

The background of the book cover is a photograph of an elderly woman from behind, wearing a bright green patterned sari and a black crop top. She is standing on a concrete step in front of a blue-painted wall and a wooden door. The wall has some peeling paint and a small red mark. The woman is looking down at something in her hand.

SAVING THE NEXT BILLION FROM OLD AGE POVERTY

global lessons for local action

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RETHINKING PENSION INCLUSION IN **KENYA**

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SUMMARY



Kenya has, in the recent past, greatly expanded its financial inclusion space and included hitherto market and population segments operating outside the realm of the formal financial system. These were kept out either by geographical distance or low and irregular incomes which traditional structured formal financial systems did not know how to mobilize savings from, among others. The financial inclusion space expanded from 27% in 2006 to over 75% by 2015. This was made possible by the advent of mobile financial services marked by the launch of M-Pesa in 2007. Due to the wide penetration of mobile phone usage in Kenya, the adoption of mobile phone based financial services was fast and easy. With this knowledge the pension sector sought to ride on the same digital platform to provide pension services to the same market and population segments that were not served by other financial services before. Typically, these were segments of the market and population that largely comprise the informal sector.

To help mobilize savings for retirement from the informal sector required innovation that would accommodate informal workers' characteristics like low and irregular incomes and high labour mobility to enable them save when they have income, at whatever time of day or night and from wherever they are. The "Mbao" Pension Plan, which materialized from this innovation, has enabled informal sector workers to save for retirement. It is currently the biggest independent pension plan in the country. It has not grown as fast as originally imagined it would, due to challenges with robustness of the platform and frequent system down times. However, once such challenges are addressed, stakeholders believe this is the way to go for expanding pension inclusion to informal sector workers.

Evidently, Kenya has demonstrated that reforms that have expanded financial inclusion also benefit pension reforms. When taken side by side with pension reforms, the two can significantly accelerate the potential to offer pension services to workers outside the formal sector. The 'M-Pesa-Mbao' combination, that has relied on mobile phone technology to grow financial and pension inclusion, demonstrates an important lesson that expanding standardized financial services, especially in markets and population segments that are difficult to serve, requires innovation currently not found in existing financial or pension literature.

This chapter starts by reviewing the initial conditions in Kenya on a range of indicators in the capital and labour market before reviewing developments in the pension system and the financial inclusion infrastructure. It then looks at successes so far, including relevant experiences from financial and pension inclusion before discussing inherent challenges.

INITIAL CONDITIONS

KENYAN LABOUR MARKET

Employment in Kenya is categorized into three sectors namely: formal, informal and agriculture. Kenya's labour market is skewed towards the informal, which comprises nearly 83% of the labour force. Although formal sector employment is growing in absolute terms, it is doing so much more slowly than the informal sector so that its share in total employment is falling. Whereas reforms to date have focused on the formal sector pension systems, an inverse relationship exists between the reform focus and the relative size of the formal and informal sectors of the economy in terms of employment.

POPULATION DEMOGRAPHIC CHARACTERISTICS

Kenya's population is currently estimated at 41 million and is projected to increase to 55.4 million by 2050. The proportion of the population above age 55 is estimated at 6% whilst 41% of the population is estimated to be below age 15. This implies that the population of Kenya is still young. However, it is projected to age and by the time today's labour force market entrants retire, the proportion of the population above age 55 is expected to almost triple. The dependency ratio (ratio of elderly to active labour force) is also expected to increase from 12% to 30% by 2050.

The majority of Kenyan workers belong to the informal-urban or agricultural sectors with the relative size of the formal sector workforce declining significantly as a percentage of total employment over the last two decades. It is also worth noting that females constitute 51% of the total population but only about 30% are formally employed and earn on average 33% less than their male counterparts. So gender inequality remains an important issue and therefore makes improving access to pensions for informal sector workers even more important as it will help to redress gender imbalance.

AGE DEPENDENCY RATIO

The number of dependants includes the population below 15 years and above 65 years with those between 15-64 years constituting the working age population. The dependency ratio, i.e., total dependents as a share of the productive work force, shows the pressure on the productive population produced by the dependent part of population. The total dependency ratio of population in Kenya is 81.5 percent. The pressure, therefore, on the productive population is very high.

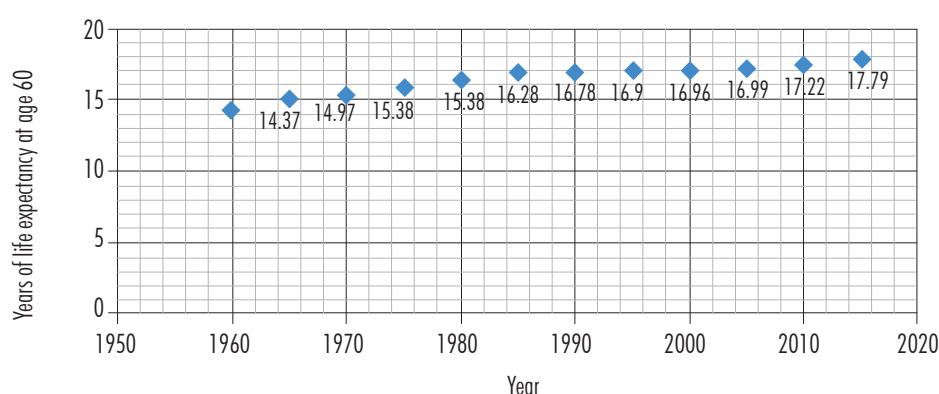
LIFE EXPECTANCY

Life expectancy at birth is one of the most important demographic indicators. It shows the number of years a new-born infant would live assuming that birth and death rates will remain the same during the whole lifespan. Total life expectancy (both sexes) at birth for Kenya is 59.5 years. This is below the average life expectancy at birth of the

global population, which is about 71 years according to the Population Division of the Department of Economic and Social Affairs of the United Nations. Male life expectancy at birth is 58.9 years while female life expectancy at birth is 60.1 years in Kenya. Kenya's life expectancy at age 60 has also been improving thanks to improvements in health care. Life expectancy for both genders at age 60 in 2015 was 17.79 years – a significant improvement from 1960, when it was about 14.37 years just before independence (World Data Atlas). The rising life expectancy, and especially that at age 60, poses challenges of longevity risk. Retirees may outlive their retirement savings and therefore would need to save more than they are saving now to adequately meet their needs in extended life spans after retirement.

