SAVING THE NEXT BILLION FROM OLD AGE POVERTY

global lessons for local action

EDITORS
PARUL SETH KHANNA
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pinBox (abbr. for “pension-in-a-box”) is a Singapore headquartered global social enterprise committed exclusively to digital pension and insurance inclusion in developing countries. By 2021, we aim to leverage existing digital finance infrastructure to help connect 100 million excluded individuals to formal pension systems across South Asia, Africa, Latin America and the Pacific and Caribbean regions.
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This book would not have been possible without the enthusiastic collaboration and unstinting support of the authors — each of whom have been extremely generous with their time and with sharing a distilled view of their invaluable perspective and ideas on the critical issue of pension inclusion.

We were truly inspired and heartened by how readily everyone in this book said yes — especially since each of the authors will continue to play such a pivotal role in implementing many of the lessons and ideas in this volume. We sincerely hope of course that this book is only the first important step on an exciting shared journey between the global pension and financial inclusion communities as we march ahead towards a common goal. And as we pool our combined wisdom and resources to carve out a new vision for our future elderly and thus create new, profound possibilities that will indeed help save the next billion from old age poverty.

The authors are too numerous to thank individually here – but we take this opportunity to convey our sincere gratitude to each of them. (Please see www.pinboxsolutions.com/book.html for a list of the authors and their biographies).

We remain very grateful to Mr. Subhash Garg for his continued support and guidance on difficult policy and implementation questions around pension inclusion and for always making the time to share his perspective and ideas with us.

We must thank the teams involved with creating, publishing, reviewing and promoting this work and for their very energetic and committed support to this book project. Pensions and financial inclusion can (sometimes) be dry and technical subjects. But everyone, from the design, communications, publishing and social media teams, did an absolutely sterling job of taking the ideas and text and helping kickstart a global conversation that we all hope will lead to new policies and new reforms to expand pension coverage and inclusion. We want to thank in particular Lois Goh, Tanika Pradhan, Achint Ahluwalia, Aalok Khemka, Angeline and Upesh Pradhan for so willingly putting their shoulders solidly into converting a seemingly unwieldy and challenging idea in 2016 into a global movement on pension inclusion in 2017.

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ABBREVIATIONS
Agricultural societies, especially those living in joint family systems, had no concept of savings for providing for one’s old age. Industrial societies with nuclear and single person families needed one to have income security for post active period of their lives. Governments and organised sector employers in such industrialised societies provided pensions to their employees. These arrangements however covered few and proved to be financially unsustainable. A large swathe of population in developed countries but almost a good majority of people in developing countries are without any public or employer supported pension arrangement.

These people, estimated to be over a billion today, need to have viable old age pension security. Given the fiscal stress, talk of a universal basis income scheme would most likely remain mostly a dream, most of these people will have to make their own arrangements for their old age pensions. That should lead to a fairly straight forward understanding- save in your active work life and invest the same to pay for your pensions in old/ non-active age. However, try making this argument to convince even a well educated 22-year old in a metropolitan city to voluntarily set aside small sums for old age, and to do so month after month over multiple decades, you may most likely encounter a yawn or an argument that there is not enough money for the present needs; how do you expect me to save for the future. Promoting pensions is probably the most difficult part of behavioural finance.

Achieving regular voluntary retirement savings by a young self-employed person whom we’ve never met would be quite challenging. Especially if the person lives in a remote rural location and faces all the usual lifecycle risks armed only with a modest income, a fragile labour market attachment, and a strong belief that children are a sound retirement portfolio. And for whom current consumption and immediate family needs seem much more visible and real than the grim certainty of extended poverty in old age.

Nearly 1.2 billion such persons work in the informal sector and live in developing countries across Asia, Africa and Latin America. All of them are excluded from formal pension arrangements. With rapid improvements in life expectancy, modest intermittent incomes, and a breakdown in traditional joint family structures, most of them will fall into poverty when they too old to work. Considering the size of the pension coverage gap, poverty among the future elderly in developing countries could well become the dominant cause for increased global poverty.

Inaction is clearly not an affordable policy option. Neither is a tax financed social pension for 1.2 billion citizens. The only sustainable choice for most developing countries is to establish inclusive retirement saving mechanisms and to motivate thrift and self-help for old
age by young informal sector citizens. Countries that succeed in achieving comprehensive coverage with contributions-based pension programs will benefit from a huge surge in stable, long-term household savings that can help fuel economic growth, employment and infrastructure development.

Comprehensive voluntary coverage will however not be easy to achieve at scale. In my experience, this will require strong political interest and commitment. It will also need clear thinking about product and process design, implementing digital mechanisms for affordable access, collaborative and cooperative actions by multiple stakeholders, as well as sustained energy and innovation on retirement literacy interventions. And of course, it will require well managed implementation and monitoring of target outcomes by a committed and empowered team working in “mission mode”. It will also require, not guarantees of specified pensions, but a strong assurance from the Governments about safety of their savings and prudent but remunerative investment of these savings and an easy and decent pension during their old age.

OECD countries already have mature pension systems and therefore have a wealth of experience with pension program design and implementation. But, unlike OECD countries, most developing nations face a gigantic pension coverage gap, a predominantly informal labour market, relatively modest intermittent incomes, insignificant formal finance access and experience, low financial literacy, a limited potential impact of tax incentives on voluntary participation and difficulties with enforcing mandatory coverage. Lessons from OECD country experiences are therefore not directly applicable in a developing country context. On the other hand, most developing nations (being mostly being either predominantly agricultural societies or coming out of it) are remarkably similar in terms of demography, economic strength, labour markets, incomes, culture, access to finance, and legal and political structures. Hence lessons from both success (and failure) with pension policy, system design and implementation may be highly portable from one developing country to another within Asia, Africa and Latin America.

Against this background, this is a unique and extremely useful book as it it combines academic insight, practical experience and real world results that will help developing nations learn from each other's experiences from expanding voluntary pension coverage – especially to non-salaried informal sector workers. The book would also help replicate and customize successful solutions from one developing country to another with lesser time required than in reinventing the wheel or building the systems all from a scratch.

The Indian experience with its national pension system has been instrumental in showing us some of the core building blocks to pension inclusion – Identity System like Adhhaar, IT and digital payments. The Indian experience also shows the power of proactive government policy – as I saw first hand many years ago as I led the roll out of national policy goals and thereafter steered the fiscal policy and financial inclusion agenda of the Indian state of Rajasthan, including piloting India’s first co-contribution pension scheme for informal sector workers.
This book encapsulates an impressive range of insights from around the world – from an amazing group of regulators, researchers, practitioners, industry figures and government leaders. Each of them have brought together new and proven ideas based on their own unique experiences on the subject. As I know from my own experience as Executive Director at the World Bank, the book reflects two important ingredients -- real solutions and a real passion for change -- that are essential to delivering positive results on the ground.

Personally, the book comes at a great time as I move back from the World Bank to lead the Department of Economic Affairs in India. It provides an unrivalled insight into challenges that would need to be addressed while expanding voluntary pension coverage to the billion people who need our innovation and drive to ensure dignity and security in old age. As we move forward on so many fronts to develop health, education and our economic growth, we must prepare now for the long and more productive lives that we hope to create for our citizens. This makes progress on digital pension inclusion even more important – and I commend this book to anyone who wants to understand solutions and develop programs to deliver the change we urgently need.

I must congratulate the team at pinBox Solutions on launching such a powerful initiative on an extremely topical and relevant issue that demands urgent attention and stakeholder action. I am sure this book would be instrumental in jumpstarting a global dialogue and collaborative action on expanding pension coverage.

And I must congratulate William Price from the World Bank, Parul Seth Khanna and Gautam Bhardwaj from pinBox for jointly pulling together such a fascinating set of country case studies, along with a number of extremely relevant chapters on foundational issues that each country that seeks to design and implement inclusive pension systems will need to address. Gautam’s unwavering passion and long standing unequalled contribution to the cause of building old age pension policies and systems forms the bedrock of this Book.

I wish each country that has participated in this effort, as also countries that I am sure will soon join this global movement, the very best in their joint pursuit and vision to help protect over a billion people from old age poverty.

Subhash Garg
Secretary
Ministry of Finance, Department of Economic Affairs
Government of India
ISSUES, EXPERIENCES AND SOLUTIONS IN SAVING THE NEXT BILLION FROM OLD AGE POVERTY

PARUL SETH KHANNA, WILLIAM PRICE, GAUTAM BHARDWAJ
This chapter sets out the motivation for the book and provides an overview of the key issues. It then highlights the main lessons from the country and thematic chapters. It ends with a call to action: to seize the opportunity and prevent the growing number of persons who will face old age poverty as a result of rising life expectancy, falling birthrates, a breakdown of family support in old age and the legacy of broad-based pension exclusion. At the heart of the book project is the realization that the development successes and rising living standards we all hope for will lead to an even greater challenge for those focused on ensuring a decent old age for their citizens.

Unprecedented numbers in the future will have the opportunity to live to old-age – and yet, we are not well positioned to deliver adequate coverage of decent pensions to the elderly, with only 25% of adults worldwide currently saving for old-age (Demirgüç-Kunt, Klapper and Panos, 2016). As Figure 1 shows, even the best performing regions still face huge challenges. Those with the lowest coverage – even if they have some of the youngest populations – will need to use every available innovation and solution if they are to deliver a decent old-age for their people.

Figure 1
The global distribution of saving for old-age by employment status.

Source: (Demirgüç-Kunt, Klapper and Panos, 2016 using weighted averages from Global Findex (2015) data)
Formal pension and social security arrangements in most countries are typically restricted to workers in formal employment – salaried employees in government service or private corporations who register to pay tax and social security. As a result, many advanced OECD countries have achieved nearly universal pension coverage simply because formal employment constitutes nearly 100% of their overall workforce. Coverage of self-employed persons in developed economies is much more variable – though some are driven into the pensions fold through a combination of tax incentives, easy access, and strong compliance and enforcement mechanisms.

Pension coverage in most developing countries on the other hand, where labour markets are predominantly informal, can be as low as 5 to 20 percent. Their remaining workforce, including owners and employees of small and micro enterprises, farmers, small shopkeepers, daily wage earners, street vendors, home help, unpaid workers, self-employed professionals, home-makers and non-salaried citizens more generally are typically excluded from formal pension arrangements. Many in this group face several formidable lifecycle challenges – often compounded not only by a scarcity of money and many urgent needs for their modest, unpredictable incomes, but also by a scarcity of time – a particularly challenging combination when a scarcity of either can make good long-term decision-making difficult (Mullainathan and Shafir, 2013). However, these states are not fixed – and for many, there is a high degree of turbulence over their working life including spells of formal employment, informal employment and unemployment, with some good years (with a good harvest for example), some bad years (with a bad harvest or a health shock).

One of the challenges that the book sets out to solve is how to try and stitch together these different periods in and out of the labour market and across the formal and informal sectors so that they can be combined into something meaningful – so that perhaps 20 years of savings can be aggregated over a 40-year working life – rather than be lost in extra years without savings, or split across multiple providers and products, none of which delivers life-changing outcomes. Whilst the concept of the ‘traditional’ OECD-style retirement from 65 with an income until death may not be feasible in most cases, the ideas in this book help to show how people can afford retirement, one year, or even one day at a time – and thus change a trajectory that currently leads too often to working until death, or existing in abject poverty when someone is too old or weak to work.

In this context, this book brings together two critical constituencies and pieces of the pension inclusion and coverage expansion puzzle: an obviously strong policy and regulatory commitment across countries to achieving comprehensive pension coverage, especially among non-salaried citizens with modest incomes, and an array of replicable tools and powerful ideas from the financial inclusion community that can be usefully applied to achieve meaningful pension coverage outcomes.

The chapters in this volume show how the transformative developments in financial inclusion can be married to pension inclusion using the existing deep knowledge of how to make modern finance work in the interests of the poor. This combination, of financial
inclusion innovations and infrastructure helping to solve the ‘how’ of linking people with pensions, with the experience from pension experts ensuring that the ‘what’ they are enrolled into is a good quality pension, can help provide solutions that will work for the poor and informal sector that have never previously existed. To put it in the language of the chapter on Mexico’s experience by Tuesta and Hoyo, putting these two elements together will deliver both access and usage – which together are necessary to achieve an inclusive pension system. And as the case-studies in the chapter on digital pensions by Khanna, Marathe and Bhardwaj show, technology could be a powerful “glue” that binds these elements into a simple, single window pension solution for the excluded poor.

A guiding principle for the work is that no one source of retirement income will be sufficient to deliver a decent and secure old age. Whether one speaks of pension pillars, or tiers or sources of retirement income, an exclusive reliance on the public sector or the State will lead to excessive fiscal pressures and an unsustainable system – as seen in many EU countries – and prompting the EU’s own 2012 Pension White Paper to argue for greater diversification. Likewise, a reliance only on private contributory pensions can never deliver the broad coverage required to ensure universal freedom from poverty in old age. As the experience of Chile in 1981 and Mexico in 1997 shows, moving wholesale from public to private provision inevitably leads to a need to re-create sources of public pension provision to ensure an acceptable mix of outcomes. As Figure 2 shows, delivering old-age security and retirement income in fact relies on bringing together a wide range of different elements. Increasingly, as the demographic challenges of aging and lower birth rates persist, it is prudent policy at an individual and national level to try and bring together multiple solutions to fix the problem – to make a dent in a huge challenge by bringing together labour income along with savings and insurance, combining family support along with public and private pensions. Moreover, this mixed solution also helps to generate the assets that can help to deliver increased investment domestically and internationally, alongside protection for the life-time poor who may never be able to make sufficient contributions to short or long-term savings. However, at an individual level, creating a new way to save for a pension that is accessible and low-cost is an important source of personal risk-mitigation – since whilst a basic poverty-alleviating floor provided by the State may be a good idea, it is very difficult to use a solution that does not exist in all countries. So, until such ‘zero’ pillars are ubiquitous, pension policy makers need to give ordinary people the best possible tools to help themselves.

A key motivation for writing the book, and bringing together an unrivalled mix of academics, policy makers, regulators and practitioners, came from a growing realization that the financial inclusion and pension communities were not energetically bringing their insights together to create new solutions. Each area has a very active academic and policy debate. But scanning the literature, or the conference agendas, too often each area seemed to miss the cross-overs and synthesis of ideas that could make the whole more than the sum of the parts. For the financial inclusion agenda, there was admirable progress into how to get people into financial services – from basic bank accounts to insurance to innovative payment channels. But there was a much greater focus on using these advances
to help access to finance – and the ability to borrow to grow businesses – than to build assets through saving and pensions. Likewise, the pension community was steeped in issues of optimal investment policies, default funds for those joining a pension plan and how to improve the payout phase – rather than focusing sufficiently on how to expand coverage to the millions, indeed billions, who do not currently have access to pensions.

To be sure, all of these issues are important – indeed it helps to ensure that there is deep knowledge on what a good pension looks like. The thesis of this chapter and this book is that it is only when the ‘how’ of financial inclusion and the ‘what’ of good pensions are brought together in a way that is focused specifically on the challenge of delivering income in old-age, particularly to those in the informal sector, that systems can be engineered to tackle the problem of insufficient coverage of pensions globally.

Figure 2

A diversified solution to deliver retirement income is most robust

Source: Authors

A further motivation for the book, and equally its timing, is that bringing together the ‘how’ and the ‘what’ is today making possible previously unattainable solutions. In the past, it was challenging or impossible to even identify people in the informal sector, let alone reach them and create a regular payment link into a pension plan at sufficiently low cost to make it worth their while. Even if this could be done once, it was extremely difficult to do it in a way that the pension would work with the reality of their labour market experience – spanning periods in the formal and informal sectors, in and out of the labour market, moving from a village to a city, or from one region to another.

A few good years may lead to some savings. But the question was how to link those original savings with another period of relatively good income in five or ten years’ time –

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The access to finance agenda is of course critically important – and helping to create a viable business can be central to delivering income to reduce current poverty and set aside small amounts to save. But the contention is that the relative balance of debate in the financial inclusion space was too heavily focussed on access to finance issues and not enough on the asset building through saving and pensions. This is understandable since the challenges of getting someone into a financial system are profound enough before thinking about how to get them to join a multi-decadal saving or pension program. However, even with the growth of non-contributory ‘social pensions’, at least for certain targeted groups, to ensure a poverty-alleviation floor as an essential part of the overall mix of a pension system, such plans will never be able to bear the full weight of retirement income even for those on modest incomes whilst being fiscally sustainable – particularly in developing countries with a very wide range of demands on (scarce) fiscal resources.

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particularly if those years were in a different job, industry or location. Even if this could be done, but if it were done at a cost of 2 to 3% of assets under management a year, it would eat up so much of the real returns (often only 3 to 4% a year on average) that saving in a bank deposit would make more sense than putting money into the pension fund. Without a low cost product and process architecture using digital solutions, any fiscal incentives by governments would at best mitigate the impact of the high costs of marketing and distribution to low income customers or subsidize excessive service charges by providers. If governments delivered incentives via tax-relief, these would inevitably flow to higher-income segments and fail to benefit those excluded from the tax net by virtue of income levels even though these cohorts would have a much stronger need for fiscal support in building a meaningful retirement income.

Another motivation for this book was that many developing countries, including those in South Asia and East Africa, are today more or less simultaneously contemplating or attempting new, contributions-led pension programs aimed at achieving broad based social protection to reduce vulnerability in old age for their excluded workforce. Many of these countries have some remarkable similarities to each other in terms of demography, economic strength, history, culture, legal and political structures. Hence, lessons from both success and failure in pension policy formulation, system design and implementation should be highly portable from one country to another within South Asia, Africa, Latin America or across the island nations in the Pacific and the Caribbean. For example, the drafting of pensions legislation by a country could greatly benefit from a study of the texts of legislations and a candid appraisal of their strengths and weaknesses by other countries. Going forward, it may indeed be feasible for developing countries to work in partnership on efforts to build a basic, poverty-alleviating floor to income. Against this backdrop, the book is also perhaps the first global platform for developing nations to share with each other (and learn from) their unique experiences and lessons from expanding voluntary pension coverage – especially among women and the more difficult to reach segments of the labour market.

The book is intended to create a bridge between the pension reform experiences of OECD countries, as well as the important interlinkages between pension inclusion and advancements in ID, IT, digital payments and financial inclusion. Indeed, one of the most exciting features is that the solutions being developed in developing countries are creating innovations that are outpacing some of the more traditional pension systems in higher income countries. They offer insights for how to make access quicker and cheaper and to help future-proof some developed market pension systems with high rates of pension coverage built on very formal labour markets from the implications of the potential ‘uberization’ of labour markets in the coming decades. In this regard, while this project emphasizes the ‘south-south’ dialogue, it also highlights the importance of a south-north flow of ideas and innovation.

