

# IMPACTS OF PENSION REFORMS ON THE KENYAN PENSION INDUSTRY

*Masinde Victoria*  
*John Oluken*

---

## Abstract

The emergence of full-fledged reforms in Kenya from the introduction of the Retirement Benefits Authority in 1997 has rekindled hopes among the ageing population in Kenya. These reforms are geared towards creating good social welfare conditions for Kenyans.

The Kenyan Pension industry remains a significant growth area which needs structural changes in management and governance in order to meet the ever changing scheme member needs. This is what forms the basis of the NSSF Act 2013.

In this study the effect of the NSSF Act contribution rate has been examined through use a Contribution rate model. Additionally, Kenyans' perception towards the yet to be implemented NSSF Act has been observed by use of questionnaire analysis.

These reforms are directly linked to the general economic growth of the country. The study asserts that the set 6% contribution is sufficient to meet the welfare conditions of Kenyans. This has been supported by majority of the stakeholders (scheme members, administrators and fund managers among others) however; good implementation strategies need to be put in place in order for the public to realize the good effects of the same.

This study therefore seeks to identify the main social welfare reforms put in place, as well as find out the effects and challenges towards implementation of these reforms on the performance of the industry with a critical theoretical look at the NSSF Act 2013.

---

**Keywords:** Pension Reforms, retirement, Contribution rate, social security, poverty

## Introduction

Over the past three decades, the living condition of older persons in Kenya has deteriorated. This is as a result of the erosions of their economic power, changes in the family structures and roles, particularly on the care of older members of the immediate family unsustainability of the pension schemes and inability of government to fulfill her expected role in the care and support of older persons in the community (Reynaund, 2000). Worldwide older persons are regarded as vulnerable group, hence, it has been accepted that older persons, the children and women are in dire need of government attention. This is because poverty affects this class of people than any other categories in contemporary world especially in developing countries. Various efforts by various successive regimes in the country to address the needs of older members of the society have proved abortive. We have seen several organizations coming in to rescue the situation. A good example could be World Health Organization which helps supply food for this unfortunate group of individuals. However, the emergence of full-fledged reforms on introduction of Retirement Benefits Authority (RBA) in 1997 has rekindled the hope of older persons especially because the

regulatory body has been keeping a close check on retirement programs in Kenya to ensure the pension industry operates with high levels of efficiency.

Kenya being a British colony has adopted so much from the British system of saving. Among many includes the formation of the National Social Security Fund (NSSF), which is similar to the state pensions of the United Kingdom (UK). In addition, the setting up of occupational pension funds in Kenya is borrowed from the UK (Mghali, 2003).

Ginneken (1998) Refers to social security as benefits that the society provides to individuals and households through public and collective measures to guarantee them a minimum standard of living and to protect them against low or declining living standards arising out of a number of basic risks and needs. Whereas pension benefits are only paid to an individual or his family on the basis of that person's employment record and prior contributions to the system, social security schemes incorporate welfare, of which financial assistance is extended by the state to persons who qualify on the basis of need. Social security is thus a social insurance program. For our case in Kenya we have NSSF.

The question of how to use social policies to link successful economic development with effective poverty reduction is at the core of contemporary political debate especially the fact that social security sector is one of the key players in the pension industry. The social security after retirement concerns for the Kenyan work force is a factor that leads to growth of the pension industry. This has been so because a large task force of the Kenyan population is increasingly being employed in the private sector which has designated occupational pension schemes for the employees. There is need to replace income after the active working years for a person who has been used to a pay check at the end of every month. Reforms to improve the efficiency of the social security sector are therefore highly needed. A vast understanding about the operations and implications of these laws is highly needed thus the basis of this report. The dilemma of efficiency of these reforms with regards to the pension industry is a big question to all stakeholders. The NSSF Act 2013 being one of the biggest impasses to Kenyans has elicited a lot of industry reactions from all corners. The Act proposes a raft of measures that aims at enhancing the old age financial security in Kenya.

The purpose of this research is to evaluate the impact of reforms on both private and the social security system in Kenya.

The specific objectives are to:

1. To identify the main reforms put in place for the Kenyan pension industry with a critical look on the NSSF Act 2013.
2. To identify the possible impacts of these identified reforms.
3. To identify the challenges towards implementation of these reforms.

Since the above developments are very crucial, it therefore calls for high level of professionalism and technical skills to evaluate the impacts of the bill before it is implemented; this is because the proposed changes in the bill tend to change the whole pension industry operation mechanism. The changes in the regulatory environment also mean that the sector has to change significantly to comply with the new requirements. This therefore must have a significant impact on the performance of the pension industry in Kenya.

Section 1 summarizes the background study, Section 2 presents an overview of previous work together with case studies of some other countries which have had pension reforms, Section 3 summarizes the contribution rate model, Section 4 describes the analysis of data followed by a discussion of the research findings and finally section 5 gives discusses research findings which are based on the objective of analyzing the impacts of pension reforms. Highlights about study limitations and recommendations for practical and further research are also given.

## Related literature

The need for reforms in social security is a question being impressed by many countries around the world. The OECD Secretary-General Angel Gurría asserts that “Further reforms are needed that are both fiscally and socially responsible. We cannot risk a resurgence of old-age poverty in the future. This risk is heightened by growing earnings inequality in many countries, which will feed through into greater inequality in retirement.” This struggle to meet the above addressed issue is the main reason as to why many countries are reforming their pension industry.

