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KENYATTA UNIVERSITY

RESEARCH STUDY REPORT

RISKS AND OPPORTUNITIES ASSOCIATED WITH PAYING LUMPSUM BENEFITS TO RETIREES IN KENYA: IMPLICATIONS FOR INCOME SECURITY

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Operational definition of terms

Business	It is an entity established for the purposes of engaging in commercial activities for a profit. In this study, the term was used to refer to informal activities for generating income for the retirees.
Income security	Is the level of income (absolute and relative to needs), assurance of receipt, expectation of income adequacy now and improvement or deterioration in the future, both during a person's working life and in old age or disability retirement. Income security is about actual, perceived and expected income.
Investment	It is the process of investing resources in a gainful venture or with the motive of gaining a profit.
Old age	The chronological age of 65 years when one is considered as 'elderly' or 'older person' as is the case in most countries of the world.
Pension	Financial arrangement between employee and employer to provide persons with an income after cessation of employment
Poverty	The inability to attain a minimal standard of living measured in terms of basic consumption needs such as food, clothing and shelter or the lack of income to satisfy them.
Re-employment	It is where employers and organizations provide retired employees with the opportunity for re-engagement.
Self-employment	It is engagement of retired persons in self-initiated income generating activities.

LIST OF ACRONYMS AND ABBREVIATIONS

ARBS	Association of Retirement Benefits Schemes
CBK	Central Bank of Kenya
CSPF	Civil Service Pension Fund
CSPS	Civil Servants Pension Scheme
DB	Defined Benefit Pension Scheme
DC	Defined Contribution Pension Scheme
FGD	Focus Group Discussion
GDP	Gross Domestic Product
ILO	International Labour Organization
IMF	International Monetary Fund
IRS	Individual Retirement Scheme
ISSA	International Social Security Association
KU	Kenyatta University
LASF	Local Authority Superannuation Fund
NSSF	National Social Security Fund
OECD	Organization for Economic Development and Cooperation
ORS	Occupational Retirement Scheme
RBA	Retirements Benefit Authority
US-SSA	United States Social Security Administration
US-IRS	United States- Internal Revenue Service
WB	World Bank
WBI	World Bank Institute
ZNPF	Zambia National Provident Fund

Executive Summary

The main goal of this research project was to assess the risks and opportunities associated with paying lumpsum pension benefits to retirees in Kenya and its implication on income security. The specific objectives were to: (i) to identify the ways in which retirees utilize their retirement benefits based on the mode of payment; (ii) to explore preferred methods of disbursement of pension savings by various stakeholders; and (iii) to investigate the merits and demerits associated with paying lumpsum benefits to retirees in Kenya. The study also aimed at making policy recommendations on the viability of lumpsum payment for financial security of retirees.

The study employed a mixed-methods approach. A sample of 2365 respondents comprising 978 retirees and 1387 prospective retirees was drawn from 18 randomly selected Counties in nine regions across Kenya. The respondents were selected from a sampling frame provided by the four categories of schemes namely the National Social Security Fund (NSSF), the Civil Service, Pension, the Occupational and the Individual schemes. A structured questionnaire was administered to retirees and prospective retirees, a key informant interview was administered to pension scheme managers while focus group discussions were held with retirees and fund administrators.

Data analysis revealed that 41 % of the respondents were retired while 59 % were prospective retirees of whom 38% were residing in rural areas and 62 % in urban areas. The gender distribution of the respondents was 41% female and 59% male with an age range between 40–58 years for prospective retirees and a mean of 52 years. The range for retirees was 56–87 years with a mean of 64.3 years was established. The modal age for retirees was 60 and that of prospective retirees was 50 years. Majority (83%) of retirees were married while 9% were widowed. Analysis of education achievement for respondents indicated that more than 90% had attained secondary or higher level of education.

From the sub-sample of the retirees studied, the mode for length of retirement was 5 years while the mean was 10.2, in addition, 40% were not engaged in any form of employment while 60%

were either re-employed or in self-employment. Of the retired respondents, 72% had received their pension as partial or total lumpsum, 23% as lifetime monthly pension while 5% annuitized their savings.

Of the 667 retirees who had received their benefits as lumpsum, the average payment received was Ksh. 800,023 with a minimum of Ksh. 10,000 and a maximum of Ksh. 8,000,000. The mode of lumpsum received was Kshs. 600,000. For this category, 321 (24%) used the benefits for household maintenance, 255 (19%) started a business with only 85 (6%) reporting saving their money in a fixed deposit account. Of the 978 retirees, 582 (60%) had put in place measures for financial security. Of those who had taken measures, 279 (47.9%) had bought/built a retirement home, 300 (51.5%) had bought land, 215 (36.9%) had started a business, and 56 (9.6%) had saved in fixed savings accounts.

Out of all the studied retirees who invested their savings, the majority (30%) invested about 41-60% of their pension income while 16% invested over 80% of their savings. Sixty five percent of the business ventures were still operational while 35% had already closed down for a variety of reasons. Overall, 61% of the retirees indicated that they were income secure in retirement while 39% indicated that they were income insecure. However, only 17% of the respondents attributed their income security to pension, 29% attributing it to other income and 54% to both pension and other income. Respondents identified access to adequate capital for investment, business and property as the main merits for lumpsum payments. The risks associated with paying lumpsum pension benefits included mismanagement in unplanned expenses and ventures, risk of business failure, loss through unscrupulous deals, loss through lending and unplanned leisure.

The findings of this study revealed that the retirees mainly utilized pension savings on household maintenance and starting up business ventures irrespective of mode of payment. On the preferred methods of payment of pension savings, retirees opted for the commuted/life pension option while prospective retirees largely preferred the lumpsum mode of payment. The implication of these results is that while retirees may require an initial lumpsum amount to ‘kick start’ their retirement life, they also preferred a regular guaranteed income throughout their retirement life.

However, hypothesis tested in this study have revealed that higher amounts of lumpsum and commuted benefits may translate into successful investments and income security.

In conclusion, the pension model emerges as the ‘best fit’ model as it provides a guarantee to the retiree for a dependable income and a lifetime cushion from extreme poverty. However, the merits of paying an initial lumpsum fraction as is provided for under the Occupational Scheme regulations and Civil Service Pension Scheme was highly supported by the study as enabling retirees to access funds for an initial investment which translates into supplemental income. However, for this initial investment to be successful, there is need for continuous training focused on investments and business skills. In this regard, RBA jointly with the Association of Retirement Benefits Schemes (ARBS) and pension scheme managers should design comprehensive retirement planning package and ensure dissemination to all schemes since the need for proper retirement preparation/pre-retirement counseling cannot be overstated.

Since only less than 6% of the retirees had annuitized their savings inspite of the known benefits, there is need to educate all scheme members on the advantages of annuities as part of their retirement preparation package. From the study, majority of retirees spent their savings on meeting basic needs meaning that it is imperative for retirement planning to focus on how retirees can maximize returns of their savings to ensure support of their daily living. There is also need for RBA to negotiate an increase in pension contributions to reasonable levels.

The study also established need for pension schemes to increase awareness among prospective retirees on how they can utilize their pension as collateral for mortgage in line with amended Section 38 of RBA Act (Legal Notice 85 of 2009). Further, there was evidence that more benefits ought to be attached to workers’ pension savings through collateralization of other forms of credit using the benefits. In addition, though expenditure on health was low in this study, there is evidence that one of the main challenges affecting retirees is poor health. The study further recommends that RBA provides for schemes to design health insurance products for retirees for purchase using a portion of their benefits or contributions.

1.0 Introduction

Retirement is defined as the period immediately following exit from active employment and is one of the key transitions expected in later life (Kee-Lee & Chow, 2005). Although retirement is marked by an age when one stops working, there is great variation across the world regarding the exact time when people completely withdraw from workforce or active life. For instance, Kenya recently raised the retirement age to 60 years departing from age 55 set during the colonial administration. Over the course of life, a number of social and economic contingencies are likely to occur, which become more pronounced in later life. Such include exiting labour force due to old age, sickness, workplace injuries, disability, or unemployment, all of which affect all the retirees (Kakwani & Son, 2006).

Traditionally, risks associated with sudden unemployment and old-age were shared by family and community members but this approach is on the decline. This has been partly due to rapid modernization and urbanization, severing this traditional support ties that protected older people and their families. This implies that social and economic risks associated with retirement in Kenya are on the rise as the family safety net declines. Thus, availability of formal financial resources to respond to the increasing old age risks, especially for a nation that has primarily an agricultural economy is warranted.

Globally, risks associated with retirement are cushioned by pensions defined as a standard contract between employers and retired employees, for a fixed amount of money paid on a regular or one-time basis to a retiree following sequestration from service. There are various forms of pension schemes around the world classified in different ways. Kenya has a Retirement Benefits Act (1997) and other legislations that provide a comprehensive legal and regulatory framework and a regulatory agency, the Retirement Benefits Authority (RBA). The mandate of RBA is to regulate, supervise and promote the retirement benefits' sector. However, only 20% of the country's retired population has a reliable safety net in times of need (Retirement Benefits Authority [RBA], 2007). While a formal system of social security program exists in Kenya, it

has a very limited coverage to only a small segment of the society. In 2012, Help Age International estimated that only 15 percent of Kenyans were covered by pensions. By 2010, the pension fund contributed about 30% to the Gross Domestic Product (RBA, 2010). Further, statistics show that employees in the formal and regular informal employment are estimated at 10.5 million, of which 5.4 million are male and 4.6 million female. However, pension contributors are mainly drawn from workers in the formal sector and a few in self-employment, leaving a vast majority of people without coverage against contingencies that occur in the course of life, especially at old age (Kakwani & Son, 2006).

According to Antolin and Stewart (2008), arguments regarding retirement life centre on type of retirement plan one should put in place, whether the traditional lifetime monthly payments or take a lump sum distribution. Other factors include lack or inadequate fund management and investment training, high cost of living and lack of retirement planning on the part of employee. On the side of employer, it acts as an incentive for older, higher-cost workers to retire early; eliminating pension payments generates accounting gains that boost corporate income, and saves administrative and insurance expenses (Ingé, 2013). While more research needs to be done to address these arguments, the focus for this study is whether paying lumpsum as opposed to annuities is more beneficial to retirees in Kenya and if it has implications for income security. Research has however shown that lumpsum payments are easier to administer from an administrative perspective since the pension plan relinquishes subsequent obligations (Anotlin, Pugh, & Stewart, 2008). Though RBA Act (revised 2009), provides the broad guidelines and regulations for payment of pension by the various categories of schemes under its jurisdiction, there are varied rules and regulations determining how much a pensioner receives upon retirement. For instance, the CSPS mainly draws its legal and operational framework from the Pension Act of 1986 (revised 2012) which makes provisions for granting of pensions , the different circumstances of retirement, situations in which pension may be differed, suspended or terminated and gives guidelines on pension computations and payment of pension upon death of a contributor. Further, pension payment is also a factor of the nature of retirement saving which may be classified as defined benefit or defined contributory.

Worldwide, it has been estimated that pension funds hold over US$20 trillion in assets, the largest for any category of investor ahead of mutual funds, insurance companies, currency reserves, sovereign wealth funds, hedge funds, or private equity (Morgan, 2008). This is an indication that the key stakeholders; government and employers have jointly ensured that retirement policies are in place to cushion their members at retirement period. It is estimated that close to 1,500 pension schemes exist in Kenya with the pension industry being worth over Kshs. 633.5 billion as of 31 December 2013 (RBA, 2014).

The Pensions schemes are classified as the National Social Security Fund (NSSF), the Civil Servants Pension Scheme (CSPS), Occupational based pension schemes and Voluntary individual schemes. Until 2013, the NSSF has operated under an Act of Parliament as a provident fund and covering employees in the formal sector excluding public service employees. However, under the NSSF Act (2013) it has transformed a defined contribution mandatory scheme. The CSPS is also established under an Act of Parliament and covers all public service servants including teachers. It is a non-funded and non-contributory scheme. On the other hand, occupational schemes are established under trust and mainly cover formal sector workers who work in companies that operate retirement schemes. Also established under the trust are the individual schemes that are open to all who would like to join on voluntary basis and are mainly started by insurance and investment companies (Raichura, 2008). The NSSF is the largest scheme with a membership of over 1 million (RBA, 2012). In Kenya, the occupational guidelines for scheme management and governance are largely provided by the RBA with the exception of the CSPS. Accordingly, governance structures mainly include the sponsors, custodians, the Trustees, the administrators, the fund managers and the members. The governance structures are mandated to ensure optimum savings mobilization, proper investment of pension funds and efficient disbursement of benefits to those who retire within the pension system.

There are recurrent debates not only in Kenya but in other parts of the world hinging on topics such as adequacy of pension (the level of income replacement ratio), inflation adjustment and the

model of pension payment. The various models currently available in Kenya for the pay-out phase mainly include lumpsum and annuities (usually negotiated between employer and employee). There exists a third option where a person may get a substantial portion of their retirement benefits at once while the rest is earned regularly as a pension.

The NSSF which has been operating as a mandatory provident fund has been paying out 100% lumpsum to its retirees upon retirement (NSSF Act, 1989 revised 2010). At the same time, occupational schemes may opt to pay 1/3 of a members total pension savings on retirement and purchase annuities with the remainder (RBA, 2009). Hence, the scenario is that pension payments differ across the categories of schemes and there is also variation in amounts termed as ‘lumpsum’ payment. More importantly for this study was the question of how the pension payment model relates to income security. Thus, there was need to investigate the relationship between lumpsum payment of pension and income security as opposed to other methods in order to provide empirical data for justifying the use of one model over the other.

1.1 Statement of the Problem

Retirement heralds a phase in life where productivity is greatly reduced and opportunities for income diversification decreased (Kakwani & Son, 2006). This is especially because people who retire suddenly cease to receive a regular salary and begin to rely on savings accumulated while in employment. Hence, models and regulations for payment of pensions are key areas of concern for pensioners, pension schemes, investors, regulators, and the financial sector at large. A recurrent debate surrounds the effect of paying out a lumpsum package to retirees, a concern that hinges the problem of this study.

To date, there is paucity evidence in Kenya to show that the lump-sum model of payment provides income security particularly in old age. Hence, the model of payment as well as prudent use of pension at retirement become important factors for circumventing old age poverty. The study in addition intended to identify recommendations to guide the RBA’s role of regulating the sector particularly the payment of pension benefits to retirees in Kenya for income security.

1.2 Objectives of the Study

The overall objective of this study was to examine the opportunities and risks associated with paying lumpsum pension benefits to retirees in Kenya and its implications on retiree income security. The specific objectives were to:

i. identify the ways in which retirees utilize their retirement benefits based on the mode of payment from various pension schemes;
ii. explore preferred methods of disbursement of pension savings by various stakeholders in the pension industry;
iii. investigate the opportunities and risks associated with paying lumpsum benefits to retirees in Kenya; and
iv. identify recommendations on the viability of lumpsum payment for financial security of retirees.

