RBA POLICY BRIEFS 2010/2011

Translating Research Evidence to Inform Policy and Practice

The Retirement Benefits Authority is mandated by the Retirement Benefits Act to promote the development of the retirement benefits industry and to advise the Government of Kenya on policy relating to retirement benefits.

The Authority believes in basing its policy recommendations on a foundation of theoretically sound and empirically proven research.

The Authority undertakes its research either in –house or in collaboration with leading academic institutions or by outsourcing to reputable research agencies.

This booklet summarizes key research undertaken by the Authority in the financial year 2010/2011. It provides a concise summary of the critical findings and significant policy recommendations from the research. The policy brief is targeted at readers who only want a quick synopsis of the research papers without the methodological and technical issues in the main papers.

This summary is not intended to be comprehensive nor conclusive. Readers seeking complete information should refer to the full versions of the papers which are available for free download at ***www.rba.go.ke****.*

Retirement Benefits Authority

Safeguarding your retirement benefits

Contents

NEED AND VIABILITY OF A BENEFIT PROTECTION FUND FOR RETIREMENT BENEFITS SCHEMES IN KENYA

Research Paper by Nzomo Mutuku, Manager Research & Development, RBA

INTRODUCTION

Retirement benefits schemes in Kenya are exposed to a number of risks that may jeopardize their ability to ultimately pay adequate retirement benefits to their members. Protection funds have been established for all the financial sectors other than in the pension sector. The paper examines the need and viability of putting in place a benefit protection fund for retirement benefits.

OBJECTIVES OF THE RESEARCH

Main objective:

To establish the need and viability of establishing a benefit protection fund for retirement benefits in Kenya.

Secondary objectives :

1. To examine the case for and against benefit protection funds for retirement benefits
2. To examine the experience of benefit protection funds in other jurisdictions
3. To examine the current protection mechanisms for retirement benefits in Kenya
4. To analyze the need and practicability of establishing a benefit protection fund for the retirement benefits industry

FINDINGS OF THE RESEARCH

The theoretical rationale for benefit protection funds in funded systems such as Kenya was identified as politics, protection against fraud, market failure and diversification.

Examination of the existing protection funds in the financial sector in Kenya identified a number of challenges including: insufficient funding; lack of institutional and/or operational autonomy; and, difficulties in liquidating assets due to delays in the legal processes.

Examining retirement benefits protection funds in other jurisdictions, the paper found an absence of such funds in developing countries with the few case studies available coming from developed economies. The main challenges in these funds are: doubts as to their long term viability; difficulty in charging adequate premiums; systematic risks whereby the protection funds face risks highly correlated to the risk faced by the companies and schemes they are insuring ; moral hazard; and, adverse selection.

Examining the structure of the pension industry in Kenya shows rapid decline in the number of defined benefits schemes *(see chart)* and this trend is expected to accelerate in the near future meaning there will be little justification for introducing the traditional retirement benefits fund that covers sponsor insolvency risk in defined benefits schemes.

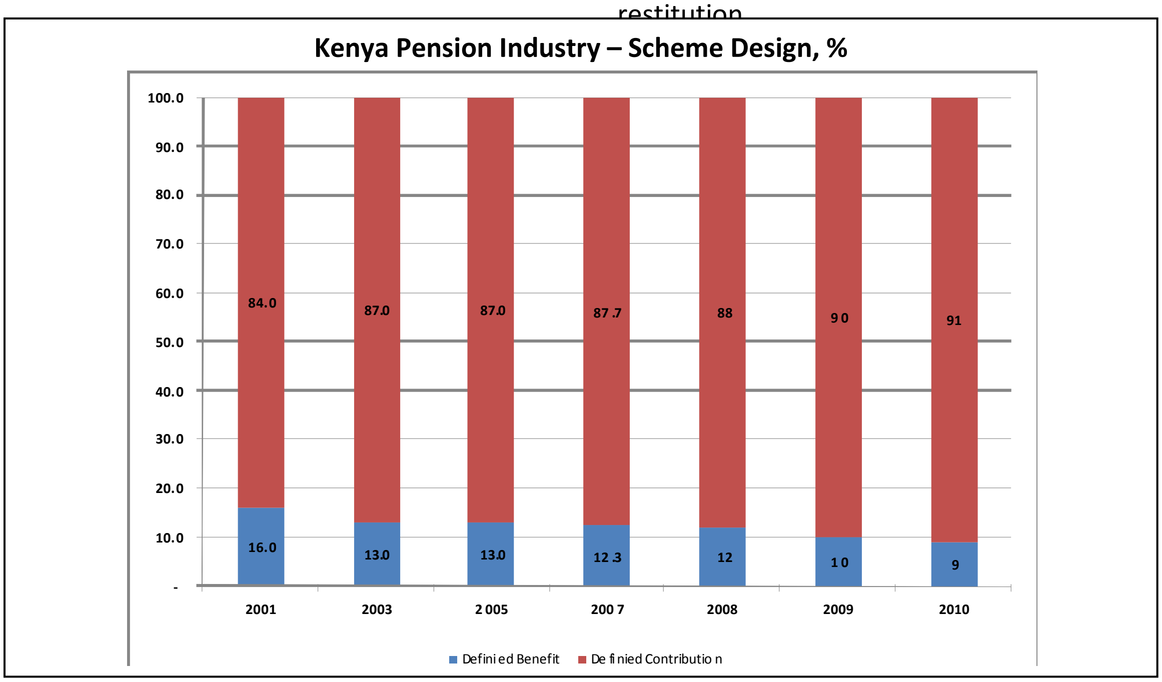
Survey of industry experts shows strong support for introduction of a benefit protection fund to be set up within the RBA and to cover key risk in both defined benefit and defined contribution schemes. This view is reinforced by examination of schemes under interim administration where it is clear members are exposed to loss of benefits particularly as a result of counter party default and fraud risks.

