frame for full integration of these programs, it is recommended that current GSIS members hired after May 1977, be given the following options:

- Remain in the GSIS at current contribution and benefit rates. Pag-ibig to remain as is.

- Join the SSS at SSS contribution and benefit rates. Keep the remainder of funds currently contributed to the GSIS to use as the individual sees fit. Pag-ibig to remain as is.

- Join the SSS at SSS contribution and benefit rates. Join a new supplementary government employee benefit scheme with those contributions currently being paid to the GSIS at a level above the SSS level going to the supplementary fund with some set percentage matched by the Government. There would also be an option for the employee to contribute a higher amount on a voluntary basis.

7. The only apparent disadvantage to the restructuring concerns the potential dislocation of several hundred current employees of the GSIS. As discussed in the Transitional Plan, this potential problem can be substantially mitigated by the development of a sound human relations plan and through the proper notification of employees.

8. It should be noted that no other developing country has accomplished a merger of separate public social security systems serving government and non-government employees. In fact, the only relevant documented experience is that of the United States, in which a "partial merger" was implemented in 1984 (see Box D.1). Since, as noted earlier, the social security system in the Philippines has a distinctly U.S. resemblance, Philippine authorities may usefully draw and benefit from the U.S. experience.

E. Actuarial Assessments

Actuarial Assessment of Merged Programs

9. An actuarial assessment of the merger of the GSIS program with the SSS program necessarily must consider the post-merger cost implications for three separate areas of benefits:

(a) Provision of SSS benefits — Social Benefits, Medicare and Employees' Compensation — for governmental employees (both current and future) who, but the merger, would have been covered under the GSIS.

(b) Provision for current GSIS participants of accrued GSIS benefits that are in excess of the then accrued benefits under the SSS formulas.

(c) Provision of post-merger "supplementary" benefits to governmental employees in addition to SSS benefits.

Only Social Benefits need be considered in (b) and (c) above. The benefit structure under the Medicare and Employees' Compensation programs are essentially the same for the SSS and the GSIS, so it can be assumed that the merger will be structured to provide uniform benefits in these areas.

10. It is assumed that the merger occurred as of January 1, 1994. Although various alternatives exist with respect to the financing of these benefits and, particularly in the case of (c), the actual design of the benefits, only one design approach was considered for purposes of the assessment. As noted in para. 15, however, certain alternatives were considered in order to investigate how the financial experience of the merged system might be improved.

11. **Provision of SSS Benefits Under Merged Programs.** Although, strictly speaking, coverage under the SSS for governmental employees would commence only as of the merger date, practical considerations dictate that current active GSIS participants be treated no worse than they would be if SSS coverage had extended during their entire period of coverage under the GSIS. Hence, the easiest approach is to determine the SSS benefits for GSIS participants assuming that years spent under the GSIS count for SSS benefit eligibility and amount purposes. This is the approach taken in the assessment.

12. Similar considerations of simplicity have dictated for purposes of the assessment that all existing GSIS benefit liabilities for inactive (i.e., retired) GSIS participants with respect to Social Benefits be held in the post-merger supplementary GSIS plan along with sufficient GSIS assets to cover these

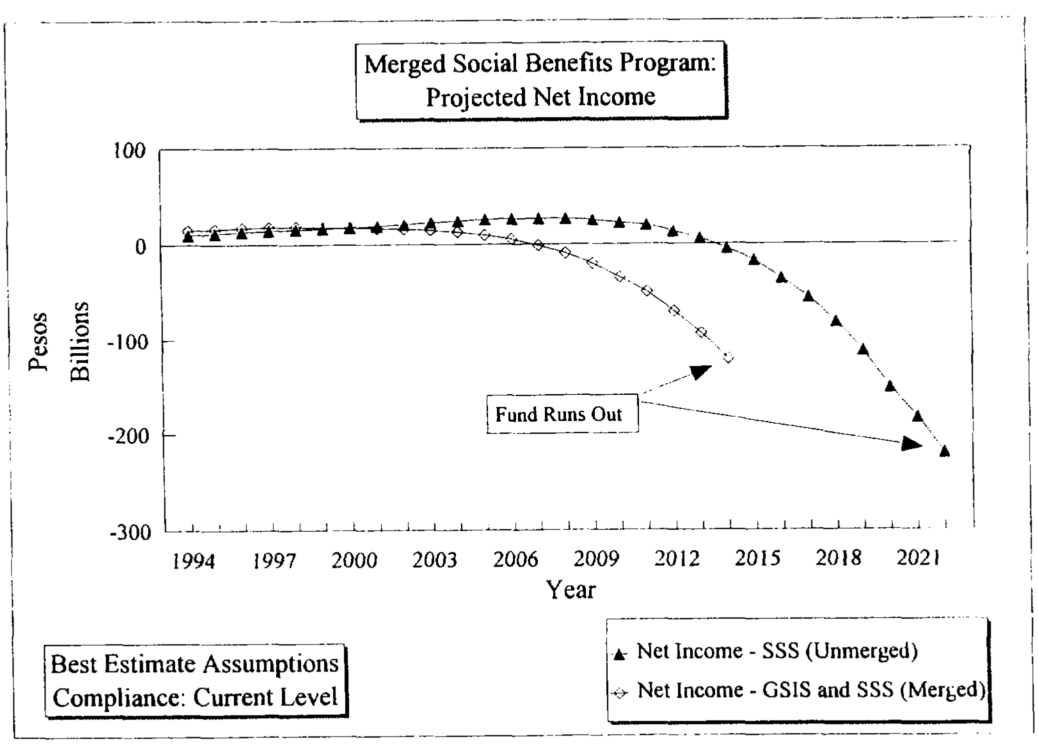
liabilities. The remaining GSIS assets, after removal of the assets associated with the compulsory insurance coverage, are assumed to be transferred to the SSS to cover the liabilities for active GSIS participants. Although other positions could be advanced, this approach assumes that GSIS retirees should continue to receive GSIS benefits, with their accrued assets set at a level to provide adequate recompense for the liabilities assumed.

13. The assessment assumes that governmental employees will in the future have their benefits determined using the SSS formulas and applicable projected wage bases.