1.3 Hypotheses

The study sought to test the following alternative hypotheses:

i. H_1: There is a positive relationship between lumpsum payment and investment viability
ii. H_2: There is a positive relationship between amount of money paid at retirement and the investment viability
iii. H_3: There is a positive relationship between amount of money paid at retirement and income security in retirement

1.5 Justification and significance of the study

As the RBA continues to pursue its mandate to promote, safeguard and develop the Retirement Benefits Sector, the income security of the retirees remains its primary concern. What therefore justifies this study is the necessity for the Authority to be guided through evidence-based

research on the impact of various policies that regulate the disbursement of retirement funds relative to income security for retirees. This is in line with the constitutional mandate which obligates the government to provide a decent standard of living for all in terms of access to quality health services, adequate housing, reasonable standards of sanitation and freedom from hunger (Article 43 Kenya Constitution, 2010).

Specifically, since the study focuses on the risks and opportunities associated with paying lumpsum pension benefits, its findings, conclusions and recommendations will provide policy direction on the lumpsum mode of payment of pension to retired persons in Kenya. It is also anticipated that the study has generated recommendations to guide RBA in regulating the sector for income security for retirees.

CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 An overview of retirement systems

Retirement programs were introduced after the industrial revolution as a means of improving well-being of the poor, reducing inequality within the society, and to placate different social demands to avert social and political conflicts when the capitalist form of production was introduced in the newly industrialized nations (Overbye, 2006). The Bismarckian social security model originated in Germany in the 19th Century targeted full-time industrial workers (Justino, 2003; Overbye, 2006). The United States' (US) 1935 Social Security Act and retirement programs implemented in the United Kingdom (UK) as summarized in the 1942 Bridgeport Report are examples of how retirement programs developed. Currently, retirement programmes are by and large established on the basis of social security as defined by the International Labour Organization [ILO] (Justino, 2003).

2.2 Pension schemes around the world

There are basically two broad categories of pension plans: defined benefit plans (DB) and defined contribution (DC) plans (Moore & Muller, 2002). In a DB pension plan, workers accrue a promise of a regular monthly payment from the date of their retirement until their death, or, in some cases, until the death of their spouse (Broadbent, Palumbo, & Woodman, 2006). In most cases, retirement income depends on the number of years of contributions and on an individual's earnings (Organization of Economic Coorperation and Development {OECD}, 2013). In this case, the member earns a unit of pension, usually expressed as a percentage of nominal earnings, for each year of credited service/participation. In a defined contribution (DC) pension plan, workers accrue funds in individual accounts administered by the plan sponsor. The contributions of employees are typically deducted directly from their pay and frequently some portion of these contributions is matched by the employer. According to Borzi (2005), DC assets build at a fairly steady rate over time since contributions to the pension scheme are generally a fixed percentage of earnings. So, in contrast to a DB plan, it is the contributions rather than the benefit that is fixed in a DC pension plan; the retirement income that will be provided is unknown in advance.

The pension benefit accumulated during the employee's working career will depend on the contributions made while working and the investment returns earned on the plan balances.

In a globalized and challenging world, governments of various countries are working to ensure social and economic development of their citizen and more so the financial stability of their retired employees. The pension landscape has therefore been changing with many countries launching significant pension reforms, including higher retirement ages, changes in the way entitlements are calculated and other measures to introduce savings in their pension systems (OECD, 2013; Broadbent, Palumbo, & Woodman, 2006; Broadbent, *et al*, 2006; Drudi, *et al*, 2006). A number of factors advice the reforms; deterioration in the funding of defined benefit (DB) pension plans, concerns regarding the effect of complex, opaque pension accounting methods on the valuation of the DB pension plan, changes in industrial structure and labour force composition that have given rise to an increasingly mobile workforce, especially in the developed countries and population ageing (OECD, 2013; Schramm, 2005).

Reforms also arise following a number of mistakes made in retirement planning which include failure to start saving early, meager savings and lack of financial literacy to make wise investment choices, manage risk, and manage investment expenses. According to Ingé (2013), retirees are exposed to grim life reality as a result of their mistakes during their retirement plan. This is often tied to poor interpretation and forecasting of what they will require at retirement as shown in the Table 1.

Table 1. Mistakes employees make and realities after retirement

Mistakes made by employees during working life	Realities after retirement
58% start saving at 28 years while recommended age 23	51% of pensioners cannot make ends meet
On average most employees invest only 7% of their salary every year, 15% is minimum recommended.	A 1/3 of pensioners don't have enough funds to cover their medical expenses (biggest expense)
62% of employees don't reinvest their retirement savings for retirement if we change jobs or are retrenched.	61% are unable to save for a rainy day fund after retirement due to pressure of expenses.
90% of employees don't relook retirement savings after initially signing up	33% are still debt after they stop working and 53% still have adult depends to support
38% of employees never get professional advice about our savings	62%. Would strongly advice the youth of today to start saving and planning for retirement early.

Source; Sanlam Benchmark survey South Africa (2013).

Further according to the Sanlam Benchmark survey, a person will require to have saved 2 times their annual salary after working for 10 years, 4 times their annual salary after working for 20 years and 7 times their annual salary after working for 30 years. Unfortunately, this is hardly achieved and in many instances, people retire without any concrete plan to support their retirement life.

To correct this, governments the world over are putting in place various systems to ensure guarantee of security from poverty in old age. Around the globe, there are two major types of pension funds, which are open and closed funds. Open pension funds are beneficial in supporting at least one pension scheme though it does not have any restrictions on membership. Alternatively, the closed pension system supports only pension plans which limits some of the employees. The closed pension systems has various sub classifications thus, the single employer pension funds, individual pension funds, related member pension funds and the multiemployer pension funds (Bonoli, 2005). Generally, retirement plans are then classified as either the defined contribution or the defined benefits. The defined pension calculates benefits by the use of a fixed formula which factors several items during the final service or pay with the employer (Preparing for an Aging World, 2001). In most cases, the payments are done from trust funds for the plan.

The United States refers to the defined benefits as pension. This pension scheme benefits from a given trust fund by the use of a particular formula.

Pension scheme systems also differ in various nations and continents. Pension schemes may be funded or unfunded. In an unfunded *pay-as-you-go* scheme, the pension represents a transfer made between the current working population and the current retired population. In a funded scheme the working population makes contributions into a pension fund which, during the *accumulation phase*, grows in value up to retirement. After retirement, the fund enters the *decumulation phase* and pays out a pension to the retired pensioners for the remainder of their lives. Among countries that have funded schemes include U.S., Tunisia, Nigeria, Kenya and Zambia.

The pension scheme system in a country such as Romania has 3 different pillars; Pillar 1- *Mandatory* is the country's pension system, the *private mandatory* pension in which the country transfers a particular percentage of the collected contribution for public use. The *private pension* is the third pillar of the country's pillar. The private pension is also known as the pension III - Voluntary. In this case, the Financial Supervisory Authority supervises and regulates the private pension system.

In the United States, the pension funds' systems entail schemes, which results in income deferral by the employees. This does not matter even if the retirement income provision is not intent. By 2010, the country's pension scheme boosted of over $9.838 trillion in assets only while the pension funds were more than $4.540 trillion. This was seen as the largest pension funds in the continent. The state itself has put various measures in encouraging responsible retirement planning. Some of the measures that the state has put in place to ensure responsible retirement planning include granting a positive tax treatment to a larger variety of plans. In the United States, the retirement plans are defined in the form of tax terms by specific code such as the Internal Revenue Service (IRS) code. The Department of Labor's provisions, which is under the Employee Retirement Income Security Act, regulates the pension schemes in the country.

In Australia, the pension scheme system is known as the *Superannuation*. This is whereby the Australian government arranges for its people to have accumulated funds for use during their retirement period. The arrangements are government-supported and provide minimum provisions for employees. In most cases, the government requires employers to pay a portion of the workers' wages and salaries into the superannuation fund. The government also encourages its people to put aside some additional funds into the superannuation. Starting the year 2014, the government requires employers to pay default funds and contributions to authorized *MySuper* product. In a situation where an individual wants to withdraw the superannuation fund, the person is required to meet various conditions of release that is contained in the schedule 1 of supervision or the Superannuation Industry regulations (Holzmann, 2009).

In the African pension's arena, several arrangements exist for pension schemes. Zambia for example has several schemes; a largely funded defined benefits by contribution payable by employers and employees by two organizations (Civil Service Pension Fund- CSPF and Local Superannuation Fund-LASF) each of which cover over 70% of workforce; a defined contributions schemes for all workers in the formal sector by Zambia National Provident Fund (ZNPF) and private pension which operates both as Defined benefit pension plan (DB) and Defined-contribution (DC) scheme. The schemes are reported to endure some weakness including being deficient in their design, financing and administration of the scheme; operational deficiency in the collection of contributions and registration coupled with improper record keeping. Tunisia has a partially funded defined benefit system which is fragmented and covers approximately 100% of workforce in the public sector and 60% of the private sector. The scheme suffers eclectic solidarity due to the link between contributions and benefits. The required minimum lengthy of services tends to cause significant distortion in the pension system. In Nigeria, there is a fully unfunded DB scheme for civil servants, a funded DC for organized private sector and a self-administered scheme and insured schemes for individuals which cover 100% public sector, 11% private and 0% informal sector. In summary, most countries pay lumpsum benefits but using different designs.

2.3 The evolution of retirement system in Kenya

Modern retirement systems in most African nations were introduced by colonial governments in the early to mid-twentieth century (Ghai, 2003; Midgley, 1984). Retirement in Kenya was introduced by the British colonial regime as a part of Western economic system (Obudo, 2005). Similar to many African countries, Kenya has a mandatory retirement at age 60, which was raised from 55 years in 2010. Retirement systems with mandatory retirement age were introduced as a way of reducing the size of the large and unsustainable public service sector developed in response to the IMF/World Bank conditions on economic assistance to African countries (Omara, 2005). Retirement and pension systems in African countries have initiated major reforms to improve coverage of retirement (Raichura, 2008). However, some are still primarily focused on retirement benefits for the workers as opposed to a safety net for an array of social contingencies likely to occur in the course of working lives (Dixon, 1993). This implies that the economic, social, and political structures found in developing countries influence the type of retirement systems found in those countries (Dixon, 1993; Ghai, 2003; Justino, 2003; National Research Council, 2006).

Since its inception in 1997, the Retirement Benefits Authority (RBA), Kenya's first pension benefit regulator, has made remarkable progress in reforming retirement benefits in the country. Prior to the establishment of RBA, as Nyayieka (2007) points out, there were inherent shortcomings in the provision of retirement benefits. The weaknesses included: individual retirement plans riddled with financial scams while occupational plans were not guided by any legal and regulatory frameworks. Investment of NSSF funds was questionable causing the contributors to lose trust with the fund managers. As a consequence of the lack of proper management of pensions in mid-90s, the coverage shrunk leading to a reduced number of workers who actively contributed to the NSSF. Establishment of RBA has however reversed the trend in the last decade-and-a-half. Most of the reforms have enhanced and improved performance in the sector (RBA, 2007).

Legal and policy reforms in the Kenyan pension system have articulated groups and categories of formal and informal sector workers to be covered, and the legal and policy measures to be adopted to ensure such workers are indeed included (Kamuzora, 1999). Government's role in enhancing private initiatives for mobilizing and organizing workers for social security coverage should be clearly described in the reforms. A set of policies specifically targeted at insuring informal sector workers, who have lower earnings to protect such workers from variability in incomes. The pension regulator, RBA, has the mandate to oversee such reforms and to protect all categories of workers through NSSF. However, caution should be exercised in converting NSSF into a comprehensive social security system because it is understood that economic and political capacity to handle such transformation is limited in Kenya (National Research Council, 2006; Raichura, 2008).

The World Bank Institute [WBI] has advocated for the introduction of a fourth pillar in Kenya's social security (World Bank Institute, 2006). This extension is more for practical than overhauling the Kenyan system into a more egalitarian system in extending coverage. The proposed reforms fall into four categories: repealing the current legislative structures, parametric reforms, reforming the funding mechanisms, and subjecting the various retirement plans to statutory and regulatory mechanism.

2.4 Kenyan retirement system in comparison to those in other developing nations

Retirement systems are not limited to industrialized countries only. Such systems exist in developing countries including Kenya, but the coverage is much more limited. More formal sector workers enjoy coverage as opposed to informal sector workers. Formal sector workers are those in government employment and the corporate sector. In the year 1999, 166 of 172 member countries of the United Nations including Kenya had employment injury insurance and old age, disability or survivors' benefits for some segments of their populations (Overbye, 2005). The major concern is the limited coverage and low amount of benefits paid to the insured workers and their households.

Currently in Kenya, only 15 % of the entire work force is covered by a pension plan (RBA, 2007). This coverage is split in different proportions between the various pillars of retirement (Nyayieka, 2007). Low and inadequate benefits, and coverage limited to urban workers and government workers is characteristic of many developing nations. Old age benefits and worker injury compensation are the most common type of benefits in these countries and this is the case for Kenya as well (Ghai, 2003). Other major impediments with the Kenyan retirement system as common with other developing countries range from those particular to the beneficiaries themselves to those related to the structural/organization problems. Even after retirement, a number of beneficiaries are entrenched in poverty.

Reasons cited for the above scenario are bottlenecks associated with accessing benefits at the National Social Security Fund (NSSF) and Civil Service pension benefits on one hand, and lack of awareness of existing benefits accrued to beneficiaries on the other hand (Kumba, 2008). Institutionalized corruption has also been identified as a great impediment in processing pension benefits. Misuse of pension fund assets and unsafe investments by the fund managers is rampant (National Research Council, 2006). The system also excludes agricultural workers who in Kenya comprise more than one third of the labour force who are predominantly based in the rural areas (Gillion, *et al*., 2000; Kakwani & Son, 2006; Overbye, 2005).

In addition to the limited coverage of Kenyan retirement is the problem that the pension amount is barely sufficient to enable retirees to maintain a decent standard of living. In assessing the adequacy of retirement income, the target of the retirement income expressed as a percentage of pre-retirement income (income replacement ratio) continues to be debated on. The proportion of pre-retirement income needed to maintain the standard of living in retirement however varies by individuals. In 2005, the replacement rate for pre-retirement income for Kenya retirees was between 20 to 40 percent as opposed to the minimum of 40 percent recommended by ILO (Mwadilo, 2006). The benefits are seldom indexed to inflation to reflect the current cost of living which also accounts for insufficiency of benefits (National Research Council, 2006). For instance, available data showed that annual average inflation rate increased from 9.8 per cent in

December 2007 to 26.2 per cent in December 2008 (Central Bank of Kenya [CBK], 2008). Such occurrences erode the purchasing power not only for consumers in the market with considerable wages but also pension for retirees who live on fixed incomes. A replacement ratio of 65 percent is found adequate, while some people may require a replacement ratio of over 90 percent to maintain their desired standard of living (Purcell, 2012). Earlier, Oyuke, (2010) suggests that higher replacement rates of between 70 to 90 percent of the pre-retirement income are needed to sustain pensioners' standards of living prior to exiting the labor force.

The Kenyan retirement system is structured like a compulsory savings plan where covered employees and their employers pay regular contributions to a central, publicly supervised fund. Dixon (1993) referred to this type of retirement plan as national provident fund, which are common in developing countries. Provident fund description by Dixon (1993) is in congruence with compulsory savings plan provided in Kenya through NSSF. Contributions are credited to an individual account for each employee and interests accrue from the balance in the account. In the eventuality of retirement, disability, or death, a lump sum amount is paid as benefits (Dixon, 1993). This approach of providing social security suffers major weakness as there is no risk pooling which does not allow resources transfers between individual members. In Dixon's study, Kenya was one of the countries that were found to have deficiency in social security coverage. Studies provide a vast body of evidence showing authentic concerns of inadequate social security coverage all over the world (Ginneken, 1999; Overbye, 2005).