Some of the theories in support of pension reforms include the permanent income hypothesis by Friedman, (1957) which investigated pre-and post-retirement living standards in “straightening out the consumption stream”. It hypothesized that individuals base their consumption on a long term view of an income measure, perhaps a notion of lifetime wealth or a notion of wealth over a reasonably long horizon. The basic hypothesis posited is that individuals consume a fraction of this permanent income in each period and this is the average propensity to consume would equal the marginal propensity to consume.

The lifecycle hypothesis by Modigliani, (1963) deals with economic decisions on retirement saving in particular the rationalization of an individual’s income in order to maximize its utility over his lifetime. It stated that households accumulate savings during their working careers up to their retirement, and de-accumulate wealth thereafter. This type of saving behavior enables households to smooth their marginal utility of consumption over the lifecycle. Their achievement laid primarily in the rationalization of the idea in to a formal model which they developed in different directions and integrated within a well-defined and established economic theory. This model assumes the following assumptions about human behavior. They are forward looking across the span of their lifetimes; they can predict the financial resources they will have over their lifetime, they understand something about the financial resources they will need in successive periods of their lives, they make informed choices about the use of their financial resource.

Other investigators have found that delegation of authority within the pension industry to the agents may result in the agent taking actions that are not in the principal’s best interests (i.e., that are acts of self-interest on the part of the agent) but which are unknown to the principal. The goals of agency theory are to constrain agents from acting improperly and to provide them with incentives to act appropriately. The goal conflict problem results when the principal and the agent have different goals and it is difficult (and/or expensive) for the principal to monitor the agent’s behavior (to ensure appropriate behavior) (Eisenhardt, 1989). The source of the conflict can be the self-interest of the agent or simply different attitudes toward risk.

Some of the recently realized reforms worldwide include the Chilean model of pension reform of 1981 replaced an earlier pay-as-you-go (PAYGO) and public pension system with a new compulsory system of individual funded and privately managed pension accounts based on Defined Contribution (DC) principles was credited for linking old age social security with the facilitation of macroeconomic growth. World Bank personnel in particular suggested that the Chilean case proved that a shift of pension provisions from the public to the private sector and from PAYGO to DC would maintain social protection while increasing economic growth via the deepening of financial markets (World Bank, 1994). The Chilean reform proved to be much less successful than was originally assumed. Although the Chilean system succeeded in making a large share of workers formally subscribe to individual funded pension accounts, the level and length of contributions and subsequent expected pension payments remained on average quite low (Feldstein, 1998). In fact, the system delivered poverty pensions rather than old age security to most contributors. In reaction to the coverage gaps of the funded system, the former center-left Chilean

government decided to phase in a new public and tax-financed basic social pension system in order to provide additional income for current and future pensioners with very small funded pensions (Riesco 2009).

Secondly came the Nigerian 2004 reform which was inspired by the experience of Chile, an economically more advanced country, Nigerian policy-makers attempted to replicate the 1981 Chilean pension reform Orifowomo 2006; Casey, 2009. Before the 2004 reform in Nigeria, the formal private sector was covered by a pay-as-you-go pension scheme, the Nigerian Social Insurance and Trust Fund (NSITF). However, its scope and coverage were more limited than those of public sector schemes. Only some larger enterprises offered access to the scheme and, since its foundation in 1994, the NSITF's accumulated capital and pension payouts were low while administrative costs were high (ILO 2006). The resulting pattern of pension provisions was highly fragmented, and the available data suggest that only 10 percent of the Nigerian workforce (about 4.8 million out of about 48 million) belonged to the Formal employment sector, out of which about 3.7 million also belonged to a pension scheme (Casey, 2009). The main draw-back being the implementation challenges.

In the same year (2004) we also had the UK pension reform. This reform also stipulated that all employers were obligated to offer a qualifying workplace pension scheme and automatically enroll eligible employees with an increase in contribution rates. (Taylor-Gooby, 2005).

On the Kenyan scenario Odundo, (2003) report on Supervision of public pension funds in Kenya he points out some of the loopholes in the Kenyan social security system. He points out the fact that the fund is faced with numerous challenges that are deeply entrenched in the operations of the scheme and which negatively impact investment returns. One of the main challenges is the fact that our investment profile is characterized by a lack of diversity: an overwhelming 72 percent of assets far greater than the recommended 30 percent are held in real property. Returns from these assets are low, and liquidating them would offer little relief since the property market is depressed and the likelihood of recovering costs is poor. Further Odundo, (2003) points out the fact that NSSF Kenya is faced with poor record keeping. This has led to delays in determining benefits precipitating a US\$100 million unallocated suspense account.