This emphasis on the role of the country – and the policy making and professional community – is important since ultimately nearly all aspects of pension policy are
controlled nationally. Success or failure will depend on the courage and vision of policy makers, regulators, academics and practitioners to develop pension systems that can work – and their humility to build them with and for those typically excluded. If Figure 1 showed the differences in regional averages for coverage, Figure 3 shows how at an individual country level, the within-region differences are just as large. In other words, there are already countries that are taking a lead and make a difference – and this book brings a number of the most compelling stories together, in the voices of those who helped create the change.

**Figure 3**

**National Differences in Saving Rates for Old Age**

This book sets out the latest picture from country case studies and from thematic reviews to create practical programs to improve their pension systems and make them fit for purpose for the rapid development we all hope to see. It also sets out an approach that any policy maker or practitioner should take to see if they are developing a viable solution – starting with the long-run outcomes that are required from the pension system and the particular part being developed and asking whether the current means of delivery can deliver wider coverage at low cost with decent real returns that are necessary to make pensions good value for members. Too many countries start with the design of a pension system without having clear metrics for what these outcomes on costs and returns and coverage will need to be – and then try to do as much as possible within the constraints of a market structure or pension value chain that will never be able to deliver good value and broad coverage (Price, Ashcroft and Hafeman, 2016).
A central message of this book is that pension policy makers need to take a broader view of the necessary digital infrastructure needed to achieve inclusive pension systems that address the unique needs and constraints of the target population and help expand coverage at an affordable cost. A key foundational development has been an expansion in national Identification (ID) Programs. Countries that do not yet have a robust national ID that can be used for uniquely linking pension accounts and multiple small contributions to a beneficiary over time, may struggle to deliver broad coverage of contributory pensions for informal sector workers. Policy makers faced with the task of expanding coverage of contributory pensions among informal sector workers may well need to put ID at the top of their agenda, rather than the normal set of pension policy issues such as regulation and supervision, investment and payouts.

The same is true of payment systems. As the policy and regulatory efforts with long-term retirement savings gather momentum and begin succeeding at scale across developing countries, millions of everyday citizens in developing countries will need a secure and convenient mechanism to channel potentially tiny pension contributions, month after month over multiple decades, to regulated fund managers. This will directly impact both voluntary savings discipline and the amount of pension that subscribers ultimately receive. Secure and well regulated technology-based, cashless payment solutions will therefore be a key ingredient for the success of any country’s pension coverage expansion effort. As with NID, countries that attempt to expand pension coverage without resolving the issue of payments will impose significant risks and challenges on beneficiaries. Some likely risks in this regard are highlighted also in the case-study on the use of prepaid cards for collecting micro-pension contributions from the unbanked poor in India in 2012 (See Chapter 16).

As Figure 4 shows, there is some cause for optimism since the foundations are being laid already for a new approach to pension inclusion given the rapid spread of mobile money accounts in Sub-Saharan Africa – a region which as Figure 1 highlighted, faces some of the most profound challenges in increasing pension coverage. Yet the issues of payment systems and different forms of settling financial transactions that are at the heart of many conferences and studies on financial inclusion are typically absent from the pension policy debate. This is despite pensions having some of the most demanding payment requirements of any financial product given the longevity of the required payment flow. As highlighted below in the review of the thematic chapters there is a full chapter on payment systems – which aims to be a start in developing new ‘curriculum’ for the policy maker aiming to build the pension system of tomorrow.

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2 See for example the ‘ID4D’ or identification for development initiative at: http://www.worldbank.org/en/programs/id4d
In addition to analyzing payment channels, it is essential to analyze carefully the groups who are closest to the (informal) workers and who could be channels for them to join and regularly contribute to a pension. Pension policy makers are typically well-versed with the issues of the formal segment of their labour markets and the role and reach of traditional providers serving well-established sectors of the economy. However, even in the formal sector, there has been perhaps a diminution in the emphasis on the role of the employer as both a channel for members to join a pension system and also, especially for larger employers, as a source of governance and expertise. As the chapters on Albania, the U.K. and Turkey show, there are very significant gains from carefully analysing the role of the employer and designing policies to maximize their potential contribution to expanding
coverage and improving efficiency. If policy makers are to expand coverage into the informal sector, or to deal with the ‘uberization’ of the labour market, they will need to develop increasing understanding of the nuts and bolts of how to deliver a pension value chain from enrolment and payments to administration, investment and then payout.

A focus on gender is important throughout, since women can be even more disadvantaged than men due to a relatively higher life expectancy, lower incomes, a shorter working life, lower access to formal sector jobs, frequent employment interruptions for child-birth and other family responsibilities and often lower formal finance knowledge, experience and access. An analysis of the Global Findex database shows that it is particularly in the informal sector that gender differences in likelihood to save for old age are found – given that in the formal sector the existence of mandatory pension contributions tends to lead to more equal outcomes (Majoka and Palacios, 2017).

EXAMPLES AND EVIDENCE OF SUCCESS

The book brings together examples, with clear evidence of success, to show what is possible by reimagining how to deliver pensions. The evidence of what has worked ranges from over 2.5 million new accounts in Turkey, over 7 million new savers in U.K., pilots in India using digital pension solutions that helped increase enrolment by between 500% and 1,000% in a fully paperless and digital process, to interventions in Albania that increased growth in private pensions from 10% a year to 40 percent. The country case studies also show that not all countries have achieved all the steps but each has done something to advance along the path. So, policy reformers in other countries have a menu - from the broad and comprehensive reforms, if this is possible – through to specific and targeted improvements if they are not able to push on all fronts immediately.

Thematic chapters show how to design digital pension inclusion that can deliver outcomes for the poorest previously only available to the richest – with gains from improved governance, expertize and scale that can reach 400 basis points a year in returns in some cases, and gains from design that can reduce costs to less than 50% of their previous levels and get below an annual cost of 1% a year compared to many informal sector schemes that are 2.5% a year or more in costs. It is only by thinking in this new paradigm of digital pension inclusion and coverage that links best practice in financial inclusion and pensions that the goal of covering one billion excluded people with good quality pensions will be achieved.

However, it is important to be clear-sighted that the design and implementation of an inclusive pension program for low income non-salaried workers is hugely challenging. It involves simultaneous, well-coordinated supply-side actions by a range of stakeholders and an appropriate response and long-term savings commitment from target beneficiaries. Pension inclusion efforts that depend on voluntary thrift and self-help can achieve suboptimal outcomes simply due to demand-side constraints and the underlying profile of
the excluded target population. The fragile labour market attachments, low intermittent incomes, frequent migration across jobs and locations, a limited potential impact of tax incentives on voluntary enrolment and sustained savings discipline, and limited knowledge of and access to banking and other formal financial and payment services creates a significant challenge for the target population to meaningfully respond to pension policy and regulatory efforts. Also, for most informal sector workers, terms like “pension” and “retirement” may not easily resonate – although these often have little resonance even in developed countries.

In the wave of pension reforms that established or expanded contributory pensions in the 1980s, 1990s and early 2000s, some of these challenges were perhaps under-estimated. Some were hoped to be transitory – with the hope that labour market informality would reduce as countries developed. The challenges have been more long-lasting however, and for this reason, for some countries, the hoped-for coverage improvements from the initial wave of reforms have not materialized. This has led to the (generally sensible) development of an expansion in the provision of a basic pension, sometimes known as a social pension – although that term is often not well-defined. Expanding coverage in this manner can be an important part of developing a diversified pension system – but the costs involved mean that it will only ever be able to be a part of delivering what will be needed for many in a country. Good examples of both the theory and practice of these non-contributory pension coverage expansion projects have been produced recently, with a particular focus on Latin America – see for example Rofman, Apella, and Vezza, 2013 and Bosch, Melguizo, and Pages, 2013).

Alongside the realization that non-contributory pensions can have an important role to play, is the equally important realization that giving up on contributory pensions is a luxury that countries, and their citizens, cannot afford. Governments will therefore need to commit significant energy and resources to tackling the barriers outlined above. Communications to citizens will need to be based on simple, accessible messages built on field-tested solutions rather than large general public education efforts. Broad-based outreach and engagement often needs to be supported also by alternative fiscal incentive programs such as matching contributions (in lieu of tax incentives) to encourage lower income citizens to voluntarily open pension accounts and make regular contributions towards their old age. Often, the ability of low income individuals to voluntarily lock-in savings over multiple decades is further constrained by low insurance access and uptake. Thus, most insurable lifecycle risks and emergencies are funded by past savings (or high-interest emergency loans) leading to a high premium on liquidity and a negligible appetite and financial headroom for long-term illiquid retirement savings. However, products that allow too much access may cease to effectively deliver any income or assets in old age so there is careful balance to be struck – one that active piloting can help determine – including experimenting with bundling life or health and accident insurance with pension products.
On the supply-side, pension inclusion needs to involve innovative use of technology to provide convenient, secure, affordable and universal access to high quality investment governance and expertise by citizens with low irregular incomes, limited experience with formal finance and low financial literacy. Governments need to specifically focus on achieving low transaction costs to ensure that high fees and charges by intermediaries do not erode modest pension contributions. It is feasible to reduce both costs and time-to-market by harnessing existing institutional capacity for regulation and oversight, Know Your Customer (KYC) and identification of beneficiaries (by integrating pensions with national ID programs), funds management, payments (including digital payment solutions for unbanked citizens), nationwide distribution and access (through banks, MFIs, cooperatives and other third-party finance distributors) and annuities (through life insurers). This can help minimize operational risks and also inspire greater public confidence as citizens would interface with the pension program through well-known and trusted entities.

Implementing an inclusive pension program based on portable individual pension accounts will need an efficient technology-led central or interoperable administration platform that should help achieve the core principles of portability, competition, individual choice, targeted fiscal incentives, optimum benefits, low transactions costs, high governance standards, automated process compliance, uniform services quality and subscriber protection. Such a platform should be capable of issuing and managing millions of individual pension accounts and accurately recording static and transactional data including periodic contributions and claims by individual subscribers in their accounts over time. Use of IT should enable financial and pension ecosystem and infrastructure integration and single-window services delivery, process automation, and transmission of micro-contributions and benefits without any risk of fraud or reconciliation errors, and of course, universal access. A technology platform, especially for micro-pension programs that target low income informal sector poor with limited access to formal finance, should be fully capable of real-time monitoring of the functional obligations of service providers, including process and turn-around time (or TAT) compliance and generate periodic MIS and compliance/exception reports for the regulator.

Table 1 brings together some of the key elements of the digital pension inclusion and coverage agenda – summarizing the key building blocks and showing the importance of bringing together the best insights from the financial inclusion and pension agendas.
Table 1
The Core Concepts of Digital Pension Inclusion

<table>
<thead>
<tr>
<th>Digital</th>
<th>Pension</th>
<th>Inclusion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Modern ID and IT to facilitate access, account opening and payments using all available channels - and allow fluid labour market attachments to stitch together into a single and meaningful overall balance.</td>
<td>Best practice design of pension product, market structure and governance for member benefit - taking clear view of different solutions for different parts of pension value chain. Typically not best delivered via sales agent distribution</td>
<td>Leveraging gains in financial inclusion for entry and payouts</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>How to join</th>
<th>What to join</th>
<th>How to payout</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Employers</td>
<td>Channels into a pension are those closest to informal sector. Typically not those with expertise to deliver 40-80 year pension. Separate but integrated providers of administration and investment at scale, with strong governance and oversight and potential to switch provision</td>
<td>Payment channels to (low income) citizens can leverage existing initiatives for Direct Benefit Transfer or delivery of other goods and services.</td>
</tr>
<tr>
<td>• Micro-finance institutions</td>
<td>• Self-help Group</td>
<td>• Individuals</td>
</tr>
<tr>
<td>• Individuals</td>
<td>• Affiliation/ professional groups</td>
<td>• Remittance to home systems</td>
</tr>
<tr>
<td>• Migrant employers</td>
<td>•</td>
<td></td>
</tr>
</tbody>
</table>

Finally, the book also focusses on some central important issues of implementation and regulation and supervision that can be underplayed. In the same way that the ID and IT foundations need to be built for a truly inclusive pension system, so does the regulation and supervision – but in a way that plays a proactive role to ensure that the pension system can deliver the necessary combination of long-run outcomes in terms of coverage, cost and returns that are necessary to be successful. In other words, the regulatory and supervisory system needs to work backwards from the necessary long-run outcomes and design a system that can deliver it, rather than create a system with inherent design weaknesses and then aim to ameliorate them. Given that there is an urgent need to build now to create systems that will be able to support the rapidly growing number of older citizens, the book also reviews how (and why) to create a ‘Mission Office’ or Programme Management Unit (PMU) that will be essential for the delivery of far-reaching and challenging reforms. In this way, the authors hope to create both the intellectual and implementation tools to help policy makers and practitioners globally.

KEY LESSONS FROM COUNTRY CASE STUDIES

The country case studies brought together in the book demonstrate a range of experience. In some case studies, the countries are leading the way in the integration of the financial inclusion and pension agendas, such as India and Mexico, or have recently demonstrated
significant improvements in coverage expansion whilst reducing costs and improving investments such as Turkey and the U.K. In others, the story is one of development of either the pension agenda – sometimes with a necessary first step of reforming an unsustainable public pension pillar in order to deliver some stability and credibility to the pension system, or developing the financial inclusion agenda – illustrating how some of the foundations have been laid and highlighting that there are great opportunities now from driving home the lessons from this book. Some countries stand on the threshold of launching just such an integration, for example in Rwanda and, potentially, Bangladesh. In all cases the aim is to show policy makers from any country that there are practical steps that can be taken in any scenario. It may not be possible to launch a broad based digital pension inclusion initiative, but countries could work on developing a national ID. A national ID may be off the table for the moment, but a country could make sure the regulatory and supervisory foundations are in place for future expansion. In other cases, perhaps it is only possible to launch some pilots of the type of approach that could be developed at a national level – to ensure that future designs are well-informed by real experience. Whatever the scenario, the authors hope that there will be practical lessons for everyone – whilst making the case that the real solution to the challenges of delivering old-age income is to launch broad based reforms that integrate the financial inclusion agenda with that to deliver good quality pensions.

This section briefly summarizes the main take-aways from each of the country chapters as a guide to the overall book and to help guide readers to the chapters in which they have the greatest interest.

Chapter 1. India: The chapter shows how powerful the integration of robust ID and effective IT can be when combined with the right market structure for pensions. It is obviously one of the key testing grounds for many of the ideas in the book overall, and shows how it is possible to create the possibilities for digital pension inclusion which were previously unattainable. However, India also shows how much further there is to go to make coverage expansion a reality – especially given the staggering size of India’s current pension coverage gap. There can be some optimism however, given the results of recent pilots which have shown an increase in enrolment of 500% and 1,000% with a fully digital and paperless enrolment process and automatic payments. A second pilot delivered the first ever enrolments at a village level into pensions using a platform that leverages previous Direct Benefit Transfer reforms – and showed in one local area, an increase in coverage from 3% to 20% among the target population of informal sector workers. India also shows how it was nearly 7 years after the foundation of the new National Pension System (NPS) that efforts began in earnest to address the informal sector. Clearly, there is scope in other countries to integrate this aim into the original pension design.

Chapter 2. Kenya: The Kenyan experience shows the importance of building the pension market and regulatory foundations alongside the opportunities created by the

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3 The pilots were delivered as part of a FIRST-funded project with the Pension Fund Regulation and Development Authority (PFRDA) and a team led by Varsha Marathe Dayal and William Price from the World Bank, Gautam Bhardwaj and Parul Seth Khanna of PinBox Solutions and Senior International Consultants Michael Hafeman and Evan Inglis.
developments in financial inclusion through the well-known M-pesa payments platform. The integration is still being developed, but having both the pension and financial inclusion pillars co-existing allowed the creation of a simple, low-cost saving platform known as Mbao that brings the two together. In most countries in the world, this is not possible – and whilst there is more work to do to scale it up and to fully realize the benefits, it illustrates the central thesis of the book that the ‘how’ of financial inclusion access should be linked to the ‘what’ of a well-developed pension program designed specifically for the purpose and target market.

Chapter 3. U.K: The U.K. example shows the profound improvements that can be brought even to a mature economy with a very well-established pension system and, seemingly, all the advantages of a developed economy status with a highly developed financial system. Despite all these advantages, the coverage of private pensions had been declining for many years before the introduction of ‘auto-enrolment’ reforms. These reforms followed many previous attempts to boost private pension coverage – from the development of new products such as individual private pensions through to financial education initiatives. It was not until the auto-enrolment reforms however, which required all employers to have a pension plan, to automatically add eligible workers into the pension plan and then to contribute if the worker stayed in, that the long-term decline in private pension coverage was rapidly, and dramatically reversed. Not only have over 7 million new savers been added to pensions in an employment market of some 30 million, it has been done in such a way that costs have been reduced through the creation of a new pension provider known as NEST (with a mandate to have total fees no higher than 0.5% a year) and the introduction of charge caps. The U.K. is a strong lesson in the importance of improving the market structure for pensions, thinking hard about the full value chain, including how to improve governance and investment and thinking clearly about the precise needs of the target market.

Chapter 4. Bangladesh: The Bangladesh chapter illustrates a country on the threshold of potentially exciting pension reforms that has the potential for dramatic impact because of the powerful platform for financial inclusion that has been built over the past decade. Bangladesh has a robust collection of micro-finance institutions that cover a large section of the population with financial services (both formal and informal), despite large challenges of low-incomes, financial illiteracy, geography and labour market informality. As the chapter highlights, this existing web of financial institutions, tailored very specifically to the lives of low income informal clients, could be connected to the kind of pension infrastructure seen in India and other countries, where those with expertise in pension administration and investment can collaborate with the MFIs who can deliver the access to savers. The MFIs will typically not be the right institutions to deliver a 40-80 year pension product – so they can focus on their core specialization, whilst the provision of administration and investment management can be procured from providers with scale and strong governance to deliver long-term returns in the member interest.
Chapter 5. Turkey: The chapter highlights the history in developing a more diversified pension system over time alongside recent reforms that have significantly increased coverage whilst also reducing costs and improving investments. The diversification started through individual voluntary provision via vertically integrated providers. Whilst this pillar did achieve nearly 6 million members – and along the way showed the benefits of switching from tax-relief to matching contributions to incentivize pensions – it did not create the right platform for broad based coverage of good quality pensions. Recent reforms to introduce auto-enrolment and improved investment strategies that came into force in January 2017 have seen around 3 million new pension accounts in less than a year, with costs less than 50% of those in the individual voluntary system. This means that in the future, hundreds of millions of dollars in fees will be saved that will boost the bottom line for members in the form of higher returns. Turkey also provides an example of a country that has shown progress in increasing the formality of the labour force – thus helping to expand coverage through ‘traditional’ means. But in the future, the coverage of the informal sector will no doubt require implementation of some of the ideas in this book.