2.5 Types of retirement benefits in Kenya

Based on the ILO minimum standards for provision of social security, certain common features of social security do exist in developing countries as well as in Kenya's system (Dixon, 1993; Ghai, 2003; Overbye, 2005). The most common features are types of benefits: work injuries compensation and retirement benefits. These two are widespread in most developing countries including Kenya (Overbye, 2005). However, health insurance, unemployment and family benefits are sparse in developing countries (Ghai, 2003; Overbye, 2005). An ongoing data collection by the International Social Security Association (ISSA) and U.S. Social Security Administration (SSA) discusses the limitations of social insurance and social protection in Kenya

as it is with many other developing countries (SSA, 2005). NSSF provides more modest benefits than the other Kenyan pension plans (RBA, 2007; SSA, 2005). The benefits provided by the NSSF include old age pension, work injury, disability, and survivors' benefits, as well as maternity benefits. Nyayieka (2007) maintained that occupational and individual retirement plans provide an array of benefits that are explained by trust deeds which establish these plans.

The Civil Service Pension plan is the only non-contributory plan in Kenya (Nyayieka, 2007). The Scheme provides a pension of 2.5% of final basic salary for each year of service upon retirement from service at age 55. The computation is based on a retirement pension of 75% of basic salary after thirty years of service (or an average of 50% of total remuneration for all categories of public service employees). A higher pension fraction applies in the case of military personnel. Under the Pensions Act, Cap 189, retiring civil servants may opt to take up to 25% of their pension in the form of lump sum. No guaranteed pension increases have applied in the past and only four increases in pension entitlement have occurred in the last forty years leading to 2004 with the last increase having been in 1991. However, modest pension increases at 3% every two years were introduced since 2005. Under the scheme, benefits vest after ten years of service and there is no portability of benefits and individuals who resign from service before retirement are not entitled to any benefits (Raichura, 2008).

The NSSF was established under an Act of Parliament in 1965 as a provident fund operating on a defined contribution basis. An amendment to the NSSF Act in 1997 defined the NSSF as a retirement benefits scheme and thus brought the NSSF into the regulatory framework of the Retirement Benefits Authority. The NSSF covers formal sector employees in Kenya other than those covered under the public service pension scheme. All employers are required to register with the NSSF but only employers with five or more employees are required to contribute to the NSSF. The total membership of the NSSF is currently estimated at 3.4m, but the active contributing membership is currently estimated at just over 1.5 million. The number of registered employers with the NSSF is estimated at close to 80,000. In 2006, the NSSF introduced voluntary membership widening its reach beyond the formal sector (Raichura, 2008).

2.6 Models of Payment of Retirement Benefits: Merits and de-merits

Different models of benefit payment at retirement exist including lump-sum, life-annuity, and programmed withdrawals (Antolin *et al*., 2008). The application of either one is determined by several factors and conditions including legal frameworks and regulations, whether the scheme is a DB or a DC, membership and individual scheme rules.

2.6.1 Lump-sum

This form of payment is whereby the retiree is given a single sum of the entire value of the accumulated retirement capital. This is usually done at retirement (under occupational pension plans) and at contract maturity (under a personal savings plan) although a delayed payment is often possible. In Hong Kong, India, Philippines and Thailand, this is the only mode of paying retirement benefits (Antolin, *et al.,* 2008).

Lump-sum mode of payment has potential advantages. From the perspective of the plan sponsor/ administrator, it is easy to operate particularly, where the payment is given with no further dealings with the client. For the retiree, he/she is able to invest part of the money and in a strategy that keeps pace with inflation. There is also the advantage that the retiree could immediately liquidate a significant debt such as clear a house mortgage (Moore & Muller, 2002). A stash of cash can be retained so as to tap into in case of emergency, and after death the heirs can inherit what is left of it. Further, lump sum payments make voluntary annuitization possible for retirees as they can take the lump sum cash and use all or part of the money to buy a conventional annuity from an insurance company (Antolin *et al*., 2008). Moore and Muller (2002) established that some retirees take their contribution and place it in a non-tax-deferred saving, such as stocks, bonds, or finance a new business.

Of key concern is the potential difficulty of some retirees to manage their retirement assests as a lump sum payout as opposed to annuity payments as the retiree shoulders all the risk of managing the money and may incur investment costs such as mutual fund fees or expense of a financial adviser (Schramm 2005; Williamson & Smeeding, 2004). While self-annuitization is complex, self-insurance entails many risks since many individuals do not manage such

arrangements very well. A more general policy concern is that some retirees spend the money in an accelerated and reckless manner making it impossible to provide adequate longer term protection to themselves and their families. In support, Antolin, *et al*., 2008 indicates that the disadvantages of lumpsum payment becomes a hazard in countries where the government or social security comes to the aid of the very poor since such retirees become a permanent burden of the state. As such, the lump sum payment scheme has far more reaching consequences that it cannot guarantee income security for the retiree.

2.6.2 Annuities

An annuity is defines as a stream of payments for a pre-established period of time. Payments can be weekly, monthly or yearly and they can be given immediately or deferred for a specified period of time. The advantages of this model include the fact that one gains longevity insurance through a guaranteed cheque till death. The client also has the option of spreading the payments over the spouse's lifetime. Unfortunately this model loses purchasing power over the years because most pensions are not adjusted for inflation. For example, at an annual rate of inflation at three percent a monthly pension cheque of Ksh. 20,000 today would be worth Ksh. 14,880 in 10 years and Ksh. 11,070 in 20 years. In addition, annuities attract taxes on pension benefits. There is also the risk that an employer may fail to pay the benefits as promised if hard times are experienced thereby terminating the defined benefit plan.

Annuities may be classified in to three categories depending of the mode of payment:

a) The *Single-life annuity* – which pays the largest monthly payment but pays only during ones' lifetime. The spouse or other dependents are not considered even though they may need financial support after death of the beneficiary.
b) *Joint and survivor annuity* – it is an annuity paid during one's lifetime and then continues to be paid to a spouse or beneficiary after demise of beneficiary. In this case, one can choose to get 100%, 75%, or 50% in their lifetime while the rest is paid after.
c) *Period certain and life annuity* – this kind of annuity pays the dependent's beneficiaries for a set number of years after death of the retiree. This works for those that are single

and prefer to receive monthly pension cheques, yet want to make sure that at least some of their wealth passes to defined heirs.

2.6.2.1 Programmed withdrawals

These are a series of fixed or variable payments whereby the annuitant draws down a part of the accumulated capital (and continued investment earnings thereon). Each payment restricted to a maximum of the greater of the current investment income and the equivalent of an annuity based on average remaining life expectancy. If one lives to an advanced age, there is a clear possibility of the money being exhausted before death. Any money remaining after death is payable to the individual's estate and distributed accordingly. The capital continues to be invested in the pension fund and to earn a higher rate of return in expected terms than is assumed by an insurance company or other provider in setting life annuity purchases rates. In Chile and Mexico, programmed withdrawals are mandatory when the individual‘s retirement capital is too small to purchase a prescribed minimum amount of life annuity (Association AFP, 2008; Antolin, *et al.,* 2008).

The advantages of the programmed withdrawals payment programme include; there is considerably more discipline on the part of the retiree since the withdrawals are programmed; Programmed withdrawals do not involve longevity guarantees that would require complex actuarial reserving and solvency margins and they attempt to produce relatively stable annual income for the lifetime of the retiree thus addressing the basic motive of paying a pension.

The main disadvantage is the risk that the capital will be completely exhausted while the retiree is still alive. Amount and duration are generally calculated on the basis of average life expectancies. While the monthly payment at the beginning is generally higher than under a conventional life annuity, the monthly payments can be very much lower in the later years. Amount of each payment can also fluctuate as a result of the volatility of pension fund returns thus the annuity is not covered against longevity risk and investment risk.

There are several variations within the programmed withdrawals (Association AFP, 2008; OECD, 2013). One approach is the totally prescriptive approach, where the amount to be withdrawn each year is calculated in accordance with a prescribed formula, and the annual withdrawal is exactly equal to this amount (Antolin, *et al.*, 2008). Other countries set a minimum or a maximum limit on the amount that can be withdrawn. There are other countries that set both a minimum and a maximum limit on each annual withdrawal, that is, the amount withdrawn must fall within a prescribed range or band. In programmed withdrawals described in this section, the remaining capital may be applied to purchase a life annuity at a maximum age set by the government e.g. within 10 years after retirement or at any earlier date chosen by the annuitant or at a relatively advanced age.

2.6.2.2 Life annuities

In this case, at retirement, the member‘s DC accumulated pension is transferred to a life insurance company. The insurance company then makes payments to the retiree for the rest of his/her life on a regular basis; weekly, monthly or quarterly. Countries that have life annuity as the only retirement benefit payout form include Austria, Bolivia, Colombia, Croatia, Hungary, Netherlands, Norway, Poland, Sweden and Uruguay (Antolin, *et al*, 2008).

The main advantage of this mode of payment is that the payments are fixed and will be made for the entire lifetime of the retiree. According to Scott (2008) many retirees face the difficult problem of turning a pool of assets into a stream of retirement income and as such recommends that retirees purchase an immediate annuity in order to maximize retirement spending. In addition, the guarantee of payments for the retiree‘s entire lifetime is only as good as the financial strength of the institution making such guarantees.

The disadvantage to this is the issuance cost since this approach involves the retiree foregoing future control over investments and losing the potential to earn superior investment returns, and runs against the desire to leave money to spouse and children. Guarantee of payments for the entire lifetime is only as good as the financial strength of the institution making such guarantees.

At the end of the day what counts is what one wants to accomplish with the money. Unfortunately individuals do not know for how long they will survive.

2.6.3 Pension legal and regulatory framework in Kenya

Historically, pensions were regulated by the Pensions Act (Cap.189) of 1942 with periodic amendments the recent one being 2009. The act was the sole regulatory mechanism for public pensions for the civil service. The enactment of the Retirement Benefits Act of 1997 which established the Retirement Benefits Authority was mainly created to regulate the occupational and individual schemes as well as widen the coverage under all the schemes including NSSF. With these two legislative pieces coupled with reforms, the pension sector has greatly improved coverage which extends to the informal sector. However, there still remain unanswered questions on the adequacy of the benefits as well as income security for the retired.

The regulations of public pension benefits are published in the first schedule of the Pensions Act. The public servants' pension scheme is a defined benefit scheme where the government as the employer is wholly responsible for the provision of retirement benefits. The provisions of the act pertinent to the regulations of the scheme includes: the qualifying period which is determined based on the length of service (currently a minimum of 10 years in public service -else gratuity is paid if length of service does not quality for pension), method of computing the pension benefits qualified for depending on length of service, circumstances under which one would qualify for early retirement benefits, and processing of the benefits.

The enactment of the Retirement Benefits Act has also seen coordinated efforts to establish a legal and regulatory framework in the country's occupational and individual retirement plans (Nyayieka, 2007). Legislation in the retirement benefits sector provides basic regulatory requirements and guidelines to be followed by all the pension funds. Some pertinent provisions under the Act that can be attributed to the legislation are: the funds must be established under an irrevocable trust, appoint separate managers and custodians, provide actuarial valuations every three years, avail annual audited accounts, and submit quarterly contributions and investments reports. Further provisions of the Act is preservation of benefits until retirement age, payment of

benefits within 60 days, providing members with annual statements, holding annual general meeting of the members, and compliance with stipulated investment guidelines (RBA, 2007). Legislation enactment and the establishment of a regulatory mechanism have however not resolved some of the concerns with pension system in Kenya, particularly concerns about the low coverage and retirees' income security.

2.7 Theoretical framework

The study was guided by two theories specific to quality of life in old age namely; the life cycle model advanced by Settersen in 2003 (Ang, 2009) and the third age theory by Leslett (1998).

2.7.1 The Life Cycle approach

The life cycle theorists argue that human beings move through a static set of phases that are outside their control. The model posits the life movement through a fixed sequence of irreversible stages which are cyclical in nature and may repeat themselves from one generation to the next (Settersten, 2003). The underlying thesis in the life cycle approach is that individuals spend their first phase of life preparing for a professional career. They then begin to earn a wage which is initially insufficient for their needs. In the second phase of life, employees earn to accumulate wealth which they save for later use at retirement. Upon retirement, which is the third phase of life, individuals spend their accumulated savings to sponsor their consumption for the rest of their life. Hence, the individual's capacity to support their retirement period is incumbent upon their earlier saving culture.

2.7.2 The Third Age theory

This theory states that old age can be a '*golden age'*, full of self-realisation, personal growth and the fulfilling of lifetime ambitions. The 'third age' is made possible by older people having higher disposable incomes and access to consumer culture in retirement. The 'third age' concept according to Hooyman and Kiyak (2011) denotes the stage in life that occurs after middle age but before the final stage, and is conceptualised as a time of continued involvement and growth in areas of life beyond employment and family. Third age concept is congruent to productivity in later life. The theory further implies that the vitality of older people must be built around the skills and wisdom through both paid and unpaid work for the benefit of older people and society.

There are obvious questions on how contribution is defined and measured. For instance, volunteering by older people may be rewarded heavily as opposed to paid work because the former is seen to have common good than the latter. For example, a retired teacher volunteering as a church lay reader is seen to make much contribution than a retiree hired as an adult education teacher. Proponents of third age theory maintain that changes in work, retirement, and productivity will require new skills and knowledge among planners by providing services such as pre-retirement counselling, learning opportunities, career development, retraining and creating opportunities for volunteering. The two theories bear relevance to the quality of life that an individual lives after retirement. The applicability of the theories to this study draws from the notion that a viable model of access to pension can be a factor of the utility of savings as well as overall financial security.

Income security in old age is paramount to the quality of life of retired persons. As the conceptual (figure 1) model shows, income security is a multiplex of factors emanating from work life such as saving for retirement to investments and utilization of pension benefits. In addition, the intersection of retirement and personal factors determine the outcome of income security which subsequently determines the quality of life.

It is hypothesized that actual amounts of retirement savings as well as having other supplemental incomes may play a critical role in shaping how individuals secure their retirement life. Family factors and individual factors may also determine a person's financial standing (after retirement) and family responsibilities may actually hamper proper use of benefits leading to insecurity. Skills and business acumen or ability to utilize their savings for regular earnings and a secure life also play a part. Finally, the presence of a retirement plan and knowledge on how to maximize the use of money (financial literacy) may also determine how successful one is in their choice of investment made using their savings. Thus, this study will attempt to fill the knowledge gaps that are pertinent to income security due to the lumpsum mode of payment of pension.