Highlights of the Actuarial Assessment

14. **Merged Social Benefits Program**. The actuarial assessment of the current Social Benefits programs of the SSS and GSIS indicated that the current levels of contributions are adequate to support the benefits under the separate programs only in the near term. As the population matures, the rapid growth in the retired population and the consequent increases in benefits payable will call for increases in contributions. Not surprisingly, this is also true of the merged program being assessed. The governmental employee population represents a more mature group which is closer to receiving retirement benefits. Chart D.2 indicates that including current and future governmental employees in the SSS contribution and benefit structure advances the time at which the net income to the fund is projected to become negative. Under the scaled premium approach of partial funding, contributions will have to be raised well before this takes place. It is also significant that the current required rate of contribution, when expressed as a percentage of covered salary, is lower under the SSS program than under the GSIS program. Under the SSS program, the governmental employees would do relatively better, in terms of benefits earned per unit of contribution, than under their own current program.

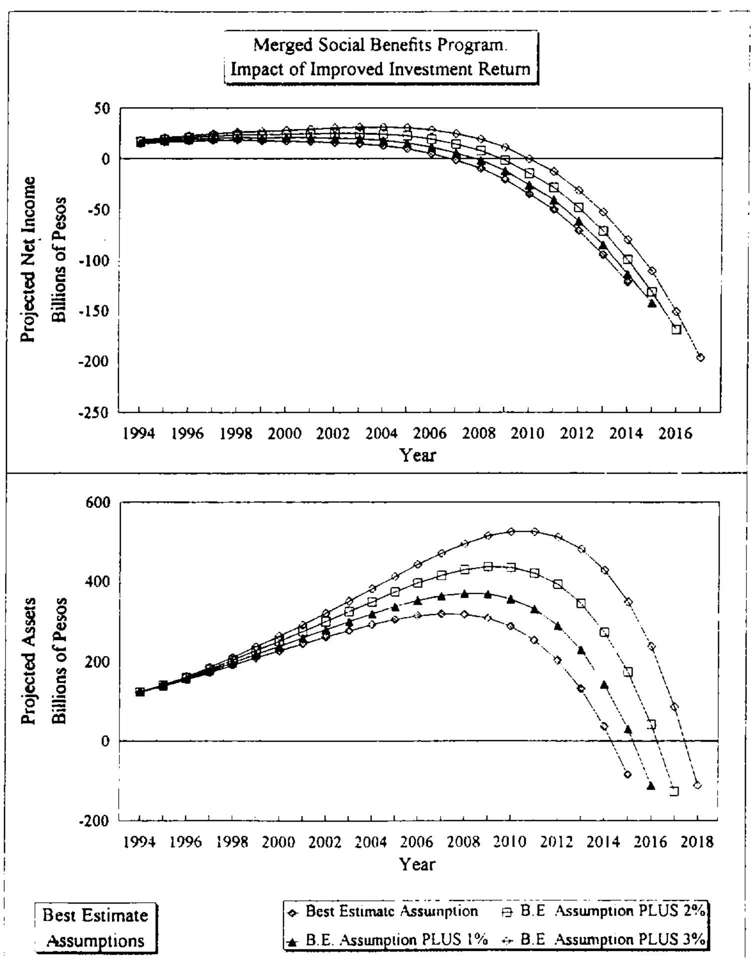
Chart D.2



15. **Alternative Scenarios for Merged Social Benefits Program.** Given the results of the actuarial assessment discussed in para. 13 above, it is clear that steps should be taken to strengthen the finances of the merged system. Chart D.2 indicates that, although the net income to the merged fund is projected to remain positive under the best estimate assumptions scenario until the year 2006, the fund will experience a rapid decline thereafter and be exhausted by the year 2014. It is important to identify the possible areas of change and determine their long-term financial impact. Two such possible areas for change have been investigated in the current assessment: (a) improving the investment return on the fund; and (b) increasing the rate of contributions.

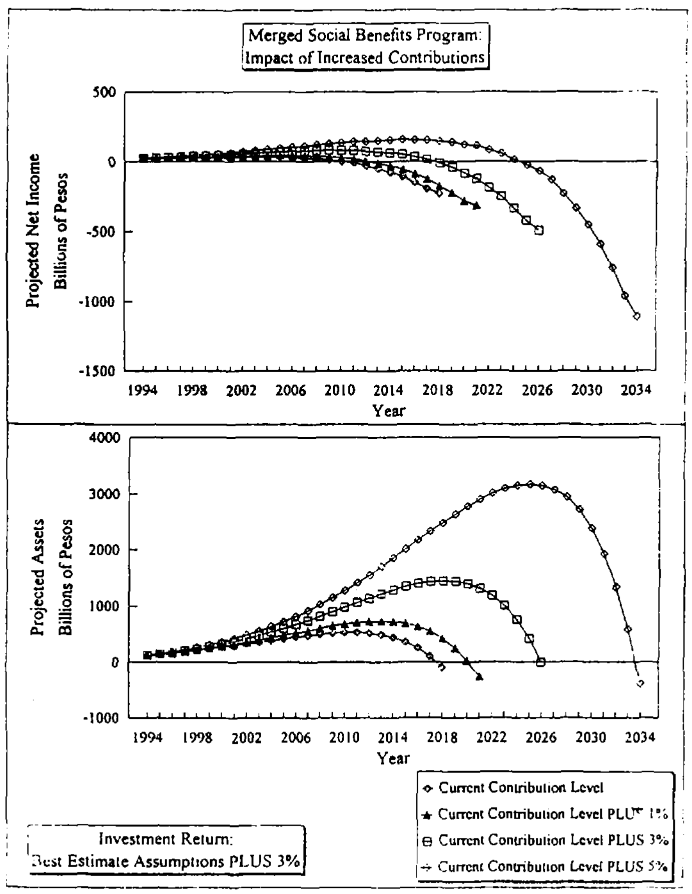
16. **Impact of Improved Investment Return**. The earlier chapters indicated that there is scope for improving the investment performance of both systems, which has been significantly below that of private funds. A logical first step therefore is to examine the impact of improved investment returns in the future to the projected financial position of the merged system. Chart D.3 shows the impact of improving the investment return by one percent, two percent, and three percent over the best estimate assumptions. The top half of the chart shows the impact on the projected net income to the fund while the bottom half shows the projected size of the fund. The chart demonstrates that improving investment returns is highly desirable and has a significant impact on the financing of the merged system; if investment returns can be improved by three percent per year over the best estimate assumptions, the projected size of the fund doubles in 16 years. However, the analysis shows that improving investment return alone is not sufficient in the long-term, due to the magnitude of the projected benefit payments.