Chapter 6. Rwanda: This chapter highlights how a country can more systematically and quickly leverage the opportunities created by a robust ID platform on which a range of government services and payment flows have already been established. Rwanda is moving quickly to use this platform to create the new approach to digital pension inclusion which is one of the central messages of this book. Whilst other countries have more history with either pensions or financial inclusion, and then have latterly brought the two together, Rwanda is moving rapidly to advance on both fronts and leverage the synergies between the two approaches. It hence shows that the timelines from development to implementation can be much shorter than previously thought if one systematically develops both elements together.

Chapter 7. Chile: In a country with a long tradition of private pensions since the formation of the system in 1981, the Chilean case shows the importance of exploring new ways to improve coverage and finding ways to address the self-employed who are typically excluded from pension coverage initiatives in both developed and developing countries. The analysis reiterates the importance of the ID and IT that allows self-employed people to be identified and targeted so that enrolment into a pension contribution system is even a possibility, and it shows another example of reforming a mature system which, although well-known and often admired, clearly has many ways to improve – mirroring the U.K. case.

Chapter 8. Nigeria: The Nigerian experience shows the importance of creating strong foundations for radical change and implementing efforts to clean up existing non-performing parts of the pension system through clear rules, secure channels and accounts into which to put the pension contributions of the future. This shows the importance of regulatory focus on compliance enforcement as a way to expand formal sector coverage
through employers, while exploring new strategies and approaches to cover the informal sector. The author highlights barriers to launching the fully operational digital pension inclusion approach advocated in this book because the unique ID has not been achieved as yet – reiterating the importance for ID in expanding voluntary micro-pension coverage.

**Chapter 9. Mexico:** The Mexican experience is a great insight into the importance of a second generation of reforms after initial hopes for coverage expansion were hampered by the persistence of informal labour markets even in a mandatory system. This has prompted the regulator and the Government more generally to focus on radical and innovative ways to rethink how to join and contribute to a pension system. This combines the way in which the regulator can direct members to the providers with the best performance rather than relying on members being experts. Innovative approaches with payments, administration and retail outlets outlined in this chapter provide a new way to reach pension contributors. The chapter also starts with some very useful theoretical material on the overall concept of digital pension inclusion.

**Chapter 10. Jamaica:** As with a number of countries, Jamaica shows the importance of developing a well-functioning pension market as a pre-requisite for expanding pension coverage. The chapter also highlights the importance of building in, earlier in the reform process, links to the financial inclusion agenda and the achievement of economies of scale that will be necessary to get costs low enough to allow pension provision for the informal sector to be value-adding to that sector. Given a regionally mobile population, the Jamaican case could be one where it is useful to develop interoperable administration across many Caribbean islands so that each one can keep its own pension system but that members can aggregate contributions in a single account.

**Chapter 11. Pacific Islands:** Whilst some of the chapters have shown the creation of the pension foundations as a first step, the chapter on the Pacific Islands shows the other side of the preparation towards digital pension inclusion with a group of countries that have focused more on developing the financial inclusion part of the story – and have had to be innovative to overcome the great challenges of small populations distributed over many small islands as well as some larger population centers. Clearly for them, the next steps for pension coverage is to be able to link the creation of a robust and efficient pension market structure than can leverage the progress on financial inclusion.

**Chapter 12. Albania:** The chapter highlights the need to create a strong foundation for private pension delivery and to expand pension coverage once the regulation and supervision is in place in order to develop the experience and trust in a population with a low trust in financial services. Moreover, as in Nigeria, the chapter illustrates the need to clean up and reform parts of the pension system that were hindering the creation of a well-functioning diversified pension system. There is then a specific focus on how coverage expansion targeted on employers can help to build coverage in a more cost-efficient way – with a project that increased the annual rate of expansion from between 8 and 12% in the three years before the project to 48% and 38% in the following two years.
The chapter also highlights the importance of the next steps to build on the developments in financial inclusion and payments – and how other reformers could learn by bringing these two elements together at an earlier stage in the process.

**Chapter 13. Indonesia:** The experience of Indonesia highlights the challenges to building digital financial inclusion until it is possible to have a clear and well-functioning pension platform – and one that can deliver the levels of efficiency and coverage even in theory that will be needed to move forward. The chapter notes the benefits of a large population (even one that is geographically very distributed) that creates the potential for the scale efficiencies in administration and investment, that like in India, helps to underpin the creation of a platform that can work for the poorest to deliver high quality pensions. The possibilities are huge and the key lesson is for a more integrated and broad-based strategy to ensure a viable digital pension inclusion strategy can be created.

**KEY LESSONS FROM THE THEMATIC CHAPTERS**

The thematic chapters follow the pension value chain and show how to build each part of a pension system in a way that brings together the financial inclusion and pension infrastructure and agenda to achieve digital pension inclusion. The essential model, illustrated in Figure 5, is to ensure multiple entry channels into a pension product that delivers low-cost, scale, expertise and governance in the delivery of the pension accounts and the investment of the money. The value chain ends with modern payout methods that are well suited to low-income members in developing countries, but also have important lessons for any pension system given the challenges to delivering a life-long annuity in a low interest rate environment. Finally, the model uses the same payment and access routes that helped the original enrolment to deliver the pension income safely, cheaply and directly to financial accounts.

**Figure 5**  
**Creating a new value chain for digital pension inclusion**

<table>
<thead>
<tr>
<th>Ubiquitous and low-cost access and payments</th>
<th>Interoperable accounts or centralized low-cost administration</th>
<th>Scale, expertise and good investment governance</th>
<th>Next generation payout products for developing markets</th>
<th>Ubiquitous and low-cost access and payments</th>
</tr>
</thead>
</table>

Source: Authors
A key question when building the value chain is to start with the vision for the next 10 or 20 years for what is needed to deliver good quality pensions with broad coverage and then work backwards to identify the necessary design features to deliver that vision. This means having a clear idea about the initial and long-run fees. It will be extremely difficult to deliver a good quality pension product unless there is a clear pathway for fees to fall below 1% (100 basis points) as a share of assets under management each year – and ideally considerably below that figure. This has implications for the role of large scale marketing and sales agent activity. For investment, there is need to focus not only on low-costs but on also ensuring that the net of fee return is maximized. But to do this well requires strong governance and expertise to ensure best execution by external providers, or the ability to create some element of viable in-house provision.

Policy makers also need to focus on understanding likely future payouts from relatively small contributions that are not likely to be made every month and every year to understand what role a contributory pension can play as part of the overall retirement income provision. There are many useful forecasting tools that can be used of varying sophistication. Finally, as highlighted above, the early stages of policy development need to include a clear idea of the regulatory and supervisory arrangements – and a timeline that allows them to be established and operational before the new system goes live. A key tool to bring together all of these issues and features is the use of a Mission Office or Program Management Unit – ensuring that all the elements are rigorously programmed to deliver significant change in a specified time period. The key messages from each of the thematic chapters can be summarized below.

Chapter 14. Identification: This highlights why ID is fundamental to delivering digital pension inclusion and meeting the challenge of expanding the coverage of good quality pensions to all. A key message for many pension reformers is that ID may be your most important and most urgent pension priority – not regulation and supervision. The chapter explores both technical and practical issues and gives a range of invaluable lessons for both the financial inclusion and pension communities.

Chapter 15. Payments: The payments chapter shows how developments in ID and IT and administration can be harnessed by low cost and ubiquitous payments solutions to allow micro-payments to be harvested from income and expenditure activity to create a new concept of auto-enrolment for the informal sector. It delivers the view of an external product provider from their current experience of markets globally. The payments experience is also central to the role of global remittances – which themselves could be channeled into well-run pension systems, where workers in host countries are likely to retire in their home country but may be excluded from formal pension programs in both locations.

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5 Another possibility created by improvements in payments, ID and IT is that non-resident workers who earn money in ‘host’ countries but are likely to retire in their ‘home’ country could remain linked to their home country pension system. In this way, when they receive typically higher pay in the host country their remittances to family can support not only short term consumption but also their old-age income. Indeed, the remittances could be directly to other family-member pension accounts to avoid a problem of a large temporary boost in consumption caused by short-term remittances followed by a return to pre-remittance low levels of income. This idea is explored in more detail in Bhardwaj, 2017 and Price, Pallares-Miralles, Demarco and Attia, 2017.
Chapter 16. Digital Solutions for Pension Inclusion: This chapter discusses the role for an integrated product and digital process architecture in providing universal access to secure, affordable and portable pension accounts that follow people through the lives they actually lead. It shows how digital (paperless and cashless) pension systems can be created largely using existing digital financial services infrastructure. It presents some case studies based on field-level challenges faced in micro-pension system design and implementation and showcases some new models for non-linear micro-pension coverage expansion.

Chapter 17. Governance and Investment: The critical role of good governance and investment in building a good quality pension product are explored in this chapter. It is an area on which there is often too little focus in pension and financial inclusion debates. The chapter helps explain why financial inclusion and pensions best practice need to advanced together to ensure that the product into which people can now be enrolled is a product that is designed and delivered in the member interest. The chapter emphasizes the need for clear thinking about these elements and about the design of market structures that have scale, expertise and governance, without which we risk enrolling people into pensions that will not work in their best interests and will not outperform simple term deposit accounts in terms of real returns, flexibility and ease of use.

Chapter 18. Costs and Investment Returns: This chapter provides a wealth of evidence on what drives costs and investment returns. It explores the fundamental cost and investment return dynamics of a pension system, why it matters and the challenge that needs to be met if pensions are going to be worthwhile. Hence, it helps to provide numbers and key insights on how delivering scale, expertise and governance can significantly increase real returns – and in some cases how the difference between in-house, external and fund of fund arrangements can add up to 400 basis points a year in costs for some assets.

Chapter 19. Experiments in Inclusive Insurance: The chapter provides a thoughtful review of multiple country experiments to expand microinsurance coverage to informal sector workers using traditional structures and delivery channels. It shows that initial successes were often difficult to sustain and, in particular, to scale up to a viable long-term business model. It is an important chapter in highlighting the need to create a new paradigm that will ensure that developments in access are matched by developments in the quality of the products in terms of costs, returns, portability and lifelong durability – and that there is a combination of scale, governance, expertise and cost that can deliver broad coverage.

Chapter 20. Payouts: The central point of a pension product is to ensure that the assets generated by harvesting small contributions over a lifetime can lead to a decent, above poverty income stream in old-age. The payout chapter reiterates the message that the design of the pension product – the ‘what’ - needs to be addressed rigorously if the promise of pension inclusion is to be delivered – and reiterates many of the messages from the governance and investment chapter that what is good for accumulation is good
for the payout. The chapter completes the circle that the developments in IT, ID and payments that can transform enrolment into pensions can also be harnessed to radically improve payouts.

**Chapter 21. Regulation and Supervision:** Ensuring that there is a secure underpin to the operation of the pension system that is tailored to the nature of pensions is a critical and sometimes overlooked part of the design discussions. The chapter emphasizes the need to combine best practice in design of pension systems to the developments in digital inclusion and not treat pensions as just another financial services product. Moreover, it highlights the importance of ensuring regulators and supervisors focus on achieving long run outcomes that are meaningful and important to the members – and being continually and proactively alert to risks to achieving those outcomes.

**Chapter 22. Financial Inclusion and Pension Inclusion:** This chapter provides an overview of the characteristics of the financially excluded and provides a range of fascinating examples from the latest in the financial inclusion side of the debate. It shows how innovation is creating revolutionary opportunities for how to link people to the financial system – and sets up the fundamental question of what they need to be linked to that ensures pensions are good value and delivered in the best interest of members.

**Chapter 23. The Role of the Mission Office:** Perhaps for the first time in a book of this kind, this chapter looks at the program and project management aspects of successful pension and financial inclusion reforms. It draws on the experiences of India, the U.K. and New Zealand to show how governments, regulators and supervisors can bring together the focus, intensity and broad range of skills necessary to design, build and deliver the new model for digital pension inclusion. The chapter emphasizes the range of skills and expertise needed as set out in the thematic chapters – so that it is more than another financial inclusion initiative, more than just another pension reform. It aims to equip a future leader of a digital pension inclusion initiative with the breadth of knowledge to know how to create and build a program and a team that will successfully implement the policy vision.

**CONCLUSIONS**

This chapter argues that there is finally an opportunity to tackle some of the most difficult issues in both pensions and financial inclusion by bringing the two agendas together in a way that has not been done sufficiently in the past. The central problem is how to deliver adequate income in old age to the billion extra people who will live beyond 60 as a result of the profound improvements in longevity and declines in birth rate driven by welcome development successes across the world. We already know that coverage of pension income for those in old-age is not good enough now. It will only become worse in the future if we do not push forward aggressively with new tools to allow contributory pensions to be extended to the informal sector as a vital income stream to add to public provision – which is a necessary but not sufficient condition for a sustainable pension system delivering a decent level of income across the population in an efficient and secure way.
The tasks of identifying, enrolling and collecting contributions from informal sector workers – and then investing those assets well over a working life and paying out a stream of income in old-age has proved to be beyond most countries. Even delivering pensions to formal sector workers in higher income countries such as the U.K. or Turkey has been challenging – and required a profound re-engineering of their systems with bold experiments in auto-enrolment in both countries that boosted coverage, reduced costs and improved investment strategies. But developments in ID and IT globally now mean it is possible to square the circle of how to deliver pensions efficiently to informal sector workers. Experiences from India to Kenya and from Mexico to Rwanda show how we are on the brink of a potential digital pension inclusion revolution.

The authors of the chapters and the supporters of this project are united by the belief that a coalition of countries, donors, practitioners and the people themselves can come together with the right support and help make the next decade the one that laid the foundation for a decent old-age for the next billion to reach the milestone of advanced years. Without a re-imagining of pension policy and financial inclusion the world will fail to deliver coverage and security – and the great successes of improved development, longer lives, lower birth rates and improved health - will be marred by avoidable old-age poverty.

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TOWARDS COMPREHENSIVE PENSION COVERAGE IN INDIA

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INTRODUCTION

This chapter reviews the initial conditions that led to major reforms in the pension system in India in the early years of the past decade. It then goes on to show how these reforms have created a very efficient, country-level administration and investment system that delivers best in class costs and returns. This ‘unbundled’ architecture can be used with multiple, and very different, entry points and product types for different groups in the country. But it is only with the advent of India’s national ID (Aadhaar) platform and modern developments in IT and payments systems, that the full potential of the Indian pension system can now finally be seen. The Indian experience shows how with the right combination of ID, IT and sensible design for administration and investment governance and execution, developing (and developed) countries will be able to achieve radically improved chances for expanding coverage to the hard to reach groups and delivering to these groups the kinds of costs and returns typically only available to formal sector salaried individuals in the country.

INITIAL CONDITIONS AND CONTEXT

Traditionally, the joint family system in India provided some protection against old-age economic crisis and a support network that excluded the need for third-party pension products. The joint family system was supported by the fact that 57% of the population was young and economically active (between age 15 years and 59 years) in 2001 and was required to support only 7.4% of the population aged over 60 years. That said, there were clearly large problems with old-age poverty within this system, and for anyone with difficulties with their family, or a lack of family, the situation was particularly difficult.

With declining fertility, along with increases in life expectancy, the number of older persons in the population was expected to increase by more than double from 71 million in 2001 to 173 million in 2026 - an increase in their share to the total population from 6.9 to 12.4 percent. The proportion of population in the working age group of 15 to 59 years was expected to rise from 57.7% in 2001 to 64.3% in 2026. On the basis of current demographic trends, India will have a larger population of the young and economically active as compared to people in old age until 2050, when the population over age 60 years would increase to about 20 percent. The focus on reaping the benefits of the ‘demographic dividend’ has pushed to the background the trend of a greying population and the challenges that this could impose.

India’s pension system for the elderly is inadequately prepared, both in terms of its coverage and financial sustainability. As is evident from Figure 1.1, the share of the elderly

population grew from 6.7% in 1991 to 8.6% in 2011 and is projected to rise to 10.7% in 2021. The absolute numbers are projected to double from 71 million in 2001 to 143 million by 2021.

However, considering that the population of India is large, aging and urbanisation are rapidly changing the total numbers and the dynamics of family support in old age. According to the estimates of the UN Population Division, 21.2% of the Indian population will be above the age of 60 as compared to 60.3% aged between 15 and 59 years by 2050. The overall number of the elderly as a percentage of the population is expected to double within the next 30 years and the rise of nuclear families in urban areas will further strain the family support system. Presently, about one-third of India lives in urban areas, which is set to rise to one-half by 2045 as per the estimates of UN Population Division. It is estimated that about 9 working-age individuals supported each person above the working age (65+ years) in 2001. This is set to reduce to a ratio of 5:1 by 2050. This profound shift in the share of older Indians—taking place in the context of changing family relationships and severely limited old-age income support—brings with it a variety of social, economic, and health care policy challenges. To be sure, many of these problems are the symptoms of success in growth and development in the country— but the pensions and old-age income issue is one in which successes in other elements of development create a stronger demand for improved policies.

The presence of “myopia” is one of the most convincing rationales for the existence of social security systems. Myopic individuals may not save for their old age, and public pension systems force them to save an appropriate amount. The main finding is that as the number of myopic agents increases, the desirability of social security increases. That workers in India suffer from a classic case of myopia is evident from the findings of the National Income, Savings and Retirement Survey conducted under the Technical Assistance Project Report of Asian Development Bank in 2006, where a large majority of people knew that their family would not support them in old age, but two-thirds of all occupation categories of workers, other than Government employees, were not even thinking about retirement, let alone preparing for it. However, the same survey also indicated that about 20 million individuals in the age group of 30-50 years were willing to sign up for a defined contribution based pension system.

The subsequent Invest India Income and Savings Survey, 2007 indicated that approximately 61 million low-income unorganised workers were interested in saving for retirement, and nearly 25.8 million of them could afford (and were willing) to pay INR 2,300 (USD 51.56) per year for a private contributory pension scheme. It was estimated that the potential for such micro-pension savings in India is approximately INR 201.3 billion (about USD 3 billion) per year.