Figure 2.1

Life Expectancy at Retirement Age 60



Source: World Data Atlas, 2016.

TAXATION OF PENSIONS

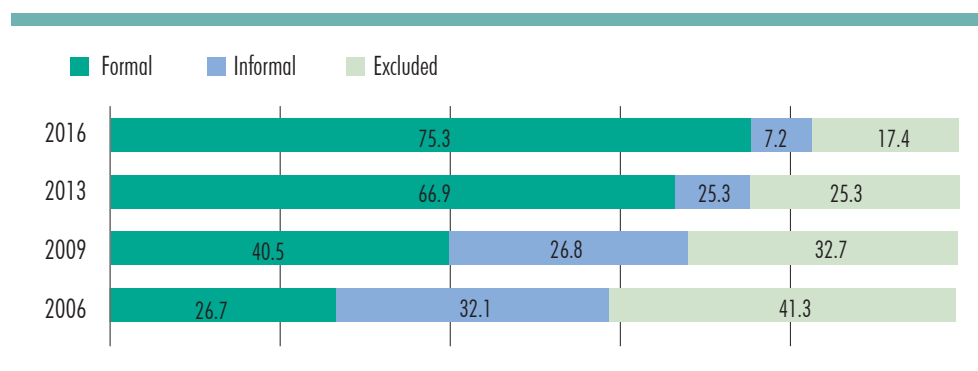
Kenya has an EET (Exempt-Exempt-Tax) system of taxation for pension contributions, investment returns and receipt of pension benefits subject to certain ceilings. For example, pension contributions of up to USD 200 per year are tax deductible. Lump sum retirement benefits of up to USD 6,000 do not attract any tax. Similarly, pension benefits of up to USD 600 per year are tax free for a maximum period of 10 years. Pension benefits received by senior citizens (those aged 65 years and above) are not taxed. As a result, for a person who defers consumption of retirement benefits till age 65, Kenya's pension system becomes EEE (Exempt-Exempt-Exempt).

PROFILE AND STATUS OF FINANCIAL INCLUSION

The government, in collaboration with key stakeholders, has played a key role in measuring and expanding financial inclusion in Kenya. Progress on expanding financial inclusion to above 75% of the adult population, is attributed to rapid innovation by the private sector in collaboration with the public sector. In 2006, only 27% of the adult population accessed formal financial services, while 32% accessed informal financial services. Around 41% of the adult population was financially excluded. By 2016, access to formal financial services

had risen to 75%. Another 7% of the adults had access to informal finance leaving only 17% of the adults excluded from financial services (Figure 2.2).

Figure 2.2
Financial Access, 2006 – 2016



Source: CBK 2016 FinAccess Survey Results

GAPS IN FINANCIAL INCLUSION BY REGION, GENDER, AGE, AND EDUCATION

Despite this remarkable achievement, a number of gaps in attaining universal financial inclusion still exist. These include a rural-urban gap and a gender gap.

Rural-Urban Gap: In 2016, formal financial inclusion in rural areas stood at 69% compared to 86% in urban areas. The rural-urban gap in financial inclusion has persisted over time due to poor infrastructure, especially electricity connectivity. However, the advent of information technology (especially through mobile telephony increasingly used to improve access to financial services) is overcoming some of these infrastructural challenges. So the gap is progressively narrowing (CBK 2016 FinAccess Survey Results).

Gender Gap: Women lag behind men in accessing and using formal financial services. This gender gap has been narrowing steadily and was down to 9% by 2016, mainly due to the use of mobile based financial services by women (CBK 2016 FinAccess Survey Results).

STATUS OF MORTALITY TABLES

The Kenya Mortality Tables (KE-2007-2010) have been approved by the Insurance Regulatory Authority (IRA) and are awaiting incorporation in the Insurance Act before they can be adopted by underwriters. The KE 2007-2010 Tables are a follow up to the initial KE 2001-2003 Tables that were commissioned in 2005 and completed in 2007 and have been in use by the industry.

Development of the KE 2001-2013 Tables for assured live mortality rates puts Kenya on the world map for being the second country in Africa to develop its own mortality tables. To date, Kenya and South Africa are the only countries on the Continent to have achieved this feat.

Prior to 2005, the Kenyan insurance market was using the A49/52 British mortality tables developed using 1949/1952 data in Britain. These tables were outdated and did not reflect Kenya's changing mortality experience.

The mortality study was financed by Financial Sector Reform and Strengthening (FIRST) Initiative and conducted by Alexander Forbes Financial Services. The survey was peer reviewed by Quindiem Consulting Actuaries of South Africa whose insights increased the value and credibility of the Tables. Subsequently, the Insurance Act was amended in 2011 to adopt the KE 2001–2003 Mortality Tables that are now used in calculating the liability under life assurance policies.

While the initial study was a great success, concerns were raised by both the actuarial team and the peer review team regarding the quality of data because this was the first time such an exercise was being carried out in Kenya. They recommended that a review be done after a five-year period as this would improve the quality of the data and subsequently impact the quality of Tables. The review would also ensure that the Tables provide a better understanding of emerging risks and trends in the market.