Chart D.3



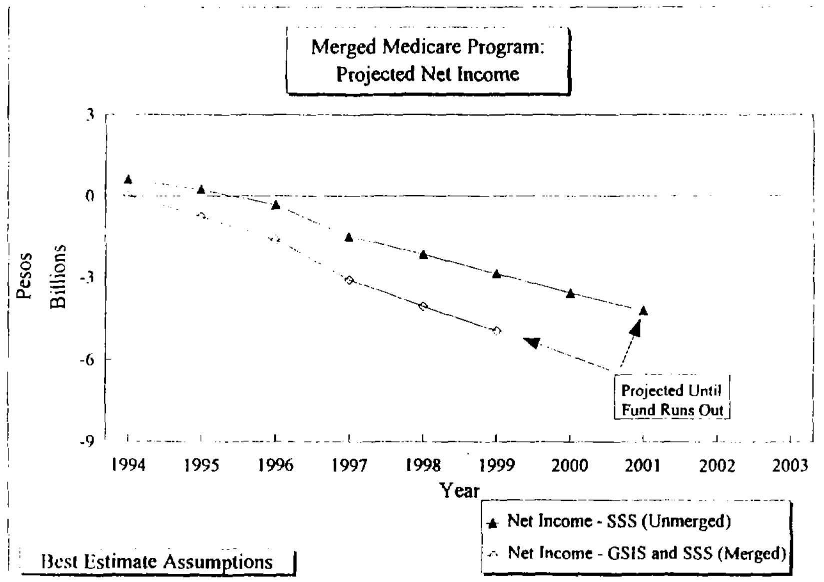
17. **Impact of Increasing Contributions**. Under partial funding, eventual increases in contributions are virtually inevitable if the current benefit structure continues to apply in the future. Increasing contributions now would help to ease the strain of rapidly increasing benefit payments in the future and would reduce the transfer of liability to future generations. An immediate increase in the current rate of contributions should therefore be considered. Chart D.4 shows the impact of increasing the current contributions by one percent, three percent and five percent of covered salaries — the top half of the chart for the impact on projected net income and the bottom half for projected fund size. The best estimate assumptions have been used for all the assumptions, except for the investment return (which has been assumed to reflect an additional three percent per year). The chart shows that increasing the current rate of contributions has a major impact in strengthening the financial position of the fund. With a three percent increase, assets are projected to run out only by the year 2026. With a five percent increase, this is extended further by eight years.

Chart D.4



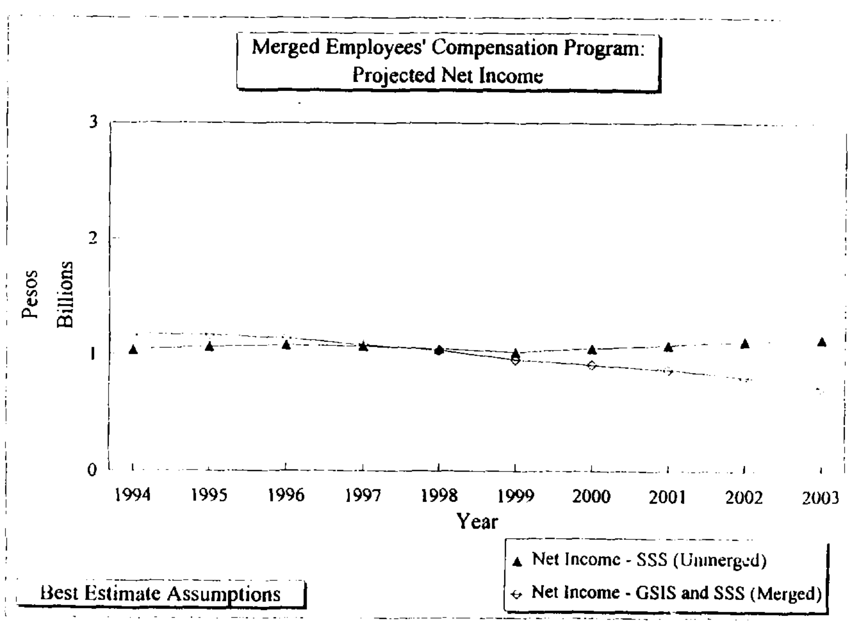
18. **Merged Medicare Program**. It has been assumed that the current SSS benefit structure, which has the higher levels of benefits, will apply in the future to both SSS and GSIS members. The contribution rates are already identical under both programs. Chart D.5 indicates that the inclusion of governmental employees will worsen the financial position of the SSS Medicare fund. This is mainly due to the higher utilization rates of the governmental employees (due to the older age group, inclusion of the armed forces, and possible administration inefficiencies in the system).

Chart D.5



19. **Merged Employee Compensation Program.** Both current programs are almost identical in structure and level of benefits provided. It has been assumed that the current SSS benefits will apply in future to both SSS and GSIS members. However, it has also been assumed that the current disparity in the rates of contributions (a higher wage base ceiling applies to GSIS members) will continue. As utilization is much greater under the GSIS, it seemed inappropriate to change the current GSIS contribution rates. Chart D.6 indicates that the <u>merged EC program is sustainable over the next ten years</u>, due mainly to the overfunded situation of the current SSS program.

Chart D.6



20. It should be noted that, under the scenarios of the merged system discussed above, it has been assumed that compliance for governmental employees will be at 100 percent, i.e., the contributions with respect to these employees will be at 8.4 percent of covered salaries. For current SSS participants, it has been assumed that the current level of compliance will continue. Currently, contributing members of the SSS make, on average, eight months of contributions per year. This, together with the fact that a certain portion of both the GSIS and SSS populations are paid more than the wage base ceiling, results in an effective contribution rate which is close to six percent of total payroll under the merged system. One way to increase the effective contribution rate would be to increase the number of months of contributions by current SSS contributing members.

21. **Other Possibilities**. As explained under the Actuarial Plan section, the design of the post-merger system needs to be re-examined to determine whether the benefits provide the appropriate level of financial security consistent with a social security system. Certain benefits would seem to be overly generous (e.g., the survivors' pensions) and the pensions provided by social security would seem to provide a high replacement rate for an unusually large section of the population. Table 6.1 compares the social security replacement rates at retirement in a selected group of countries that offer defined benefit social security retirement pensions. The table shows the replacement rates at each country's average wages and at twice the average wages. It will be noted that except for the Philippines and Spain, the replacement rate at twice average wages is significantly below that at average wages. The wage base ceiling under the SSS is scheduled to increase to ₱ 12,000 per month by the year 1999. When this happens, a high replacement rate will be provided to an even larger portion of the population.

