

PENSION SYSTEMS IN EAST AFRICA A DEEP DIVE



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FOREWORD

Although the populations of the countries in East Africa are still young, there is a growing awareness among policy makers that they too will face the interlocking challenges of demographics and urbanization. The lesson learned from other regions is that policies need to be put in place now to ensure that pension systems are robust and affordable. So too, pension savings should be used to fund economic growth and development. Otherwise, we risk the fate of becoming old before we become rich.

This book was initiated by the pension regulators, specialists, consultants and practitioners within the East African Community (EAC) partner states. Many of us have partnered with the World Bank on pension reforms in our countries. Together, we drew on global policy lessons and experience, and are glad to do so again for this publication.

In this book, the authors share the East African story of pensions with the world. We have tried to give readers a perspective on the state of pensions within the EAC and contribute toward the development of the sector. We have also sought to provide practical advice to the business community that has embraced the opportunity to invest in pensions businesses across the region.

In this book, the authors take the readers through the historical and political events stemming from colonial days, as well as the effects of these events on the development of pensions across the Community. It includes an analysis of the diverse pension systems, including the characteristics, challenges and opportunities yet to be dealt with in delivering sustainable pensions to East Africans.

Throughout the EAC, regulatory authorities have been established to manage the pensions sector. In a concise and easy to understand manner, this book seeks to outline and differentiate between the various regulatory and supervisory approaches, the investment management practices, the governance frameworks and the tax policies that have been adopted across the Community. It delves into the real challenges of optimizing returns on investments, increasing coverage and harmonizing taxation policies across the diverse partner states.

We hope this publication will provide a useful guide not only to the history, but to the future of our pension systems. With well-thought through policies and robust implementation, we believe that East Africa can put in place pension systems fit for the 21st century and beyond. In so doing, the region can provide leadership and lessons for the rest of the world.



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ACRONYMS AND ABBREVIATIONS

ACCA	Association of Chartered Certified Accountants
AFPS	Armed Forces Pensions Act (Uganda)
BIF	Burundian francs
BNR	National Bank of Rwanda
CalPERS	California Public Employees Retirement System
CatR	Catchment Rate
CEO	Chief Executive Officer
CFA	Chartered Financial Analyst
CIS	Collective Investment Scheme
CORE	Comprehensive Replacement
CPG	Commutated Pension Gratuity (Uganda)
CR	Coverage Ratio
CRISA	Code for Responsible Investing in South Africa
CSR	Caisse Sociale du Rwanda (Social Security of Rwanda)
DB	Defined Benefit
DC	Defined Contribution
DR	Demographic Ratio
EAC	East African Community
EAPSA	East African Pension Supervisory Association
EEE	Contributions, investments and pay-outs exempt from tax
EET	Contributions and investments exempt, with pay-outs taxed
E-KYC	Electronic Know-Your-Customer
ESG	Environmental, Social and Governance
ETT	Contributions exempt, with investment and pay-outs taxed
EU	European Union
FSB	Financial Services Board of South Africa
GDP	Gross Domestic Product
GEPF	Government Employees Pension Fund (Tanzania)
GIPS	Global Investment Performance Standards
GRR	Gross Replacement Rate
IFRS	International Financial Reporting Standards
ILO	International Labour Organization

INSS	National Institute of Social Security (Burundi)
IOPS	International Organization of Pension Supervisors
IPP	Individual Pension Plan
ISSA	International Social Security Association
KACITA	Kampala City Traders Association
KCB	Kenya Commercial Bank
KSh	Kenyan shilling
LAD	Longitudinal Administrative Database
LAPF	Local Authorities Pension Fund (Tanzania)
LCH	Life-cycle Hypothesis
LTSS	Long-Term Savings Scheme (Rwanda)
MURBS	Makerere University Retirement Benefits Scheme
MVIRBS	Mazima Voluntary Individual Retirement Benefits Scheme
NBS	National Bureau of Statistics
NSE	Nairobi Securities Exchange
NSSF	National Social Security Fund
OECD	Organisation for Economic Co-operation and Development
ONPR	National Office of Pensions and Occupational Risks (Burundi)
PAYG	Pay-As-You-Go
PESTEL	Political, Economic, Social, Technological, Environmental and Legal
PPF	Pension Protection Fund (Tanzania)
PSPF	Public Service Pension Fund (Tanzania)
PSPS	Public Service Pension Scheme (Uganda)
PSSF	Public Service Superannuation Fund (Kenya)
PSSSF	Public Service Sector Security Fund (Tanzania)
RAMA	National Medical Insurance (Rwanda)
RBA	Retirement Benefits Authority (Kenya)
REIT	Real Estate Investment Trust
RSSB	Rwanda Social Security Board
RwF	Rwandan Franc
SRR	System Replacement Rate
SSRA	Social Security Regulatory Authority (Tanzania)
TEE	Contributions taxed, income exempt, with pay-outs taxed
TTE	Contributions and investments taxed, with pay-outs exempt
TTT	Contributions, investments and pay-outs taxed
TZS	Tanzanian Shilling
UK	United Kingdom
URBRA	Uganda Retirement Benefits Regulatory Authority
US	United States
VAT	Value-added tax

CHAPTER 1

PENSIONS IN EAST AFRICA: THE JOURNEY THUS FAR

- David Nyakundi Bonyi -

Introduction and History of Pension Systems in the East African Community (EAC)

Pension systems have two main functions, namely, to alleviate poverty and smooth consumption over an individual's lifecycle. Whereas cash transfers are state programs intended to alleviate extreme poverty among the elderly, other retirement saving plans are generally designed to provide income replacement in old age. Barr and Diamond (2008,

p. 25) state that “the primary objective of pensions is economic security in old age, achieved through consumption smoothing, insurance, poverty relief and redistribution. The primary objective of a pension design is to optimize old age security, including the cost of providing it”.

Pension systems can be designed in a variety of ways and built from different ‘pillars’ in World Bank parlance, to achieve these goals (Figure 1).

Figure 1: Pension System Pillars

Pillar 0 / Pillar 1	Pillar 2	Pillar 3	Pillar 4	Pillar 5
• Mandatory – poverty alleviation pillar public pillar • Mandatory public consumption smoothing pillar	• Mandatory private pillar (DB or DC)	• Voluntary pillar (DB or DC)	• Financial Assets (housing/ physical assets/ family transfers)	• Labor income + own consumption

Source: World Bank

Diverse retirement benefits systems exist within the member states of the East African Community (EAC). These include a mixture of cash transfer programs, national mandatory schemes, work-based retirement schemes and individual retirement savings plans. The differences in these plans can be explained by the political and social history of EAC member countries.

The regulatory framework for retirement benefits in EAC member states mirrors the policies adopted by each state, as well as the historical influence of their colonial past. With the introduction of the modern state, traditional social support systems were gradually dismantled, and market-based social protection policies were introduced with the gradual collapse of traditional social protection practices, new policies were established, which rewarded civil servants who remained loyal to the colonial government. The bulk of the employees who benefited from the policies of their colonial powers were themselves white employees. Their benefits were guaranteed by statute even after independence¹.

The effect of providing coverage to loyal civil servants was that the rest of the citizenry remained uncovered, including the casual and agricultural workers employed in white-owned plantations. In the Francophone countries of Rwanda and Burundi, the colonial powers established contributory defined benefits schemes for civil servants. Soon after independence, these were converted to contributory defined benefit social insurance schemes for all formal workers. The situation was different in Kenya, Tanzania and Uganda, where the British left a legacy of non-contributory defined benefit pension schemes for civil servants working in the colonial government. These were originally designed to cover European employees. The scheme was gradually extended to Africans working for colonial governments, but it excluded women who were employed on short-term government contracts.

In 1999, Tanzania enacted the Public Service Retirement Benefits Act No. 2 to provide for the establishment of the contributory Public Service Pension Fund. The Act repealed the Pension Ordinance of 1954, which was non-contributory. In 2012, Kenya's efforts to reform the civil service non-contributory pension scheme (which commenced in early 2000) culminated with The Public Service Superannuation Scheme Act, which is intended to make the scheme contributory. Unfortunately, the Act has not yet been implemented by the Minister of Finance. The pension scheme for civil servants in Kenya has remained the same scheme, that is, it continues to utilize the system established by its colonial powers in 1946. In Uganda, the non-contributory public pension scheme began in 1946 with the enactment of the Pensions Act. To date, efforts to reform the system to a contributory scheme have been slow and tedious.

Aside from these traditional civil service schemes, policies and regulatory frameworks extending coverage to the formal private sector workers were nearly absent during colonial days. After independence, mandatory contributory retirement benefit schemes were established. These required private sector formal workers and employers to contribute to national mandatory social security schemes. In some countries, these mandatory schemes were defined contribution provident funds, whereas in other countries, they were defined benefit pension schemes.

The various policy approaches were informed by colonial legacies or national development policies adopted after independence. In the case of Tanzania, in keeping with its affinity for eastern socialism, institutions were nationalized, and social security choice demanded solidarity rather than the individualistic approach of the west. This explains the existence of mandatory defined benefit schemes which currently operate in Tanzania. Under the defined benefit schemes, intergenerational transfers exist along with redistribution among the current members.

The Francophone countries, Burundi and Rwanda, reformed the contributory public schemes established during colonial days to include private sector workers. Kenya and Uganda adopted the neoliberal economic principles of the west, which to a large extent prioritize individual responsibility over collectivism or solidarity vis-a-vis retirement savings. These national socioeconomic development choices led to the development of defined contribution provident funds in Kenya and Uganda, where there is no intergenerational transfer or redistribution within the scheme. Kenya, which is more capitalist than other countries, established the national social security scheme in 1965. It had a very low contribution rate to cover the low-paid workers as opposed to the senior officers who had started developing the private work-based retirement benefit schemes.

Kenya currently has the largest number of private occupational and individual retirement benefit schemes among the EAC countries. The legal framework for retirement benefits in the EAC is Eurocentric, that is, it favors the formal sector rather than the informal sector. However, the informal sector has grown tremendously in recent years. The framework also favors individual responsibility

over national solidarity. Other than in Kenya, where a universal, cash transfer scheme is being rolled out on a national basis, the official design does not incorporate participation by workers in the informal sector. The obvious implication is one of massive exclusion. Unemployed people and the informal sector need to be covered in the retirement benefits sector. This can only happen if fundamental reforms of the retirement benefits sector are comprehensively carried out to extend coverage to both the formal and informal sectors.

Over and above the design of the pension system overall, the parametric design of the individual schemes varies by country (Table 1). This has fiscal and other policy implications for these countries. For example, spending in Tanzania on the national scheme is high, not just by EAC standards, but also by regional African standards (Figure 2).

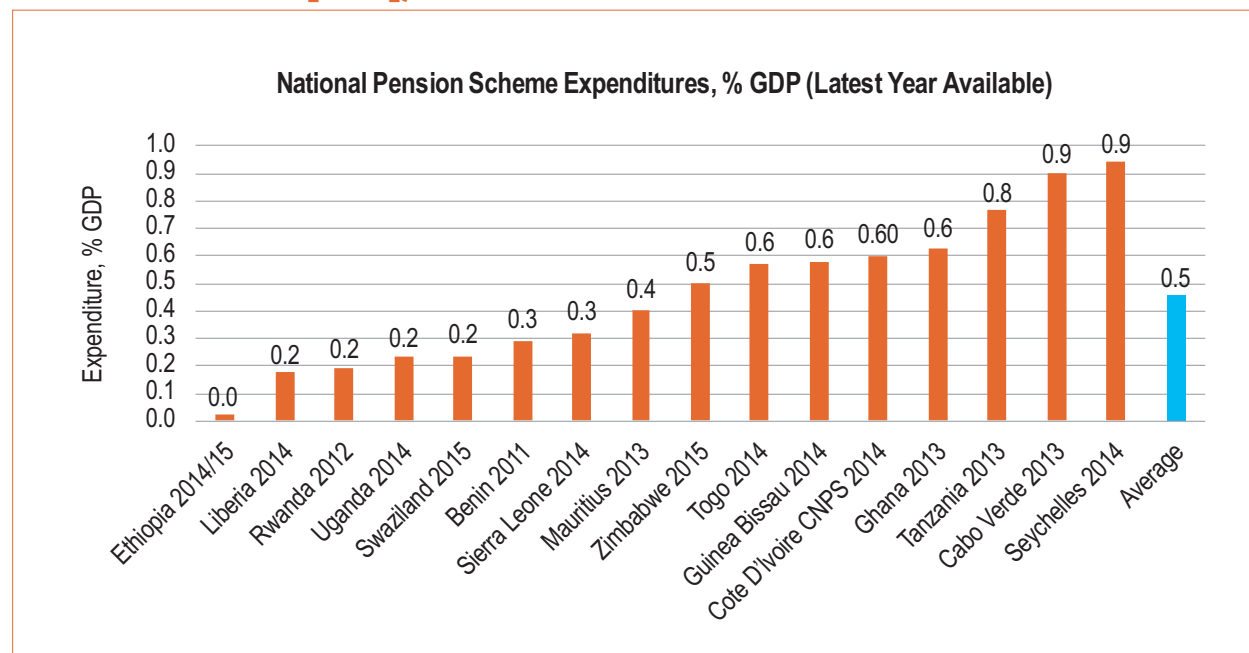
By contrast, spending on civil service pensions is relatively low in EAC countries as compared with its regional peers — although it is expected to grow significantly (due to the demographics of these schemes vis-à-vis their national populations) (Figure 3).

Table 1: Main Pension Schemes by Country

Country	National Pension Scheme	Civil Service Scheme
Burundi	Institut National de la Securite (National Institute of Social Security) – INSS Pay-As-You-Go (PAYG) Defined Benefit (DB)	Office Nationale des Pensions et Risques Professionnels (National Office of Pensions and Occupational Risks) – ONPR PAYG DB
Kenya	National Social Security Fund – NSSF DC Provident Fund	Public Service Superannuation Fund - PSSF DB – Transitioning to DC
Rwanda	Rwanda Social Security Board – RSSB PAYG DB	
Tanzania	National Social Security Fund – NSSF (main) PAYG DB	Public Service Sector Security Fund – PSSSF PAYG DB
Uganda	National Social Security Fund – NSSF DC Provident Fund	Public Service Pension Scheme – PSPS Non-Contributory DB

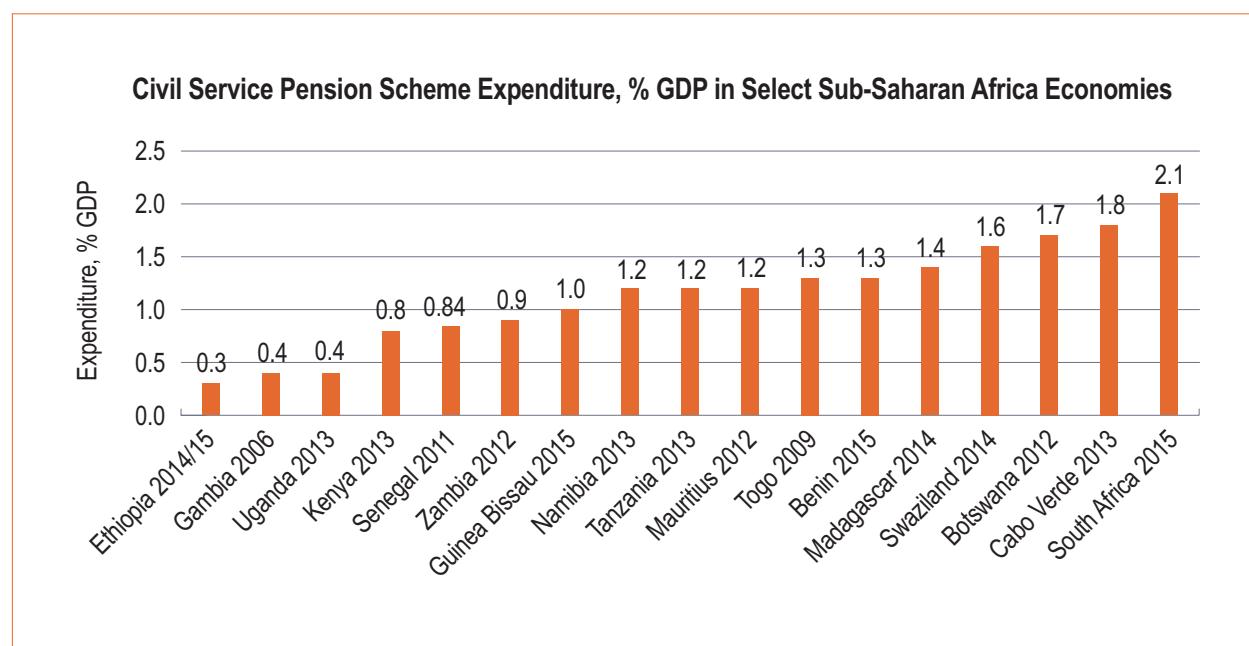
Source: Authors

Figure 2: National Pension Scheme Expenditures (As a Percentage of Gross Domestic Product [GDP])



Source: World Bank (2016).

Figure 3: Civil Service Scheme Expenditures (As a Percentage of GDP)

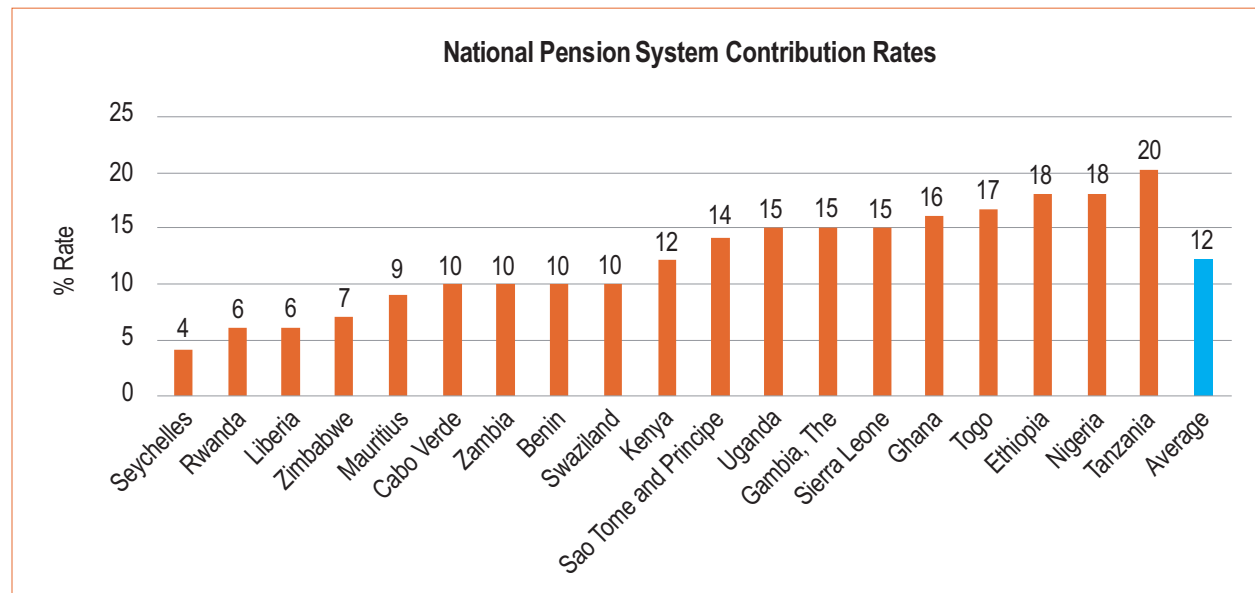


Source: World Bank (2016).

This is driven by the fact that although contribution rates paid to the schemes are relatively high, the benefit levels are also generous (Figures 4, 5 and 6). This is particularly the case for the defined benefit

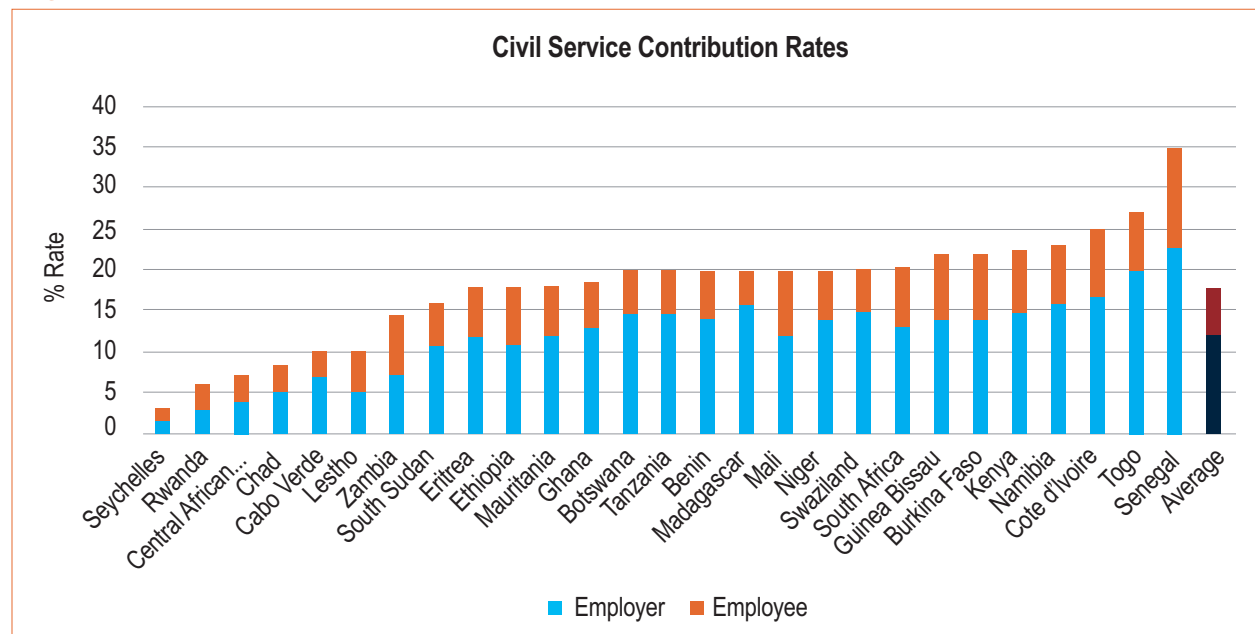
(DB), civil service schemes, which are chronically underfunded. As such, they require parametric adjustments, as well as extra contributions from the government budget to cover benefits.

Figure 4: National Pension System Contribution Rates



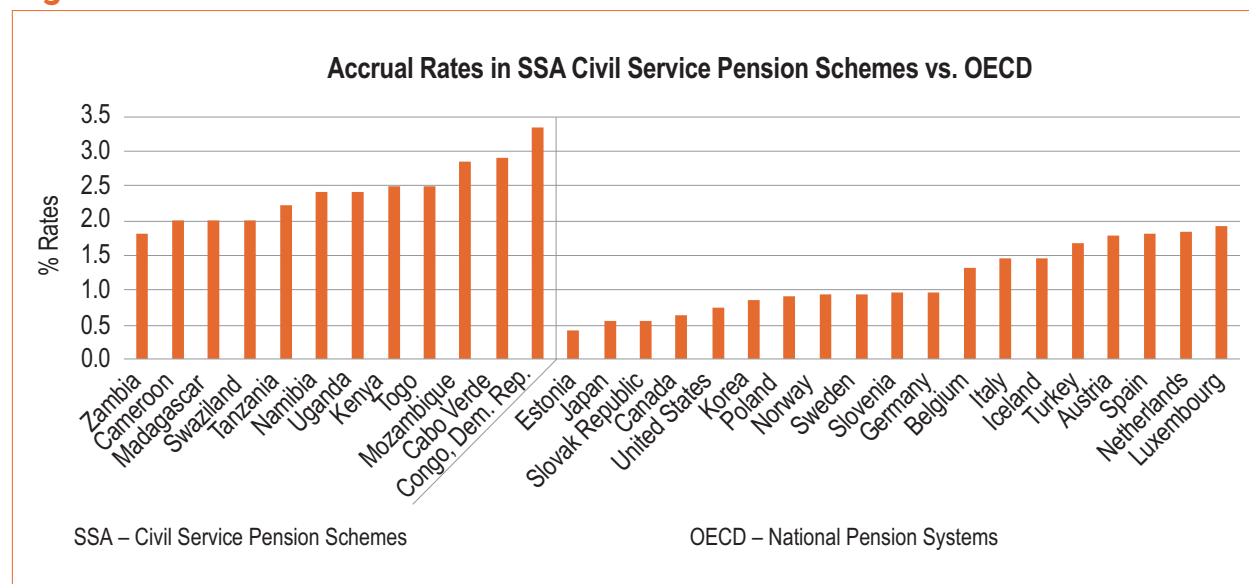
Source: World Bank (2016).

Figure 5: Civil Service Pension Scheme Contribution Rates



Source: World Bank (2016).

Figure 6: Civil Service Pension Scheme Accrual Rates



Source: World Bank (2016).²

Despite these relatively high costs, the coverage of the national schemes is relatively low as compared to other African peers, largely due to labor market dynamics.

By comparison, civil service pensions in the region cover a significant percentage of the population at age 60 and above (Figures 7 and 8), particularly in Kenya, although their costs are higher relative to the population covered.

Opportunities for Integration

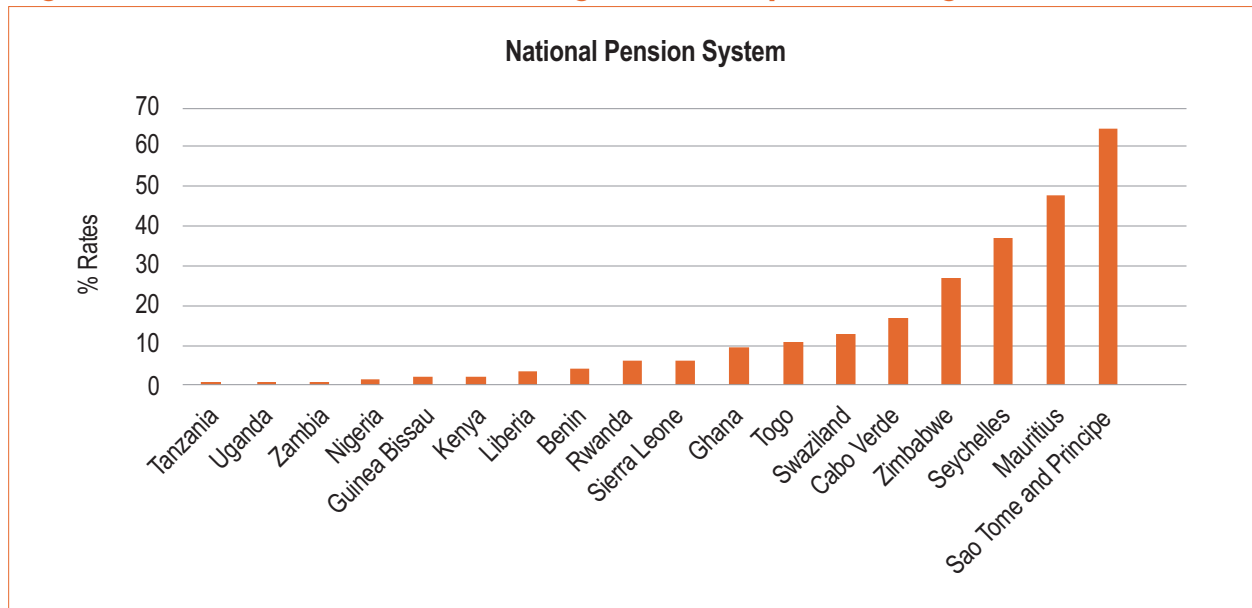
As discussed, retirement benefit systems in East Africa are diverse, as are their regulatory frameworks and system designs. As discussed elsewhere in this book, EAC partner states have adopted different taxation regimes for the retirement benefits sector. These differences range from regulatory regimes, funding, systems design, coverage, and investment regimes. As such, a lack of cross-border portability, insufficient annuitization policies, and other aspects have hindered integration of the retirement benefits sector in the region.

In order to realize regional integration of the sector as envisaged in the EAC Common Market Protocol, the Monetary Union Protocol and the EAC Treaty, policies need to be developed to address the differences obstructing regionalization of the sector. Under the auspices of the EAC Secretariat, partner states need to develop a regional pension policy to guide the sector harmonization process. Critical areas that need to be addressed include: portability; tax harmonization; coverage; annuitization; the supervisory framework; cross-border investment; and regional provision of services.

Portability

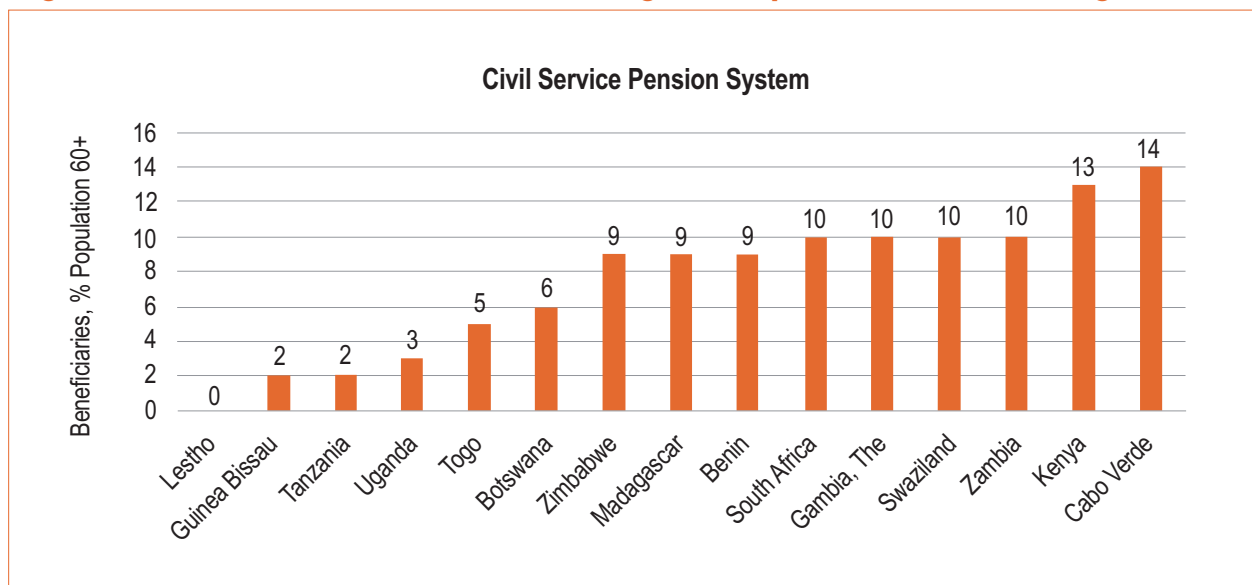
Whereas Rwanda, Tanzania and Uganda have provisions in their respective laws to restrictively permit portability of benefits across borders, other member countries do not have such provisions. As a matter of a regional policy, all EAC member states should review their laws to enable portability of benefits within the region.

Figure 7: National Pension Coverage of the Population Aged 60



Source: World Bank (2016).

Figure 8: Civil Service Scheme Coverage of Population Over the Age of 60



Source: World Bank (2016).

Tax Harmonization

EAC partner states have different taxation regimes for the retirement benefits sector, impacting the way in which contributions, investments and benefits are treated. These differences hinder the portability of benefits and cross-border investments in assets of retirement benefits schemes. Differences in tax regimes are viewed as the greatest obstacle to integration of the sector. A policy to harmonize the tax applicable to retirement benefits sector is currently being developed at the EAC level. This represents a great opportunity to integrate the sector in the region.³

Coverage

The population covered by the retirement benefits sector in the EAC region is low, and the sector reforms will not benefit many people unless there are legal and institutional reforms to enhance the scope of coverage. The current system covers the formal sector, whereas ever-growing informal sector remains largely uncovered. In this context, some EAC partner states are establishing mechanisms to increase pension coverage to the informal sector.

A policy to mandate the participation of all formal sector workers could help enhance coverage. However, such a policy needs to also enable informal sector workers to participate in the retirement benefits sector. Enhanced coverage for both formal and informal sector workers will also promote the regional movement of retirement benefit assets in search of appropriate investment opportunities. At the same time, it would spur activity at the payment phase through the development of annuity markets in the region.

Annuitization

The level of annuity market development in the EAC is varied, but generally low. Most scheme members of defined contribution schemes have tended to favor lump sum access at the payment phase as opposed to purchasing annuities. In order to enable scheme members to purchase annuities from any

member state in the EAC, the annuity market will need to be developed. A policy review to enforce the purchase of annuities will also need to be adopted. This will contribute to the regionalization of the sector, not only at accumulation phase, but also at the payment phase.

Supervisory Framework

Apart from Burundi and South Sudan, all other members of the EAC have established authorities to supervise the retirement benefits sector. The existence of independent supervisory authorities is critical toward the harmonization of regional policies, and legal and regulatory frameworks of the retirement benefits sector. In order to implement regional policies for a harmonized sector, a policy statement requiring all partner states to establish independent supervisory authorities for the retirement sector is required.

Cross-border Investment and Regional Provision of Services

Investment guidelines for the retirement benefits sector in the region are being harmonized. For example, the EAC has developed investment principles which are to be implemented by all partner states. These principles will allow for investment in each other's economies. As such, the EAC region will be deemed a domestic market for the purpose of investment in all retirement benefit schemes. Currently, in practice, cross-border investment is limited.

By contrast, licensed players in the sector are not recognized in other partner states. In order to create a common market for retirement benefit schemes, there is a need to mutually recognize licensed service providers across borders. This could be achieved by simply sharing information between the supervisory authorities of the licensed players.

Political goodwill from all member states will be required for these opportunities to integrate the sector within the region to be realized.

Conclusion

The need for an effective, sustainable retirement benefits sector that allows for wider coverage cannot be overemphasized. Indeed, a well-functioning retirement benefits sector is a prerequisite for sustainable socioeconomic development in any country.

Partner states in the EAC have shown interest in reforming their retirement benefits sectors to respond to current socioeconomic dynamics, such as labor mobility, the breakdown of traditional social security systems, fiscal pressures, and the increasing informality of the labor markets. With the convergence of the EAC as a common market, it is prudent that partner states undertake their reforms with this reality in mind. Political will and

a uniform strategy to guide the harmonization of the sector in the region is required to support the intended EAC integration.

The supervisory processes of the retirement benefits sector in the region are globally influenced and seem to be gradually harmonizing. However, in order for the citizens of the EAC to enjoy portability both at the accumulation and payment phases of retirement benefits, the work to harmonize the regulatory framework and taxation policies needs to be continued. Initiatives underway include the establishment of the East African Pension Supervisory Association (EAPSA), which is driving the move to have all partner state regulatory bodies adopt risk-based supervision as well as a communications strategy for the sector.

CHAPTER 2

REGULATION AND SUPERVISION OF RETIREMENT BENEFIT SCHEMES IN EAST AFRICA: INTEGRATION OPPORTUNITIES

- David Nyakundi Bonyi and Fiona Stewart -

Introduction

This chapter will make a differentiation between regulation and supervision of the retirement benefits sector. The regulatory framework and supervisory approach taken by the regulatory authorities within the member states of the East African Community will also be described, highlighting similarities and differences.

Regulation versus Supervision

Oversight of the financial sector is needed to protect individuals and to ensure overall stability. Regulatory frameworks and supervisory oversight ensure compliance while addressing the following challenges: market imperfections and failures; asymmetric information; moral hazard; consumer myopia; and competition and efficiency.

Within the financial system, the oversight of pensions is particularly important as individuals are vulnerable to poverty in old age. This means that risk tolerance when it comes to pension savings is generally low. This is especially the case when dealing with mandatory savings of lower income workers with less financial knowledge, as well as the fact that pensions can constitute a high proportion of people's net worth.

Pensions are also particularly complex products, involving long-time horizons, with low liquidity, multiple layers of intermediaries (from employers to trustees to service providers), difficult investment decisions and non-transparent incentives and guarantees.

There is a distinction between regulating and supervising the retirement benefits sector. Regulation involves prescribing laws, rules, standards, guidelines and practices, with which all entities participating in the sector must comply.

Following the setting of a national policy relating to the retirement benefit scheme, legislation should prescribe the nature of the retirement benefits sector, the design of schemes and the types of schemes. The supporting regulatory framework for the sector should follow this policy and legislative structure.

The fundamental purpose of regulation is to ensure that order, stability, and predictability exist in the retirement benefits sector, without which 'would-be' consumers of the services would shy away because of a lack of confidence. Regulation should always guarantee the protection of rights of all parties in the sector.

Under regulation, a number of features pertaining to the sector will be prescribed. Some of the features, which will be covered by regulation, include: licensing procedures and requirements; a legal framework for the retirement benefit scheme; governance of schemes and service providers; administrative procedures; funding; accountability and financial management; vesting; investment guidelines for scheme assets; costs and fees; management of payment of benefits; coverage; rights of members; and covenants of the governing body and founders of these schemes. In a nutshell, regulation will prescribe the structure of the retirement benefits sector, as well as the

management of the accumulation and payment phases of a retirement benefit scheme.

The framers of regulation primarily include the legislature, the ministers responsible for the sector and, in some cases, the supervisory agencies acting on delegated legislative powers. Regulation contributes greatly to the failure or success of supervision. Consumers of retirement benefit sector services and supervisory agencies of the sector should clearly understand the regulations relating to the sector. A continuous review of regulation is always important because the sector is dynamic. Indeed, factors such as labor, new risks, the investment environment, fiscal factors and national demographic features may change over time.

Supervision is concerned with overseeing compliance with regulation. Most countries have established supervisory agencies to enforce regulation. A supervisory agency that establishes that a retirement benefit scheme is non-compliant with the legal requirement may invoke permitted sanctions to enforce compliances. Supervisory agencies are under an obligation to translate the law into operational procedures. These procedures should be clear and predictable in order to enhance confidence. For effectiveness and continuous stability, the supervisory agency should have sufficient flexibility to enable rapid adaptation to the changing risks in the retirement benefits sector — risks which the regulator may not have anticipated when framing the regulation.⁴

The distinction between regulation and supervision is often less obvious in the retirement benefits sector because supervisory agencies continue to be empowered under the enabling laws to create and enforce sector regulation. The need to combine creation and enforcement of regulation is premised on the realization that the role of supervisory agencies goes beyond enforcing compliance to managing risks in the sector, which continue to evolve.

The adoption and effective execution of risk-based supervision⁵ requires a considerable amount of discretion and competence on the part of the

supervisory agency. Rigid regulation, which denies the supervisory agency sufficient discretion to respond to emerging sector risks, is unsuitable for effective supervision of the retirement benefits sector. Practically, a distinction between regulation and supervision is rapidly becoming blurred as supervisory agencies assume greater roles in creating and enforcing rules at the same time (Denters 2009).

Regulatory Approaches

As noted, the regulatory framework in any country should be suited to the pension policy and system that it is designed to protect. The broader country context — including the level of financial market development, the legal system, and so on — also play a role in shaping the appropriate approach to regulating a given pension system.

Hinz and Mataoanu (2005) describe two stylized models at opposite ends of the possible regulatory framework spectrums. The ‘Latin American’ model is driven by a mandatory pension system, with profit-making commercial entities serving as pension providers. Consequently, prescriptive regulatory approach has been adopted, with strict licensing (including capital) requirements, quantitative investment regulations and preventative sanctions. By contrast, the ‘Anglo Saxon’ approach adopted in countries such as the United States (US) and the United Kingdom (UK) is based on a trust-based pension system. In this system, the pension funds are non-profit entities, and are normally sponsored by employers. The regulatory approach is far more open, with minimal entry requirements, ‘prudent expert’ investment standards, exception-based remedial actions/ sanctions, and so on.

Pension regulation in the EAC countries falls between these two extremes. The model of several of the systems (except Burundi and Rwanda) comes from an ‘Anglo-Saxon’ heritage (that is, trustee-based, occupational pensions). However, the lower levels of financial development, industry skill and inadequate expertise have understandably

necessitated a more prescriptive approach, although not to the extent seen in Latin American countries.

Supervisory Tools

The supervisory process of pension schemes in most EAC member states includes; (i) registration and licensing, (ii) monitoring, (iii) analysis, and (iv) intervention and enforcement. In this regard, they have tended to follow the International Organization of Pension Supervisors (IOPS) Guidelines on pension supervision.⁶

Licensing and Registration

Licensing entails a process of controlling entry of schemes and service providers into the retirement benefits market. It is intended to eliminate the risk of incompetent or unqualified entrants into the system. Licensing enhances the confidence of consumers of retirement benefit sector players, especially members and beneficiaries of such schemes.

Although all EAC member states with supervisory authorities license players in the sector, the process differs by country. As such, requirements are not

necessarily the same, and not all entities are licensed by all supervisory authorities. Table 2 details the licensed entities in EAC countries.

Under their respective legislation and regulations, each partner state has detailed the licensing requirements that each licensed entity must satisfy before a license can be issued. Licensing requirements include a variety of factors, such as capitalization; competence; fitness and propriety of trustees and senior management of service providers; suitability of technical and operational systems; office accessibility and visibility; acceptable business plans; and other requirements as the supervisory authority may prescribe in writing.