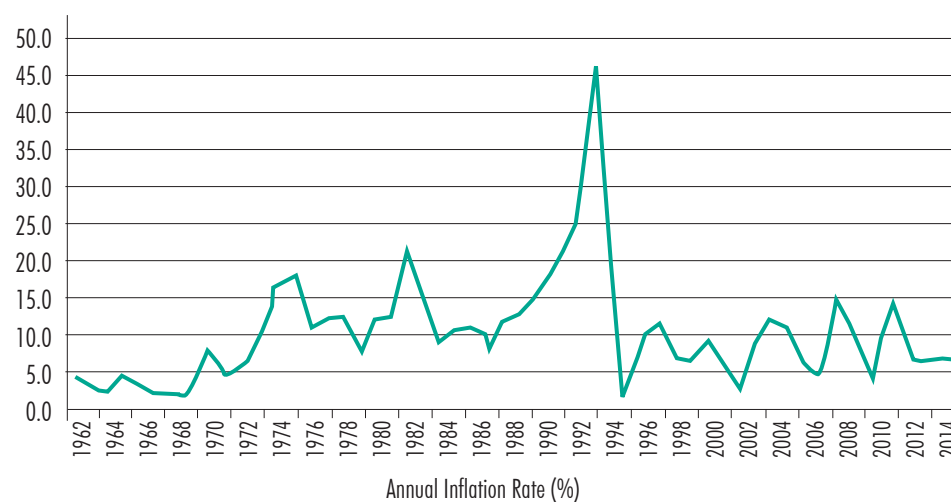
In 2014, Association of Kenya Insurers (AKI) commissioned Alexander Forbes to study the Kenyan Assured Lives Mortality Experience for the Period 2007-2010. The study was peer reviewed by The Actuarial Society of Kenya (TASK) Life Insurance Working Party. The Mortality review exercise was completed in 2015, resulting in the KE 2007-2010 Mortality Tables.

HISTORICAL INFLATION

Although Kenya has experienced strong economic growth over the past decade, high and volatile inflation continues to pose a significant threat to robust economic performance and has had a large adverse impact on the poor. A combination of factors have contributed to the high inflation levels observed in recent years including rising global crude oil prices, erratic weather patterns that adversely impact agriculture, and a weakening domestic currency as a result of an increasing current account deficit.

The following table shows the annual inflation trend from 1962 to 2015. Kenya witnessed the highest inflation rates in the period between 1991 and 1993 attributed to depreciation of the Kenyan Shilling and low investor confidence due to the tumult that followed the re-introduction of multi-party politics in Kenya (Economic Survey, 1994).

Figure 2.3
Annual Inflation Trend (1962-2015)



Source: Kenya National Bureau of Statistics, Statistical Abstract, 2016

STRUCTURE OF KENYA'S PENSION SECTOR

Kenya's retirement benefits industry is divided into four categories summarized and thereafter described below.

Table 2.1
Summary of the Retirement Benefits Structure

	National Social Security Fund	Occupational Schemes	Individual Schemes	Civil Service
Legal Structure on which scheme is founded	Act of Parliament (Pillar 1)	Trust Deed & Rules (Pillar 3)	Trust Deed & Rules (Pillar 3)	Act of Parliament (Pillar 1 or 2)
Membership	<ul style="list-style-type: none"> Mandatory for all employees in formal sector Voluntary for employees in the informal sector 	Employees of the specific company—Employer based	Open to the Public, all employees	Only employees of the Civil Service
Assets (Kes)	156 billion	629 billion	28 billion	Non Funded
Funding	Joint contributions by Employer and employee	Funded by either employer alone, employee alone or joint contributions of Employer and Employee	Funded by member contributions. In some cases jointly employers and employees	Not Funded - It is a Pay as You Go through funding by Government Budget Allocation

Structure	<ul style="list-style-type: none"> • Defined Contribution • Provident 	<ul style="list-style-type: none"> • Mixture of defined Contribution and Defined Benefits • Mixture of Provident and Pension 	<ul style="list-style-type: none"> • Defined Contribution • Mixture of Provident and Pension 	<ul style="list-style-type: none"> • Defined Benefit • Pension Scheme
Regulation	Retirement Benefits Act	Retirement Benefits Act	Retirement Benefits Act	Exempt from Retirement Benefits Act

NATIONAL SOCIAL SECURITY FUND (NSSF)

The NSSF is a mandatory scheme where employers and employees, both private and public, are mandated to make joint monthly contributions of 12% of the pensionable salary under the new NSSF Act, 2013. However, due to a myriad of court cases from various stakeholders, employers and employees jointly make a flat monthly contribution of only KES 400 (~USD 4.1)¹ – with employers and employees each contributing KES 200. Benefits are preserved (or locked-in) till age 50, at which point a member can opt for early retirement. The Fund is managed by a Board of Trustees representing various stakeholder categories including employer and worker associations. The managing trustee is appointed by the government. The NSSF has a fund value of over KES 156 billion (~USD 1.6 billion) with an active member base of over 2.1 million which constitutes 18.2% of the working age population.

OCCUPATIONAL RETIREMENT BENEFITS SCHEMES

The occupational retirement benefit schemes are employment based and are established by employers on a voluntary basis. These schemes are funded through contributions from employers and employees. Contribution rates and benefit structures may vary from one scheme to another. Similarly, contributions from employer and employees may also differ across these schemes. However, the majority of these are Defined Contribution (DC) Pension schemes.² There are currently over 1,306 registered schemes with a membership of over 447,000 and a fund value of over KES 657 billion (USD 6.7 billion). This is a significant number of individual schemes – and obviously impacts the economies of scale that each is able to exploit.

INDIVIDUAL RETIREMENT BENEFITS SCHEMES

Individual retirement benefits schemes, although relatively new, have become the fastest growing component of Kenya's retirement benefit industry. All but one individual retirement benefit schemes are operated by insurance companies. Membership is voluntary and open to anyone who wants to save for retirement. These schemes are especially useful for salaried workers whose employers have not established an occupational scheme, self-employed professionals and formal sector workers who are already contributing to

¹ USD 1 = KES 98.2 Annual average inflation in 2015 (Economic Survey 2016).

² Kenya has witnessed a shift from Defined Benefits (DB) schemes to DC Schemes following a government directive in 2010 for all State Corporations to convert from DB to DC Schemes. The private sector has followed suit.

the NSSF but wish to make additional voluntary retirement contributions. Small and micro-employers who are not able to establish independent occupational schemes are encouraged to direct their employees to the individual schemes. All individual retirement benefits schemes must be registered by the Retirement Benefits Authority (RBA) and must also be fully funded. Contributions to such schemes vary from one scheme to another with minimum contributions ranging from KES 500 to KES 2000 (~USD 5 to USD 20) per month. Contribution amounts are flexible and members can save varying amounts depending on their income and cash-flow positions subject to a minimum contribution value. Employers whose employees are members of individual pension schemes can make contributions on behalf of their employees. This contrasts with traditional occupational schemes whose membership is open only to employees of the employer establishing the scheme. Currently, 32 individual retirement benefit schemes, with an asset value of over KES 28.8 billion (USD 300 million), are registered with the RBA. Membership in these voluntary schemes has grown at a healthy pace and stood at over 162,000 subscribers by December 2015.

