

PROBLEMS FACING KENYA'S PENSION SYSTEM:A CASE FOR REFORMS OF LAWS RELATING TO PENSIONS

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ABSTRACT The structure of Kenya's pension system comprises of (i) the civil service pension scheme (ii) the National Social Security Fund (iii) Private Occupational Pension Schemes and (iv) Individual Retirement Savings which are limited in significance for purposes of this project. Individual retirement saving schemes are insignificant in terms of their asset base and coverage and are therefore not discussed in this project. The system is fragmented lacking a harmonized policy and operates on different Acts of parliament. The concerns of the pension system in Kenya relate to (i) lack of longevity insurance (ii) low coverage (iii) unfunded liabilities (iv) imprudent asset management (v) non-payment or delayed payment of pensions and (v) weak enforcement of pension laws. For purposes of this project, the problems facing Kenya's pension system which have been analyzed relate to (i) low coverage (ii) under funding in pension schemes (iii) imprudent asset management and (iv) weak enforcement mechanism of pension laws. Low coverage of the pension system is attributable to the current pension laws which have established pension schemes largely for formal employees. A policy to initiate pension reforms which will extend coverage to majority of uncovered elderly poor by introducing a universal pension scheme will be ideal. In the meantime, National Social Security Fund Act, the Pensions Act and the Retirement Act should be amended to extend coverage to all formal employees. Unfunded and under-funded liabilities in pension schemes raise the issue of long term sustainability of the current system. The unfunded civil service scheme is becoming too expensive to be sustained by general tax revenues. The NSSF although designed to be a fully funded provident fund with member accounts, it is underfunded owing to historical political influence on its asset management. The Kenya Social Security Pension Bill, 2005 which proposes to repeal the current NSSF Act if enacted, will improve governance standards of the mandatory scheme and widen coverage to majority of the workers in the formal sector. Occupational pension schemes face problems of unremitted contributions from sponsors who go under any time leading to under-funded liabilities in these schemes. Section 112 of the constitution and the Pensions Act need to be amended to provide for a fully defined benefit scheme for civil servants and redefine the benefits structure to make the scheme affordable and sustainable. In order to address funding problems in NSSF as a short term solution, it is recommended that section 33 of the Retirement Benefits Act must be operationalized to subject NSSF to competition as a way of improving its governance. Internal governance of NSSF needs to be reformed through clear provisions of an amended Act. Also, the collection of contributions will be enhanced if collected together with pay-as-you-earn taxes under Income Tax Act by the Kenya Revenue Authority. Funding in Private Occupational Retirement Benefits Schemes can be improved by extending criminal sanctions to employers who fail to remit all contributions to schemes. The law should also provide adequate guidelines on applicable actuarial assumptions when valuing the funding levels of defined benefits schemes. Those defined benefits schemes which cannot meet the required funding levels should be obligated under the law to convert to defined contribution pension schemes. Centralized management of NSSF assets exposes participants to a high political risk and imprudent asset allocation by trustees. There is a case to amend the National Social Security Act to create transparency in asset management with clear objectives for investment. The law needs to be amended to establish an independent and professional investment board to manage the assets of NSSF for investment purposes. With regard to private occupational pension schemes, fund managers should be outlawed from assisting trustees to develop investment policies because of conflicts of interests. The Retirement Benefits Act should differentiate the roles of fund managers and investment advisors in schemes. Investment Policies should enable fund managers to select investment securities which match the liability profile of the scheme. The Investment Guidelines under the Retirement Benefits Act need reconsideration with a view to allowing more assets to be invested offshore and

allow to some extent the "prudent person standard" in asset management. The enhancement of enforcement mechanisms of the law requires legal reforms of the Pensions Act to transform the governance structure of the civil service scheme into a statutory trust answerable to the Retirement Benefits Authority. The many laws, to which NSSF operations are subject to, need to be harmonized and consolidated in the National Social Security Act. The Authority shall then be mandated under the National Social Security Act to enforce and monitor compliance of that Act. This will restrict the Authority to supervisory role only rather than also playing the regulatory role on NSSF. Further amendments to the Retirement Benefits Act need to refocus on the mode of supervision the Authority should adopt owing to its capacity limitations. This will enhance supervision so that it addresses risks rather than mere compliance with the law. Further amendments of the Act should enhance the autonomy of the Authority in order to enable it execute the statutory mandate without external interference. Enforcement of criminal sanctions should revert to the Attorney General and Police Department who have the capacity to arrest, investigate and prosecute offenders of the law. The current legal framework which requires the Authority to prosecute offenders of the Act does not seem to work owing to limited capacity and police reluctance to arrest and investigate offences under the Retirement Benefits Act. In total sum the pension system in Kenya is now ripe for reforms designed to address its limited coverage in order reduce old age poverty. Pension laws in the country need to be reformed to address those concerns and guarantee old age income security to majority of the elderly poor.