2.8 The Conceptual framework

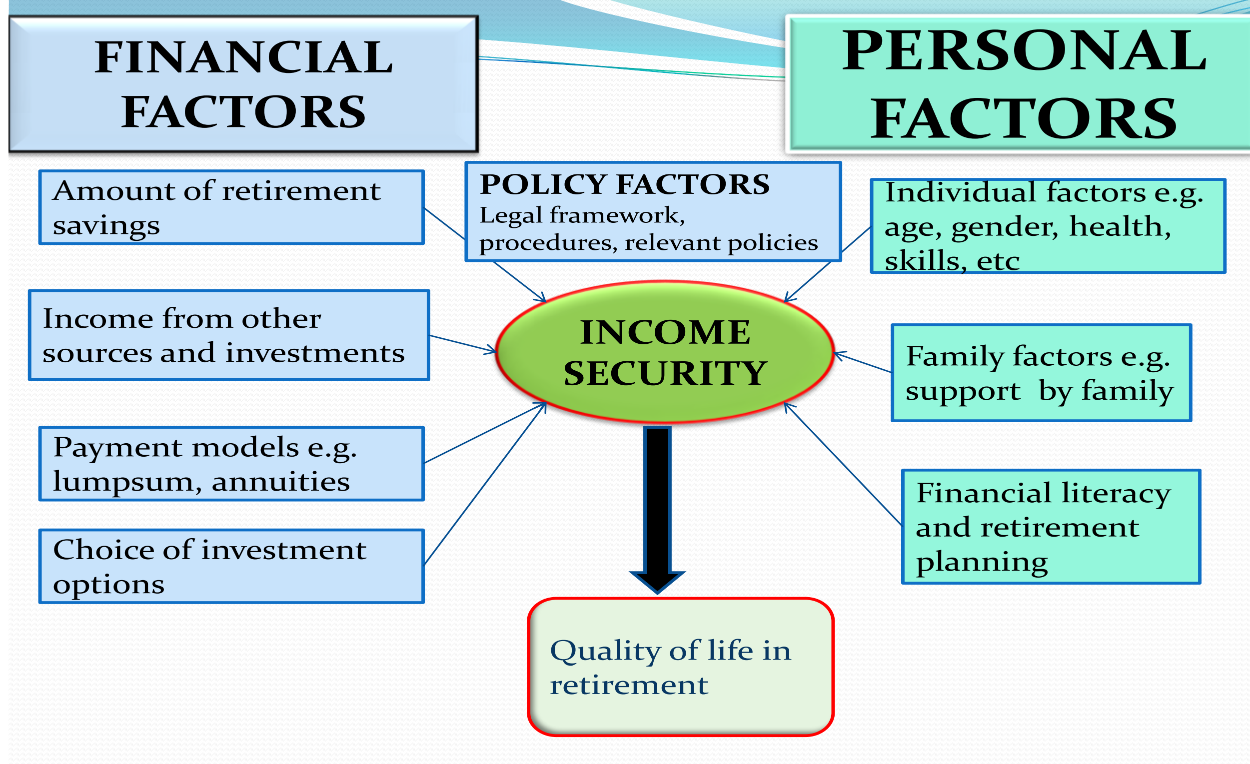

Figure 1: The conceptual framework

CHAPTER THREE
3.0 METHODOLOGY

3.1 Research design

The study employed a mixed-methods design. The advantage of using this approach was that it allowed for the utilization of a cross-sectional survey, exploratory and descriptive approaches as well as the collection of both quantitative and qualitative data. An exploratory survey tool was utilized to gather views from retirees as well as prospective retirees in order to investigate their views and perspectives regarding the preferred mode of payment of pension benefits within the framework of risks and opportunities associated with each mode. The exploratory method allowed an understanding of the dynamics associated with common modes of pension payment while the descriptive approach allowed an understanding of how pension benefits are utilized across board leading to either income security or insecurity.

3.2 Study population

The target population for this study comprised:

a) The retired persons in Kenya from the four main types of pension schemes namely: NSSF, Occupational, Civil Service, and voluntary/individual schemes. Specifically the study endovoured as much as possible to target those who had been retired for a period of over 5 years. This was necessary in order to gather varied experiences in retirement touching on investments/business, expenditure of benefits and income security.

b) Prospective retirees who were to retiree in 10-15 years selected from both the public and private sectors. In selecting the prospective retirees, the study took cognizance of the rapid changes being experienced in the retirement benefits sector which may not been experienced by the most retired workers. Their prospective views on the most viable mode of payment of retirement benefits was important in informing the study findings since as current employees, any policy recommendations emanating from this study would impact directly on them. Further, the period 10-15 years to retirement was deemed appropriate since most employees begin to focus on retirement during this period (Lusardi and Mitchell, 2008: Taylor and Doverspike, 2003).

c) In addition the study also targeted industry players who manage, administer, invest, execute decisions pertaining to pensions and dispense pensions to retirees as key informants among them administrators, pension personnel, trustees, custodians, and sponsors of pension funds.

3.3 Sampling

The total target sample for the study was 2500 comprising 1000 retired and 1,500 prospective retirees drawn from 18 counties and 7 regions (Nairobi, Central, Eastern, Coast, Western, Nyanza, North and South Rift Valley) across Kenya. North Eastern region was excluded due to its vastness and population sparcity. However, the data collected in this study revealed that among the retirees and prospective retirees sampled in the study, there were 0.8% who indicated their original home districts as being in the North Eastern region. In order to obtain a representative sample in the selection of study respondents, quota and random sampling as well as snowballing techniques (where appropriate) were employed as follows:

a) Sampling technique for retirees

The respondents were selected from a sampling frame provided by the four categories of schemes as follows:

- For the NSSF, the list containing retirees' names, date of pension payment, residence/location, and contact information was provided by the Research and strategy division.
- For the Civil Service, the Pension department provided the list of pensioners with their contact details.
- For occupational schemes, lists were obtained from the various fund administrators of the main pension fund managers.
- The individual schemes lists were obtained mainly from individual pension scheme providers registered with RBA including Old Mutual, BRITAM and CFC Life.

Where possible, the lists obtained were supplemented with those listed on the RBA website.

b) Sampling technique for prospective retirees

In order to obtain a sample of prospective retirees, the following methods were applied:

1) For members of occupational schemes (desired target being 850), the full list of membership was obtained from the RBA Website. In order to arrive at the desired sample for prospective retirees, a random sampling technique was applied.
2) For NSSF (target 700) and Civil Service Pension Schemes (target 900), a list of all ministries, departments, educational institutions, and other public sector entities under the scheme was obtained from the Pensions Departments. In order to ensure a fair representation of ministries, institutions, and armed forces, rural/urban, counties and regions, quota sampling technique was applied. Further, a random sampling procedure was applied to proportionally select respondents from the above institutions.
3) For individual schemes, a systematic sampling technique was applied to come up with a sample of 15 companies out of which 76 respondents were selected for interview.

c) Other key informants

Other sources of information in the study were key informants who included: the fund administrators, pension personnel, trustees, custodians, and sponsors of pension funds, representing the four categories of scheme types.

3.4 Data collection tools

The study utilized three instruments for data collection. The items in the tools were developed based on the existing literature and guided by the research objectives and hypothesis:

- *Semi-structured questionnaire:* the tool was administered to both retired persons as well as prospective retirees. The questionnaire was designed to elicit information pertaining to the preferred mode of pension payment by both categories of respondents. Thus, in order to apply to both categories, the questionnaire employed a skip pattern which provided specific sections for either category.
- *Focus Group Discussion Guide*: the tool was administered separately for men and women retirees. Participants were drawn from across all the schemes and regions with each group

comprising 12-15 members. The tool elicited information pertaining to the views on the preferred mode of payments, utilization of pension on benefits, risks and opportunities of lumpsum payments of pension. The discussion aimed mainly at generating group consensus on each issue under discussion in order to guide the conclusions. In the FGDs, the viability of lumpsum mode of payment in regard to income security was deeply investigated.

A separate FGD guide was used to elicit views pertaining to merits and demerits of various modes of pension payment from fund administrators, managers and custodians

- *Key Informants Interview Guide*: the guide was used with the administrators, pension personnel, trustees, custodians, and sponsors of pension funds, representing the four categories of scheme types. The tool particularly aimed at gathering views pertaining to the use of pension savings by retirees vis a vis the available modes of pension disbursement and how each of them impacts on income security of retirees.

3.5 Data collection procedures

Following the development of the questionnaire by the research team, research assistants were identified and trained. During the training, the research team elaborated the purpose of the study, the organization of the Retirement Benefits sector/industry, pensions and their administration, the objectives of study, data collection methodology as well as modalities of reaching the retirees and the prospective retirees. More emphasis was put on the understanding of the semi-structured questionnaire and expectations of the research team from the entire field study. In order to test for validity and reliability of the tool, the entire team conducted a pilot study in two urban locations namely, Kiambu and Thika towns in Kiambu County. This afforded the research team an opportunity to familiarize themselves with the field work. The data obtained from the pilot study was analyzed, gaps identified and the instrument revised and improved.

Once all the logistical arrangements were finalized, the research team embarked on identification of the respondents across the schemes, regions and counties by phone calls and short message services. In a few instances, snowballing was utilized to locate people retired from the same

organization. The research assistants administered the questionnaire under the supervision of the research team while the team also conducted the FGDs interviews.

For the retirees sub-sample, respondents for the FGDs were identified using a pre-identified contact person. In this case, existing retiree organizations and groups came in handy. The identified contact mobilized 12–15 members to participate in the FGDs. The groups were categorized on the basis of gender, hence 6 FGDs were conducted in six study regions namely Nairobi, Central, Eastern, Rift Valley, Coast and Western.

Finally, key informant interviews were administered to scheme trustees and office bearers as well as key pension personnel in selected schemes within each category. The selected officers were contacted and traced through their relevant offices for interview.

3.6 Data entry and analysis

The analysis of data took into account the research design which combines both exploratory and descriptive survey. Quantitative data analyses made consideration of the scales of measurement. Measures of dispersion and central tendency mainly mean, mode and median were used to analyse the data while the main outputs were reported in form of percentages, frequencies and means where applicable. Cross tabulation and correlation coefficient were used as measures of comparison and associations to examine prevailing relationships between variables. Where applicable, the hypotheses were tested using the Chi square test of significance, comparison of means (t-test) and logistic regression. Logistic regression procedure was also used to isolate the significant factors that determine income security in retirement. Qualitative data was analysed descriptively by themes, classification and comparison. The data was then interpreted and presented using the method of triangulation.

CHAPTER FOUR
4.0 RESULTS AND DISCUSSIONS

4.1 Key study findings

The findings presented in this emerge from data collected in the 7 regions and 18 counties of Kenya from where the respondents of the study were drawn. The findings are informed by three categories of respondents; structured interviews conducted with retirees and prospective retirees, key informant interviews with pension scheme managers as well as focus groups discussions held with retirees and pension fund administrators. Out of a targeted sample of 2,500 retirees and prospective retirees, the study reached 2,365 respondents translating into a response rate of 95%. A total of 978 retirees were reached against a target of 1,000 while 1,387 prospective retirees were reached out of the targeted 1,500. For pension scheme managers, the study reached 45 officials out of the targeted 60.

For the unit of analysis, the study utilized the retirees and prospective retirees and relied on their views, perspectives and experiences to analyse the risks and opportunities associated with lumpsum mode of payment of retirees' benefits. In order to generate the varied views, the four main types of retirement schemes were included namely; the Occupational, Individual, Civil Service pension scheme and the NSSF.

4.1.1 Distribution of study respondents

Table 2 shows the distribution of respondents by scheme type and that the highest number of respondents was drawn from the Civil Service Pension scheme members followed by the Occupational category.

Table 2: Sample distribution by scheme type and retirement status

Scheme type	No. of Retired (%)	No. of Prospective retirees (%)	Total
Occupational	246 (25.2%)	533 (38.4%)	779
Civil service pension	387 (39.6%)	553 (39.9%)	940
NSSF	315 (32.2%)	255 (18.4%)	570
Individual schemes	30 (3.1%)	46 (3.3%)	76
Total	978 (100%)	1387 (100%)	2365

Notably, pension scheme managers that were studied were drawn from the four scheme types.

4.2 Respondents profile and socio-demographic characteristics

The study endevoured to establish key characteristics of respondents especially those hinging on spending patterns, aspirations and perspectives of income security. The main characteristics analysed include age, gender, education level, marital status and employment status. Table 3 summarizes these characteristics for the **2365** participants of the study.

Table 3: Social, economic and demographic characteristics of the respondents

Variable*		**Number**	**Percent**
Retirement status	Retired	978	41%
2365	Non-retired	1387	59%
Gender	Female	968	41 %
n=2365	Male	1397	59 %
Location	Rural	906	38%
n=2365	Urban	1459	62%
Educational Level	None	22	1%
N=2350	Primary	168	7%
	Secondary	618	26%
	College	1121	48%
	University	421	18%
Marital Status	Married	1962	83%
n=2365	Single	82	3%
	Separated	64	3%
	Divorced	55	2%
	Widowed	202	9%
Age Category (in years)	40 – 45	96	4%
n=2365	46 – 50	457	20%
	51 – 55	598	25%
	56 – 60	451	19%
	61 – 65	399	17%
	66 – 70	242	10%
	71 and older	122	5%
Employment Status	Employed	1337	58%
n=2306	Self-Employed	511	22%
	Not employed	392	17%
	Retired and re-employed	66	3%
Scheme type	Occupational Schemes	779	33%
n=2365	NSSF	570	24%
	Civil Service	940	40%
	Individual Schemes	76	3%

The value (n) varies due to missing responses

As Table 3 indicates, 41% of the respondents were retired while 59 % were prospective retirees. The sample closely reflects the target sample which was envisaged to be 40% retirees and 60% prospective retirees.

Majority of the respondents (59%) were male while female respondents comprised 41%. This distribution is in consonance with the gender disparity in formal workforce participation which has been historically skewed towards the male gender. These disparities consequently spill over to the distribution of male versus female retirees. In order to get a clear picture of gender representation of retirees and prospective retirees, a cross tabulation was done revealing that there were more males in both the prospective retirees (55%) and retiree (68%) sub-categories further clarifying the historical gender disparities in employment. Previous studies conducted among the workforce continue to report glaring gender disparities (Campa, *et al*. 2011 and ILO 2012).

With regard to location of respondent, the study established that 38% lived in rural areas while 62% were in urban locality. Further investigation revealed some differences of locality when the two groups (prospective retirees and retirees) were compared, in that a majority of prospective retirees were based in urban areas while retirees were primarily rural area residents. This may be attributed to the fact that after retirement, there is a trend of return migration to the rural areas by those who previously worked in major towns (Mberu *et al.***,** 2013; Grenier *et al*., 2012).

Analysis on the education attainment of the respondents revealed that most had a fairly good education with over 90% of the respondents reporting having obtained secondary education or higher. This may indicate that most of the retired and prospective retirees were in occupations requiring higher educational qualification. About 8% had either primary or no education at all implying that they may have been in occupations requiring low skill attainment.

Majority of the respondents were married (83%) while the other categories of marital statuses were represented by a fewer number of respondents. As it would be an expectation in older ages,

there were more cases of widowhood than any other unmarried categories representing 9% of the total sample. Further analysis revealed that female retirees were more likely to be widowed than their male counterparts.

The mean age for both retirees and prospective retirees was 57.2 years with a minimum age of 40 and maximum of 89 years. This distribution of retired and non-retired participants reflects a wide spectrum of experiences that were important for the study to understand. Later in this study, the views on pension utilization are compared across age and other important factors. More importantly to note is that the study closely adhered to the intended purpose to mainly target prospective retirees who were within 5 - 15 years to retirement in anticipation that those within this range would already be planning for retirement.

From Table 3, majority (58%) of the respondents were employed as would be expected given that 59% of the respondents were prospective retirees. There is also indication that retirees are actively engaged in employment-related activities with 22% reporting being in self-employment. Notably, 3% of retirees were re-employed after retirement while 17% were not engaged in any form of economic activity implying that they may not have had any other income sources save for pension. Drawing from the section, the profile indicates fairly well educated respondents, in the range of 40-89 years, predominantly male, living in urban area and largely employed.