CIVIL SERVICE PENSION SCHEME

This scheme has been in existence since colonial times to provide retirement benefits to all civil servants. This non-contributory Pay-As-You-Go (PAYGO) pension scheme was established under an Act of Parliament to provide retirement benefits to all government employees. Benefits are paid from government revenue collections and currently cover over 500,000 civil servants (including employees of the national government, county governments and teachers). There are plans for the traditional civil service pension scheme to be converted into a DC scheme. The Public Service Superannuation Act, 2012 was enacted to jump-start the conversion process and establish a pension program based on a contribution of 7.5% of the pensionable earnings by employees and a 15% contribution by the government.

SOCIAL PROTECTION FOR THE ELDERLY

Social transfers are increasingly being seen as a tool for combating the threat of chronic poverty, hunger and HIV/AIDS. In 2013, the government of Kenya, through an Act of Parliament, approved a more robust social protection framework to generate positive reforms to social assistance programs in the country through enactment of the Social Assistance Act, 2013. The framework referred to as the National Social Protection Policy (NSPP) aims to strengthen the delivery of social assistance to poor and vulnerable populations and promises progressive realization of the rights to social security and protection to persons who are unable to support themselves and their dependents.

The first step in the reform agenda on social safety-nets and social protection for the vulnerable populations was the establishment of the National Safety Net Program (NSNP). The NSNP aims to strengthen operational systems while expanding the coverage of five cash transfer programs; the Older Persons Cash Transfer (OPCT), the Cash Transfer for Orphans and Vulnerable Children (CT-OVC), the Hunger Safety Net

Program (HSNP), the Urban Food Subsidy Cash Transfer (UFS-CT), and the Persons With Severe Disability Cash Transfer (PWSD-CT). The old Person Cash Transfer Programme (OPCT) was launched in 2006 on a pilot basis with a government budget allocation of KES 4 Million (USD 41,000). The programme is not universal and targets poor and vulnerable older persons aged above 65 years. It is means tested and only those who meet the prescribed criteria receive the benefit. The programme is still a pilot and yet to be rolled out country-wide. The objective of the program is to provide regular and predictable cash transfers to vulnerable older persons in identified households.

During the first part of the pilot phase, the Older Persons Cash Transfer (OPCT) program provided a monthly cash transfer of KES 1,000 (USD 10.2) to 300 households with destitute elderly people in three districts (Nyando, Busia and Thika) under the Rapid Results Initiative (RRI). This was scaled-up in 2009 after an allocation of KES 550 million (USD 5.6 million) from the government to cover 33,000 households in 44 districts receiving KES 1500 (USD 15.3) per month. The programme allocated a further funding of KES 1 Billion (USD 10.2 million) in the 2011-12 financial year and was up-scaled to cover 36,036 eligible households – each receiving a monthly transfer of KES 2000 (USD 20.4). By 2012-13, the number of beneficiaries rose to 59,000 households across all sub-counties. The program was allocated KES 1.5 billion (USD 15.3 million) during the 2012-13 financial year. In 2013-14, the programme enrolled 105,000 new beneficiaries leading to a total coverage of 164,000 households following an allocation of KES 3.2 billion (USD 32.6 million). By the end of the 2014-15 financial year, the programme had registered 225,000 beneficiary households in all 290 constituencies. In 2015-16, the Old Person Cash Transfer programme (OPCT) targeted a further 100,000 households to reach a total of 325,000 beneficiary households before June 2016. Initially, when the transfers began, the money was being distributed through branches of the Kenya Post Office (KPO); this has since expanded to include local banks handling the cash distribution.

The funding for the cash transfer programs has largely been provided by the government but working in partnership with donor partners. Progressive funding for cash transfer is as shown in Table 2.2.

Table 2.2
Disbursements to Older Persons Cash Transfer Programme

Fy Year	No. Of OPCT Beneficiaries	Amount (KES).
2007/2008	200	2,400,000
2008/2009	300	4,000,000
2009/2010	33,000	530,000,000
2010/2011	33,000	530,000,000
2011/2012	36,036	1,000,000,000
2012/2013	59,000	1,500,000,000
2013/2014	164,000	2,474,000,000
2014/2015	225,000	5,040,000,000
2015/2016	310,000	7,329,512,963
TOTAL	310,000	18,405,512,963

Source: National Gender and Equality Commission 2014, The Cash Transfers in Kenya.

SOCIAL PROTECTION STATUS

There is a growing recognition of the potential impact of social protection in reducing poverty, child labour and inequality, especially given the global economic downturn. It has been understood that social protection can assist people in escaping chronic poverty and help those hit by shocks to avoid destitution. Despite the existence of an integrated Social Protection Policy, a number of challenges still prevail. These include

- Development/articulation of a clear and coherent vision on social protection in Kenya which needs to be supported by strong leadership and by a focal point within government that can manage effective institutional coordination.
- Organisational capacity to implement and expand cash transfer programs. The organisational capacity is weak, creating the need for a strong Management Information System platform for social protection to effectively coordinate social protection programmes, expand coverage and provide robust evidence on impact.

The status of Occupational Safety and Health (OSH) has been an issue of growing concern. The scarcity of data, which makes it impossible to characterize the conditions under which workers are engaged, and the fact that the majority of workers in Kenya are transitory, operating mainly in the informal economy, poses a challenge. In addition, awareness on OSH is low and thus exposes a huge number of workers to work place risks.

FINANCIAL INCLUSION IN KENYA

Over the last decade, Africa has been the world's second fastest growing region after Asia, growing in excess of 5% of annual GDP (Triki and Faye 2013). However, the impressive growth has not translated into shared prosperity and better livelihoods for the majority of her population. Financial inclusion is key to fostering inclusive development, but it is an area where Africa has lagged behind other continents. For example, in Sub-Saharan Africa (SSA) alone, to which Kenya belongs, 80% of the adult population has no access to basic financial services (CGAP, 2011). Expanding access to financial services, will mobilize greater household savings, increase accumulation of capital for investment and boost shared prosperity.