POLICY RECOMMENDATIONS

i. Kenya should establish a retirement benefits protection fund under the Retirement Benefits Act that covers all types of schemes from loses arising due to counterparty default or fraud on the part of trustees and service providers. It should be registered under the Retirement Benefits Act and should only cover those defaults not covered by other financial protection funds.

ii. The fund should be modeled on best practices in benefit protection including:

- Risk based premiums – Schemes are going to pay premiums according to their risk score that is the higher the risk score, higher the premiums thus incentivizing schemes to have a lower risk score;
- Mitigation of moral hazard including making contributions to the fund compulsory for all schemes. This also incentivizes the industry to self regulate to ensure premiums are kept low;
- Institutional autonomy from the regulator so as to ensure that any governance weaknesses in the regulator are not replicated in the fund and also remove the moral hazard of the same institution controlling a safety net for what may be perceived as its own failures of regulation;
- Share in recovered assets from failed schemes and service providers in the fund itself and;
- Effective and efficient resolution processes to avoid long delays in restitution



THE EFFECTIVENESS OF ANNUAL GENERAL MEETINGS FOR RETIREMENT BENEFITS SCHEMES

Research Paper by Koome Kathurima, Research Officer, RBA

INTRODUCTION

Under the Retirement Benefits Act, schemes are required to convene and hold Annual General Meetings (AGM's) every year. The AGM is convened by trustees of the scheme for the general benefit of the members of the scheme. The general objective of the paper was to evaluate the effectiveness of AGM's for retirement benefits schemes in Kenya. The specific objectives of the paper were to investigate the reason behind the low turnout in the annual event, whether trustees follow the stipulated regulations in carrying out the events and investigate other alternatives that trustees may use to communicate to members other than in AGM's. The other specific objectives the paper investigated were the benefits the annual event presented to members and whether or not the costs of AGM's were justified.

RESEARCH FINDINGS

1. Majority of members and trustees felt AGM's were a critical governance mechanism and should continue to held on annual basis.

2. The paper established that for a meeting to have a good turnout meeting notices are supposed to be sent two (2) weeks before the meeting and in the form of board notices. The accessibility of the venue, presentation of financial reports, and convenient timing of meetings will highly influence the turnout of the AGM's.

3. The cost of AGM's was less than 5% of the total administrative cost with major expenses been borne by the employer/sponsor of the scheme.

POLICY RECOMMENDATION

1. AGMs remain an important forum for scheme governance and member involvement. Scheme trustees should put in place necessary internal mechanisms to ensure adequate turnout at AGMS.

2. Trustees should be educated and sensitized on their responsibilities in convening and carrying out the meetings to ensure statutory minimum requirements are followed.

3. The alternative mode of communication that trustees can use to educate their members is through a member educational days/program. The education day should be held frequently to ensure all members are educated.

4. The Authority should ensure that scheme trustees are prudent in spending and leverage on sponsors to burden the costs of AGM's.