On the other hand, besides the demographic and sociological change, the pressure on Government finances had been building up rapidly on account of the funding liability of supporting the pay-as-you-go defined benefit pension system for civil servants. Moreover, the pressure on government finances would only increase further if viable old-age income solutions were not developed for other parts of the labour market, since it would be increasingly unacceptable, in a rapidly developing country, to have large segments of the older population facing poverty whilst younger cohorts prospered. Pressure would almost certainly grow for increasing public provision in this scenario.

Considering that ageing populations are driving a growing need for private long-term savings products for retirement, the pension sector is likely to exert an increasing impact on financial markets. Relative to the size of financial markets in many developed countries, aggregate pension fund assets currently represent more than 9% and 12% of equity and bond market capitalisations, respectively. In view of this demographic shift, occupational and personal pension funds (and possibly also funded public schemes) are expected to grow further, inviting greater attention to be paid to these institutions and their market activities.

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4 Cremer, Helmuth and Pestieau, Pierre (2010).
Towards Comprehensive Pension Coverage In India

PENSION REFORM CONSIDERATIONS

Given the initial conditions and the constraints of the pension systems, we may examine if the pension system reforms in India are optimum – although some would argue that there are no single best pension systems, but only the best long-term objectives for which the most effective policy solutions are developed. Employing the World Bank’s multi-pillar pension system model, we may focus on the importance of identifying the core objectives of country pension systems – protection against the risk of poverty in old age and smoothing consumption from one’s work life into retirement. In India, a country-wide social security system that provides a poverty-alleviation floor, or the equivalent of the ‘first pillar’ contributory social security system as seen in other developed and developing countries, is not adequately provided, although specific social security schemes have been introduced. Formal employer-based pension coverage is about 14% of the working population compared to near universal coverage in countries such as the Netherlands. The remaining 86% of the workforce in the informal sector has been traditionally excluded from such formal pension arrangements. However, while broad-based pension exclusion, ageing and social change were important considerations for introducing pension reform targeting India’s informal sector, it was actually the fiscal stress of the DB pension system for civil servants that was the major factor driving pension reforms for Government employees. In the years since the original Budget announcements in 2001-02 to create the ‘New Pension System’ or (NPS), the underlying logic that led to subsequent budget announcements on a wide range of extensions and changes to the NPS to the present day have all underlined the need for pension reforms for both Central Government and equally for the unorganised sector.

LABOUR MARKET PROFILE AND PENSION COVERAGE

There are three major components of the Indian pension system: the mandatory civil service pension, the mandatory pension and provident programmes administered by the Employees’ Provident Fund Organisation (EPFO) and other Statutory Provident Funds Organisations for salaried workers, and voluntary pension schemes (both contributory and non-contributory pension schemes financed out of Government revenues) including those for the unorganised sector. India’s total workforce, as per the 66th Round NSSO Survey (2011-12), is about 473 million. Of them, barely 14% of the workforce is covered by a formal pension program. These include central and state government employees, private and public sector salaried workers covered by the EPFO or other statutory provident and pension funds, and a small section of the population that is covered by private pension plans offered by insurance companies.

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6 Barr, Nicholas and Diamond, Peter. (2010).
7 Holzmann, Robert, Hinz, Richard Paul and Dorfman, Mark.
### Table 1.1

**Schemes for old age income security in India**

<table>
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<tr>
<th>Mandatory</th>
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<tr>
<td><strong>Programme</strong></td>
<td><strong>Legal Coverage</strong></td>
<td><strong>Effective Coverage</strong></td>
<td><strong>Financing</strong></td>
</tr>
<tr>
<td>Employees’ Provident Fund</td>
<td>Employees in firms with more than 20 workers</td>
<td>About 8.5% of the labour force</td>
<td>Employer and employee contributions</td>
</tr>
<tr>
<td>Employees’ Pension Fund</td>
<td>Same as above with some exemptions</td>
<td>About 5% of the labour force</td>
<td>Employer, government contributions</td>
</tr>
<tr>
<td>Civil Service Pension Scheme</td>
<td>Civil servants at state and Central level</td>
<td>About 3% of the labour force</td>
<td>State or Central Government budgets</td>
</tr>
<tr>
<td>Government Provident Fund</td>
<td>Civil servants at state and Central level</td>
<td>Most civil servants</td>
<td>Employee Contributions</td>
</tr>
<tr>
<td>Special Provident funds</td>
<td>Certain occupations and employee’s in specified occupations</td>
<td>Around 0.5% of the labour force</td>
<td>Employer and employee contributions</td>
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<th>Voluntary, tax-preferred</th>
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<tr>
<td>Public Provident Fund</td>
<td>All individuals</td>
<td>About 0.7% of the labour force</td>
<td>Contributions</td>
</tr>
<tr>
<td>Superannuation plans</td>
<td>All employees</td>
<td>About 0.4% of the labour force</td>
<td>Contributions</td>
</tr>
<tr>
<td>Personal pensions</td>
<td>All individuals</td>
<td>About 1% of the labour force</td>
<td>Purchase of annuity-like products</td>
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<tr>
<th>Social Assistance</th>
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<tr>
<td>State level social Assistance</td>
<td>Varies by state</td>
<td>Varies by state</td>
<td>State budgets</td>
</tr>
<tr>
<td>National Social Assistance Programme</td>
<td>Destitute persons over age 60</td>
<td>About 19% of population over 60</td>
<td>Central budget</td>
</tr>
</tbody>
</table>

**Notes:**
1. Legal coverage for EPS/EPF extends to 187 types of establishments.
2. Effective EPS coverage refers to a subset of EPF members.
3. General Provident Fund and defined benefit pension scheme stopped for civil servants with effect from January 1, 2004 and all new employees are covered under the National Pension System (NPS).

FINANCIAL INCLUSION

Financial inclusion is a critical part of India’s strategy to achieve inclusive and sustainable economic growth. Recognising this, the Government of India launched an ambitious programme of financial inclusion under the Pradhan Mantri Jan Dhan Yojana (PMJDY) that sought to deliver a bank account to each Indian household. This programme was launched in August 2014 and by March 2017, around 281 million bank accounts were opened under this programme. The PMJDY initiative is clearly at the core of India’s financial inclusion policy agenda and has been widened to include savings, credit, insurance and pension products under various social security schemes of the Government. The more recent demonetisation drive in India (2016) has further fuelled the use of both banking and digital (cards and mobile-based) payment mechanisms by everyday Indians.

Although India has achieved tremendous growth in access and use of banking and payments infrastructure, the challenge of achieving broad-based pension coverage continues and is compounded by the low level of retirement literacy and low use of formal financial instruments. Despite modest pension coverage however, retirement assets are an important part of the economy. According to the basic statistics for the Indian economy published by the Reserve Bank of India in 2015-16, about 14% of India’s total financial assets were in pension and provident fund instruments.

COVERAGE AND COST OF FORMAL FINANCE

Fees and charges are critical components of financial inclusion and play an important role in both financial services access and outcomes. Costs of a pension system are especially important when compounded over a multiple decade savings and pay-out horizon.

A simplified, maximum all-in-cost for a mutual fund product in India is 2.25% of assets and varies between 2.50% to 5% of assets for various retail insurance products. The equivalent fee on assets under the National Pension System (NPS) ranges between 0.025% and 0.138% for different categories of subscribers. The cost of offering pension products under NPS in India is low even when compared to some of the more mature and larger pension systems in OECD countries, although it is slightly higher than the world leading low cost plan which is US Thrift and Savings Plan for Federal workers which has an Annual Management fee between 0.03% and 0.06% (3-6 basis points). However, the cost of India’s NPS is well below the costs of comparable systems in several other markets, including Australia and Hong Kong, and many pension plans in the U.K. and Chile. Annuity prices and the costs incurred during the payout phase are equally important and India’s experience in this area is discussed ahead.

SALES AND DISTRIBUTION INFRASTRUCTURE

The financial services distribution industry in India is expected to see a rapid growth in the coming years as a high rate of economic growth increases employment and raises incomes, and as India’s demographic dividend causes an increase in long-term savings instruments.
Voluntary pension products in India are offered by mutual funds and insurance companies using both tied and third-party distributors. The NPS is distributed through a range of third-party distributors including banks. A number of factors influence the success of a distribution channel for pension products – including trust and public confidence in distributors, quality of customer servicing, convenient access to service points and an efficient, technology-driven process architecture. India already has a significant number of widely distributed physical outlets for financial services distribution including around 170,000 bank branches. By March 2016, this banking outreach was being supported by around 590,000 rural, village-level banking agents (up from 67,694 in March 2010) and over 100,000 bank correspondents (BCs) in urban locations (up from 447 in March 2010).

Traditionally, individual agents have been the major distribution channel for mutual funds and insurance products. As of March 2014, the insurance industry had 2.2 million individual agents and only 689 corporate agents. More recently however, corporate agents, and especially private sector banks, have emerged as a key retail distribution vehicle for both mutual funds and insurance. Mutual funds and insurers have also actively started using the Internet for direct distribution. While roughly 30% of mutual fund and insurance assets have been driven by web-based sales, this channel appears to be more popular with corporate and institutional clients as most retail investors still appear to prefer investing through agents and distributors.8

Around 57,000 bank branches and other third-party financial distribution outlets today distribute the NPS. While physical outreach and distribution infrastructure is necessary for increasing pension coverage, it is essential to focus equally on persistency as regular pension contributions are critical for building pension wealth over a multi-decade horizon. It is therefore especially important that pension products be distributed by credible entities who have the ability to handhold subscribers over time and encourage them to stay invested in the pension system even when faced with emergencies and a strong desire to prematurely access pension assets.

The national survey by Asian Development Bank in 2004-05 and the Invest India survey in 2007 clearly indicated that public sector banks and India Post enjoyed hugely higher levels of public confidence than other financial institutions. Financial institutions that enjoy higher levels of public confidence would naturally be the best distributors of pension products. However, in a recent study, Halan and Sane (August 2016)9 found that banks often mis-sell insurance products, in line with their economic incentives. This risk of mis-selling can be mitigated by increasing transparency, improving the financial literacy and knowledge of finance consumers, and by training and certification of distributors. PFRDA, India’s pension regulator, has started the process of training of pension sector intermediaries through specialised training agencies.

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9 Monika Halan and Renuka Sane (2016).
Towards Comprehensive Pension Coverage In India

An important lesson from the Indian experience is that comprehensive participation in pension schemes based on individual contributions depends heavily on intensive communications and marketing, as well as on efficient and consumer-friendly business practices. There is considerable need for improvement in these areas. Recent experience from three pilots funded by the World Bank FIRST Project and managed by pinBox Solutions (described in more detail in Chapter 16) clearly shows how a combination of a robust national ID, a technology-led digital process and third-party service outlets that citizens in India already use for regularly accessing financial or non-financial services can effectively link them to a funded pension system at a modest transaction cost.

LONG-TERM RATES OF RETURN

There is ample global evidence on the existence of an equity risk premium relative to investments in bonds across many countries. Several theories have been offered to explain the often high levels of this equity risk premium.\(^\text{10}\) The indications for investment guidelines for pension funds in general terms are clear that asset restrictions skewed in favour of fixed income instruments need to be relaxed and investments in newer financial instruments may be permitted subject to prudential norms. In parallel, newer instruments need to be created also.

Countries that launch private pension systems may often be motivated by a confluence of factors and expect their pension program to address a number of issues including the macroeconomic framework. This is also highlighted in the work for the ‘Outcomes Based Assessment Framework’ (Price, Ashcroft and Hafeman, 2016).\(^\text{11}\) As the authors argue, countries like Chile, Mexico, Poland, Romania and others were motivated by large ‘stability creation’ returns from investing pension assets in government bonds at the outset. The previously poor macro-economic framework and the associated high returns on government bonds and inflation falls significantly over the first 5 to 10 years as the macro-economic framework improves. This creates large windfall gain from investing in government bonds that should not be ignored. The general diversification advice should therefore be tempered by the potential for this one-off, though critically important fact. After ten years or so, when both bond rates and inflation are at stable long-term levels, there would be a strong case to diversify. In some countries an initially cautious investment strategy may be needed to de-risk pension savings in the initial years so that a new pension system is not fatally harmed by an unpredictable, domestic or global stock market crash. Finally, the relevant stock market into which pension assets are channelled needs to meet core standards for fair dealing.

\(^{10}\) Damodaran, Aswath (2012); Duarte, Fernando and Rosa, Carlo (2015).

\(^{11}\) Price, William; Ashcroft, John; Hafeman, Michael (2016).
THE EVOLUTION OF INDIA’S PENSION REFORM

Recognising the pension coverage gap. India’s tax and social security base is low due to a large informal workforce. Further, with a public debt of over 65% of GDP, India does not have the fiscal space to implement a meaningful tax financed pillar-1 social pension scheme that provides effective old age income security to the destitute elderly. One way to cover the unorganised sector under formal pension provision could be to expand the mandatory pension schemes (under second pillar) of the EPFO. But the high number of excluded informal workers imposes limits on the possible coverage that can be achieved through mandatory pension schemes in practical terms as informal sector workers are not registered and cannot be easily found by enforcement activity. Besides the NPS that has become recently available to all citizens, voluntary private pension plans have traditionally been offered by insurance companies and mutual funds. However, the coverage of the population through such plans is quite limited and is estimated at around 2.6 million, although hard numbers on coverage are not readily available.

Designing a comprehensive pension program. In view of inadequate coverage by formal pension schemes, the lack of fiscal space to launch a pay-as-you-go nationwide social security scheme and increasing fiscal stress on account of the traditional DB pension system for Government employees,12 the Government of India decided to accept the recommendations of the Project OASIS (Old Age Social and Income Security) Committee in 2000. The OASIS Committee had proposed a new DC pension system based on portable individual pension accounts and administered by an unbundled institutional architecture. This DC pension program would be common for employees of Central and State Governments and autonomous bodies, and also for non-salaried unorganised sector workers.

India’s new National Pension System for Civil Servants. The Government of India notified the new defined contribution National Pension System (NPS) on 22nd December 2003. All new entrants to Central Government service, except the Armed Forces, who joined service on or after 01st January 2004, were mandatorily covered by the NPS. The Government constituted an interim regulator, the Interim PFRDA through a Government Resolution in October 2003 as a precursor to a statutory regulator. This Resolution was re-issued on 14th November 2008. The design principles of the NPS include self-sustainability, scalability, individual choice, affordable and easy access, efficiency, competition and sound regulation. PFRDA became the statutory regulator for the pension sector after enactment of the Pension Fund Regulatory and Development Authority Act, 2013. The said Act came in force with effect from 01st February 2014.

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12 A number of studies estimated the implicit pension debt (IPD) of civil services. Gautam Bhardwaj and Surendra A. Dave (Bhardwaj and Dave 2005) estimated the IPD of only Central Civil servants was 64.51% of GDP in 2005. A World Bank Study of 2008 of 5 States revealed that IPD ranged between 41% and 116% of the Gross State Domestic Product (World Bank 2008).
Expanding Voluntary NPS Coverage. Since its launch in 2004, the NPS has been extended also to employees of autonomous bodies and State Governments, as well as to unorganised sector workers. NPS has been adopted resoundingly by twenty-seven State Governments and Union Territories that have notified this new DC pension scheme for their own new employees.

Due to the financial and practical difficulties of extending coverage through the first and second pillar pension arrangements and dwindling family support, voluntary retirement savings are seen as an important policy tool to provide old age income security to the majority of citizens who are employed in the informal sector. The NPS emerged as an important policy tool to achieve a higher coverage of the formal pension system among the informal sector workforce.

To encourage citizens from the unorganised sector to voluntarily use the NPS to save for their retirement, the Government introduced a co-contributory benefit (Swavalamban) linked to the National Pension System. Under Swavalamban, the government announced a fiscal incentive of INR 1,000 for NPS contributions by low income individuals for a period of 5 years. This co-contribution incentive for NPS was formally launched in September 2010 at Jangipur, a district in West Bengal.

A New Hybrid Scheme for Low Income Earners: In 2015, the Swavalamban benefit was substituted by a hybrid, DB and DC pension scheme, named the Atal Pension Yojana (APY). The experience with NPS and APY over the last few years strongly suggests that fiscal incentives cannot by themselves resolve the voluntary pension coverage challenge. Fiscal measures must be combined with strategies to overcome other key coverage challenges including extensive efforts at promoting the program and increasing awareness and retirement literacy among citizens, increasing convenient and affordable access to the program through a nationwide distribution and marketing network and ensuring tax equivalence with other long-term savings instruments. Nevertheless, by March 2017, over 4.8 million voluntary subscribers had been enrolled under the APY with a corpus contribution of INR 17.51 billion.

Rationale for the un-bundled NPS architecture. Transparent disclosure of returns and investment management fees by pension fund managers (PFMs), subject to a fee cap by a regulator, should presumably allow subscribers to take a rational decision on PFMs and product options. This is however not always the case. Choi, Laibson and Madrian (2006) examined the approach of Wharton MBA and Harvard students to mutual fund investing. The authors presented their test subjects with four mutual funds that were all substantially similar: tracking the S&P500 Index. They were asked to choose a mutual fund in which to invest USD 10,000, following receipt of standard investment information, for example fund prospectuses. In the control group without fee information, 95% of test subjects did not minimise fees when picking funds, which was the only real differentiator between the funds. In the group with fee information, 85% did not minimise fees. This study also revealed that provision of fee information had only a marginal impact on decisions.

Furthermore, the group provided with information regarding historical performance, chased historical performance even though these funds had higher fees.

The “unbundled” NPS institutional framework was designed to address such learning from human psychology and behavioural economics that suggest that pricing of financial products is complex, and, even with the best of information, customers of financial products do not always take rational decisions. It was, therefore, decided to keep both product and fund manager choices under NPS simple and finite.\textsuperscript{14}

The clean answer to the fuzziness around the all-in-cost of a pension system is to allow standardisation of fund management into a group of index funds and publically procure a finite number of pension fund managers through an auction. This has two effects: economies of scale (a small number of very large assets under management) and low investment management fee (since fund managers compete with each other in an auction).

The unbundled institutional architecture of NPS also avoids the oft repeated charge of creating a DC pension system which has high costs, charges and fees leading to a lower pension wealth. An intelligently designed default investment option under NPS, based on a life cycle investment approach for subscribers is one such mechanism to maximise returns for subscribers under the given constraints of low financial literacy. Even when active investment choices are available, this would be the main instrument to be used by subscribers on account of general inertia and low level of financial literacy.