4.3 Utilization of retirement benefits by retirees based on mode of payment

The first objective of the study aimed at establishing how retirees utilized their retirement benefits according to their mode of payment. The modes of payment that were considered were categorized as monthly pension, annuity benefit, commuted benefit and lumpsum. As a prelude to understanding the various ways that retirees utilized their retirement benefits, it was important to document how long studied retirees had been in retirement, retiree monthly salary at point of retirement, current employment status, mode in which their benefits were paid, amount of benefits received, and viability of investing pension in business as well as preferred methods of disbursement of pension savings by various stakeholders.

4.3.1 Years and employment status in retirement

The study revealed that the mean number of years in retirement was 10.2 years though the majority of retirees (64%) had been retired for less than 10 years. Conversely, a very small proportion (2%) had been retired for over 30 years. The retirees' period in retirement is shown in Figure 2.

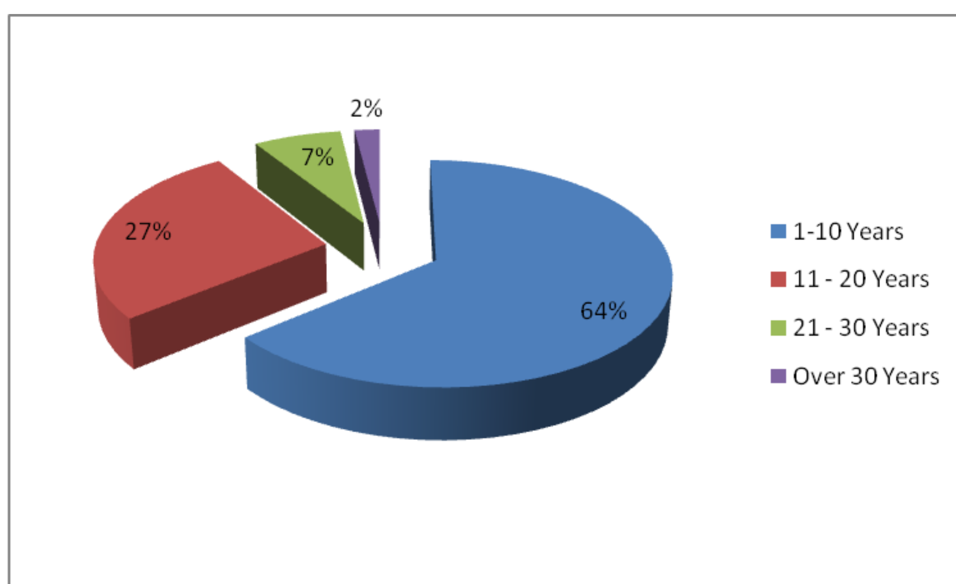

Figure 2: Retiree's period in retirement

The findings attest to long experience in retirement which is important for the study to draw from in concluding on the risks and opportunities that arise from the use of different modes of payment. The spread may be utilized to plan for the payout phase given the observed decline beyond 30 years.

4.3.2 Retirees monthly salary at retirement

The retirees' monthly salary at the point of retirement was investigated. This was deemed important in order to establish it there was a relationship between income security and salary at retirement. Evidently, there was an even distribution of respondents in all income categories indicating fair representation across all income brackets. Table 4 shows that nearly 50% earned less than Kshs. 20,000 per month with 5.4% earning less than Kshs. 5,000. There was 23% who earned above Kshs. 100,000 with the modal earnings being in the cluster 20,001-30,000.

Table 4: Retirees monthly salary at retirement

Income at retirement	Salary at point of retirement	
	Frequency	Percent
Less than 5,000	69	7.1
5,001 - 10,000	94	9.7
10,001 - 15,000	131	13.5
15,001 - 20,000	151	15.6
20,001 - 30,000	181	18.7
30,001 - 40,000	116	11.9
40,001 - 50,000	110	11.3
50001-100,000	9	1
Above 100,000	109	11.2
Total	970	100

Further tests using a Spearman rank correlation revealed a significant but a weak relationship between monthly salary at retirement and income security at retirement where r_s=0.3 (p<0.0001). The results indicate a convergence between pre-retirement income and income security in retirement since savings within defined contribution systems are often based on the amount of earnings. Also, there is a likelihood that earning a higher salary may translate to viable investments for retirement. Thus, those retirees who earned a higher salary prior to retirement may have enjoyed a more secure retirement owing to their commensurate higher pension benefits. These findings concur with the (RBA report, 2012; Rusconi, 2008). The weak relationship between pre-retirement income and income security in this study may be attributed to the fact that majority of the retirees were members of a provident fund (i.e., NSSF) where the contributions were not based on their pre-retirement earnings.

4.3.3 Retirees current employment status

It was also important for the study to establish the retirees' employment status as it may hinge on how the retirees had utilized their retirement savings (e.g. opening a business) or may actually indicate the inability of their retirement benefits to sustain them. The Figure 3 shows the status of retiree's employment.

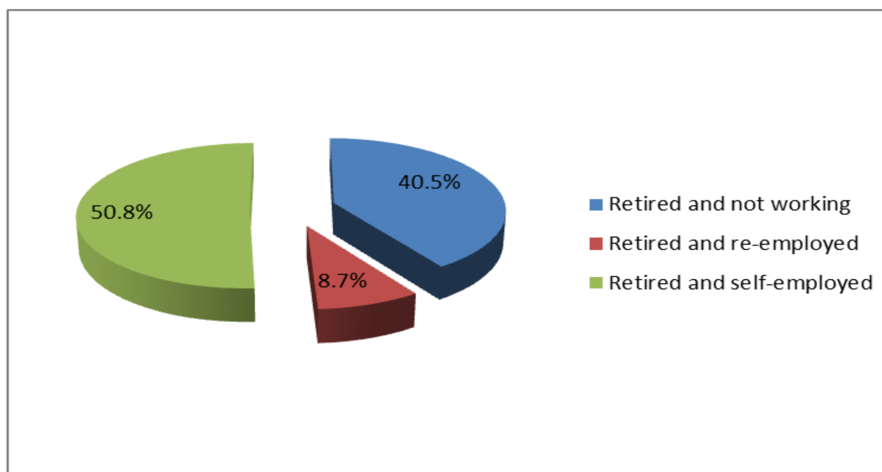

Figure 3: Retiree's current employment status

As detailed on Figure 3, over 59% were engaged in employment either through self-employment or re-employment. The remaining 41% of the retired respondents were not actively engaged in employment, raising a concern as to how they were meeting their daily life sustaining needs. Further investigation revealed that those gainfully employed were in varied engagements such as small businesses and elderly self-help group activities while a few were formally retired but re-hired through extension of their employment contracts or re-employment. Those engaged in small businesses were mainly farming with a few in consultancy, or real estate businesses.

The findings further show that a majority of retirees are self-employed in the informal sector. Though self-employment may be considered as a 'soft landing' for those exiting formal employment, documented evidence also reflects low earnings in the informal sector (Bigsten, Kimuyu, & Lundvall, 2004; Tokman, 2007). However, the focus group discussions in the current study confirmed that most retirees enter into self-employment without ample preparation and anticipation of the challenges ending up with frustration as a result of the low earnings.

It also emerged that retirees who sought re-employment after retirement were those not adequately prepared to retire. Focus group discussions confirmed that most retirees were rarely psychologically prepared at the onset of retirement and often found themselves unable to adjust to the new reality. The sudden cessations of employment, routine engagement at work place as

well as work networks come as a shock to most retirees. It is then not a wonder that one male retiree informed the study that for six months after retirement he continued to dress formally and leave home to unknown destinations in the pretext of going work as confirmed with the following voice.

> "*Let nobody deceive you that anyone is ever adequately prepared for retirement. For me, it took six months to accept the reality and I kept on waking up at 5am as usual to wear my suit and tie, polishing my shoes and leaving my home religiously without knowing where I was going*" FGD with retirees.

4.3.4 Retirees mode of receiving pension

Respondents were asked to state how they had been paid their pension benefits and to estimate the amounts they had received during the payout phase. Given that some of them were receiving a pension, it was important to establish how much they received regularly in form of pension and how they continually utilized it. Figure 4 illustrates that majority of the retirees received their pension benefits as a lumpsum (72%). Close to one-quarter commuted their benefits opting to receive a portion as lumpsum and a monthly pension. Only 5% fully annuitized their pension.

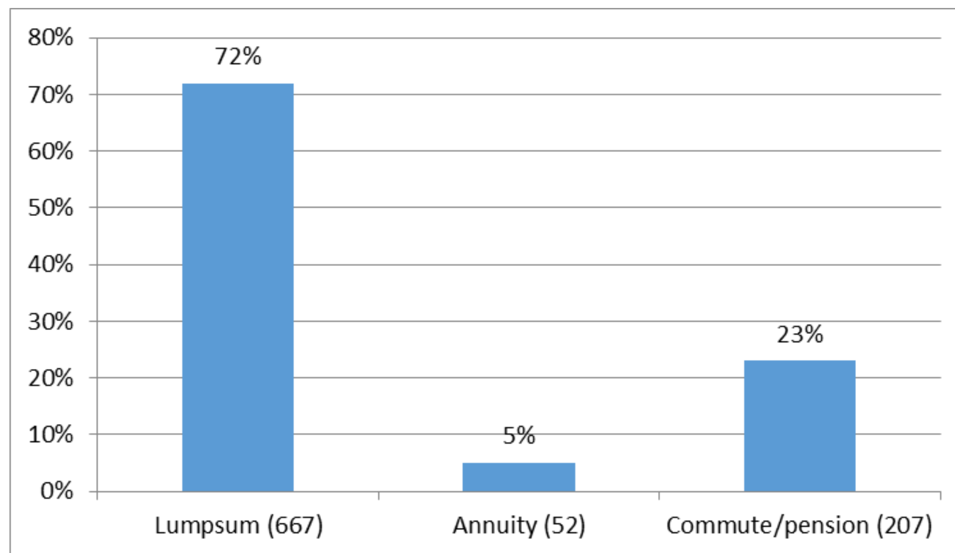

Figure 4: Retirees mode of receiving pension

These results are a pointer to low level of annuities in Kenya attested to in other previous studies (Njuguna *et al*., 2011, Keizi, 2007). Further analysis in Table 5 shows that those who received their pension by lumpsum were the majority across the four schemes with NSSF having the highest percentage as would be expected.

Table 5: Pension payment mode by scheme type

Pension Payment Mode	Partial or total Lumpsum	Annuity	Life Pension
Occupational	165 (71%)	16 (7%)	49 (21%)
NSSF	254 (85%)	23(8%)	22 (7%)
Civil service	233 (63%)	6 (2%)	132 (36%)
Individual	16 (59%)	7 (26%)	4 (15%)
Total	**668 (72.1%)**	**52 (5.6%)**	**207 (22.3%)**

It is important to note that the 71% of those members of occupational schemes who received a lumpsum may have received their pension under the old regulations where occupational schemes were free to pay a lumpsum pension. Further, the current regulations for occupational schemes allow retiring persons to access 1/3 of their total savings as partial lumpsum (Occupational Retirement Benefits Schemes) Regulations, 2000. On the same token, civil servants who reported to have received a lumpsum are likely to be those who accessed an initial lumpsum payout of 25% as regulated by the Pension Act Cap 189 (Raichura, 2008). Though NSSF is a provident fund that pays a total lumpsum, 7% of respondents drawn from the scheme indicated receiving a monthly pension and 8% self-annuitized their benefits. The anomaly in this case may be attributed to the fact that a number of retirees under study were members of both NSSF and occupational schemes which created an overlapping of payment modes.

4.3.5 Amount of money received based mode of payment

Respondents were asked to report how much they had received as retirement benefits according to the mode of payment and Figure 5, 6 and 7 show the results obtained after the amounts were clustered depending on the range of the amounts. From the graphic presentation, those who were paid by lumpsum had received amounts ranging from Kshs 10,000-8,000,000 the modal cluster

being Kshs. 250,000-500,000. For those paid a monthly pension, the minimum was KShs. 1,700 and the mode was in the cluster of Kshs. 5,000-10,000.

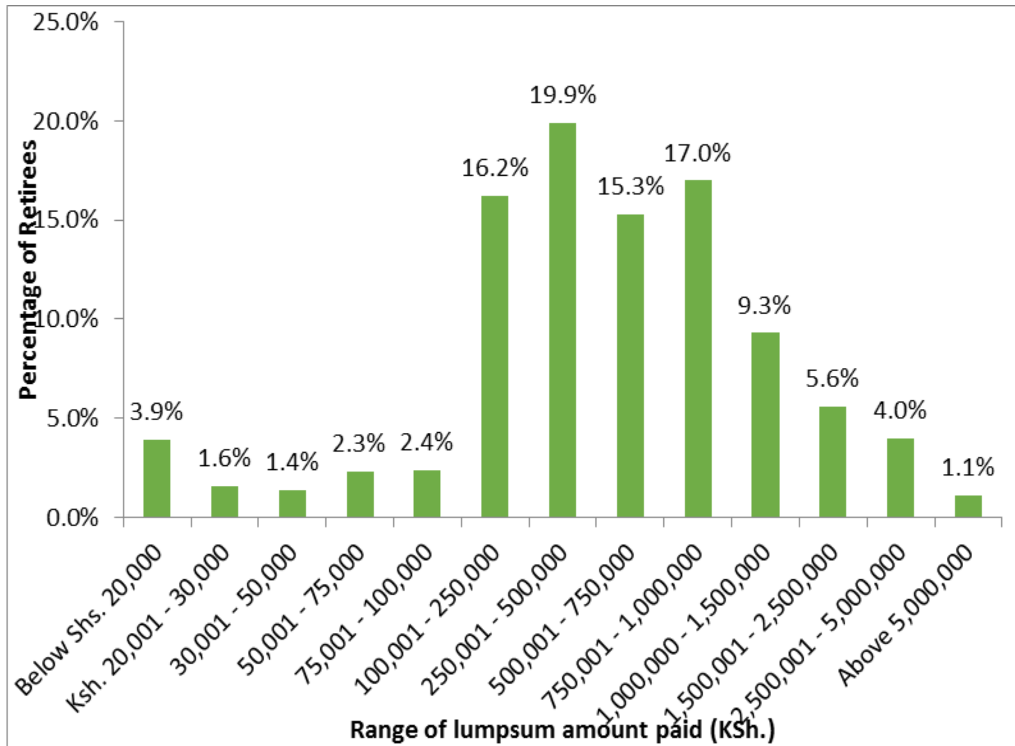

Figure 5: Lumpsum benefits amount received by retirees

For those who commuted a portion of their pension, the minimum amount received was Kshs. 15,000 while the maximum was KShs. 1,200,000 with the modal amount laying in the category KShs. 250,000-500,000. Only 5.6% of retirees indicated annuitizing their pension out of which the minimum annuity was KShs. 3,000 and the maximum was KShs. 75,000. It is important to note that a number of respondents who had commuted their savings may also have been receiving annuities or a monthly pension implying an overlap of categories.