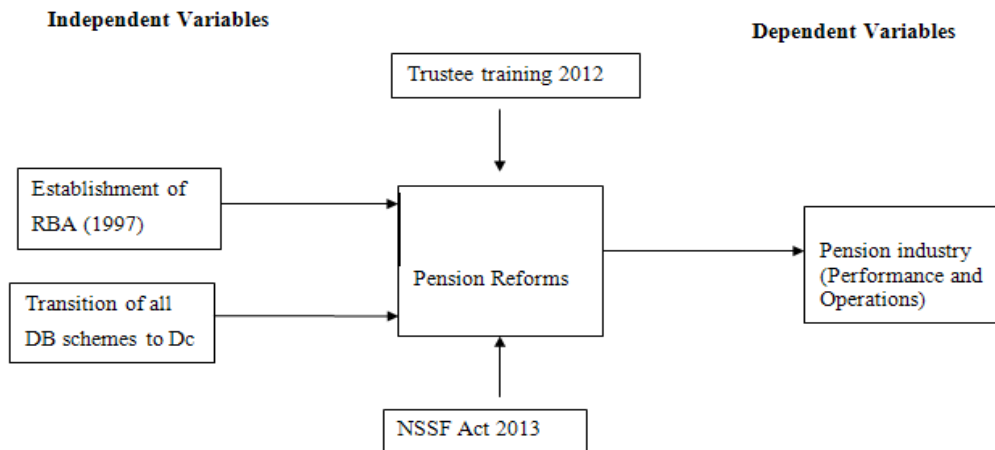
The afore mentioned issues have led to a number of strategies being put in place to try and better the operations of NSSF first the Retirement Benefits Act has been introduced in part to address these issues by requiring the adoption of international fund management practices. Also on the part of management the introduction of the trustee training requirement in 2011 is also a big step that will ensure that the scheme funds are managed appropriately. On the regulations part, RBA also calls NSSF to be compliant with its regulations as the regulator of all retirement benefits schemes in Kenya. The above concerns have also led to the major pension reform in Kenya; the proposed 2012 NSSF bill.

More authors include Fultz, (2006) who also assesses the impact of pension reforms by comparing pre- and post-reform replacement rates, but includes a fuller treatment of the possible effects of this decline in generosity on poverty rates.

### **Conceptual Framework**

Kenya has so far had a number of pension reforms. Below is a pictorial representation of the different reforms that have so far been implemented in Kenya.

Figure 1: Different pension reforms



**Methodology**

**Contribution rate model**

**Model Definition**

The objective of a pension model is to evaluate the financial viability of a pension scheme or pensioner to confirm the income and expenditure that should remain in force over a definite period of time or make recommendations on the necessity to revise the contribution rate to maintain a sustainable benefit (Latulippe, 1997)

**Model Assumptions**

Assume:

1. salary amount S
2. Interest rate r
3. Salary increase rate e
4. Assuming an individual would like to maintain a given lifestyle after retirement his/her salary is expected to increase constantly at a rate  $r^s$ .
5. Monthly effective will be  $r^m = (1+r^s)^{1/12} - 1$

A mortality table will then be prepared from the principle;

$$q_x = 1 - P_x$$

Table 1 below shows values used for the specific assumption;

Table 1

Assumed Age of Entry	25
Assumed Retirement age	60
age of the ,member at date of valuation	30
Rate of pension accrual	80
Rate of Pension Increase	5.00%
Assumed annual salary growth	1.50%
Interest Rate	18%
Inflation Rate	7.36%

Table 2

Male Percentage	67%	
Female Percentage	33%	
Salary level	Min	Max
Males	\$4,011	\$14,815
Females	\$4,411	\$11,024

Dollar - Kshs Conversion Rate	90
-------------------------------	----

The model also incorporated mortality assumption; that is the Association of Kenya Insurers (AKI) tables were used.

### Model Specification

The main objective was to determine the appropriate contribution rate that the individual can use to contribute an amount that will be able to sustain him/her during the retirement period. This was by use of a contribution rate model whereby a hypothetical situation of an average earning Kenyan was considered.

All the contributions were accumulated to age 60 years and the expected pension benefits discounted to age 60 years, using excel functionalities. An appropriate standard contribution rate that can make the difference between the individual contributions and his/her benefits equal to zero such that he/she does not under or over contribute was calculated. The model was meant to give an approximate estimate of the appropriate contribution rate to help compare with the proposed 6% in the proposed bill.

The model made use of the following pension standard contribution rate formulas;

### Attained Age Standard Contribution Rate (AASCR)

$$AASCR = \frac{\frac{(R-X)S}{A} \times \left(\frac{1+e}{1+i}\right)^{R-X} \times a'_R}{S \times a_{R-X}|} \quad (1)$$

Where:

R= Assumed Retirement Age

X=Age of member at date of valuation

S= Salary at date of valuation

A= Rate of pension Accrual

E= Assumed annual earning (salary) growth

I= Discount Rate

$a'_R$ = Value of Annuity payable from age R (Allowing for any spouses pension and pension increases)

$a_{R-X}|$ = An annuity to determine the present value of all future earnings (Allowing for the timing of contributions and salary increases)

### Entry Age Standard Contribution Rate (EASCR)

$$EASCR = \frac{\frac{(R-E)S}{A} \times \left(\frac{1+e}{1+i}\right)^{R-E} \times a''_R}{S \times a_{R-E}|} \quad (2)$$

Where:

E=Assumed Entry Age

$a_{R-E}|$ =An annuity to determine the present value of all future earnings for a new entrant.