**Performance of Different Pension Systems.** Since April 2008, the NPS has delivered nominal returns of between 10.5 and 11% on contributions by Central Government employees. In comparison, the Employees’ Provident Fund, the mandatory, publicly managed scheme for formal sector salaried workers, has delivered returns ranging between 7 and 12%, and an average return of about 9.9%, between 1975 and 2015. The administered returns under the voluntary Public Provident Fund and the General Provident Fund have ranged between 8 and 12% with an average return of 8.5% between 1983 and 2015. In comparison, the long-term returns on 10 year Government bonds have ranged between 5.4% and 13.7%, with an average return of 8.9%, between 1996 and 2015. Therefore, the net returns under NPS have not been inferior to those achieved under other long-term savings instruments over a long period and even for the comparable period.

**DESIGN OF THE PAY-OUT PHASE**

**ANNUITISATION PUZZLE**

Individual subscribers in the de-accumulation phase of a pension system have choice. This need not be a binary choice and could instead occupy a continuum from complete

discretion to full annuitization. This range, in theory, includes full lump sum withdrawal, systematic withdrawal, various forms of annuities or a combination.

In view of the emerging worldwide trends to move away from DB plans in favour of DC schemes for non-public sector pensions, the decision about an optimal pay-out option becomes increasingly relevant. Countries have approached the issue in varied ways. While economic theory suggests that rational individuals with no bequest motive should convert all of their retirement wealth into an annuity at retirement, the evidence on actual consumer behaviour suggests otherwise.

The literature identifies several key factors that influence the rate of annuitization in a country, including competition between annuity providers, especially given the impact of adverse selection; investor psychology; and the underlying public policy regime. Globally, the evidence suggests (as measured by Money’s Worth Ratio) that private annuity markets can provide competitively priced annuities to retirees if one calculates competitive prices relative to investment returns from government bonds or a portfolio with some corporate bonds.

Given this, the requirement for mandatory annuitization of 40% of NPS accumulations may be seen as a welfare enhancing measure and Government actions should then be carefully calibrated and designed to support a well-functioning annuity market. The remaining pension wealth may be carefully allocated to other de-accumulation products like systematic (or phased) withdrawal plans and partial withdrawal plans. Subscribers under NPS are permitted to withdraw up to 60% as a lump sum. Such lump sum withdrawals, as well as annuity benefits from NPS are taxed under the EET (exempt-exempt-tax) regime in India.

Insurance firms and annuity providers are regulated by the Insurance Regulatory and Development Authority of India (IRDAI). There are a small number of annuity service providers in India, with Life Insurance Corporation of India (LIC) enjoying about 80% share of the total annuities market. This means that the cohort longevity risk (the systematic trend to live longer for a group of the population) is highly concentrated in a small number of annuity service providers. There is a supervisory question as to whether these annuity service providers have the capacity to absorb the extra risk associated with increased annuity demand. One advantage multi-line insurance companies have in providing annuities is that they also provide life insurance products, so to the extent that annuity pay-outs are higher because people are living longer, the insurance company wins by having lower life insurance pay-outs.

As in many countries, India has seen calls to allow people to take more of their wealth in lump sum and to avoid having to buy ‘expensive’ annuities (where part of the expense is of course the cost of the guarantee of income until death). Therefore, there are demands that the level of annuitization (mandatory 40% of pension wealth under NPS) needs to
be re-examined from the perspective of consumption as well as the ability of the financial market to provide such an annuity. This leads to questions such as vesting age, the level of mandatory annuitization, the type of annuity, as well as the design of a programmed withdrawal product.17

The mandatory annuitization of 40% of the pension wealth and complete lump sum withdrawal of the remaining 60% does not admit the possibility of a systematic withdrawal as a de-accumulation product and, to this extent, there is a need to review and redesign the pay-out phase of the NPS. However, in view of a very strong economic case for annuitization and the level of financial literacy of subscribers, some level of mandatory annuitization may still be retained.

An enabling framework for the pay-out phase of a pension system would include equivalent tax treatment for all long-term savings products, equivalent consumer benefits and protection, and equivalent solvency standards (usually reflected in capital requirements), and in ensuring financial markets (and their regulators) have the tools (inflation indexed bonds or longevity bonds)18 needed to enable the private sector to offer a range of de-accumulation products including annuities. Tax policy ideally should be neutral toward long term savings products and we may move towards an EET provision for all pension products, which is the emerging international norm, facilitates savings and also helps overcome “myopia”.19

**ISSUES WITH A FRAGMENTED PENSION SECTOR**

The pension products being offered by mutual funds, insurance companies and NPS all provide different benefits, have different all-in-costs and are differently regulated. The governance structures for pension funds by different types of entities also differ. Some pension products do not conform to the entire pension cycle of accumulation and de-accumulation with clear and distinct functions of a pension system – such as contributions collection, record-keeping, asset management and payout including annuities. Some pension products allow single contributions (single premium annuity) or only phased withdrawals (under mutual fund pension products).

The regulatory environment for pension products offered by different types of financial firms also differs. For example, pension plans of mutual funds are regulated by the Securities and Exchange Board of India (SEBI) while the IRDAI regulates pension schemes and annuities offered by life insurance companies and the PFRDA regulates NPS. Other statutory pension and provident funds are regulated as per their own legislative provisions. Importantly, each regulator allows regulated entities to levy very different fees and charges for pension products.

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17 Sane, Renuka (2016).
18 Blake, David., Cairns, Andrew I.G. and Dowd, Kevin (2008).
In view of the above, there is a case for unification of the pension system at the level of players and regulators in the interest of consumers and for collaborative action to rapidly increase coverage under a unified pension system. In view of the direct effect of good governance on the pension wealth (as highlighted in Chapter 17 on governance and investment), we should attempt also to conform to the international best practices on governance of pension systems.

CONCLUSIONS

A recent global review of the policy approach to pension system reform is broadly driven by three changes: a readjustment of objectives (such as a refocus on basic social protection for the vulnerable elderly); evolving reform needs (such as recognising the urgency of addressing the phenomena of demographic changes of population aging and deferred retirement ages); and perceived and actual changes in enabling environments (such as more realistic views about the capacity of funded schemes to manage risks, the achievable rates of return, and the fiscal restrictions to finance transition deficits).20

As India faces rapid demographic and social changes, with limited fiscal space to provide social security on a country-wide basis funded by the Government, the issues of adequacy, sustainability and integrity of India’s pension system become very important. The Melbourne Mercer Global Pension Index benchmarks a pension system against other pension systems globally, although some components are difficult to compare across countries. However, it is acknowledged that India does not fare highly on adequacy and financial sustainability scores. Therefore, several challenges remain and need to be overcome to make pension system in India comparable with other developed pension systems.

A more comprehensive set of criteria are used in the Outcomes Based Assessment Framework (Price and others 2016) that includes the core outcomes of coverage, sustainability and adequacy against which to review performance in India and other countries, but also includes efficiency (costs, investment returns and labour market impact) and security (and particularly the role of the regulator and supervisor). Some of these challenges, as also some of the key lessons encapsulated below have been drawn from three recent pilots jointly conducted by The World Bank FIRST Project and pinBox Solutions for expanding voluntary pension coverage in India. It is very likely that several other countries in Asia and Africa may be able to readily relate to both challenges and the lessons learnt from India’s recent experiences with the National Pension System.

KEY CHALLENGES

1. Creating public awareness and literacy about pensions to remove the classic case of “myopia” and to increase voluntary NPS coverage, especially among unorganised sector workers, who constitute more than three-fourths of the total labour force.
Auto enrolment of workers and auto escalation are some approaches to dramatically increase coverage under voluntary NPS, which is based on studies in behavioural economics.\textsuperscript{21}

2. Preparation of simple and standardised information, retirement literacy and communication tools and ensuring full transparency around fund performance intermediary fees and charges to enable informed investment decisions by NPS subscribers.

3. Establishing an efficient, third-party distribution and marketing architecture and an incentive-compatible business model to motivate optimum intermediary behaviour for increasing coverage of formal pensions without involving conflict of interests.

4. Developing newer intermediaries, like retirement advisors, as well as new financial instruments to offer a market-based guarantee mechanisms (through selection of a reference portfolio to minimise the cost of a guarantee).\textsuperscript{22} New instruments could also include inflation indexed Government bonds, innovative annuity options and structured phased withdrawals under the benefits pay-out phase.

5. Unification of regulatory and supervisory capability to develop and regulate the pension system in an efficient manner, and sponsoring research into the behavioural aspects of subscribers to prompt innovative marketing and distribution strategies and to in turn increase coverage.

KEY LESSONS FOR OTHER COUNTRIES

1. A fundamental, front-end question that any country planning to launch a national pension system would face, would be around the product and process architecture design and approach. Should one adopt a “bundled” (vertically integrated) or “unbundled” institutional architecture? The Indian experience of handling the political economy of pension reforms and building an unbundled institutional architecture provides some important lessons. India’s unbundled approach, with centralised record-keeping and administration, a national-level trust with independent trustees, wholesale asset management by dedicated pension fund management companies, and distribution and services delivery by existing third-party distributions (banks and post offices) helps achieve economies of scale, lowers time-to-market and avoids “regulatory capture” by pension sector intermediaries.

2. The NPS design also reiterates the virtues of a limited number of simple product choices and a limited number of pension fund managers (selected through a bidding process). Studies of human psychology and behavioural economics ("Libertarian Paternalism") and the research by Schiller, Fama and Hansen on net returns and minimisation of costs of a pension system reckoned in terms of “charge ratio” and “equivalent asset fee”, may be gainfully used to create efficient pension systems, while maximising pension wealth and subscriber welfare.

\textsuperscript{21} Choi, James, Emily Haisley, Jennifer Kurkoski, and Cade Massey (2012).

\textsuperscript{22} Consiglio, Andrea., Tumminello, Michele and Zenios, Stavros A. (2015).
3. An equally important feature of India’s NPS is the centralised IT platform that ensures clean and fully reconciled individual pension account balances, facilitates labour portability and reduces the traditional inflexibility in labour market movement. In the long run, this may be growth enhancing considering the increasing informalization of labour.

4. Faced with a gigantic coverage gap, it is essential to implement a sustained public awareness campaign using public funds to increase retail knowledge and interest in the pension system, motivate early voluntary coverage and supplement market-based sales and marketing efforts.

5. Although fiscal incentives (such as matching government contributions) can play an important role in jump-starting voluntary enrolments, especially by those in the lower end of the income distribution, it is equally important to develop market-based guarantee mechanisms to help minimise the market risk in a DC pension system.

REFERENCES


2

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.
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.

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**

![Financial Access Chart]

<table>
<thead>
<tr>
<th>Year</th>
<th>Formal</th>
<th>Informal</th>
<th>Excluded</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
<td>75.3</td>
<td>25.3</td>
<td>17.4</td>
</tr>
<tr>
<td>2013</td>
<td>66.9</td>
<td>25.3</td>
<td>17.4</td>
</tr>
<tr>
<td>2009</td>
<td>40.5</td>
<td>32.7</td>
<td>25.3</td>
</tr>
<tr>
<td>2006</td>
<td>26.7</td>
<td>32.1</td>
<td>41.3</td>
</tr>
</tbody>
</table>

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)


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

<table>
<thead>
<tr>
<th></th>
<th>National Social Security Fund</th>
<th>Occupational Schemes</th>
<th>Individual Schemes</th>
<th>Civil Service</th>
</tr>
</thead>
<tbody>
<tr>
<td>Legal Structure on which scheme is founded</td>
<td>Act of Parliament (Pillar 1)</td>
<td>Trust Deed &amp; Rules (Pillar 3)</td>
<td>Trust Deed &amp; Rules (Pillar 3)</td>
<td>Act of Parliament (Pillar 1 or 2)</td>
</tr>
<tr>
<td>Membership</td>
<td>• Mandatory for all employees in formal sector</td>
<td>Employees of the specific company—Employer based</td>
<td>Open to the Public, all employees</td>
<td>Only employees of the Civil Service</td>
</tr>
<tr>
<td></td>
<td>• Voluntary for employees in the informal sector</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Assets (Kes)</td>
<td>156 billion</td>
<td>629 billion</td>
<td>28 billion</td>
<td>Non Funded</td>
</tr>
<tr>
<td>Funding</td>
<td>Joint contributions by Employer and employee</td>
<td>Funded by either employer alone, employee alone or joint contributions of Employer and Employee</td>
<td>Funded by member contributions. In some cases jointly employers and employees</td>
<td>Not Funded - It is a Pay as You Go through funding by Government Budget Allocation</td>
</tr>
</tbody>
</table>
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) – 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. 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

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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.
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 workplace risks.
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 cyclicality 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 access 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 become 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, 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.

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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

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

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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.

REFERENCES


THE EXPERIENCE WITH AUTO-ENROLMENT IN THE U.K. ¹

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¹ See also Chapter 23 on the way in which a ‘Mission Office’ or a Program Management Office was used to achieve robust implementation in the U.K., New Zealand, and India in the context of the U.K. experience.
INTRODUCTION

This chapter outlines the experience of the reform to private pension savings in the U.K. over the past 15 years. The reforms that the U.K. is undertaking are very significant. The reforms are focussed on improving the coverage of private savings for retirement, particularly amongst groups where savings were low – women, low earners, and those working for small companies. They are also aimed at trying to increase the number of people who will retire with an adequate income (defined by replacement rates). This chapter reviews the background to the reform, the historical trends that led to the debate, and how the proposals came about. It then discusses the implementation of the reforms, the challenges faced, key lessons learned, and things that could have been done differently. Getting the policy direction right is only the first challenge. The implementation of the policy is at least as big a challenge, and therefore also included in the chapter are the evaluation results to date, including the findings of independent reviews of the implementation.

The implementation of the reforms started in 2007, with the roll out of the reforms to businesses starting in 2012. The reforms will be completed in 2019 when the final contribution increase takes place. It is important to remain vigilant as a programme and not to declare success too early. The chapter therefore provides a summary of the approach the U.K. took and the lessons that have been learned thus far.

INITIAL CONDITIONS, CONTEXT AND HISTORY

Through the 1960s and 1970s, the U.K. had a successful private pension system with high levels of coverage when compared to other voluntary pension schemes. This success was based on large employers in both the private and the public sector providing good Defined Benefit (DB) pensions for their full-time workers. This meant that coverage of second tier pensions was very high, though there were pockets of employees without access. This coverage however declined through the 1980s and 1990s. This was partly driven by improvements in longevity, making these schemes very expensive for employers who bore not only the investment risk of the scheme but also the longevity risks. This reduction in coverage was also driven by changes in the labour market and industry. There was substantial growth in employment amongst small and medium employers, where the availability of good company pension schemes was usually lower. In addition, the industrial base moved away from manufacturing and towards retail where there was traditionally more turnover of staff and less of a tradition of providing pensions for the workforce. Female participation and part-time work also increased significantly through this period.
Many employers chose not to provide pensions to part-time workers or had reduced the generosity of the offer for newer workers. Women and others who took career breaks or moved jobs frequently were also penalised by long vesting periods and waiting periods to join schemes.

The State Pension System in the 1970s and 1980s was focussed on a high level of support from the State, including providing an earnings-related element. The State effectively provided a combination of a “zero” and “first” pillar in terms of the World Bank pensions taxonomy. In addition, the State support was uprated by earnings and therefore kept pace with rising living standards. Following concerns about the cost of State Pensions, reforms in the 1980s and the 1990s reduced the generosity of this support. One example of the reduction was the move from earnings indexation to price indexation in 1980. These changes helped control costs that came from significant increases in longevity. The State System became more focussed on poverty alleviation for current pensioners. The means-tested system for pensioners did increase in generosity and poverty rates fell significantly. The poverty rate for pensioners in the U.K. is now below the poverty rates for other age groups having previously being above them. However, as more means-testing came into the system, there was concern that this was reducing the incentives for people to save for retirement because extra income in retirement could reduce the means-tested benefits in old age.

Tax incentives for pensions were generous (currently around GBP 40 billion or USD 60 billion) but largely focussed on better-off people. In addition there was increasing evidence that these did not lead to additional savings and that people were generally confused and did not understand the impact of tax on retirement savings. Around two-thirds of expenditure on these reliefs go to those paying higher levels of taxation and, given that these are paid at the marginal rate of taxation, they are more generous for higher earners. The incentives for lower earners were less and also less understood by them. Over the decades, there had been multiple attempts to tackle the problem of low pension savings in relation to the growing need and gradually retreating coverage. Following the introduction of personal pensions in the late 1980s, the financial incentives to save were increased and this lead to an increase in the number of personal pensions held. However, when the costs of these incentives were cut back during the recession of the early 1990s, the persistency of savings was reduced. In addition, there had been significant mis-selling scandals that led to a loss of confidence in the financial industry to provide secure retirements.

The U.K.’s financial sector is one of the most developed in the world. However, despite this, insurance companies found it hard to distribute pensions to an increasingly disparate workforce at a reasonable cost. The growth of small and medium firms and the increasing prevalence of part-time work were challenges to providing pension schemes at a reasonable cost. A cost in a small company pension of over 1.5% per annum on

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2 Converted at an exchange of USD 1.5 to 1 GBP.
3 Chetty et al
assets under management was not unusual with some costs being significantly higher than this. To put this in perspective, a charge of 1.5% per annum reduced an average earner's pension pot by around a quarter, compared to an estimated reduction of less than 10% for a charge of 0.5 percent.4

Alongside these issues, the demographics in the U.K. continued to change in line with those of other Western economies. Improvements in health care and public health changes, such as reductions in smoking and improvements in diet, led to significant increases in longevity. In 1950 the dependency ratio was five people of working age for every pensioner. This was estimated to move to two to one without further reforms.5

THE PENSIONS COMMISSION

Throughout the 1990s and early 2000s, both the Major (Conservative) and Blair (Labour) governments tried to increase private pension savings by introducing simpler products, improving financial incentives and focussing on financial education.6 However, the reduction in private pension saving continued. In 2002 the government set up a Pensions Commission to look at the issue of why people appeared to be “undersaving” for retirement and what the government needed to do to address it. The Commission was made up of three individuals. Adair Turner, the former head of the Confederation of British Industry, represented employers/industry; Jeannie Drake, a senior official from the Trade Union movement, represented the worker perspective; and John Hills, a professor from the London School of Economics, represented the academic world.

Their first report, published in 2004, did not look at the policy issues but instead focussed on the nature of the problem. Their Report looked at various trends, international comparisons, and forecasts of future changes. The Report diagnosed the following problems with the U.K. pensions system – a useful breakdown that can also be seen in many other countries in the world.

