PENSION REFORM OPTIONS IN KENYA

Coverage & Incentives

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<table>
<thead>
<tr>
<th>Demography &amp; Economy</th>
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<tbody>
<tr>
<td>Population</td>
<td>37.5 million</td>
</tr>
<tr>
<td>Life expectancy</td>
<td>48.93</td>
</tr>
<tr>
<td>Dependency ratio</td>
<td>81.4</td>
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<tr>
<td>Fertility rate</td>
<td>4.91</td>
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<tr>
<td>GDP</td>
<td>USD 26,920 million</td>
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<tr>
<td>GDP Growth</td>
<td>1.70%</td>
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<td>GDP per capita</td>
<td>USD 717.87</td>
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<tr>
<td>Budget deficit</td>
<td>USD 65 million (0.2% of GDP)</td>
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</table>
# The current pension system

<table>
<thead>
<tr>
<th></th>
<th>Civil Service Pension Scheme</th>
<th>National Social Security Fund</th>
<th>Occupational Schemes</th>
<th>Individual Schemes</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Legal Structure</strong></td>
<td>Act of Parliament</td>
<td>Act of Parliament</td>
<td>Trust Deed</td>
<td>Trust Deed</td>
</tr>
<tr>
<td><strong>Membership</strong></td>
<td>All civil servants</td>
<td><strong>Formal sector workers in companies with 5+</strong></td>
<td>Formal sector workers in companies that have schemes</td>
<td>Individuals – formal or informal sector join voluntarily</td>
</tr>
<tr>
<td><strong>Funding</strong></td>
<td>Unfunded</td>
<td>Funded</td>
<td>Funded</td>
<td>Funded</td>
</tr>
<tr>
<td></td>
<td>Non-contributory</td>
<td>Contributory</td>
<td>Contributory</td>
<td>Contributory</td>
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<tr>
<td><strong>Regulation</strong></td>
<td>Exempt from RBA</td>
<td>Subject to RBA</td>
<td>Subject to RBA</td>
<td>Subject to RBA</td>
</tr>
</tbody>
</table>
Membership of the pension system

Membership estimated at 15% of the working population

NSSF
67%

CSPS
22%

Occupational
11%

Individual
0%
Assets of the pension system

Total assets of USD 3.5 billion as at 31 December 2008, approximately 13% of GDP.
Reform needs

Industry

• Coverage extension
  – Coverage currently estimated at 15% of the working population
  – Informal sector barely covered by retirement schemes
  – No incentives currently exist to entice them to participate

• Improvement of benefit replacement rate (BRR)
  – Current BRR for covered population = 10%

Civil Service

• Reform of the Civil Service Pension Scheme (CSPS)
  – Benefits currently funded from taxes
  – Government spending on CSPS was 5.8% of GDP
  – Scheme anticipated to become contributory
Reform challenges

• Goodwill for reforms in the Civil Service Pension Scheme

• Current government spending on pension payments:
  – 5.8% of GDP
  – Estimated to rise to 7.5% by 2015
  – Unfunded actuarial liability of 25% of GDP!

• Education

• Low savings culture

• Preservation rules
  – Disincentive for prospective retirement savers
  – Competition from other investment products
Enabling conditions

- Increasing awareness on the need to save for retirement
- Regulator enjoys the confidence of stakeholders
- Technological infrastructure
  - Success of M-Pesa & Equity Bank
- Large proportion of the population – economies of scale
- Opportunities for growth
  - SACCOs
- Capital markets
- Favorable tax environment
Dealing with coverage - incentives

• Use current social pension to incentivize voluntary contributions to a DC fund:
  – Current proposal is to set social pension at 20-50% of GDP/capita
  – Propose to reduce basic social pension to 20% of GDP/capita
  – Use savings from social pensions to increase social pensions to those that contribute to the voluntary DC scheme
  – Peg increases in social pensions to the number of contributions
  – Incentive is limited to 60 monthly contributions
Proposal - graphical illustration
Proposal - results

• Results
  – Person aged 30 contributes for 10 years
  – Contribution is USD 7.73 per month
  – At age 60, social pension is 56% of GDP/capita
  – DC fund contributes a further 44% of GDP/capita
  – Total pension is 100% of GDP/capita
Assumptions

- Government will provide a universal social pension of 35% of GDP/capita funded from revenue
- Real interest rate is 5% per annum
- Annuity factor is 10
- Uptake of subsidy is evenly/uniformly distributed
- Use savings from social pensions to increase social pensions to those that contribute to the voluntary DC scheme
- Peg increases in social pensions to the number of contributions
- Retirement age is 60
Proposed coalition

• Present conceptual framework to Minister of Finance
• Establish pension reform task-force
• Refinement of the system
  – Refine proposal and set clear objectives of targets
  – Technically test proposals
  – Document proposal and benefits clearly
• Focus group discussions
• Discussions to inform communication strategy
Communication strategy

• Stakeholders
  – Civil servants
  – Informal sector
  – Policy makers – pension reform task-force
  – Service providers (asset managers, administrators, custodians, M-PESA)
  – Regulators (pension and telecommunications)

• Communication
  – Infomercials
  – Lobbying
  – “Soap-opera”
  – Market subsidy under “TAKE ADVANTAGE OF THE GOVERNMENT!”
Summary

• Coverage has been addressed by
  – Incentivizing working population to contribute to DC scheme by offering MDC
  – The extent to which this will be successful is dependant on the level of subsidies – a decision for policy makers
  – DC scheme open to anyone

• Adequacy
  – DC contributions will augment social pensions and increase ultimate size of pensions relative to GDP/capita