In Uganda, the URBRA Act does not prescribe any capital requirements for service providers. In other countries where capital requirements have been prescribed, the amounts are not necessarily the same. Rwanda sets the highest academic competence requirements for trustees before they can qualify for a license. Section 53 of the Law Governing Pensions requires that a Board of Trustees comprise persons with skills in “pensions or social security, finance, insurance, accounting, actuarial science and human resource management”. Also, trustees in Uganda

Table 2: Licensed Entities by Country

Entity	Kenya	Tanzania	Uganda	Rwanda
Mandatory public pension schemes	✓	✓	✓	✗
Voluntary occupational pension Schemes	✓	✓	✓	✓
Fund managers	✓	✓	✓	✓
Administrators ^a	✓	✓	✓	✓
Custodians	✓	✓	✓	✓
Trustees	✓	✓	✓	✓
Individual retirement benefit schemes	✓	✗ ^b	✓	✗ ^c

Source: Authors

Note:

a Kenya and Uganda do not license in-house administrators.

b Members who wish to contribute supplementary savings in Tanzania will do so under the licensed mandatory schemes in which they participate.

c In Rwanda, the regulator is mandated to authorize a licensed financial institution that intends to provide personal pension plans.

are licensed. Although the law does not prescribe academic qualifications for trustees, applicants for a trustee license must undergo a fit and proper test before they can be properly licensed.

In Kenya, trustees are not licensed. However, the law⁷ prescribes the suitability criteria for any person proposed to serve as a trustee of a pension scheme. Under Section 22A of the Retirement Benefits Act, the regulatory authority is required to ensure that a trustee of any other service provider is not financially insolvent. The proposed trustee should also have the requisite education or qualifications relevant to the functions and have the ability to carry out the regulated activity competently, honestly and fairly. In addition, such a person must have a good reputation, character, and financial integrity.

The regulatory authority is also mandated to consider whether the person is fit and proper for the purposes. Under Section 26 of the same Act, no person shall of being a trustee of a pension scheme if he/she has been convicted and imprisoned of a criminal offense for a term exceeding six months, is bankrupt, was previously involved in the mismanagement of a pension scheme or is disqualified under any other written law. The regulatory authority has the power to disapprove of any such person from acting as a trustee.

Monitoring

All supervisory authorities have been mandated to supervise and regulate the sector. Effective supervision requires a process of monitoring entailing: (i) information gathering; (ii) enforcing reporting requirements; and (iii) exercising the power to ask for more information as need be. Information gathering as a process of supervision varies from country to country. In Tanzania, the supervision of pension scheme financial matters is vested in the Bank of Tanzania. Thus, there is a joint supervisory activity in Tanzania relating to pension fund investments, as well as other matters pertaining to the finances of the scheme.

Generally, supervisory authorities will collect information relating to: the basic scheme (membership, contributions, benefits, vesting, and so on); financial information (assets and liabilities including funding status); governance structure (trusteeship and mandate); investment information (investment policy statements, reports) and disclosure policies (communications and information sharing). Some of the documents that supervisory authorities may collect from schemes and service providers include: trust deed and scheme rules, audited financial statements, returns of records of contributions, investment reports, custody reports, actuarial valuation reports, compliance reports and any other information the supervisor may require to assess potential risks to which the scheme may be exposed.

Analysis

The collected information is analyzed to determine compliance and the extent of risk exposure before appropriate action is applied. The process involves both offsite analysis and onsite inspections. Upon analysis, supervisory authorities will produce a report highlighting the identified risks and possible risk mitigation recommendations, which a scheme will be required to implement to lower the risk. The report shall be provided to the scheme or service provider, as the case may be. The process of analyzing scheme compliance and risk is complicated, and it requires skilled personnel to effectively execute the function. An analysis may be carried out to cover the following potential risks:

- Compliance checks (specifically, compliance with the law, funding regulations, investment guidelines, service providers, administration costs, statutory returns, and so on);
- Financial checks (financial management, solvency requirements, and so on);
- Governance checks (suitability of the board, disclosures to members, meetings, appointment of service providers, and so on);

- Operational checks (contribution receipts, benefit payments made on time, and dispute resolution effectiveness);
- Disclosure checks (disclosure of information, for example, trustee allowances, information accessibility, member handbooks, and benefits statements); and
- Performance checks (investment performance, compliance with investment policy, investment returns, custody returns, and so on).

Intervention and Enforcement

Supervisory agencies have powers under their respective laws to take remedial measures against a retirement benefit scheme or service provider for any failure to comply with the law, regulation or issued guideline. There is commonality of intervention and enforcement powers given to these agencies. The power to issue directives to regulated entities to mitigate risk after an analysis or issue supervisory guidelines applies to all supervisory bodies in the region⁸. In extreme cases, these agencies may prosecute any person who engages in unlicensed activities, or who misleads or deceives the public with regard to the services purportedly offered — or by refusing entry of any external auditor to carry out audit services.⁹

In cases where a retirement benefit scheme or service provider misleads the regulator with false documents pertaining to their application for registration, or where the scheme is terminated or dissolved, or in case the scheme fails to comply with the law, supervisory agencies are possessed of statutory powers to cancel the registration certificate or license. As a result, the operations of the regulated entity will cease.¹⁰ The law of natural justice requires that before a license is revoked, an affected entity will be given sufficient notice to make representations against the intended revocation.

Another intervention supervisory agency may opt for the appointment of a special administrator. Supervisory agencies may appoint a special

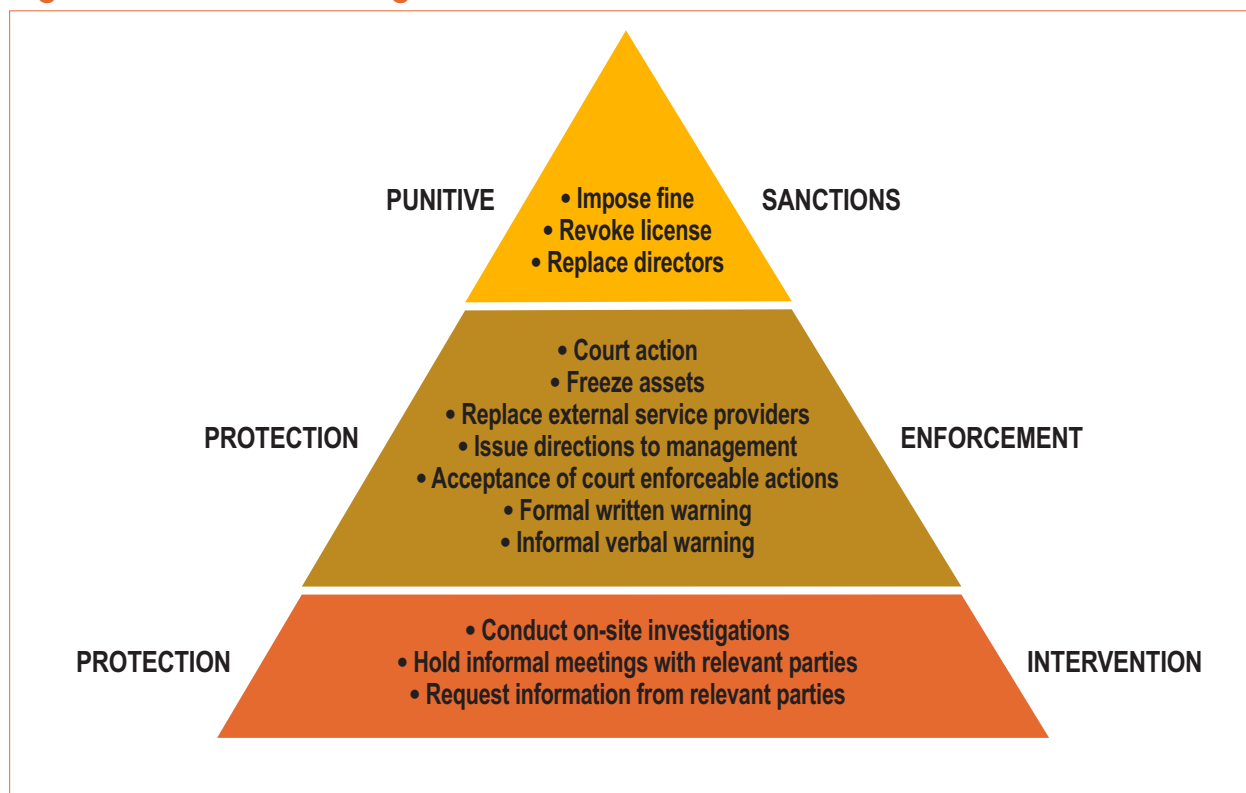
administrator to take over responsibilities of any retirement benefit scheme in the following instances: (i) in case the scheme or service provider fails to comply with the law; (ii) if the governance and operations structure may jeopardize the pension scheme and its members; (iii) if the pension scheme or service provider is engaged in risky or unlawful practices, such as money laundering or terrorist financing; (iv) in case the scheme or service provider hinders the supervisory activity; (v) in order to restore confidence in the sector and the financial system as whole; and (vi) if trustees fail to submit audited financial statements to the supervisor, or submit false or misleading financial statements.¹¹ The special administrator shall investigate and take control of the pension scheme or service provider and assume the functions of the scheme or service provider. The special administrator shall assume the role of a statutory manager and interim trustees for the purposes limited to the appointing order.

Interventions of supervisory agencies are intended to protect the interests of members and beneficiaries by enforcing compliance and mitigating any risks to which the scheme or service providers may be exposed. It is good practice for supervisory agencies to communicate clearly with the entities they oversee, appropriately using and applying their enforcement tools (for example, through the publication of an Enforcement Pyramid; see Figure 9). Indeed, using their powers proportionally is one of the IOPS Principles. It is also an important element in building the confidence and trust of supervisory entities, helping them to operate effectively.

Supervisory Approaches

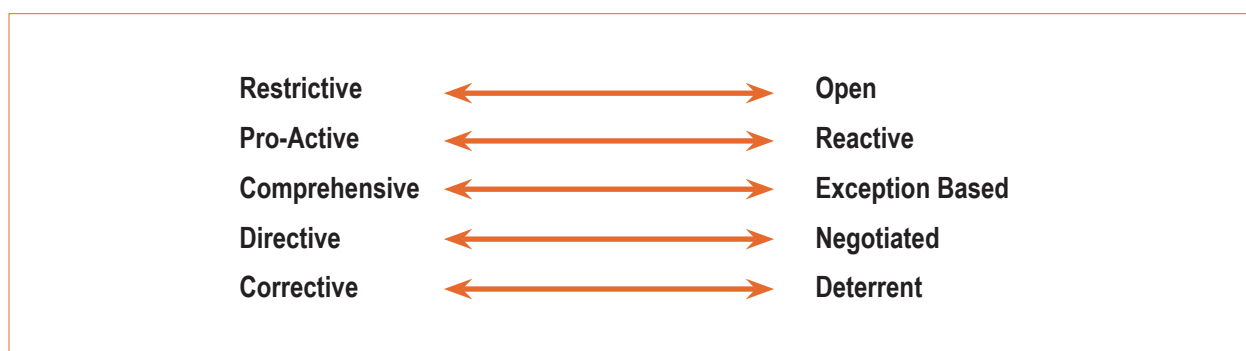
As with the regulatory framework, Hinz and Mataoanu (2005) describe how supervisors adopt different approaches and use their supervisory tools to varying extents and degrees of intensity (see Figure 10). These again are driven by the nature of the pension system and the country in which the supervisor is operating. For example, ‘Anglo-Saxon’ countries with a high level of economic

Figure 9: Enforcement Pyramid



Source: IOPS Toolkit.

Figure 10: Stylized Mapping of Pension Supervision Approaches



Source: Hing and Mataoanu (2005).

development, deep financial markets and a strong rule of law could apply a far lighter supervisory touch than was traditionally the case in Latin American countries, where such conditions did not apply.

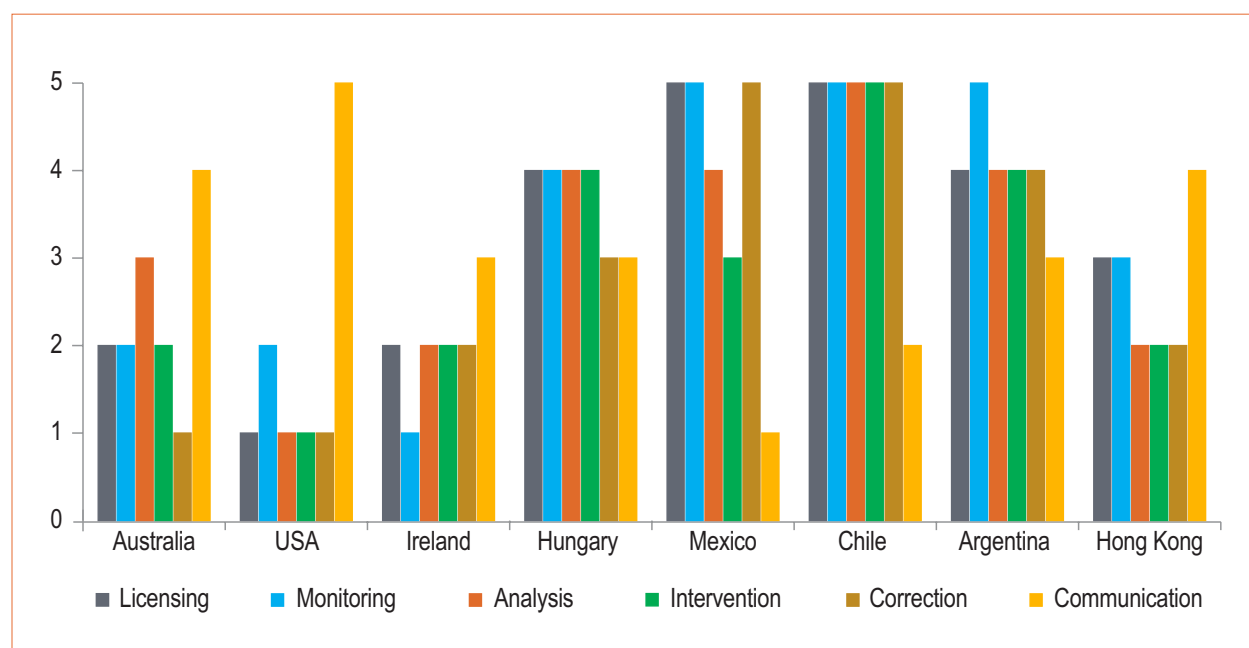
The study describes the extent to which the different supervisory tools are subsequently used. For example, the Australian supervisor (operating in a classic ‘Anglo-Saxon’ environment) relies heavily on analysis, with little intervention and correction. By contrast, the Chilean supervisor (in an archetypal Latin American context) utilizes intervention techniques far more heavily (Figure 11).

The supervisory approach of the EAC supervisors differs by country and is, again, somewhere between these extremes. The supervisory process adopted by Kenya, Rwanda, Tanzania and Uganda is similar, as reflected in their respective enabling legislation. Despite these similarities, there are differences in supervisory processes reflecting the

unique pension systems in the respective EAC member states. For example, the supervisors in Kenya and Uganda have many schemes to oversee. This leads to more analysis and monitoring and fewer on-site inspections than would be the case in countries with a lower number of funds. However, enforcement needs to be relatively strong due to their nascent level of economic development and the lesser degree of protection expected from financial market competition.

As noted, supervision involves the implementation of regulations. With the exception of Burundi and South Sudan, all other EAC member states are members of the International Organization of Pension Supervisors (IOPS¹²). Members of IOPS have tended to adopt agreed principles for pension supervision. As such, the supervisory approach standards in the retirement benefits sector are gradually converging. The approach emphasizes risk management more strongly than mere compliance with statutory provisions. With the ongoing EAC regionalization efforts in the financial sector,

Figure 11: Use of Supervisory Tool in Selected IOPS Member Countries



Source: Hing and Mataoanu (2005).

Table 3: Structure of IOPS Members

Specialized Pension Supervisor	Semi-Integrated (Pensions + Insurance /or Capital Markets)	Integrated (Non-bank Financial Institutions)	Central Bank	Ministry
Kenya	North Macedonia	Botswana	Rwanda	Jordan
Tanzania	Morocco	Albania	Czech Republic	Spain
Uganda	Mozambique	Austria	Hungary	Turkey
Brazil	Portugal	Gurnsey	Kazakhstan	United States
Canada	Ukraine	Belgium	Kosovo	
Chile	Zambia	Bulgaria	Lesotho	
Colombia	Zimbabwe	China	Lithuania	
Costa Rica		Egypt	Malawi	
Dominican Republic		France	Netherlands	
Ghana		Germany	Papua New Guinea	
India		Gibraltar	Russian Federation	
Ireland		Honduras	Serbia	
Italy		Iceland	Suriname	
Nigeria		Indonesia	Trinidad and Tobago	
Peru		Isle of Man		
United Kingdom		Israel		
		Jamaica		
		Lichtenstein		
		Luxembourg		
		Maldives		
		Malta		
		Mauritius		
		Namibia		
		Poland		

Source: IOPS.

Note: For the full IOPS membership list, see <http://www.iopsweb.org/membership/iops-members-observers.htm>. Membership is categorized based on this list. It should be noted that this was not checked with the IOPS or the membership. Consequently, some reclassifications may be merited.

it is expected that both regulation and supervision systems will, to a large extent, become harmonized.

Supervisory Structures¹³

The structure of the supervision agencies themselves has also become a topic of global debate. Pension supervision can either be handled by a stand-alone agency, or it can be combined with the insurance and/or capital markets oversight. Alternatively, pension supervision can be managed by an integrated financial sector supervisory agency. Central Banks sometimes undertake this role, whilst occasionally, it is still housed within a Ministry (Table 3).

There is often a debate around which structure is ‘optimal’. Again, the answer is partly driven by the nature of the pension system. In Kenya and Uganda, there are a large number of occupational, trust-based schemes. As such, it can be argued that a separate regulator is justified as these are quite different structures than other types of financial products. However, the IOPS concludes that communications and cooperation within and between regulators is more important than the agency structure.

With the exception of Burundi and new entrant, South Sudan, all other EAC partner states have established institutions mandated to supervise the retirement benefits sector. Kenya, Tanzania and Uganda all have separate pension (social security) supervisory agencies. In 1997, Kenya established the Retirement Benefits Authority (RBA). Tanzania established the Social Security Regulatory Authority (SSRA) under the provisions of the Social Security Regulatory Act of 2008. The Uganda Retirement Benefits Regulatory Authority (URBRA) was established in 2011 under the URBRA Act.

The Law Governing Pensions in Rwanda establishes a pension regulator, although under the law governing the National Bank of Rwanda, the bank is mandated to supervise social security institutions and pensions. It remains to be seen

whether the regulator intended under the newly enacted pension law will continue to be the National Bank of Rwanda.

It is important to note that the laws establishing supervisory authorities in the EAC provide specific objectives for these authorities. Although similar in certain respects, they are different in others. For example, in Kenya, the RBA is mandated to:¹⁴ regulate and supervise the establishment and management of schemes; protect the interests of members and sponsors of schemes; promote the development of the retirement benefits sector; advise the Minister on the national policy to be followed with regard to schemes and to implement all government policies relating thereto; and perform such other functions as are conferred on it by the Act.

In Uganda, the URBRA’s mandate is to: supervise and regulate the establishment, management and operations of retirement benefit schemes; protect the interests of scheme members and beneficiaries; provide various functions to the sector including, licensing, approving the scheme auditor and actuary; carrying out awareness campaigns; promoting the development of the sector and financial sector security; and ensuring that the sector is sustainable. The URBRA is also mandated to advise the minister on the national policy relating to the sector, as well as implementation of the government’s sector policy.

In Tanzania, the SSRA Act provides the supervisory authority with powers to: register, regulate and supervise, including monitoring the performance of managers, custodians, administrators and schemes; issuing guidelines under the Act for the efficient and effective supervision of the sector; protecting the interests of members of schemes; initiating studies, recommending, coordinating and implementing sector reforms; carrying out sector awareness campaigns and sensitization; facilitating extension of coverage; where necessary, appointing interim administrators for schemes; and advising

the minister on policy and operational matters relating to the sector.

In Rwanda, the Law Governing Pensions provides a regulatory framework for pension schemes, but not the operations of the Authority. However, the Law outlines the functions of the pension regulator, including: establishing rules under the principle law; enforcing compliance under the Act; revoking activities inconsistent with the law; and collecting information from sector players to enable effective supervision.

Thus, the mandates of the respective authorities relate to licensing, regulation by issuance of guidelines, supervision, protection of interests, sector development and provision of advice to the government. There are differences though regarding licensed entities and protection of interests. The mandates of the URBRA, the SSRA and the RBA are largely similar, except that in Kenya the protection of interests in the sector relate to both the employer and the employee, whereas in Uganda and Tanzania, the URBRA and the SSRA are not mandated to protect the interests of employers who establish the retirement benefit schemes.

Conclusion

The regulation and supervision of the pension sector is an important task in any country. However, the oversight of the sector is particularly important in developing economies where pensions represent a large portion of the savings in the country and impact vulnerable individuals. To operate effectively, the broad principles of pension regulation and supervision need to be suitably adapted to the context of the pension system, the financial markets and other specific country contexts.

Devising a robust regulatory framework and building supervisory capacity takes time. The supervisory authorities tasked with these functions in the EAC are relatively new, and are still developing the tools they need, learning how to employ them effectively. Some, notably the RBA in Kenya, have already made great strides. They have adopted and indeed are helping to share international good practice. Yet for all the authorities in the region, continuing on this journey and learning from each other and from international good practice will be vital to building the robust pension systems which the population needs.

CHAPTER 3

TAX TREATMENT OF RETIREMENT BENEFITS IN EAST AFRICA: A CROSS-COUNTRY COMPARISON OF POLICIES

- Dr. Winifred Taringeba Kiryabwire -

Introduction

A variety of factors have influenced tax policy in the EAC, including social, economic, and political considerations. These are reflected in the nature, structure and impact of the tax system. This chapter presents an analysis of the tax treatment of retirement benefits in East Africa. It demonstrates that although there are common elements in the treatment of contributions toward retirement benefits, there are significant variations in the tax treatment of retirement benefit investments, as well as in the payment of retirement benefits.

This chapter identifies similarities in the treatment of employer and employee contributions to retirement benefits, except for Kenya which applies territorial qualifications to employer contributions that have implications for economic integration. These differences are a result of retirement benefits in Kenya rooted in a constitutional socio-economic rights construct that is different from other East African countries where the fiscal regime is aligned with the economic role of pension and retirement benefits. The differences have implications for institutional domestic capital mobilization, cross-border economic activity, and particularly for the free movement of labor, portability of retirement benefits and cross-border investments by pension funds.

The term “retirement benefit” is broad and includes pension, provident and other arrangements to provide post-employment income to people. The most common form of retirement benefits are occupational pension schemes that may be either defined contribution¹⁵ or defined benefit schemes.¹⁶ In the labor law context, retirement benefits form

part of the employment contract. However, beyond the employment relationship, retirement benefit funds — more commonly referred to as pension funds — have an economic function. They are an important source of long-term capital for investment.¹⁷ Traditional sources of finance, such as bank finance, are not suitable for long-term investment. In addition, in the major economies of the world, pension funds constitute a significant portion of institutional investors. These investors play a key role in the functioning of financial markets, including financial intermediation, investment analysis and governance.¹⁸

Financial markets in low-income economies such as Uganda are often shallow, dominated by bank finance, with very limited sources of long-term finance. There are many factors that constrain the development of long-term capital, including macroeconomic factors, low levels of savings, and the absence of policies to support the eco-system for long-term savings. This chapter will analyze the tax policies and laws governing retirement benefits in selected East African countries (Kenya, Rwanda, Tanzania and Uganda).

Fiscal Regimes for Retirement Benefits

The taxation of retirement benefits varies across jurisdictions. Governments make various policy considerations in arriving at a fiscal regime for retirement benefits. Fiscal regimes for retirement benefits can be categorized variously depending on the tax treatment of contributions, investment income and pay-outs. These can either be taxed

(T) or exempt from tax (E). Therefore, it may be a TTE (contributions and investments taxed, with pay-outs exempt), ETT (contributions exempt, with investment and pay-outs taxed), EET (contributions and investments exempt, with pay-outs taxed), or TEE (contributions taxed, income exempt, with pay-outs taxed). Alternatively, all 3 categories can be either exempt (EEE) or taxed (TTT). This categorization has wide-ranging implications, including impacts on disposable income, the development of long-term contractual savings and capital and financial market development.

- TTE is used to describe a system of tax, whereby the first T represents the tax treatment of the income of an individual or entity making the contribution toward the retirement benefit. It refers to a situation where the contribution is not exempt from income tax. The second T applies to taxation of income from retirement benefit investments. The E refers to the exemption of retirement benefit payments from tax, that is, the pay-out to the individual. Some jurisdictions such as Uganda treat the employer and employee contribution differently for tax purposes. As such, for purposes of the income of an employee, Uganda and Tanzania are TTE countries because an employee's contribution toward pension/retirement benefits is not an allowable expense, and the income of the pension funds is not tax-exempt. However, the payments from pension funds to individuals/retirees are tax-exempt.
- An ETT is a system in which the income tax paid by an individual is computed on income, excluding contributions made toward retirement benefits, that is, contributions are exempt from tax. In this case, the income from retirement benefit investments and pay-out to individuals are both subject to tax. An ETT system of taxation allows employers and employees to treat the contribution toward retirement benefits as a deductible expense. This may serve as a carrot and encourage higher compliance with statutory obligations in relation to employee retirement benefits. However, in relation to employee income, it reduces the tax base and tax revenue that may not be realized at the time of taxing

investment income of pension funds or at pay-out. If investments perform poorly, the pension fund may earn less revenue or even suffer losses — with less taxable revenue. In addition, since pay-outs are usually made at the time the contributor retires, the value of pay-outs may be affected by inflation and other factors.

- Concerning the EET system, the employee and employer contributions toward retirement benefits and the income from the pension fund investments are both exempt from tax. However, the pay-out to the individual is subject to tax. In East Africa, only Kenya has an EET fiscal regime. The EET is widely used among European Union (EU) countries and is considered appropriate for encouraging savings toward retirement. The exceptions are Denmark, Italy and Sweden which have ETT regimes.
- With respect to TEE systems, employer and employee contributions toward retirement benefits are subject to income tax. However, pension fund investment income and pay-outs to contributors/retirees are exempt from tax. Examples of TEE countries are Rwanda¹⁹ and Luxembourg.

Each of the four fiscal regimes have advantages and disadvantages, ranging from impact on disposable incomes, to building up savings and the cost of doing business. Uganda has a TTE system that has its roots in the country's Constitution. Retirement benefits form part of the socio-economic safeguards for citizens in Uganda. In this respect, Principle XIV of the National Objectives and Directive Principles of State Policy states that:

The State shall endeavour to fulfill the fundamental rights of all Ugandans to social justice and economic development and shall, in particular, ensure that—

- all developmental efforts are directed at ensuring the maximum social and cultural well-being of the people; and
- all Ugandans enjoy rights and opportunities and access to education, health services, clean and safe

water, work, decent shelter, adequate clothing, food security and pension and retirement benefits.

Article 254 (2) of the Constitution of Uganda provides the constitutional basis for the TTE fiscal regime. Specifically, it states that the pension payable to any person shall be exempt from tax. This explains why the payment of retirement benefits for both private and public schemes is exempt from tax. The implications of a TTE system are wide-ranging and include the following:

- The contribution by the employee is not an allowable deduction for purposes of computing the employee's chargeable income. This reduces disposable income for employees.
- A TTE system discourages voluntary pension arrangements for those not covered under a mandatory pension system, as well as those who may wish to contribute to voluntary arrangements over and above the mandatory contributions.
- In an environment of less than optimal compensation arrangements, particularly in the public sector and a large part of the private sector, the taxation of employee contributions is a disincentive to savings.
- Taxation of the investment income of the pension may stifle growth of pension assets, which are a critical source of long-term institutional finance in an economy.
- This system is prone to defaults and high rates of non-compliance by employers who may under-declare the number of employees or fail to remit contributions.
- Taxation of investment income of pension funds increases the operational costs and ultimately decreases the funds available for distribution to beneficiaries. In an environment of macroeconomic instability and other economic shocks, the value of the pay-outs to beneficiaries is significantly reduced.
- A TTE system may be a disincentive to provision of retirement benefits, and some analysts have historically been critical of a system that taxes the "build up" of pensions, that is the contributions and investment income.

In terms of which type of regime is preferable, the generally accepted view is as follows:

"... on the whole, the most satisfactory principle to adopt in designing suitable tax regulations is to exempt from taxation the cost of building up pensions and similar benefits and to tax the benefits when they become payable."
(Institute and Faculty of Actuaries 1951).

Tax Treatment of Contributions toward Retirement Benefits

The example of occupational pension schemes helps to explain the tax treatment of contributions toward retirement benefits. Kenya, Rwanda, Tanzania and Uganda have historically had defined benefit public service pension schemes for civil servants, as well as defined contribution schemes for employees in the private sector and some public sector institutions.

All four East African countries have laws that govern private sector pension schemes. In Uganda, the National Social Security Fund Act, Cap. 222, established the National Social Security Fund. Employers of eligible employees are mandated to make monthly remittances comprised of both the employer (10 percent) and the employee (5 percent) contributions. In Tanzania, the National Social Security Fund Act No. 2 of 1997 established the National Social Security Fund. The Fund is mandated to receive contributions from both the employer (15 percent) and the employee (5 percent) for all self-employed, private sector and non-pensionable employees in government service and parastatal organisations. In Kenya, the National Social Security Fund Act Cap. 258 established the National Social Security Fund. Employers of eligible employees are required to remit contributions comprised of both employer and the employee contributions. In Rwanda, Law No. 45 of 2010 established the Rwanda Social Security Board whose mandate includes managing contributions to the Fund.

Employer Contributions toward Retirement Benefits for Employees

Employer contributions in the traditional public sector are not subject to any tax considerations because they are usually non-contributory and are appropriated through the national budget. Public sector employers in the non-traditional public service are required to contribute toward the retirement benefits of the employee. However, the contribution has no tax implications since these agencies are not subject to income tax (except for income earned from investments) in the same manner as private sector organizations. The retirement benefit obligation is met out of budgetary allocations from the consolidated fund.²⁰ Therefore, the analysis will focus on the tax treatment of employer and employee contributions in the private sector. Table 4 provides a summary of employer contributions in East Africa.

The contribution by the employer is a cost for the employer. Except for tax exempt organizations, employers are expected to pay tax on their income. In Uganda, Section 4(1) of the Income Tax Act, Cap. 340 is the charging provision for income tax. Sub-section (2) provides that subject to sub-sections (4) and (5), the income tax payable by a taxpayer for a year of income is calculated by applying the relevant rates of tax as determined under the Act to the chargeable income of the taxpayer for the year of income. From the resulting amount, any tax credits allowed are subtracted to the taxpayer for the year of income.

Section 22 (1) (a) of the Act permits the deduction of expenses and losses incurred during the year of income to the extent to which they were incurred in the production of income included in gross income. Using Stanbic Bank as an example, the income statement for the year ending December 31, 2017 stated that employee benefit expenses amounted to Uganda shillings 141,491,545,000 — of which 23,454,963,000 constituted contributions to statutory and other defined benefit plans.²¹

Therefore, although not expressly stated, employer contributions toward the retirement benefits of an employee are expenses incurred in the production of the employer's income. Prior to 2005, a contribution or similar payment made to a retirement fund either for the benefit of the person making it or for another person was not an allowable deduction for income tax purposes. This meant that the employer's contribution was not an allowable deduction. However, following the 2005 Amendment to the Income Tax Act, the employer's contribution is an allowable deduction. This is because only the employee's contribution has been retained in the category of deductions that are not permitted for purposes of assessing income tax.²²

Other jurisdictions that treat the employer's contribution as an allowable deduction include Kenya, Rwanda, South Africa and Tanzania (PWC 2015). In Kenya, Section 15(2)(0) of the Income Tax Act of 2014 expressly provides for employer contributions as an allowable deduction. In Tanzania, the treatment of employer contributions

Table 4: Employer Contribution Level by Country

Country	Employer Contribution (Percentage)
Uganda	10
Kenya	5
Tanzania	15
Rwanda	5

Source: Regulatory Authorities

is inferred from Section 11(2) of the Income Tax Act. It provides the general principle for allowable deductions. Specifically, it states that for purposes of calculating a person's income for a year of income from any business or investment, there shall be deducted all expenditures incurred during the year of income by the person wholly and exclusively in the production of income from the business or investment. In Rwanda, Article 19 of the Law establishing taxes on income states that business profits are determined as the income from all business activities reduced by all business expenses. In addition, Article 25 which provides for deductions from taxable income states that in determining profits, expenses incurred for the direct purpose of the business and directly chargeable to income are allowed. Therefore, similar to the situation in Uganda and Tanzania, the tax treatment of the employer's contribution toward employee retirement benefits is inferred from both Articles 19 and 25.

The treatment of employer contributions in Kenya, Rwanda, Tanzania and Uganda is in line with global practice. Jurisdictions such as the United Kingdom take a similar approach, whereby employer contributions are treated as an allowable deduction provided it is paid wholly or exclusively for the employer's trade or business.²³

The tax treatment of employer contributions, particularly for employers in the private sector whose income is subject to income tax, has several advantages. It eases the cost of doing business for employers since the contribution is an allowable expense. For employers who are not subject to mandatory retirement benefit arrangements, it may be an incentive to consider retirement benefits for their employees. Additionally, it may encourage employers to contribute towards retirement benefit arrangements — over and above the mandatory arrangements which contribute to domestic savings mobilization. Some scholars attribute growth in pension plans in jurisdictions such as the United States to favorable tax treatment of pensions, among other factors.²⁴

Section 15(2)(o) of Kenya's Income Tax Act only treats the employer's contribution as an allowable deduction where it is paid to a national provident fund or other retirement benefits scheme established for employees throughout Kenya. Rwanda, Tanzania and Uganda do not have specific provisions regarding the tax treatment of the employer's contribution. As stated earlier, this is inferred from the general provisions on allowable expenses. The provisions do not have domestic or territorial restrictions. Therefore, in Kenya contributions to a foreign retirement benefits scheme — including one in any other East African country — are not an allowable expense. This undermines regional integration and particularly the freedom of movement of labor. This has been an issue of concern among some European Union member states.²⁵

Employee Contributions

It is interesting to note that within East Africa, there is considerable variation regarding the tax treatment of employee contributions. Rwanda, Tanzania and Uganda do not treat the employee contribution as an allowable expense for purposes of calculating employee taxable income. In Kenya, Section 67 of the National Social Security Fund Act No. 45 of 2013 provides that contributions to the pension fund form part of tax-deductible expenses in the computation of taxes payable by the person or the employee under any relevant law applicable to income tax. The effect of this provision is that, subject to territorial qualifications, it exempts both employer and employee contributions. However, except for thresholds below which an employee is permitted to treat the contribution as exempt, the Income Tax Act only provides tax relief in respect of the employer's contribution by virtue of Section 15 (2)(0). Section 16(2)(d) expressly states that the employee contribution is not an allowable deduction. Table 5 illustrates the variations in selected countries within East Africa.

Table 5: Employee Contribution by Country

Country	Employee Contribution	Comment
Uganda	5%	The employer contribution is exempt, but the employee contribution is taxable. Section 22 provides for allowable expenses in deriving income. However, sub-section (2) prohibits certain expenses including: (i) a contribution or similar payment made to a retirement fund by the employee either for the benefit of the employee or any other person; and (ii) the amount of a pension paid to any person.
Kenya	5%	Employer contributions are exempt and employee contributions are generally taxable, ^{ab} except for contributions in respect of income which, prior to payment of bonus and overtime allowances, does not exceed the lowest tax band provided for under Head B of the Third Schedule of the Income Tax Act. ^c
Rwanda	3%	Law No. 16 of 2018 regarding Establishing Taxes on Income provides for exempt employment income, stating that the following are not included in the calculation of taxable employment income: 2° Contributions made by the employer for the employee to the public institution in charge of social security; 3° Pension payments from the public institution in charge of social security or from a qualified pension fund.
Tanzania	5%	Employee contributions are considered taxable income, ^d and only contributions under the Public Service Retirement Benefits Act are exempt. ^e

Source: Regulatory Authorities

Note:

a Section 15 of the Income Tax Act of 2014 provides for allowable deductions for purposes of ascertaining income. Sub-section (2)(0) permits the deduction of any sum contributed in the year of income by an employer to a national provident fund or other retirement benefits scheme established for employees throughout Kenya by the provisions of any written law.

b Section 16 of the Income Tax Act of 2014 provides for deductions that are not allowed. It specifically states in sub-section (2) that notwithstanding any other provision of this Act, no deduction shall be allowed in respect of – (d) sums contributed to a registered or unregistered pension, savings, or provident scheme or fund, except as provided in section 15(2)(o), or any sum paid to another person as a pension.

c Section 16 of the Finance Act No. 38 of 2016.

d Section 7(2) of the Income Tax Act, Cap. 332 of 2008 provides that subject to the provisions of subsection (3), (4) and (5), in calculating an individual's gains or profits from an employment for a year of income, retirement contributions and retirement payments shall be included.

e Section 7(3)(h) of the Income Tax Act, Cap. 332 of 2008 excludes retirement contributions and retirement payments exempted under the Public Service Retirement Benefits Act from computation of employment income under section 7.

The rationale for exempting employer contributions, but taxing employee contributions is unclear. In jurisdictions such as the United Kingdom, contributions by the employer and the employee are tax-exempt provided they do not exceed the prescribed limits (Maas 2015). The following may have informed the distinction in tax policy between employer and employee contributions:

- The employer's contribution is considered a cost, whereas the employee's contribution is income and therefore subject to tax.
- It is easier to tax the employee at the time of earning the income than at the time of receiving the retirement benefit. In particular, it avoids the adverse effects of taxation on pay-outs to retirees.

- Including the employee's contribution in the calculation of an employee's income increases the chargeable income, thereby increasing tax revenue for the government.
- The government can collect taxes on a high base (high chargeable income) over the working period of the employee as opposed to an uncertain base (pay-out) at retirement.

The Tax Treatment of Pension Fund Investments

"The general principle is that pension funds suffer no liability to income tax or corporation tax..." (Ellison 2008, p. 156).

Discussions regarding the tax treatment of pension fund income tend to focus on the investment income of pension funds, and particularly whether the income is subject to or exempt from income tax. However, there are other activities that should be of concern in relation to pension funds. These include the tax treatment of gains pertaining to the disposal of pension fund assets, particularly capital gains tax, as well as taxes such as value-added tax (VAT) and other charges, such as the stamp duty, that may apply to pension fund transactions.

The TTE and ETT fiscal regimes tax income earned from pension fund investments. Other regimes, including the EET, the TEE and the EEE exempt pension fund investments from tax. Both Uganda and Tanzania tax the income of pension and retirement benefit schemes, whereas in Rwanda and Kenya, the income of qualified pension funds is exempt from tax.

In Uganda, Section 8(4) of the Income Tax Act, Cap. 340 states that the chargeable income of a retirement fund for a year of income is charged to tax at the rate prescribed in Part III of the Third schedule to the Act.²⁶ Private sector pension schemes such as the mandatory National Social Security Fund (NSSF) and other private pension funds invest the funds they collect and the income earned is also subject to income tax. For example, the NSSF fund size

amounted to Uganda Shillings 6.6 trillion in 2016²⁷, which was invested in a wide range of investments including equity securities, investment securities, loans and advances and investments in associates, among others.²⁸ In the financial year ending June 30 2016, the NSSF's major sources of revenue were interest, rental, and dividend income.²⁹ Income tax expenses amounted to Uganda shillings 102,331, 080,000 in relation to the withholding tax deducted at source. For the same period, no income tax was charged to the fund because it accumulated trading losses amounting to Uganda shillings 819 billion.

The Makerere University Retirement Benefits Scheme (MURBS) had an income tax charge amounting to Uganda Shillings 2,556,322,000 for the period ending June 30, 2017.³⁰

In Kenya, the income of a registered pension scheme, pension fund, provident fund, individual retirement fund and the National Social Security Fund are all exempt from income tax.³¹ In addition, Section 65 of the National Social Security Fund Act exempts the National Social Security Fund from stamp duty. It is not clear whether following the liberalization of the pension sector in Kenya, the stamp duty exemption was extended to other pension funds. However, Section 117 of the Stamp Duty Act provides for various exemptions from stamp duty that include asset classes to which pension funds typically invest, such as transactions on the Nairobi Securities Exchange. In the United Kingdom, stamp duty is considered one of the disadvantages compared to their European counterparts. This accounts for the decision to domicile certain types of funds in Luxembourg or Ireland (Ellison 2008).

In Tanzania, income from retirement funds is subject to the applicable rules on taxation of income under the Income Tax Act.³² However, for purposes of ascertaining the income of a retirement fund, the Act makes a distinction between approved and unapproved retirement funds. An approved retirement fund is defined in Section 3 of the Act as a resident retirement fund having a ruling under Section 131 of the Act. Contributions received by an approved fund are not considered

income of the fund, and retirement payments made are not deductible expenses or liabilities of the fund.³³ Unapproved funds are required to include contributions received in computing income.³⁴

In Rwanda, Article 46 of the Law No. 16 of 2018 on Direct Taxes on Income exempts qualified pension funds and public institutions in charge of social security from income tax. A qualified pension fund is defined under Article 2 as any fund established according to Rwandan laws, operated for the principal purpose of providing pension payments to residents in the country, that has effective management in Rwanda at any time during the tax period.