- **Under-saving** - people were not saving enough for retirement;
- **Complexity** - people did not understand pensions and this caused an unwillingness to engage in the issues;
- **Inequalities of outcome** - the system was delivering unequal outcomes, between genders most notably, but also between several other groups; and
- **Sustainability** - increased costs due to an ageing population but these were not being borne in proportionate ways.

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4 Department for Work and Pensions, 2006, Security in Retirement: towards a new pensions system, TSO
6 This included the “Stakeholder” suite of products including Stakeholder pensions. Employers with over five employees in fact had a duty to offer a stakeholder pension to their workers – which had its annual fees capped at 1.5% per year. However, employers had no duty to make contributions and there was no automatic enrolment or automatic deduction from salaries for workers so the spread of the product was very limited. But this experience was very useful in helping to develop the subsequent more successful approach as it highlighted the limits to improving coverage.
Whilst not proposing policy changes, the Report laid out the choices for the U.K. (and indeed any other economy facing these issues) very starkly. The U.K. could:

- Work longer
- Save more
- Have higher tax rates
- Or be poorer

This first Report was very important in building consensus around the need for radical change in the system. By using their first report to only lay out the analysis and issues, they were able to build a consensus about the scale of the challenges and the need for significant change amongst the various stakeholder groups. This consensus, about the size of the problem and the agreement that there were no other options apart from the four outlined above, was important. It meant that when the policy proposals from the Commission were put forward, it was difficult for the various groups involved in the debate – industry, employers, trade unions and individuals – to criticise the reforms without putting forward options of their own.

The Commission published their second report in 2005. This Report outlined their proposals in detail. It said that in order to address the size of the issue the U.K. should:

- **Work longer** – the report suggested significant and continuing increases to State Pension age;
- **Increase government spending** – the State offer needed to be simpler, increase with earnings, and provide much broader coverage; and
- **Save more** – the U.K. should introduce a system of Automatic Enrolment to affect the demand side problems in the market with a government-backed scheme to address supply side issues in the pensions market.

This chapter focuses on the changes around the “save more” agenda. However, it is important to understand the changes to the State Pension that have been made alongside the “Automatic Enrolment reforms”. Since the Pensions Commission Report, there have been two major reforms of the State Pension System. The first provided greater coverage for those with caring responsibilities, which significantly benefited women by compensating them for time spent outside the labour market for childcare or other caring responsibilities. The complexity of the system was also reduced. In the second reform, a new State Pension was introduced with a single rate set above the poverty level (the Pensions Commission reforms started this process but still retained an earning related element). This was paid for by getting rid of the earning related elements. Alongside these reforms, the State Pension age has also increased through this period (currently moving to 66, with legislation for increases to 67 in the mid-2020s). These changes together should make it much clearer to individuals what the State will provide them at retirement (and when that will start). The simplification of this system should make the importance of private savings much clearer to individuals as well as ensuring that the incentives to save for retirement are not eroded by a means-tested system.
WHAT IS AUTOMATIC ENROLMENT?

The Pensions Commission put forward a three-pronged plan to “save more”:

• that employees should be automatically enrolled into a retirement savings vehicle;
• that if they remained in the pension, then the employer should have to make contributions to that pension; and
• that the government should set up a pension scheme that would take any employer who wanted to use it. This scheme should be a low cost scheme (the Commission suggested a 0.3% annual management charge).

Through 2006-2008, the U.K. government worked through and legislated for these proposals. Some of the original Commission suggestions were changed as the practicalities of delivering them or securing a consensus for the whole package became apparent. For example, the original proposal for a government pension scheme (called the National Pension Savings Scheme – NPSS) was proposed as the default scheme was not introduced as it was felt that this would damage a lot of good existing provision. Instead the government scheme (the National Employment Savings Trust – NEST) is offered as an option for employers to choose (and which must accept any employer) among other options.

AUTOMATIC ENROLMENT – THE BASICS

The basic requirement in Automatic Enrolment is that all employers (regardless of size) provide access to a pension for all of their eligible workers (earning more than GBP 10,000 a year, over 22 and under state pension age). The earnings thresholds are the subject of an annual review by the government.

Employers need to automatically enrol their workers into that pension and, assuming the individual does not opt out, the employer and the individual pay at least 8% (of which a minimum of 3% must come from the employer) from a band of earnings. Employee contributions receive tax relief. So, if the employer pays the minimum 3% and the employee pays 5%, 1% of that will be made up of tax relief. This means that for the 4% contribution from the employee they will receive another 3% from their employer and 1% from government. This 1:1 ratio is important in communicating the reforms.

Employer who do not run a pension scheme, or do not want to set one up, can use the one set up by the government (NEST). NEST has a Public Service Obligation (PSO) and

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7 One of the main questions around this reform is why the Pensions Commission did not suggest a mandatory savings system, similar to the system set up in Australia for example. The Pensions Commission report does look at this as an option but dismissed it because it felt it may lead some groups to oversave. It is also clear in subsequent comments that the Commissioners have made that they did not believe that they could gain political acceptance for a mandatory pensions saving scheme as it would be viewed as an increase in taxation.

8 Note that the level of contributions started at a total of 2% (1% from the employer, and 1% from the employee including tax relief), and will rise to 5% in April 2018 and to 8% in April 2019.
must take any employer who wishes to join. Employers can decide which pension scheme to use as other pension schemes are available them. NEST is a public body that is accountable to Parliament through the Department for Work and Pensions (DWP) but runs at an arm’s-length from the government. It is set up as a trust, which means that it is legally required to work in the best interests of its members and is run on a not-for-profit basis.

Workers can opt out within a short window after they have been enrolled and their contributions would be refunded. After that window, workers can cease membership but their contributions cannot be returned and will stay within their pension fund. It is illegal for employers to try and persuade or induce their workers to opt out.

All employers must inform the Pensions Regulator that they have complied with the legislation and this must be done within five months of the start date of duties for that particular employer.

Every three years, employers must re-enrol all their workers who opted out or who have ceased membership in the intervening period.

These are legal duties on employers. If they do not fulfil their duties, they can be fined and ultimately can be subject to criminal sanctions.

AUTOMATIC ENROLMENT AND BEHAVIOURAL SCIENCE

The reforms were developed with a real desire to use and benefit from behavioural science. The early work of Leibsom, Benatzi, Madrian, and Thaler was very influential in the development of automatic enrolment. The “failure” of individuals to save for their retirement was viewed as the break down of perceived rationality. The work of the Pensions Commission showed that “initiatives to stimulate personal pension saving have not worked” and pointed to “the limited impact of providing better information and generic advice”. Joining a scheme required an active decision, but there is strong evidence that people often experience inertia when confronted with such decisions. These are now well-known concepts but at the time were only entering the U.K. and global policy agenda.

There are two main hurdles for people to overcome. First, they see the consequences of their actions as too far into the future because people find it difficult to imagine old age, and the decision to act does not seem to be a high priority and apparently is easily deferred. And second, regardless of how simple the product appears, pensions remain complex and confusing instruments. Selecting a pension scheme, even the decision to join one, is a complicated decision that requires significant mental effort. Therefore, loss aversion, hyperbolic discounting, and complex decision-making are all barriers to people behaving in an apparently “rational” manner when it comes to pensions.

Automatic enrolment overcomes these barriers by using people’s inertia to encourage savings. The whole process is designed so that even if an individual does nothing they
will be defaulted into saving for their retirement. The process places the employer in a central position and requires that they have to enrol the employee into savings and that the individual must make an active decision not to save. The reform also provides a “matching” contribution so the communication around the gains for the individual can be straightforward and clear.

Insights from behavioural science have been used throughout the design of the programme. From the letters sent to employers encouraging them to comply with their legal duties, to the design of the default fund in the NEST scheme. The original communication campaign for the programme used the slogan “we’re all in” to highlight and stress the importance of this new social norm of saving.

Figure 3.1
A Behavioural Challenge

<table>
<thead>
<tr>
<th>Why aren’t people already saving more and working longer? What are the barriers?</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>CAPABILITY</strong></td>
</tr>
<tr>
<td>• Large number of people working for employers who don’t offer private pensions (opportunities)</td>
</tr>
<tr>
<td>• Yet even for those who did, not many choose to enrol</td>
</tr>
<tr>
<td>» Even if only employer contribute! (Capability? Motivation?)</td>
</tr>
<tr>
<td><strong>MOTIVATION</strong></td>
</tr>
<tr>
<td>• Informed choice?</td>
</tr>
<tr>
<td>» Fund charities to educate people, information campaigns... nothing made a difference!</td>
</tr>
<tr>
<td><strong>OPPORTUNITY</strong></td>
</tr>
<tr>
<td>• People wanted to save more, but didn’t!</td>
</tr>
</tbody>
</table>

**HOW WAS THE REFORM IMPLEMENTED?**

The implementation of the reforms started alongside the policy development. The initial work was largely around the feasibility of the plans, pulling together the business case for the reforms and learning from other countries that had undertaken reforms of a similar nature (the Kiwi-Saver in New Zealand, the Superannuation reform in Australia, and the PPM reform in Sweden were particularly helpful in sharing their experiences). By 2007/8 the programme was ready to start formal implementation of the reform.

There are three main delivery bodies within the programme, each with a different role:

- **Department for Work and Pensions**: has the overarching responsibility for the delivery of the programme, is responsible for the legislation (and owns the policy),
The Experience with Auto-Enrolment in the U.K.

communication to individuals and stakeholder handling. In addition, it is the “sponsor department” for the other two stakeholder organisations.

• **The Pensions Regulator:** has lead responsibility on maximising employer compliance, educating and supporting employers to make the necessary changes and enforcing the law if they do not, working with employer groups and delivery partners such as payroll providers, pension schemes, and accountants to support employers. For more details on the role of the Pensions Regulator see Chapter 23 on the Mission Office.

• **NEST:** provides a low cost scheme that is required to take on any employer that chooses to use it. It is set up as a trust that has to act in the interests of its members and is responsible for investing members’ money.

**NEST – A NECESSARY GOVERNMENT INTERVENTION?**

One of the more contentious parts of the package proposed by the Pensions Commission was to establish a government backed scheme in the sector. The response from consumer groups to this proposal was generally positive. They felt that it would ensure that people received good value on their savings and that this would provide a challenge to the perceived high charges in financial products at the time. However, the existing pensions industry felt that such an intervention was not necessary. They argued that the introduction of automatic enrolment would reduce costs in the industry by increasing demand and that they would be able to serve most of the market. Some argued that the government should pay them to take on unprofitable business rather than starting a separate scheme.

Part of the compromise was to change the default for employers. The original Pensions Commission proposal required all employers to use the NEST equivalent scheme unless they could show that they were providing something better. The legislation allowed employers to choose any scheme they wanted as long as it met certain “qualifying conditions”. This approach was criticised by some who felt this put the government scheme at a disadvantage as it would allow the private sector operators to “cherry pick” the best employers and then leave the least profitable business to the government scheme.

The next challenge for the establishment of the NEST scheme was to agree that the proposal met the conditions for “State Aid” with the European Commission. It was clear that this was an intervention into a market and a case was needed to be made that the intervention was proportionate. This was agreed in 2010 and the scheme was established.

Since the start of the reforms, one of the areas of continuing debate has been around NEST and its place within the market. It seems fair to say that NEST is now accepted by most people as an essential part of the reforms. However, the debate on its size and possible market advantage continue. The criticism comes in two forms. First, a belief that NEST is too large and distorts the market. With over four million members, NEST is a very large pension scheme for the U.K. (by members it is probably the largest pension scheme in the U.K.). However, its assets under management remain relatively low at GBP 1.4 billion (although these assets will, of course, grow over time). The alternative criticism
is that it is too costly and that it will take too long to repay its loan to government. In some ways these two criticisms are contradictory.

Most commentators view the NEST intervention as a positive one and central to the success of automatic enrolment. They view it as addressing the market failures that the Pensions Commission highlighted. The average salary for a NEST member is significantly below the national average and NEST market share is highest amongst the smaller companies. Its mission to provide low charges in the market has also provided a clear incentive for others to reduce their charges to savers. In addition, it has been very innovative in how it approaches investment and communication.

**DELIVERY TIMELINE**

- Oct 2004 – Pensions Commission analysis report
- Dec 2005 – Pensions Commission report on policy recommendations
- 2006 – Government response to the report (May and December publications). Through this period there was also an “Industry Challenge” to come up with different models after criticism that the Pensions Commission approach was too government led and a more market-based approach may work better.
- 2007 and 2008 – legislation written and passed
- 2010 – change of government and review of the policy and programme
- 2011 – NEST went live
- 2012 – first employers required by law to auto enrol their workers
- 2012-2015 – all large and medium firms (with more than 30 employees) roll out
- June 2015 – test group of small and micro employers (1-29 employees) were subject to duties
- 2016-2017 – all small and micro employers subject to duties in a staged roll out
- 2018 and 2019 – increases in contribution levels, and employers established since October 2017 subject to duties

**IMPLEMENTATION APPROACH**

*Big bang or cohort by cohort?*

The sheer scale of implementation meant that a big bang implementation was never an option. In total there are approximately 1.3 - 1.4 million employers in the U.K. who would have new legal duties as a result of automatic enrolment, and approximately 10 million workers would be directly affected by the change and would be put into a pension scheme or be saving more in a pension scheme. The pension schemes would not be able to deal with this administration and the Pensions Regulator would have been unable to build sufficient capacity to deal with its role.

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10 Making Automatic Enrolment Work
An important decision made in 2008, was that the roll out would start with the very largest employers, and would be sequenced by size. Once implementation reached employers with fewer than 30 employees, the implementation would be randomized and each month a certain number of employers would be subject to the duties until all employers were covered.

The advantage of starting with large employers was that it would set the tone for success. Large employers were most likely to be compliant, both from a reputational perspective, and also because they were most likely to be familiar with pension issues as most of them already offered a pension scheme, even if it did not cover all their employees.

Larger employers are also more complex and so many would find implementation harder. However, it was felt that they would have the resources to make the implementation work.

Finally, larger employers employ a large proportion of the U.K.’s workforce and therefore millions of workers would benefit from an early adoption of automatic enrolment. While it is true that many of these employers already had schemes, these schemes were not necessarily available to all staff from day one of their employment or to all types of staff. So, for instance over a 100,000 workers were put into pension schemes by just four employers in the early months of the roll out of Automatic Enrolment.

The original implementation was planned over three years – starting in 2012 and ending in 2015 (this was seen by some as a delay from the original Pensions Commission proposal to go live in 2010 and complete in 2012, which was assessed as not possible when looked at in greater detail).

The original timeline was set before the financial crisis, and the U.K.’s coalition government decided in 2010 to extend the implementation. While implementation to large organisations would still begin in 2012, the roll out to micro and small employers would now be delayed until 2015. This gave small organisations breathing space while the economy was recovering from the financial crisis.

The implementation plan included a small test phase with a group of 30,000 small and micro employers to test systems before going live with the remaining 1.2 million employers. These employers took on the duties six months prior to any other small and micro employers, and allowed the programme to test its communications and enforcement approaches and to understand the behavioural pattern of these employers.

**Phasing**

The other major implementation decision made up front was to ‘phase in’ contributions levels. The idea behind this was to provide a gradual increase in contributions so as to have both a minimal impact on worker’s take home pay and to cushion the costs for employers.

There are three phases. In phase one, employers pay 1% of earnings and employees pay 1%, though this includes a contribution of 0.2% by government in the form of tax relief. In phase two, this increases to 2% from employers and 3% from employees (including tax
relief by government), and in phase three this increases again to 3% from employers and 5% from employees (including tax relief) from government. Phase two is due to come into effect in April 2018 and phase three in April 2019.

The original Pensions Commission Report recommended that the U.K. should aim for a replacement ratio in retirement of two-thirds of the final wage for the average worker. With State Pension and contributions through Automatic Enrolment of 8%, the total pension likely to be accrued by workers is below this. There will be a continued debate in the U.K. about how to increase contributions further in the 2020s.

**WHAT HAS BEEN ACHIEVED?**

**EARLY EVALUATION FINDINGS**

Automatic enrolment has reversed the long term decline in pension savings in the U.K.. Between the introduction of the reforms in 2012 and April 2015, the overall proportion of eligible employees saving into a workplace pension increased by 20 percentage points from 55% to 75% (as seen in Figure 3.2). Much of this has come from increases in private sector saving, which has increased by 28 percentage points (from 42% in 2012 to 70% in 2015), whereas public sector participation increased by three percentage points (from 88% in 2012 to 91% in 2015). This can be seen in Figure 3.3.

**Figure 3.2**

*Proportion of all eligible employees belonging to a workplace pension*

![Graph showing percentage of all eligible employees belonging to a workplace pension from 2005 to 2015, with a notable increase from 2012, labeled AE starts 2012.](image)

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11 Automatic Enrolment – Commentary and Analysis”, The Pensions Regulator, July 2016
By January 2016, over seven million workers had been auto-enrolled into a DC pension scheme and a further 600,000 are due to be put into a DB (Defined Benefit) pension scheme in 2017.

The opt out level by individuals is less than one in 10 (originally estimated at around one in three), and while it is still too early to confirm, indications are that re-enrolment (three year cycle for all employers) is also increasing pension savings. Even workers that originally opted out when enrolled a second time have a high rate of remaining in a scheme. A total of over 250,000 workers have been re-enrolled through this process.

Before automatic enrolment began, 35% of women employed full-time in the private sector had a workplace pension. As of 2015 this had risen to 65 percent. ¹²

From a compliance perspective, most employers are doing the right thing and are becoming compliant within the expected time. The Pensions Regulator has taken a firm stance with employers who do not, and to date has issued:

- Over 27,000 compliance notices (these are a warning notice from the Regulator that the employer may get fined if they do not become compliant); and
- 7,500 penalty notices (these are financial penalties).

Overall compliance levels have been excellent with over 99% of medium and large organisations compliant, and over 95% of micro and small employers, who have been subject to the duties, compliant.

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The programme has been subject to many independent reviews, including the U.K.’s National Audit Office who called the programme a “tremendous success” and value for money.

In November 2016, the Institute of Fiscal Studies (IFS) issued their report on automatic enrolment titled “What happens when employers are obliged to nudge? Automatic enrolment and pension saving in the U.K.”. The research exploits data on almost half a million jobs from April 2011 to April 2015 to look at how contributions to workplace pensions by private sector employers and their employees have been affected by automatic enrolment.