$a''_R$ =Value of annuity payable from age R, Based on Assumed Proportion of males and females in the scheme (Allowing for any spouses pension and pension increases)

### Projected Unit Standard Contribution Rate (PUSCR)

$$PUSCR = \frac{\frac{1 \times S}{A} \times \left(\frac{1+e}{1+i}\right)^{R-X} \times a'_R}{S \times a_{1|}} \quad (3)$$

Where:

$a_{1|}$ =an annuity to determine the present value of earnings over the next year (Allowing for the timing of contributions and salary increases)

**Current Unit Standard Contribution Rate (CUSCR)**

$$CUSCR = \frac{\frac{1 \times S \times (1+e)}{A} \times \left(\frac{1}{1+i}\right)^{R-X} \times a'_R + (CUAL \times e)}{S \times a_{\overline{1}|}} \quad (4)$$

Where:

$$CUAL = \frac{P \times S}{A} \times \left(\frac{1}{1+i}\right)^{R-X} \times a'_R \quad (5)$$

**Data analysis, discussions and findings****The data**

Data was obtained from self-administered questionnaires, completed by 50% of respondents from different pension schemes in Kenya. Secondary data was obtained from various researches done on the Kenyan pension industry.

**Data Analysis and findings**

The main aim of the contribution rate model was to establish if 6% contribution is a good rate for Kenyans since this is the most crucial part of the act which has created tension in the industry.

From the four funding methods of valuation of pension standard contribution rates the 6% line graph seems to be the average for all the four methods. This implies that the stated contribution rate in the act could be fair and is not lean on any particular individuals.

The six per cent deduction is not to be imposed on employees immediately but will be increased gradually over the next five years. Employers will also be required to match the deduction by every employee.

An average employee changes jobs at least seven times during his or her working life. Under the current law, he can access up to 75 per cent of his pension contribution.

**Attained Age Method**

In Attained Age Standard Contribution Rate (AASCR) method, the model targets a stable level of contribution which can then be adjusted as appropriate with adjustment in the model parameter (age, salary retirement etc.) The model assumed that benefits are expected to be paid over the expected future membership of the beneficiary thus will accumulate to the value required to provide the benefits that are expected to accrue. The model results for different corresponding salary increases and interest rates are as shown below.

This method gave a total contribution rate of 10.33%. This is to mean 5.16% employer contribution and the same rate also applies to the employee contribution. The deviation between the model result (5.16%) and 6% percent could be as a result of other extra scheme expenses like the regulatory levy and scheme administrative expenses. 6% could be a good contribution rate according to Attained age method. *See Figure 2 and Table 3 on the appendix.*

**Entry Age Method**

The calculation for Entry Age Standard Contribution Rate (EASCR) is similar Attained age Standard Contribution Rate above. The only difference is that for this method the calculations are performed at the beginning of the member's service period. In this case the entry age assumption (25 years) was used. The method gives a total contribution rate of 11.6% as highlighted below. This is to mean 5.8% employer contribution and the same rate also applies to the employee contribution. These results are on average in agreement with 6% in the NSSF Act. *See Figure 3 and Table 4 on the appendix.*

### **Projected Unit Method**

In this method the Projected Unit Standard Contribution rate (PUSCR) was calculated by getting the present value of all benefits that will accrue in the year following the valuation date, by reference to service in that year and projected final earnings divided by the present value of all members earnings in that year. In this case the standard contribution rate is based on a one year time period. The method gives a total contribution rate of 11.92% as highlighted below. This is to mean 5.86% employer contribution and the same rate also applies to the employee contribution. These results are on average in agreement with 6% in the NSSF Act. *See Figure 4 and Table 5 on the appendix.*

### **The Current Unit Method**

The Current Unit Standard Contribution Rate (CUSCR) was modeled by getting the present value of all benefits that will accrue in the year following the valuation date by reference to service in that year and projected earnings at the end of the particular year *Plus* the present value of all benefits accrued at the valuation date in respect of members in service, multiplied by the projected percentage increase by the projected percentage increase in earnings over the next year divided by the present value of all members earnings in that year. *All divided by* the present value of all member`s earnings in that year. *See Figure 5 and Table 6 on the appendix*

### **Different stakeholders' perspective about Impacts of pension reforms in Kenya**

**Scheme Members** concerns include expressed fears that whereas there is an opt-out clause in the Act, it could prove hard for companies to get the necessary waiver to run their own schemes. Stakeholders are of the opinion that the requirements for applying for the waiver are expressly provided for, as is the timeline for any inquiry. Besides, the application will be made directly to the Retirement Benefits Authority (RBA) and thus NSSF will have no role in it.

As the country moves towards implementing the proposed reforms, the NSSF will be expected to operate three funds the current provident fund, the new pension fund and a new provident fund.

**Fund Managers** - A higher contribution as expressed by some respondents means an additional expense on employers and may affect the new employment – thus erasing the need to create about one million jobs promised by the Government. Fund managers are of the opinion that the new law will enable the NSSF to be professionally managed by external fund managers thus promising better returns for members. Once the law is in place a lot of people who have been left out under the current scheme will come on board. Indeed, if an emerging economy like Kenya wants to foster 'sustainable and inclusive growth' fight poverty and reduce inequalities, the Government needs to provide a social safety net for its population.