"98% of Scheme Members find AGM's important"

THE IMPACT OF ACCESSING BENEFITS BEFORE RETIREMENT AGE
Research Paper by Monica Were, Senior Research Officer, RBA

INTRODUCTION

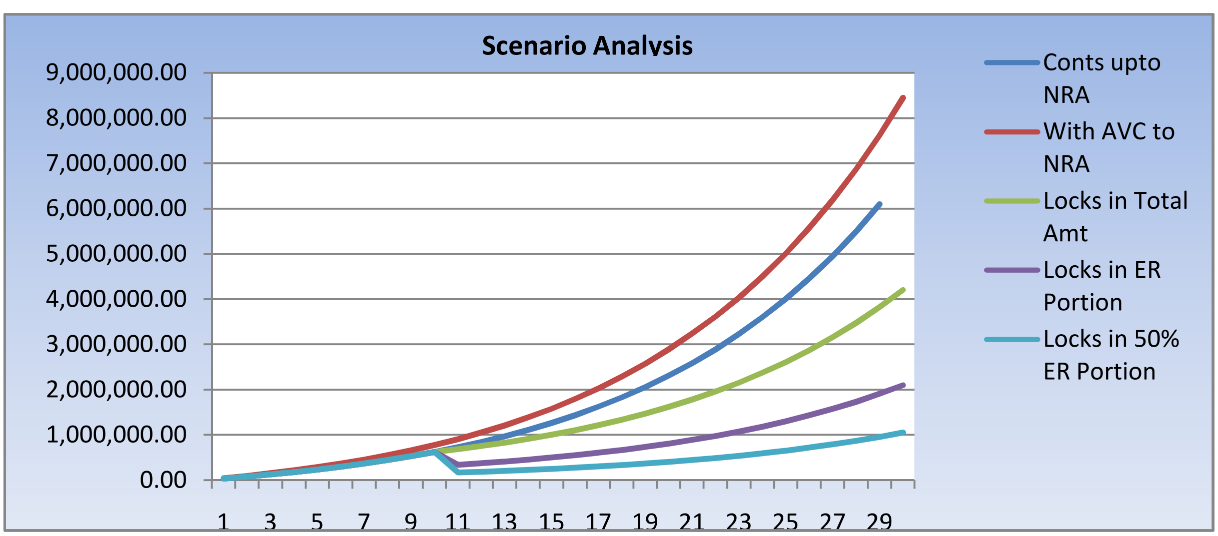
The 2011 amendment allowing members of retirement schemes to access 50 percent of employer's benefits on changing jobs has been met with mixed reactions. The Regulations allowed members to access more of their contributions upon changing jobs or leaving employment. The main objective of the paper was to assess the impact that the new regulations on access of benefits would have in the pension industry. The specific objectives of the paper were to investigate the reasons why members choose to unlock their benefits before retirement and using a scenario investigate the variables that affect an individual's decision on locking or unlocking of their benefits. The other objectives of the paper were to establish the impact of unlocking the benefits to the members, the schemes and the economy.

RESEARCH FINDINGS

1. The Research revealed that within a span of 6 months over Kshs 2 Billion had been accessed by over 6,400 members. The research established that early access of benefits impacts on the adequacy of retirement benefits to pensioners.
2. The scenario analysis (see chart 2) showed that members, who made additional voluntary contributions into their scheme, would retire with a higher benefit in comparison to members who did not.

POLICY RECOMMENDATIONS

1. Government of Kenya should reverse the recent change of Regulations that allow members to access up to 50% of employers' contributions.
2. Retirement benefits schemes should have at least one member education program/day annually to train members on investments, taxation of retirement benefits, implications of early withdrawal of pension benefits, and any other topics that will enable them make informed decisions.
3. Hence members should be encouraged to make additional voluntary contributions into the schemes in order to have sufficient income upon retirement



FINANCIAL AND PENSION LITERACY: A SURVEY OF PENSION SCHEME MEMBERS IN KENYA : Research collaboration between the United States International University and the Retirement Benefits Authority

INTRODUCTION

Financial and pension literacy influences the saving behavior of individuals that in turn contributes to economic growth of countries. The gist of the study was to assess the levels of finance and pension literacy, determine the financial literacy needs, establish the challenges to participation in finance and pension education and to recommend the strategies that can be put in place to enhance financial and pension literacy amongst members of pension schemes in Kenya

RESEARCH FINDINGS

Financial and pension literacy levels amongst pension scheme members in Kenya averages 54.3%; with awareness on pension matters exceeding that of general finance matters. The literacy levels further differ significantly across gender, education level, occupational level, participation in previous education and provinces.

A pension literacy program for the pension scheme workers should include the “technical” aspects of pension scheme management such as the pension law, investments, designs and calculating the retirement benefits. The “operational” aspects such as rights of members and responsibilities of the various stakeholders require less effort in training.