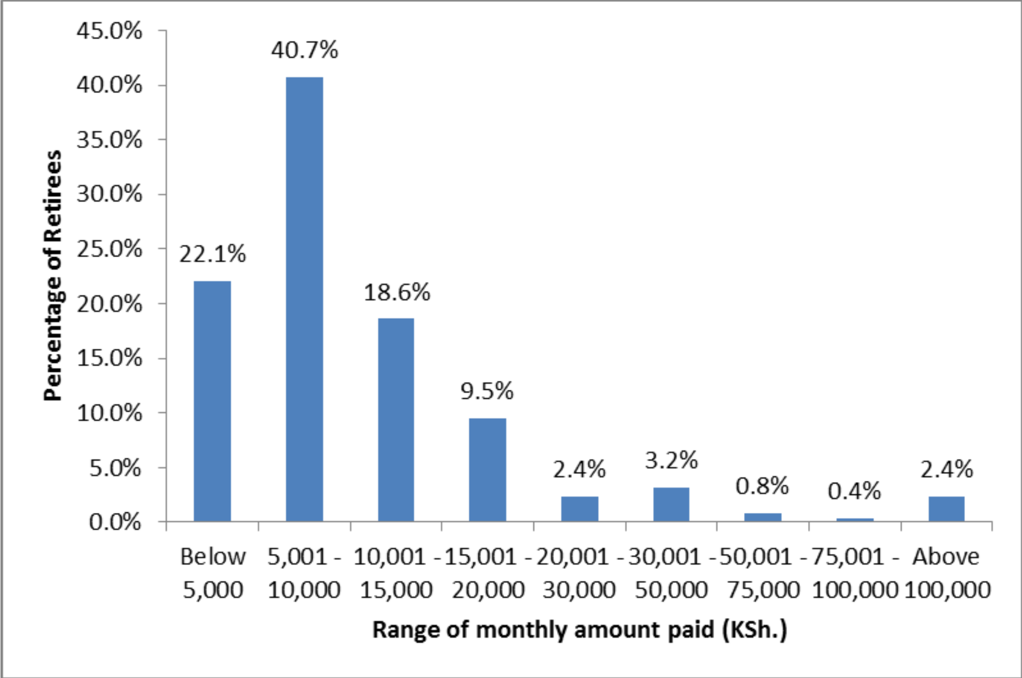

Figure 6: Monthly pension amount received by retirees

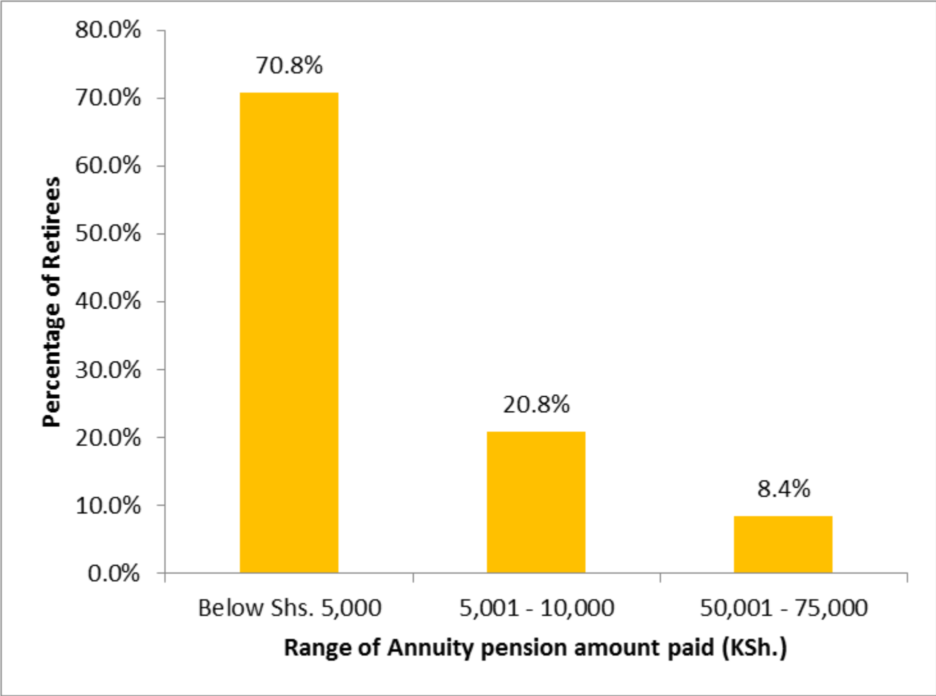

Figure 7: commuted pension amount received by retirees

However, investigations further revealed that most of the retirees (70%) did not know their actual pension entitlement or their total accrued pension at retirement. This is contrary to findings from the key informants who revealed that scheme members obtain regular statements showing their accrued pension amounts. Yet, the failure to know ones' pension entitlement would greatly impact on planning for its use. From other studies, utilization of pension and other retirement benefits have been linked with retirement planning (Hershey, *et al.* 2007; Dulebohna *et. al.,* 2009). From this study, given that a majority were insecure, it is surprising that 62% indicated having planned for retirement.

4.3.6 Retirees utilization of retirement benefits

An investigation into the utilization of retirement benefits established that retirees utilized their benefits in a variety of ways as indicted in Table 6. The spending patterns were also cross-tabulated with mode of receiving retirement benefits in order to unravel if utilization differed depending on the mode of payment.

Table 6: Retirees utilization of retirement benefits

	Lumpsum		Annuity/commute/life pension	
	Number of mentions	Percent	Number of mentions	Percent
Household Maintenance	321	24	240	38
Retirement house	199	15	79	13
Bought land	152	11	50	8
Started a business	255	19	100	16
Fixed saving	85	6	29	5
Financed schooling	238	18	105	17
Medical costs	79	6	25	4
Total	1329*	100	628**	100

N=978*multiple responses allowed n=259**

From Table 6, most retirees irrespective of how they had been paid their benefits had spent their savings mainly on maintenance (24%) for those who had received a lumpsum and 38% for those who had annuitized or commuted their benefits). The other major expenditure for both groups included starting a business and financing school fees. In this regard, 19% of those who had

received their benefits by lumpsum had start started a business which was slightly above the 16% of those who received annuities. Of those who received a lumpsum, 18% financed schooling compared to 17% who had annuitized or commuted their benefits. Surprisingly, expenditure on medical cost was the lowest for both groups with 6% of those paid on lumpsum spending on it and 4% of those who annuitized their savings spending on the same. Though health needs are pressing for retirees, focus group discussions conducted confirmed that the meager cash that most of them received as pension was mainly spent on basic needs such as shelter, food and education of dependents. The implication of these results is that retirees are often unable to meet their health needs and therefore do not age gracefully but encounter an early death (Coea, 2011 and Kowal *et. al.*, 2010).

4.3.7 Viability of investing pension in business

This study endevoured to establish the investment patterns of retirees in order to ascertain their success as conduits for guaranteeing income security at retirement. Successful investment was defined from the retirees own reporting based on the ability of the investment/business to support their daily necessities. Out of the 978 retirees, 355 (35%) invested their pension in businesses such as farming, bar and restaurant, regular grocery shops, educational institutions, hardware stores, transportation, *posho* mill, and real estate. Analysis shows that 64% of the businesses started were still operational though this was not a guarantee that they were profitable enough to offer income security. On the other hand, 36% had already been closed down for a variety of reasons including business failure, lack of entrepreneur skills, low start-up capital, stiff competition and low returns as a result of high cost of living.

4.3.8 Proportion of retirement benefits invested

Retirees were also asked to indicate how much of their retirement benefits they had invested irrespective of the mode in which their benefits were paid. The results contained in Table 7 indicate that the modal amount of invested funds is within the range of 41-60%. Notably, about 16% of retirees had invested more than 80% of their retirement benefits.

Table 7: Percentage of retirement benefits invested by retirees

Percentage invested	Number of Respondents	Percentage
1-20%	37	10.3
21- 40%	120	18.5
41- 60%	194	30.1
61- 80%	158	24.5
Above 80%	105	16.4
Total	614	100

Though the high tendency to invest retirement benefits is evident, FGDs with retirees established that most invest in risky ventures such as buying of *matatus* and low return businesses further jeopardizing their income security. In addition, most do not have the basic business skills to support viable investment projects as they enter into a field congested by more experienced fore-runners. Fund administrators who participated in the FGDs also confirmed that retirees' investments are often unviable since they are undertaken without prior planning not to mention that retirees also encounter longevity risks, upfront tax liability and risks of inflation further jeopardizing their investment ventures, as confirmed in the words of one fund administrator;

> *....a lumpsum pension appears plenty to the retiree hence the temptation to start a huge project with least thought about how it will ever be completed. Eventually, the venture is abandoned while the retiree gets frustrated for life... Fund administrator.*

Other retirees were found to have invested without a foresight as confirmed by one female respondent who had this to say;

> *....I used all the money from NSSF to buy a plot in our local shopping centre, started a huge building hopefully for rental part of which I would also be housed. Unfortunately, just before reaching the lintel beam, the money got finished and I was forced to abandon the project.... I now rent a small room which I am hardly able to pay.*

From the foregoing, few retirement investments succeed to provide ample income or income security.

4.4 Preferred methods of disbursement of pension savings by various stakeholders

In line with objective two of the study sought to explore the preferred methods of disbursement of pension savings by various stakeholders of the pension industry. In order to establish this,

prospective retirees were asked to state how they would prefer their benefits paid upon retirement. From the Figure 8, most of the prospective retirees (61%) prefer to receive a lumpsum upon retirement with only 11% choosing to annuitize their savings.

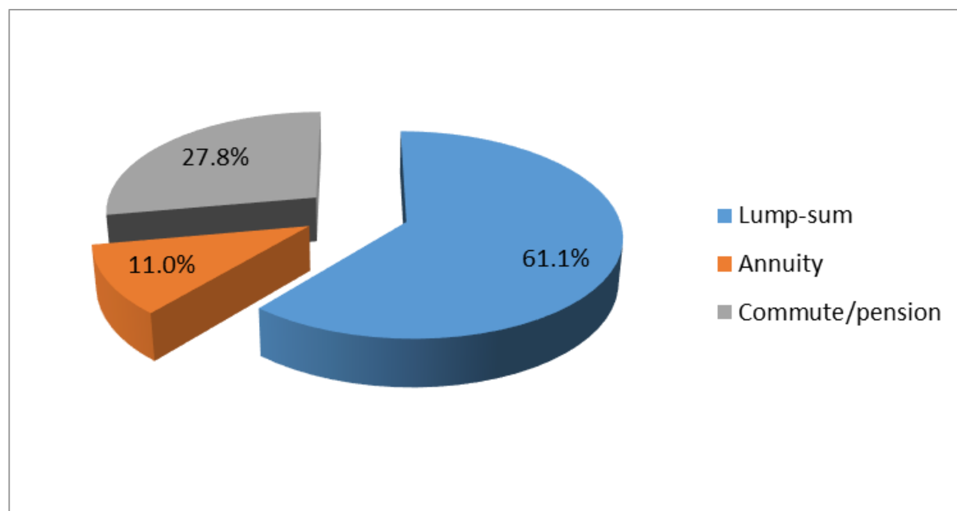

Figure 8: Preferred mode of payment of retirement benefits

From the FGDs conducted with the retired sample, there was general consensus on the preference for commuting an amount and receiving a pension on the balance for life. Some of the reasons given for this preference were that one needs to make an investment upon retirement but should the investment fail, they will still be cushioned by the pension. The retirees also expressed that lumpsum payment if paid at once may be wasted or misused on un-planned activities. As one retiree observed:

> *I was given all the money which I put in "Deci" (pyramid scheme). Now I regret and wish I had something coming regularly at least to buy medicine which I need on regular basis. FGD with male retiree.*

Findings from key informants (pension managers) overwhelmingly favoured commuting and monthly pension (approved by 92%) as the best option for paying out retirement benefits while fund administrators who participated in the FGDs showed a high preference for monthly pension as the best model for payment of benefits. For those who preferred the commute/pension option, 30% of an initial lumpsum was indicated as sufficient. The high preference for the pension

model was attributed to the income security it provides regularly during retirement and the high risk associated with lumpsum payments.

These results imply that those who were yet to retire largely hoped to get their savings at once while those who had retired desired to spread the risk. This variance may be attributed to the first-hand experiences the retirees have gained implying that lumpsum payment of benefits does not guarantee income security. On the other hand, the perspectives from the scheme managers and fund administrators concurred largely with those of retirees and may be indicative that pension is a more viable option for long-term income security. However, the concurrence between the pension scheme managers and retires in favour of a commuter sum being availed upon retirement is indicative of an immediate need to 'kick start' retirement life.

4.5 Merits and demerits associated with paying lumpsum benefits to retirees in Kenya

Objective three of the study aimed at investigating the opportunities and risks associated with paying lumpsum benefits. In section 4.3.4, it was established that 72% of retirees had received their benefits in this mode. In section 4.4 majority of prospective retirees expressed preferring this mode of payment. However, the key informants and FGDs with fund administrators revealed a contrary opinion with majority favouring the life pension mode of payment.

4.5.1 Merits associated with paying lumpsum benefits to retirees

In order to underscore the merits associated with lumpsum, respondents were asked to indicate if there were any opportunities associated with paying retirement benefits in this mode. From the findings, the merits that were identified are shown in Figure 9.

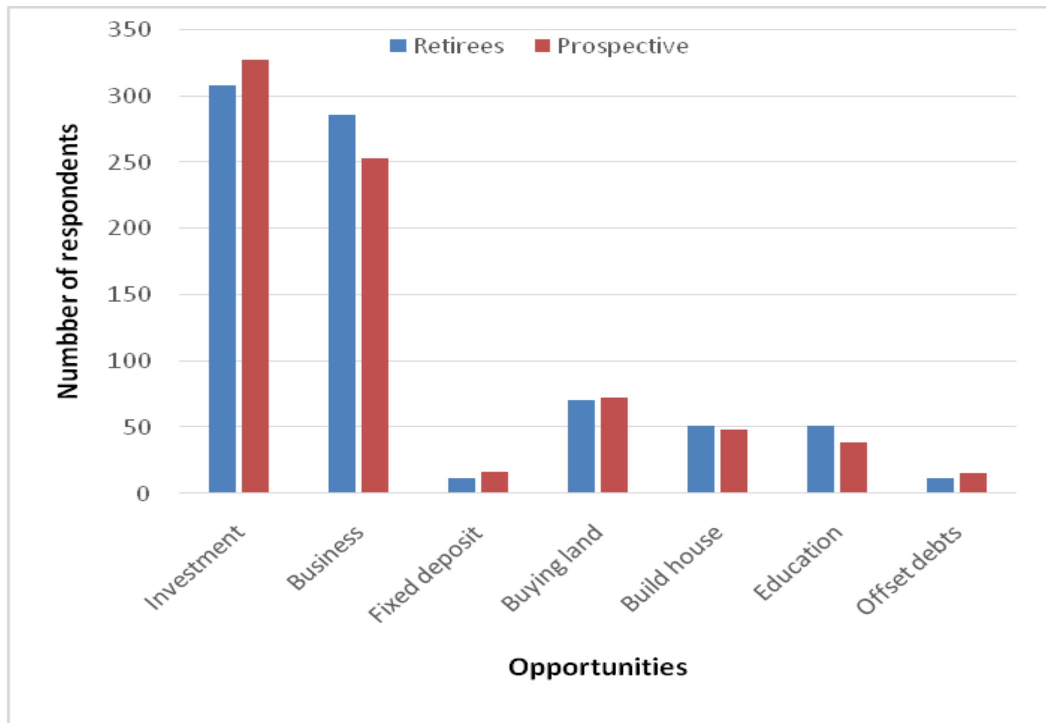

Figure 9: Merits of paying benefits in a lumpsum

From Figure 9, the merits of lumpsum payments that were identified leaned heavily on the ability to make viable investment and start business which often large-scale funding such as real estate, adequate capital to start business or boost existing business. The least favourable opportunities associated with lumpsum were fixed deposits and offsetting accrued debts.