22. Table 6.1 also compares the contribution rates under the retirement-related social security programs of the various countries. It will be seen that the contribution rates for all of the countries are higher than for the Philippines, relative to the replacement rates being provided. Except for the Philippines, the social security system in all the countries are minimally funded or use a pay-as-you-go system.

23. Chart D.7 shows the projected level of contributions and benefit payments under the merged social benefits program, expressed as a percentage of total payroll. As explained in paragraph 6.24, the contributions are currently some six percent of total payroll; they are expected to remain relatively unchanged if the current level of compliance persists. Benefits, when expressed as percentage of payroll, are close to five percent currently but are expected to increase sharply after 10 years, mainly as a result of the demography of the population; this explains the eventual steep downward slopes of the lines in Charts D.2, D.3 and D.4. This benefits to payroll ratio also defines the contribution requirement under a pay-as-you-go system of financing or, alternatively, the contribution requirement when the fund is exhausted. It is interesting to note that at the end of the projection period, the pay-as-you-go contribution rate approaches that currently required under the social security systems of the countries with more mature populations, as shown in Table D.1.

24. **Conclusions**. The financial situation of the merged Social Benefits program can be considerably strengthened by improving the investment performance and increasing the current rate of contribution. A plausible scenario would be to achieve investment returns that are three percent higher, on average, than that assumed under the best estimate scenario (inflation plus 2.8 percent), and to increase the contribution rate from 8.4 percent of covered salary to 11.4 percent of covered salary. Efforts to improve compliance by increasing the average number of months of contributions being made by current SSS contributing members will also help the system considerably. Another approach would be to level benefits to conform to expected income. As discussed in the Actuarial Plan in this annex at para. 45-52 issues related to benefit design also need to be reexamined.

Chart D.7

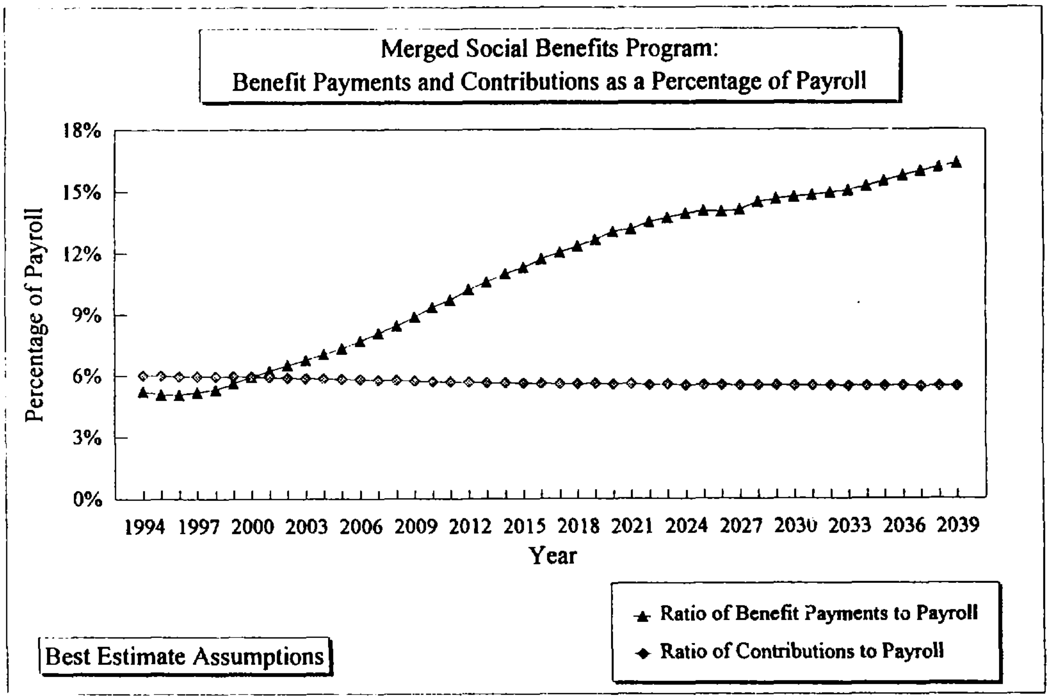


Table D.1: Comparison of Social Security Replacement Rates at Retirement in Selected Countries

Country	Current Monthly Income (Local Currency)		Current Normal Retirement Age	Pension Replacement Rate as % of Final Salary		Contribution Rate 1/
	Minimum Wages	Average Wages		At Average Wages	At Twice Average Wages	
Philippines	3,380	4,000	60	78%	74%	8.40%
Japan	105,559	272,743	65	53%	41%	18.50% 2/
Korea	180,900	450,000	60	70%	53%	8.00% 3/
Taiwan	13,350	30,220	60	38%	21%	8.00%
Germany	None	4,300	65	47%	35%	19.20%
Spain	60,570	178,571	65	93%	85%	29.30% 4/
U.K.	None	1,000	65	38%	20%	20.20% 5/
Mexico	458	1,603	65	17%	8%	7.60% 6/
Venezuela	15,000	23,438	60	33%	16%	6.75%
U.S.	765	1,833	65	65%	53% 7/	12.40%

1/ Unless stated otherwise, the contribution rates shown are essentially for retirement-related and death benefits. In all of the countries considered, the contributions are applied to wages up to a wage base ceiling.

2/ The actual amount consists of a level premium plus an earnings-related component. The amount shown represents the rate at average wages.

3/ Scheduled to increase to 12% from 1998 onwards.

4/ includes contribution for sickness and medicare.

5/ No allocation exists between different components of social security benefits. There is also additional financing through general tax revenues.

6/ Represents the rate (from 1996 onwards) at average wages.

7/ Including the value of spouse benefits.

Source: Wyatt.

25. The merged Medicare Program needs to be analyzed to determine the areas where there can be greater efficiencies, particularly with respect to current GSIS participants. One possibility that could be explored would be to provide the benefits for armed forces personnel out of general tax revenues. Once these issues are resolved, a revised contribution structure that would sustain the merged medicare fund for several years would need to be designed.

26. The merged Employees' Compensation program currently appears to be sound financially, due to the overfunded position of the EC program of the SSS. Attention may need to be focused on increasing the awareness of the program for current SSS participants and reducing the inefficiencies and duplication of benefits for current GSIS participants.