A finance literacy program for pension scheme workers in Kenya should include investments, cost management, debt and savings options and setting personal financial goals.

The main hindrances to participation in finance and pension literacy programs are; lack of forums for involvement, lack of understanding on pension fund matters and work commitments. Having a suitable finance and pension literacy program can create forums for involvement and ensure understanding of pension fund matters.

The major challenges to participation in finance and pension literacy programs are finance, lack of the programs at the work place, courses not available in the market, work load, perception that pension education does not have immediate benefits and increased family commitments. .

Awareness campaigns carried out by the RBA have a moderate effect on stimulating interest and learning on pension matters.

“Awareness on pension matters exceeds that on general financial matters”

POLICY RECOMMENDATIONS

RBA should seek partnerships with interested parties (universities, colleges and NGOs) on the provision of finance and pension literacy programs. The role of RBA will be to ensure that the programs offered have the suitable content especially relating to pension matters. The other partners will be responsible for training (including training of trainers) and availing the appropriate facilities and venues. The partnerships should ensure that the programs are relevant in terms of content and are delivered in a practical and simplified mode.

RBA should liaise with the central government to seek ways of raising funds to support finance and pension literacy programs. These funds can be channeled through training institutions (partnership agreements with RBA) to subsidize the literacy programs.

All the finance and pension literacy needs reviewed in the study are significantly different on the basis of education level, occupational level, monthly income and participation in financial literacy programs. This finding calls for specialized financial literacy programs to be tailored to satisfy the various niches on the basis of education, management level, income and those who have already attended past finance and pension literacy forums.

There is need to encourage the finance services sector (commercial banks, insurance companies and others) to engage in a win-win situation by expanding their literacy programs to the general public with the aim of increasing their market shares and capturing the unbanked market niches.

Finance and pension literacy issues should be introduced in tertiary education institutions in form of extra-curricular activities.

Kenya should have a national financial literacy strategy that should include retirement planning. The strategy should aim to equip Kenyans with lifelong understanding of finance and pension matters and should be made in consultation with all the relevant stakeholders (business, government and non-governmental organizations).

RBA should mandate pension scheme trustees to orientate members once they join the pension schemes and make it a compliance requirement. This will create awareness of the existence and operations of pension schemes by the members but will require a change in the RBA Act.

Taxation incentives can be introduced to encourage both employers and employees to encourage work place financial literacy.

LIST OF RESEARCH PAPERS UNDERTAKEN BY THE AUTHORITY

2003/2004 - Pensioners Survey

2004/2005 - Pensioners Survey

2005/2006
- Barriers to Participation in Pension Schemes
- Members Survey
- Promoting Home ownership

2006/2007
- Annuities Market in Kenya
- Developing Individual Retirement benefits Schemes in Kenya
- Rationale for Quantitative Investment Restrictions in Kenya
- Trustees Survey
- Universal Pension for Poverty Reduction

2007/2008
- Pensioners Survey
- Case for Consolidated Financial Regulation in Kenya
- The Challenges faced by fund managers in investing retirement benefits funds in Kenya
- Does The Design of the Scheme Matter?

2008/2009
- Dipstick Research on impact of Media Campaigns (outsourced)
- Young Savers Survey (outsourced)
- Members Survey
- Income Replacement Rates
- Impact of Increase in Retirement Age

2009/2010
- Conversion from Defined Benefits to Defined Contributions
- Impact of global financial crisis on Kenyan Retirement Benefits Industry
- Quality of Life Survey (Collaboration with Kenyatta University)

2010/2011
- Feasibility of a Benefit Protection Fund for Retirement Benefits Schemes in Kenya
- Analysis of the effectiveness and utility of Annual General Meetings for Retirement Benefits Schemes
- Penetrating the professional working population Survey (Outsourced)
- Factors Affecting the Adoption of Financial Literacy in Pension Schemes among Kenya Employees (Collaboration with USIU)
- Impact of assessing retirement benefits before retirement age

2011/2012 – (ongoing)
- Governance of Retirement Benefits Schemes in Kenya (Collaboration with UON)
- Critical Success Factors for a Sustainable Micro-Pension Scheme (Collaboration with USIU)
- Impact of Market Volatility on Pension Schemes Long Term Asset Allocation and Risk Tolerance
- Review of Mortgage Regulations
- Compulsory Saving
- Impact of Retirement Benefits on the Economy

The above papers are available for download at: www.rba.go.ke/publications/research-papers

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