It is evident from this discussion that in Tanzania and Uganda, the investment income of pension funds is subject to income tax, whereas in Kenya and Rwanda, it is exempt. The taxation of investment income of pension funds increases the operational costs, and ultimately decreases the funds available for distribution to beneficiaries. In an environment of macroeconomic instability and other economic shocks, the value of pay-outs to beneficiaries/retirees is significantly reduced.

In the United Kingdom, registered pension schemes are exempt from income tax on investment income, underwriting income and capital gains tax (Ellison 2008; Maas 2015, p. 293). A fiscal regime that exempts pension fund investment income from tax allows for tax neutrality between institutional and retail investments. As such, it is an incentive for the development of institutional vehicles, such as pension funds, to participate in financial markets. Major financial markets are dominated by institutional rather than retail investors. Controlling for adverse economic effects, fraud and mismanagement — which may affect the value of pension funds — income tax exemption may allow for increased pay-outs, which may or may not be subject to tax.

Another issue in relation to pension fund investments is the tax treatment of and, in particular, the application of the value-added tax on

services connected and incidental to pension fund investments, such as investment management and brokerage services. This has historically been an issue in other markets such as the United Kingdom (Ellison 2008; Maas 2015, p. 293). In Uganda, the Value-Added Tax Act does not specifically exempt these services from tax, but it can be inferred from the second schedule of the Act that some services fall within the category of exempt services, in particular those that are considered financial services.³⁵ In Kenya, VAT-exempt services are listed in the third schedule to the VAT Act, and include services dealing with bonds, debentures, treasury bills and other securities.³⁶ These constitute some of the pension fund investments. In Rwanda, the transfer of shares and capital market transactions for listed securities are exempt from VAT.³⁷ In Tanzania, the supply of financial services is among the services exempt from VAT.³⁸

The Tax Treatment of Retirement Benefits Paid to Contributors

“Tax provision plays a key direct or indirect role in influencing payout options. Cross country evidence is varied but suggests that there is often an unequal tax treatment of the various forms of retirement payout options.” (Antolin, Pugh and Stewart 2008, p.3).

In Uganda, retirement benefit payments are exempt from tax by virtue of Article 254(2) of the Constitution. In addition, pension and lump sum payments by retirement funds are exempt from tax.³⁹ In this regard Uganda differs from its East African counterparts. Possible explanations for this include the following:

- For both defined benefit and defined contribution schemes, an individual expects to receive their pension after a long period of service. The retirement age in Uganda is 60 years of age. Assuming a continuous period of employment from the time of university graduation at about age 23, this is a period of 37 years. Considering Uganda’s history of political and economic turbulence characterized by macroeconomic

instability, it is possible for the value of pension payments to be affected by inflation, with attendant poor returns on investment. Therefore, taxation of pay-outs would significantly disadvantage retirees and perhaps discourage pension plans.

- In the absence of meaningful social protection schemes for the elderly, taxation of pensions is likely to engender poverty as it reduces the income of retired individuals who may not have any other source of income.
- The government has for several years been unable to fully meet its public pension scheme obligations. Thus, taxation of pension payments would be detrimental to the recipients.

In Kenya, a pension, charge or annuity and any withdrawal or payment from a registered pension or provident fund is subject to income tax.⁴⁰ However, Section 8 imposes thresholds for various retirement benefit payments, the effect of which is that any payments below those thresholds are not taxable. Therefore, the following payments are exempt:

- Annual pension and retirement annuities received by an individual from a pension fund or the National Social Security Fund that are below Kenya Shillings 150,000;⁴¹
- A lump sum commuted from a registered pension fund that is below Kenya Shillings 360,000;⁴²
- Payments as a result of withdrawal from a registered pension fund or termination of employment that are not in excess of Kenya Shillings 36,000 per full year of pensionable service or a total of Kenya Shillings 360,000;⁴³ and
- Lump sum payments from a registered or deemed provident fund that are not in excess of Kenya Shillings 240,000, or the first 24,000 per year of pensionable service, or all benefits based on amounts accumulated in a fund as of December 31, 1990.⁴⁴

In Tanzania, Section 5 of the Income Tax Act defines total income for a person for a year of income as chargeable income from employment,

business and investment, less any reduction relating to contributions to an approved retirement fund. Retirement benefit income is neither expressly included in the chargeable income of an employee in Section 7(2) nor from the allowable deductions in Section 7(3). It is also not expressly stated as exempt income or an allowable deduction. Therefore, it can be inferred that income received from retirement benefits is not subject to tax. In addition, for unapproved retirement funds, the Act exempts payments that constitute a gain⁴⁵ from an interest in the fund for resident funds, but not for non-resident funds.⁴⁶

In Rwanda, pension payments from a public institution in charge of social security or from a qualified pension fund are exempted from income tax.⁴⁷

Conclusion

This chapter has demonstrated that in the four East African countries of Kenya, Rwanda, Tanzania and Uganda (where the pension systems are more developed), the tax treatment of employer contributions toward the retirement benefits of employees is similar and in line with global practice. In addition, except for minor variations in Kenya, the tax treatment of employee contributions is also similar. In this regard, the fiscal regime is neutral and does not create any distortions in the labor market within the context of the East African Community.

However, there are considerable variations in the tax treatment of pension fund investment income and pay-outs. The position in Kenya and Rwanda in relation to pension fund investment income is aligned with the practice of major financial markets that exempt pension fund investment income from tax.

The differences in the tax treatment of investment income and pay-outs have implications for cross-border investment of pension funds. These differences are likely to force pension funds to invest in domestic markets or only those markets

with favorable tax treatment, or to selectively contribute to investments that have favorable tax treatment. Kenya, Rwanda and Uganda permit pension funds to invest in assets within the region as if these were domestic investments, as well as in foreign markets within prescribed limits.⁴⁸

Access to foreign markets allows pension funds to diversify investments, enabling them to explore opportunities in domestic and foreign markets that provide an attractive return on investment. However, inconsistencies in the treatment of investment income may force pension funds to restrict their investments to domestic markets. This has several challenges including limited investment opportunities in domestic markets, as well as an inability to explore the benefits of economic integration such as the free movement of capital.

As the individual countries within East Africa position themselves to transition to middle-income economies and collectively prepare for economic integration at the East African and continental level, it is important to understand the economic role of retirement benefits and ensure that policies and legal frameworks are aligned and support the broader economy. In the context of freedom of movement of capital and labor, it is also important to ensure that the tax policies of the individual countries do not undermine these principles. In this context, they should be supportive of cross-border retirement benefit arrangements. Developments within the European Union may also be instructive.⁴⁹ Thus, the East Africa Community is working to harmonize the pension tax regimes for the systems in the region (converging on an EET model).

CHAPTER 4

PENSION FUND GOVERNANCE

- Japheth Katto and Miriam Ekirapa Musaali -

Introduction

Pension fund governance is important for the growth of pension funds in East Africa. The International Social Security Association (ISSA) Guidelines on Good Governance recognize that good governance of pension funds is aimed at delivering what is mandated and ensuring that what is delivered is responsive to the evolving needs of the individual and the society. Sluchynsky (2015) rightly argues that the quality of governance remains an important indicator of the financial health of any social security program in both the short and long term.

This chapter highlights the importance of pension fund governance within both public and private pension schemes. The key elements of pension fund governance are explored and proposals for the improvement of pension fund governance in East Africa are recommended.

Recently, there has been a lot more focus globally on the governance of private schemes. In East Africa there are private schemes as well as public pension fund schemes. The distinction between public and private pension schemes lies in the fact that the beneficiaries of the public pension schemes have no proprietary rights over pension fund assets. The legal owner of the fund assets is either the government or the institution that establishes the fund.

It is important to note that some of the standards and principles for governance of private pension funds can be applied to improve governance of public pension funds⁵⁰. Authors Souto and Musalem (2012) citing Impavido (2002) argue

that good governance of public pension funds is an issue of public interest because such pension funds are funded by taxpayers and contingent liability for payment of pensions lies with the government.

The origins of pension funds dates back to the late 19th century. The demand that retirement savings are properly managed stems from the failures experienced in the pensions industry dating from the Robert Maxwell Scandal of 1991. The scandal highlighted the need to separate pension funds from sponsors of pension schemes. It resulted in the enactment of the UK Pensions Act of 1994, which dealt with issues such as the composition of the Board of Trustees (the inclusion of member-nominated Trustees), the establishment of a compensation fund, and accountability and disclosure to members. In this context, it is important to note that East Africa has not been immune from scandals within the pension sector either⁵¹.

Defining Pension Fund Governance

According to the International Organization of Pension Supervisors, pension fund governance refers to the framework by which the governing body — whether individuals or a body corporate (through its Board of Directors and senior management) — makes decisions about a pension fund's business. The ISSA defines governance as the way in which the vested authority uses its powers to achieve the institution's objectives, including its powers to design, implement and innovate the organization's policies, rules, systems and processes, including engaging and involving its stakeholders.

According to the International Organization of Pension Supervisors (IOPS 2008), there is a difference between corporate governance and pension fund governance. Whereas corporate governance deals with safeguarding the interests of shareholders, pension fund governance deals with safeguarding the interests of another group of stakeholders (plan members and beneficiaries). The IOPS recommends that additional, different requirements be set for pension funds, particularly with respect to pension fund governance.

A survey of 362 pension plans in Kenya in 2011 revealed that pension governance is influenced by pension regulations, leadership and membership age. (Njuguna 2011).

The governing body (that is, the persons responsible for management of the pension fund) are expected to uphold the highest levels of governance and act in the best interests of the members. Governance practices are aimed at ensuring that managerial controls are exercised by the Trustees.

In 2010 at the inaugural ceremony of the NSSF board, the Ugandan Minister of Finance underscored the need for good governance of pension funds in her address to the NSSF Board⁵² commenting that: “The first step in strengthening our pension sector starts with acknowledging that the existing system has been unsatisfactory and not responsive to the needs of a large majority of Ugandan workers. For the fund to achieve high levels of performance and efficiency and to lift its image from where it is, good corporate governance and professionalism in running the fund are imperative.”

According to the IOPS, the goal of good governance is to minimize agency problems or conflicts of interest that can arise among those responsible for scheme operations and oversight.

Drivers of Pension Fund Governance

According to the OECD (2017), assets in funded and private pension arrangements exceeded US\$ 40 trillion in the OECD area at the end of 2018.

With this kind of phenomenal growth, the proper governance of pension funds is essential.

According to URBRA,⁵³ pension fund assets in the East African region as at December 2017 were in excess of Ugandan Shilling to US\$ (UGX) 77 trillion (approximately US\$ 21 billion). The growth of pension fund assets over the last decade has highlighted the need for these assets to be properly managed and the scheme to be well governed. Njuguna (2011) opines that increases in returns and pension asset values make the members of the scheme more sensitive to governance practices.

Within East Africa, the establishment of regulatory agencies has highlighted the importance of proper regulation and supervision of the pension sector. A well-run pension system places a strong emphasis on governance issues. Souto and Musalem (2012) (quoting Iglesias and Palacios 2000) argue that there is factual evidence that seems to indicate that the worst returns are produced by publicly-managed pension funds in countries with poor governance records. Despalains, Remizova and Stewart (2017) argue that improving governance of pensions, particularly for the large public sector social security funds which dominate many emerging markets, is key to improving diversification and returns.

The establishment of regulatory agencies in East Africa was preceded by the promulgation of social security laws⁵⁴. This was pioneered by Kenya in 1997. The Retirement Benefits Act of Kenya established a governance framework for the regulation and supervision of retirement benefits in Kenya. Tanzania followed suit in 2008 with the enactment of the Social Security Regulatory Authority Act.

A social security policy was developed in Rwanda in 2009. The policy highlighted the need for proper administration of the social security system. The proposals that were put forward were for a proper framework for social security in Rwanda. As a result of this policy, the Rwanda Social Security Board (RSSB) was established in 2010 by Law N° 45/2010 of 14/12/2010. The mandate of the

RSSB is to administer the social security system in Rwanda. The National Bank of Rwanda (BNR) is the supervisor of the pension system.

The Uganda Retirement Benefits Regulatory Authority Act was put in place in 2011. The Act established the Uganda Retirement Benefits Regulatory Authority (URBRA). The URBRA is committed⁵⁵ to working with the industry to improve scheme governance, thereby ensuring protection of member interests and building confidence in the system.

The development of these laws facilitated the movement toward good governance of schemes. The laws provide for the establishment of a regulator for the sector. They also provide for various aspects of pension fund governance, such as accountability, disclosure, and separation of duties of the custodian, fund manager and trustee.

Njuguna (2011) argues that adherence to pension regulations exerts a positive influence on pension plan governance. Specific areas that should be legislated include pension design, financial reporting and service providers.

Ensuring Good Pension Fund Governance

Good governance can help a pension fund to achieve its objectives and goals. The first among these is the achievement of the purpose for which the scheme was established. The overriding objective of a scheme is the provision of retirement income to members, their dependents or beneficiaries. In a well-governed scheme, trustees work toward the achievement of that purpose, and ensure that the objectives set out in the trust deed are met.

The International Labour Organization (2010) emphasizes that “No system of social protection can achieve its objectives without good governance.” In a well governed scheme, the benefits that are promised to the members are delivered.

High pension fund performance is another key objective. Stewart and Yermo (2008), referencing Ambachtsheer and others (2006), show how good governance and performance are linked. The writers base their conclusions on research undertaken regarding pension funds in Australia, Canada, Europe, New Zealand, and the United States. They conclude that the governance gap, as assessed by pension fund Chief Executive Officers (CEOs) (or equivalents) themselves, has been worth as much as 1-2 percent of additional return per year. Njuguna (2011) argues that poor pension fund governance results in poor, inefficient and irrational decisions that increase the costs of operating pension plans. Pension governance should aid in the efficient transformation of pension fund income into retirement benefits and high asset values.

A well-governed scheme will also focus on mitigation of risk, lowering costs and ensuring that the fund performs well. Trustees in a well-governed scheme take the time to choose good service providers and comply with regulatory requirements, thereby minimizing the costs of regulation that arise from enforcement actions being taken against the scheme. As such, there is an optimization of the benefits and risks are effectively mitigated.

Good governance confidence of members and stakeholders in the scheme. Good governance ensures transparency in the way in which the pension fund assets are used. In this context, there is full disclosure about the costs incurred by the scheme and regular reporting. This gives confidence to the members and stakeholders because they know that nothing is being hidden from them.

A survey taken among 24 IOPS members in 2008 revealed that the changing legislative environment has raised the level of competence/expertise that is required of the governing body. As such, it has compelled the governing body to disclose information transparently and clearly to members and beneficiaries, thereby reinforcing accountability. The survey revealed that the major governance issues were in the areas of competence/

expertise, accountability and internal control of the governing body.

Good pension fund governance can have a positive impact on the corporate governance practices of the companies in which it invests. The pension fund conducts its role as an institutional investor with diligence, and it is an active shareholder in the companies in which it invests. Pension funds that are well governed will not shy away from pursuing companies that they invest in to cover their stock losses and protect the investments of the fund. The California Public Employees Retirement System (CalPERS), for example, requires the companies they invest in to have proper governance systems and to abide by the CalPERS governance and sustainability principles. CalPERS believes that fully accountable governance structures produce the best returns to shareholders over the long term. Indeed, CalPERS has become a respected leader in the public and pension benefits industry.

Pension fund governance determines the regulators' supervisory approach. Most pension fund regulators have adopted a risk-based supervisory approach. This approach requires that attention be paid to funds that pose the greatest risk to the pension fund members and beneficiaries. A firm that is well governed will most likely not be the focus of regulatory compliance visits. This lighter touch enables the fund to concentrate on other operational matters.

Key Elements of Pension Fund Governance

According to the IOPS, the following are the key elements of pension fund governance:

- The structure of the governing body (including the legal basis and segregation of functions);
- The decision-making processes within the governing body (including internal controls, risk management, compliance functions and internal oversight structures);

- The requisite skills and competency of the governing body; and
- The means by which the governing body is accountable to stakeholders (principally, plan members and beneficiaries, as well as a wider stakeholder group including employers, supervisory boards, supervisors, regulators and government).

According to the ISSA, the following are the five principles of good governance: accountability, transparency, predictability, participation and dynamism. These elements will be examined in detail with specific reference to the governance practices within the East African region, including any applicable legislation.

The Structure of the Governing Body

In East Africa, the governing body of public pension funds is established by law, whereas private pension funds are established under trust arrangements or as a body corporate. In Kenya and Uganda,⁵⁶ the entire Board of Trustees of the NSSF is appointed by the Minister. In Tanzania, the Chairman is appointed by the President, and in Rwanda the Board of Directors of the Rwanda Social Security Board are appointed by the President.⁵⁷ The NSSF Board of Uganda is comprised of worker and employer representatives, the permanent secretary responsible for social security matters, as well as a representative from the Ministry of Finance, Planning and Economic Development. The effect of these politically motivated appointments is that it may result in direct or indirect political influence over the fund.

In East Africa, the law governing private funds generally requires every scheme to have a governing body. The Board of Trustees must be vested with the power to manage and administer the scheme. This is an obligation to ensure adherence to the scheme rules and protect the members/beneficiaries. The responsibility to govern the scheme must be consistent with the overriding

objective of the scheme, which is the provision of retirement income.

Trustees hold the assets of the scheme on behalf of the members. In this context, they serve as fiduciaries. The Oxford Law Dictionary defines a fiduciary as a person such as a trustee who holds a position of trust or confidence with respect to someone else, and who is therefore obliged to act solely for that person's benefit. In Uganda, the URBRA Act has extended the fiduciary principle to not only the trustees of the scheme, but also to other service providers. These include persons responsible for the control, administration or management of a retirement benefits scheme; the application or interpretation of scheme rules in the determination of benefits for members or beneficiaries of a retirement benefits scheme; and the management of assets or investment of funds of a retirement benefit scheme.

The fiduciary duties mentioned in the URBRA Act include the duty to act with due care, skill, diligence, good faith and prudence, as well as the duty to act in the best interest of the scheme members and beneficiaries. The fiduciary duties also include ensuring that all decisions regarding the scheme comply with scheme rules under the Act. These fiduciary duties are applicable in other East African Countries as well.

The Role of the Board of Trustees

The Board of Trustees of the pension fund is responsible for oversight of the fund. The Board is also the ultimate decision maker. As such, it is responsible for setting the strategic direction and investment policy for the fund, choosing service providers and reviewing fund performance.

In Tanzania, the Government Employees Pension Fund (GEPF) is one of the five mandatory social security schemes regulated by the Social Security Regulatory Authority. The Board of Trustees is responsible for approval of the annual plans and budget, audited financial statements, and major

investments of the Fund. Management has delegated authority to make decisions on operational matters, including those relating to the placement of funds in commercial banks, and investments in government securities, fixed deposit receipts and listed equities within the framework of the approved investment policy.⁵⁸

Trustees are ultimately responsible for the scheme, even when they delegate certain functions to service providers. Trustees retain the responsibility of monitoring and oversight of service providers. Trustees are also accountable to members/beneficiaries and the regulatory authority. In addition, Trustees may be accountable to scheme sponsors, who are in effect guarantors of benefits in a defined benefit scheme.

The Board of Trustees is led by a chairman who is responsible for the conduct of meetings, setting the agenda with the assistance of the secretary, and ensuring that there is open communication between members of the Board. In selecting a chairman of the Board of Trustees, it is important to seek the following skills: good communications, strategic leadership and negotiation skills. The chairman should have sufficient knowledge of pension matters, although he/she may not necessarily be an expert in the field.

The secretary of the scheme should be independent from the Board of Trustees. The secretary supports the chairman, organizes meetings, reviews scheme documents, ensures that board evaluations are carried out and that information is dispersed to members in a timely manner.

In selecting the Board of Trustee members, it is important that there be a balance of both skills and experience on the board. Some of the relevant experiences and skills include: financial management, investments, business development, legal, compliance, audit, leadership and operations management. It is also important that independent trustees be included on the Board. These independent directors bring objectivity and balance to the board.

At the time of becoming board members, the trustees should be given an induction, which will help them appreciate and understand their roles, duties and obligations. Mentoring relationships between established trustees and newly-appointed trustees should also be forged to augment the learning process. Continuous training of the Board of Trustees should follow. In Kenya, the RBA has taken a risk-based approach to pension supervision⁵⁹. In assessing the effectiveness of the Board of Trustees, the RBA considers the following factors: (i) whether there is a written governance document outlining the roles and responsibilities of the Board of Trustees; (ii) whether the board has undertaken a self-assessment; (iii) whether all members of the Board have passed the fit and proper tests; (iv) whether there is a code of conduct for board members.

Board committees are useful in enabling the board of a pension fund to operate smoothly. Small schemes should consider carefully whether there is a need to establish these subcommittees. Some of the critical committees include the audit and investment committees. The audit committee is responsible for the review of financial statements, the internal audit function, the appointment and performance review of the external auditor, and the effectiveness of internal controls.

The Board of Trustees should meet on a regular basis. The frequency of meetings should be determined by the size of the scheme and the nature of business to be conducted. The Board is also responsible for oversight of the scheme. As such, the number of meetings held by the scheme should enable the Board to carry out this role effectively.

The following agenda items should be included in Board meetings: (i) declaration of conflicts of interest; (ii) reports from management; (iii) investment performance reports and other reports relating to strategy; (iv) a risk report; (v) a report on outgoing communications to members; (vi) subcommittee reports; (vii) updates on legal or other regulatory developments; and (viii) training reports.

The decision-making process within the governing body (including internal controls, risk management, compliance functions and internal oversight structures) should also be considered. The trust deed and scheme rules stipulate how schemes make decisions. In most cases, the Board of Trustees acts jointly. The scheme rules may stipulate that the decision-making process is by a majority vote. This means that the minority should respect the decisions taken at a board meeting. However, it does not negate the rights of individual members to state their divergent view and have them recorded in the board minutes.

The trustees are responsible for the establishment of internal controls that enable them to identify, evaluate and manage risks relating to the scheme. Risk management by pension scheme trustees should be conducted on an ongoing basis. The compliance function carried out by the trustees is done with reference to the laws, the trust deed and scheme rules. Internal controls should cover the operations of the scheme including for example, administration, management, and custody of assets. Pension schemes should also retain a code of conduct governing the behavior of the members and the trustees.

According to the UK pensions regulator,⁶⁰ the areas that have a significant impact on clients of defined benefit schemes are: (i) existing controls not operating effectively; (ii) strength of employer covenant; (iii) investment strategy; (iv) fraud; (v) corporate changes and transactions relevant to the scheme; (vi) legal requirements; (vii) administration; (viii) operational procedures and technical systems; and (ix) scheme management (including costs) and delegated responsibilities. Trustees should therefore provide adequate oversight in these areas.

Requisite Skills and Competence of the Governing Body

In all East African countries, trustees of private pension funds are subject to minimum suitability standards to ensure a high level of integrity, competence, experience and professionalism in

scheme governance. Collectively, trustees should have the necessary skills and knowledge to oversee scheme operations, including monitoring the performance of service providers. Suitability criteria for trustees must be stated in the law. Unfortunately, the same standard does not apply to public pension funds. Souto and Musalem (2012) make the point that senior managers and directors in government institutions may not be selected according to fit and proper criteria, but rather to political affiliation.

The IOPS (2008) stipulates the minimum qualifications for trustees as required by the various regulations. In Kenya, for example, trustees are required to attend trustee training and pass a qualification exam. In Poland, the law stipulates that a member of the management board should possess higher education, and a track record of employment of seven years or more (no less than two-thirds of the management board members have to satisfy this requirement). Also, no fewer than two management board members, including the President of the management Board, should have mastery of the Polish language, and no less than one-third of management board members should have a higher education in law or economics or be approved investment advisers. Where it lacks sufficient expertise to make fully informed decisions and fulfill its responsibilities, the governing body could be required by the regulator to seek expert advice or appoint professionals to carry out certain functions, which is recommended by the OECD.

In Uganda, the URBRA Act introduced the fit and proper test for the Board of Trustees. The test covers issues of criminal or civil convictions, bankruptcy, academic qualifications and professional experience. The main objective of this test is to disqualify people who may not have the requisite integrity and honesty to manage the pension funds, or who do not have the minimum competence standards for the governing body. The OECD Guidelines for Pension Fund Governance (2009) state that the governing body should be subject to minimum suitability standards in order to ensure a high level of integrity and professionalism in the administration of the pension fund. In Rwanda, Law N°. 45/2010 of 14/12/2010 clearly states that the members appointed to the Rwanda Social Security Board should be appointed on the basis of their competence and expertise.

In Kenya, the composition of the NSSF Board includes employer and worker representatives, as well as three persons appointed by the Cabinet Secretary by virtue of their knowledge and experience in matters relating to administration of scheme funds, actuarial science, insurance, accounting and auditing and/or law. These competences on the Board of Trustees ensure that there are competent persons on the board who can offer meaningful contributions to the deliberations at hand.

In his report on institutional investment in the United Kingdom, Paul Myners (2001) recommended that there be a legal requirement to require that

Box 1: NSSF Governance

Andrew Mwenda (2012) evaluates the competence of the NSSF Board of Uganda at the time:

"Who are these five eminent men and women whom the democratic process has thrust onto the NSSF board? How competent are they to guide the fund when making long-term investments? The fund has to decide a portfolio mix of whether to invest in stocks (and there are different types), precious metals, fixed deposit accounts in banks and real estate (different types as well). This means that the board has to have members with [a] wide knowledge of investments in different sectors that give good yields over time".

only those with the necessary skills, information and resources should make those decisions. His proposal was adopted in the 2004 Pensions Act of the UK.

Trustees should rely on the support of committees and delegate functions to service providers or in-house staff where applicable. External advice received must be assessed in terms of quality and independence. Efforts should also be made to ensure that the external advisors have adequate qualifications and experiences.

The Board of Trustees should have a performance measurement/assessment/evaluation tool. This tool should enable the Board of Trustees to assess their effectiveness on a regular basis (at least once a year). The evaluation should preferably be handled by an independent facilitator. The Board evaluation also assists in assessing the contribution of individual trustees to the Board. The Board performance measurement tool is also important in assessing training needs for the Board of Trustees. This paves the way for their education and training. The King IV report on Corporate Governance for South Africa (2016) outlines the scope of an effective board evaluation. Specifically, it should cover the Board, its structures, its chair and members and the principal officer to help ensure continued improved performance and effectiveness.

Transparency and Administration

Information provided to members of pension funds should be timely, relevant, accurate and objectively reliable (ISSA Good Governance Guidelines 2014). The administration of the pension scheme should be governed in a manner that promotes transparency. Pension fund administration is therefore critical to the overall success of pension funds in East Africa. A pension fund administrator is usually responsible for the day-to-day operations of a pension fund.

The ILO (2001) recommends that schemes be managed in a sound and transparent manner with administrative costs as low as practicable. Sluchynsky (2015) considers administrative costs

an important aspect of reforms, especially where new mandates extend to low-income or informal sector workers.

It is within the mandate of the governing body to oversee scheme administration. In Rwanda, for example, the role of the Rwanda Social Security Board includes the registration of employers, employees and beneficiaries, the collection and management of contributions, and the payment of social security benefits to beneficiaries.⁶¹ The ILO (2010) identifies the following factors as evidence of efficient administrative operations: (i) efficient collection of contributions; (ii) accurate accounting of contributions and benefits which must be promptly paid; (iii) improved cost of administration within the desired level of service; (iv) awareness on the part of contributors and beneficiaries about their rights and obligations; and (v) monitoring and review of administrative performance.

In Uganda, the administration can be conducted on an in-house basis or outsourced to a licensed person. In both Kenya and Uganda, the administrator is defined as a person appointed by the trustees to administer a scheme in accordance with the terms and conditions in the instruments of appointment.⁶² In Tanzania, the Social Security Regulatory Act of 2008 does not define an administrator, but rather defines an administrative expense. The definition of administrative expense gives insights into the services provided by the administrators⁶³.

In Kenya, Rwanda and Uganda, the law requires an administrator to be licensed, approved or registered. For an entity to qualify, the entity must be a corporate body licensed under the Companies Act of Kenya,⁶⁴ whose liability is limited by shares (60 percent of paid-up capital should be owned by Kenyans) and whose main objective is to render administrative services to schemes.

In Kenya, unlike in Uganda, administrators are required to have a minimum paid up of share capital. The administrator is mandated to meet the obligations to members and sponsors specified in the scheme rules. In both jurisdictions, the

administrator is required to have professional and technical capacity and adequate operational systems to perform its functions.

In Rwanda, the role of the administrator and investment manager can be carried out simultaneously for the same scheme if both licenses are held by the same entity.⁶⁵ However, in Uganda, the administrator cannot act as a custodian, trustee or fund manager of the same scheme. The provision applies to both assignees and related parties.⁶⁶

In Kenya, there are also specific requirements for the Board of Directors and top management of a pension fund administrator. The academic and professional qualifications should be pertaining to administration of schemes, insurance, law, accounting, actuarial science, economics, banking, finance and/or investment of scheme funds.

The role of an administrator includes keeping the records of the scheme; processing receipts and invoices; producing quarterly and annual accounts for audit purposes; organizing and arranging meetings; and preparing annual benefit statements and trustee reports. It is important that schemes maintain records of members, contribution schedules, benefit payments, income, expenditures and assets. In Kenya, for example, the RBA Act⁶⁷ requires trustees of every scheme to keep proper books and records of account regarding income, expenditures and assets of the scheme fund. Records of the scheme can be inspected by an inspector appointed by the RBA. Failure to produce records is an offense under the RBA Act.⁶⁸

Accountability of Governing Body to Stakeholders

The OECD⁶⁹ recommends that appropriate controls be put into place to ensure that all persons and entities with operational and oversight responsibilities act in accordance with the objectives set out in the pension entities. This means that they must act in compliance with all laws, statutes, contracts or trust instruments, as well as documents associated with any of these.

The ISSA Guidelines on Good Governance underscore the point that accountability is the ability to hold legally responsible those officials who are in charge of the institution. It requires the establishment of norms and standards to evaluate the achievement of the institution's mission, as well as a well-functioning system of redress that protects the interests of stakeholders and deters mismanagement and deviations from the institution's mandate. A recent case in Uganda⁷⁰ proved to be a landmark case in terms of highlighting the need for proper accountability in public pension funds, including the need for public pension funds to be regulated and adhere to the same standards as private pension funds.

According to the OECD,⁷¹ the governing body should be accountable to the pension plan members, beneficiaries and competent authorities. The governing body may also be accountable to the plan sponsor to the extent commensurate with its responsibility as benefit provider. To guarantee the accountability of the governing body, it should be legally liable for its actions.

The Financial Services Board of South Africa (FSB) addresses the issue of pension fund governance in its circular (PF 130) on Good Governance of Retirement Funds. Specifically, it makes an important point regarding accountability of the trustees to the sponsor of the scheme. The FSB argues that the sponsor has made a promise to its employees who are members of the fund. As such, it is important that the trustees be accountable to the members, ensuring that promises made are fulfilled.

All East African country pension funds are required to submit audited financial statements to the regulatory authorities on an annual basis. The NSSF Act of Uganda, for example, requires that annual and supplementary budgets be submitted to the minister for approval. The Board is required to keep proper account books and records. The fund is audited by the Auditor General, or an auditor appointed by him/her. The audited financial statements and annual report are submitted to the minister at the end of each financial year. The audited financial

statements of these funds whose membership is open to the public (such as the NSSF) are to be published. Closed pension funds are to have a copy of their audited accounts available at their office for inspection by members.

Rwanda's Law No. 45/2010 of 14/12/2010 establishes the Rwanda Social Security Board (RSSB) and requires the head of the RSSB to submit an annual financial report to the supervising authority of the RSSB within three months from the end of the year.

In Kenya, Tanzania and Uganda, audited financial statements of schemes are required to be published⁷². Non-submission of audited financial statements is an offense that is punishable by law. For example, in Kenya, failure to submit audited financial statements constitutes an offense that is punishable by a fine or imprisonment. Further penalties may be issued if the breach continues. In Tanzania,⁷³ the failure to publish audited accounts may lead to the disqualification of the Chairman or Chief Executive to act in those roles.

Accountability can be reinforced by the activism of institutional investors in pension schemes. Paul Myners (2001) in his report on institutional investors in the United Kingdom opines, "It is not clear the extent to which beneficiaries of a pension fund scheme are aware of fund performance, the objectives set for the fund, or the benchmarks used and are therefore able to ask questions about them. In particular, to question the Trustees and their advisers about the decisions they have made."

To strengthen accountability, the Board of Trustees may establish an Audit Committee. The Audit Committee enables the Board to effectively exercise its functions. It is important for members of the committee to be financially literate. It is also critical for this committee to monitor the solvency of the fund, including its ability to meet future obligations.

Accountability implies that where there are breaches of the trust deed, the scheme rules, or the

laws, those responsible should be held to account. The Board may be held accountable collectively or individually for breach of scheme rules. In South Africa, the role of the Pensions Adjudicator is to determine breaches and liability of the Board of Trustees when it results in loss to the fund. In East Africa, this determination is made by the Courts of Law.

Accountability can also be achieved through independent voices representing the interests of pension plan stakeholders. The use of professional independent parties, such as independent auditors and actuaries, can be helpful in verifying compliance and ensuring that the scheme can meet its obligations.

Trustees are required to appoint a custodian to hold the assets of the scheme and to ensure that those assets are legally separated from the assets of the custodian. This safe-keeping role of the custodian supports accountability within the scheme. In Uganda, the custodians are financial institutions.

Management of Conflicts of Interest

The King IV Report on Corporate Governance for South Africa⁷⁴ encourages the governing body to set the tone and provide ethical and effective leadership. The report also recognizes that the governing body must collectively set the ethical example and tone.

Stewart and Yermo (2008) address pension fund governance with specific reference to private pensions.⁷⁵ They argue that the basic goal of pension fund governance regulation is to minimize the potential agency problems, or conflicts of interest, that can arise between the fund members and those responsible for the fund's management. Such conflicts can adversely affect the security of pension savings and promises. Trustees should also manage the conflicts of interest of those involved in the scheme (including scheme members, trustees and advisers) Pension schemes should also have policies in place to identify, monitor and manage

conflicts of interest. Accordingly, the policy should stipulate the approach to be taken in the management of conflicts of interest.

Pension schemes should develop a list of potential conflicts of interest for each trustee and should maintain a register of each trustee's interests (actual) and manage them effectively. Examples of conflict of interest include a recommendation of third-party service providers where a trustee has a shareholding. In Rwanda, Law No. 45/2010 of 14/12/2010 prohibits the members of the RSSB from performing any remunerated activity within the RSSB. The members of the RSSB are also forbidden from bidding for tenders directly or through the companies that they own. Umbrella funds that consolidate a number of smaller schemes into a larger group are often riddled with conflicts of interest. Such providers are usually profit-motivated and may not act in the best interests of members.

Trustees should understand that they have an obligation to declare the conflicts and notify the scheme. At every meeting of the Board of Trustees, a declaration on any conflict of interest (if any exists and depending on the matters on the agenda) should be made.

Trends and Recent Developments

Pension fund governance has developed beyond the need to provide retirement income to embrace principles of sustainable investment. Under the principles of sustainable investment, pension funds are expected to consider environmental, social and governance (ESG) issues when making investment decisions and engaging stakeholders. For instance, when considering sustainable investment, pension funds make investment decisions based on assets that are related to sustainability, such as sustainable agriculture, green technology, and clean energy. Such an investment would be aimed at solving social and environmental problems. As institutional investors, pension funds can use their power to influence corporate behavior. In this context, it is

expected that pension funds that embrace ESG will influence the companies in which they invest to apply sound governance principles and care for the environment in which they operate.

As part of the United Nations-supported Principles for Responsible Investment (UNPRI 2016), a global statement on investor obligations and duties was made by various stakeholders on June 21, 2016⁷⁶, “Sustainability is an important factor in the long-term success of a business. Therefore, as with any other issue related to the prudent management of capital, considering sustainability is not only important to upholding fiduciary duty, it is obligatory”.

The following investor/organizational fiduciary obligations were outlined in the global statement (UNPRI 2016):

- Act with due care, skill and diligence, in line with professional norms and standards of behavior.
- Act in good faith in the interests of their beneficiaries and clients, including avoiding conflicts of interest, or where such conflicts are unavoidable, to balance and disclose such conflicts.
- Take account of environmental, social and governance (ESG) issues, in their investment processes and decision-making, encourage high standards of ESG performance in the companies or other entities in which they are invested, and support the stability and resilience of the financial system.

In South Africa, the Code for Responsible Investing in South Africa (CRISA) was established to encourage institutional investors to integrate sustainability into their investment decisions, for example, environmental, social and governance concerns. The code is applied on a voluntary basis (apply or explain). Regulation 28 of the South African Pensions Act requires pension funds to extend appropriate consideration to any factor that may affect the long-term performance of pension fund assets. The objective of the King IV report

on Corporate Governance is to broaden corporate governance by making it accessible and suitable for application by organizations of all sizes, resources and complexity.

Recommendations for Improving Pension Fund Governance in East Africa

It is critical that public pension funds be held to the same standards as private pension funds. Public pension funds should be overseen by the regulator, particularly as they transform into funded schemes. Regulatory laws should provide for oversight of public pension funds by the regulator. There is anecdotal evidence⁷⁷ that regulatory oversight of public funds by an external regulator improves the governance, management and investment performance of the scheme.

Tougher sanctions for misuse of pension funds would go a long way towards improving pension fund governance. In the United Kingdom, there are proposals for jail terms of up to seven years for mismanagement of employee pension schemes. The proposals were drafted following concerns over the issuance of fines for mismanagement of pensions, a move that was not considered a deterrent.

In East Africa, only Kenya has put in place specific regulations or guidelines regarding the governance of pension funds. Njuguna (2011) argues that to improve pension fund governance, practical pension laws should be crafted to specifically focus on the enhancement of leadership practices.

It is recommended that pension funds include a corporate governance statement from the Board of Trustees in their annual report. In Tanzania, for example, the GEPP Retirement Benefits Fund includes a corporate governance statement in the Annual Performance Report for the year 2014/2015. The statement broadly covers the composition of the Board and Committee, the meetings held during the year under review, the role of the Board and the

Committee, risk management actions taken by the Board, and training undertaken during the year.

In order to strengthen pension fund governance, it is imperative that trustees are properly trained. In jurisdictions such as Kenya, the RBA undertakes training of trustees, and there is also a certification program for trustees. The RBA also undertook a trustee's survey in 2007 (RBA 2007) and discovered that the schemes whose trustees were trained had higher registration rates. In addition, they were less likely to undergo risk-based inspections, and had fewer complaints filed. Further, they had a higher incidence of provision of member statements and holding of annual general meetings.

The appointment of independent trustees within the governance body of public and private pension funds is essential. In umbrella funds, the law should provide for the appointment for independent trustees, as well as member-appointed trustees. This would help to balance the composition of the board and mitigate against potential conflicts of interest.

In Kenya, there is a requirement that independent trustees be appointed. However, there is no similar requirement in other East African countries. As noted, the appointment of independent trustees to the board will improve the effectiveness of the board and mitigate conflicts of interest on the board.

Regarding public pension funds, it is important for the laws to be amended to remove provisions that could facilitate political interference in the fund. In Uganda, for example, the NSSF Act Section 30 provides that all monies in the fund (including the reserve account) shall be invested as determined by the Board in consultation with the Minister. Such provisions should be amended, and the supervisory frameworks for adherence to investments of scheme funds should be adhered to, as provided for by the regulator. In Kenya, the NSSF Act Cap. 197 stipulates that the requirements in the Act are in addition to the requirements of the Retirement Benefits Act Cap. 197. Provisions such as these reinforce the role of the regulator in providing

oversight of public pension funds, including mitigation against political interference.

The use of nomination committees for the appointment of members of the governing body of public pension funds will encourage transparency and accountability in the selection process. The principal officer appointed by pension fund trustees plays a key role in working with the administrator to ensure that the scheme is well governed. However, the legislation in Kenya, Rwanda, Tanzania and Uganda does not adequately address the roles of the principal officer. The laws should be strengthened to provide for the role of the principal officer. In jurisdictions like South Africa, the principal officer has been dubbed “the guardian of good governance.” Further, the principal officer is required under the Pension Funds Act to be a resident of South Africa and is charged with ensuring that the rules of the fund are followed.

Recommendations should be adopted in overseeing the administrative expenditures of mandatory social security programs. These include cutting redundant staff, employing more advanced technology, sharing certain functions with other public entities, and outsourcing select tasks to other agencies (Sluchynsky 2015).

There are some overlaps in the regulation of service providers within the pension industry, which can lead to over regulation and arbitrage. In Kenya and Uganda, for example, asset managers are regulated by both the securities and the pensions regulators. Therefore, there is a need to streamline the

regulation of service providers to avoid duplication and waste of scarce regulatory resources.

Pension legislation that requires the governing body of public pension funds to obtain approvals from the Minister or other governmental entities for the exercise of decisions relating to fund matters is outdated and disempowers the Board of Trustees. Such laws should be amended, and the power handed over to the governing body to execute their functions in a prudent manner.

In view of EAC integration, there is a need to harmonize the pensions framework within the region. The EAC common market protocol provides for the free movement of labor within the EAC, among other things. Therefore, the portability of pensions is highly recommended to ensure that there is mitigation of asset leakage that results from changing jobs from one EAC partner State to another. Portability within the region will assist with protection from old age poverty. A harmonized framework for pensions will encourage workers to save for retirement irrespective of where one is resident within the EAC.