Accrued Past Service GSIS Benefits

27. As noted above, it is assumed in the assessment that current active GSIS participants are covered under the SSS during their period of GSIS participation, and hence accrue SSS benefits during those years. However, because of the differences in the GSIS and SSS benefit formulas, the accrued GSIS benefit is not the same as the SSS accrual. For many employees, the SSS benefit will exceed the GSIS benefit, despite the greater GSIS benefit accrual percentage, because of the lower GSIS wage base. However, for some GSIS participants, particularly the lower paid and pre-1977 participants (for whom the wage base does not necessarily apply for benefit purposes), the GSIS benefit accrual will exceed the SSS accrual. Equity then suggests that this excess be set up as an additional past service benefit for any GSIS participant so affected.

28. For the purposes of the assessment, the accrued GSIS and SSS benefits have been calculated on a prorated basis using compensation up to the time of merger.

29. The single sum present value of the additional past service benefits has been estimated to be about ₱ 14 billion.

30. As noted above, it has been assumed that all the GSIS Social Benefits assets attributable to active participants are transferred to the SSS to support the SSS benefits. This implies that the costs of these additional past service benefits will be met by the Government.

31. One reasonable approach would be to finance these benefits on a pay-as-you-go basis. It would of course be possible to finance them in a different way. A portion of the GSIS assets could be allocated to support them, or a level funding approach could be adopted, and the Actuarial Plan suggests that these alternatives be explored.

Future Supplementary Benefits

32. Although governmental employees will in the future be covered under the SSS, and some will be entitled to certain past service benefits, there remains the question of what, if any, additional benefits they will accrue in the future. The contributions for most governmental employees are markedly greater than the contributions that will be called for under the SSS. These excess contributions could be used to provide supplementary benefits.

33. Various alternatives may be considered:

- Use the excess to support a defined contribution formula.
- As the excess contributions will vary depending on the wage and will change with every change in the SSS scaled premium, define a new contribution formula, which will be "fixed", at least as far as the employee is concerned, to support a defined benefit or defined contribution formula.
- Allow governmental employees to select the percentage of pay contributed under a defined contribution formula, with allowance for employer matching.
- Give current GSIS participants the option of continuing participation in the GSIS rather than going over to an "SSS plus supplement" approach; this could be particularly attractive to pre-1977 participants.
- Make any supplementary benefit optional — i.e., participation only in the SSS is permissible, at employee option.

34. A simple approach is to assume that the current GSIS contribution percentage (essentially 14 percent) will continue but will be applied to pay up to the SSS contribution wage base ceiling. The excess of this amount over the SSS Social Benefits contribution will be used to provide supplementary defined contribution benefits.

Box D.1: Merger of Civil Service and Social Security Pension Schemes in the U.S.

Background. The Civil Service Retirement System in the U.S. was instituted in the early 1920's. From the beginning, it was a defined benefit plan that covered retirement, survivors and disability benefits based on a formula that included the age, average earnings and years of service of the employee. The Federal Government provided these benefits as a good employer and not as a program for all citizens working for other employers. Other employers including the military and some state and local governments also developed employee pension programs.

The U.S. Social Security pension system was created in 1935 as a social insurance program and was to become a primary vehicle for fighting poverty among the elderly particularly after the great depression of the 1930's. The program grew from its original pension for retirement and survivors of workers to include disability pensions in the 1950's. Coverage of workers expanded from the original industrial sector workers to eventually include almost all workers including the self-employed and farmers. The only major categories of employees not covered by the Social Security System were employees of state, local, and federal government. The system was politically popular and grew to be the dominant pension program in the country.

While the Social Security System was growing in coverage and benefit amounts, the Civil Service and other state and local government pension systems were also improving their programs so that there was somewhat of a parity between the benefits of the programs. While the Civil Service system offered the opportunity for earlier retirement and a little higher replacement ratio of benefits to pre-retirement earnings, it also included a higher employee contribution and less than adequate benefits in most cases of disability.

Funding. Both of these programs were financed by contributions or taxes on the employee and the employer. These payments were made to trust funds which by law had to be invested in U.S. government securities. They were generally financed on a pay-as-you-go basis; that is, contributions paid in by today's workers were used to pay the pension benefits to today's pensioners with a modest reserve to finance unforeseen eventualities. These trust funds proved to be a source of revenue for deficit financing of government budgets and also became a source of political controversy. Moreover, given the defined benefit basis of these programs there has also been considerable questions about how the government will meet their obligation to the growing unfunded liability accruing to the future generations of workers. While the ratio of workers to retirees was about 16/1 in the early days of the Social Security program it is now about 3/1 and will go below 2/1 after the turn of the century as the U.S. population continues to age.

The Merger. In the early 1980's, a funding shortfall in the Social Security programs led to the creation of a bi-partisan National Commission on Social Security Reform. As a part of overall recommendations for program changes the Commission recommended increasing the retirement age for pensioners, taxing of benefits above certain income levels, and the merger of the Civil Service retirement, survivors, and disability pensions into the Social Security program on a prospective basis. This means that all newly hired employees of the Federal Government would be covered by the Social Security program and the Civil Service pension programs would be replaced by an optional defined contribution savings plan as a second tier of pension benefits. This new program called the Federal Employee Retirement System or FERS became applicable to all federal employees hired after 1983. Therefore, all federal civil service employees hired in 1984 and later are covered under Social Security and have the option to contribute additionally to a savings plan which to some degree includes matching contributions from the employer (in this case the federal government). These funds are then invested in specified securities, subject to guidelines, and are managed by government appointed fund managers.

In order to try and accelerate the growth of this new program, several incentives were offered on a one time basis for employees of the Civil Service Retirement system to convert to this new program of Social Security and the optional investment fund. Although quite a few of the younger and less tenured employees opted for the new program, most of the more senior civil servants stayed with the old program because of the earlier retirement option. This means that the civil service pension fund will have a growing liability for many years to come but will eventually phase out.

Results. As a result of this merger, there is now greater flexibility for workers to move from federal government employment to employment in the private sector and vice-versa. There is also a greater parity of benefits for pensioners especially of those benefits paid for, or subsidized by, the federal budget. In addition, the government has avoided at least one portion of a future unfunded liability and there is less of an opportunity for persons to receive unintended benefits or penalties for working under two separate retirement schemes during the course of their working lives. The prospective nature of the merger and the provision of incentives to employees to join the new system minimized disruption. The introduction of these changes was accompanied by a massive program to inform employees of the benefits of the changes and the rationale behind them. Special efforts were made to provide each employee with detailed information about how they would fare under the old and the new systems. These public and employee relation activities were critical to the successful implementation of the new combined program.