KEY FINDINGS BY THE IFS

- Their estimates suggest that in April 2015, a total of GBP 2.5 billion a year more was saved as workplace pensions as a result of automatic enrolment. This amount is highly likely to increase significantly over the next few years as more employers are brought into the scope of automatic enrolment and as minimum contributions increase from 2% to 8% of qualifying earnings. The increase in pension saving arises from a big increase in pension membership.

- Automatic enrolment increased pension participation among those eligible by 37 percentage points, so that by April 2015, 88% of these private sector employees were members of a workplace pension scheme. In contrast, prior to automatic enrolment, around half of these employees were members of a workplace pension and membership had been falling over time.

- In 2012, there were around 5.4 million private sector employees who were members of a workplace pension. By 2015, this had increased to 10 million. At this point one-quarter of eligible private sector employees (3.4 million) worked for an employer that was yet to be brought into the scope of the policy.

- Automatic enrolment boosted pension coverage the most among those aged 22 to 29, those earning between GBP 10,000 and GBP 17,000 per year, and those who have been with their current employer for less than a year. For each of these groups, for whom pre-reform coverage rates were particularly low, automatic enrolment has increased membership rates in workplace pensions by over 50 percentage points. In 2015 coverage among all of these groups had risen to over 80%.

- Automatic enrolment has also increased the number of employees putting considerably more than the current minimum amount into a workplace pension. The proportion placing 5% or more of their total earnings into a workplace pension has increased by seven percentage points.

- The IFS find no evidence of employers reducing employer contributions for newly-hired employees or existing members of workplace pensions.

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WHAT WERE THE MOST DIFFICULT AND IMPORTANT CHALLENGES?

This section outlines what were the most difficult challenges for the programme during the past 10 years or so. These challenges are unlikely to be unique to the U.K.

STAKEHOLDER SUPPORT AND RETAINING A CONSENSUS

A key challenge has been to maintain strong political and stakeholder support for the policy and for the implementation. The Pensions Commission did a significant amount of work to gain consensus for reforms. However, this is difficult to maintain when there are challenging periods and when there are changes in government.

Following the Pensions Commission, all political parties were in agreement but there was still a need for political parties to “own” the programme. The Labour Government set up the Pensions Commission and was committed to the implementation of its key recommendations. It committed to start the roll out of automatic enrolment in 2012.

The DWP worked hard over the period from the launch of the Pensions Commission Report until the passing of the legislation in 2008 to maintain consensus, working with stakeholders on the detail of the legislation. All stakeholders supported the principle of automatic enrolment, but to turn this into a piece of legislation that everyone could support was a major challenge. Issues related to NEST positioning were key to this, and this challenge is described in detail below.

The first major potential challenge to the programme came after the 2010 election, which led to a coalition government of Conservative and Liberal Democrats. Both parties had supported the principle of automatic enrolment and in the negotiations that followed the election, its implementation was included in the Coalition Agreement – the coalition government’s equivalent of a manifesto.

How it was to be implemented was, however, under discussions and the government set up a review called “Making Automatic Enrolment Work”.¹ The review focused on four key questions:

1. Is there a case for excluding a substantial additional tranche of workers from automatic enrolment, for example those earning below a particular threshold, or those above a certain age?
2. Is there a case for excluding any group of employers, in particular the very smallest employers, from the additional responsibilities implied by the policy?
3. Would any changes to the proposed regulations, implementation and details surrounding automatic enrolment, enhance the policy? and

¹ Making Automatic Enrolment Work – a review for the Department of Work and Pensions” (DWP), 27th October 2010
4. Under what circumstances is NEST necessary for the successful implementation of automatic enrolment and are there changes to the rules surrounding NEST that would be helpful?

THE REPORT CONCLUDED THAT:

1. The earnings threshold at which someone would be automatically enrolled was too low, well below the income tax threshold, potentially enrolling low earners into a pension leading to a higher level of income in retirement than they can get in their working lives. In addition, contributions were due from the first pound earned above that threshold. This meant that many people on very low earnings would build up very small pots. They proposed that people should only be automatically enrolled once they reached the income tax threshold but that contributions should be on earnings in excess of the National Insurance earnings threshold. This would avoid automatically enrolling those not earning enough to pay income tax, would ensure that the very tiny levels of pension contribution possible under the original proposals are avoided, but would ensure that many who would benefit from automatic enrolment are not excluded by a higher threshold.15

2. The review looked at whether some employers should be excluded from the automatic enrolment duties, say those with fewer than 10 or five employees. In the end it concluded that no such change should be made, because it would exclude 1.2 million employees from pensions, potentially create a barrier to employer growth, and create major issues in enforcing the regulations at the margins of employer size.

3. The report also looked at the detailed regulations and found four areas where it believed change could improve the regulations:
   - Introduce a three month ‘waiting period’ for employers. This would mainly help employers who employ seasonal staff, allowing them in effect to not enrol these staff if their contracts were for less than three-month periods.
   - Introduce a new certification process for earnings.
   - Allow employers in the first stage of automatic enrolment the flexibility to bring forward their staging date by three months.
   - Introduce a three-month window around the three yearly re-enrolment date, again giving employers flexibility to choose a date that aligns with other business processes.

4. Finally, the review considered whether there was a need for NEST. It concluded that, along with the recommendation to not exclude any employers from scope, NEST was needed as the smaller end of the market was not profitable for other providers. It also concluded that some restrictions on NEST (a contributions cap and a ban on transfers in and out) should be lifted at the end of staging, and that the government should legislate for this earlier than necessary to provide clarity.

15 The programme will undertake a statutory review in 2017. One area that it will consider is whether very low earners are being excluded from pension savings and whether these rules need to be reviewed.
The review recommendations were accepted by the government and this gave the green light for the subsequent implementation of Automatic Enrolment starting in 2012.

There was a further change of government in 2015, although this was a change from a Conservative-Liberal coalition to a Conservative majority government. This again introduced some uncertainty around the programme. However, by this stage, the rollout was proceeding well and the results were even better than had been anticipated. On this occasion, no further changes were made to the regulations.

The support of all political parties introduced complexity to the policy delivery (for more on this, please see the sub-section on complexity) but ultimately was key to policy success. Getting all the main political parties to agree on areas such as implementation was very difficult. It did mean that there was early debate on major issues and this created stability and reduced “tinkering” to support the successful implementation.

NEST CAPACITY AND DELIVERY

One of the biggest challenges and risks for the programme was the setup and delivery of NEST. From day one, NEST had to be ready to take any employer that wanted to use it. The scheme has a PSO unlike others in the market and, therefore, it could not turn away business if it had capacity problems. As the largest employers come in first, NEST’s functionality had to be in place from day one as the largest employers had the most complicated workforces. It was also clear that NEST would become a very large pension scheme. It was set up to focus on small and micro employers as well as employers that were unprofitable for other businesses to provide pensions to, and this market was a significant size.

In addition to these challenges, NEST also had to serve its market whilst providing a low charge (an equivalent of 0.5% of assets under management or AUM). To ensure that NEST remained focused on its target market (and as part of achieving a continued consensus on reforms), the government placed restrictions on what it could provide (there was initially a ban on transfers and a maximum contribution of GBP 4,900 at 2016-17 levels) which made it more challenging to deliver.\[16\]

From day one, NEST was clear that in order to meet these challenges, it would need to use technology very effectively and support most employers with a self-service facility. NEST partnered with Tata Consultancy Services (TCS) to run nearly all the operational aspects of the scheme.

NEST dealt with these challenges very well. Alongside TCS, it designed customer journeys to reduce the need for employer contact with TCS staff so it could deal with such a large scale of input. NEST has also continued to enhance its online functionality so that it could automate more employers. More recently NEST, like a number of other providers, has integrated its core pension payment site with the payroll software that most employers use to manage employee benefits. This further increases the ease with which employers

\[16\] These restrictions were in place from NEST’s launch until April 2017.
can meet their obligations and hence further reduces costs. In line with the programme approach, to test and learn, NEST has also tried to ensure that it tests its processes on a smaller scale before expanding their availability. The programme is now at a position where the vast majority of employer sign-ups and contributions are completed online with no direct input from NEST or TCS staff.

As NEST is financed by a loan from government, its viability is constantly monitored. The loan will be repaid through charges levied on members but it is important also that costs are kept as low as possible. The current expectation is that NEST will pay back its loan in line with the original timetable.

Currently, NEST has over four million members and serves over 250,000 employers. It has GBP 1.4 billion in assets under management. It continues to grow and it is not unusual for 1,000 employers a day to join NEST as the roll out for small and micro employers continues. However, the systems it has put in place continue to hold up well. In addition, it receives very good customer satisfaction scores from both the employers and employees who use it.

**SCALE OF MARKET CHANGES AND OTHER PROGRAMMES ROLLING OUT IN PARALLEL**

While the introduction of NEST was an important intervention, the entire existing pension system would be required to adapt to the changes in Automatic Enrolment. In order to be used for automatic enrolment, Defined Contribution (DC) pension schemes would have to become qualifying – meaning they would have to:

- be a personal or occupational scheme;
- be tax registered;
- accept minimum contributions;
- ensure that there is nothing in the rules of the scheme which would act as a barrier to automatic enrolment; the jobholder must also not be required to provide any information or express a choice, such as choosing funds; therefore, the scheme will need to have a suitable default fund in place; and
- apply a charge cap to default funds in workplace pensions schemes being used for automatic enrolment, the charge is set at 0.75% of funds under management or an equivalent combination charge.

DB schemes could also be used, though different criteria are set for them. It was expected, and has turned out to be the case, that the use of DB schemes is low.

The other important supplier to employers were payroll providers. The basic processes that an employer needs to do for automatic enrolment are:

- check whether each employee is over an earnings threshold or within an age band;

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17 These figures are at January 2017.
calculate the pensions contributions to be made by the employees and the employer;
• deduct these contributions and pay them to the scheme; and
• inform the employee what they have done and how much their deductions are – usually via the payslip.

All of these tasks are ones that payroll software carries out in each pay period in order to deduct tax. The process is basically a payroll one. If payroll carries these out, then the burden on employers is minimised. Getting the payroll providers ready was a major task.

The Pensions Regulator recognised the importance of this market early. It set up a specialist team that travelled the length and breadth of the country focused on educating the suppliers on the regulations, and diving deep into product specifications to ensure that the products were Automatic Enrolment compliant. It also conducted training of technical staff and front-line support staff.

While both the pensions and payroll industries are relatively concentrated, there is a long tail of small suppliers. Getting the large players compliant was the key to success but getting to this tail has been a challenge.

Similarly, many employers already have advisers either providing advice or carrying out processes for them. Very often, payroll is outsourced to an accountant, bookkeeper, or bureau. It was essential that when employers turned to their advisers for help with Automatic Enrolment, the advisers were ready and knowledgeable. The following chart tracks levels of understanding of the key adviser groups and is an indication of the types of critical success factors that can be used in a Mission Office as set out in Chapter 23.

**Figure 3.4**
Level of understanding amongst key adviser groups

Source: TPR published data
As we see in Figure 3.5, understanding reached near universal levels in the early months of implementation to micro and small employers. Again, the Pensions Regulator set out a detailed and comprehensive programme of education and enablement to this group. It set up a panel of professional advisory bodies that provided huge support to and education of their members, using material supplied by the Pensions Regulator.

Finally, a major complication to the implementation of Automatic Enrolment came when HMRC (the U.K. tax authority) announced that it was to implement Real Time Information (RTI) in the same time frame (2011-12 and 2012-13). This initiative meant that employers would be assessing, deducting and paying employee income tax in real time (at every payrun) rather than at the tax year-end. This transformational programme had many advantages, but it did mean that payroll companies were adjusting their software to enable RTI at the same time that large employers were implementing Automatic Enrolment and many large employers had to implement both at the same time. RTI could not wait for the roll out of Automatic Enrolment to complete, and similarly Automatic Enrolment could not be delayed. The programmes ran in parallel. There was good cooperation between HMRC (who adjusted their roll out timelines to ease the pressure on large employers) and the Regulator who worked alongside HMRC to ensure consistency of messaging.

**SCALE OF THE ROLL OUT TO SMALL AND MICROS AND UNCERTAINTY OF BEHAVIOURS**

Sitting at the top of the Automatic Enrolment programme’s risk register was the uncertainty around employer behaviours. It was expected that large employers (those with more than 250 employees) would largely behave in accordance with the new law. They might need help (see the section on complexity) but typically they would not wish to be in breach of the law, be fined, and risk the reputational damage that comes with it. Additionally 89% of private sector employers with more than 250 employees offered a workplace pension in 2011 and these could often be used for Automatic Enrolment).

In total there are approximately 45,000 large and medium sized employers (250+ and 50-249 workers respectively) and 1.3 million small and micro employers.

<table>
<thead>
<tr>
<th>Size band</th>
<th>Approx number</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Large (250+ workers)</td>
<td>11,000</td>
<td>0.8%</td>
</tr>
<tr>
<td>Medium (50-249 workers)</td>
<td>34,000</td>
<td>2.5%</td>
</tr>
<tr>
<td>Small (5-49 workers)</td>
<td>540,000</td>
<td>39.6%</td>
</tr>
<tr>
<td>Micro (1-4 workers)</td>
<td>780,000</td>
<td>57.1%</td>
</tr>
<tr>
<td>Total</td>
<td>1,365,000</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: TPR data
Of these, only 23% had existing pension schemes in 2011, and many of these were ‘shell’ schemes set up through earlier legislation called ‘stakeholder pensions’. These pensions were set up by employers (with five or more employees, because it was the law, but few joined them and fewer still kept making contributions).

An additional complication is that many of these employers are not employers in the traditional sense. They employ someone in the home, either as a domestic worker or as a personal care assistant (‘carer’). In total it is believed that there are approximately 150,000-200,000 such employers with about 100,000 of them employing a carer. They would not respond to messages aimed at businesses.

The Pensions Regulator’s challenge was to get the message to all employers irrespective of size and to tailor this message so that an employer with 100,000 employees knew what it had to do just as an employer of a carer did. The staging profile was an important lever for this segmented communication message, allowing The Pension Regulator (TPR) to focus first on the messages to the very largest employers and then adapt its messages for the smallest employers.

The Regulator’s strategy is to educate, enable and enforce. It chooses to enforce only where employers have not responded to its education and enabling messages. We conducted detailed qualitative and quantitative research on all the messaging, both offline and online, to ensure that it was fit for purpose.

The key message that resonated with all employers irrespective of their size was “It’s the Law”. Change theorists would argue that in order to make major change happen, you need to identify the benefits of a change and be able to answer the question “What’s in it for me?”. A message focused on the benefits of pensions or the desirability of being a good employer may have met this challenge. However, employers were clear that this message would be patronising, and that the message that would resonate was the simple reminder that it is the law.

TPR also designed a direct mail campaign under which all employers receive five letters from the Regulator. The first is sent 12 months before the staging date of the employer and is the call to action; the second is sent six months before the staging date and calls on employers to choose a pension scheme; the third is in the month before staging and reminds the employer to complete its preparation; the fourth is in the month after and tells the employer what it must do to enrol its workers; the final letter is four months after staging and a month before the declaration of the compliance deadline and prompts the employer to comply to avoid a fine.

A key enabler to this campaign is the support that HMRC have provided. TPR receives a data feed from HMRC based on its Pay as You Earn (PAYE) records. This tells TPR who each employer in the country is and allows it to derive a staging date. TPR then informs the employer of the staging date. The employer can also look this up on TPR’s website using a simple tool.
Nearly 75% of employers are triggered into taking action by one of TPR’s letters.

For the largest employers with the most complex implementation challenges, TPR published detailed guidance of over 250 pages. This guidance was comprehensive and designed to turn the legislation into plain English. It also published complementary guidance to software providers.

Gradually TPR adjusted its guidance so that it was focused on medium-sized employers.

The year 2015 marked a major change in the programme. Instead of TPR continuing to evolve its communications to smaller and smaller employers, it took a different approach. It now focused on employers with one or two employees. It considered that if it could design a campaign and a set of tools that were fit for these employers, then they would also likely work for employers with 5 to 30 employees.

These employers told TPR that “we just want to be told what to do”. TPR therefore devised a ‘duties checker’ that enabled employers to work out which duties applied to them and which did not. This filtered out employers with no workers who had no duties, those with no workers earning over the threshold of GBP 10,000 per year and who had duties but did not need to set up a pension scheme unless someone opted in, and the rest who had full duties. It also filtered those with domestic or care workers who got a customised journey designed specifically for them.

Alongside this, the Regulator introduced a simple five-step process which, if followed, allowed employers to become compliant. This process stripped out all the options that are available to employers and in so doing simplified the process substantially. Clearly employers could choose to follow a more complex journey and many have, often with the support of advisers. However, for employers who choose to manage the process for themselves and want to be told what to do, these five steps are sufficient.

Another challenge for the programme was to raise TPR’s profile so that all employers had heard of it. HMRC is well known, and somewhat feared by employers. The Pensions Regulator was not. Only large companies, particularly with DB schemes, would have heard of TPR. But almost no small companies were aware of the Regulator.

TPR’s letters acted as a major mechanism to increase such awareness, as did its campaigns through advisers and employer bodies. It also conducted advertising with the Department for Work and Pensions (DWP) using a memorable character which promoted both workplace pensions and the Regulator. Finally, TPR also ran radio campaigns with its brand as the strapline. These campaigns had real impact. The Figure 3.5 shows how the proportion of small and micro employers with some knowledge of TPR grew over time.
COMPLEXITY

The need for building a strong political and stakeholder consensus has been discussed above. This, however, also had a downside as the interests of many stakeholders needed to be reflected in the legislation. The U.K. has a relatively mature pensions system and to enable the new legislation to work alongside existing pensions practices for industry and employers, a large number of options were designed into the legislation including, but not limited to:

a. the concept of pay reference periods;

b. the need to reflect multiple earnings types and multiple ways to calculate the contribution levels;

c. the desire to allow as many people as possible to save, while allowing opt-outs and enabling opt-ins; and

d. widening the field of pension to allow all sorts of pension schemes to be used.

This complexity has meant that codifying the legislation into online processes was complex and, once done, difficult to change. For employers, this complexity has meant that preparation time has been longer than many would have wished.

Additionally, there is a plethora of legacy schemes and payroll providers. There are no single data standards between these two industries, which has meant that, simplistically, each scheme has had to provide a customised solution to work with each payroll provider and vice versa.
Two attempts were made to create a standard, with the ‘PAPDIS’ gaining some traction. However, the transfer of data between employers and pension schemes through payroll has been a major issue and continues to be so. Gradually, the issue is reducing as more schemes and payroll providers have established linkages and as more modern technical solutions (including APIs) are becoming established. However, this remains a cause of frustration for many employers, as also their payroll software providers and scheme providers. This issue is particularly acute in the U.K. as it has a long history of pensions, much of it in a pre-digital era. For new adopters, it should be possible to do away with these concerns if sensible steps are taken on data protocols.