Finally, pension regulators in the EAC can borrow best practices from the Capital Markets Authority of Kenya⁷⁸. The CMA requires issuers to undertake an independent annual governance audit. This audit enables the issuer to assess the level of governance. As such, it acts as an early warning sign to both the regulator and the issuer regarding governance issues that need to be addressed.

CHAPTER 5

INVESTING PENSION FUND ASSETS IN EAST AFRICA

- Patricia Kiwanuka, CFA, MBA -

Introduction

There are many aspects to consider in any discussion of pension funds in the East Africa region, such as significant (policy) changes and developments in the area of retirement funds, and their contribution to the economy, capital markets and so on. From the mid-2000s, there has been a notable increase in the level of assets under management, as well as improved structured governance and regulatory supervision. Indeed, retirement funds in the region are now considered a significant source of capital for investment.

The EAC pension funds have been characterized by growth in the value of assets under management, and significant and continued investment in capital markets. These trends have both positive and negative impacts. On the positive side, government policymakers are looking into directing capital to more than just government securities, including new kinds of capital allocation for infrastructure projects, other private-public partnerships, and pension funds. Corporates coming to the capital market or seeking to raise private capital are also targeting pension funds. Finally, fund members have growing demands for returns above the rate of inflation, whereas fund managers are experiencing downward pressure on fees despite demands for more innovative investment alternatives. As such, fund trustees/directors are under pressure to further diversify their investments as they pursue healthy returns.

On the negative side, the region has had to grapple with cases of financial lapses in accountability and mismanagement. For instance, the banking sector in

Kenya, where in a period of less than one year (from 2015), three banks were placed under statutory management due to reported financial irregularities. Corruption is hardly unheard of in the region, and the retirement industry is no exception. Yet, until recently, there have been no widely reported cases or convictions. However, there has been a heightened focus on the investment decisions being made by the trustees, which may in turn increase costs (and reduce returns) through the bureaucratic process. For example, there is anecdotal evidence of procurement loopholes being exploited. Among other policy measures, regulators are promoting training programs to improve governance and reduce such instances of unethical behaviors.

Asset allocation remains the key driver of investment returns. In this context, it is important to note that most of the retirement funds are segregated mandates and do not invest in pooled vehicles. Therefore, the market is rather fragmented in contrast to the situation in developed markets, where investments are assigned to fund managers based on asset class capability and expertise. This degree of specialization allows a fund manager to focus on an asset class, without necessarily having to claim expertise in separate individual asset classes.

In this chapter, the strategic issues affecting retirement funds in the region will be explored. There are a variety of tools that may be applied. However, given the strategic objective, this chapter has adopted the Political, Economic, Social, Technological, Environmental and Legal (PESTEL) tool for analysis of the macroeconomic factors affecting pension funds. Finally, some

recommendations are offered to improve the investment discipline for retirement schemes. Where policies are in place, it is essential that they be viewed as enabling policies that will allow the industry to develop without hindering product innovation and market competitiveness.

PESTEL Analysis

Fund managers generally adopt a research-based approach to their investments and provide adequate disclosure through reports to the trustees. Their results need to be measured based on performance. As will be discussed, there is a need for retirement funds to move beyond a short-term profit focus, as the factors that drive significant returns occur over a longer period.

Political Environment

Regarding politics, the widely accepted truth by investors in developing and/or frontier markets, such as in East Africa, is that politics influence investment decisions. Indeed, politics impacts all regions.

Politics sets the policy direction for the macroeconomic environment and affects decisions made by the government about monetary and fiscal policies, revenue collection and disbursement. In younger democracies in particular, the degree of the political impact on investments is further exacerbated by any interference on the financial system. Fortunately, over time, the region has moved to separate politics from policy implementation.

The trustees of retirement funds need to be aware of their primary role as fiduciaries. As such, they need to have a good understanding of the legal framework. This framework will offer them adequate protection when making investment decisions, including a separation of responsibilities from the sponsor. The need to ensure independence and make the right investment calls for the long-term viability of the pension fund is one of their core mandates.

One of the areas where politics has been seen to play a role in the pension markets has been on early access of benefits by members. The argument for preservation of retirement savings to meet needs of retirees is appreciated. However, as the pension laws are debated in parliament, the issue of the ability to access benefits early takes center stage.

In Kenya, the benefits law has undergone several amendments, the most recent (and current practice) is that members can withdraw 100 percent of their member benefits and 50 percent of the employer portion of their benefits. That leaves only 50 percent of the employer portion to await retirement date. In Rwanda, the pension law that was passed in 2015 mandated 100 percent preservation, as is the case in the mandatory scheme. There has been significant outcry, with a number of pension arrangements converting to savings schemes. One of the reasons given is that they would be able to allow members access to funds on leaving service.

The payments for early withdrawal are accessed in lump-sum form. Most individuals use this for personal consumption, to pay off outstanding loans or as capital injection to start a business. From a retirement benefit fund perspective, the early access and payment of lump-sum benefits impacts the liquidity profile of the scheme. There are clearly behavioral and other needs-based reasons for accessing retirement benefits that are not limited to political reasons. However, early access does have implications on the investment (liquidity needs). Thus, it must be considered when making investment decisions. This section does not seek to argue the merits or demerits of early access to overall retirement benefit. Rather, it seeks to examine the investment decision-making aspects.

Some trustees and investment managers focus on liquidity management, and in some cases hold significant cash or near cash reserves to meet this need. It is important to note that this has been suggested as a reason for holding significant cash reserves. However, in practice, in most cases, the contributions received are able to meet the liquidity needs. The exceptional or unique cases arise when

there have been large staff rationalization exercises, as in Kenya. From 2016-2018, financial institutions made significant job cuts. This would also apply where there are unremitted contributions, necessitating that liquidity be created from the portfolio to pay benefits.

Economic Environment

In understanding the economy of a country, several measures may be applied. However, the focus of this chapter will be on GDP and inflation. Policymakers consider these measures in setting monetary policy, and investors (both domestic and foreign) consider them when determining their asset allocation and flow of capital. Retirement funds in the region are no exception. At the minimum, they aim to secure real rates of return, implying returns above inflation. This is a key parameter for ensuring that member benefits are able to pay for their retirement upon maturity.

A country's GDP is one measure of its production, the key determinants of which are private consumption, business investment, and government spending plus exports less imports. If growth is positive on a quarter-to-quarter basis, then positive sentiments rise vis-à-vis the economy and investment markets. However, if growth is negative, it may be a signal for a potential recession. On the other hand, inflation is the measure of changes in price and money supply levels in the economy. Theoretically, inflation should be correlated with government interest rates. However, in the East Africa region, this is not the case. The higher than expected rates of interest in government borrowing are seen to influence investment behavior by crowding out other investment asset classes.

The East Africa region has been referred to as a middle-class economy, which means that GDP is being spurred largely by personal consumption and imports. The downside of this is that employees are driven to spend, thereby reducing the level of voluntary savings to retirement funds and increasing the demand for early access to savings. In most

cases, this undermines the policy of promoting long-term savings for retirement. With the exception of South Sudan, across East Africa inflation remains range bound with positive GDP growth. This is beneficial for retirement funds, which have invested in the equity markets because this positive growth is reflected in the profits of both listed and unlisted firms. Investment in property also benefits from positive GDP and inflation, as property prices are expected to rise over time. This provides a valuable hedge against inflation for long-term assets.

When growth is positive, government securities are another attractive investment for both foreign and local investors. The prescribed investment limits applied by regulators in the region allow for a higher allocation to this asset class. Government policies regarding long-term funding recognize that the retirement funds are an essential source of this income. However, the high interest rates on the short end of the yield curve make the investment profile of the schemes short term in duration. As such, there is little if any benefit to taking a long-term investment risk, even on government securities.

In Kenya, the regulation prescribes that all retirement funds must adopt financial reporting for their investment in government securities as “marking-to-market”. It is important to note that the International Financial Reporting Standards (IFRS) provide for alternative valuation methods, such as hold to maturity (still practiced largely in Rwanda, Tanzania and Uganda), as well as available for sale (which is mainly used by banks and corporate treasuries). The rationale for “marking to market” is to ensure that when the assets and liabilities of the fund are valued, the funding level remains reflective of the true position at a given point in time. Thus, this is the most prudent valuation methodology. The volatility of the yield curve represents a challenge to the fund manager to explain to the trustees and members why the “risk free” government securities are delivering negative returns whenever there is an increase in interest rates.

Social Demographics

From a retirement industry perspective, social demographics may be viewed using two indicators: age and employment. The East Africa region boasts large numbers of citizens in informal employment, with only a fraction of citizens formally employed in government or private firms. When looking at age, these countries have a large youth (ages 18 – 35) cohort. Reportedly, a large proportion of youth are also unemployed.

The experience of Rwanda's mandatory scheme is that more payments are being made in lump sums. One reason for this is that most people do not work for the mandated 15 years necessary to collect pension benefits. Job mobility is also high in Kenya and Uganda. As individuals are able to access their benefits on changing employment, this affects the retirement scheme's ability to invest for the long term.

Policy reforms have been geared to support entrepreneurship as a means of stimulating economic growth and creating employment opportunities. However, the challenge for regulators and policymakers in the region is to create an environment that encourages private firms to establish retirement funds and/or contribute to the currently existing pooled arrangements. The introduction of the pension and long-term savings laws in Rwanda sought to increase coverage by offering personal pension scheme arrangements. The mandatory scheme also introduced a category for voluntary savings to target the large, informal employment sector.

The uptake for the two products remains low. The experience is no different than in other countries. Part of reason for this is that high acquisition or distribution costs are required to target this market. To address this issue, the regulator in Kenya partnered with a market player to promote the Mbao Pension Scheme.

Technological Aspects

Technological improvements are about convenience (use and cost) and access to knowledge and information (connectivity and networking). Technology has made information readily available, and it has also changed the pace of product innovation, with constant adaptations. Therefore, to keep up with the times, trustees are pushing fund managers to innovate and introduce new products and enter new markets as competitive pressures increase.

When pension funds are managed in-house, the cost for information technology and administration platform upgrades will continue to put upward pressure on expenses. On the other hand, by leveraging technology, trustees can reduce some of the other administrative costs, such as printing costs for Annual General Meeting, statements, financial accounts, Board meetings and others. In making investment decisions, the fund manager must consider expenses, keeping in mind the overall objective of delivering a positive return (after expenses) to members.

Trustees have adopted technology applications, including providing members with online statements and mobile updates. In this context, there is increased pressure for managers to deliver positive short-term returns. The challenge of such a short-term focus from an investment perspective is that managers will increasingly take fewer risks to secure capital in an effort to avoid negative returns. For unit trusts, the daily updating of net asset values through unitization happens. However, for pension fund accounting this is done on a monthly basis, usually for valuation purposes. It is also done annually (post audit) for member benefit statements. It is not possible to always maintain an expectation of positive returns. Therefore, expectations about performance will need to be managed with regular communications and education directed to members.

Environmental Concerns

The East Africa region is located along the Equator. Thus, it enjoys a great climate and is recognized as a tourist destination. Also, it has been rightly observed that with the right incentives, agricultural production can be a significant benefit for its economies. For instance, the Kenyan government's big four agenda focus on manufacturing, housing, universal health care and food security. In Rwanda, agricultural production also remains a key driver of the economy.

Regarding retirement funds, citizens will need to look at the securities being chosen, review the policies on proxy voting, and take an active part in encouraging a sustainable business agenda. As a long-term investor, the sustainability of the environment in which we do business and invest is a key consideration. It is important to note that currently only a few multinational companies are reporting on environment and sustainability concerns in their annual accounts. However, this remains a footnote. Indeed, very little weight is given to environmental concerns when making investment decisions.

Regional experience indicates that fund managers recognize the principles for sustainable investment and ESG criteria. However, the practical application of such criteria is difficult. In most of the research models, the fund managers take into account the governance practices of the firm. In some cases, they use the opportunity to make investor views heard during proxy voting. The structure of most investment houses is one of balanced portfolio management with a few specialist mandates. In developed markets, ESG investments are directed to specialist managers as part of the overall asset allocation decision by trustees. However, the allocation by capabilities has not taken root in the East Africa market.

While the capital market in Kenya enjoys higher number of entities reporting sustainability from listed securities, there is no independent body that evaluates or reports on ESG practices. In recent years, a few multinational companies have included disclosures about their sustainability practices. It is expected that as the Capital Market Authority enforces the Corporate Governance and Steering Codes, there will be increased disclosures to support such reporting. In the other East African countries, the equity markets remain largely under-developed with very few listings. As such, sustainability reporting as a kind of screening criteria would largely be viewed as theoretical from an investment perspective. In East Africa, most managers adopt the prudent person investment principles, that is, they recognize that as fund managers, they have a fiduciary role to conduct adequate fundamental research to support their investment decisions. However, the screening criteria adopted is chosen at the discretion of each investment house as part of their investment strategy and philosophy.

Legal Matters

From a retirement fund investment perspective, there are prescribed guidelines in Kenya and Uganda for asset allocation, including a requirement to have professional investment managers on board. The guidelines are broad and not unduly restrictive. However, there has been a push to have these guidelines dropped in favor of the prudent person approach.⁷⁹ This would allow retirement funds the latitude to determine their asset allocation. There are pros and cons to this argument. However, given past adverse experience with funds holding as high an allocation in property of 70 percent, these guidelines continue to be retained by the regulators. In the other jurisdictions, the legal environment is not as regulated, but that does not mean that there are no restrictions on investments. These could take the form of restrictions for out of country investment, as well as limits to projects that can be undertaken with the intention of protecting member dues.

As part of the EAC regional harmonization process, proposals have been developed. Partner states have been encouraged to adopt these proposals. This includes the following broad principles:

- Adopt a robust legal and regulatory framework to regulate pension investment activities.
- At a minimum, pension funds should be required to make investments in diversified asset classes; and only prescribe a maximum limit.
- Develop guidelines for the operations and procedures to be adopted for investments by pension funds, including minimum guidelines to be included in the investment policy.

- Consider investments across EAC markets as domestic investments under investment regulations
- Encourage the gradual adoption of appointing professional fund managers and custodians for the investment of assets.

Table 6 provides a snap-shot of the current prescribed investment limits applicable to pension funds in the EAC region. In Rwanda, the pension regulator is looking to introduce maximum limits in line with EAC harmonization principles as part of the ongoing review of the pension law.

Table 6: Prescribed Investment Limits for EAC Pension Funds (Percentage)

Asset Class	Kenya Limits	Kenya Actual 12/2017	Uganda Limits	Uganda Actual 12/2017	Tanzania Limits
Government securities	100	36	80	72	20-70
Bank deposits	30	3	30	3	35
Corporate bonds	20	4	30	1	20
Equity	70	19	70	15	20
Real estate	30	21	30	5	30
Private equity	10	<1	15	2	5
Other			5	2	
Guaranteed funds	100	13			
Offshore	15	1			
REIT	30	<1			
Direct loans to government					10
Private debt	10	<1			5
Infrastructure					25
CIS					30

Source: The data is drawn from the regulators website, specifically the provisions pertaining to investment regulations, as well as actual industry-wide allocations for Kenya and Uganda (from their regulators' annual reports).

Note: CIS = collective investment scheme; and REIT = real estate investment trust.

From the investment allocations listed in Table 6, some broad observations can be made:

- Tanzania maintains a much lower limit for equity than the other countries. However, it allows for other types of asset class investments, for example, direct loans to government, and infrastructure. These investments are aligned with the investment policy direction for long-term funds to be available to support the country's development.
- Kenya's limit is set at 100 percent, but only 36 percent of funds are invested in government securities. By contrast, in Uganda, the limit is 80 percent, with the actual allocation to the asset class standing at 72 percent.
- Kenya has a higher exposure to real estate investments than Uganda, with 21 percent compared to 5 percent in Uganda. The prescribed limit for both countries stands at 30 percent.

In Kenya, over time, the regulator has also introduced other categories in a response to market movements, as well as a bid to spur market development. The introduction of the new asset classes, for example, private equity, infrastructure and possibly derivatives, has not been successful. It should also be noted that in a number of cases — with the exception of the property asset classes where there is push by schemes to take more exposure — the funds have not reached the limits.

Investment Knowledge and Access to Professionals

The managing of investments and the investment management process are technical skills that need to be developed both by the service providers, as well as for the trustees who are charged with oversight. The past few years have seen an increase in the number of investment professionals, with the number of qualified Chartered Financial Analyst (CFA) Charterholders now estimated at over 140. These professionals are now represented in each of the East African countries, with a larger number in Kenya. However, even with the increased numbers,

very few are employed by pension regulators, pension fund management houses or capital market firms.

The knowledge gap is even wider for trustees who are charged with the mandate of overseeing the investment process. Some trustees do not even have personal exposure to investments in the capital market related to assets. Thus, some may have a bias for land or property, areas where they tend to have personal knowledge. The risk and return focus for trustees also tends to be short term, which is usually the investment bias for the individual seeking capital preservation.

Training and development of technical skills must be an essential part of the policy agenda for regulators across the region. In Rwanda, the government has encouraged a policy whereby individuals are promoted based on obtaining professional qualifications. To encourage the acquisition of these qualifications, employers sign up to sponsor training offered by the Association of Chartered Certified Accountants (ACCA) for professional accountants and Chartered Financial Analysts (CFA) for fund managers and research analysis. The training in areas such as administration and custody are largely left to the service providers and tend to be done in-house. The cost for such training remains significant for these firms, and constant job mobility increases the associated costs.

In Kenya, following the introduction of a five-day program on the retirement industry that seeks to provide trustees with an overview of their fiduciary role, experience shows that trustees struggle with the investment concepts. To address this issue, across the region, the majority of service providers also offer trustee education as part of their services, either free or for additional cost. This process has introduced a minimum basis of knowledge for trustees. The vetting process adopted in other countries only provides a minimum of education, qualifications, experience and certified training before sign-off by the regulator. This experience is not necessarily pension-related. Thus, the gap in knowledge remains a key concern.

Performance Measurement and Reporting

The main objective of retirement fund investing should be to generate adequate risk-adjusted returns. Specifically, returns alone are not the overriding, binding consideration. Rather, one must understand the degree of risks being taken by the fund manager in generating returns. In this context, performance measurement remains an area devoid of independent verification, and trustees must rely on the fund manager's report.

The Chartered Financial Analyst Institute has introduced minimum guidelines for compliances with Global Investment Performance Standards (GIPS).⁸⁰ The GIPS are designed as voluntary standards, but they have adequate depth to address most of the challenges pertaining to investment performance reporting and monitoring from the perspectives of both the asset owners and the regulators. Policymakers need to be educated about these standards, and consider their application in their individual markets, given country nuances. At a minimum, an effort should be made to adopt a policy that ensures that performance measurement reporting is done in a consistent manner that allows for some degree of comparison and standardization across funds and asset classes. The GIPS recognizes that moral suasion by regulators — either by key retirement fund trustees, insurance firms, and so on — will influence the fund manager community. The local CFA Society for East Africa is undertaking an education initiative for regulators and key stakeholders regarding the benefits of GIPS in East African markets as part of its ongoing advocacy efforts.

In the current form, a comparison of investment returns across East Africa would be difficult. For example, the results would not be comparable when examining the National Social Security Fund in Kenya, whose larger assets (government bonds) are priced on marked to market basis and the National Social Security Fund in Uganda, which values government bonds on hold to maturity. To take another example, the equity portfolio of the

Rwanda Social Security Board (RSSB) would not be comparable to the other countries, given the low depth in equity markets in Rwanda and higher exposure to private equity. For Tanzania, the comparisons would need to allow for direct loans to government and infrastructure, which are not common in the other regions.

Asset Allocation

The readily available asset classes for investors in the East Africa region can be broadly categorized as cash and cash deposits, equities (listed and unlisted), fixed income (government and private) and property. This section will examine these securities broadly, including the manner in which these investments are being undertaken in the region.

Cash and Cash Deposits

The old adage that “cash is king” is prevalent in the mind of retirement fund trustees. The perceived security of cash, despite the low interest rates offered by banks, remains pertinent. There are stories of deposits being held with preferred banks to shore up liquidity, or to obtain favorable loan rates for members and in some cases the employer.

In a majority of cases, the fund managers are able to conduct due diligence and negotiate more favorable rates than those offered to individual trustees. Clearly, there is a need to hold liquid assets, but this needs to be supported by an adequate understanding of the cash flow needs of the fund into the future, thereby avoiding a drag on investment returns. Indeed, the whole purpose of investing retirement assets is to generate a reasonable investment return.

Equities (listed and unlisted) and Securities

The securities markets in the region have seen an improved position over the past decade. The Nairobi Securities Exchange (NSE) in Kenya remains the most active. Despite the large value

of assets under management, the largest players in the NSE remain foreign investors. This is because local investors remain averse to the volatility in stock prices. It is only through persuasion that some exposure is taken in the stock markets. Allocations to securities is particularly touchy during election periods. However, based on past experience, the stock prices drop during this period and rebound thereafter, making it a good time to invest.

Private equity deals are continually reported in the East Africa region. Like stocks, the bulk of participation is by foreign investors seeking exposure to the regional markets — not local institutional investors, such as retirement funds. In developed markets, retirement funds are key investors in private equity given the longer-term nature and attractive return potential.

There is no need for further market regulation, but trustees need to have a clear understanding of the long-term nature and stability of liabilities involved in the investment in equities. Experience in East Africa shows listed equity allocations in the range of 0 – 30 percent, with private equity being less than 5 percent of retirement fund assets. In developed markets, the allocation to both local and offshore equity markets is higher as retirement funds seek the capital appreciation and dividend income available from this asset class.

Debt (Government and Corporate) Securities

The bulk of retirement industry assets, currently estimated at over 70 percent on average across the retirement industry, continue to be held in debt securities with the government. This is because the interests on offer are attractive, and these investments are also considered risk free. The perception of “risk free” is one that is continually being evaluated and does not mean the complete absence of risk.

The Kenyan government issued a Euro bond, with an impressive subscription. However, it continues to show significant price volatility on the international

market. This is an indication of the perceived risk level associated with the country — mainly due to its politics. Also, it is important to note that the Euro bond issue was open only to international investors.

The market has had negative experience with corporate securities, with firms either defaulting, seeking to renegotiate and/or refinance following a rapid expansion drive or failed business strategy. In some cases, the pricing of the corporate debt does not reflect the interest rate margin that would be commensurate to the risk being taken. Such experiences and the subsequent risk aversion (particularly by retirement fund trustees) have led investors to stay away from corporate securities. The resultant cost for corporate management to convince the market to invest in any firm through debt, as well as the high mark-up on the potential interest margin demanded by the fund managers, has increasingly caused corporate firms to focus on bank borrowing or equity to raise capital for their businesses. Again, this is a lost opportunity for local retirement funds to participate in the economic growth of the region.

Property

From a primal instinctual level, there is a strong desire to own property (land) directly as part of the average East African citizens’ investment dream. This motivation does not change when one becomes a trustee/director of a retirement fund. Further, the property prices in the region have continued to experience price inflation, with some individuals making huge returns from either the sale of land or development of properties.

For retirement funds, the investment in property has been largely focused on land as well as commercial and residential developments. The older, more established retirement funds also inherited significant property portfolios that had been in place before the capital markets became an attraction.

The investments are largely held for the long term and are not for sale in most cases. This suggests

that the return from the investment in properties is largely limited to the rental yield, which ranges from 5-9 percent, depending on the actual property. In this context, it is important to note that higher returns are possible when the investment is sold, and capital gains are realized.

A variety of investment risks are evident. Examples include fraudulent transactions, ownership disputes, location and zoning changes, and limited liquidity (especially during times when GDP is contracting). These and other risks need to be considered when making investments. As such, in comparison to the risk-free rate proxy, treasury bill rates offer higher returns in some instances. There is also a clear disconnect that suggests that property investment is not necessarily a rational decision. Rather, it is driven more by the desire to own a tangible asset that is perceived to be risk-free.

Conclusion

Definite similarities and differences emerge in the East Africa region retirement industry. However, in terms of investments, the firms remain largely allocated in similar assets. At present, the bulk of investments by pension funds are largely placed in the home country, with minimal investment across partner state economies. The asset class location is very country specific, despite the potential regional allocation benefits that would accrue if pension funds would invest in the EAC region. From the pension regulator perspective, there is a recognition of the EAC region as a similar destination, but this has not been borne out in the actual fund allocation and investments. Therefore, there is a need to educate and encourage fund trustees to diversify into other asset classes (as well as EAC countries) not only to manage risk, but to enhance their long-term returns.

As demonstrated, there is a clear need to have more products and solutions available for investment by pension firms. The available range is currently limited, which means that all retirement funds are competing for the same securities. In some cases, for example, the securities markets have seen

artificially high prices driven by supply and demand forces. The stock exchanges in the region need to address the reasons why there is limited appetite for listing by private firms seeking to raise capital. It is possible that this is due to the stringent listing requirements, although as has been demonstrated at the NSE, even the introduction of the over-the-counter equity platform has not seen an increase in uptake. Thus, there is a clear need to bridge the gap between private firms seeking capital and their reluctance to come to market.

On the product side, very little innovation has taken place in introducing new investment capabilities to the market. The attempts to introduce product capabilities such as private equity funds, Sub-Saharan market funds and such have not been successful with retirement funds. This has largely been due to a lack of adequate knowledge (awareness) by the trustees. As such, they fear taking a risk and investing in such product. However, some trustees also perceive these as foreign products, and would prefer home-grown solutions.

In these markets, there have been opportunities to fund tenders, which could be large government or private sector out-sourcing of projects in need of financing. This represents a home-grown version of project funding, whereby the pension fund takes on project-related risk for businesses that are not infrastructure related. Some areas currently seeking funding include housing and infrastructure, such as university hostels and road construction. Looking back at the early banking environment, products such as Limited Public Offering (LPO) financing were not available in the formal sector. However, this is now considered a common business practice. The challenge to firms therefore is to find an appropriate vehicle by which to avail such opportunities to investors.

Legislative and policy reforms should be considered as they do not seek to over-regulate and increase the cost of doing business. Although the markets are linked, there is room to take advantage of changes in yield curve (based on a given monetary policy in a country), foreign exchange movements, and/

or share prices. Unfortunately, the costs are quite prohibitive. Also, not many market makers have a presence in the various countries, which introduces counterparty risks. To address this, there is a need to review the costs of cross-border transactions, taxes and legal charges.

Currently, the majority of pension funds in the region operate as segregated mandates, meaning that they are stand-alone schemes. In other markets, the fund managers offer pooled funds and sign pension fund mandates based on capability. This shifts the marketing focus to fund managers, who are responsible for looking at investment mandates, strategy and returns associated with a given execution and/or skill.

From an investor perspective, having segregated mandates also creates a situation in which the trustees focus on security selection, leaving space for trustees' personal views and biases to distract from the investment process and longer-term goals. Any policy reform that encourages the allocation of assets to fund managers based on capability will enable the pooling of assets which can then be directed to investment.

Fund manager fees are determined based on assets under management. Given the segregated mandates, the manager must compete for business and negotiate prices separately with each retirement fund. There has been a reduction in fee rates applied

despite the growth in assets, as firms compete for business mainly based on price strategy. These price wars are not unique to fund managers. Indeed, they apply to all other service providers in the industry as well. By encouraging pooled assets, there may be space to have passive funds that support this low-price margin. At the same time, this would allow for investment managers to create other pooled funds to target more aggressive returns. It is possible that having pooled funds will also help address concerns about the constant reduction in fees paid to fund managers, thereby shifting the focus from fees to evaluating the fund manager's capabilities (mandate size, risk and return considerations) for each asset class.

The outlook and opportunities for pension sector growth in the region remain optimistic. Certainly, the investment process and asset allocations will play a significant role in the deployment of assets the issues preventing further diversification into different asset classes is not due to limitations imposed by regulations. The regulatory framework is broad enough and provides flexibility to any fund manager to take exposure in the available assets. However, as demonstrated, the issue is the lack of market knowledge and the short-term focus of trustees, and the increased pressure on fees. This causes firms to adopt less intense investment activities, given high government security returns for lower risk. The result is a crowding out of other asset classes.

CHAPTER 6

EAST AFRICA'S EXPERIENCE WITH RETIREMENT SCHEMES FOR THE INFORMAL SECTOR

- Joseph Lutwama -

Introduction

This chapter explores the challenges and opportunities of extending pension coverage to the informal sector from an East African perspective. The informal sector dominates the economies of East African states. However, to date, pension coverage has been limited to the formal sector. Therefore, it is critical to devise strategies to extend pension coverage to the majority of the population in East Africa. This is not without its challenges. However, the informal sector also presents unique opportunities that can be leveraged to ensure the futures for most East Africans.

The analysis and discourse focus on four countries, including Kenya, Rwanda, Tanzania and Uganda. This chapter is divided into three sections. The first discusses the concept of the informal sector and analyzes the extent of the informal sector in East Africa. The second section analyzes the state of pensions in East Africa, focusing on the extent of pension coverage for the informal sector. The third and final section presents the key considerations involved if pension coverage for the informal sector is to increase in East Africa.

Understanding the Informal Sector

Informality can be viewed according to three different perspectives: the firm's perspective (productivity view); the employee's perspective (the social protection view); and the regulatory perspective (Oviedo, Thomas and Karakurum-Ozdemir 2009). The firm's perspective focuses on the legal status of the firm, for example, whether it

is registered. The employee's perspective focuses on the contractual obligations of the employee, that is, whether they have a formal employment contract with attendant employment benefits. The firm and employee perspectives are interconnected in the sense that one can be informally employed in the formal sector, that is, where a formal registered firm employs workers without formal contracts and employment benefits.

The regulatory perspective focuses on the extent to which both firms and individuals comply with regulations. This perspective can be regarded as a sub-set of the firm perspective because in most cases it is the unregistered firms that are more likely not to comply with the law. The International Labour Organization (ILO) (International Labour Organisation 2018) provides a detailed framework on measuring the size of the informal sector using the firm and employee perspectives.

Thus, how the informal sector is defined will depend on the perspective in which informality is discussed. In this chapter, emphasis will be placed on the firm and employee perspectives. Indeed, the main focus will be the extent of pension coverage of the informal sector, which is affected by both informal firms and informally employed workers.

The State of Informal Employment

Two billion (61.2 percent) of the world's population above the age of 15 is estimated to be informally employed (International Labour Organisation 2018). Africa has the highest level of informal employment, with an estimated 85.8 percent of

the total African population above the age of 15 informally employed (International Labour Organisation 2018). In East Africa, informal employment levels are equally high at 91.1 percent of the total African population above the age of 15. (International Labour Organisation, 2018). Among the four focus countries, Uganda has the highest informal employment levels at 93.7 percent. However, all the focus countries also have informal employment levels above 90 percent (Figures 12 and 13). (International Labour Organisation 2018).

Pensions and the Informal Sector in East Africa

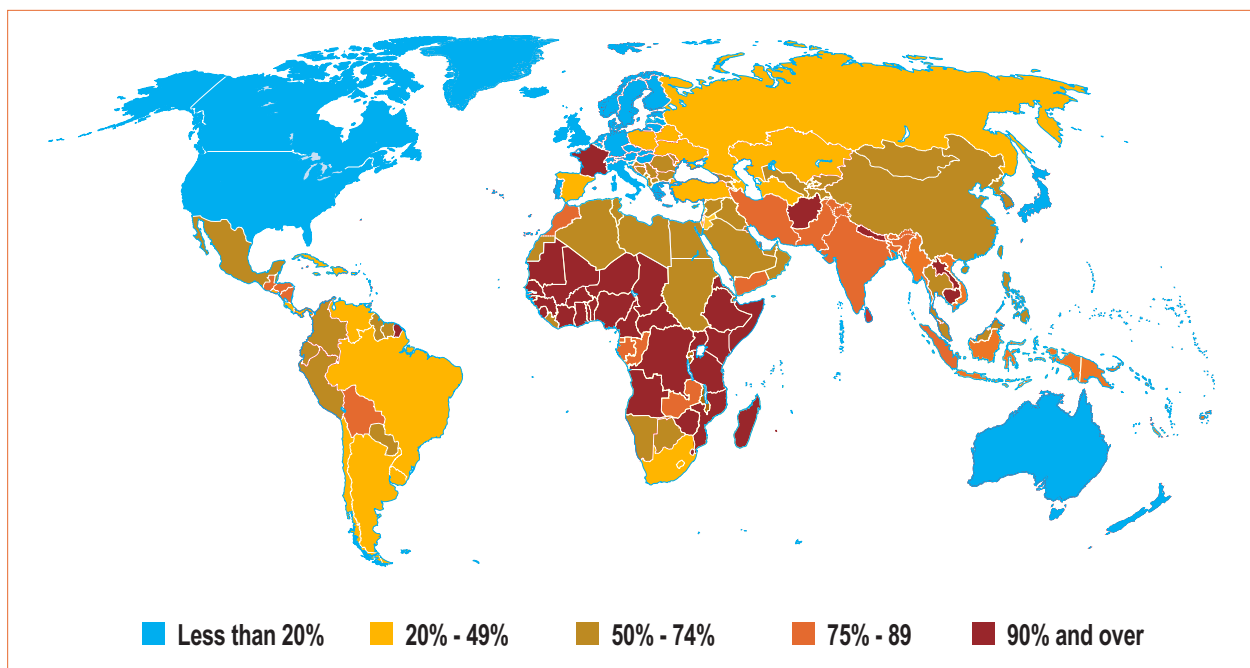
In analyzing the state of pensions and the informal sector in East Africa, the myth that the informal sector is synonymous with poverty needs to be debunked. When extending pension coverage to the informal sector, this does not mean pensions for the poor. The informal sector is heterogenous, with different income levels ranging from the poor to the rich. Some choose to be informal not because

they are poor. There are reasons other than income levels. Thus, there is a population segment of the informal sector that have the will and the ability to save for retirement (see Figure 14). This segment should be the target for expanding pension coverage to the informal sector.

Demographics and Pensions for the Informal Sector

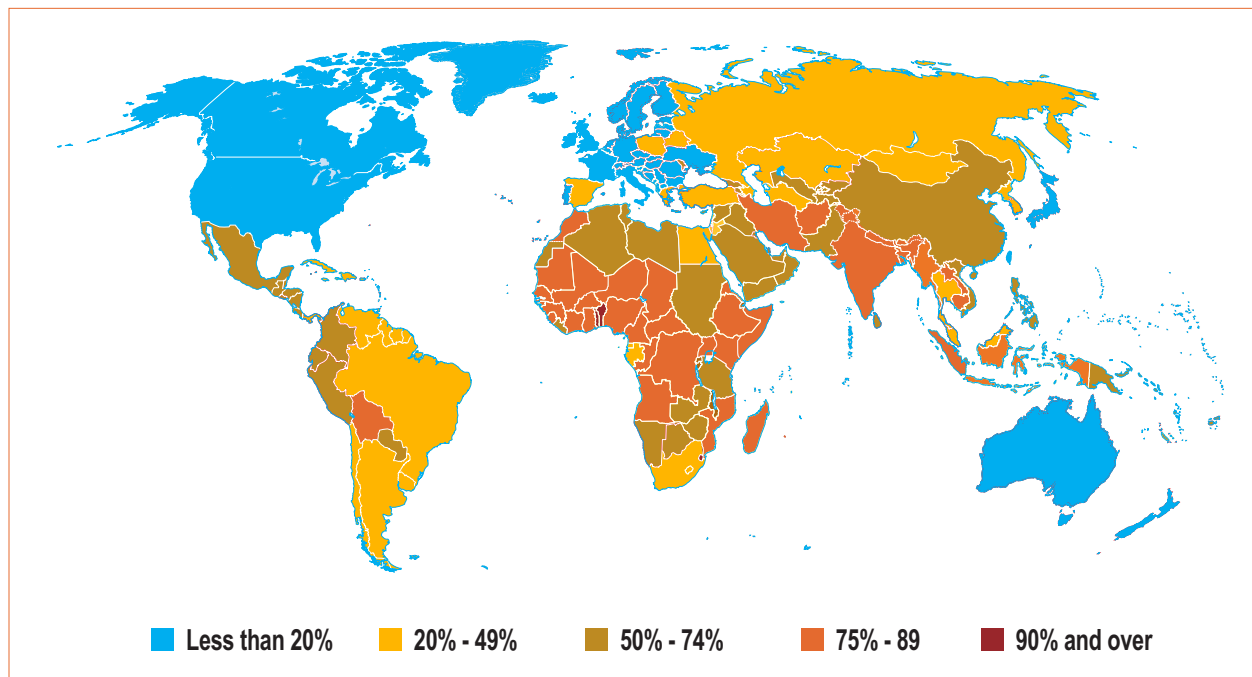
Traditionally, in the absence of formal pension mechanisms, pensions have been in the form of extended family support to the retired persons in the community. This partly explains the situation in East Africa. With high fertility rates, families had to hedge their bets for retirement because the mortality rates were also high. Therefore, if one had a large family — and even if some of the children died before they retired — they still had some remaining children to take care of them in their retirement. This system worked well so long as the life expectancy at birth was low and the fertility rates were high.

Figure 12: Share of Informal Employment, Including Agriculture, 2016 (%)



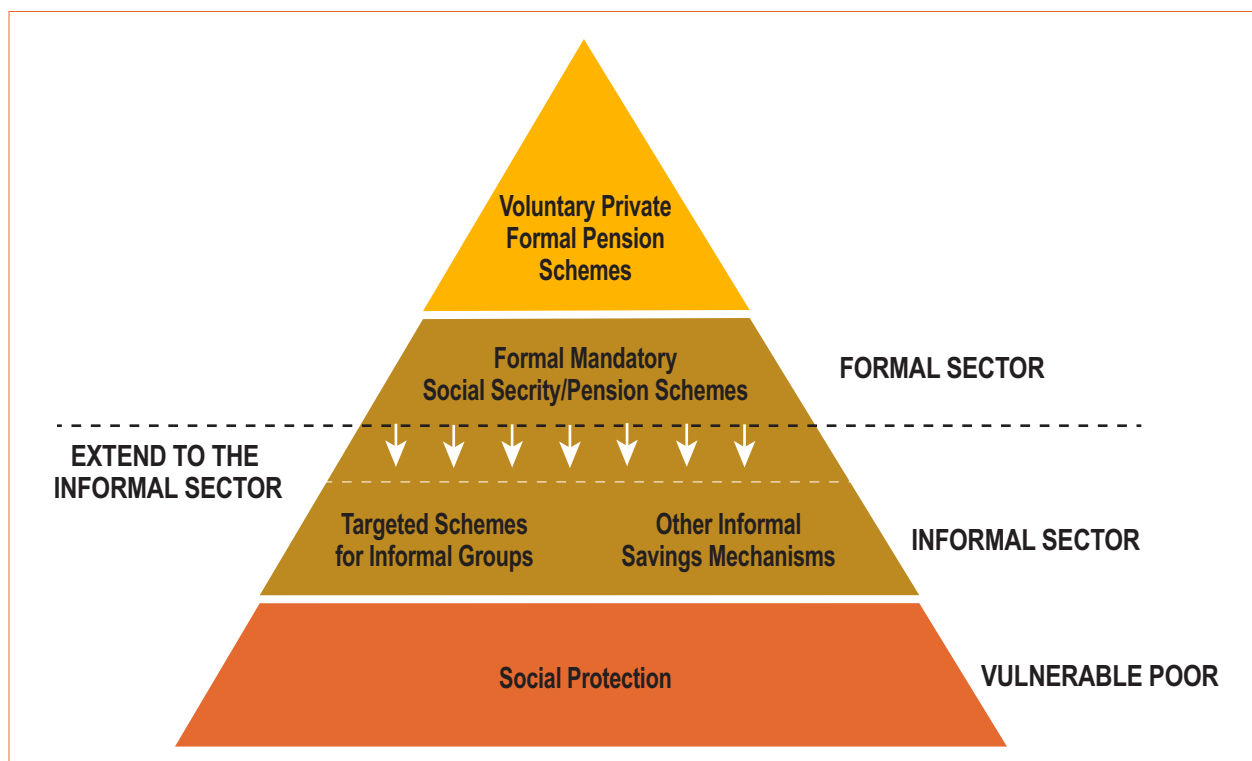
Source: (International Labour Organisation 2018)

Figure 13: Share of Informal Employment, Excluding Agriculture, 2016 (%)



Source: (International Labour Organisation 2018)

Figure 14: The Labour Force Pyramid

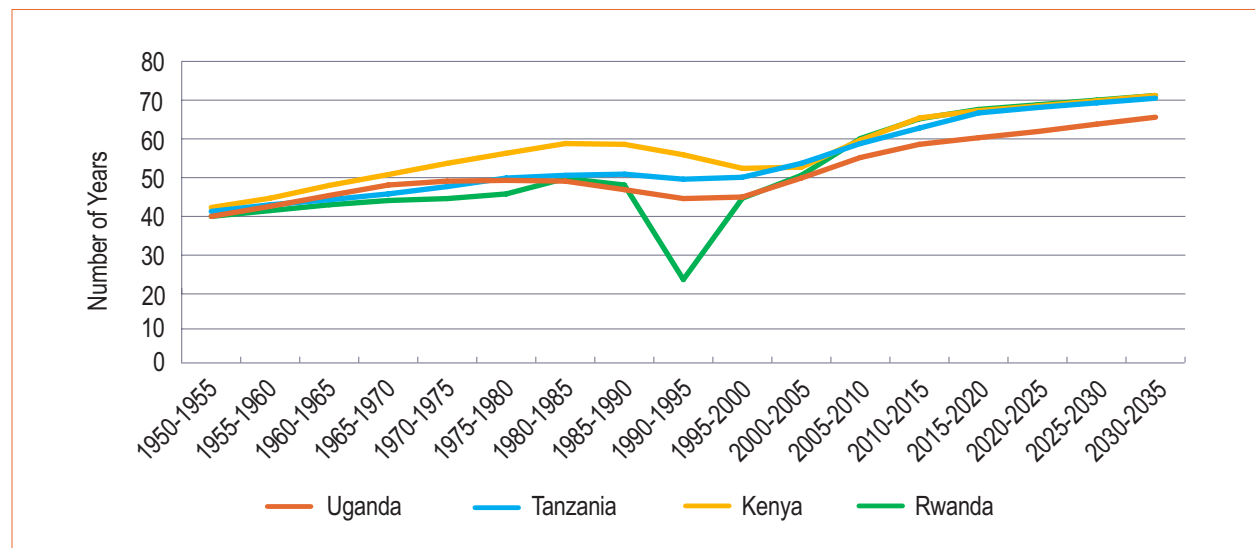


Source: World Bank

This meant that there would be fewer old people to care for, and enough children to take care of them. However, the rising life expectancy at birth (Figure 15) and the declining fertility rates (Figure 16) threatens the status quo and places old people at risk of poverty.