F. Transition Plan

35. While the recommended approach offers substantial potential gains with few risks, its successful implementation will require a number of important transitional actions to current programs carried out and without creating unnecessary fear and disruption among the members. The following steps will be necessary to ensure a smooth transition. These have been grouped into four categories or sub-headings: (a) administrative plan; (b) financial plan; (c) actuarial plan; and (d) legal plan. A time frame for the implementation for these plans is also suggested.

a. Administrative Plan

Appointment of a Blue Ribbon Steering Committee

36. In order to ensure plan implementation, the President of the Philippines should appoint a blue ribbon Steering Committee to oversee the development of a detailed plan with a definite time frame. This Committee would not be expected to complete the work on these various items but to direct and coordinate these activities. Therefore, it should be of a high level of visibility and confidence, and would meet on an as-needed basis until the plan is fully implemented.

37. Staff to support this Committee should be provided by the SSS and the GSIS with a high level person in the SSS designated as the Coordinator. Provision should also be made for the Committee to call on assistance from other government agencies or to contract expertise, if necessary. The Chairman of the Committee should be named as soon as possible and the Committee should consist of no more than seven members representing various professions and interests.

Selection of Group to Perform Actuarial and Audit Activities

38. In order to ensure full understanding of the current value and future liabilities of the various funds, it will be necessary to have each fund reviewed and audited. The Committee should select an organization to perform separate actuarial valuations and audits of assets as soon as possible. These organizations could be existing government officials or contractors hired specifically for these functions.

Human Resource Management

39. The employees of the SSS and the GSIS are valuable resources and should be given the utmost care and consideration in these efforts. A human resource management plan must be developed for this purpose so that the reforms result in a pair of streamlined organizations which are efficient and capable of handling their new responsibilities. Consideration must be given to ensuring that a maximum number of current employees have the opportunity to move to the private sector with the divestment of the insurance functions. Also, consideration must be given to a program to encourage early retirements from these organizations. The SSS also has a need for additional inspectorate staff. Some preference should be given to this need. A special pay scale should also be devised for key SSS managers in order to allow the SSS to compete with private sector employers in this area. An executive and management development program should be designed and implemented for the SSS and waivers to the attrition law should be developed where there are legitimate needs which cannot be met from existing staff in these two organizations.

Public Information Campaign

40. It is essential that the activities involved in this merger be fully and timely explained to the members of the two systems as well as the general public. A grass roots education to the public about the goals and the benefits of the social security programs could be a very positive factor in increasing participation in the program as well as enhancing public understanding. If this full and early disclosure is not made, there is a risk that employees may fear that this is an attempt by the Government to lower their protection while employers may see this as a burden to their international competitiveness. Increased public education and involvement would be recommended even if no changes were being recommended.

Insurance Divestiture

41. One of the key elements of the restructuring of the sector is a transfer of the insurance functions of the GSIS to the private sector. Representatives of the insurance industry can provide suggestions regarding the options for the divestiture of the insurance functions. Several items need to be considered in this area:

- Since there will be a substantial downsizing of the GSIS overall, it is imperative that consideration be given to the transfer of maximum numbers of the current GSIS employees to comparable jobs in the insurance industry.

- The Government's continuation of the self-insurance program is a separate issue from the divestiture of the insurance business. If self-insurance continues, a proper administrative agency (perhaps the DBM) needs to be designated to carry on this activity.

- A considerable amount of work needs to be done to value existing assets so as to ensure fairness to both parties. This work should begin as soon as possible. Whether this work is contracted out or is performed by some part of the Government, it would be advisable to have the same person on the overall committee (or subcommittee) who has a familiarity with the insurance industry.

b. Financial Plan

42. **Current Liability**. Since there is currently an outstanding liability to the GSIS from the Government, someone must be designated to work with the DBM and the GSIS to determine the amount of the liability and the method and timetable for payment. Various options could be developed, but they should be done in advance of the merger and with full disclosure so that there is no question that full payments have been made.

43. **Housing**. As mentioned in Chapter 5, the government policies regarding the financing of housing need substantial revision. A method needs to be developed whereby the social security institutions can support the housing program of the Government without jeopardizing their fiduciary responsibilities. For this purpose, a new housing plan should be developed in parallel with this transition so that both objectives can be met.

44. **Investment Policies**. Investment policies for both the organizations should be reviewed and revised to maximize the risk-adjusted returns. Since the new GSIS will be a second-tier program, there would appear to be more of an opportunity to broaden investment opportunities.

c. Actuarial Plan

45. The study of the SSS and the GSIS and the proposed merger of these two systems have brought to light a number of issues that need further consideration and analysis from an actuarial perspective. This Actuarial Plan is intended to lay out an agenda for studying these issues.

46. The Actuarial Plan is presented in para. 52 in schematic tabular form. For each area requiring study, a table identifies in three columns the objectives sought in the studies, the various types of study needed, and who will be carrying them out.

47. It should be noted that the focus of this Plan is on issues requiring the application of actuarial expertise. Studies focusing on other types of issues, such as investment and general administration considerations, are described elsewhere.

48. It is assumed in the Actuarial Plan that the GSIS and the SSS will be merged as discussed in this Annex.

49. Attention herein is focused on the programs that will continue to be covered under the merged system and on the disposition of the life insurance coverage (both compulsory and optional) now provided under the GSIS. As the other types of insurance coverage offered in conjunction with the GSIS were not considered in the actuarial assessment, potential issues relating to them are omitted from the Actuarial Plan.

50. Six general areas of study are considered in the Actuarial Plan:

- Privatization of GSIS life insurance coverage.
- Compliance and administration under SSS.
- Design issues relating to the post-merger SSS.
- Design of the post-merger supplementary GSIS.
- Post-merger benefits of current GSIS participants.
- Medicare and Employees' Compensation issues.

These areas of study are listed in order of general priority. Although some studies might initially appear to be of greater immediate concern, as for example the determination of post-merger benefits for current GSIS participants, the correlated issues listed before them — i.e., the shape of the post-merger SSS and the supplementary coverage for GSIS employees — require prior resolution.

51. It will be noted that no precise time deadline has been attached to any element of the Actuarial Plan. The issues are complex and in many cases involve considerations outside the actuarial sphere. Hence, only the degree of urgency, and not a fixed completion date, can be prescribed.