The wide-spread use of mobile phone technology, however, has opened new markets across the region, most notably in the financial sector with mobile phones widely used to provide financial services. The advances in technology and especially the mobile phone technology, has revolutionized financial services provision and introduced new models for delivering financial services to the hitherto excluded majority poor. Providing these services through mobile phones has made them relatively cheap, secure, reliable and speedily accessible. This has enabled the majority of the poor expand their financial platforms. In Kenya, before the advent of mobile financial services in 2007, occasioned by the launch of M-Pesa in 2007, access to financial services was a paltry 27% – which has now risen to more than 75 percent.³

Financial inclusion, therefore, is important in ensuring that economic growth is inclusive and sustainable. It generally refers to all initiatives that make formal financial services available, accessible, affordable, and sustainable to all segments of the population. However, broadening financial inclusion requires focusing attention to segments of the population that have been historically excluded from the formal financial sector for a variety of reasons. For example, it could be because of their low income levels, volatility of income, gender, location, type of activity, financial illiteracy, religion, or models of financial services provision.

ADVENT OF THE MBAO PENSION PLAN

In view of Kenya's large pension coverage gap, the RBA has shown a lot of concern and desire to bring informal sector workers into innovative pension arrangements. It recognized that the existing pension arrangements, namely the civil service pension scheme, employers sponsored occupational pension schemes, and independent pension plans as currently constituted would not serve the needs of informal sector workers due to their peculiar attributes.

³ See Figure 2.2

Informal sector workers generally earn low incomes, which are irregular. Some of their activities are seasonal, dictated by the weather, as is the case for small scale farmers or by cyclicity of the tourism industry. Besides, the workers experience very high labour mobility by changing jobs and/or economic activities very rapidly. These attributes, amongst others, cannot enable them to participate in existing pension arrangements that serve workers in the formal sector who earn regular and stable incomes and can therefore afford to make predetermined monthly contributions towards their retirement benefits.

Even with this level of awareness on the part of the regulator and stakeholders in the industry, innovative pension arrangements to serve this market segment eluded them for long. At best the regulator stumbled on an innovation through its Cooperate Social Investment (CSI) activity, which, to say the least, became an eye opener on how best to serve pension services to informal sector workers. The RBA partnered with specialists on ear, nose, and throat (ENT) called the Operation Ear Drop Kenya to undertake a Hearing Conservation Programme. The partners sought to provide free ear check-ups for artisans particularly targeting tinsmiths and welders. Although, there are many such workers, the focus was on tinsmiths working in Nairobi in a constituency very close to the central business district called “*Kamukunji*”. The place is known for high levels of noise, produced by work of the tinsmiths, which is the predominant economic activity. The tinsmiths recycle used drums, tins, or plates of metal into new products, such as metal boxes, charcoal stoves, wheelbarrows, chicken feed holders, etc. To the authorities and ENT doctors, checking hearing disabilities was therefore very important for these workers, together with the women folk who served them food with their babies strapped on their backs, whose hearing abilities were actually discovered to have been impaired as a result of living in the same environment.

THE NATIONAL “JUA KALI” ASSOCIATION

Although casually, one would out-rightly dismiss informal sector workers as disorganized, it is actually quite the opposite. They have an association that brings them together to discuss their issues. They have the umbrella National “Jua Kali” Association and of course regional ones as well, given that informal sector workers are present everywhere in Kenya and some of them today are differentiated by their trades, such as the Motor Cycle Riders Association among others. This action by the RBA and the ENT specialists, however, surprised the association that initially never thought that they would attract a lot of attention for what they do by a government entity. This recognition did wonders and set the tone for innovative mechanisms to help their members save for retirement by joining the scheme that emerged from deliberations between their association, the RBA, and other retirement benefits sector stakeholders. This led to the birth of the biggest independent pension plan by the number of members and assets in Kenya today – the “Mbao Pension Plan” amongst the 32 independent pension plans Kenya has to date.

THE MBAO PENSION PLAN

“Mbao” Pension Plan was set up as an independent pension plan and officially launched on 28th June 2011 to specifically target workers in the informal sector who run micro, small, and medium enterprises (MSMEs), commonly referred to as “*Jua Kali*” in Kenya. It is a voluntary defined contribution provident fund, which began as a successful CSI. During the events, the RBA conducted pension education and awareness campaigns to the “*Jua Kali*” artisans on the importance of saving for retirement. Subsequent meetings were held with their representatives to discuss ways of forming a pension scheme for them to enable them save for retirement. These efforts led to the creation of Mbao Pension Scheme in Nairobi and which has since expanded to cover all 47 counties in Kenya, which covers not only the intended informal sector workers but also formal sector workers who wish to join the scheme.

The pension scheme is called “*Mbao*” because this is a Kenyan colloquial terminology for KES. 20, which was the equivalent of one Sterling Pound (locally pronounced Mbao) at independence in 1963. Today it is the equivalent of USD 0.2. The scheme requires members to make a daily minimum KES. 20 contribution using their mobile phones that is affordable to almost all informal sector workers. They use the mobile money transfer services offered by the two leading mobile phone networks in Kenya, namely, Safaricom and Airtel. They can, therefore, make their payments through M-PESA and Airtel Money transfer services in real time 24 hours a day and from anywhere within the mobile phone network coverage and from the comfort of their homes or business premises. The contributions are reflected instantly on the members’ phones as receipted by the Fund and they are able to check contribution balances. The transaction fee charged by the service providers is subsidized at three US cents up to USD 2,000. This has helped address low income workers as it is affordable to most people working in the sector; seasonality of incomes in the sector for they can make bulk contributions to cover periods of no income; and high labour mobility in the sector because by using mobile phones to make contributions, they can do it from anywhere any time, day or night.

OBJECTIVES OF THE MBAO PENSION PLAN

The main objectives of setting up the scheme were to:

- i. Extend pension coverage to the informal sector thus allowing workers in the sector to contribute towards their retirement benefits;
- ii. Create a National Retirement Benefits Scheme for *Jua Kali* workers;
- iii. Educate members of the scheme on matters of retirement benefits; and,
- iv. Promote the Mbao Pension Plan among informal sector workers.