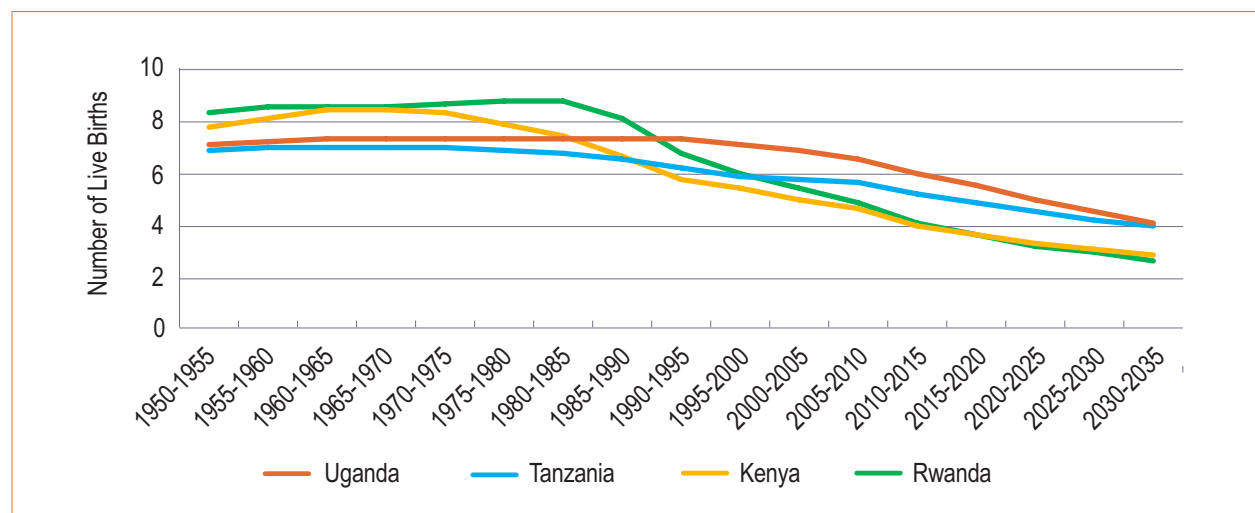
Developing innovative and creative pension mechanisms for the informal sector which account for the largest proportion of the East African economies is a key priority. Such pensions will greatly minimize the potential risk of old age poverty arising from the shifting demographics.

Figure 15: Life Expectancy at Birth (Years)



Source: United Nations data. <http://data.un.org/Data.aspx?d=PopDiv&f=variableID%3A54> accessed on 14/11/2018

Figure 16: Fertility Rates (Live Births per Woman)



Source: United Nations data. <http://data.un.org/Data.aspx?d=PopDiv&f=variableID%3A54> accessed on 14/11/2018

State of Pension Coverage in East Africa

Kenya has by far the largest number of pension schemes in East Africa, most of which are voluntary occupational pension schemes (Table 7). All East African countries except Rwanda have a pension scheme targeting workers who are self-employed or who work in the informal sector (Table 7). In this context, it should be noted that the government of Rwanda is working on a national pension scheme for the informal sector which will be partly subsidized by government.

In terms of workforce coverage, Kenya still leads the other East African countries with a coverage ratio (that is, workers covered/total labor force) of 20 percent (Table 8). Tanzania and Rwanda have the lowest coverage ratio at 10 percent (Table 8).

Increasing the Pension Frontier to the Informal Sector

There is an opportunity to restart the pension system in East Africa so that it can meet the needs of workers in the informal sector. The formalization of the East African society is likely to take time, which means that informality will continue to be a major part of the East African economies. Therefore, it makes more sense to adapt the formal pension system to the conditions and needs of the informal sector.

Table 8: Coverage Ratios of Pension Schemes across Selected East African Countries

Country	Coverage Ratio (%)
Kenya	20%
Tanzania	10%
Uganda	14%
Rwanda	10%

Sources: (Uganda Retirement Benefits Regulatory Authority, 2017), (East African Pension Supervisors Association 2017)

Mismatch between the Formal Pension System and the Informal Sector

Formal pensions systems dominate the East African pension landscape (Table 7). However, these pension systems are limited in design, making it difficult to meet the needs of the informal sector. There are five fundamental aspects that need to be addressed if the current formal pension systems are to extend their frontiers to the informal sector. These are the irregularity of identification; income variability; contribution matching and incentives; a lack of access to financial services infrastructure; and preservation. Each of the fundamentals will be discussed in turn, including how they relate to the East African economic landscape.

Table 7: Types of Pension Schemes across Selected East African Countries

Country	Mandatory Schemes	Voluntary/Occupational Schemes	Informal Sector Schemes
Kenya	1	1,302	1
Tanzania	7	7	5
Uganda	2	61	2
Rwanda	1	2	1

Sources: (Uganda Retirement Benefits Regulatory Authority 2017), (National Bank of Rwanda 2017).

Identification

Identification is at the heart of formal pension systems. Given their long-term nature, an authentic and uniform identification system is critical to minimizing potential fraud in the pension systems. Therefore, in countries where there is no uniform national identification system, the formal pension system is unworkable outside of the formal workplaces which have recognized identification documents. All EAC countries have a national ID system, albeit at different levels of development (Table 9). Furthermore, all EAC countries, with the exception of Burundi, have digital national ID systems (table 9). These systems provide a good foundation for extending formal pensions to the informal sector.

Despite having national ID systems in place, the proportion of the adult population with a national ID varies from country to country. Kenya and Rwanda have registered the highest proportions and South Sudan has registered the lowest (Table 10).

Most EAC countries have made progress toward digital national identity systems. However, much more needs to be done to establish electronic Know-Your-Customer (E-KYC) systems. E-KYC is a process in which approved entities query a digital (and usually national) ID system to authenticate or verify their customers' identities and, in some cases, retrieve basic information about them.

Most financial institutions within EAC countries still rely on paper-based KYC procedures, which can be very cumbersome and plagued with many errors and risks. These challenges are further amplified if these financial institutions are looking at extending their services to the informal sector which has its own challenges with record keeping.

Financial institutions face a number of challenges with a paper-based KYC system⁸¹:

- A single KYC view of a customer may not be available within the various departments of a financial institution because such physical documents may be restricted to a particular department.

Table 10: Proportion of Adult-Population with a National ID

Country	Percent
Kenya	91
Rwanda	91
Tanzania	77
Uganda	81
South Sudan	21

Sources: World Bank data at: <http://id4d.worldbank.org/global-dataset> accessed on 22/05/2018. <https://www.ippmedia.com/en/news/22m-tanganyans-will-have-received-national-identity-cards-dec-2018> accessed on 22/05/2019

Table 9: Status of the National Identification Systems in the EAC

Country	National ID System	Mandatory Age	Digitized ID System	Fingerprint and/or Iris Biometrics Collected
Burundi	Yes	16	No	No
Kenya	Yes	18	Yes	Yes
Rwanda	Yes	16	Yes	Yes
South Sudan	Yes	18	Yes	No
Tanzania	Yes	18	Yes	Yes
Uganda	Yes	18	Yes	Yes

Source: World Bank data at: <http://id4d.worldbank.org/global-dataset> accessed on 22/05/2019.

- Erroneous details may be updated to the system without sufficient supporting documentation.
- KYC documents can be more easily misplaced.
- The document collection process can be cumbersome and time-consuming.

E-KYC systems can improve the onboarding process by reducing or eliminating paper-based procedures and record-keeping. This also reduces the cost and time spent on verification, making it more profitable to provide services to low-income customers. E-KYC also improves on the quality of customer data and reduces the risks of identity theft and document forgery.⁸²

Regularity of Incomes and Contribution Matching

Most formal pension schemes are designed to account for regular incomes and matching of pension contributions by employers or governments. The employees usually make regular monthly pension contributions, which are then deducted from their salaries. These employee contributions are also usually matched by contributions from the employers. The employer's contribution acts as an incentive to the employee. The automatic deductions and matching employer contributions make saving for retirement easier and more accessible.

By contrast, many workers in the informal sector are self-employed without a stable, regular income. Finscope survey data⁸³ shows that in both Uganda and Tanzania 60 out of every 100 individuals earn their incomes from trade of merchandise, in most cases, petty trade. Incomes from trade are too intermittent to sustain contributions to a formal pension plan.

The Finscope survey data also shows that 70 out of every 100 individuals in Tanzania and Uganda who are engaged in trade have seasonal incomes. In this case, access to retirement savings becomes a major challenge because the incentives and automatic

deductions applied in the formal sector become almost untenable. It is also more challenging to deduct retirement savings from one's income rather than having the employer do so. In the latter case, the impact of the deduction is not as impactful as in the former case.

Access to Financial Services Infrastructure

Access to financial services infrastructure is another critical factor in the provision of formal pension services. Most pension contributions are paid by employers and sent directly to the bank. This makes retirement savings mobilization more efficient and less costly. In a scenario where most potential pension customers do not have access to a bank account, as is the case in the informal sector, retirement savings mobilization becomes more difficult and costlier.

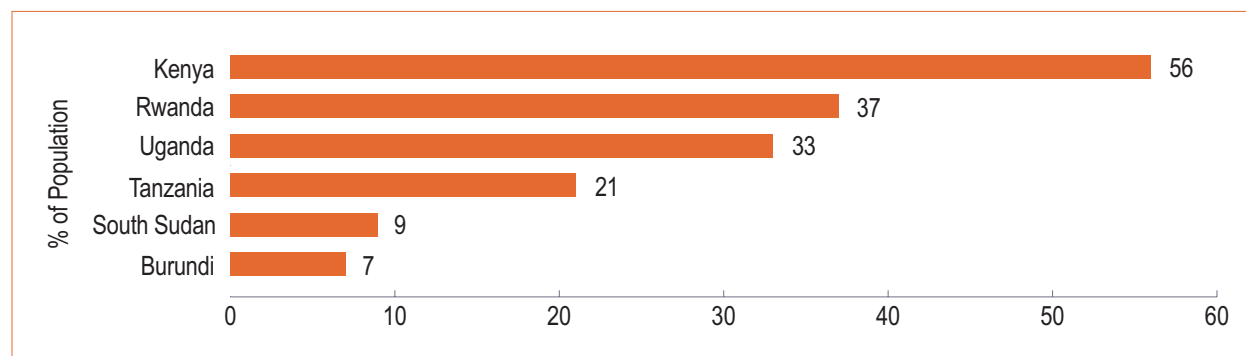
In all the EAC countries, with the exception of Kenya, less than 5 of every 10 adults have access to a financial institution account (Figure 17). However, more East Africans have access to a mobile money wallet (Figure 18).

Currently, more than 5 out every 10 East Africans own a mobile phone (Table 11) there is a huge potential of leveraging the mobile phone to increase access to pension products and promote retirement savings.

Preservation of Retirement Savings

Pensions require that one's retirement savings only be accessed in retirement, usually 20 to 30 years from the time that retirement contributions are made. This is possible for formal employees who have disposable income to make regular pension contributions over the long-term. Such workers can afford to save money for the long-term because they have sufficient income to meet their short- to medium-term needs.

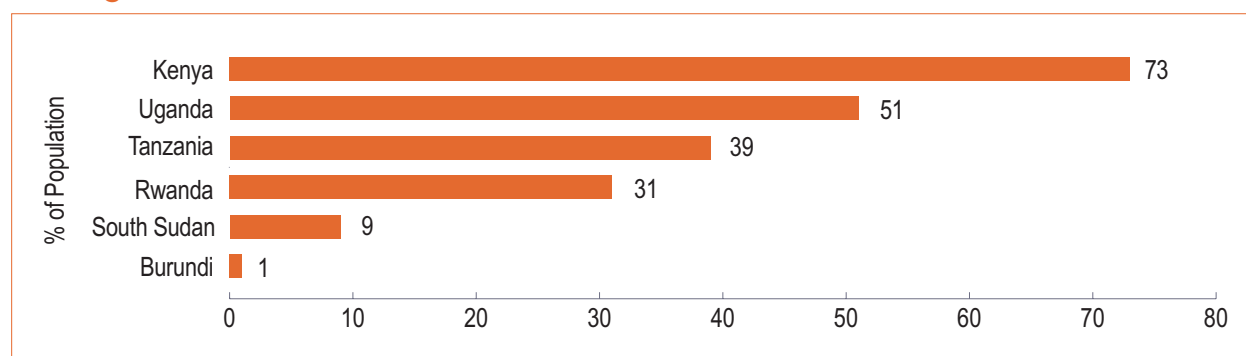
Figure 17: Proportion of Population (aged 15+) with a Financial Institution Account, 2017



Source: Global Findex Database 2017

Note: The figures for Burundi are from the 2014 Findex Survey.

Figure 18: Proportion of Population (aged 15+) with a Mobile Money Wallet, 2017



Source: Global Findex Database, 2017.

Note: The figures for Burundi are from the 2014 Findex Survey.

Table 11: Proportion of Adult Population (aged 16+) who Own a Mobile Phone

Country	Percent
Kenya	79
Rwanda	47
Tanzania	64
Uganda	54

Source: http://finclusion.org/data_finder/ accessed on 22/05/2019

Note: The latest date for Kenya, Tanzania and Uganda is from 2017, and the data for Rwanda is from 2015.

Apart from a few informal workers and entrepreneurs with stable incomes and cashflows, many self-employed workers in the informal sector do not have the luxury of being able to save for the long-term. For some, what they earn is insufficient or barely enough to meet their short-term needs. For example, instead of putting money into a pension scheme be accessed 10 to 20 years later, these informal workers may spend that money to meet the education expenses of their children or a medical emergency. Findings from the FinScope surveys indicate that meeting daily expenses is the major purpose for savings across all East African countries (Tables 12 and 13).

Table 12: Purpose of Savings, Tanzania

Purpose	Number	Percent
Living expenses (when there is no money)	5,675,915	45
An emergency (other than medical)	2,345,608	18
Medical expenses (either planned or emergency)	1,331,451	10
Education or school fees	794,688	6
Retirement or old age	106,991	1
Others	2,492,684	20
Total	12,747,338	100%

Source: Finscope, Tanzania, 2017 Survey Data.

Table 13: Purpose of Savings, Uganda

Purpose	Number	Percent
Support regular expenses	3,635,831	37
Support unexpected expenses	2,598,102	26
Business purposes	872,767	9
Farming/fishing purposes	772,298	8
Support for old age	65,332	1
Other	2,011,246	20
Total	9,955,576	100%

Source: Finscope, Uganda, 2018 Survey Data.

Case Studies of Informal Pension Schemes in East Africa

Mbao Pension Plan of Kenya⁸⁴

The Mbao Pension Plan is a voluntary retirement savings plan, mainly targeted to the informal sector employees who have no access to occupational pension schemes. This pension plan was established in 2009 as an Individual Pension Plan (IPP), and it is open to all Kenyans above the age of 18 who either have a National ID or a passport.

The scheme is registered by the Retirement Benefit Authority (RBA) and enjoys tax exemption status from the Kenya Revenue Authority. The retirement benefits are not taxable at the point of exit, unless they exceed the maximum exception taxable limit of KShs 20,000 (US\$ 200) per month, and up to KShs 240,000 (US\$ 2,400) per year.

The Mbao Pension Plan is distributed and managed through the mobile money platforms of the two largest mobile telecommunications operators in Kenya: Safaricom and Airtel. As the corporate fund trustee, the Kenya Commercial Bank (KCB) is the legal owner of the scheme. The Co-Trust Investment Services Limited, a subsidiary of Cooperative Bank, serves as the fund manager, and Eagle Africa Insurance Brokers serves as the fund administrator.

The retirement savings contributions can be made on a daily, weekly, fortnightly, monthly, quarterly, seasonally, or yearly basis, according to the decisions of the members. The member also determines the amount to save. The minimum savings is KShs 20 (US\$ 0.20cents) per day, KShs 500 (US\$ 5) per month and KShs 6,000 (US\$60) per year. There is no maximum or ceiling on savings. Furthermore, there are no penalties in case of default. Members are encouraged to save promptly. The benefits are accessible after a minimum of 3 years, 10 years, 15 years, 30 years, and so on, depending on the age of a member at entry.

As of March 2018, the Mbao Pension Plan had 100,000 active members with a fund value of

US\$ 1,342,000⁸⁵. The target is to cover 50 percent of the informal sector by 2030⁸⁶.

The low uptake and levels of awareness about the Mbao Pension Plan remain the biggest challenge of this scheme. With an estimated informal population of 12 million, the current active membership of 100,000 amounts to just 1 percent penetration. This challenge partly stems from the limited capital base of the scheme, impacting its ability to finance a massive growth plan. The other major challenge of the scheme relates to the high cost of administration. Proposals to address these issues and potentially other micro-pension schemes are currently being considered by the Kenyan authorities.

Mazima Voluntary Individual Retirement Benefits Scheme (MVIRBS) of Uganda

The Mazima Voluntary Individual Retirement Benefits Scheme (MVIRBS) was one of two voluntary individual pension schemes licensed by the Uganda Retirement Benefits Regulatory Authority (URBRA) in 2016. The other scheme is the Kampala City Traders Association (KACITA) Retirements Benefits Scheme. The primary objective of these two schemes is to increase the access of informal sector employees to formal pensions (Financial Sector Deepening Uganda 2017).

Mazima was established as a not-for-profit entity and an irrevocable trust. Accrued contributions are invested according to the asset allocation benchmark stated in the trust deed. The MVIRBS has a flexible retirement savings contribution plan with no penalties for inconsistent contributions. All that is required for an individual to enroll in the MVIRBS is payment of a registration fee of UGX 10,000 (US\$2.70). The next requirement is to make a regular contribution of as little as UGX2,000 (US\$0.50 cents) a day or UGX 10,000(US\$2.70) per week — with no upper limit on contributions (Financial Sector Deepening Uganda 2017).

The recommended withdrawal age is 50, although the scheme permits early withdrawals after one year from the initial contribution. Like all the other

pension schemes, the MVIRBS is also governed by licensed pension fund trustees and managed by a licensed pension fund manager and custodian.

The MVIRBS has also partnered with the biggest mobile telecommunications company, MTN Uganda; one of the largest microfinance institutions, Pride Microfinance; and one of the largest insurance companies, Britam, to distribute its pension plans and increase access to its products.

To date, the MVIRBS has a total of 1,900 members, with cumulative savings amounting to UGX 1.3 billion (US\$ 352,625). A total of Ushs 250 million (US\$ 67,812) has been paid to members. Like the Mbao Pension Plan in Kenya, the single biggest challenge is low uptake and awareness. The current membership is 1,900 members and the penetration level for the informal sector is well below 1 Percent. The low capital base of the MVIRBS and a weak distribution network partly explain this predicament. If the MVIRBS is to scale up and increase its penetration rate within the informal sector, it will need to address the high administration costs to make it more affordable and accessible.

The Long-Term Savings Scheme (EJO HEZA) of Rwanda

The Long-Term Savings Scheme (LTSS) of Rwanda is the most recent addition to the pension schemes targeting the informal sector in East Africa.

Launched in December 2018, it is a voluntary defined contribution pension scheme sponsored by the government of Rwanda and established by law⁸⁷. It is managed by the Rwanda Social Security Board (RSSB) and covers both formal and informal sector workers. The primary target market is those Rwandese who previously could not access retirement savings because they did not belong to an employer sponsored pension scheme.

The members of this scheme can only access their retirement savings when they reach the age of 55. However, a member of this scheme is permitted to take a lien of up to 40 percent of his/her pension amount to access a housing mortgage or education loan from a bank or financial institution (Ministry of Finance and Economic Planning 2018). Members can also access up to 25 percent of the accumulated savings in their pension accounts to meet their liquidity needs (Ministry of Finance and Economic Planning 2018).

To encourage uptake of this product and to build a culture of savings for retirement, the government of Rwanda has provided incentives for different categories of members to this pension scheme for the first three years of enrollment (Ministry of Finance and Economic Planning 2018) (Table 14).

There are four categories based on the cultural community support structure, “Ubudehe⁹³”. Members in categories 1 to 2 who have each saved

Table 14: Government Incentive Structure for the Long-Term Savings Scheme, Rwanda

Ubudehe Categories	Subscriber Eligibility Minimum Amount per Year	Government Co-contribution Ceiling	Government Co-contribution (%)	Life Insurance	Funeral Insurance
Categories 1 & 2	RwF 15,000	RwF 18,000	100%	RwF 1,000,000	RwF 250,000
Category 3	RwF 18,000	RwF 18,000	50%	RwF 1,000,000	RwF 250,000
Category 4	RwF 72,000	-	-	RwF 1,000,000	RwF 250,000

Source: (Ministry of Finance and Economic Planning 2018) Note: Ubudehe refers to the long-standing Rwandan practice and culture of collective action and mutual support to solve problems within a community. The Rwandese government has since adopted aspects of this culture to facilitate and promote a participatory development approach to poverty reduction in Rwanda.

at least RwF 18,000 (US\$ 16) are eligible to receive a 100 percent government co-contribution up to a ceiling of RwF 18,000 (US\$ 20) (Ministry of Finance and Economic Planning 2018). Members in category 3 who have each saved at least RwF 18,000 (US\$ 16) are eligible to receive a 50 percent government co-contribution up to a ceiling of RwF 18,000 (US\$ 20) (Ministry of Finance and Economic Planning 2018). Finally, members in category 4 who have each saved at least RwF 72,000 (US\$ 80) are not eligible for any government co-contribution (Ministry of Finance and Economic Planning 2018). However, all categories benefit from a life insurance cover in case of death in the amount of RwF 1000,000 (US\$ 1,114), as well as a funeral insurance cover of RwF 250,000 (US\$ 278) one year from signing up for the scheme (Ministry of Finance and Economic Planning 2018).

The LTSS has leveraged the local administration structure up to the village level to mobilize people to enroll in the scheme. The district, sector, cell and village leaders have been trained to lead in the mobilization of people supported by the LTSS district coordinators at RSSB (Ministry of Finance and Economic Planning 2018). The scheme has also partnered with the leading mobile telecommunications companies, banks and their agents to both receive the retirement savings contributions and to mobilize people to enroll in the scheme.

The partnership with the government and the leveraging of the local administration structures seems to be a brilliant solution to the uptake challenges facing the pension schemes in other East African countries. Therefore, it will be critical to monitor how much the government co-contributions and insurance plans will contribute to the growth of the LTSS in Rwanda.

Unlocking the Informal Pensions Puzzle in East Africa

Having considered the limitations of formal pension products in reaching the informal sector, this section will consider ways in which the informal

sector pensions puzzle can be solved. There are five aspects to consider in solving this puzzle: adoption of electronic Know-Your-Customer (E-KYC); leveraging the mobile telecommunications infrastructure; rethinking the business models of pension products; and targeted financial capability programs.

Adoption of Electronic Know-Your-Customer (E-KYC)

The adoption of E-KYC by the EAC countries will be critical in addressing the identification challenge of increasing informal sector workers' access to pensions. E-KYC makes it possible to verify and authenticate the identity of the customer remotely, without the customer being physically present. All EAC countries, with the exception of Burundi and South Sudan, have made progress toward establishing digital national identification systems. Digital identification systems are a prerequisite to having E-KYC, which is driven by technology. Pension providers who plan to leverage technology to provide digital pensions need to be able to integrate with the electronic national identity database if they are to use E-KYC to on-board new customers from the informal sector.

Leveraging Mobile Telecommunications Infrastructure

With limited access to formal financial institutions, mobile telecommunications infrastructure is going to play a critical role in increasing access to pensions by the informal sector. Most formal pension plans are designed to target individuals in formal employment, and the target customers access them through their employers. Outside the formal employment structures, however, the dynamics of access change because the formal pension providers are now directly targeting the individual customer. Therefore, pension plan providers must become innovative and creative with their distribution channels if they are to deliver their services at the lowest possible cost while still achieving a decent return on investment for their customers.

Mobile telecommunications technology presents the best possible alternative to addressing the access challenge. Data from the Financial Inclusion Insights Surveys across four East African countries shows that at least five out of every ten East Africans owns a mobile phone, with varying proportions in the individual countries. Kenya has the highest mobile phone ownership coverage, with eight of every ten Kenyans owning a mobile phone. Therefore, there is potential to deliver pension products through mobile phones. The use of mobile phones can tremendously increase pension sector coverage across the East African countries. Kenya and Uganda are already experimenting with this pension distribution model. However, it is still too early to make a judgement about the viability of this distribution model.

Rethinking Pension Business Models

To address the challenges of irregular incomes and the short-term perspective of savings prevalent in the informal sector, a rethinking of the design of the formal pension plan product/service offering will be required. The product needs to be designed in such a way that it can accommodate the seasonal income cashflows of most of the workers in the informal sector.

One possible approach that could align the pension product to the behavior of the target market is to bundle the pension plan with a product that is consumed most by the target market. In most cases, the pension product will be offered as a bonus rather than as a direct product to the customer. For example, if a microfinance bank which offers micro-credit products mainly to clients in the informal sector entered into a partnership with a pension fund manager, it could offer a pension plan to its clients who take loans of a certain size or duration. Thus, as the clients go about their normal short-term business, they are rewarded with a pension plan. This could act as an incentive for the microfinance institution to retain its customers for a longer duration. It could also encourage good

credit behavior. Clients who pay their loans on time and return for more loans and banking services would be rewarded with more pension benefits. This model would be like an occupational pension scheme, with the only difference being the nature of the relationship. In the occupational pension scheme, it is the employer and employee; in this case, it would be the provider and the customer.

In both cases, the employer and provider want to retain the employee and customer, respectively, for the longest time possible. The pension benefit provides the perfect incentive to enable both the employer and provider to achieve their objectives. The pension plan will be considered as a cost of customer retention on the part of the provider, which can then be recovered with higher revenues and profits from increased customer loyalty and repeat sales. This approach could substantially increase the pension coverage among the self-employed and informal sector workers by leveraging strategic partnerships that are aligned to their needs.

Dedicated Administration and Government Support

Pension schemes targeted to the masses have largely been successful in markets where they have received a dedicated commitment from the government in terms of mass sensitization and matching contributions to the schemes. Given the low-income levels and intermittent cashflows, the population market segments targeted by these schemes cannot sustainably contribute toward their retirement savings without a boost from the government. In East Africa, Rwanda has taken this route, and it remains to be seen if the successes brought by government support in other markets will be replicated in Rwanda as well. It is already evident in both Kenya and Uganda that the private sector, when left to itself, cannot sustainably operate pension schemes targeting the low-end of the market.

Targeted Financial Capability Programs

The approach taken to increase access and usage of pension offerings in the informal sector needs to be complimented by targeted financial capability programs. Given the uniqueness of pension offerings, it will take more than sensitizing the potential customers about the products. Focus needs to be placed on building the financial capability of the customer, which goes beyond literacy, to address issues of financial management, investment advice seeking, planning for the future, and making choices between different financial products. The customer needs to appreciate how pensions are an integral part of their social wellbeing, even when their consumption patterns differ.

Furthermore, for the financial capability programs to be effective, they need to be targeted to focus on an uptake of pension products already on the market that are designed to meet the needs of the informal sector. The programs need to be linked to pension products that potential customers can easily take up once they have fully appreciated the value of pensions.

Noting that cost-effective financial education programs with real impact are difficult to design and implement, programs need to be developed at all levels of society to increase the levels of financial capability of the targeted population.

CHAPTER 7

PENSION SYSTEM ADEQUACY: AN EMPIRICAL ASSESSMENT OF PENSION PAYMENTS IN MAINLAND TANZANIA

- Dr. Irene Isaka -

This chapter examines the adequacy of the social security system in mainland Tanzania. The main objective is to assess the adequacy of benefits to determine whether there is room for further improvement. The study applies the life-cycle theory of savings and consumption, which predicts a negative correlation between savings and age. The methodology used time-series pensioner data from the pension schemes. The simulation was made using average pension payments against average salaries from the years 2010 to 2045. To assess system adequacy, this study deployed a number of system adequacy ratios, such as demographic ratios, system replacement ratios and coverage rates.

Results show favorable demographic ratios. However, actual pension payments are below the statutory level of replacement rate, as stipulated in the respective establishing legislation. The results also show that there is no room for improvement of pension payments without addressing parametric reforms. The study's policy implication is that despite high statutory replacement rates, the monthly pension payments are inadequate due to huge commutation (pension gratuity) and low catchment levels. The main policy instruments are: increased social security awareness, enhanced compliance, reduced administrative costs. and introduction of parametric reforms.

Introduction

Pension adequacy is the degree at which pension payments meet the objective of social security, that is, income smoothing and prevention of poverty. Adequate pension systems⁸⁸ provide periodic

payments to its members that are sufficient to prevent old age poverty and maintain a decent standard of living. The stream of payments ensures reliable incomes to retirees and beneficiaries, and the income smooths lifecycle consumption for the majority of members of the schemes (Holzmann and others 2005). Adequacy means securely financed pension payments, and adequate income to members that does not destroy government finances or impose any excessive burden on future members of the pension scheme. At the same time, the pensions maintain equity, fairness and solidarity.

The main objective of achieving adequacy is to ensure that all older people enjoy a decent living standard, share in the economic well-being of their country, and participate actively in public, social and cultural life. Payment of pension benefits requires the systematic redistribution of benefits over the life cycle of a member between members or between generations (Draxler and others 2009). For instance, the EU level has set adequacy as one of the objectives of pension schemes. Specifically, it states that “public earnings-related schemes (first pillar), private occupational schemes (second pillar) and individual retirement provision (3rd pillar) provide good opportunities for most Europeans to maintain their living standards after retirement.” (Fornero and others 2005).

Three dimensions of adequacy are considered critical, including: consumption smoothing, mitigating poverty, and maintaining the intergenerational standard of living. Consumption smoothing is the first because the individual maintains the same or a better pattern of income

after retirement (Bernheim and others 2003). The second dimension of adequacy is an anti-poverty focus, whereby the pension system can deliver a universal basic benefit/social assistance granted on a citizenship basis. The other part of this equation is that the system aims more toward actuarial fairness of pension payments (Draxler and others 2009). The third dimension relates to generational effectiveness, which compares the living standards of the generations. In so doing, it may call for a redistribution of income between generations.

Adequacy can be measured by the quantity and quality of benefits offered by the system; the involvement of the beneficiaries and other stakeholders; state guarantees; turn-around time of benefit payments; and the benefit equivalence scales or replacement rates (that is, actuarial fairness), which basically relates to the degree to which the replacement of income matches an individual's income before retirement. Normally, in the discussion of adequacy, one can always have recourse to the notion of actuarial fairness.

The actuarial fairness is indicated by the accrual rates (replacement rates). The accrual rate of the mandatory pension schemes in Tanzania ranges between 67 and 77 percent for a contribution of period of 35 years. This is regarded as an adequate accrual rate internationally because the ILO minimum standard is 40 percent. However, beneficiaries (especially pensioners) have been persistently complaining about low monthly pensions. This chapter will assess the situation, determining the main cause of the complaints, specifically whether actual payments are in line with the statutory accrual rates, and whether there is room for enhancement of monthly pensions. It will also examine the adequacy of the system by employing ratios such as the coverage ratio, the demographic ratio, and the system replacement ratio. The chapter also introduces indexation to the analysis.

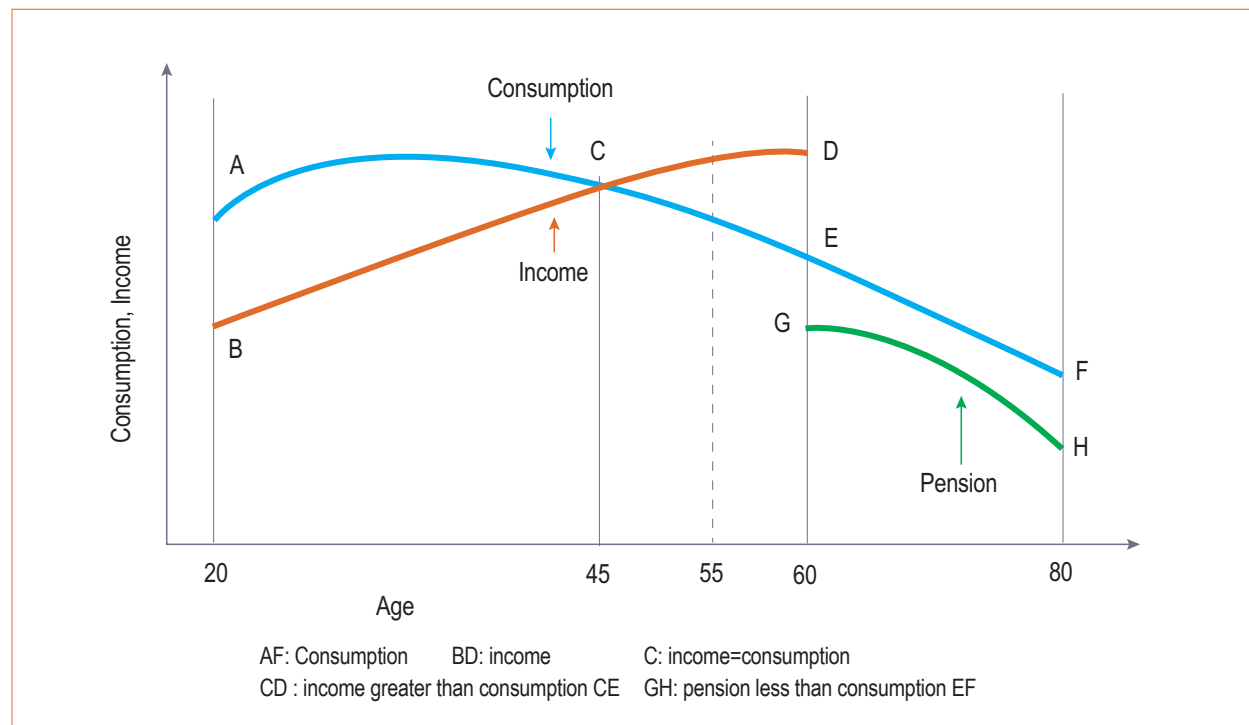
Theory of Adequacy of Pension Systems

The adequacy of pension payments can be explained by use of the Life-cycle hypothesis (LCH) (Ando and others 1963). The LCH predicts an increase in savings during the early stages of the life cycle, which then decreases at a later stage. The theory suggests that at an early stage, a household or individual will borrow; after the early stage, they will save for retirement. Then they will reach a maximum point beyond which they start to dissave.

Thus, the insufficiency of the pension payments would undermine the social security principle of adequacy, which advocates that a stream of income to the retiree be adequate to enable the person to live a decent life in retirement. Hence, adequacy of benefits depends primarily on the level of savings, the density of contributions, the replacement rates and catchment influences. The system that uses a consolidated approach, whereby insurable income includes all allowances, tends to produce more adequate benefits. However, this complicates saving patterns, whose effect has not yet been determined (Crown 2002; Feldstein 1974). This is mainly because, in theory, consumption would not be continuous as expected from savings for retirement.

According to Baranzini (2005), at the early ages of the lifecycle, there will be no savings provided for by the individual. Rather, it is assumed that income earnings and, therefore, savings would start at the age of 20. As a person grows and ages, both income and consumption increase up to the age of 55, when income reaches a peak beyond which dissaving and dependence on pension funds starts (Figure 19). In the case of an inadequate pension, the amount of pension received (GH) is less than the level of consumption (EF). Hence, inadequate pensions make the pensioner worse-off, assuming the pension is not indexed. Modigliani assumed that income remains constant during the working

Figure 19: Initial Negative Savings Ratio and Inadequate Retirement Pensions



Source: Modified from the Life-Cycle Theory of Modigliani, Brumberg and Ando (Baranzini, 2005).

life and reaches a maximum point at the retirement age. He also assumed that consumption patterns remained the same during the lifecycle, and that there were no inheritances (bequests) (Modigliani 1980; 2001).

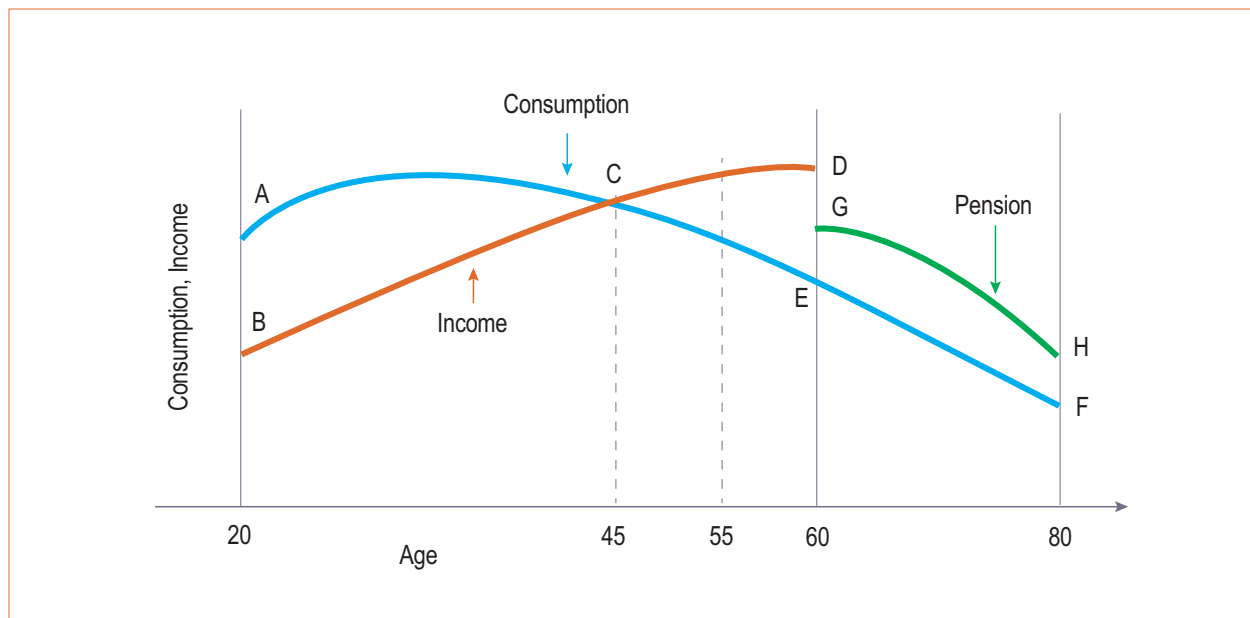
The adequacy of a pension system is positively correlated with the adequacy of pension benefits (Holzmann and others 2005). Hence, to be adequate, the pension has to provide extensive benefits to the beneficiaries throughout their lifecycle. Also, these benefits should smooth income to reduce or avert poverty in old age for retirees. If the pension scheme is adequate, as indicated in Figure 20, then the amount received by a retiree should be equal to the level of consumption. It is assumed that the pension is indexed in line with the increase in the cost of living. Other assumptions are as presented by Modigliani (Modigliani 1980; 2001).

Empirical Literature

The empirical literature concerning the adequacy of pension schemes is diverse. Whereas some studies focus on the adequacy of pension benefits with respect to consumption patterns of individual(s) at retirement, others address the objectivity of adequacy. Alternatively, some measure the adequacy to compare results obtained using different methodologies.

Filip (2012) analyzed adequacy using income, covering 26 European countries, and found that the most adequate pension systems were those of Austria, France, Germany, Luxemburg, and the Netherlands. The countries whose pension systems were least adequate included Cyprus, Estonia, Latvia and Lithuania. The synthetic approach is advantageous for analyzing issues differently. However, the major drawback is the relativity of the assessment of adequacy. For instance, Filip

Figure 20: Initial Negative Savings Ratio and Adequate Retirement Pension



Source: Modified from the Life-Cycle Theory of Modigliani, Brumberg and Ando (Baranzini 2005).

(2012) places Norway in the category of countries with inadequate pensions, whereas Global Pensions Watch places Norway in the best 10 countries in terms of welfare of the elderly.

La Rochelle-Cote and others (2010) used a Longitudinal Administrative Database (LAD) that covered a period of 26 years from 1982-2007 to examine the extent to which family income during their working years is replaced during retirement. The focus was on individuals aged 54-56 in 1983, and their incomes were tracked until they reach 77-79 years of age. The study observed that some individuals had very low replacement rates (about 20 percent had replacement rates of 6 percent). The study concluded that replacement rates during retirement were inadequate, including negative correlation with family income.