52. The tables presenting the Actuarial Plan follow.

Table D.2: Privatization of GSIS Life Insurance Coverage

Purposes	Required Actions	Who Will Carry Out
To determine which private insurer(s) will assume the compulsory and optional life insurance coverages presently insured under the GSIS. To determine the amount of GSIS assets that must be transferred to the private insurer(s) assuming the coverages in order to effect the transfer. As a consequence, to determine the residual amount of GSIS assets available to support Social Benefits programs.	1) Determine the current face amount of each GSIS participant's compulsory life insurance (and, if necessary, optional life insurance), allowing for compensation increases since the last coverage adjustment, and the total contributions payable to provide the coverage.	1) Government organization or contractor.
	2) Obtain quotations from private life insurers on assuming the compulsory and optional life insurance (each insurer to bid on both); this will determine the "market value" of the insurance - the amount of assets an insurer will require to take over the coverage.	2) Government organization or contractor.
	3) As a check on the validity of the "market value" quotations, carry out an independent determination of the prospective insurance reserves.	3) Government organization or contractor.
	4) Select the insurer quotation(s) to be accepted; this will determine the asset amount to be transferred and residual assets left to provide Social Benefits to GSIS participants.	4) Designated Board.

Table D.3: Compliance and Administration Under SSS

The need for these studies is independent of any other aspects of the Actuarial Plan.

Purposes	Required Actions	Who Will Carry Out
To increase the extent of participation of persons eligible for SSS coverage (i.e., improve "compliance"). To reduce the number of unpostable SSS participants.	1) Determine estimated impact on SSS finances of changes in design of SSS benefit provisions: • Crediting service on basis of contributions made rather than credited years of participation. • Tightening service requirements for minimum benefit (increasing number and/or currency of service years).	1) SSS staff, with possible assistance of contractor. (These studies can be independent of or coordinated with studies in (iii).)
	2) Carry out inquiries and surveys to obtain missing data that render participants "unpostable"; this will be a major on-going project facilitated by improved computer facilities.	2) SSS Staff.

Table D.4: Design Issues Relating to Post-Merger SSS

Coverage of GSIS participants under the SSS affords an opportunity to reexamine the goals of the SSS. Issues of concern relate to the design and financing of benefits for persons covered under the SSS, including current GSIS participants.

Purposes	Required Actions	Who Will Carry Out
To determine whether the SSS benefits provide the appropriate level of financial security consistent with a social insurance system. To explore the impact of cost-of-living increases on SSS benefits before and after commencement of payment. To determine a pattern of scaled premiums that will support the SSS benefits satisfactorily.	1) Determine levels of income replacement at retirement (or other benefit eligibility) under various scenarios for the SSS, for purposes of comparison with the system's goals. This includes consideration of (i) variations in the benefit formulas, (ii) differing patterns of increase in the wage compensation base and (iii) alternative assumptions as to future cost-of-living increases. 2) Study impact on benefits in payment of various patterns of benefit levels adjustment for cost-of-living. 3) Estimate impact on costs of SSS of the various alternatives considered in 1) and 2). 4) Determine patterns of estimated scaled premiums that will meet the various alternative cost levels developed in 3). It will be noted that these studies are inter-related, although the number and types of alternatives considered are subject to time and cost constraints. The ultimate objective is to arrive at an SSS design that meets social insurance income replacement goals at a defined and affordable cost.	Any and/or all of the studies can be carried out by a government organization (e.g. SSS staff) possibly with the assistance of a contractor. Any recommendations for change in the SSS would be developed by the Social Security Commission or other designated Board.

Table D.5: Design of Post-Merger Supplementary GSIS

The purpose of these studies is to explore the impact of various alternative scenarios with respect to the post-merger benefit status of governmental employees who would have been covered under the GSIS except for the merger. The Actuarial Assessment assumes that supplementary benefits will be provided after the merger to these employees on a defined contribution basis, with the level of contributions selected so as to have the total of the SSS and supplementary plan contributions replicate the pre-merger GSIS contribution level.

Purposes	Required Actions	Who Will Carry Out
To explore the impact of alternative defined contribution formulas.	1) Estimate the income replacement and cash flow impacts of alternative levels of contribution to a defined contribution supplementary plan, including (i) consideration of setting contribution percentages independent of the SSS contributions, and (ii) adjustment of supplementary plan contributions to allow for changes in SSS contributions.	1) Government organization, with possible assistance of contractor.
	2) Based on the studies to be carried out in 1), determine a suitable design for supplementary post-merger benefits for governmental employees; this includes consideration of both voluntary and compulsory participation.	2) Designated Board.

Table D.6: Post-Merger Benefits of Current GSIS Participants

The Actuarial Assessment assumes that all GSIS participants at the time of merger will transfer to the SSS and the new supplementary governmental employee plan; they will also be entitled to an accrued GSIS benefit based on prior GSIS participation to the extent such benefit exceeds the accrued SSS benefit. The Assessment also assumes that all assets remaining in the GSIS Social Benefits fund after privatization of the life insurance coverage will be transferred to the SSS Social Benefits fund and the excess accrued GSIS benefit will be paid for by the government.

Purposes	Required Actions	Who Will Carry Out
To explore the impact of optional election of continued participation in the GSIS benefit formula. To explore alternative allocations of residual GSIS Social Benefits fund assets. To explore alternative means of financing the excess accrued GSIS benefits.	1) Estimate the cost and income replacement impact of continuing GSIS coverage for current participants on voluntary basis; this requires different assumptions of continuation percentages for pre- and post- 1977 participants, and assumptions as to future changes in GSIS compensation caps and in split of future total contributions between SSS and GSIS excess benefits.	1) Government organization, with possible assistance from contractor.
	2) Determine cost impact of various alternative allocations of GSIS assets at time of merger between SSS and GSIS supplementary benefits.	2) Government organization. Decisions will be by agreement between GSIS and SSS or by designated Board.
	3) Determine cost impact of various patterns of financing GSIS excess <u>accrued</u> benefits after consideration of asset allocation as in 2), including pay-as-you-go and various alternative funding strategies.	3) Government organization. Preliminary decisions will be made by designated Board.

Table D.7: Medicare and Employees' Compensation Issues

These studies are intended to explore solutions for various issues which arose in the actuarial assessment of these programs.