Otherwise, if that is not done people will fall back into poverty again and again because of substantial income reductions due to social risks, including sickness, unemployment and old age. But how will a country like Kenya, which struggles with an increasing informal sector, non-registered and some mobile population, establish social safety nets such as a pension system for a billion-plus population? Pension reform is one of the most difficult challenges in Kenya's economic reforms which require innovative public policy solutions primarily at the national government level

The old provident fund will be given five years to settle its dues to members, after which it shall be closed down. East Africa has been looking for ways to reform its pensions sector.



**NSSF Perspective** -NSSF research justifying the need for NSSF's transformation depicts that only 3.1% of elderly in Kenya above the age of 55 had reported receipt of any pension. Such statistics, pointed out confirm the growing need for NSSF to transform into a statutory national pension scheme to stem the growing incidences of poverty amongst the elderly which is currently much higher than the national average incidence of poverty.

**Factors other than the ones indicated as determinants in the questionnaire that affect the performance of the pension industry in Kenya?**

From the respondents some factors other than the determinants already identified came out strongly as some of the other factors which may influence the financial performance of the schemes.

The trustees considered the global economic conditions as crucial in determining how the Kenyan economy is going to perform. They cited the recent 2008-2009 global financial crisis which affected the general world economy .This crisis also shrank the gains which had been made by the retirement benefits schemes as most investments incurred losses.

The respondents also deemed it important to analyze the political situation in the country before investing in any sector. They gave an example of the post-election violence and how it affected the stock market negatively affecting the schemes financial performance.

The long term strategies adopted by the scheme determine the strategies to be adopted by the fund managers in investing the schemes funds. This goes a long way in delivering good returns to the scheme.

The trustees cited the government regulations as some of the factors which affect the performance of retirement benefit schemes. Some regulations cited was where the government allowed deferred members to withdraw some of their benefits before retirement. This occasioned losses in some schemes' since the funds had been locked up in long term investments.

From the questionnaires it was clear that already 86.5% of the sample data are registered members of NSSF. Of which 23% are satisfied with NSSF services. Some of the reasons given for satisfaction include the fact most people are aware of the tax benefits pegged on their NSSF contributions. Some of the positive aspects highlighted include the fact that all employees including self-employed persons can participate in the social security. Article 43(1) (e) of the Constitution states that every person has the right to social security. There are also various tax incentives such as exemption from the payment of stamp duty of any benefit or the refund of any contribution. Benefits payable by the Fund or from a contracted-out scheme are also generally exempted from income tax and contributions are also made tax-deductible expenses. Provision is also made for Reciprocal Arrangements with countries both within and outside of the East African Community. The provisions that exclude contributions from attachment, including in bankruptcy proceedings, are commendable for their intention to insulate the retired against poverty. Most of the respondents are confident that NSSF will benefits will do help them meet their retirement needs.

On the other hand, some of the reasons given for those who are not comfortable with the act include their past bad experience with the old NSSF scheme. Respondents pointed out the fact that the act has several negative provisions that would impact on the retirement benefits industry and increase unemployment. It came out clear that the act re-establishes a statutory fund with no clarity as to whether it is to take the form of a trust or a body corporate and the reference to "pension" schemes rather than "retirement benefit" schemes limits the opt-out option to pension schemes. The NSSF Board of Trustees is set up as a body corporate thereby causing confusion and ambiguity as to whether the Fund is established as a statutory

fund or as a trust. Furthermore, the NSSF Board comprising two principal secretaries, seven cabinet secretaries and a managing trustee appointed by the Board will be largely appointed by the Government. The Bill makes occupiers of premises liable to inspection and any employer, servants and agents of such occupier, and any employee, shall be required to furnish a Compliance Officer all such information and documents for inspection. This is notwithstanding Article 31 of the Constitution that grants natural and corporate persons the right to privacy including the right not to have their person, home or property searched; information relating to their family or private affairs unnecessarily required or revealed. The Second Schedule to the Bill provides for the compulsory transfer of members from the old provident fund to the new fund, but prohibits the transfer of assets, including members' contributions, to the new fund.

Misappropriation of funds and mismanagement of investments come out clear from most of the respondents. According to the report by Auditor General, NSSF may have incurred up to 76.5% of contributions on administration fees. It is on this premise that the act has attracted scrutiny and criticism from most of the stakeholders.

Transparency of the act is one of the major concerns raised by the respondents. It is clear that stakeholder education is needed as most of the respondents as much they are so emotionally negative about the bill they seem not to understand the key aspects of this bill. Most of the respondents were not able to clearly state what the bill states. One thing that came out clear is that most respondents are aware of the increase in contribution rate though they cannot really explain how the increase is to be incorporated. With lack of awareness, most stakeholders pointed out the fact that the Bill risks creating greater confusion in the retirement benefits sector. As part of a solution for the same the respondents are of the opinion that there awareness sessions should be organized in order to enlighten the public.

60% of the respondents are both members of NSSF as well as private pension. Members are fascinated with the tier 11 option of opting out as this will help grow their private pension. Specifically the private pension administrators are of the opinion that this will help grow their industry as most of their trusted members will go for the opting out option. It is of concern to them that this provision of contracting out of regulations referred to in the Fourth Schedule, are yet to be prescribed and therefore employers cannot benefit from the said provisions. The CEO of RBA in his reports said that though the Bill has room for employers with sound benefit schemes to opt out of the mandatory NSSF contributions, the conditions for opting out have not been well defined under the proposed law. This is what brings tension to private pension holders as they are not sure if the provision may be made not to be in their favor hence stands a chance to lose out.