Zaid (2010) examined the adequacy issue by assessing the financial sustainability of public finances in 13 EU countries. Among other components, the study analyzed the public pension

benefit ratio over the years 2008-2060 across these EU countries. The analysis was based on the Gross Replacement Rate (GRR) of earnings. The GRR is a measure of average pensions as a share of the economy. The results suggested that future pensioners of Austria, Estonia, France, Poland, Portugal, and Sweden were at high risk of lower pensions. Additionally, six countries showed a considerable decline in the value of their pensions. Zaid (2010) concluded that pension reforms protected low earners in the Belgium, Finland, France, Germany and the United Kingdom. However, Austria, Italy and Portugal experienced a decline in adequacy, whereas in other countries such as Hungary, Poland and Slovakia, payments were strengthened.

Borella and others (2009) used a Comprehensive Replacement (CORE) rate to analyze the adequacy of benefits in European countries. The study used the European Community Household Panel (ECHP) data to compare individual standards of living when working and retired. Projections were

made for individuals aged 65-69 over the average of 15 years before retirement, that is from ages 50-54. The countries included Denmark, France, Germany, Italy, Spain, and the United Kingdom. The results of the study suggested a decrease in adequacy as the replacement rate declined. For instance, in France, the CORE declined from 57 percent in 2020 to 47 percent in 2050. Other countries that showed a declining replacement rates included Germany and Spain. The study also found Denmark, Luxembourg and the United Kingdom to be more stable. Countries that indicated an increase in adequacy included Hungary, Latvia, the Netherlands, and Slovakia.

Mintz (2009) assessed retirement income adequacy in Canada following a sharp decline in stock values in 2008. The study observed that the financial crunch had affected income levels of individuals. For example, low-income Canadians needed to replace higher levels of income during their retirement, whereas higher-income Canadian needs were lower. The study found that the 60 percent replacement rate of pre-tax income was adequate to maintain the standard of living. Mintz (2009) also concluded that there is no exact rule regarding replacement rates in Canada because replacement levels depend on a number of factors, such as the size of the household, the existence of disabilities and income levels.

Hurd and others (2006) used data for the United States to analyze both expected and actual consumption patterns at retirement, hypothesizing that consumption after retirement would be lower. The study analyzed the pattern of expenditures of the household level and found that the purchase of goods and related services declined at retirement. The findings were consistent with the lifecycle theory of consumption.

Hamermesh (1984) assessed adequacy concerns by testing the theory of lifecycle utility maximization after retirement. The study linked a retirement history survey and social security administration data to analyze the adequacy of social security in the

US. Using information of 1,797 retirees aged 62-67 years in 1973, and 1,422 household members aged 64-69 in 1975, the study found that, on average, consumption of about 500 whites aged 62-69 was inadequate to cover their day-to-day requirements after retirement. Conversely, the retirement benefits were adequate to cover consumption expenditures of the white married couples included in the study in 1973.

Empirical studies regarding adequacy issues in Africa are very scarce. A few studies were conducted by international organizations between 2008 and 2010. These studies applied a social protection model to study adequacy of the pension system. For instance, the ILO (2006, 2008 and 2010) performed a critical analysis of social protection interventions in Mainland Tanzania, Zanzibar and Zambia. The main finding was that social security interventions were inadequate to prevent poverty at old age. Accordingly, the studies recommended reforms of the existing social insurance schemes, with special emphasis on health care and maternity. By design, these studies were very broad; as such, they did not analyze the social security sector very deeply, especially the pension schemes.

In sum, most of the reviewed studies analyzed adequacy issues by employing both pension as well as other incomes (Borella and others 2009; Hamermesh 1984; Hurd and others 2006; La Rochelle-Cote and others 2010; Mintz 2009; and Zaid 2010). The approach assumed that adequate pension benefits positively influence the well-being of the beneficiaries. Some analyses used wealth in both the working and retirement phases as a measure of adequacy and found a negative correlation between replacement rates and family wealth. However, wealth as a measure of adequacy is inappropriate when applied to economies with large informal sectors, such as Tanzania. This is because a large chunk of the income is not recorded in the official statistics.

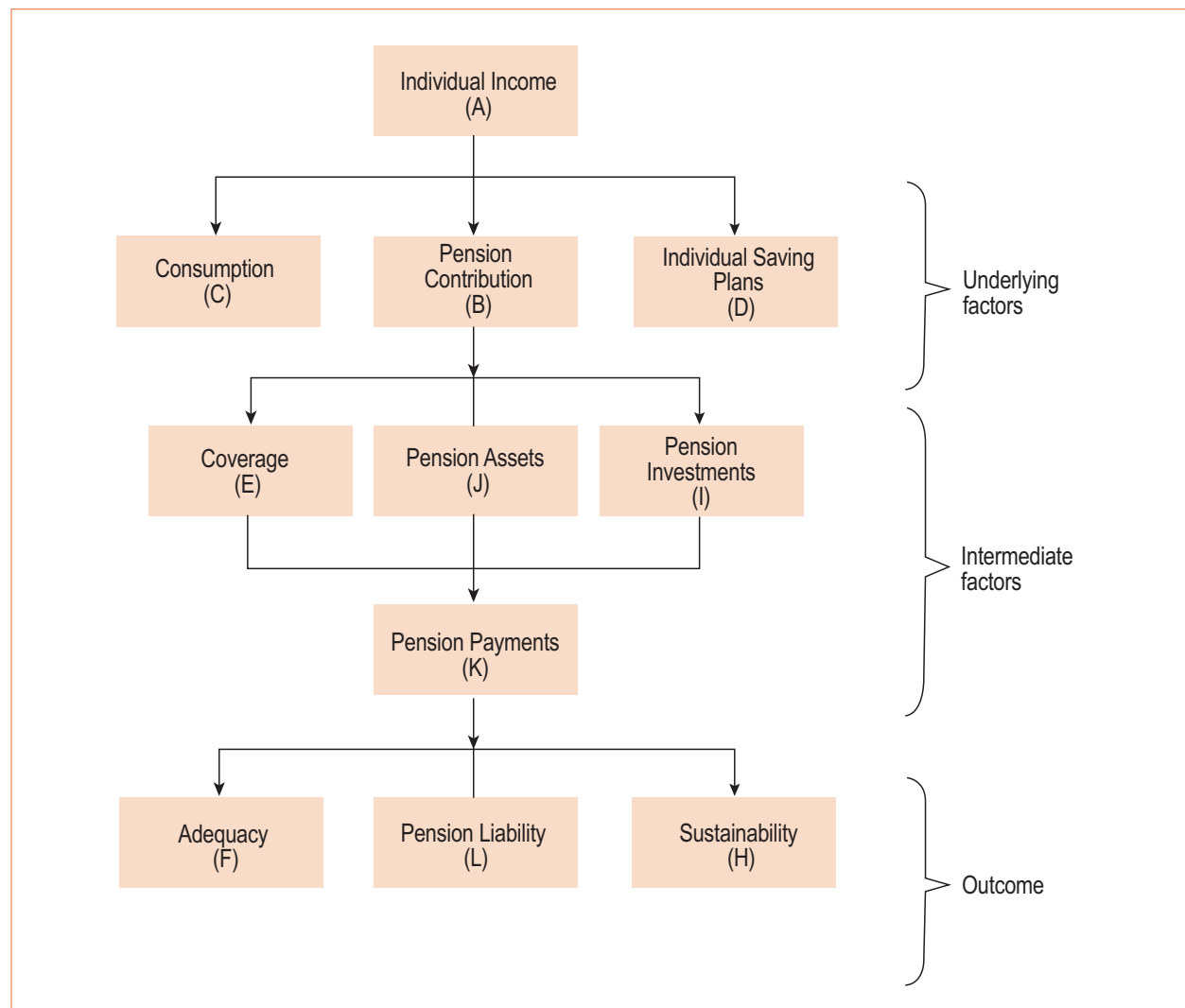
Most of the reviewed studies on adequacy issues focused on the lifecycle earnings, how they

are distributed across the population, and their relationship to age. However, no study examined both adequacy and fiscal implications of pension schemes. Also, there was no empirical study that used ratios (that is, demographic, catchment, or system replacement ratios) to measure adequacy. Instead, most of the studies used replacement rates. Thus, in assessing the social security system adequacy in Tanzania, this study has modified the approach used in the previous studies to include the demographic ratio (DR), the catchment ratio (CatR), and coverage ratios (CR).

Conceptual Framework regarding Pension Adequacy

The conceptual framework regarding pension adequacy is based on the individual, which will be referred to hereafter as a member of a social security scheme. As shown in Figure 21, such a member has a life time of income (A), which is partly used to remit contributions (B) to a social security scheme. The remaining income is used for consumption (C) and savings (D). The level of contributions to the social security scheme depends on coverage (E),

Figure 21: Conceptual Framework on Pension Adequacy



Source: Author's construction.

which includes both the number of members and the amounts contributed.

Coverage is an important component of the adequacy of benefits (F). Adequacy determines both the pension payments/retirement income (K) and sustainability of the social security system (H). The contributions remitted to the social security schemes are invested (I) in order to build pension assets (J). Pension assets are normally used to pay benefits (K) when a member retires. These payments constitute what is known as a pension liability (L). When the liability created is equal to or less than pension assets, the system is adequate and sustainable. In this case, the pension debt is called implicit pension debt. However, when the assets are insufficient, the debt created becomes an explicit pension debt. The explicit pension debt has to be budgeted and paid for by the State because the pension schemes are unable to pay the pensions.

Empirical Model

A pension system integrates all the social components at both the individual and national levels. Hence, a pension system's functioning is not independent of demographic and economic factors (Cichon and others 2002; ILO 1997; and Illinois 1998). Thus, a number of models have been developed to address the system using these linkages. One such model is the ILO pension model, on which this chapter is based. However, in this study, the ILO pension model has been modified to suit the social security system in Tanzania, keeping in line with Bagliano and others (2010) and Coco and others (2005). The model is used to establish whether the social security benefits in Tanzania have been adequate. Furthermore, it is modified to accommodate both the accrual rates as stipulated in the legislation pertaining to the social security schemes and lifecycle hypothesis, as presented by Modigliani and others (1957).

The model assumes a member (i) who optimizes utility throughout his/her entire lifecycle, who also plans to set aside an inheritance (bequest) as well.

The duration of a member's life ends at period T , which is determined by the survival probability. At each time (t), the survival probability ($t+1$) is represented by (l_t). The member enrolls to work at age (t_0), and stops working at (t_0+g), and his/her preference at time (t) is determined by a utility function that is specified as:

$$Utility = (X_{it_0}^{1-\delta}) (\frac{1}{1-\delta}) + E_{it_0} [\sum_{j=1}^T V^j (\prod_{t=0}^{T-2} L_{it_0+g})] \{1L_{t_0+j}\} C (\frac{Z_{it_0+j}}{c})^{1-\delta} (\frac{1}{1-\delta}) \dots \dots \dots 7.1$$

where X_{it_0} is expenditure at time t ; Z_{it} is the assets that member (i) accumulates to bequeath for an inheritance (C) at death, $c > 0$ is the magnitude of inheritance; V^j is the discounting factor; δ is the risk avoidance factor; E_{it_0} is labor income determined by individual characteristics such as gender, marital status, education, and household composition; L_{it_0} is survival probability at the beginning of the working life; L_{it_0+g} is the survival probability at the end of the working life; and Z_{it_0+j} represents assets accumulated at the end of the period and E_{it} (Bagliano and others 2013; Cocco and others 2005). By considering working members who have already registered in schemes, such that:

$$Log E_{it} = f(A, M_{it}) + u_{it} + d_{it}; \dots \dots \dots 7.2$$

$$t_0 \leq A \leq t_0+g$$

(A) is age, (M_{it}) is a set of demographic factors of members including sex, literacy and size of the household. The symbol (u_{it}) is a shock and (n_{it}) is a disturbance term, (Bagliano and others 2013). Symbols (u_{it}) and (d_{it}) are unforeseen contingencies, such that:

$$u_{it} = u_{it-1} + \mathcal{E}_{it} \dots \dots \dots 7.3$$

where $\mathcal{E}_{it}$ is disturbance distributed as $h(0, \Theta_{\mathcal{E}}^2)$ and shock d_{it} is distributed as $h(0, \Theta_{\eta}^2)$. The $\mathcal{E}_{it}$ applies to all members, that is, $\forall \sim h(0, \Theta_{\mathcal{E}}^2)$. An idiosyncratic component is $\alpha \sim h(0, \Theta_{\alpha}^2)$ uncorrelated across members of the schemes such that:

$$\mathcal{E}_{it} = \forall_t + \alpha_{it} \dots \dots \dots 7.4$$

Here, the correlation is allowed and a shock element to a member's income $\forall_t$ and social security returns. However, in the defined benefit (DB) schemes, the risk of assets is borne by the schemes, not the members. Hence, during retirement, income is certain and equal to a fixed proportion (∂) of the permanent component of the insured wage during the working life (Bagliano and others 2013).

$$\text{Log } E_{it} = \log \partial + f(A_{(0+g)}, M_{it(0+g)}) + u_{it(0+g)} \dots 7.5$$

where, $A_{(0+g)} < A \leq T$ and, the level of replacement rate (∂) is meant to capture mandatory social security schemes (Campbell and others 2001). Depending on the level of adequacy, members maximize utility over the lifecycle by choosing the consumption and rules derived from their pension and asset returns.

Data

Base data used to analyze the adequacy of pension system include pensioners and contributors to all pensions schemes in Tanzania. The data was aggregated from annual reports of the social security and pension funds in Tanzania, which included pension payments, member wages (insurable wages), contributions, and investments undertaken in 2010. The source of the data is the audited financial accounts of the NSSF, the Pension Protection Fund (PPF), the Public Service Pension Fund (PSPF), the Local Authorities Pension Fund (LAPF) and the Government Employees Pension Fund (GEPF). The data for population, inflation and GDP growth was obtained from National Bureau of Statistics (NBS) publications. Other demographic data used were also obtained from the NBS.

Sample Size

In sum, the analysis was based on 1,146,584 members of pension funds, and 48,581 pensioners whose average insurable wage was Tanzanian Shilling (TZS) 5.8 million per year. The total expenditure, including benefit payments, was TZS 737 million.

Descriptive Statistics

Table 15 depicts a very wide range for the number of pensioners. The variations could be explained by high increases over the sample period. This wide range, as well as the standard deviation in membership, is also reflected in their contributions to the pension benefits. Since pension schemes depend on member contributions for their investment, this fact is then reflected in the variance. The Kurtosis statistic suggests that members, their contributions, as well as the investments made by schemes were skewed. Hence, they were not normally distributed. Other variables included in the analysis were also not normally distributed.

Measurement of Variables

Adequacy can be measured by either the quantity or quality of benefits offered by the pension system. In terms of quality, adequacy can be measured by the involvement of the beneficiaries and other stakeholders. When beneficiaries are involved during legal and regulatory reviews and member conference and investment decisions, then the system is regarded as adequate. Another measure of adequacy is the turn-around time for payments. When members or beneficiaries are paid their benefits on time (in line with the Customer Service Charter), then the system is regarded as adequate.

Regarding the quantity, the measure is the benefits equivalence scales or accrual rates (replacement rates). The measure is based on actuarial fairness, which relates to the degree to which the replacement of income matches the member's income before retirement. Normally, the discussion of adequacy is closely linked with actuarially neutral concepts (Draxler and others 2009). In this context, the pension payment adequacy is measured using accrual rates (replacement rates).

In Tanzania, the replacement rate ranges between 67 and 77 percent for a member who has contributed for a period of 35 years. The contribution rate is 20 percent of the insurable wage. At retirement, the

Table 15: Descriptive Statistics

Description	Max	Min	Mean	Standard devia	Kurtosis	Variance	Skewness	Median
Active contributors in '000,000'	2.86	1.15	2.04	0.55	(1.43)	0.31	-0.138387	2.09
Total Pensioners in '000'	2,202.80	48.58	632.67	613.35	0.27	376,193.75	1.139584	376.95
Avg Contribution in Tzs Mln	104.60	0.79	6.98	17.13	32.50	293.49	5.58132	2.85
Contribution Rate	0.20	0.20	0.20	0.00	(2.12)	0.00	-1.044014	0.20
Total Contr. Intrn	11.00	1.19	5.95	3.12	(1.25)	9.73	0.05	5.90
Avg Pension in Tzs Mln	16.28	1.67	6.43	4.28	(0.41)	18.31	0.83	5.10
Avg insurable wage in Tzs Mln	30.30	5.82	14.81	4.86	1.78	23.57	0.58	14.90
Total Pension in Tzs Trln	15.90	0.45	8.35	5.08	(1.41)	25.79	(0.21)	9.40
Investment in Tzs Trln	89.00	4.14	13.09	13.59	29.80	184.64	5.23	10.75
Investment Income in Tzs Trln	8.90	0.47	1.33	1.37	29.40	184.64	5.23	10.75
Total contr in Tzs Trln	11.00	1.19	5.95	3.12	(1.25)	9.73	0.05	5.90
Total income in Tzs Trln	13.40	1.73	7.42	3.57	(1.24)	12.78	(0.00)	7.5
Admin. expenditure in Tzs Trln	1.65	0.19	0.91	0.46	(1.23)	0.21	0.03	0.90
Total expenditure in Trln	17.55	0.76	9.49	5.42	(1.35)	29.38	(0.23)	10.40

Source: Author's computation

value of wealth (that is, accumulated contributions during the working part of the lifecycle) is then transformed into a riskless annuity or pension, which is paid throughout the remaining life of a member.

The insured population was obtained by using the total population, with the active labor force(LF_{it})

identified. The employed population(EP_{it}), was identified from the active labour force. From the employed population, the insured population was established using the following equation:

$$LF_{it} = \gamma[\sum_{t=0}^{T-1} (1 - IC_{it})] \dots \dots \dots 7.6$$

whereby γ is the proportion of the general population that is active, and IC_{it} is the inactive population. From Equation 3.6, the insured population was derived as:

$$EP_{it} = \beta [\sum_{t=0}^{T-1} LF_{it} (1 - Un)] \dots \dots \dots 7.7$$

The insurable wage (IW_{it}) (was established by using the following expression:

$$IW_{it} = \alpha [\beta [\sum_{t=0}^{T-1} (\gamma [\sum_{t=0}^{T-1} (1 - IC_{it})]) \times (1 - Un)]] \dots 7.8$$

where β and $(1 - Un)$ are proportions of the unemployed population and labor force that are formally employed, Un is unemployed labor force and is the proportion of the employed labor force. Other variables are as already defined. In a simplified form, Equation 3.8 is expressed as:

$$IW_{it} = \sum_{t=0}^{T-1} \alpha [EP_{it}] \dots \dots \dots 7.9$$

The coverage rate (CR) is given as:

$$CR_{it} = \sum_{t=0}^{T-1} \frac{\beta [LF_{it} (1 - Un)]}{(\gamma [(1 - IC_{it})])} \dots \dots \dots 7.10$$

The System Replacement Rate (SRR) was established by using the benefits offered in relation to the wage used to calculate the pension. The derivation of the measure did not take into consideration other incomes accruing to pensioners because the rate used to calculate the pension was based on the statutory contributions and benefit package with two components, that is, the commuted pension (CP_{it}) and the monthly pension (MP_{it}) such that:

$$CP_{it} = \prod_{t=0}^{T-1} [\partial (P_{it})] [(E_{it}) * (CF_{it})] + \varepsilon_{it} \dots \dots \dots 7.11$$

where: ∂ is the accrual rate of the member, P_{it} is number of months of contribution; CF_{it} is the commutation factor, which currently stands at 12.5 for some schemes and 15.5 for other schemes. E_{it} is the emoluments, CP_{it} is the rate of the commuted pension, which is 25 percent for some schemes and 50 percent for other schemes; ε_{it} captures some other lump-sum payments, such as the penalty

resulting from delays in processing payments that can be paid to members. The monthly pension (MP) was obtained by using the following equation:

$$MP_{it} = \prod_{t=0}^{T-1} [\partial (P_{it})] [(E_{it}) * (1 - CF_{it})] (1/12) \dots 7.12$$

where all the variables are as already defined. Note that where the pension funds do not allow for commutation, beneficiaries receive their full pension.

In such a situation $(1 - CF_{it}) = 1$, such that the total pension (S_{it}) is:

$$S_{it} = CF_{it} + MP_{it} \dots \dots \dots 7.13$$

In a more expanded form, the total pension can be expressed as:

$$S_{it} = \sum_{t=0}^{T-1} CP_{it} + MP_{it} + \varepsilon_{it} \dots \dots \dots 7.14$$

Estimation Methods and Techniques

The estimation of the model was carried out using the Excel program, this study assumed that the working life of a member starts at the age of 25, and she/he would work for 35 years to reach a retirement age of 60. After retirement, the pension would be determined by a constant proportion = 0.67. By using several assumptions and some information specific to Tanzania, the pension model was estimated. Using the optimal rules, it was possible to simulate adequacy using the life-cycle hypothesis. All permanent and transitory shocks were not taken into consideration, as they are beyond the scope of this study.

The System Replacement Rate (SRR) was measured as the fraction of the average with respect to S_{it} and the average of E_{it} . From Equation 7.14, it follows that;

$$SRR = \sum_{t=0}^{T-1} \frac{(CP_{it} + MP_{it})}{(EM_{it})} \dots \dots \dots 7.15$$

The Catchment Rate (CatR) was derived using equation 3.15. The ratio measures the amount of earnings paid as contributions to the total amount of earnings received by the insured person from their employment. The ratio assists policymakers in deciding on the effective ways to enhance contributions, which would make the system adequate or sustainable. The expression used to calculate CatR is given as:

$$CatR_{it} = \frac{\left\{ \sum_{i=0}^{T-1} \alpha [EP_{it}] \right\}}{TI_{it}} \dots\dots\dots 7.16$$

Where

$$TI_{it} = \sum_{i=0}^T (Sl_{it} + Ha_{it} + Ua_{it} + Ta_{it} + Ca_{it} + \varepsilon_{it}) \dots\dots\dots 7.17$$

In equations 7.16 and 7.17, Sl_{it} is salary, Ha_{it} is housing allowance, Ua_{it} is the utility allowance, Ta_{it} is the transport allowance and Ca_{it} is the communication allowance; ε_{it} is the stochastic term that captures experience, promotions and special duties of beneficiaries.

Empirical Results regarding Adequacy of Pension Schemes

In this section, a number of factors are presented and analyzed, including the computed demographic

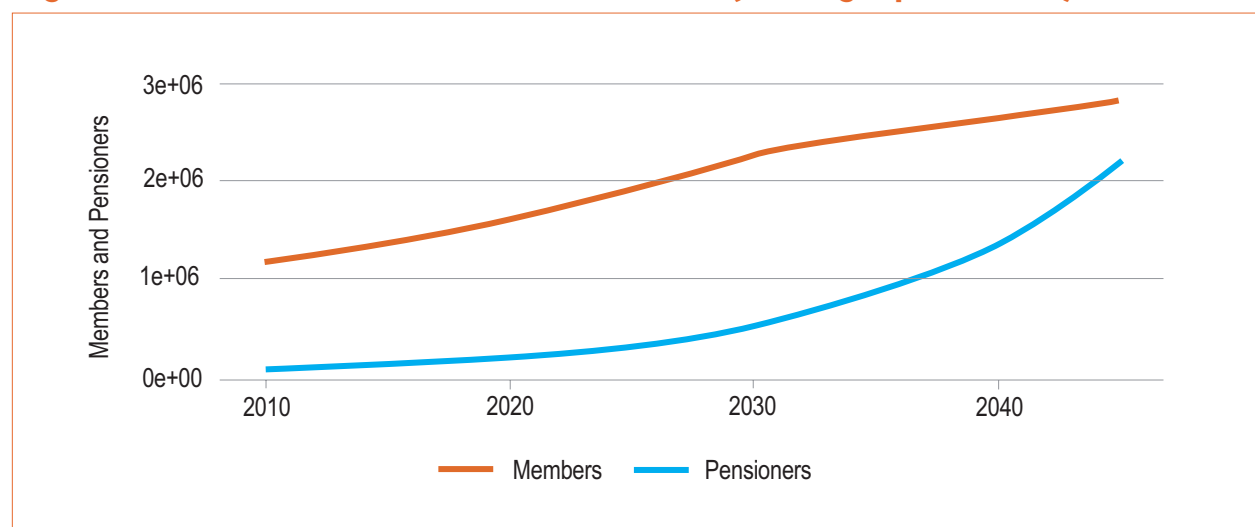
ratio, system replacement rates, coverage rates, total benefits paid to beneficiaries and catchment rates in the sample covered by the study.

Demographic Ratio (DR)

This is the ratio of pensioners to the total registered members. The lower the ratio, the better outcome for the system. To obtain the demographic ratio, the insured population is divided by the number of pensioners. Hence, Equation 7.6 was divided by the number of pensioners who were in the sector during the time of analysis.

The result shows that the system has a very strong demographic ratio (Figure 22). The demographic ratio (pensioners to members) simulation results show that the demographic ratio rises from 5 percent in 2010 to 18 percent in 2045, a result that suggests there is adequate room to increase the membership of the social security schemes. The result also shows that, as of 2013, the actual and projected coverage of pension schemes was 8.4 percent (Figure 23). This coverage is deemed to be inadequate, in which case it may hinder growth in benefit payments. Hence, if coverage is reduced, it would not only affect benefits. It would also lead

Figure 22: Ratio of Pensioners to Members (Demographic Ratio)



Source: Author's computation

to an intergenerational transmission of poverty among the beneficiaries.

Figure 23 shows that coverage is projected to increase from 5 percent in 2010 to more than 17 percent in 2045. However, this is still small because 83 percent of the workforce would still be uncovered in 2045. To improve coverage, effective interventions are required to ensure that at least 50 percent of the workforce is covered.

The results show that there is adequate room to allow for the growth of membership coverage should the government introduce appropriate interventions. The analysis also indicates that growth of 8 percent per year could increase the coverage from the current level of 8.4 percent to about 70 percent of the working population in the next 35 years (Figures 24 and 25).

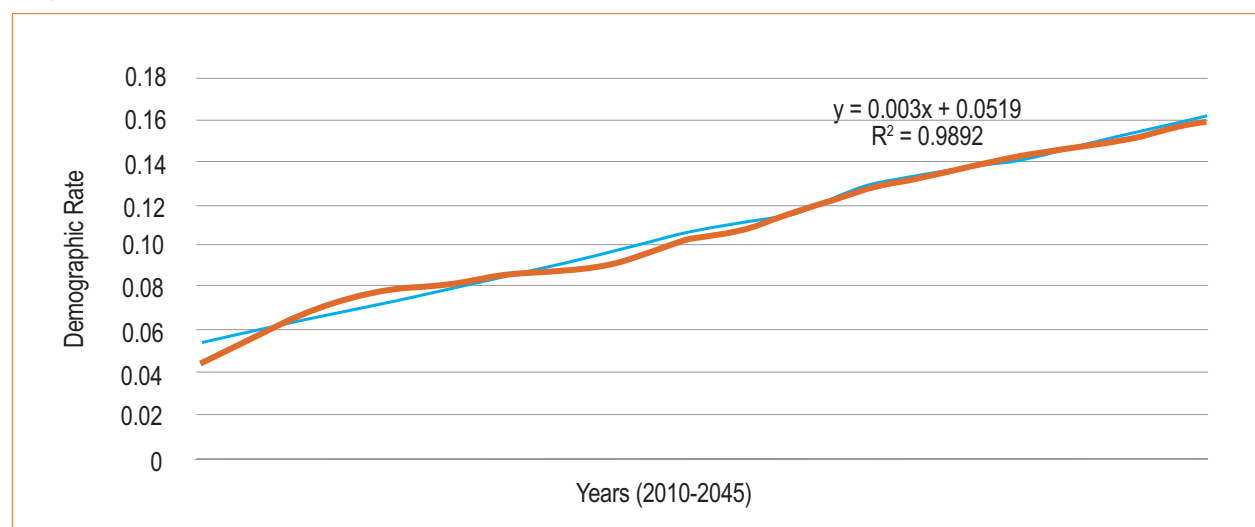
Assessing the monthly pension payments, the results show that System Replacement Rates are below the statutory payment of 67 to 77 percent (Figure 28). The SRR starts from 29 percent in 2010 and decreases consistently during the projection period. The SRR of 29 percent is below

international standards, which are set at 40 percent. The introduction of pension indexation seems to improve monthly pension payments (Figure 26). Similarly, total benefits payments show an increasing trend (Figure 27).

In line with benefits adequacy and international best practice, the ILO minimum standard rates of income replacement are set at 50 percent of lost wages for a worker with a family who is injured on the job, 45 percent for unemployment and maternity, and 40 percent for a married worker who retires due to old age, a worker with a family who retires due to a disability, or the survivors of a deceased worker (Frota 2012).

In Tanzania, the statutory replacement rates range between 67 and 77 percent (Figure 28). However, due to commutation, monthly pension payments replace only 26 percent of the average salary. This creates complaints and it means that it is not possible to achieve the pension objective of income smoothing and prevention of poverty at old age. Hence, pensioners' complaints regarding inadequate monthly pensions are genuine.

Figure 23: Rate of Pensioners to Members

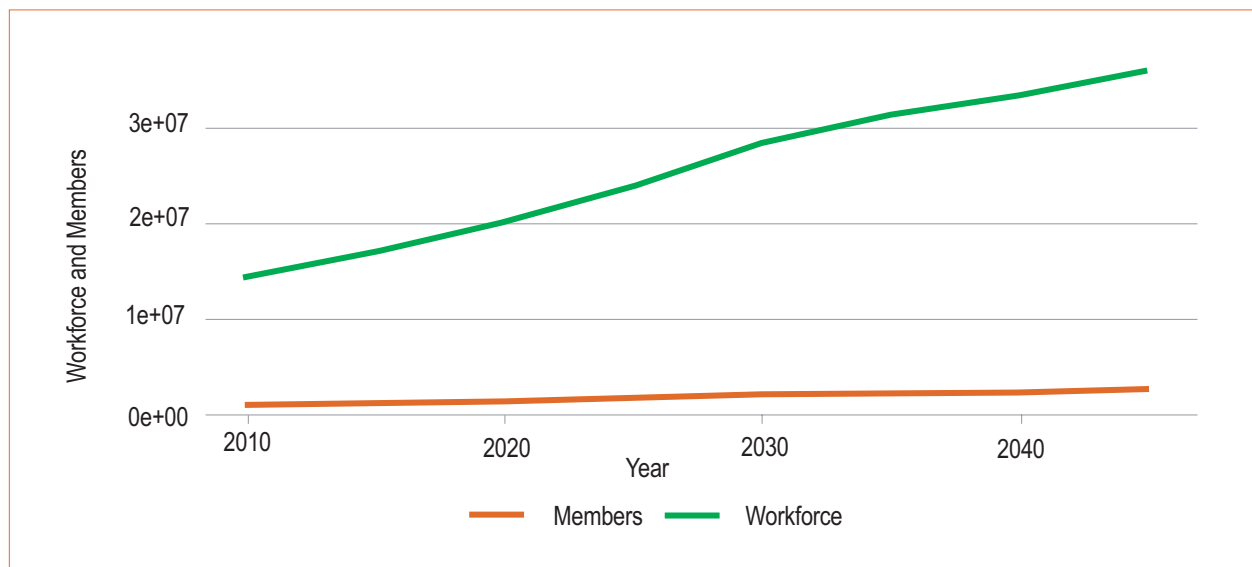


Source: Author's plot from computation.

The overall pension system in Tanzania seems generous because some pension funds pay high levels of commutations, especially the PSPF and the LAPF. These funds allow a member to commute up to 50 percent. Commutation rates are also high, and they differ from one scheme to another. For instance, some schemes allow commutation rate

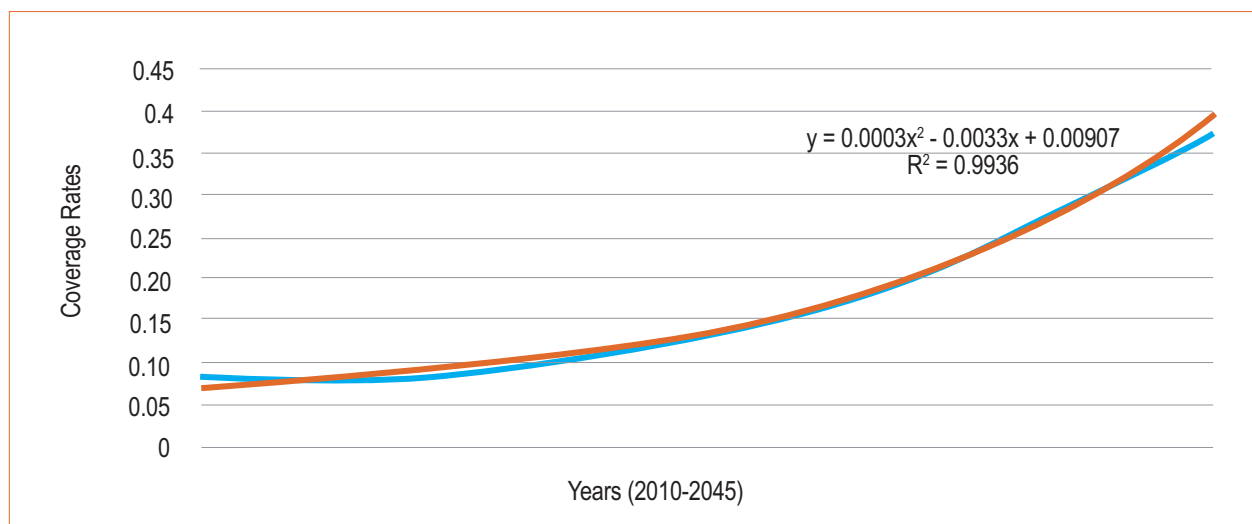
of 15.5 percent and some pay 12.5 percent. Some funds use final salaries (LAPF and PSPF) and some use average salary of five years (NSSF, GEPF and PPF). Without commutation, the results show that monthly pensions are adequate. However, with commutation, monthly pension payments become inadequate (Figures 29 and 30).

Figure 24: Level of Members to Workforce (System Coverage Levels)



Source: Author's computation

Figure 25: Ratio of Members to Workforce (System Coverage Rates)



Source: Author's computation

This analysis examined different scenarios to improve adequacy. The results show that with a removal of commutation, replacement rates improve from 29 to 54 percent. Nevertheless, the amount of the pension seems to decrease over time due to increases in the cost of living (Figure 31).

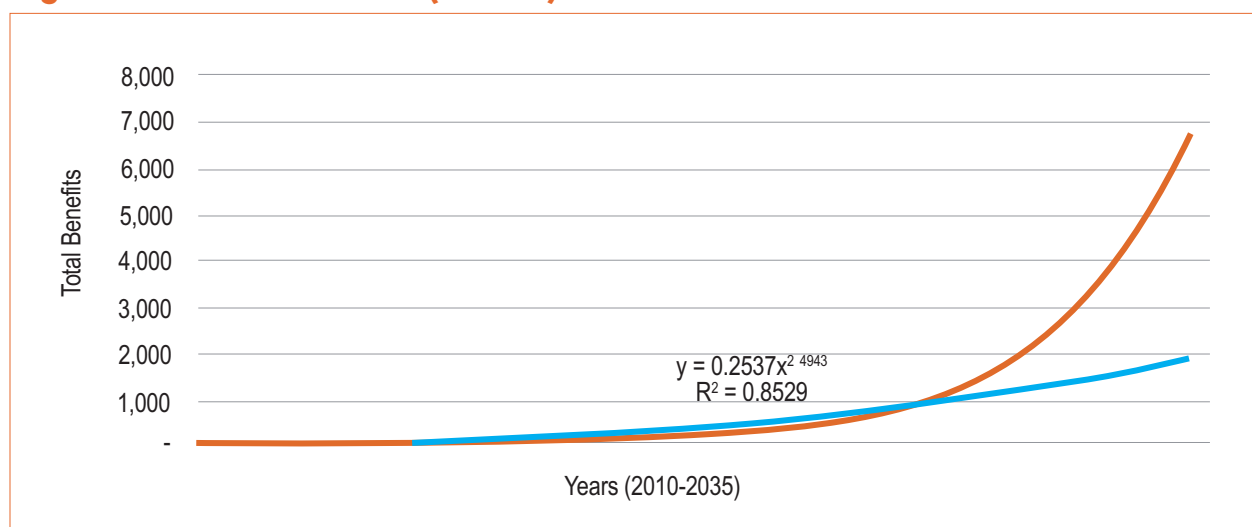
Although there is a negative correlation between commutation and the monthly pension, members have always preferred lump-sum payments to sort out their lifetime requirements, such as building houses, farming or starting businesses to boost their income after retirement. However, the lack

Figure 26: System Replacement Ratio (Ratio of Pensions to Salaries)



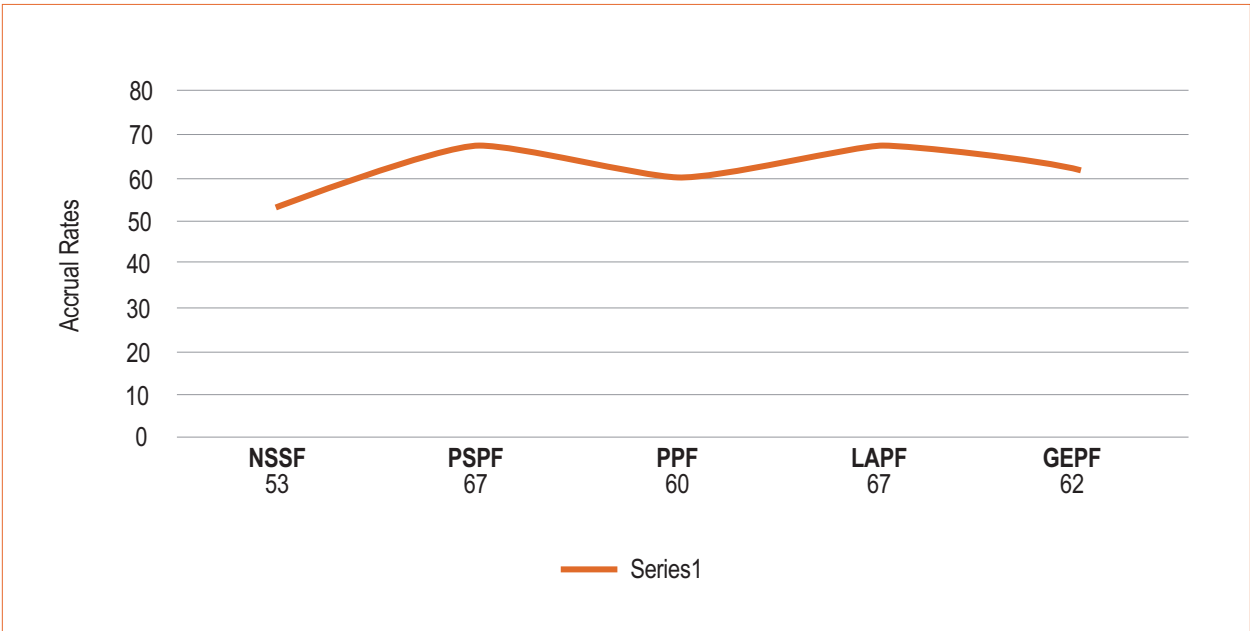
Source: Author's Computation

Figure 27: Total Benefits (in TZS)



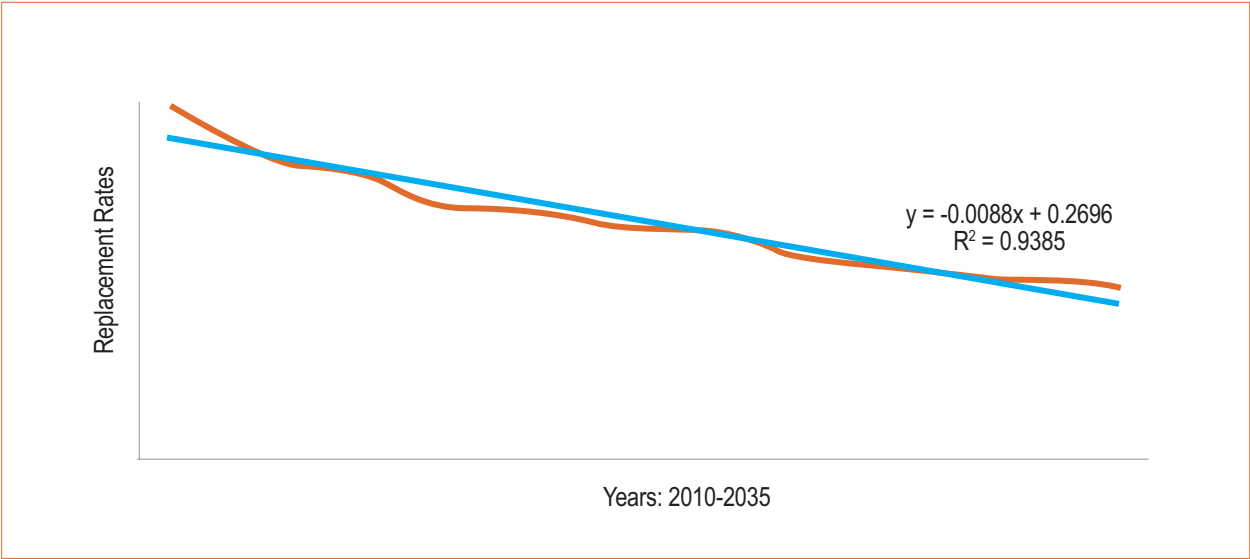
Source: Author's computation

Figure 28: Pension Fund Accrual Rates



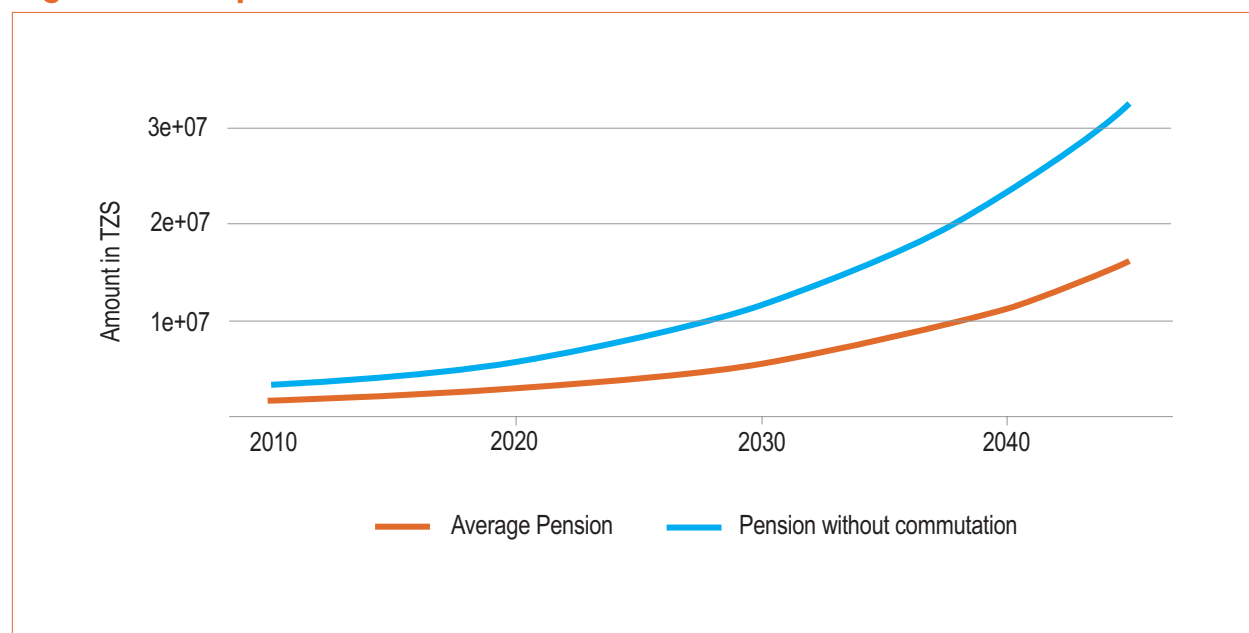
Source: Author's Computation
Note: GEPF = Government Employees Pension Fund; LAPF = Local Authorities Pension Fund; NSSF = National Social Security Fund; PPF = Pension Protection Fund; PSPF= Public Service Pension Fund.