Both retirees and prospective retirees expressed nearly the same merits, FGDs conducted with retirees further revealed that lumpsum payment of benefits enables one to acquire high value property which one would not ordinarily afford. Another identified opportunity for paying lumpsum benefits is the ability of the retirees to cope with rising cost of living assuming that the savings are invested gainfully. However, retirees expressed the need for training on how to make investments since many invest without prior knowledge or planning and many do not have the requisite business skills to run their businesses smoothly. The same sentiments were confirmed by the FGDs with administrators as expressed by one participant;

...I have been working and salaried all my active life and now you expect me to became a business and finance manager overnight at the age of 60 without prior preparation ..... FGD: 18th July 2014

Additionally, retirees expressed that the benefits paid to those who retire from low cadre jobs were too meagre for any meaningful investment. In this study, 27.8% of retirees had received a lumpsum benefit worth below Kshs. 250,000 meaning if they were to receive a pension it would be a trivial one.

4.5.2 Demerits of lumpsum payment of retirement benefits

Though a few merits were reported, the study also revealed a host of risks associated with payment of retirement savings through the lumpsum mode. Figure 10 shows a number of demerits associated with this mode of payment.

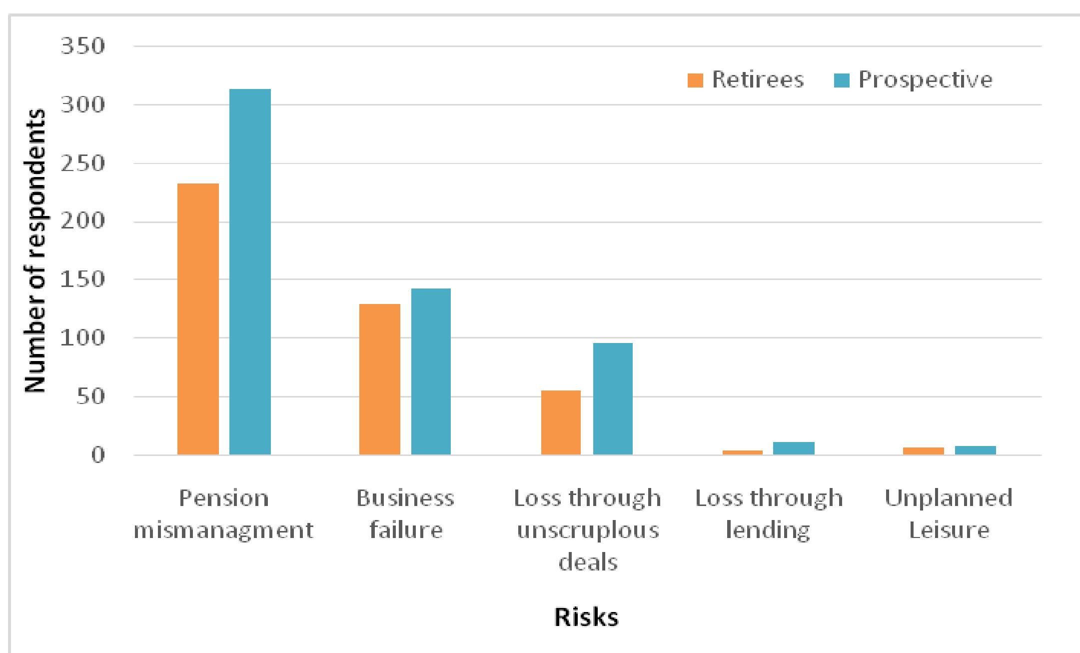

Figure 10: Demerits of paying a lumpsum

These are discussed in the following section in order of severity.

a) *Pension mismanagement*:

The risk of pension mismanagement arose from both internal pressures and external environment. Many of the risks pertain to loss of the savings even before planning for their use. Among the risks established included apportioning the savings to daily/arising needs such as paying medical bills for extended family and giving to opportunists who prey on retirees during this payout phase. Retirees also expressed the temptation to buy luxuries that would otherwise not be afforded which include gifts, unnecessary travels, motorcars and household goods. Key informant interviews were in consensus that retirement savings are often spent on impulse buying and entertainment.

b) Business failure:

Business failure was identified as another risk associated with lumpsum payments. Though investment and business ventures were identified as a merit, retirees were also particularly concerned that many venture into a market which is already flooded and have had no prior experience with micro-financing which often puts them at a disadvantage. Consequently, these businesses, many of which are hurriedly started and poorly informed fail and their investment is lost. In this regard, one key informant expressed;

> *"Pension money is not for starting business but to help maintain life in retirement". (P*ension fund administrator).

The same views were held by pension scheme managers who expressed

> *"If the money is invested, there is a high risk of failure due to unwise and hurried investment venture" (*pension scheme manager).

In the words of another retiree:

> *The need to continue being engaged makes us rush to start business… reasons. We have retired, we are not sick or disabled… so you rush to business to keep yourself busy.* FGD with Retirees.

c) *Loss through unscrupulous deals*:

Other loses of the savings occurred through target by fraudsters/robbers and enticement by con-artists who promise to multiply the savings. From the FGDs, the study also established that for retirees, the risks associated with paying lumpsum benefits include losing the same through pyramid schemes or similar ventures that promise to increase the savings to higher proportions. Findings from key informants also corroborate the same.

d) Loss through lending and unplanned leisure:

The study established that often, retirement savings are lost through lending to friends and relatives who often fail to pay back. In the words of one male retiree;

> *"when you receive your lumpsum, people think you have a lot of money, all needs come to you, others borrow and not return, yet the money is little, you end up with nothing, and the needs continue. When it is over (the money) your wife leaves you because you have no money, you loose your friends and you fall into financial distress" FGD 24/3/14.*

On the other hand, respondents also expressed expenditure on leisure activities such as alcoholism and entertaining friends and family as other methods through which lumpsum savings are spent. A female retiree had this to say;

> *"Paying lumpsum is a risk because our husbands see like it is a lot of money and rush to get a younger wife or squander the money freely with friends… you know they easily dish out money….". FGD 2/4/2013.*

From the foregoing, it is apparent that the risks far outweigh any merits that would be associated with lumpsum mode of payment to retirees. This is because both the internal and external pressures put the retirees' savings at stake and compromise their income security in retirement. Confirming the demerit associated with this mode of payment, one fund administrator expressed;

> *The current level of financial literacy in Kenya makes lumpsum mode of payment a recipe for disaster, most retirees are not the best financial managers. Fund administrator, 18th July 2014.*

Documented evidence corroborates these findings. For instance Schramm (2005) and Antolin (2008) observe that it is often difficult for retirees to manage lumpsum payments while self-annuitization is complex and many retirees are not well informed to take advantage of self-insurance which would offer an alternative financial cushion. The obvious outcome is often to spend the savings in an accelerated and reckless manner leading to exhaustion of the funds in a relatively short time (Antolin, 2008). Other documented evidence shows that retirees endure hardships during their retirement as a result of wrong or lack of retirement plans (Inge', 2013).

The findings in this section are further supported by the results obtained after testing the first hypothesis which explored the relationship between lumpsum payment and investment viability. In testing of the hypothesis, the variables that were considered were payment mode (independent) and success of pension-funded investment (dependent). In this study, successful investment was defined from the retirees own reporting based on the ability of the investment/business to support their daily necessities.

The cross-tabulation between payment mode and success of investment reveals 74% of retirees who were paid by lumpsum had successful investment while 26% did not. Among those paid by other modes (monthly, commuted and annuity), 68% had successful investments while 32% were not successful. However, the chi sq. test to determine if there was a relationship was found not to be statistically significant since $p = 0.12$ as shown in Table 8.

Table 8: Pension payment mode by investment success

	Investment Success		
Pension payment mode	Successful Investment	Unsuccessful investment	Total
Lumpsum mode	305 (74.0%)	108 (26.0%)	413
Other modes	117 (68.0%)	56 (32.0%)	173
Total	422	164	586

$\chi^2 = 2.34$, N = 586, df = 1, p= 0.12

The results displayed in Table 8, imply that the viability and success of investments done by retirees does not vary by mode of payment and that payment of lumpsum benefits does not guarantee successful investments. It may be interpreted that other extraneous factors besides the

payment mode determine the returns accrued from an investment. Hence, the hypothesis may be rejected on the basis of the statistical test. This was corroborated by FGDs and key informants as discussed elsewhere in this study.

4.5.3 The implications of lumpsum payment of retirement benefits on income security

In order to underscore the implications of lumpsum payment with respect to income security, the study began by investigating the definition of income security from the all categories of respondents'. The results reveal that income security may be conceptualized in terms of:

- At least 60% of net replacement ratio of the income earned before retirement implying that this would be sufficient to maintain pre-retirement standard of living
- Ability to meet basic life sustaining needs during retirement
- Guarantee of some form of income during retirement

The definitions provided by respondent are consistent with those documented in past studies. According to Purcell (2012), a replacement ratio of 65% is considered adequate though some exemptions are made for very high and very low earners. Oyuke (2010) observe that 70-90% of income replacement ratio is sufficient while ILO attest that the minimum IRR should be 40% (Mwandilo, 2006).

The study sought to establish if retirees felt income secure using a likert scale. As Table 9 indicates, 61% reported experiencing income security in retirement compared to 40% who reported not being secure.

Table 9: Retirees rating of income security

Income security	Number of Respondents	Percent
Very Secure	58	7.0
Secure	470	54.0
Insecure	265	30.0
Very Insecure	77	9.0
Total	870	100.0

N = 870

To clarify on the status of income security, retirees were asked to give reasons for their status. Majority (80%) indicated that they were income secure because they had been able to meet their everyday expenditures, supplement rental income with their pension and assist their kin to pursue different aspirations. However, for about 20% of retirees, their insecurity was pegged to collapsing of business, high cost of living, and feeding large families which constrained their resources. Other manifestations of income security included dependency on children/family members, dependency on meagre pension, inadequate income/little earnings from other sources, pension income being lower than the costs of living/inflation, failure to find employment, poor health and associated high cost of healthcare.

Further analysis was conducted to compare retiree income security with mode of receiving benefits. Using two clusters of income security (secure and non-secure) a cross tabulation was conducted to establish if there were any patterns in security for those paid by various modes. The Chi sq. test revealed (see Table 8) no significant relationship between the two factors implying that there may be other factors that play a role in determining financial security of retirees aside from how they receive their payment. The results in this section are consistent with the further analysis where retirees who indicated being secure in retirement were asked to state if their status of security was attributable to pension benefits or other income. Figure 11 shows that 29% did not attribute their success to pension but rather to other income while 54% believed their pension as well as other incomes contributed to their income security.

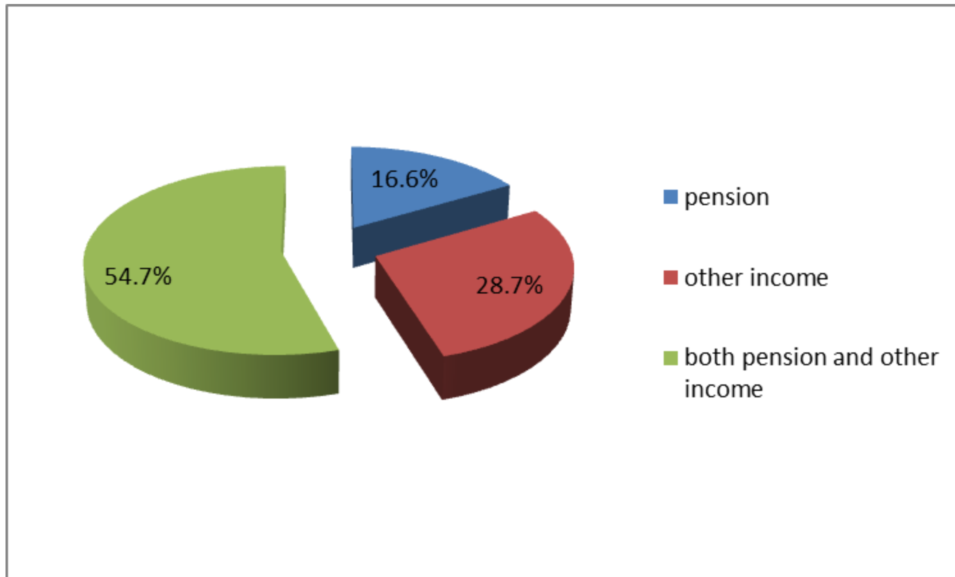

Figure 11: Sources attributed to income security by retirees

Noting that a lack of a significant relationship was established between income security and payment mode, respondents were further asked to indicate if they had personally taken any additional measures prior to retirement to guarantee income security. A majority 62% indicated having taken measures to this end. Asked what measures they had undertaken in preparation, 48% reported having bought or built a house, 52% had purchased land, 44% had started a business, 14% had deposited savings in a fixed savings account while 3% had taken a variety of measures such as dairy farming, buying shares, joining a *SACCO* and furthered education.

On the other hand, asked if lumpsum payment guarantees income security, the views of the prospective retirees were split in the middle with 50% agreed and the other half disagreed. Noting that prospective retirees did not have tangible experiences to base their arguments, these findings may indicate only a preference rather than actual association between income security and lumpsum payment of retirement savings.

To further underscore the importance of sufficient income during retirement the study tested the hypothesis on the relationship between amount of money paid at retirement and the investment viability. The hypothesis was tested using the variables:- mode of payment: amount paid in

lumpsum, monthly annuity and commuted (independent) and investment success (dependent). Since the amounts received were measured on an interval scale, a paired means comparison test (paired t–test) was used to establish if there were any significant differences in the means of the 4 groups. The results as indicated in Table 10 show that those who had successful investments among those paid a lumpsum pension had a higher mean of pension amounts while those unsuccessful had a considerably lower mean. In this case, the test show that this mean difference is statistically significant at $p<.05$. The implication of these results is that the higher the lumpsum amount (not the fact that one get a lumpsum), the higher the chances of having a successful investment.

The comparison of means for those paid a monthly pension, annuity and those who commuted reveal no statistically significant difference in means at $p<0.05$ confidence level (Table 10). However, the mean of amount paid for those who commuted their benefits was found to be significantly higher for the successful group and as opposed to those unsuccessful. This difference is statistically significant at $p<0.1$.