The opt-out provision of the NSSF Act 2013 is evidently a blessing as indicated by private pension scheme members. Members are of the opinion that in opting out one may use the opportunity to set up a private pension scheme account, take advantage of contributions beyond Tier 2, which are available to all members of private pension schemes as well as diversify your retirement savings investment strategy. Some of the reasons given as to why they want to remain in their private schemes included:

- Increased transparency on reporting and investing
- Ease of accessing account statements
- Ease of managing contributions beyond Tier 2
- Ease of managing third party pension transactions, such as mortgage guarantees.
- Ease of accessing pension benefits upon attaining retirement age
- Portability of the pension scheme

## **Impacts of Pension Reforms on the Kenyan Pension Industry 5**

### **Summary, Conclusions and Recommendations**

#### **Summary**

##### **Positive aspects of the NSSF Act**

The NSSF Act 2013 does not necessarily claim private pension scheme to lose. There will still be money. Private schemes will continue to receive Tier II contributions if they are contracted out of NSSF, in addition to any extra contributions made by members. The accrued balances over the previous years will also continue being invested. Further, companies that do not have private schemes are allowed to contribute Tier II deductions to either personal or umbrella schemes that have contracted out of the NSSF. The graduated nature of the new mandatory pension scheme means that in the second year, NSSF will calculate the 6 per cent deduction on 100 per cent of the national average earnings. In the third year, the Upper Earnings Limit will be two times the national average earnings. In the fourth year, it will be three times average earnings, and in the fifth year, the upper earnings limit will be capped at four times the national average income. The reason for this is to ensure contributions move with the economic times. So the figure contributed will vary, depending on what the national average earnings will be then. However, for Tier I contributions, lower earning limits have been fixed at Sh6,000, Sh7,000, Sh8,000 and Sh9,000 from 2014 to 2017, respectively.

##### **Concerns about the Act**

Some of the fears include the fact that NSSF is taking the risk of taking what people earn today and ensuring they are better off a few years down the line requires prudent investment, which is something many analysts and workers fear NSSF cannot do. “Restructuring the NSSF scheme is something to welcome, especially for those workers without private pension schemes, who are in the majority. The higher the amount they contribute, the better the benefits they get. But NSSF must sort out its governance issues. Further, the provision that employees cannot access their pension until they reach retirement age is set to be particularly unpopular with the younger generation of workers who regularly change jobs. If you get the money when you retire, you could die soon, and the family you leave behind will find it difficult to get your benefits. Having that money now is much better.

##### **Increased Responsibility to NSSF Stakeholders**

The NSSF ACT 2013 which has replaced the NSSF ACT (Cap 258) has introduced new responsibilities for the employer with respect to NSSF contributions. The execution of these tasks calls for caution because of the implicit cost of error within the provisions of this new law. In addition to the existing financial and administrative roles under the old NSSF ACT, the introduction of Tier I and Tier II categories of contributions imposes operational and fiduciary responsibilities on the employer. These are new roles and fiduciary responsibilities can often by omission lead to adverse outcomes. The financial responsibilities are increased because the employer now has to pay more money to the benefit of the employee.

In addition the employer has to ensure contributions are remitted promptly particularly to avoid incurring heavy penalties as implied in the provisions of this new Law. It is primarily also the duty of the employer to now manage the remittance of Tier II contributions and where there is contracting out, the employer is to operate the separation of Tier I and Tier II contributions. This duty is important because of the need for competitive investment performance on Tier II over Tier I.

Small differentials in investment returns carried over several years can have very large implications on the final value of pension benefits. Moreover based on precedents

elsewhere in many cases the accurate reporting of both Tier I and Tier II contributions by the employer is an important factor in mitigating employment compensation and benefits disputes whenever they have occurred.

Some of the proposals are that the NSSF Board first addresses the key administrative and governance issues within the organization prior to implementing any radical changes. Further, the structured scheme ought to embrace a competitive market driven economy and not a monopolistic tendencies which are against the law. Following the above concern about the implementation process, stakeholders are of hope that the recent postpone of the implementation date from 1 Jan 2014 to 31 May 2014 will help put things in place.

The Act by adopting a wide definition of employee and employer compels every person in any form of employment to join the scheme. APAK is concerned that this may lead to a Monopolistic Universal Pension (albeit an occupational scheme in set-up) scheme without the critical Government's contribution for every citizen using tax which is a crucial component to any scheme providing "Universal Pension Benefits for all citizens in a country". The ILO Convention provides that universal schemes be funded by the state and are not contributory therefore in essence the Act shall be in contravention with internationally accepted industry best practice.

This mandatory membership of persons to the scheme violates Articles 36(2) of the Constitution that safeguards a person's right not to be compelled to join any association of any kind. It is therefore noteworthy that all citizens and not just a few members of NSSF should be accessing state funded social security albeit in the long-term.