Figure 29: Prevailing Replacement Rates



Source: Author's Computation

Figure 30: Replacement Rates without Commutation



Source: Author's Computation

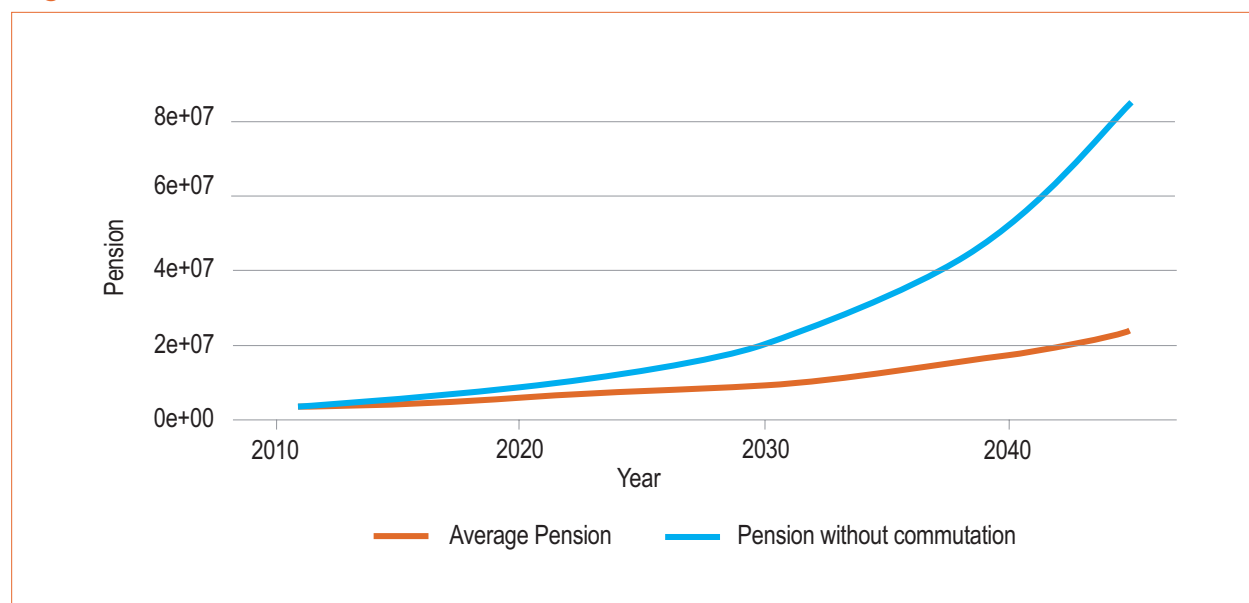
of entrepreneurial skills leads to some pensioners losing the entire lump-sum. As such, they become entirely dependent on the monthly pension. As a result, they are in a worse position because after the huge commutation, their monthly pension becomes inadequate.

In considering the cost of living as part of the assessment of adequacy, the analysis introduced the indexation factor. In this case, indexation is based on an inflation rate of 6 percent. The results show that the adequacy of benefits improves as replacement rates increased from 26 to 56 percent. Although the improvement is in line with best practices as well as ILO minimum standards, the results also show that indexation to inflation replacement rates tend to decline in the long run. However, when pensions are indexed to wages, the adequacy seems to improve, remaining adequate in line with the international standards (Figure 31).

Policy Recommendations

The policy implication of this analysis is that, despite high replacement rates, the pension system is inadequate due to huge commutations. Several recommendations can be offered to policymakers to improve this situation. First, to improve adequacy, it would be necessary to address some policy and operational issues. Policies should ensure that contributions are based on the consolidated income of members (as such, contributions should include bonuses, per-diems, and allowances). It seems that improvements in the replacement rates without increasing and/or consolidating the income of members may not entirely improve the welfare of pensioners. The proposed solution is to institute consolidation. This might improve catchment and result in the provision of decent incomes to pensioners.

Figure 31: Pensions Indexation



Source: Author's Computation

Second, policymakers could consider increasing the density of contributions. A strict follow-up regarding compliance would help to ensure that contributions match the statutory level. The current amount of contributions, which is lower than statutory requirement, may need an immediate action to restore the balance.

Third, replacement rates are lower than the statutory level, thereby reducing adequacy. Two interventions could be instituted to ameliorate this situation. Close follow-up of pension payments to ensure that members receive the correct amounts and a removal of the commutation might improve monthly pensions. The analysis found that commutation not only reduced monthly pensions, but also distorted expenditure patterns of pensioners. Although pensioners seem to receive huge sums at retirement, limited development of financial markets coupled with lack of financial knowledge and inadequate information about investments in financial products could make pensioners poor in the long run. In this context, the introduction of an annuity market could be one interim solution, that is, lump-sum amounts could be traded in annuities to enhance monthly pensions.

Fourth, to improve adequacy, pension payments could be indexed against wage growth. Other recommendations on the operational side include: improvements in membership records; reductions in operational costs; increases in investment income; reductions or an elimination of premature withdrawals; and reinforced compliance with the legal and regulatory framework.

Policy Instruments

To ensure that the system is adequate, the following policy instruments could be made available: a legal enforcement mechanism to increase compliance and increase catchment; parametric reforms of the pension system to reduce commutation; the formation of policies to foster automatic enrollment of members; and reduced administrative costs of social security schemes to increase efficiency. Increased awareness of social security products and services and enhanced financial literacy among the members and the public at large would also strengthen the pension system.



ANNEX A:

CURRENT PENSION SYSTEMS IN BURUNDI, KENYA, RWANDA, TANZANIA AND UGANDA

The retirement benefits sector in Burundi consists of three pillars comprised of the following: (i) a mandatory public pension scheme, known as the National Institute of Security [INSS], (ii) a Civil Service Pension scheme (the MFP and ONPR); and

(iii) private occupational and individual pension plans that cover a very small percentage of the working population. The sector is summarized in Table A.1.

A.1: Overview of Pension System in Burundi

	National Institute of Social Security – INSS	National Office of Pensions and Occupational Risks – ONPR	Private Pension Arrangements
Legal Structure	Law on Pension and Occupational Risks Statute No. 1/11 of 2002	Restructuring of Pension Schemes and Work Risks of Civil Servants, Magistrates and Judicial Officers Law, 2009	Legal Contracts
Coverage	All formal employees in the private sector, state agencies, police and army	Civil service and judicial service officers, except the army and police	Private employees covered under complementary private pensions established by employers or insurers
Funding	Funded – contributory		
Mandatory [10% of salary]	It was unfunded until 2010, when funding was introduced [9% of salary]	Funded employee/employer contributions - an average of 10%	
Regulation	Relevant Ministry – No supervisory agency	Relevant Ministry	Unregulated
Design	DB	DB	DC
Benefits	Annuities/Lump sums	Lump sums/Annuities	Lump Sums

Source: Regulatory authority

Note: DB = defined benefit. DC = defined contribution.

Mandatory Public Pension Scheme

The mandatory public pension scheme otherwise known as the INSS was established pursuant to the Law on Pension and Occupational Risks, Statute No. 1/11 of 29 November 2002. The law relates to the Reorganization of Regulations of Work Allowances and Risks for Workers under the Employment Act and other laws of that category. Following enactment, the law has been implemented since 2003. In terms of structure, the INSS is established as a corporate body with legal personality. It has a representative Board of Directors. The government, workers and employers are represented on the INSS board, with the Minister in charge of social security overseeing the scheme. As a contributory defined benefit scheme, the continued solvency of the scheme is guaranteed by the state.

Retirement benefits promised under the INSS are funded by contributions made by both employees and employers. The rate of contribution for pension benefits is 10 percent of salaries (capped at Burundian francs [BIF] 450,000), of which the employer pays 6 percent together with 3 percent toward the funding for occupational hazard benefits; 4 percent is paid by employees. The retirement age is 60, but a member will be eligible for a pension at age 60 after serving for 15 years.

As a defined benefit scheme, the benefits are calculated on the basis of final salary which is the average salary for the last three years of service. In determining a member's benefits, 2 percent of the final salary is added to the calculated pension amount for each year of service. However, the law caps the maximum pension at 80 percent of final salary. Those scheme members with less than 15 years of service are entitled to a lump sum benefit calculated as a monthly average salary times the number of years of service.

Civil Service Pension Scheme (ONPR)

The Civil Service Scheme, known in French as The Office National des Pensions et Risques

Professionnels des Fonctionnaires, des Magistrats et des Agents de l'Ordre Judiciaire (ONPR), falls under the law concerning the Restructuring of Pension Schemes and Work Risks of Civil Servants, Magistrates and Judicial Officers of 2010. The law consolidated earlier laws which covered civil servants, magistrates and judicial officers. Under Article 1 of that law, the scheme also covers the officers and their dependents, including widows, widowers and children. Thus, the scheme covers traditional civil servants, teachers, and government workers in the health and judicial sectors. The scheme is a corporate body with legal personality and is governed by a tripartite Administrative Council, which falls under the regulation and supervision of the Ministry of Social Affairs.

The scheme covers old age, disability, and death risks⁸⁹. The retirement age for accessing old age pensions is 60. The pension vesting requires participation totaling 15 years in the scheme⁹⁰. A disability pension is also payable to a member who becomes disabled before reaching retirement age on condition that such a person shall have participated in the scheme for at least three months, and in the calendar year preceding the beginning of the disability.⁹¹ Upon the death of a member, the scheme also pays a survivor's pension to a spouse, an orphan or descendant⁹².

Like the INSS, the ONPR scheme is a defined benefit contributory scheme with a pension formula based on acquired "points" through the payment of contributions. Employees make contributions calculated on the basis of nine salary brackets, and the employer contributes twice the amount paid by the employee — but not less than 4 percent of the basic salary. In order to provide for occupational hazard benefits, employers will pay 1 percent and another 1 percent of the cost of administration.

Occupational and Individual Pension Plans

Private occupational and individual pension plans are voluntary in Burundi. The few occupational schemes existing in Burundi are established

by employers for the benefit of their formal employees. The administration and management of these schemes is largely carried out by insurance companies.

Individual private pension schemes are contracts between the saver and the provider of the pension saving vehicle often insurance companies. These schemes are a segregated pool of assets without a legal personality but governed by a separate entity such as insurance companies. Owing to lack of a regulatory agency statistics of licensed occupational and private scheme is scanty.

Kenya

The retirement benefits sector in Kenya is comprised of the Civil Service Pension Scheme; the National Social Security Fund; the Occupational Retirement Benefit Schemes; and the Individual Retirement Benefit Schemes (Table A.1).

Civil Service Pension Scheme

The current pension arrangements for pensionable employees of the Kenyan civil service are provided for through the Pensions Act (Cap. 189), which commenced on January 1, 1946. A provision for the grants of pensions to widows and children of deceased male officers in the civil service is governed under the Widows and Children's Pensions Act (Cap, 195). Non-pensionable employees in the civil service comprised of junior subordinate staff currently participate in and contribute to the NSSF.

Under the provisions of the Pensions Act (Cap. 189), membership in the civil service pension scheme is compulsory for all full-time, permanent and pensionable employees in the civil service. The Act does not apply to employees on non-pensionable contract terms or employees of state corporations which have been declared to be public service because these employees are covered by their own

Table A.1: Pension System in Kenya

	Civil Service Scheme	National Social Security Fund	Occupational Schemes	Individual Schemes
Design	DB	DC [min. Interest Guarantee]	DB/DC	DC
Legal Structure	Pensions Act	NSSF Act	Trust Deed – RBA, Other Acts	Trust Deed – RBA
Coverage	all civil servants, military, teachers, MPs	All formal sector workers – mandatory	formal sector workers in companies that have schemes – voluntary	individuals formal/informal sector join voluntarily
Funding	Non-funded	Funded	Funded	Funded
Regulation/Supervision	Exempt from RBA	Subject to RBA	Subject to RBA	Subject to RBA
Benefits	Annuities and Lump sums	Lump sums	Annuities and Lump sums	Lump sums

Source: Regulatory Authority

Note: DB = defined benefit; DC = defined contribution; NSSF = National Social Security Fund; RBA = Retirement Benefits Authority.

separate pension plans or Acts of Parliament. The civil service scheme is non-contributory, with the government meeting the full cost of the pension benefits through tax revenues from the public.

The continued sustainability of the scheme is fully dependent on the sustainable collection of tax revenues at a rate which is proportional to the increase in pension liabilities. The pensions Act (Cap. 189) does not specifically provide for a normal retirement date for civil servants. The Regulations to the Act however require that no pension benefits can be paid unless retirement occurs on: (i) attaining the age of 50; (ii) abolition of the office; (iii) compulsory retirement; (iv) ill-health retirement subject to satisfactory medical evidence; and (v) termination of service in the public interest.

The in-service employees may retire at or after age 50 on unreduced pensions with the consent of the government. Employees in specific categories (for example, police officers or subordinate officers; prison officers below the rank of chief officer; administration police officers below the rank of senior sergeant; and forest guards of grade 1, 2 and 3) may opt to retire after a period of service exceeding 12 years — but not exceeding 20 years, provided that at least one month's notice of intention to retire is given⁹³.

Pension benefits accrue to a member of the scheme after such a member has served for a period of more than ten years of pensionable service. An annual pension amounts to 1/480th of the final pensionable emoluments for each month of pensionable service⁹⁴. The fraction of 1/480 of the final pensionable salary is applied to all the months of pensionable service of the member to determine the payable pension. Under the law, employees may opt to commute or convert up to one-quarter of their accrued pension for a cash lump sum payment on retirement. Currently, the applicable cash commutation is Kenyan shilling (KSh) 20 for each 1 KSh of the pension given to a member.

On the death of a member while in service, but before retirement, a lump sum of the higher of twice the pensionable emoluments at the date of death and 5/480ths of the pensionable emoluments multiplied by the period of pensionable service in months is paid. The pension to the spouse or child for a period of five years is calculated at a rate not exceeding the pension that could have been granted to the employee if he/she had retired on ill-health grounds of at the date of death.

On the death of a pensioner, the pension payable continues for five years after death. If the pension payments received since retirement are a total of less than twice the pensionable emoluments at the date of retirement, then the difference is paid in a lump sum⁹⁵. The maximum pension payable under the Act may not exceed 100 percent of pensionable emoluments drawn by the employee at the date of retirement⁹⁶. The minimum pension currently payable is KSh 500 per month. The Act does not guarantee pension increases. In this context, there have been only four pension increases in the last 40 years.⁹⁷

Thus, the Kenyan pension scheme has a generous benefits design. However, this will expose the scheme's continued sustainability, especially when the government continues to increase civil service salaries without adjusting the pension benefits. It is important to note, though, that civil servant pensions are pegged to 'basic salaries', which are usually very small. Therefore, the generous benefits design does not necessarily translate into high benefits for an individual pensioner.⁹⁸

To stem the ever-growing implicit pension liability of the government, it enacted the Public Service Superannuation Act in 2012. This Act establishes a contributory public service superannuation scheme for providing retirement benefits to public service employees. The scheme introduces reforms in the civil service pension scheme by including pre-funding and converting it into a defined contribution scheme. New civil service employees and current civil servants who at the commencement of the Act were below 45 years of age are subject to the

provisions of the Act. Those employees who at the commencement of the Act are above 45 years may opt to transfer their accrued rights to the new scheme and be subject to the new law⁹⁹.

Civil servants and the government will make contributions to the scheme fund, and it will be supervised by the Retirement Benefits Authority. The rate of contribution is 22.5 percent of pensionable emoluments, of which the employee will contribute 7.5 percent and the employer at least 15 percent¹⁰⁰. A member is permitted to make additional voluntary contributions, subject to guidelines issued by the Board of Trustees. Unlike other schemes in the country the full vesting of employer contributions is delayed up to the tenth year of participation in the scheme. The aim is a deliberate strategy to retain civil servants and avoid frequent staff turn-over in the public service. Although enacted by Parliament on May 9, 2012, the Minister responsible for matters relating to finance has not implemented the Act. Thus, the Act is not yet operational.

National Social Security Fund (NSSF)

The NSSF is established under the provisions of the National Social Security Fund Act (Cap. 258). The NSSF is a provident fund and operates on a notional defined contribution basis with a member maintaining an individual, numbered account. The NSSF Act vests the management of the fund in a Board of Trustees comprised of ten members appointed by the Minister in charge of labor and social security matters, as follows:¹⁰¹ (i) the permanent secretary to the Treasury; (ii) the permanent secretary to the Ministry responsible for labor and social security; (iii) the Managing Trustee of the NSSF; (iv) two representatives of employers; (v) two representatives of employees; and (vi) three others appointed by reason of their skill in matters relating to banking, insurance, investments, pensions, auditing, law and corporate business management. The Chairman shall be chosen from among those members who are not ex-officials. Thus, the Board of Trustees is comprised

of representatives of government, the trade unions and the federation of employers.

The NSSF covers salaried employees in the private sector, including employees of non-exempt parastatals and non-pensionable junior officers in the civil service. Contributions to the NSSF are set at 10 percent of wages, shared equally by employer and employee with a ceiling of KSh 400 per month. The Act requires employers to deduct the employees' contribution at the end of each month and remit all contributions to the NSSF. The current contribution rate is trivial because an employee with a 30-year career history would accumulate KSh 144,000 only in contributions. The NSSF is subject to the supervision of the parent Ministry of Labor. In addition, the NSSF is subject to the provisions of the Retirement Benefits Act (Act No. 3 of 1997). Therefore, the Retirement Benefits Authority has a regulatory and supervisory role over the NSSF.

Part IV of the Act provides for the benefits structure payable by the NSSF. The benefits payable includes:¹⁰² old age benefits, survivor benefits, invalid benefits, withdrawal benefits, and emigration grants. Old age benefits are paid in the form of a lump sum at the retirement age of 55, but early retirement at age 50 is also allowed by the law.

The Board of Trustees is vested with powers to invest the assets of the NSSF. The law does not require the use of professional asset managers in the investment of NSSF assets. The NSSF however, is required to comply with the investment guidelines provided for in the Retirement Benefits Act¹⁰³.

In order to reform the National Social Security Fund, in December 2013, the government enacted the National Social Security Act (No. 45 of 2013). The new legislation repealed the previous National Social Security Act (Cap. 258). The new NSSF Act of 2013 became effective on January 10, 2014. However, implementation of the Act has been delayed because of legal disputes by employers and employees opposed to the requirement for increased contributions provided for in the Act.

The objectives of the new NSSF Act of 2013 include: (a) the establishment of a pension fund as opposed to the previous provident fund, where benefits were paid in lump sum at retirement; (b) an increase in coverage to the previously uncovered workers in both the informal and formal sectors by promoting voluntary membership in a new provident fund established under the new Act; and (c) the provision for contracting out of the scheme for tier two contributions; this is to be permitted by supplementary occupational retirement benefit schemes. In order to manage the transition from the previous scheme, the new NSSF Act of 2013 ring-fences the assets and liabilities of the previous scheme until the last member of that scheme is paid. Policy makers expect that the new NSSF Act of 2013 will generally facilitate the improvement of the level of benefits commensurate with enhanced contributions, as well as with the introduction of pension benefits instead of the previous lump sum payments.

The new NSSF Act of 2013 provides a new basis for contributions to the scheme. Contributions are a percentage of pensionable earnings. These earnings, which comprise gross earnings excluding fluctuating earnings, are categorized as lower and upper earning limits. The rate of contribution is 12 percent of pensionable earnings shared equally between the employer and the employee. The implementation of the rate of contributions is phased in over a period of five years from the date of

commencement. Table A.2 indicates how the phase out of the new contributions will be implemented.

The scheme operates two savings tiers. Tier I contributions comprise 12 percent of pensionable earnings but are limited to the lower earnings. Tier II contributions will also be limited to 12 percent of pensionable earnings between the lower earnings limit and the upper earnings limit. Contributions made to Tier II may be contracted out of the scheme and made to other schemes, as permitted by the Retirement Benefits Authority.

The new National Social Security Fund remains a defined contribution scheme, except that it provides for a pension benefit unlike the previous provident fund. The enhanced mandatory contributions will certainly reduce the amount of contributions previously remitted to the supplementary schemes. The opposition to the new scheme by employers and employees operating voluntary occupational schemes is premised on the suspicion that the new scheme — based on experience with the previous scheme — will not have superior governance standards to guarantee optimal performance compared to the privately managed occupational schemes.

Upon operationalization, the new scheme will collect huge contributions. Indeed, it is poised to become the scheme with the largest assets in the East Africa region.

Table A.2: NSSF Contribution Schedule

Year	Lower Earnings Limit	Upper Earnings Limit
1	KSh. 6,000	50% of the National Average Earnings
2	KSh. 7,000	1 times the National Average Earnings
3	KSh. 8,000	2 times the National Average Earnings
4	KSh. 9,000	3 times the National Average Earnings
5 Years and Beyond	Lower Earnings Limit as defined in the Act	4 times the National Average Earnings

Source: Regulatory authority

Note: The lower earnings limit is the average statutory minimum monthly wage for top urban centers, second tier urban centers and rural areas. The national average earnings are the average wage earnings, as published by the Kenya National Bureau of Statistics in the Economic Survey Publication for the prior year. The upper earnings limit is four times the national average earnings.

Occupational Retirement Benefit Schemes

Occupational retirement benefit schemes form the second pillar of social security. These are voluntary schemes set up by employers and are specifically designed for their employees. The number of occupational retirement benefit schemes is estimated at 1,200. However, the membership of these schemes remains low, with membership drawn mainly from the private sector and quasi-governmental institutions.

Private occupational retirement benefit schemes are established under the law of trusts as irrevocable trusts, except when established under a written law.¹⁰⁴ The management of this scheme is therefore vested in Boards of Trustees of not less than 3 persons for defined benefits schemes and 4 persons for defined contribution schemes.¹⁰⁵ To enhance governance, the Retirement Benefits Act Regulations require that for defined benefit schemes, members shall elect one-third of the Board of Trustees, whereas for defined contribution schemes, the members shall appoint 50 percent of the total number of trustees.

As legal owners of the scheme assets, trustee duties include:¹⁰⁶ (i) administering the scheme in accordance with the provisions of the Retirement Benefits Act and regulations thereunder, as well as scheme rules; (ii) keeping all proper books and records of accounts with respect to income, expenditures, liabilities and assets of the scheme; (iii) developing an investment policy to guide the asset manager of the scheme assets on the day-to-day investment of the assets of the scheme; (iv) ensuring collection of the correct contributions from the scheme sponsor and remittance of the same to the scheme custodian from which the assets are invested; and (v) appointment of professional service providers of the scheme, including fund managers and custodians; they must be appointed for compliance with the statutory requirement in the Retirement Benefits Act.

Each scheme pays pension benefits in accordance with the provisions of the scheme rules. Some

are provident funds, which pay lump sums at retirement, whereas others are designed to pay monthly pensions or annuities at retirement. Under the Retirement Benefits (Occupational schemes) Regulations, a member of the scheme leaving employment before attaining retirement age may access the whole of all member contributions and fifty percent of the employer contributions together with interest earned thereon. The effect of this rule is that most members who opt for early exit from employment and access withdrawal benefits, may, at normal retirement, not have an adequate flow of retirement income.

The Retirement Benefits Act also requires all defined benefit schemes to undergo actuarial valuations every three years.¹⁰⁷ Most of the defined benefit schemes are established by state corporations. However, with their budget deficits, these corporations account for most of the underfunding of pension schemes.

Individual Retirement Benefit Schemes

Individual retirement benefit schemes are private retirement arrangements set up by financial institutions to provide an avenue for retirement savings for those employed in the informal sector, the self-employed or those workers whose employers have not set up retirement benefit arrangements. The schemes typically operate like individual bank accounts in that contributions made by an individual are credited to individual accounts and invested. The accrued benefits together with the investment income are payable at the time of exit. Retirement savings in these schemes is also encouraged by tax incentives.

This summary of Kenya's pension system reveals that it is comprised of pension schemes that seek to largely cover the formal sector. Competition for membership also occurs from that same sector. The appropriate policy and legal reforms to cover all citizens are long overdue. An ideal pension system would have a first pillar to provide a social safety net in the form of a universal pension to the

elderly poor. The second pillar would address the smoothing of consumption of those employed by requiring mandatory saving, as well as the guarantee of a basic pension with some level of government guarantees. The third pillar will also address the smoothing of consumption, but with a higher incentive to save more to supplement income from the second pillar. Such a structured system would help widen coverage to the elderly poor, enforce coverage for workers and encourage consumption smoothing for those employed.

Rwanda

The Rwanda pension sector is dominated by the national mandatory scheme known as the Caisse Sociale du Rwanda (Social Security of Rwanda) (CSR), which is a defined benefit mandatory

pension scheme. Voluntary pension schemes are few and small in fund size (Table A.3).

On 18th May 2015, through the official gazette, the government of Rwanda published the Law Governing the Organization of Pension Schemes.

The mandatory pension scheme covers all employees in formal employment situations, whether public or private sector, irrespective of their nature, type and duration of employment or salary. Political employees are also covered, including employees of international organizations operating in Rwanda.¹⁰⁸

Occupational pension schemes are work-based schemes intended to cover employees of a particular employer as a term of employment. They are established upon an agreement between

Table A.3: Pension System in Rwanda

	Mandatory Pension Schemes	Occupational Pension Schemes	Personal Pension Schemes
Legal Structure	Laws enacted by Parliament [Pension Law and CSR]	Pension law and scheme rules	Pension law and law of contract
Coverage	All public and private sector employees in Rwanda, including political appointees.	Formal sector workers of employers with occupational pension schemes.	Self-employed persons, salaried employees whether active in a pension scheme or not and a pensioner who transfers accumulated savings to a personal pension scheme.
Funding	Funded – contributory Mandatory scheme	Funded – either contributory or non-contributory; funded by employers only or by employer and employee contributions	Funded – own contribution Voluntary
Regulation	Subject to the Pension Law – with the BNR as supervisor	Subject to Pension Law – with the BNR as supervisor	Subject to Pension Law – with the BNR as supervisor
Design	DB	DB/DC – Employer and employees to agree	DC – contract-based saving schemes
Benefits	Annuities/Lump sums	Lump sums/Annuities	Lump Sums/Annuities

Source:Regulatory authority

Note: BNR = National Bank of Rwanda; DB = defined benefit; DC = defined contribution.

the employer and employees. The terms of an occupational pension scheme will therefore be subject to negotiation between the employees' representatives and the employer. As such, each new employee will adhere to the agreed terms of the pension scheme under the contract of employment.

Personal pension schemes are established under a contract between a provider (of a provider) of a personal pension scheme and the individual saver. These schemes cover self-employed persons on a voluntary basis, as well as formal employees not covered under an occupational pension scheme and deferred members of occupational pension schemes.¹⁰⁹

Mandatory Pension Scheme

The mandatory pension scheme is a prefunded defined benefit pension scheme providing old age benefits, early retirement benefits, non-occupational disability benefits and survivorship benefits. Old age pensions are computed on the basis of final salaries and shall be equal to thirty percent of the average monthly earnings of the insured. Old age benefits shall be increased by two percent for every twelve months exceeding one hundred and eighty months. The average monthly earnings are defined as the last five years preceding the date of entitlement.¹¹⁰

The benefits provided by the mandatory pension scheme are pre-funded. Contributions to the mandatory pension scheme are calculated on the basis of gross salaries, excluding allowances that are compensatory in nature. The rate of contribution is determined by a presidential order and is equally shared between employees and employers.

Article 11 obligates the employer to collect and remit contributions to the public entity in charge of the scheme. This would be done on a monthly basis by the fifteenth of the subsequent month. The mandatory pension scheme is not exempt from the requirement of appointing a custodian¹¹¹. The requirement to remit contributions to the RSSB may appear contradictory with Article 62,

which requires custodians to receive and keep in good record all the contributions of the scheme. This regulatory challenge may be clarified by the guidelines of the regulator. Employers are liable to pay any amount due and unpaid contribution together with a pecuniary penalty of 1.5 percent per month of the unpaid contributions.

The law specifies a number of benefits payable from the mandatory pension scheme. The benefits include: (i) old age benefits; (ii) early retirement benefits; (iii) non-occupational disability benefits; and (iv) survivorship benefits for beneficiaries. Benefits under the voluntary schemes shall be provided for according to the respective scheme rules. Article 33 requires pension benefits to be paid in Rwanda. They are not transferable abroad, except as may be permitted under reciprocal agreements or international conventions such as the East African Community Treaty, which permits the free movement of labor and services within the region.

The administration of the mandatory scheme is vested in the RSSB.

Occupational Pension Schemes

The design of occupational pension schemes will be determined by the scheme rules. Most of the occupational pension schemes are defined contribution schemes, although some may have death benefit guarantees which are self-insured.

Contributions to occupational pension schemes are determined by the scheme rules as negotiated and agreed between employee representatives and the employer. The regulator has the power to issue regulations to provide for the governance and operations of the scheme. The rates of contributions vary from scheme to scheme depending on the nature and extent of the benefits promised.

Personal Pension Schemes

Personal pension schemes are individual accumulation accounts without any guarantees.

Account holders in a personal pension scheme shall determine their own rate of contribution and frequency of remittance, subject to any minimum amounts which may be set in the contract or regulations under the law. In cases of default of remittance of contributions, trustees, administrators and custodians have been obligated under the law to report to the regulator if such a delay exceeds 30 days after the due date of remittance.¹¹² The administration of voluntary pension schemes is outsourced to licensed administrators.¹¹³

The Rwanda pension system has been dominated by CSR, and it will continue to be dominated by that mandatory scheme. The new regulatory framework will enhance supervision, incentivize the development of supplementary pension schemes on a voluntary basis, and enable portability of benefits across the EAC region. Whether the legal recognition of voluntary occupation schemes and personal pension plans will translate into extended coverage remains to be seen.

Republic of South Sudan

The Pension sector in the Republic of South Sudan is mandatory defined contribution. It was established after the attainment of independence in 2011 from the Republic of Sudan. The pension sector is governed by the following laws: (i) The transitional constitutional of the Republic of South Sudan 2011 that gives the rights of establishment of the pension sector in the country; (ii) The South Sudan pension fund Act 2012 and the civil service pension scheme Act 2013 are currently the only functional pension Acts in the country. Other pension Bills like that of the Military pension scheme, the organized forces pension scheme, the private sector pension scheme, Bank of South Sudan scheme are currently under development cover the formal pension sectors; (iii) The RSS civil service provisional order, 2011; (iv) The civil service regulations 2011¹¹⁴; (v) ILO Convention number 102.

The informal sector workers are the majority in the Republic of South Sudan. However plans are underway to establish the informal sector pension

in the country. There is need to put in place a regulatory framework for the pension sector.

Tanzania

Until February 8, 2018, Tanzania had five mandatory social security schemes, including: (i) the Government Employees Pension Fund (GEPF); (ii) the Local Authorities Pension Fund (LAPF); (iii) the Pension Protection Fund (PPF); (iv) the National Social Security Fund (NSSF); and (v) the Public Service Pension Fund (PSPF). However, on February 8, 2018 the Government of Tanzania enacted the Public Sector Social Security Fund Act, which established the Public Service Social Security Scheme in Tanzania. The Act provides for social security benefits for employees in the public service and details the manner of funding those benefits through contributions.

The Act repealed the existing legislation establishing the public sector social security schemes which included: The Public Service Retirement Benefit Act, Cap. 371; the LAPF Pensions Fund Act, Cap. 407; the GEPF Retirement Benefits Fund Act Cap. 51; and the PPF Pensions Fund Act, Cap. 372. As such, the Public Service Social Security Fund (PSSSF) represents a consolidation of the previous public sector schemes into one scheme¹¹⁴. In order to improve the arrangement of the social security sector in Tanzania and address the problem of fragmentation and unhealthy competition, the Act amends the National Social Security Fund Act. Specifically, it mandates it to cover and provide social security benefits to employees in the private sector, as well as the self-employed.

Tanzania currently has two tiers of social security schemes, namely: (i) the Public Service Social Security Fund under the Public Service Social Security Act; and (ii) the Private Sector Social Security Scheme under the National Social Security Fund Act, which is supervised by the Social Security Regulatory Authority. The new Act provides for the transfer of membership and accrued social security benefits between the two schemes if an employee were to transfer his/her services from one sector to

the other. Table A.4 provides a brief description of the two schemes.

The Public Sector Social Security Fund

Section 29 of the PSSSF Act provides for a wide range of the following social security benefits payable to eligible members of the scheme; (i) retirement pension benefits; (ii) survivor benefits; (iii) invalid benefits; (iv) maternity benefits; (v) unemployment benefits; (vi) sickness benefits; and (vii) death gratuities. In this context, it should be noted that the PSSSF scheme introduced survivor and unemployment benefits, which were not provided under the previous public sector schemes. Survivor benefits will be payable to the dependents of the deceased member including the surviving spouse, children or parents of the deceased.

Eligibility for Benefits

Eligibility requirements for benefits are set out in Section 26 of the Act. They include the attainment of the compulsory retirement age of 60, attainment of the voluntary retirement age of 55, being a

medical invalid, and termination of employment for the public interest. Unlike the previous public sector schemes, the Act provides for the preservation of benefits and outlaws the withdrawal of benefit to members. The introduction of unemployment benefits is intended to lock in accrued benefits of a member who leaves employment before their retirement date in order to guarantee a stream of income in old age.

Funding

In order to fund the guaranteed benefits, the PSSSF Act provides for a monthly contribution at the rate of 20 percent of the employee's monthly salary, which shall be shared between the employer and employee at the rate of 15 and 5 percent respectively.

National Social Security Fund

The scheme is established under the provisions of the National Social Security Act (Act No. 28 of 1997), becoming effective on July 1, 1998. The Act replaced the former National Provident Fund (established in 1964) to provide a wider range of benefits. It is a compulsory scheme administered

Table A.4: Pension System in Tanzania

	NSSF	PSSSF
Legal Framework	NSSF Act	Public Sector Social Security Fund Act
Coverage	All private sector employees and self-employed workers	All formal public sector employees on permanent and pensionable terms
Funding Status	Funded	Funded
Contributions	Employer – 10%	
Employee – 10%	Employer – 15%	
Employee – 5%		
Design	DB/DC	DB
Benefits	Annuities and Lump sums	Annuities

Source: Regulatory Authority

Note: DB = defined benefit; DC = defined contribution; NSSF = National Social Security Fund; PSSSF = Public Service Social Security Fund.

by a representative Board of Trustees. The scheme covers all employees in the private sector, as well as informal sector workers. Contribution rates are set at 20 percent shared equally between employer and employee. The scheme is designed on the International Labour Organization (ILO) social security principles and provides an array of benefits, including: old age benefits; disability benefits; survivor benefits; funeral grants; maternity benefits; employment injury benefits; health insurance benefits; and withdrawal benefits.

In sum, Tanzania has two mandatory schemes, both defined benefit schemes, with one covering public sector workers and the other private sector workers, including the informal sector. The sector is regulated by the Social Security Regulatory Authority (SSRA). Although there is effort to extend coverage to all formal sector workers, the extension of coverage to the informal sector workers is limited. The NSSF has been given a specific mandate (under the amended section 6 of the NSSF Act) to provide coverage to informal sector workers through more flexible arrangements.

Uganda

Uganda's pension system has been undergoing reforms since early 2000. The reform agenda was aimed at creating a supervisory agency for the retirement benefits sector and liberalizing the national mandatory scheme by creating more channels through which statutory contributions can be collected, invested and benefits paid to members. It also sought to reform the public service pension scheme by pre-funding the benefit currently offered under that scheme. The reform program has achieved one goal, that is, the enactment of the Uganda Retirement Benefits Regulatory Authority (URBRA) Act, 2011. It establishes a supervisory agency and mandates it to regulate and supervise the retirement benefits sector. The other two reform objectives relating to liberalizing the management of mandatory contributions and pre-funding the benefits promised under the public service scheme are still under discussion by stakeholders.

The current retirement benefits sector in Uganda is comprised of four main components, namely the mandatory NSSF for formal sector employees, the Public Service Pension Scheme, the Military Pension Scheme, as well as several supplementary occupational pension schemes and individual savings and retirement benefit schemes. Table A.5 presents a summary of the retirement benefits sector.

The retirement benefits system in Uganda, as in other Commonwealth countries in sub-Saharan Africa, was designed by the colonial powers to provide coverage for formal employees, particularly for those working in the colonial administration. It catered only to public and formal private sector employees. The system has undergone parametric changes over the years and is currently regulated by an array of laws including; the Constitution of Uganda; the Pension Act; the Armed Forces Pension Act; the Uganda Public Service Standing Orders (2010 edition); the Parliamentary Pensions Act; the Retirement Benefits Regulatory Authority Act; and the National Social Security Fund Act. In addition, since the enactment of the Uganda Retirement Benefits Regulatory Act which established a regulatory agency for the sector, a number of private occupational retirement benefit schemes have been established under irrevocable trusts by employers to cover their employees.

In this section, an analysis of the types of schemes in Uganda is provided. The system largely covers formal sector workers. It is only recently that informal sector workers have developed an interest in establishing suitable schemes.

Public Service Pension Scheme

The scheme was established on January 1, 1946 to regulate the arrangements of pensions for traditional civil servants, primary and secondary school teachers, police officers, prison officers, doctors and public employees in the judiciary. The Pensions Act also covers civil servants working for the local authorities. It should also be noted

Table A.5: Pension System in Uganda

	PSPS/Local Authorities	AFPS	NSSF	Occupational Schemes
Legal Framework	Pensions Act [Cap. 286]	Armed Forces Pensions Act [Cap. 298]	NSSF Act [Cap. 222]	URBRA Act 2011/Trust Law or Act of Parliament
Coverage	Civil servants, local Government workers, police, prison officers, judiciary, doctors, and teachers	Military officers	Formal sector workers – employers with 5 or more employees	Formal employees in companies /institutions with pension plans
Benefits Financing	Tax revenues	Tax revenues	Accumulated individual accounts (employer 10%; employee 5%)	Scheme funds - contributory according to plan rules/enabling Act
Benefits Payment	Annuities and lump sums	Annuities and lump sums	Lump sums -Provident Fund	Annuities and lump sums, depending on plan rules

Source:Regulatory Authority

Note: AFPS = Armed Forces Pension Scheme; NSSF = National Social Security Fund; PSPS = Public Service Pension Scheme; URBRA = Uganda Retirement Benefits Regulatory Authority.

that until 1994, the urban authorities had their own provident funds established under the provisions of the Municipalities and Public Authorities Provident Fund (Cap. 291). After a 1994 amendment of the Pensions Act, all urban authorities were required to provide pensions to their workers. The scheme commonly called for public service pension schemes to cover civil servants working in the central government and local authorities. The Armed Forces are provided for under the Armed Forces Pension Act. The scheme provides various types of benefits (Table A.6).