MBAO’S GOVERNANCE STRUCTURE AND INVESTMENT STRATEGY

The “*Jua Kali*” Association of the informal sector workers is the sponsor of the scheme. However, as is required by the legal and regulatory framework of the retirement benefits sector, the association has delegated the governance function to one of the largest banks

in Kenya and East Africa, the Kenya Commercial Bank (KCB), which is the corporate trustee of the Fund. The bank is responsible for the governance of the scheme, including the appointment of service providers, investment returns and provision of benefits. The Association concentrates its efforts on distribution and promotion of the scheme. Members are allowed to withdraw 100% of their savings after three years, however, this is not promoted and members see “Mbao” as a retirement fund only. Interestingly, the return of those who earlier withdrew from the scheme has also been witnessed. Its investment strategy is low risk with the objective to provide a steady positive return. Currently all its investments are in the money market/treasury bills. Since its inception in 2011, the scheme has been growing in membership and fund value. By June 2015, it had more than 70,000 members with a fund value in excess of KES. 100 million (USD 1 million).

MBAO PENSION SCHEME CHALLENGES

The Scheme has had its challenges despite being the largest IPP in Kenya today.

Unmet expectation: The expectation was huge when Mbao became operational. Given its big labour force, enrolment was expected in droves. But it did not happen at such a scale. It was not clear why this was so and this still seems to be the case. The blame was largely laid on poor awareness about the need to save for retirement and the prevailing high levels of financial illiteracy. The two issues have attracted not only the steady focus of the RBA, they have also led to all domestic financial sector regulators,⁴ to combine efforts and focus on improving financial literacy levels.

System down times: The system would go down frequently and sometimes it still happens that the system mobilizing the savings for retirement from this market segment can be down a number of times and at times for significant time periods. The design was not meant to run like this. It is supposed to provide instant acknowledgement when a deposit has been made and show an instant update of balance in that account. When the system is down, therefore, members get very apprehensive as to the security of their hard earned savings and this has contributed to the slow pace of member enrolment and sometimes also withdrawals of membership. The RBA, together with stakeholders, is working to ensure the platform is robust and that system down time is minimized if not eliminated altogether.

GROWTH IN PENSION ASSETS IN KENYA

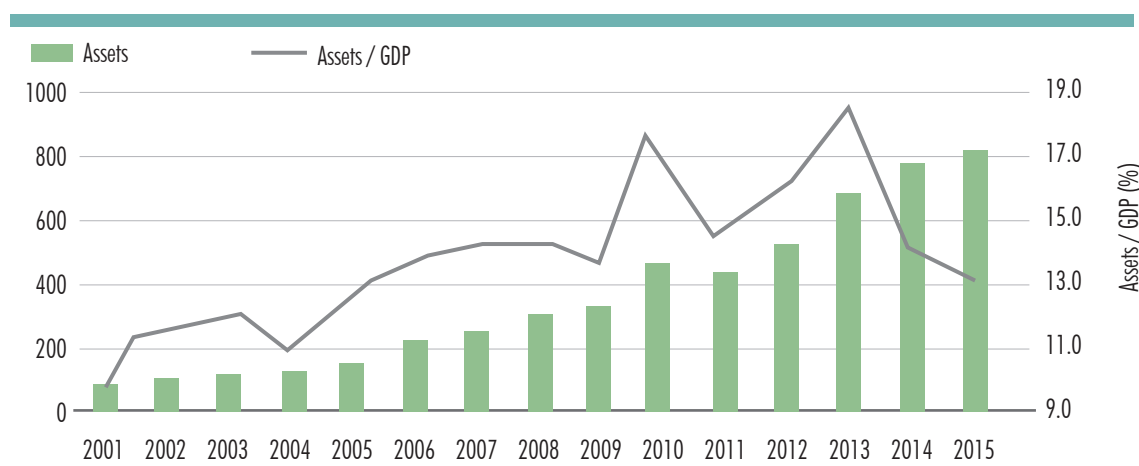
The retirement benefits sector has grown tremendously both in membership and assets. Currently, there are over 1,306 registered pension schemes with over 2.2 million members.

⁴ Kenya has five domestic financial sector regulators, namely, the Central Bank of Kenya (CBK) regulating the Banking sector, Capital Market Authority (CMA) regulating capital markets, Insurance Regulatory Authority (IRA) regulating the insurance industry, Sacco Societies Regulatory Authority (SASRA) regulating the savings and credit cooperative societies, and the Retirement Benefits Authority (RBA) regulating the retirement benefits sector.

This, however, means that the average number of members per scheme is only 1,700, with KES 623 million (USD 6.3 million) in assets. The increasing scale will be very powerful in reducing costs and increasing resources available for improving governance. The retirement benefits assets have increased, both in absolute terms and as a ratio of GDP. The pension assets grew from KES 85.6 billion (USD 0.9 billion) in 2001 to KES 814.1 billion (USD 8.3 billion) in 2015 (see Figure 2.4). As a share of GDP, the ratio improved over the period from a ratio of 9.6% in 2001 to approximately 13.1% in 2015. The drop in the ratio of assets to GDP in 2014 and 2015 can be attributed to the rebasing of the country's GDP.

Figure 2.4

Awareness of automatic enrolment by size, over time



Source: Retirement Benefits Authority 2015, Statistical Digest.

The improved performance over the period can be attributed to improved regulatory environment and prudent management, and investments of the schemes funds. Also, the various reforms and initiatives geared towards the promotion and development of the sector has contributed to this growth.

PENSION COVERAGE

Despite the enormous growth that has been witnessed in the pension sector, pension coverage is still low and majority of the working population is not covered. This is partly attributed to the skewed labour market in favour of the informal sector which employs nearly 83% of the workforce but who earn generally low and irregular incomes. The low coverage has also been attributed to the fact that the pension system in Kenya is largely voluntary and employers are not compelled to establish schemes nor enrol members in existing schemes. The low coverage has also been blamed on the low financial literacy and the negative attitude towards the idea of saving for retirement.