Table 10: T-test- comparing investment success by mode of payment

Payment mode	Investment successful	N	Mean Pension received (KShs.)	*p*-value
Lumpsum (total lumpsum)	Successful Investment	306	1,076,417.00	0.0128*
	Unsuccessful investment	131	771,886.00	
Monthly	Successful Investment	96	20,674.40	0.6991
	Unsuccessful investment	49	17,580.00	
Annuity	Successful Investment	16	98,098.80	0.5730
	Unsuccessful investment	3	10,000.0	
Commuted (partial lumpsum)	Successful Investment	34	1,785,070.00	$0.0790^{\dagger}$
	Unsuccessful investment	15	274,466.00	

$^{\dagger}p<0.1$; $^{*}p<0.05$; $^{**}p<0.01$; $^{***}p<0.001$

The other hypothesis tested in the study was to establish the relationship between amount of money paid at retirement and income security in retirement. It was tested using the variables amount paid whether in lumpsum, monthly annuity and commuted (independent) and income security at retirement (dependent). Four independent samples t-test were carried out. The results in Table 11 show that income secure groups have higher means of amount paid at retirement as

opposed to the insecure groups across all the four modes of payment. All the means' differences in this case were statistically significant implying that the higher the amount of benefits paid at the point of retirement, the higher the likelihood to be income secure. Hence, it may be concluded that income security is a factor of the amount of money received at retirement.

Table 11: T-test- comparing income security by mode of payment

Payment mode	Income Security	N	Mean Pension received (KShs.)	*p*-value
Lumpsum (total lumpsum)	Insecure	257	503,624.00	<.0001***
	Secure	341	1,011,429.00	
Monthly	Insecure	88	12,929.60	0.0293*
	Secure	133	20,444.00	
Annuity	Insecure	2	5,050.00	0.0519*
	Secure	20	82,129.00	
Commuted (partial lumpsum)	Insecure	30	297,775.00	0.0146*
	Secure	55	964,344.00	

*$p<0.05$; **$p<0.01$; ***$p<0.001$

4.6 Multivariate analysis to determine factors explaining income security

The testing of hypotheses employed bivariate statistical analyses showing a number of statistically significant predictors of income security while the objectives and research questions employed descriptive statistics. To link the research objective and hypotheses, there was a need to undertake multivariate analyses using factors that had emerged as significant in influencing income security. The binary logistic model was thus used to isolate the key factors explaining income security and to provide in a summative way the odds ratio statistic showing the strength of each factor in predicting income security. The model fit statistics (Likelihood Ratio and Wald Chi-square tests) show that the logit model was statistically significant at *p*-value of 0.05. The key variables under consideration were level of education, marital status, salary at retirement, number of years in retirement, knowledge of pension entitlement, retirement planning and payment mode. Table 12 summarises the output of the eight predictors of income security with education and marital status as the control variables.

Table 12: Logit model of income security on a number of variables

Variables	Parameter Estimate	Standard Error	Wald χ^2	DF	*p*-value	Odds Ratio	95% Confidence Limits	
Intercept	1.4864	0.6295	5.5749	1	0.0182**	-	-	-
Education level	0.2285	0.1089	4.4033	1	0.0359**	1.257	1.015	1.556
Marital status	0.00698	0.0606	0.0133	1	0.9082	1.007	0.894	1.134
Salary at retirement	0.2235	0.0485	21.2714	1	<.0001***	1.25	1.137	1.375
Length retirement (in year)	0.00496	0.013	0.1446	1	0.7037	1.005	0.98	1.031
Knew Pension entitlement	-0.8545	0.2074	16.9781	1	<.0001***	1.350	0.565	2.529
Retirement planning	-1.1436	0.1708	44.8057	1	<.0001***	1.138	0.245	3.386
Payment mode	0.0811	0.0902	0.809	1	0.3684	1.085	0.909	1.294
			Chi-sq.	DF	*p*-value			
	Likelihood Ratio		145.375	7	<.0001***			
	Wald		111.608	7	<.0001***			

***$p<0.001$; **$p<0.05$; *$p<0.1$

The binary logistic regression analysis results indicate that education, salary at retirement, knowledge of pension entitlement and retirement planning were significantly related to income security. Specifically, those retirees with higher education had 26% higher chances of enjoying income security.

Salary at retirement was significantly related to income security with those earning higher salary having 25% higher chances of having a secure income at retirement. Those who had knowledge of their pension entitlement had 35% higher chances of being income secure while those who had planned for their retirement had 14% higher chances of achieving income security. Marital status, number of years in retirement and mode of payment of retirement benefits did not show any significant relationship with income security in retirement according to the logit model.

Further interpretation of these results is that education and salary remuneration are closely related and may imply that those earning higher salaries are more likely to want to establish their pension entitlement and to plan for the its utilization. It may also reflect on their concern about their income security and their ability to make higher contributions to pension and therefore

higher pensions at retirement. Well salaried individuals are also more likely to make viable investments than low salaried employees which guarantees them a more secure retirement.

4.7 Other challenges in maintaining income security in retirement

On a general note, retirees were asked to state any challenges experienced in their retirement in order to clarify if the challenges hinged on income security or other factors. The challenges reported are presented in Figure 12.

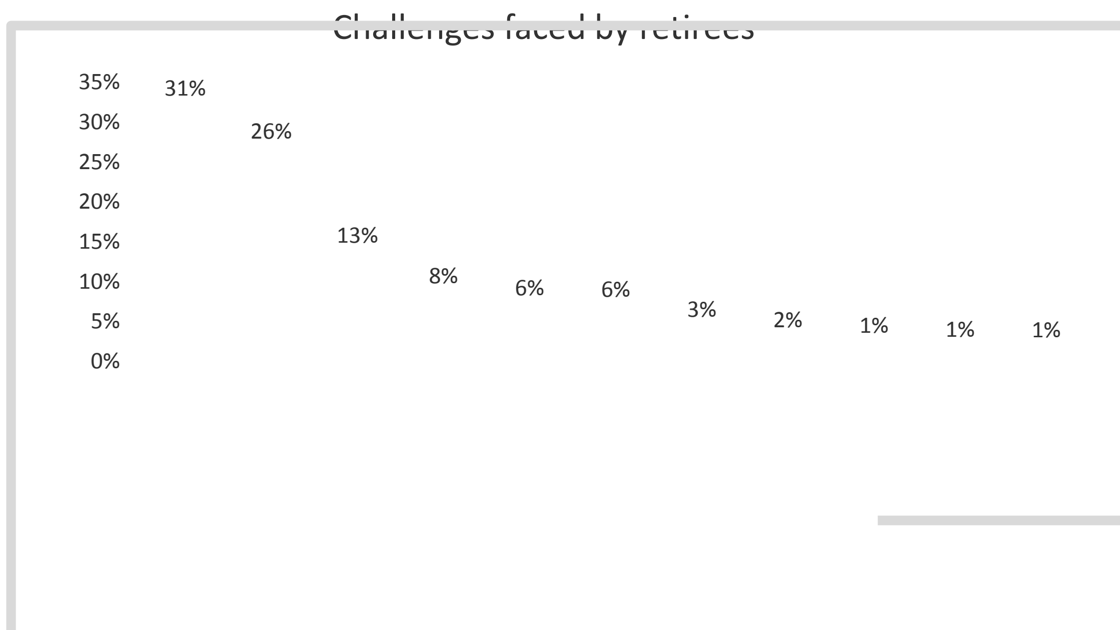

Figure 12: Challenges experiences by retirees

Three challenges that emerged as most common in retirement included inadequate pension amounts, high cost of living and health challenges. Further analysis revealed that retirees also face the problem of stress and depression especially due to unmet expectations. As one fund administrators put it;

> *….we spend most of the time counseling retirees most of whom have slipped into depression out of unmet financial expectations not to mention the many who come to me with chronic health problems only to discover that their savings are exhausted….* FGD 18th July 2014.

In the FGD held with retirees, idleness was identified as a challenge that breeds multiple negative effects confirmed in the following voice;

> *.....after retirement, you have no purpose yet you are used to waking up to go to an office. You end up going to look for company in the bar, you spend everything you have, then you feel useless, lonely and neglected...* FGD with Pensioners.

When faced with these realities, retirees seek various coping mechanisms. According to the FGDs with retirees, some are forced to adopt negative coping methods such as alcoholism and escape from family responsibilities. The available positive coping mechanisms that were identified included joining elderly social groupings, community based organizations and religious activities. The social organizations that retirees join afford for most social capital, joint welfare opportunities and other group support assistance especially in times of crises.

4.8 Study conclusions

This study set out to investigate the risks and opportunities associated with paying lumpsum benefits to retirees in Kenya and its implications on retiree income security. It was guided by the need to identify how retirees utilize their retirement benefits based on the mode of payment, explore preferred methods of disbursement of pension savings and identify recommendations on the viability of lumpsum payment for income security of retirees. The overarching research question that guided this study was to establish if lumpsum payment of retirees' benefits guaranteed income security. The empirical evidence arising from the findings indicate that the lumpsum mode of payment comes with greater risks, greater challenges of managing the savings, greater propensity for misuse of the savings, the tendency to allocate the funds to unviable ventures and little guarantee of income security in retirement life. Specifically, relying on the empirical evidence provided by the retired persons in this study most of whom had received a lumpsum payment, the hypothesis that a lumpsum payment offers income security cannot be upheld.

In view of this, the study concludes:

a) Retirees mainly utilize their pension savings on household maintenance and establishment of business ventures. There were no major difference in how retirees utilized their savings irrespective of whether they were paid by lumpsum or through annuities and monthly pensions. The implications of this finding are that most retirees spend their savings on non-return expenditures or invest in unviable businesses which often fail.
b) On the preferred methods of payment of pension savings, the study findings show that the perspectives depended on whether one was retired or not with most retirees opting for the partial lumpsum/life pension option while prospective retirees largely preferred the lumpsum mode of payment. The implications of these results are that while retirees may require an initial lumpsum amount, there is need to guarantee a regular income throughout their retirement life.
c) With regard to the opportunities and risks associated with paying lumpsum benefits, the study established that the risks are far greater than the opportunities further supporting the need to ensure a regular pension during retirement as a guarantee of income security. However, hypothesis tested in this study have revealed that higher amounts of lumpsum and commuted benefits may translate into successful investment which would imply income security.
d) Bearing that the overriding objective of the RBA is to regulate and safeguard the retirement benefits sector, the study singles out the lifetime pension model as the least risky, most sustainable, most tenable and dependable payment option for income security in retirement. However, the study also noted the great potential existing in other arrangements such as annuities and income drawdown options which should be continually encouraged and supported by a robust legal and policy framework.

4.9 Policy recommendations for pension payment

A number of suggestions and recommendations for payment of retirement benefits in Kenya to ensure income security were offered by retirees and other key informants studied. The suggestions can be used to inform the designing of the payment phase of retirement benefits for retirees' income security and stability. From the empirical and conceptual evidence provided in this study, the key recommendations pertaining to enhancement of financial security in retirement are as follows;

- By and large, retirees prefer to commute a small portion of their benefits and annuitize the rest in order to be guaranteed sustenance should other sources of income fail. As indicated elsewhere in the study, an initial lumpsum amount enables the retiree to fund an income generating activity that can engage the retiree and contribute an income in the absence of other gainful employment. A pension will guarantee the retiree a dependable income and a lifetime cushioned from extreme poverty.
- The study established that 28% of retirees paid a lumpsum benefit had accumulated savings of less than Kshs. 250,000. This is an amount barely enough to sustain a post retirement life given the cost of inflation. There is therefore need to revise guidelines for schemes to nurture a savings culture and raise contributions to reasonable levels which can then translate into a sustainable retirement pension.
- Increasing saver contribution should also be coupled with continually encouraging employees to increase their savings for retirement and employers to put more of their workers under pension. This effort may be supported by an initiative to legislate and guarantee a minimum pension amount similar to minimum wages set for workers.
- The study established that most retirees often leave work with an aim to invest their savings in business enterprises. However, due to poor business skills, low knowledge of business financing, widespread competition, poor choice of business ventures among many other factors, many business do not become sustainable and many sink along with the retirees' lifetime savings. There is need to continually provide adequate pre-

retirement information to help retirees make informed choices and to de-incentize the clamour for the business option.

- At the same time, there is need to conduct systematic business training for those exiting the workforce prior to retirement. It may also be important to link the prospective retirees to business financing firms and micro-financiers.
- A robust and comprehensive retirement planning package should be prepared and disseminated to all schemes by RBA and pension managers should be tasked to systematically train and prepare their members for retirement.
- The need for proper retirement preparation/pre-retirement counseling cannot be overstated. A lot of retirees expressed losing their savings either through unscrupulous deals or through relatives and friends. These losses can be prevented by ensuring a planned expenditure through sound personal financial management by retirees.
- The study reveals that 70% of the retirees did not know their pension entitlement. Hence, there is need for pension scheme managers to re-evaluate their methods of disseminating information to their members.
- Since only 5.6% of the retirees had annuitized their savings in spite of the known benefits, there is need to educate all scheme members on the advantages of annuities as part of their retirement preparation package.
- Although the study found the need to create awareness on annuities, the RBA and other stakeholders of the retirement benefits industry should work at increasing the advantages pegged to annuities by ensuring that gains are protected to shield pensioners from inflation.
- From the study, majority of retirees spent their savings on meeting basic needs meaning that it is imperative for the retirement planning to focus on how retirees can maximize returns of their savings to ensure support of their daily living.
- Though expenditure on health was relatively low in this study, there is evidence that one of the main challenges affecting retirees is poor health. There is therefore need for a legislation supporting a health insurance package for retirees purchased in their working

life using a portion of their retirement savings and for schemes to design the deferred health insurance product for workers under their schemes to purchase.

- There is ample evidence arising from this study to suggest that prospective retirees have a somewhat unrealistic outlook of retirement life and a belief that self-managing lumpsum pension is easy. In view of this, there is need for pre-retirement training to focus on the management of old age risks and sensitize prospective retirees on the drawbacks of lumpsum payments.
- The study also unraveled that most retirees view their retirement saving as 'idle' money that does not enable them to offset immediate needs. While this may explain the reason for the greater preference of lumpsum payments by prospective retirees in the study, it also raises the question of how benefits accruing from such savings may be optimized to ensure sustainable living for retirees. Though a few financial products collateralized through the savings for instance the mortgage loan supported by Legal Notice 85 of 2009 exist, there is need to increase and diversify loans accessible to workers and retirees in this manner. In this regard, loans for such needs as children's education, hospital bills and other emergencies could be provided based on ones level of saving. This will enable people in their work and retirement lives to appreciate saving for retirement.
- Further, there is need to enhance awareness by retirees of such products and their benefits in view of the low usage of the mortgage loan facility to date.
- Further education through pension schemes to retirees needs to focus on existing market products such as insurance packages and the awareness of the income drawdown provision that is meant to maximize benefits from retirement savings.
- To address isolation, loneliness and idleness faced by retirees, there is need to create opportunities at the community level for incorporating retirees in activities of Community Based Organizations where they can contribute ideas and be engaged.
- There is need for retirement planning to emphasize on psychological preparedness of retirees given the findings that majority of retirees do not accept the reality of retirement nor plan for it.

4.10 Suggested areas for further studies

- There is need for further studies to establish a pragmatic model of paying retirement benefits based on levels of earnings since one model may not respond appropriately to the needs of different income groups.
- A study is recommended to investigate the viability of a health insurance cover for retirees financed through retirement benefits.
- A systematic study may be required to establish the most appropriate age for retirement informed by income security status of people who have retired at various ages (golden handshake, optional early retirement and 60 years and beyond).
- It would be important for a study to establish how retirees who are not gainfully employment support their livelihoods and the inter-generational dynamics that exist in such a scenario.
- Due to changing demographic realities in Kenya, a study should be conducted to evaluate risks faced by retirees due to increased longevity in old age.

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