The public service pension scheme is a non-contributory defined benefit scheme. As a pay-as-you-go scheme, the benefits are funded by the general tax revenues. The Ministry of Public Service is responsible for the administration of the scheme, although recently through government policies, retiring public officers are paid their benefits through the last Ministry they worked for before their retirement.

The scheme has generous benefits in terms of accrual rates. As such, it will face challenges in terms of sustainability and affordability. The need for reform of the scheme is currently under consideration, and it is based mainly on the inability of the scheme to balance its liabilities and financing obligations. In order to address the problem of benefit financing, policymakers may consider systemic reform of the scheme from the current non-contributory defined benefit scheme to a pre-funded scheme on a defined contributory scheme basis. Pre-funding will require that employers and employees make regular contributions to the scheme in order to deliver the promised benefits. However, if it remains a defined benefit pre-funded scheme, the government will assume the investment risk. Pre-funding the scheme will trigger other governance challenges, such as scheme asset management and governance. The scheme is supervised by the URBRA, which is necessary to build confidence among members and other stakeholders.

Table A.6: Parameters of Armed Forces Pension Scheme

Type of Benefit	Eligibility	Benefit Calculation
(a) Commuted Pension Gratuity (CPG)	At least 45 years of age, with service of at least 10 years or 20 years continuous pensionable service. Mandatory retirement is 60 years of age, except for the police service who shall retire at 55.	$(1/500\text{th of the annual salary before retirement} * \text{No. of months served}) * (1/3) * 15$. [The maximum number of months to be considered while computing pension benefits is 435 months according to the Pensions Act].
Monthly Pension	At least 45 years of age with a service of at least 10 years or 20 years' continuous pensionable service. Mandatory retirement is at age 60, except for the police service who shall retire at age 55.	$[(1/500\text{th of the annual salary before retirement} * \text{No. of months served}) * (2/3)]/12$. [The maximum number of months to be considered while computing pension benefits is 435 months according to the Pensions Act].
(b) Survivors' Benefits	Paid to spouse and children below the age of 18 when the pensioner dies before expiry of 15 years after the date of retirement.	Monthly pension of a pensioner paid for 15 years.
(c) Benefits on abolition of office.	Abolition of office	Normal pension plus 25 percent of pension plus severance pay plus repatriation expenses plus six months' pay in lieu of notice, plus pay in lieu of approved, earned leave.
(d) Contract Gratuity (for public officers on contract)	Expiry of contract agreement	Gratuity in line with the terms of the contract agreement. It is often a predetermined percentage of the annual gross salary.
(e) Death benefit	Death of a public officer	Deceased public officer's annual salary at time of death x 3, or the amount of the deceased officer's commuted pension benefit, whichever is greater.
(f) Short-service benefit	Termination of service of a public officer on account of public interest or on medical grounds on condition that the officer completed at least 10 years of pensionable service.	$(1/500\text{th} * \text{annual salary before retirement} * \text{No. of months of service}) * 15$
(g) Marriage benefit	Female public officers retiring on marriage grounds.	$(\text{No. of months worked} * \text{Annual salary}) * 15$
(h) Benefits for Police and Prison Officers	Police officer retiring below rank of Assistant Inspector of Policar, or Prisons officer below a Principal Officer, having served for 12 years or more.	25 % of total emoluments or less.

Source: The Pensions Act [Cap. 281] and the Pensions Regulations and Standing Orders.

National Social Security Fund

The National Social Security Fund is a mandatory, pure defined contribution provident fund which pays lump sums at retirement. The contribution rate to the NSSF is 15 percent shared at 5 and 10 percent between employees and employers, respectively. The scheme is a creation of the National Social Security Fund Act (Cap. 222) Laws of Uganda. Its core objective is to protect formal employees against the uncertainties of social and economic life. In order to realize its core objective, the Fund provides the following benefits to its members:

- Old age benefits in the form of lump sum payments at age 55, after retiring from regular employment, or early withdrawal at age 50;
- Invalid benefits;
- Death benefits (survivors' benefits); and
- Benefits paid on the basis of permanent emigration from Uganda.

The core mandate of the NSSF Board of directors is to efficiently collect contributions, prudently invest such contributions, and pay benefits promptly. To achieve this objective, the governance of the Fund must be of high quality. As it is a mandatory contributory scheme for every employer with more than 5 employees, the scheme has accumulated a large amount of assets. In this context, it has become dominant, effectively amounting to a monopoly in the retirement benefits sector.

Most eligible employers have not registered with the National Social Security Fund, and the capacity to enforce statutory registration by the Fund is ineffective. Further, the legal framework under which the Fund operates excludes from registration those employers with less than 5 employees. As such, it excludes a large number of employees working in small enterprises from coverage. The scheme faces political and governance risks owing

to its size in the market and the interest it attracts. Institutional reforms to strengthen its governance framework and complete the outsourcing of its asset management may address the scheme's political, governance and investment risks.

Private Occupational and Informal Schemes

Before the enactment of the Uganda Retirement Benefits Regulatory Authority Act, few employers had established private occupational retirement benefit schemes as trusts. The number of private occupational retirement benefit schemes has increased since its enactment. The Act also regulates the establishment, licensing and management of these schemes. Unless established under an Act of Parliament, all schemes are required to be established as irrevocable trusts. Trustees of these schemes must be licensed by the Authority and appoint service providers who are also licensed. The assets of private occupational retirement benefit schemes are held separately from the employers (sponsors) and are instead held by licensed sponsors of the schemes. Fund managers who are duly licensed to offer fund management services are the only persons permitted to invest assets of pension schemes in Uganda.

As noted, the legal framework does not favor participation by the informal sector workers in the system. However, since the enactment of the URBRA Act, 2011, informal sector workers have established two informal sector schemes, which have been licensed by the Authority. These schemes established as irrevocable trusts provide for flexible entry and exit rules, thereby allowing members to contribute an amount they can afford without any regularity. The working population not covered under the National Social Security fund can find private occupational retirement benefit schemes and informal schemes suitable as savings vehicles for their retirement.



ANNEX B:

PENSION REGULATORY FRAMEWORKS IN EAC COUNTRIES

Kenya

The primary legislation for the regulation of the retirement benefits sector in Kenya is the Retirement Benefits Act of 1997. The Act establishes the Retirement Benefits Authority and mandates the Authority to regulate and supervise the retirement benefits sector. The specific objects¹¹⁵ of the Authority are to:

- Regulate and supervise the establishment and management of retirement benefit schemes;
- Protect the interests of members and sponsors of retirement benefit schemes;
- Promote the development of the retirement benefit sector;
- Advise the minister responsible for the national treasury on the national policy for the sector; and
- Implement all government policies relating to the retirement benefit sector.

Unless established by a written law, retirement benefit schemes in Kenya are constituted as irrevocable trusts. The common law and doctrines of equity applicable to trusts also apply to retirement benefit schemes established under trusts so long as those doctrines do not conflict with legislation. All retirement benefit schemes established as irrevocable trusts maintain the three features of a trust, including: the maker of the trust (sponsor), the trustees and beneficiaries of the trust property. The sponsors include employers or any other institution or organization resolving to establish a retirement benefit scheme. The trustees are appointed by the sponsors. However, scheme members are legally

empowered to nominate up to one half of the total number of trustees. The beneficiaries include members and any other persons entitled by law to make a claim for a benefit from the retirement benefit scheme.¹¹⁶

Apart from establishing the supervisory agency, the Retirement Benefits Act provides procedures for the establishment of a retirement benefit scheme, as well as registration procedures. The Act also provides for the governance of the scheme, which would primarily entail scheme funding, investment of scheme assets and the effective management of the benefit payment phase. The Act covers a variety of other issues, such as member rights, the supervisory process covering the monitoring of the sector, analysis of information collected and enforcement of supervisory stances depending of the level of risk identified by the supervisory agency.

A person who proposes to establish a retirement benefits scheme or to act as a manager, custodian or administrator of a scheme is required to apply for registration with the Authority.¹¹⁷ The Authority shall issue a certification of registration upon satisfactory compliance with the registration requirements. Although registration of a retirement benefit scheme is perpetual, that the registration of service providers must be renewed annually.

The scheme rules must adequately protect the rights and interests of sponsors and members of these schemes. In addition, scheme funds as trust property must be maintained separately from any other legal entities, including the sponsor. The statutory

requirement to separate the functions in the scheme to different parties may appear expensive, but the risk of self-dealing and conflict of interest appear to be more costly than separating the roles to various service providers.

It is an offense to establish a retirement benefit scheme in contravention of the provisions of the Act and without a certificate issued by the Authority. In addition, persons purporting to act as managers, custodians and administrators contrary to the provisions of the Act commit an offense and are liable to a fine on conviction.¹¹⁸

The governance structure of retirement benefit schemes is set out in legislation. A clear distinction of the roles of the different players in a retirement benefits scheme is provided under the Retirement Benefits Act. Key players in the governance of a scheme include Trustees, Managers, Custodians, Administrators and Sponsors whose roles are always distinct.

The sponsor passes the resolution to establish a scheme. The powers and roles of the sponsor are limited, as specified in the written law. They include deciding on the rate of contributions payable, making deductions and remitting contributions to the scheme fund. The sponsor does not have statutory powers to terminate the scheme once it has been established. However, the sponsor may give notice of cessation of further contributions to the scheme, which may in turn trigger a winding up process by the trustees. All funds of the scheme constitute the trust property of the scheme and any portion thereof can only revert to the sponsor under very limited circumstances and with the permission of the Retirement Benefits Authority.¹¹⁹

Trustees are the legal owners of the scheme. They are responsible for effective scheme governance, and they execute their responsibilities for the benefit of scheme members and beneficiaries. They are directly responsible to the members and have a duty to act in the best interests of the members as beneficiaries. The duties of the trustees are stipulated in both the Retirement Benefits Act

and the Regulations. The Retirement Benefits Act provides fit and proper criteria for the appointment of trustees, including those who have been imprisoned for more than six months, those adjudged bankrupt, and those who have previously been involved in mismanagement of schemes. All such persons are ineligible for appointment as trustees.¹²⁰ Under the Occupational Schemes Regulations, the term of office of trustees is three years. However, they are eligible for reappointment.

In order to build confidence in schemes, the Board of Trustees, unless a corporate trustee is appointed, is comprised of member and sponsor appointees. The institutions allowed to act as corporate trustees are trust corporations incorporated under the Companies Act and are empowered to undertake trusts.

The law provides for the appointment of other service providers of a scheme. This includes the Manager whose function is primarily to undertake investment activities of the scheme fund, the Custodian who is responsible for the safe custody of scheme assets including title documents, and the Administrator who carries out administrative functions of the scheme, such as keeping and maintaining accurate member records.

Tanzania

The primary law regulating the retirement benefits sector in mainland Tanzania is The Social Security (Regulatory Authority) Act (Cap. 135) of the Laws of Tanzania. The Social Security (Regulatory Authority) Act [SSRA Act] establishes a regulatory and supervisory agency known as The Social Security Regulatory Authority [SSRA], which is mandated to carry out a number of functions and duties as detailed below:¹²¹

- Register all Managers, Custodians and Schemes;
- Regulate and supervise the performance of all Managers, Custodians and Social Security Schemes;
- Issue guidelines for the efficient and effective operation of the Social Security Sector;

- Protect and safeguard the interests of members;
- Register, regulate and supervise Administrators;
- Advise the minister on policy matters relating to the Social Security Sector;
- Adopt and promulgate broad guidelines applicable to all Managers, Custodians and Social Security Schemes;
- Monitor and regularly review the performance of the Social Security Sector;
- Initiate studies and reforms in the Social Security Sector;
- Appoint an interim administrator of schemes, where necessary;
- Facilitate the extension of social security coverage; and
- Conduct public awareness and sensitization regarding social security.

The regulatory framework in Tanzania creates five mandatory schemes under respective statutes. The legislation under which those schemes are established also creates respective boards of trustees as body corporates appointed by the President. This differs from the Kenyan case, where members of voluntary schemes have a right to appoint a portion of the trustees as a way of enhancing confidence in the system and removing the schemes from extreme political risks. However, all schemes in Tanzania hold annual general meetings where trustees present to scheme members the annual scheme performance in terms of performance, investment, financial management, benefits paid and future scheme plans. During these annual general meetings, members have an opportunity to ask questions relating to their scheme. Trustees or their agents are under obligation to respond accordingly. Annual general meetings do contribute to the transparency and accountability required of the schemes' governing bodies.

The statutory provisions in Tanzania, as in Kenya, Rwanda and Uganda, require that all schemes outsource asset management to licensed fund

managers. The implementation of this requirement has not yet been fully undertaken by the regulatory agencies. In Tanzania, the schemes are institutional in nature with independent legal personality. As such, they have the internal capacity to carry out asset management. Consequently, most of the assets are centrally managed by the respective schemes with limited outsourcing.

The power to regulate investments under the SSRA Act is vested in the Minister and Bank of Tanzania. The Minister shall issue investment regulations, and the Bank of Tanzania will issue investment guidelines.¹²² This duplicate role requires continuous consultation between the two institutions to enable harmony, thereby creating a clear regulatory process of the industry.

Rwanda

The sector is supervised by the National Bank of Rwanda. On May 18, 2015, the government of Rwanda published the Law Governing the Organization of Pension Schemes in the official gazette. The Law determines the regulatory framework for the pension sector and creates a supervisory framework for all pension schemes. It is expected that the new pension law will spur the growth of private pension schemes, which is vital in the formation and development of long-term capital needed for national development. The key features of the new pension law and its likely implications for the pension sector in Rwanda are highlighted herewith.

Until the enactment of the Pension Law in 2015, a number of laws regulated pension schemes in Rwanda. Those laws include: (i) the Law Governing the Central Bank of Rwanda, which mandates the National Bank of Rwanda (BNR) with responsibility to regulate and supervise pension schemes and social security institutions; (ii) the Law Establishing the Rwanda Social Security Board [RSSB] and Determining its Mission, Organization and Functioning, which mandates the RSSB with governing the Social Security of Rwanda (CSR) and a National Medical Insurance (RAMA) (which

under that law have been merged); (iii) the Law Determining the Responsibilities, Organization and Functioning of the CSR, which provides for the CSR and its operations before the merger with RAMA under the RSSB; and (iv) the Law on Direct Taxes, which makes a provision for the taxation of pension assets and sets the criteria for qualified schemes for purposes of tax exemptions.

The regulatory framework did not clearly determine the operating standards of pension schemes. In particular, there was no provision regulating the establishment and management of private pension schemes. The power to supervise is provided to the BNR. However, the legal framework was silent on the supervisory activities expected of the BNR regarding pension funds. As a result of this regulatory lacuna, the government enacted the Pension Law of 2015 to consolidate the governance, operations and supervision of all pension schemes, as well as the service providers permitted to participate in the sector.

The Pension Law regulates the mandatory pension scheme (CSR), the voluntary pension schemes and all service providers.¹²³ A mandatory pension scheme is established pursuant to Article 3 of the Pension Law to cover employees and political appointees. The CSR was established under the Decree Law of August 22, 1974 regarding the organization of social security in Rwanda. Article 3 of the new Pension Law seems to have reestablished the CSR. The mandatory pension scheme shall be governed by a qualified public entity¹²⁴. The law applies also to voluntary pension schemes which consist of complementary occupational pension and personal pension schemes.¹²⁵

Service providers to which the pension law applies include trustees, an administrator, a custodian, and an investment manager. These particular service providers are to be licensed by the regulator¹²⁶. Other service providers include auditors and actuaries who are not required to be licensed.

The governance structure of the mandatory pension scheme is established under a specific statute¹²⁷.

The scheme is governed by the Rwanda Social Security Board. The board is appointed by the President, but it reports to the Prime Minister. The selection of board members is informed by competency and expertise. The board is guided by the relevant statute and other government regulations in the execution of its governance obligation vis-a-vis the mandatory pension scheme.

Occupational pension schemes are governed by a Board of Trustees, thereby implying that they are established as trusts. The law is not explicit that these schemes must be established under a trust, but it is explicit that they must be governed by trustees. The trustees shall be appointed by the employer in collaboration with employees and approved by the regulator¹²⁸. Trustees are obligated to: (i) direct, control, and oversee the operations of a scheme; (ii) ensure that the operations of the scheme remain compliant with the requirements of the plan rules, investment policy and the law; (iii) develop scheme governance policies, such as the investment policy, and ensure prudent asset management; (iv) appoint service providers; (v) ensure timely and accurate payment of benefits; (vi) ensure the pension schemes funds are audited and that actuarial valuation is carried out as applicable; (vii) protect member interests during mergers, liquidations and acquisitions of the sponsoring employer; and (viii) ensure the timely collection of contributions and reporting to the regulator any incidences of delayed remittance of contributions¹²⁹.

Under the principles of the trust law, trustees will hold trust property as legal owners—and in trust for the beneficial ownership of members and beneficiaries. The structure creates a separation of assets of an occupational pension scheme from those of the sponsoring employer. This is intended to ring-fence pension assets from the reach of an employer, thereby enhancing the safety and protection of those assets from possible misapplication. As legal owners of pension assets, trustees are exposed to joint or several liability for any breach of trust. Although the whole obligation of scheme governance rests on trustees, they will typically not directly engage in daily and routine

management activities. In this regard, the law requires that trustees appoint administrators, custodians and investment managers to carry out the various management activities. However, even with the outsourcing of the various activities as permitted under the proposed law, the trust and the resultant obligations are not delegable.

Authorized financial institutions will provide personal pension schemes available to individual persons who will voluntarily open retirement savings accounts¹³⁰. The arrangement between the provider and the account holder is a contract. The law requires the standard contract to be approved by the regulator before it is marketed to potential account holders. The governance of the personal pension scheme is vested with the boards of directors of the provider of the product.

As in the case of occupational pension schemes, the provider will hold and invest those assets on behalf of the account holders. The arrangement creates a fiduciary relationship for which the provider is liable in the event of breach of terms of the contractual relationship. Further, providers are also required to appoint service providers to undertake the various activities involved in the management of the personal pension plan with a view to enhancing performance and protecting assets of account holders¹³¹.

The treatment of asset management between the mandatory pension scheme and the voluntary pension schemes in the Rwanda pension law is similar. All schemes are required to outsource asset management to investment managers, develop an investment policy and file an investment performance report with the regulator¹³².

The investment policy shall require scheme assets to be invested in the best interest of members and beneficiaries. In this context, best practice would require that the investment policy: (i) set appropriate benchmarks; (ii) provide for liquidity levels of pension assets; (iii) state the diversification policy intended to secure reasonable rates of return without unwarranted risk of loss and volatility;

(iv) identify areas of investment and allocation limits; (v) determine the risk tolerance levels; and (vi) provide for trustee oversight procedures regarding investment activities. The governing board of pension schemes is obligated to monitor investment performance on a quarterly basis. Investment activities shall comply with the regulations issued by the regulator.

The administration of voluntary pension schemes shall be outsourced to licensed administrators.¹³³ Administrators are the agents of the trustees of voluntary pension schemes. Essentially, administrative responsibility lies with the governing boards and trustees of pension schemes. The role encompasses the formulation of governance policies and the execution of all day-to-day administration activities of pension schemes, including monitoring the performance of service providers and liaising with the regulator. Some of the generic administrative activities, some of which are envisaged in the pension law, include the following:

- Ensure all eligible members are registered and covered under the pension scheme. In the case of the mandatory pension scheme, the governing board will ensure that employers and employees are registered¹³⁴.
- Ensure the accurate and timely remittance of contributions from the employer(s) to the scheme custodian. This obligation applies to all governing boards and trustees of all pension schemes.
- Undertake the development of governance policies, which include risk management, investment, outsourcing, and communications policies, and so on. It will be a function of administration to oversee the implementation of these policies.
- Ensure the accurate and timely payment of benefits to members.
- Ensure that the scheme complies with the law and that it is registered. The scheme should maintain its registration status with the regulator and analyze performance and risk management. In the case of supervision, as an administration

activity, provide information to the regulator as may be required¹³⁵.

- Maintain and keep accurate records of the pension scheme, which should include the minutes of the governing boards and trustees, constitutive documents of the pension scheme, outsourcing agreements in relation to service providers, contribution records, financial records, particulars of members and correspondence with third parties, and in particular, the regulator and service providers.
- Provide adequate and appropriate information to members and beneficiaries¹³⁶. The information shall specify member rights, benefits and duties in terms of the scheme rules. To enable effective

communication with members, governing boards and trustees will need to develop an effective communications policy. Communications with members are crucial, especially in defined contribution schemes where the risk of investment is borne by a member.

- Ensure the accurate and timely remittance of contributions from the employer(s) to the scheme custodian. This obligation applies to all governing boards and trustees of all pension schemes.
- Undertake the development of governance policies to include risk management, investment, outsourcing and communications policies, and so on. It will be a function of the administrator to oversee the implementation of these policies.

ANNEX C:

PENSION SCHEMES IN TANZANIA

Table C. 1: Previous Pension Schemes in Tanzania

Provision	NSSF	PSPF	PPF	LAPF	GEPF
Type of scheme	PAYG DB; converted from a provident fund in 1998.	PAYG DB; converted from a non-contributory DB scheme in 1999.	PAYG DB (PPS) and funded by DC (DAS)	PAYG DB; converted from a provident fund in 2005.	PAYG DB; converted from a provident fund in 2013.
Membership	• Private sector (formal and self-employed) • Government employees and others not covered by any pension scheme.	• Central government (pensionable positions)	• Parastatals • Companies with governmental shares • Private sector (formal and self-employed)	• Local government • Open to others	• Government employees in non-pensionable positions • Open to others
Contributions (employee/ employer)	10%: 10% or 5:15	5% :15% or 10:10	10:10 or 5:15	10:10 or 5:15	5%:15% or 10:10
Types of benefits	• Old age (retirement) • Invalid • Survivorship • Health (insurance) • Funeral grant • Maternity • Withdrawal • Employment injury	• Old age (retirement) • Invalid • Survivorship • Withdrawal • Funeral grant • Illness	Traditional Pension Scheme (PPS): • Old age (retire-ment) • Invalid • Survivor-ship • With-drawal • Education Deposit Administration Scheme (DAS): • Defined contri-bution scheme (lump sum)	• Old age (retire-ment) • Invalid • Survivor-ship • Funeral grant • Maternity, marriage, other unem-ployment • With-drawal	• Old age (retirement) • Invalid • Survivorship • Withdrawal • Funeral grant • Illness

Provision	NSSF	PSPF	PPF	LAPF	GEPF
Retirement age	60; minimum 55 (0.5p.p. replacement rate reduction per year prior to age 60)	60; minimum 55 (with no reduction)	60; minimum 55 (with no reduction)	60; minimum 55 (with no reduction)	60; minimum 45 (with no reduction)
Vesting period (number of years)	15	15	10	15	15
Annual accrual rate	2% for first 15 years, plus 1.5% for each year above 15	2.22%	2.0%	2.22%	2.07%
Maximum replacement rate	67.5%	No maximum	66.7%	No maximum	No maximum
Income measure	Best 5-year average of last 10 years (not valorized)	Final salary	Best 5-year average (not valorized)	Final salary	Best 3 years
Indexation	Follow actuarial recommendation	No indexation	No indexation	No indexation	Follow actuarial recommendation
Minimum pension, monthly	TZS 100,000/-	TZS 100,000/-	TZS 100,000/-	TZS 100,000/-	TZS 100,000/-

Source:

Note: DAS = Deposit Administration Scheme; DB = defined benefit; DC = defined contribution; GEPF = Government Employees Pension Fund; LAPF = Local Authorities Pension Fund; NSSF = National Social Security Fund; PAYG = Pay-As-You-Go; PPF = Pension Protection Fund; PPS = Traditional Pension Scheme; PSPF = Public Service Pension Fund.

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ENDNOTES

1. The Pensions Act (Cap 189) and European Officers' Pension Act (Cap. 66) of Kenya protect the interests of retired white civil servants and their widows, most of whom currently live in the United Kingdom.
2. Note that the integrated schemes (those that combine civil service and private sector schemes) are also presented as national schemes. For example, Sierra Leone is higher than Uganda and Tanzania because it covers civil servants as well. The picture may change if civil servants are excluded.
3. It should be noted that the tax regimes for other income also play a role (assuming individuals choose between different options when they make savings decisions), but this is beyond the scope of pension supervisors. Fiona Stewart is a Lead Financial Sector Specialist with the Long-term Finance Team in the World Bank's Finance, Competitiveness and Innovation Global Practice. She provides policy advice on pension and insurance market reforms to governments around the world, including in the East African region and the EAC. Previously, she worked for the Organisation for Economic Co-operation and Development (OECD) Financial Affairs Division for eight years and led the Secretariat of the International Organisation of Pension Supervisors (IOPS). Prior to working at the OECD, Fiona worked in the pension fund industry.
4. For further discussion of the necessary powers and resources of pension supervisory authorities, see 'International Organization of Pension Supervisors (IOPS), Principles of Pension Supervision.
5. For further discussion of risk-based supervision, see IOPS Toolkit www.iopsweb.org
6. IOPS Guidelines for The Supervisory Assessment of Pension Funds.
7. Sections 22A and 26 of the Uganda Retirement Benefits Act.
8. Section 75 of the Rwanda Pension Law, Section 39 of the Kenya Retirement Benefits Act, Section 74 of the Uganda URBRA Act prescribe broad powers at the disposal of their respective supervisory agencies to effectively intervene and enforce the requirements of the law.
9. Section 88 of the Rwanda Pension Law, Section 39 of the Kenya Retirement Benefits Act, Section 74 and many other sections of the Uganda URBRA Act make provisions for many offenses of breach of the URBRA Act and accompanying regulations.
10. Article 65 of Rwanda Pension Law, Section 20 of the Tanzania Social Security Regulatory Authority (SSRA) Act. The Uganda URBRA Act provides for various circumstances under which licenses of regulated entities can be

revoked. The Kenya Retirement Benefits Act empowers the Retirement Benefits Authority (RBA) to revoke the registration certificates of schemes and service providers.

11. Section 45 of Kenya Retirement Benefits Act; Section 41 of the Tanzania SSRA; Section 78 of the Uganda URBRA Act, and Section 66 of the Rwanda Pension Law.
12. The IOPS is a global forum of pension supervisors with headquarters at the OECD in Paris, France.
13. For further details, see IOPS, “A review of the Pros and Cons of Integrating Pension Supervision with that of Other Financial Activities and Services”, IOPS Working Paper No.1 (2007). See also IOPS, “Structure of Pension Supervisory Authorities and their Approaches to Risk-based Supervision”, IOPS Working Paper No. 16 (2012).
14. Section 5 Retirement Benefits Act, Kenya.
15. This is a type of scheme whereby both the employer and the employee make a defined or stated contribution to the employee’s retirement benefit. There is no guaranteed benefit and the employee receives a payout that is either a lump sum (in the case of provident funds), or both a lump sum and a pension whose value depends on the return on investment of the pension funds over the period of the contribution.
16. These are schemes in which the employer undertakes to pay to the employee benefits based on the employee’s salary and length of service with the employer. These types of schemes were commonly used in both private and public employment contracts. However, they are not considered a good practice now due to concerns about the ability of employers to meet these obligations. Several governments and private sector organizations have faced difficulties in meeting their defined benefit obligations.
17. See Jeffrey Carmichael and Michael Pomerleano, “The Development and Regulation of Non-Bank Financial Institutions,” pp. 93-128. The World Bank Group, 2002. Available at [file:///C:/Users/WINNIE/Downloads/multi0page%20\(1\).pdf](file:///C:/Users/WINNIE/Downloads/multi0page%20(1).pdf) (accessed July 7, 2018).
18. See Richard A. Johnson and Daniel W. Greening, The Effects of Corporate Governance and Institutional Ownership Types on Corporate Social Performance, (1999) *Academy of Management Journal* 42(5): 564-576; E. Philip Davis, “The Role of Pension Funds as Institutional Investors in Emerging Markets.” A Paper presented at the Korean Development Institute conference on Population Aging in Korea: Economic Impacts and Policy Issues, Seoul, March 2005. <http://buratest.brunel.ac.uk/bitstream/2438/3550/1/05-18.pdf> (accessed May 25, 2018).
19. Rwanda applies a different regime for the main social security fund, the RSSB, and private pension funds – TTE.
20. See Sections 154 and 155 of the Constitution of the Republic of Uganda.
21. See Stanbic Bank Uganda, Annual Report 2017, pp.114 and 150. https://www.stanbicbank.co.ug/standing/Uganda/fileDownloads/UG_AnnualReport2017.pdf (accessed May 14, 2018).
22. See Section 22(2)(i) of the Uganda Income Tax Act, Cap. 340.
23. S.34 Income Tax (Trading and Other Income) Act 2005.
24. For a discussion of tax effects on pension policy, see James L. Bicklser and Andrew H. Chen, “The Integration of Insurance and Taxes on Corporate Pension Strategy,” *Journal of Finance*, 1985, 40(3) pp. 943–955.

25. See Peter Shonewille, “The Elimination of Tax Obstacles to Pan-European Pension Funds: An Overview,” https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/occ_pen_article3.pdf (accessed July 7, 2018).
26. The applicable rate according to Part III of Schedule 3 is 30 percent.
27. National Social Security Fund Transparency Statement for the year ended June 30, 2016. https://www.nssfug.org/uploads/NSSF_transparency_statement_2016_new.pdf (accessed June 26, 2017).
28. National Social Security Fund Statement of Financial Position as of June 30, 2016.
29. According to the NSSF statement of changes in net assets, total revenues for the year ending June 30, 2016 amounted to Uganda Shillings 707, 989, 927,000.
30. <http://www.murbs.org/wp-content/uploads/2016/10/MURBS-Summary-Financial-Statements-Advert-2016-FINAL-1.pdf> (accessed June 26, 2017).
31. Sections 13, 14 and first schedule of the Income Tax Act, Cap. 470.
32. Section 62(1) Income Tax Act.
33. Section 62(2)(a) and (b) of the Income Tax Act.
34. Section 62(3)(a) of the Income Tax Act.
35. See Value Added Tax Cap. 349, S.19 and the second schedule clauses 1(c), 2(b)(iii) and (iv).
36. See clause 1(k) of the Third schedule of the Value Added Tax Act, Cap. 476.
37. Article 6 of Law No. 37 of 2012 Establishing the Value-Added Tax.
38. See clause 13 of the schedule to the VAT Act of 2014. Financial services are broadly defined under this section of the Act to include transactions relating to shares, stocks, bonds payment of pension and retirement fund benefits.
39. Section 21(n) and (o) of the Income Tax Act Cap. 340.
40. Section 3(2)(c)(i) and (ii) of the Income Tax Act, Cap 470.
41. Section 8(4) of the Income Tax Act.
42. Section 8(5)(a) of the Income Tax Act.
43. Section 8(5)(b) (i) and (ii) of the Income Tax Act.
44. Section 8(5)(b)(i) and (ii) of the Income Tax Act.
45. A gain is defined in Section 63(2) as an interest that is in excess of retirement contributions.
46. Section 63 of the Income Tax Act.
47. Article 16 of Law No. 16 of 2006 on Direct Taxes on Income.
48. For example, Table G of the Retirement Benefits (Individual Retirement Benefit Schemes) Regulations of 2000 provides for investment guidelines of pension schemes that include investments in securities of issuers within the East African Community.
49. See Peter Shonewille, “The Elimination of Tax Obstacles to pan-European Pension Funds: An Overview,” https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/occ_pen_article3.pdf (accessed July, 7 2018).
50. For example, the OECD developed guidelines for private pension supervision in 2002.

51. In Kenya, the case of *Shah Munge & Partners Ltd. vs. Capital Markets* (Civil Appeals 913 & 930 of 2003) brought to light the fraudulent acts of the stockbroker that were aimed at fleecing the National Social Security Fund (NSSF). Shah Munge was a licensed stockbroker and the other four appellants were directors in the Company. Shah Munge represented to the NSSF in Kenya that there was a treasury bond available on the secondary market. NSSF then issued a check in the amount of KShs 251,505,500 (approximately US\$ 2,468,996) for the purchase of the treasury bonds. However, the treasury bond was not in fact available, and the appellants authorized the deposit of the funds in the company's office account in Euro Bank, which was failing. The appellants withdrew the monies and utilized them for other purposes.
52. *New Vision Newspaper*, September 14, 2014.
53. Uganda Retirement Benefits Regulatory Authority, Sector Performance Report 2017. Total assets in Uganda amounted to Ugandan Shillings to the US\$ 10.04 trillion, Kenya 37.80 trillion, and Tanzania 20.00 trillion.
54. According to the International Labor Organization, Social Security is a broad term that covers aspects relating to protection from insecurities relating to making a living through work for example old age, retirement. Unemployment. Illness, injury, invalidity.
55. Andrew Kasirye, Chairman, URBRA, Statement, Annual Pension Industry Report, 2015.
56. Kenya National Social Security Fund Act No. 45 of 2013, and the Uganda National Social Security Act (Cap. 222).
57. Section 53 (3) and Schedule 1 of the NSSF Act of Tanzania 1997, and the Rwanda Law No. 45/2010.
58. GEPF Retirement Benefits Fund Annual Performance Report for the Year 2014/2015.
59. See the IOPS Tool Kit for Risk-based Pension Supervisors, case study Kenya at: www.iopsweb.org/rbstoolkit.
60. Guidance on Scheme Governance and Controls <https://www.thepensionsregulator.gov.uk/en/trustees/managing-db-benefits/governance-and-administration/scheme-governance-and-controls>
61. Law No 45/2010 of 14/12/2010 Establishing Rwanda Social Security Board and determining its mission, organization and functioning.
62. Section 2, Kenya Retirement Benefits Act No. 3 of 1997, Section 1, Uganda Retirement Benefits Regulatory Authority Act 2011.
63. All costs are incidental or in relation to the registration of members, the collection of member contributions and the disbursement of member benefits.
64. In Uganda, natural persons may undertake administrative services for a scheme, in which case there would not be a requirement for licensing.
65. Law No.05/2015 of 30/03/2015 Governing the Organization of Pension Schemes.
66. Section 53(2) of the Uganda Retirement Benefits Regulatory Authority Act 2011
67. Section 34 (1) of the Kenya RBA Act
68. Section 41(3) of the Kenya RBA Act
69. OEC Pension Fund Governance Guideline 9
70. This refers to Criminal Session Case 9 of 2015 of the High Court of Uganda. The three accused persons were experienced public officers who were responsible for pensions in the Ministry

of Public Service. The accused persons were charged with the following counts; causing financial loss, abuse of office, false accounting, conspiracy to defraud and diversion of public funds. The accused persons budgeted for payment of UGX 88,241,784,930 to the NSSF. This was an anomaly, as the Ministry of Public Service is not responsible for the NSSF. Public servants do not contribute to the NSSF, and the budget provision for the NSSF was illegal. The budget item was then reclassified as a gratuity for teachers, traditional servants and veterans. However, this was also contradictory because teachers, soldiers and other pensionable staff do not pay NSSF contributions. The funds were not sent to the NSSF; rather, they were paid to ghost pensioners through the Cairo Bank. The money was paid to persons whose identity the Cairo Bank could not confirm. These accounts were also opened at Cairo Bank before the money was illegally budgeted. The Court found the accused persons guilty of causing financial loss, abuse of office, false accounting, conspiracy to defraud and diversion of public resources.

71. OECD Pension Fund Governance Guideline 7
72. Section 28(5) Social Security Regulatory Authority Act No. 8 /2008 (Tanzania); Section 34 (5) Retirement Benefits Act Cap 197 (Kenya); and Section 65 Uganda Retirement Benefits Regulatory Authority Act.
73. According to the Tanzania Social Security Regulatory Authority Act.
74. Institute of Directors, South Africa
75. The issue of conflict of interest would also apply to public pensions.
76. <https://www.unpri.org/page/sustainability-is-not-only-important-to-upholding-fiduciary-duty-it-is-obligatory>
77. World Bank, unpublished research
78. Kenya Code of Corporate Governance Practices for Issuers of Securities to the Public (2015).
79. The prudent-person rule is a legal maxim restricting the discretion allowed in managing a client's account to the types of investments that the prudent-person (also known as the "prudent man rule") would adopt.
80. The GIPS are designed as voluntary standards. However, policymakers can use moral suasion, cajoling, and so on to influence the fund manager community, also helping prominent trustee boards to push for this.
81. <https://www.finextra.com/blogposting/12460/digital-kyc-a-key-to-transform> accessed on 22/05/2019
82. <https://www.finextra.com/blogposting/12460/digital-kyc-a-key-to-transform> accessed on 22/05/2019
83. This is an analysis of the 2018 FinScope Uganda Survey and the 2017 Finscope Tanzania Survey.
84. Retirement Benefits Authority, Kenya, Mbao Pension Scheme, <http://www.rba.go.ke/index.php/en/mbao-pension-scheme> accessed on 23rd November 2018.
85. MBAO Pension Scheme, 2018. <https://spc.socialprotection.or.ke/images/downloads/presentations/Rose-Kwena-MBAO-Pension-Plan.pdf> accessed on 5th February 2019
86. MBAO Pension Scheme, 2018. <https://spc.socialprotection.or.ke/images/downloads/presentations/Rose-Kwena-MBAO-Pension-Plan.pdf> accessed on 5th February 2019.
87. EJOHEZA - Long Term Savings Scheme, <https://ejoheza.gov.rw/ltss-registration-ui/> accessed on 5th February 2019.

88. In this chapter, the social security system and pensions system are used interchangeably because the main focus is on the replacement rates.
89. Article 7, ONPR Law.
90. Article 9, ONPR Law.
91. Article 19, ONPR Law.
92. Article 22, ONPR Law.
93. Regulation 26 of the First Schedule of the Pensions Act (Cap. 189).
94. Regulation 4, Pensions Act.
95. Section 8, Pensions Act.
96. Section 10, Pensions Act.
97. Alexander Forbes Financial Services (EA) Ltd. (2005): Actuarial Study on Superannuation in the Public Service, Kenya. Unpublished report submitted to the Government of Kenya.
98. Others smaller schemes covering specific public service groups (e.g. judges, parliamentarians) with different benefit formulae also exist, but are not covered in detail here.
99. Section 5, Public Service Superannuation Act (No. 8 of 2012).
100. Section 16, Public Service Superannuation Act (No. 8 of 2012).
101. Section 1 of the First Schedule of the National Social Security Act (Cap. 258).
102. Section 19 of the National Social Security Fund Act.
103. Section 26, National Social Security Fund Act.
104. Section 24, Retirement Benefits Act (Act No.3 of 1997).
105. Regulation 8 of the Retirement Benefits Act (Occupational Retirement Schemes) Regulations, 2000.
106. Regulation 8 of the Retirement Benefits Act (Occupational Retirement Schemes) Regulations, 2000.
107. Section 35 of the Retirement Benefits Act.
108. Rwanda Law Governing the Organization of Pension Schemes Article 4.
109. Rwanda Law Governing the Organization of Pension Schemes Article 38.
110. Rwanda Law Governing the Organization of Pension Schemes Article 19.
111. Rwanda Law Governing the Organization of Pension Schemes Articles 47 and 62.
112. Rwanda Law Governing the Organization of Pension Schemes, Articles 59, 60 and 62. 2
113. Rwanda Law Governing the Organization of Pension Schemes, Article 49.
114. Minor schemes, such as the political service retirement benefits (PSRB) scheme, will continue to exist as independent schemes.
115. Section 5 of the Kenya Retirement Benefits Act.
116. Section 2 of Kenya Retirement Benefits Act.
117. Section 22 of the Kenya Retirement Benefits Act.
118. Section 22(4) of the Kenya Retirement Benefits Act.

119. Regulation 32 of the Kenya Occupational Retirement Benefits Schemes Regulations, 2000.
120. Section 26 of the Kenya Retirement Benefits Act.
121. Section 5, Tanzania SSRA Act.
122. Sections 24(4), 26(2) and 48(a) of the Tanzania SSRA Act.
123. Chapter II and III of the Rwanda Law Governing the Organization of Pension Schemes.
124. Article 3 Rwanda Law Governing the Organization of Pension Schemes.
125. Rwanda Law Governing the Organization of Pension Schemes, Article 34.
126. Rwanda Law Governing the Organization of Pension Schemes, Articles 47 and 48.
127. The Law No 45/2010 Establishing the Rwanda Social Security Board (RSSB) and Determining its Mission, Organization and Functioning.
128. Rwanda Law Governing the Organization of Pension Schemes, Article 52.
129. Rwanda Law Governing the Organization of Pension Schemes, Article 59.
130. Rwanda Law Governing the Organization of Pension Schemes, Article 39.
131. Rwanda Law Governing the Organization of Pension Schemes, Article 47.
132. Rwanda Law Governing the Organization of Pension Schemes, Articles 70, 71 and 72.
133. Rwanda Law Governing the Organization of Pension Schemes, Article 49.
134. Rwanda Law Governing the Organization of Pension Schemes, Article 6.
135. Rwanda Law Governing the Organization of Pension Schemes, Article 79.
136. Rwanda Law Governing the Organization of Pension Schemes, Article 80.