Purposes	Required Actions	Who Will Carry Out
To determine appropriate contribution and benefit structures for both programs. To explore the need for further controls on Medicare costs. To minimize duplication of benefits under the Employees' Compensation program and other SSS (and GSIS) programs.	1) Develop suitable contribution structures for the programs, both separate and merged, based on cash flow projections; this will include a study of patterns of increases in wage compensation bases for those programs.	1) Government organization, with assistance from contractor.
	2) Estimate costs of providing benefits which are consistent with the provisions of the separate programs, allowing for differences in utilization rates.	2) Government organization, with assistance from contractor.
	3) Analyze the trends in costs under the current Medicare programs, including a study of differences in the SSS and GSIS experience, and explore alternative additional cost controls.	3) Government organization(s), with assistance from contractor.
	4) Determine areas of duplication between Employees' Compensation and other programs, with particular emphasis on disability benefits; explore cost impact of various means of reducing such duplication, including changes in benefit design and conditions of eligibility.	4) Government organization, with assistance from contractor.

G. Transitional Structure

53. Inevitably, transitions take time if they are to be done properly. Since all of the actions included in the transition plan are likely to take up to a year, it is strongly recommended that a transitional structure be adopted sooner (see Chart D.8). Under this structure, the following need to be done:

- The GSIS Board of Trustees, as a first step, would grant administrative authority to SSS to administer the EC and MC programs for the government employees. This would be done as soon as a decision is made to adopt the recommendations of this study.

- As a second step, the current social insurance fund of the GSIS would be transferred to SSS oversight along with administrative responsibilities.

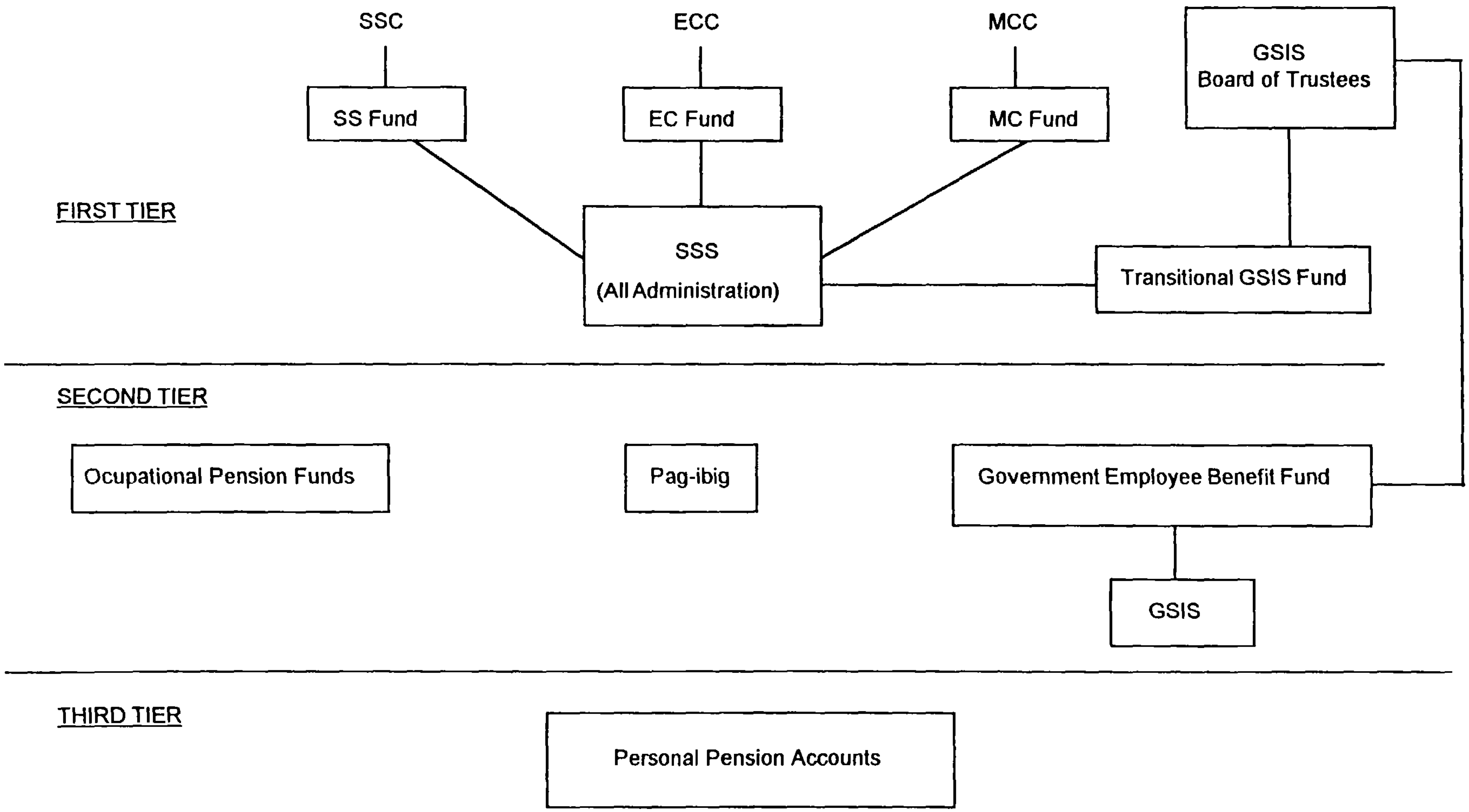
- The insurance activities of the GSIS would continue as is, until divestiture.

54. This transitional structure will allow the country to gain almost immediate benefit from the recommendations of this report and will allow for a smooth transition of employees who transfer from the GSIS to the SSS. It will also allow for the Administrator of the SSS to be responsible for the myriad of details necessary to accomplish the administrative changes without disruption of service. For instance, GSIS member services can be transferred from the current GSIS branch to the receiving SSS branch in a staged order best suitable to maintaining service. This will also eliminate the need for the appointment of a separate Transition Director. Care will have to be taken to ensure that the GSIS employees do not see themselves as without a role or a job. These details will have to be worked out in the human resources plan.

55. Once full integration has been accomplished, a determination of the proper organization for SSS and the 'new' GSIS can be determined. All of this can be done while the longer term transitional measures are being completed. The Steering Committee could serve as an 'oversight watchdog' on this process. This arrangement should eliminate the malaise likely to occur in both organizations waiting for the completion of all transition items.

CHART D.1: PHILIPPINES - TRANSITIONAL STRUCTURE FOR THE SOCIAL SECURITY SECTOR

For all Private & Public Sector Employees



IMAGING

Report No: 15400 SH
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