Although the NSSF scheme is mandatory, most of the employers in the informal sector and self-employed workers have not registered or contributed to the scheme. Currently, there are slightly over 2.1 million active members contributing to the fund. This is low compared to over 15 million workers recorded in 2015 (GOK, 2016). This situation, therefore, implies that the strategy employed by the fund to extend pension coverage is somewhat ineffective. The NSSF Act compels every employer, who under a contract of service, employs one employee or more to register with the fund as a contributing employer and to also register its employee or employees as members of the fund. The Act also provides for registration of self-employed persons who wish to become members of the fund as voluntary members. NSSF has not had a sound mechanism to enforce stipulations in its Act. The outcome, therefore, in terms of pension coverage is dismal despite the fact that one of the objects of the fund is to increase coverage.

REFORMS IN THE RETIREMENT BENEFITS SECTOR IN KENYA

The Retirement Benefits Act was enacted as part of the on-going reform process for the financial sector in the country in order to bring the retirement benefits industry under harmonized legislation and address the many problems that the industry had faced. The enactment of the Retirement Benefits Act filled a regulatory vacuum that existed in the country. At the time the Authority came into existence, retirement benefits schemes in Kenya were regulated by fragmented legislation, mostly trust and income tax laws. The Authority was thus established to facilitate industry reforms and, most importantly, ensure that members' interests are protected.

The absence of specific retirement benefits regulations allowed schemes to adopt different styles of operations. Frequently, sponsors (employers) dominated the operations of the industry including management of members' funds and assets to the extent that at the time of retirement, members' benefits could not easily be determined. In addition, sponsors treated members' contributions as their own and ploughed back the money into their businesses. A majority of the schemes, therefore, lacked the funds to pay their members on retirement.

With the enactment of the Retirement Benefits Act (1997) and the Retirement Benefits Regulations (2000), the retirement benefits schemes are now distinctly separate entities from their sponsors, established under an irrevocable trust and administered by a legitimately appointed board of trustees. The structure of the retirement benefits sector comprises four distinct categories of schemes, namely the NSSF, Occupational Retirement Benefits Schemes, Individual retirement benefits schemes, and civil service pension scheme.⁵

⁵ See Table 2.1

EXPANDING COVERAGE

Low pension coverage has been a key concern for the retirement benefits sector regulator. It has sought out ways and means in which to grow it. One way has been intensive public education and awareness campaigns explaining the need to save for retirement. Surveys undertaken by the RBA show that awareness levels on the need to save for retirement are quite high. The challenge, however, is the conversion of the high levels of awareness into actual enrolment in the different pension arrangements that would lead to saving for retirement. Of greater concern has been the extremely low pension coverage in the informal sector, a sector that employs a majority of Kenyan workers, as mentioned earlier. The launch of the “Mbao” Pension Plan to specifically target informal sector workers has shown results, which has made it the biggest independent pension plan in the country. The results have demonstrated two key ingredients of the innovation. The first is based on mobile phone money transfer services of M-Pesa and Airtel money, to which Kenyans were already acquainted for more than five years since the launch of M-Pesa in 2007 and this proved very useful and aided easy acceptance of sending pension savings through these platforms. Second, the innovation accommodated the peculiar attributes of informal sector workers, e.g., low and irregular incomes, high labour mobility, etc., which would not allow them to save in pension schemes that require regular and predetermined retirement benefits savings. The accommodation of their special characteristics by “Mbao” Pension Plan has enabled them to save towards their retirement conveniently whenever they have some income from wherever they are, at home or at work, 24 hours a day and seven days of the week, throughout the year. Although, the scheme has not performed as expected, it is still the way to go forward and existing challenges need to be addressed in order to make it more robust in order to enroll more informal sector workers in the scheme.

RISK BASED SUPERVISION

Previously, the Authority followed a fairly extensive review process in regulating pension plans, with few considerations of the risk profile of different plans. This resulted in an inordinate amount of time being spent on pension schemes and provident funds that are largely in compliance with the requirements under the legislation and the regulations.

The risk-based approach to supervision is an approach whereby the intensity of the work of a regulatory agency and the resources allocated to supervising individual schemes are in proportion to the size and risk of each scheme. The approach is borne out of the recognition of the need to have a more proactive approach to the regulation of the pension sector. The objectives of this approach are to identify cases requiring closer supervision on a timely basis; to focus limited resources on review of those cases identified as requiring closer supervision; and to ensure timely corrective action. The risk based supervision framework was adopted in 2010.

In addition, the Authority has implemented an online portal that enables parties wishing to establish pension schemes to submit their applications, together with the requisite documents, electronically. This has hastened the application process significantly. Schemes

and their service providers also use this electronic system to submit the statutory returns that the Authority requires to continually gauge the scheme's health status and level of compliance with set regulations. Relying on the data that is thus submitted and held in the system, the Authority can then quickly undertake quick interventions on schemes that do not meet requirements and, therefore, protect scheme members and sponsors' interests.

NATIONAL PENSION POLICY

In order to build on the success of the Retirement Benefits Act, harmonize all the various sectors of the retirement benefits industry and improve the lives of all Kenyans after their retirement, the Authority is developing a National Pensions Policy to be considered by the government and other stakeholders. The national pension policy, inter alia, considers the following areas of further reform:

The key policy areas discussed here include the following;

- i. **The pension structure and legal framework:** The policy seeks to provide a comprehensive pension system framework that follows a structure that recognizes the different level of needs, utilizes various sources of funding, and reflects the various roles of stakeholders. The policy, therefore, proposes the development and implementation of a harmonized legal and regulatory framework for pension.
- ii. **Pension coverage:** The policy seeks to have measures in place to broaden pension coverage in both formal and informal sectors to enhance social protection for all citizens.
- iii. **Consumer protection:** The policy seeks to develop mechanisms of consumer protection of members and beneficiaries of pension schemes and stakeholders.
- iv. **Transferability and Portability of Retirement Benefits:** There is a need to allow for portability of accrued benefits to another retirement savings arrangement in the country, East African Community (EAC) region, and in other countries with which Kenya has bilateral arrangements.
- v. **Administration and Management of pension funds:** The policy should come up with innovative ways to optimise administrative costs in relation to returns in order to grow members' pension savings.
- vi. **Annuities and Income Drawdown:** To promote the development of the market for annuities and income drawdown in Kenya.
- vii. **Indexation:** To promote indexation of pension benefits in order to avoid erosion of retirement benefits.
- viii. **Mutual recognition:** The policy seeks to encourage pension supervisors to practice mutual recognition of service providers and share information pertaining to registration to allow pension players registered in one EAC to operate more or less in a similar fashion.