### **Integration of NSSF ACT and third Parties**

Various stakeholders in the pension sector propose the development of the National Social Security Policy with the NSSF being one of the pillars with its role confined to providing cover to the vulnerable sector of the society as envisioned by article 43(1) (e) of the Constitution or managing the scheme as a scheme of last resort for members (employees) without any membership in any occupational retirement scheme or leave NSSF to be one of the occupational pension/provident schemes for employed persons who do not subscribe to any other scheme registered under the RBA Act.

This approach will also be in line with the models adopted by other East African States who have liberalized their pension sector with the 1st Pillar Schemes offering just but a safety net for the vulnerable in the society. As such, persons already enrolled in a pension scheme ought not to be compelled to join the scheme (NSSF) as this would amount to a violation of their rights. Tanzania has adopted a similar approach where the NSSF Tanzania is under the supervision and regulation of the Tanzania Regulatory Law and operates as just but one of the many occupational retirement benefit schemes and competes with other statutory and non-statutory funds. NSSF Kenya should not it seeks to unlawfully tout the NSSF Board as a judge/regulator of all other retirement benefit schemes.

It is important to separate and respect the regulatory role of the Retirements Benefits Authority as mandated by the RBA Act No. 3 of 1997 with the mandate of the NSSF. Applications ought to be heard and determined by the RBA as the independent oversight authority. It is the Association's submission that Reference Scheme Test has not been outlined in the said schedule and that the RBA ought to be empowered to set and adjudicate which schemes meet universal criteria. The NSSF cannot be the Judge and Jury in its own case. The RBA Act clearly empowers the Authority to independently regulate the activities of retirement benefit schemes. The Cabinet Secretary in charge of matters of Social Security ought NOT to assume the role of the Authority.

The Tier I, II & III fund system should be well outlined and made easy to understand the nature of the scheme as provided for in the Act. APAK recommends that a

simple illustration of the scheme be adopted to avoid the scheme being subject to different interpretations thereby causing confusion in the industry.

### **Limitations to the Study**

The research experienced a number of constraints while undertaking the research. The major limitation was the limited literature available on similar work done in Kenya. Most of the literature references were from western countries such as, United States and European countries that had carried out various studies related to this one.

Lack of adequate resources (time, finances) meant that the researcher was limited to a few areas of research. The lack of resources meant the researcher could not be able to reach to all the service providers of a pension scheme to be able to get a feedback from them on the determinants of schemes financial performance.

The respondents felt they needed to be thoroughly educated on the area of study before they could fill the questionnaire. Some of the trustees expressed the concern that they did not have data for their schemes since most of the data was with the appointed service providers.

There was a poor response in terms of filling in the questionnaires. Out of the sample population only 50 % filled the questionnaires even after numerous follows by email and phone calls. This reduced the sample population though it was still representative.

### **Conclusion**

Reforms will always be welcome. I laud efforts by the forces driving the changes in NSSF. We support especially the drive to at least ensure that the benefits that NSSF provides to Members at their retirement are meaningful and if this is the only way Members can secure their retirement, so be it. For employers who have adamantly refused to allow their Members to enjoy the benefits of having their own occupational retirement benefits schemes, the new Fund will at least create a platform that will allow worker feel like their retirement welfare is at last secure. The current move to conform NSSF to the provisions of the Retirement Benefits Act is also long overdue and should be encouraged. It is hoped that investment returns will continue to increase as the administration costs reduce or at least arrested.

However, we must reiterate the need for NSSF (at least in the mutated form) will be fully compliant with the Retirement Benefits Act and more so that its management will be required to accept the complete oversight of the Retirement Benefits Authority. This will inject professionalism, transparency and accountability

There is therefore a need to engage all the stakeholders in the pension's industry/sector so as to allow them air their views on the Act and have their contributions incorporated. This is in line with good Corporate Governance and industry best practice.

It is further opined that consequent to the Bill, the RBA Act No.3 of 1997 ought to be amended to provide that all employers must enlist their employees in a retirement benefit scheme of their choice or the NSSF. This is in line with international best practice industry standards. Consequently, the Retirement Benefits Authority (RBA) should be mandated to FULLY oversee the activities of NSSF in accordance with the provisions of the RBA Act;

The Pension Industry seeks a fair competitive environment where each player is given a freehand to offer service to members in the retirement industry.

According to the ILO, Universal Pensions are basically 1st Pillar social assistance measures formulated and funded by the state. A major element of the scheme is "Government or State Funding' through taxation measures so as to avail social security benefits to ALL persons and not just persons in employment. The social assistance is most critical to persons who cannot afford to support themselves and usually takes the form of social programmes

such as Income Support or un- Employment Support, housing, medical aid etc. to persons who are vulnerable to a society. This is the basis of the Act.

### **Suggestion for Further Research**

The present study should be replicated to include pension scheme members in other regions of the country to find out whether the same results will be obtained. The sample size should also be increased to get a more representative sample and make better conclusions.

The study should also be replicated to include Kenyans working in the informal sector and find out if they save for retirement and how they save, either through personal pension plans or by saving in the bank.

The study can be carried out to include those who have already retired or who are above the age of 60 years as this study was limited to those below 60 years of age.

A broader research could be carried out to measure the impact of a reform on an individual's total net worth. This study would require greater resources and would require at least 3 years in order to educate individuals and measure the impact.

A study could also be carried out to determine what role policy makers can play, if any, to increase efficiency in the pension industry.