INVESTMENT GUIDELINES

There have been some significant changes to the investment guidelines in Kenya. The changes allow schemes to diversify into more sophisticated investments that were not there more than 10 years ago. Today, Kenya allows pension funds to be invested into 14 different assets classes ranging from Cash to Real Estates Investment Trusts (REITS), both Development and Income REITS. The industry has played a significant part in the turnaround in the domestic savings rate as well as the strong rebound in the overall economic growth. Investment portfolio returns have also improved tremendously over the years as a result of diversification and the guidance of independent investment managers.

TRUSTEES CERTIFICATION PROGRAM

The pension Trustee Development Program Kenya (TDPK) was officially launched on 29th August 2011. The programme was developed through the collaborative efforts of the Retirement Benefits Authority, Association of Retirement Benefits Scheme (ARBS) and College of Insurance. The Humber Institute of Technology and Advanced Learning of Canada provided the technical and academic assistance. The program is part of an effort by the Retirement Benefits Authority to improve governance and management of pension schemes and prudent investment of their funds. The trustee development programme is also created in response to the requirement of every scheme or corporate trust to have in the board of trustees, at least one member who has been vetted by the Authority to provide Trust services. All trustees of retirement benefits schemes and directors of corporate trustees of retirement benefit schemes in Kenya are required to undergo training in the program in order to be certified by the RBA to engage in the provision of Trust services.

PRESERVATION OF RETIREMENT BENEFITS

The Retirement Benefits Act (1997) and the Retirement Benefits Regulations (2000) were amended to allow for preservation of 50% of the employers' accumulated benefits upon changing jobs – meaning that 50% of the assets had to remain within the pension and could not be withdrawn. Although the initial intention was to preserve the employer's entire benefits, members are now able to access their accumulated benefits and 50% of the employers' accumulated benefits upon changing jobs. Through pension education, however, a number of members are now opting to have their benefits preserved until retirement age. The industry growth can partly be attributed to preservation of benefits, which has had a significant impact on replacement rates.

THE RETIREMENT BENEFITS APPEALS TRIBUNAL

The Retirement Benefits Appeals Tribunal is established under Section 47 of the Retirement Benefits Act. The Tribunal is expressly vested with jurisdiction to hear appeals by any person aggrieved by a decision of the Authority or the Chief Executive Officer within thirty days of receipt of the decision.

Prior to its establishment, its meetings were held in hotels, between 2003 and 2013. To acquire a permanent address, the RBA designed and built a “state of the art” Appeals

Tribunal Office that has a dynamic recording system technology, video conferencing facilities, a flexible witness stand, a well-equipped resource centre, utility facilities that cater to persons with disabilities, a flexible office layout that transforms to three boardrooms, and other amenities.

The Tribunal has ensured a more effective response to the public and complaints handling. It has also resulted in a significant reduction in the running costs of holding Tribunal Hearings. The office has also ensured a smooth facilitation in terms of research and adequate preparation within the office for appeals hearings. In addition, the Tribunals' state-of-the-art multimedia recording equipment, registry and archiving equipment, dynamic communication systems, and other amenities have improved customer response time and quality of service.

PENSION EDUCATION CAMPAIGNS

The RBA has continued to undertake research driven multi-faceted Public Education campaigns to educate Kenyans on the importance of saving for retirement and the channels available for saving, encourage employers to establish pension schemes for their employees and urge the Kenyan citizenry to sign up for pension. The messages are designed based on communication gaps identified in the surveys and disseminated using the recommended communication channels.

In addition, the Authority also prepares Kenyans for old age pension saving. It hosts seminars for members of retirement benefit schemes to equip them with skills that enables them to participate actively in the management of their schemes.

CHALLENGES TO THE RETIREMENT BENEFITS SECTOR

Despite the tremendous progress made in the retirement benefits sector, in terms of enhanced governance and management of schemes, growth of the sector in terms of industry assets and as a ratio of GDP and enhanced mobilization of long-term savings to fund long-term investments achieved so far due to the reforms, a number of challenges still exist, namely; growing pension coverage especially to informal sector workers and the self-employed; addressing longevity risk because of the rising life expectancy at retirement for Kenyan workers, which now averages 17.9 years and is still increasing; enhancing pension adequacy; improving returns from pension funds investments and thus also improving pension adequacy; and enhancing capacities for better governance, management, and administration of pension schemes, among others.

CONCLUSION

Pension inclusion is still a major challenge for the country. Less than eight out of 10 Kenyan workers are covered by pension arrangements. A lot of effort is required to change this scenario, especially for extending pension coverage to the informal sector, which employs more than 80% of Kenyan workers who are not saving for retirement. Lessons Kenya has learned from growing financial inclusion from 27% in 2006 to over 75% today are proving valuable for expanding pension inclusion, especially amongst informal sector workers. The huge expansion in financial inclusion witnessed in Kenya has been strongly buttressed by the launch of M-Pesa in 2007 and consequent growth of mobile money transfer platforms that have now evolved into mobile financial services platforms adopted by banks to serve their clients better. The pension sector is not being left behind. Though it could be starting from a very low base, i.e., 18% pension coverage, unlike banking services that started from 27% in 2006 but the impetus to grow pension inclusion along this path is already demonstrated. The “Mbao” Pension Plan uses the same mobile phone technology to attract savings for retirement. It has made it the biggest IPP in less than five years. Although it still faces robustness challenges, these would be addressed in due course to unleash its potential in expanding pension inclusion akin to what has been achieved by M-Pesa and generally mobile phone based financial services. Working on expanding both financial and pension inclusion would thus spur growth of both and lead to a rapidly developing financial sector that fosters faster shared economic growth and development by all.

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