### **Policy Recommendations**

Based on these research findings the following are the recommendations to the various stakeholders.

The trustees of pension schemes should engage the services of a professional consultant to draft policies to guide the investment manager on the investment strategy of the scheme. This policy should take cognizance of the age structure of the employees and the various risk appetites for the employees. This will help in matching the assets and the liability profile for the scheme.

The trustees should also have a risk mitigation policy in place. The various inherent risks should be identified through consultative forums to identify them and also mitigate their effects. The trustees should also have a trustee liability cover to reduce their risk in case of any litigation issues which may arise.

There should be a policy in place to guide the government in policy making. The process should be consultative to ensure that the interest of the stakeholders is considered in making the regulations.

Policies with regard to NSSF investment strategies should be put in place in order to realize good return from expected increase in fund as a result of increase in contribution rate.

Information sessions and seminars should be conducted in order to enhance member education before implementation of the Act in June. This will help reduce levels of misconception among scheme members and employers.

### **References:**

- (2000, 12 28). *After insurance: Need for focus on Pension Reforms to increase contractual Savings to fuel economic growth.*
- Alo, O. (2004). *Current pension reforms: implications for career development in the public and private sector.* Lagos.
- Bonilla, A. G. (2003). *Social Protection.*
- Casey. (2009). *Pensions in Nigeria: The performance of new system of personal accounts.* Geneva.
- Cooper, D. . (2003). *Business Research Methods.* New Delhi: Tata Mc Graw-Hill.
- Dearborn. (1999). *Principles of Retirement Planning.* Prentice Hall New Jersey.
- Diamond, B. a. (2009). *Reforming pensions. Principles and Policy Choices.*

- Eisenhardt, K. M. (1989). "Agency Theory: An assessment and Review". *Academy of management review*, 14(1), pp. 57-74.
- European, C. (2006). *Long-Term Sustainability*.
- Feldstein, M. (1998). *Privatizing Social Security*. London: The University of Chicago Press.
- Friedman, M. (1957). *A theory of the Consumption Function*. Princeton: Princeton University Press.
- Fultz. (1997). Social Security for Rural Households Problems. *Challenges and Prospects*.
- GINNEKEN, V. (1998). *Social Security and Income Distribution*. Sankaram.
- Hawley, J. a. (1996). "Corporate Governance in the United States: The Rise of Fiduciary Capitalism". Working paper, saint Mary's College of California, School of Economics and Business Administration. California.
- Howse, K. (2004). Ageing horizons. *Social justice and pension reform*.
- ILO. (2006). *Federal of Republic of Nigeria: Report to the government-Actuarial assessment of NSITF*. Geneva.
- Latulippe, M. c. (1997). *Comprehensive Quantitative modelling for a better pension strategy*.
- March, P. (2003). *Quantitative Survey*.
- MCGraw. (2002). Business weekly. *The Enron Scandal*.
- Mghali. (2003). *Employee Pension and its Effects*. Nairobi.
- Modigliani, a. A. (1963). "The Life cycle hypothesis of saving: aggregate implications and tests.". *American economic review*, 53(1), pp. 55-84.
- Odundo, E. (2003). *Public Pension Fund Management-Proceedings of the second public fund management conference*.
- Oladimeji, A. (2004). *Current Pension Reforms: Implications for Career Development in the Public and Private Sectors*.
- Riesco, I. a. (2009). *Development welfare state and social change in Chile*. UK: Houndmills.
- Roscoe, J. (1975). *Fundamental Research Statistics for the Behavioural Sciences*. New York: Holt Rinehart & Winston.
- Taylor-Gooby, P. (2005). *Ageing and Pension Reforms around the World-UK pension reform*. Edward Elgar Publishing Limited.
- World Bank, Z. S. (1994). *Averting the Old age Crisis: Minimum pension insurance in the Chilean Pension System*. Washington.

## **Appendix I: Questionnaire**

### **Questionnaire on the impacts of reforms on the kenyan pension industry**

#### **Section one: general information**

**1. Are you a member of NSSF Kenya?**

Yes

No

**2. Do you have a private pension scheme?**

Yes

No

**3. At what rate do you contribute to your private pension schemes?**

**4. Is your retirement benefits scheme registered by Retirement Benefits Authority?**

Yes

No

**Section two: Pension reforms**

**5. In general, what are the main elements that have been addressed in the recent reforms of the pension system in Kenya?**

---



---

**6. If any, how do are these elements likely to affect operations of your scheme?**

---



---

**7. Do you support the proposed increase in the rate of contribution in the proposed bill (6%)? Please explain?**

---



---

**8. Using a scale of 1-5 to represent the level of agreement where 1 represents totally disagree and 5 represents totally agree indicate your level of Agreement with the issues addressed in the bill by ticking the most appropriate box as related to the following statements?**

	1	2	3	4	5
The proposed 6% is good and will translate into an increase in members benefit.					
The proposed bill will benefit the private sector.					
The bill is consistent with the Kenyan constitution					
NSSF investment strategies are good					

**9. What are some of the aspects of the bill you agree with and should they be implemented? Suggest any improvements to issues you don't agree with.**

---



---

**10. What improvements should be done to improve the bill and improve the performance of the pension industry?**

---



---

**Is the proposed bill inconsistent with any other regulations within the pension industry? Please explain**