FIVE KEY LESSONS LEARNED

A very clear and shared goal or vision – the programme is designed to get 8 to 10 million people saving or saving more. This clarity helps guide all decisions. It brings all the partners together with a single goal. From this simple, shared goal, the programme developed a small number of clear and long standing Critical Success Factors (CSFs). These are:

- The programme is able to commence within budget;
- NEST accepts all employers who choose the scheme, whilst offering low costs to members and remaining financially viable;
- Employers know about, understand, and comply with their duties;
- An increase in the number of those saving into a workplace pension; and
- Increases in the total amount saved in workplace pensions.

Having a very clear objective that is known by everyone within the programme has provided clarity at difficult times. It has also allowed the programme to consider how to make certain trade-offs. All of the programme team have worked on other programmes where the overarching goal was not clear or where different partners have different ideas of what success is. Having a very clear shared sense of the objective is very important in a successful programme. This is echoed in the experience of other countries, highlighted in the book, and in the Outcomes Based Assessment Methodology for Pensions that puts clarity on long-run outcomes at the heart of the approach.\(^{18}\)

Three delivery partners – having three delivery partners created some real tensions at times. This approach seemed to complicate delivery at the beginning. The fact that the different organisations came from different perspectives and saw problems and issues differently often led to decisions being slowed down or simply to disagreement. There was obvious tension in discussions and often hard negotiations. A good example of this was in the discussion about around implementation. The Department had a political imperative to get

things done quickly, whilst NEST and the Regulator argued for more time. NEST wanted small employers to go first as they were less complicated, whilst the Regulator wanted larger employers to go first as they were more likely to comply with their duties.

The constant debates and conflicting views also had a number of advantages. Multiple discussion meant that all assumptions were challenged and undoubtedly led to better answers. It also meant that the programme did not suffer from “optimism bias”. As all the parties had to agree to assumptions, if anything, the programme had a slight “pessimism bias” and has therefore outperformed in areas such as on-time compliance by employers and lower opt-out by individuals.

The key to success was to be clear about individual accountabilities. This separation of accountabilities meant that each partner was able to deliver to its own core focus. Most importantly, each partner was responsible for its own area specialisation and for knowledgeable and specialist staff.

Importance of strong programme management – this was a complex implementation, with three core implementation partners and around 1.4 million target employers, and which would impose important changes on the pensions industry, payroll providers and business advisory community.

Strong programme management within the Department and in each of the delivery partners was essential. Both TPR and NEST decided to enter into major outsourcing contracts to support their processes. These contracts, and ultimately the third party suppliers, became critical to the success of the programme. Both TPR and NEST put in place top-quality contract management processes and both contracts have delivered very good outcomes.

At the heart of the programme management approach has been:

A clarity of goals and critical success factors

• Clear accountabilities between the three parties;
• Continuity of senior personnel;
• A strong and active risk management approach, with constant monitoring of the effectiveness of risk mitigations;
• Active stakeholder management;
• A realistic business case that did not suffer from optimism bias;
• Regular external reviews to keep the programme on its toes, and to provide reassurance that nothing was badly off track.

Test, Adapt and Change – where it was possible the programme tried to test processes and products before they went live. In addition, processes and changes were rolled out in phases rather than using a “big bang” implementation approach.
The staging profile was designed so that only a small number of employers were subject to the duties in the first phase (only four in the first month, though collectively they employed half a million workers), but by the end of the profile, 80,000-100,000 employers per month were subject to the new duties. This staging approach allowed all parties to test their capacity and ready themselves before they were tested at scale.

It was recognised that the challenges that small and micro employers would face would be completely different to those of larger employers. A pathfinder (test group) was therefore built into the roll out profile. This tested actual behaviours of micro-employers against their new duties, and also tested education material, processes, and systems before expanding volumes. Behavioural insight experts advised on these tests. The employers in the test group were subject to the duties six months prior to any other employers with less than 30 employees. This gave the programme time to learn from these employers and adapt its approaches. Some of the key learning from this was:

- Communications must be direct – “just tell us what to do”; a simple five step process was created for employers;
- Communications should be frequent – the Pensions Regulator writes five letters to employers starting 12 months before employer duties and ending with a letter just before deadline day;
- Employers need simple tools to help them to become compliant; and
- Some employers have specific needs and segmented communication was necessary (for example, an employer of one carer is very different to a florist employing two or three staff).

Educate and enable before enforce – or “prevention is better than cure”. The Pensions Regulator’s approach has been to help employers and their advisers to get it right by providing them with all the information they need, segmented to various audiences. It carries out comprehensive campaigns by writing to all employers in the lead up to each employer’s duties, by e-mailing employers several times in the lead up to their duties, and by making available a range of tools for them. These tools include a ‘know your duties date’, a duty checker, an assessment tool that allows employers to know which workers to enrol, and the level of contributions. It also provides videos, case studies, as well as social media information.

The Pensions Regulator has a well-resourced and trained call centre available to provide telephone support to employers and to their agents. It also has a whistleblowing line available for employees who have concerns that their employer is not fulfilling its duties.

However, the Pensions Regulator made it clear that non compliance was not acceptable. It set out and published a compliance and enforcement strategy in which it described its approach to enforcement. It has taken the view that it is simply not fair on a worker if they are not provided with the pension that they are due in the law, and it is not fair competitively if one employer had an advantage by being non-compliant. It, therefore,
uses its powers, including fining employers, to ensure that workers do get what is due to them. Interestingly, the Regulator innovated its approach to the use of fines as a result of the huge volume of employers involved in Automatic Enrolment, but did so within the same principles of educate, enable and enforce. This highlights the benefit of having clear regulatory principles to guide behaviour that can then be adapted to changing roles and circumstances on the ground.

The programme recognised early that automatic enrolment would not be a success unless the ‘supply chain’ to employers was also ready and able to support employers and provide them with the necessary products. The Pensions Regulator, therefore, put in place dedicated teams that support pension providers, payroll software providers (because for most employers, the bulk of the set up and ongoing processing is payroll-driven), accountants, bookkeepers, etc. It has information and guidance available on its website specifically for these groups.

Finally, the programme has supported all this activity with a substantial advertising campaign. For large employers this focused around the catch line “We’re all in”, and for smaller employers around a character called ‘Workie’ around the catch line “Don’t Ignore the Workplace Pension”.

WHAT WOULD WE DO DIFFERENTLY?

Whilst the programme has been very successful to date, there are still a number of areas that we would have liked to have handled differently. These, of course, all have the benefit of hindsight but it is an interesting exercise and challenge to think of what we could have done better.

- **Complexity** – some areas of the policy could have been simpler. The programme could have challenged itself more on having simpler solutions to problems and imparting the advantages of these to employers and individuals. Not all areas of the legislation are intuitive for employers, particularly for small employers. In simplifying the legislation for the future, it will be important to find solutions that match other business processes that an employer is familiar with. In 2017, there is a year-long review of Automatic Enrolment and the question about whether the policy can be simplified will be a central part of that review.

- **Industry regulation** – this has developed throughout the programme. The regulation of trust based DC schemes in the U.K. is not traditionally strong. Historically, they have not represented a great risk as there was often an important link between an employer and a scheme, which led to good governance and oversight. DC pensions offered by insurance companies were subject to strong regulation, but Trust based occupational schemes were not subject to the same level of oversight. This was less of an issue as these tended to be large schemes that were established by larger
employers. The care and attention of the trustees, who are required to act in the best interests of members, meant that they were generally well run. And they were frequently large schemes where they had the resources and scale to develop expertise.

There have been two significant reforms to improve industry regulation since the start of Automatic Enrolment. In 2015, after much debate, the government placed a cap on charges on schemes used for automatic enrolment of a maximum of 0.75% of AUM. Whilst there was little evidence that many people were paying more than this under automatic enrolment, it seemed important to give people certainty that there would be a maximum charge for these schemes. This introduction of the charge cap allowed the government to provide greater assurances that consumers would not suffer losses on account of high fees and charges.

In addition, the introduction of Automatic Enrolment has seen a rapid growth in what are known as “master trusts”. These are trust-based DC schemes for multiple employers. NEST is set up as a master trust. Many of the large master trusts have very high levels of governance and oversight. However, with the rapid growth in the number of such Trusts being set up, there are concerns that not all of them have such high governance standards.

There is currently legislation going through Parliament to introduce a fit and proper test for those who run these schemes and to put in place capital adequacy requirements. This new regime should be fully in place by 2018. Both changes could have been part of the original reform although it is not clear whether it would have been possible to achieve consensus around these changes.

In terms of lessons for other countries, perhaps the key one is accepting that it is not possible to get everything right at the front-end and that there will always be a need to adjust the policy based on implementation experience. It is difficult of course to balance this against a need for stability as the reforms are implemented.

- **Choosing a scheme** – this is the area that most small and micro employers have found difficult. While most of the processes can be automated for employers through the payroll, a decision on the choice of the pension scheme is not possible to automate.

The vast majority of small and micro employers did not have a pension scheme before Automatic Enrolment and had no experience with choosing a scheme. This presented a potentially significant burden on employers, and a real concern by them that they may make the wrong choice. Some employers took advice from independent financial advisors, but this advice could often be expensive. Some chose NEST simply because it was “government backed”.

To address this issue, the Pensions Regulator decided to publish a list of schemes that could be used by small and micro employers. Schemes had to apply to be on the list based on criteria set by the Regulator including that the scheme should be open to
all employers irrespective of their size and the value of their business, and that the scheme would either be a Group Personal Pension (a type of contract base pension) regulated by the Financial Conduct Authority or a master trust whose standards of governance and administration were independently audited in line with standards agreed by the Institute of Chartered Accountants of England and Wales and the Pensions Regulator.

While this list has helped, it is still the single biggest challenge for employers.

SUMMARY

The U.K. pension reforms have been very successful to date. They have increased pension coverage amongst the group they were designed to help and have led to an increase in savings in pensions in the U.K.

There still remain a number of challenges for the reforms as they continue to roll out. In particular to reach the remaining hundreds of thousands of employers that are yet to reach the date on which the reforms apply to them, and to increase contributions for employers and employees to the 8% rate.

The reforms are generally seen as very positive. The implementation to date has gone relatively smoothly, but that should not be seen as a sign that these are simple reforms. The success of the implementation is due to the hard work of many people over a long period of time, not just within the programme but within employers and pension schemes throughout the country.

There is significant hope that by the end of the programme the long term decline in pension savings in the U.K. will be reversed and that many people who were previously excluded from pensions will have the opportunity to build up savings for their retirement.

The reforms show how a careful analysis of the issues, a realistic understanding of human behaviour when it comes to savings, allied to a rigorous approach to building consensus and supervising an efficient pension value chain were able to deliver a historic improvement in the U.K.’s pension outcomes and reverse decades of previous decline in pension coverage.

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4
PENSION AND POPULATION ON
RAZOR’S EDGE IN
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BACKDROP TO POVERTY AND OLD AGE POVERTY

The Government of Bangladesh (GoB) is strongly committed to reducing poverty, improving human development and reducing inequality. The “Vision 2021” policy and associated “Perspective Plan of Bangladesh (2010-2021)” envisage Bangladesh as a middle-income country, free from poverty, with healthy and equitable growth. Household Income and Expenditure Surveys (HIES)1 show that coverage of programmes targeting poor and vulnerable households has increased and has helped lower poverty levels. The rate of poverty has reduced by half over the last few years – from 48.9% in 2000 to 24.8% in 2015 while the rate of extreme poverty has fallen sharply from 34.3% to 12.9 percent.

NATIONAL SOCIAL SECURITY STRATEGY

Bangladesh approved the National Social Security Strategy (NSSS) in 2015, with a vision to “build an inclusive Social Security System for all deserving Bangladeshis that effectively tackles and prevents poverty and inequality and contributes to broader human development, employment and economic growth”. The GoB bears a constitutional obligation to ensure citizens’ rights to social security. It seeks to streamline and strengthen existing social protection programmes in order to achieve better value for money and to broaden the scope of social protection from the existing narrow safety net concept to include employment policies and social insurance while addressing the emerging needs of a middle-income Bangladesh in 2021 and beyond.

Over the long-term, the policy goal is to move towards a social security system that is available to all citizens who are in need of support, and provide them a guaranteed minimum income along with a comprehensive safety net against shocks and crises that may push them into poverty. The NSSS is designed with this long-term vision in mind. Therefore, GoB will have to take appropriate steps towards achieving this vision, while being aware that substantial change will take time. The government will focus on building the foundations of a progressive and inclusive system. The goal for the NSSS is to “reform the national Social Security System by ensuring more efficient and effective use of resources, strengthened delivery systems and progress towards a more inclusive form of Social Security that effectively tackles lifecycle risks, prioritising the poorest and most vulnerable members of society.”

SOCIAL SAFETY NETS (SSN)

Though there is no specific definition, or differentiation between social protection (SP/SPS) and / or social security, the Bangladesh Ministry of Finance (MoF) has identified and listed 145 Social Safety Net (SSN) programs that are being implemented by more than 30 ministries and agencies. Bangladesh’s current social security system is both complex

1 HIES provides data for estimating poverty and other socio-economic characteristics since 1973-74. The uniqueness of the HIES is its collection of year-round data in order to eliminate seasonal variations in income, expenditure, and consumption. In determining the poverty line, the Cost of Basic Needs (CBN) approach is used.
and expensive. There is no formal mechanism for sharing information and data on beneficiaries among the implementing ministries. Importantly, the 145 social safety net programmes cost USD 6.78 billion (BDT 542 Billion) or 2.44% of GDP. This includes the cost of pension payments to retired civil servants. While the civil service pension scheme has only 0.6 million beneficiaries, it consumes more than 41% of the overall budget for social safety nets. However, reflecting Government’s commitment to social security, budgetary allocations have grown both in absolute terms and as a share of GDP. The allocation for SSN increased from 1.3% of GDP in 1998 to 2.3% in FY 2011. Since then, it has stabilized at around 2.0% of GDP and is currently 2.44% of GDP for FY 2018. Although this level of funding is modest by international standards, when measured against the government’s budget situation, this represents a substantial commitment, accounting for 13.54% of total government spending.

ADDRESSING POVERTY AND VULNERABILITY

The Bangladesh social safety nets programme addresses poverty and vulnerability from a broad perspective and covers education, health, nutrition, employment, and disaster response. Vulnerable groups, particularly the elderly, women, children, and disabled persons, are given priority in the delivery of safety net support. The programmes provide benefits in the form of food, cash transfers, or a combination, and are administered through the government’s administrative bodies and elected local government officials. Given Bangladesh’s history of famines and catastrophic natural disasters, food based transfers have traditionally been the main form of income support to the poor. Well designed and implemented SSNs not only reduce poverty and vulnerability, they also improve the welfare of women. In the face of global food and energy price shocks in the past decade, Bangladesh was able to scale up coverage of several ongoing SSNs. These programs, which started in the 1960s, historically have been the Government’s main response to reducing poverty and vulnerability and have been serving combined objectives: a safety net function to help smooth consumption during lean seasons and a community infrastructure function.

CHALLENGES AND ISSUES

While there are multiple challenges and issues in implementing the SSN programs, most emanate from inaccurate targeting due to the lack of a poverty database and mapping between schemes and areas, non-existence of a robust centralized recordkeeping mechanism, and leakages in delivery, including fragmented payment systems. Because of the proliferation of a large number of programmes, the budget for most programmes is small and the average benefit per programme per individual is low.
TARGETING AND INCLUSION ERRORS

One of the most common challenges faced by Bangladesh pertains to the selection of beneficiaries due to missing data of beneficiaries on one hand and lack of poverty mapping on the other. Despite an increase in coverage, targeting needs considerable improvement. For example, of the 24.5% households who reported benefitting from at least one of the 30 SSPs during the Household Income and Expenditure Survey 2010, 82% of the beneficiaries belonged to the poor and vulnerable group while some 18% of the beneficiaries were non-poor.

FOOD TRANSFER AND INCLUSION ERRORS

Most of the SSNs are focused on addressing consumption and income interruption risks faced by the rural poor. There is a dominance of food-transfer and rural employment programmes both in terms of beneficiary participation as well as funding owing to the nation's focus on eliminating hunger and reducing rural poverty. Presently, the employment market is dominated by informal employment and is largely excluded from formal social security programs. Recent household income and expenditure surveys suggest that although SSN coverage of the poor has improved over time with extensive Government interventions, it nevertheless remains low and that a large section of the poor are unable to access SSN benefits.

TARGETING EFFICIENCY

Share of total program spending benefitting the poor (targeting efficiency) dropped from 52.6% to 35.3% within the previous five-year period. Average transfer adequacy (i.e. generosity) on average is also low, and has worsened over the years: the share of real value of transfers of the total consumption levels of poor households has almost halved, falling from 22% to 11 percent.

DELIVERY SYSTEM

Social safety net programs mainly deliver cash, food and assets under different schemes.

PAYMENT SYSTEM

Direct cash benefit transfers cannot be effectively undertaken in the absence of appropriate payment systems. Analysis of the existing payment systems in Bangladesh reveals that all the prevalent methods of delivery suffer from challenges on the demand-side as well as on the supply-side, and are generally characterized by weak information systems and lack of adequate accountability structures. Inadequate monitoring along with unsatisfactory beneficiary identification mechanisms may also usher duplicate and fraudulent payments. Some SP programmes are way too costly for beneficiaries in terms of their travel expenses leading to a high opportunity cost. As the current system stands, beneficiaries usually have no right to choose the mode of payment most suitable to them.

The Government of Bangladesh has recently embarked upon reforming its payment system as well as Information system by linking the MISs of the line ministries to that of
Finance Division. It would use the MIS central platform at the FD to validate beneficiary data with that of NIDs and check for leakages by eliminating double dipping and duplicates. It would also allow direct transfer of funds into the individual accounts of the beneficiaries to be held through a payment service provider of their choice. This would be accomplished using the Bangladesh Electronic Fund Transfer Network (BEFTN) of the Central Bank.

**NON-CASH DELIVERIES**

The delivery system suffers from the lack of a centralized beneficiary database, use of different channels for delivering benefits to the same beneficiary, an inefficient public distribution system and lack of a transparent and direct payment mechanism. It is being widely acknowledged that direct cash transfers to SP beneficiaries may be a far more efficient instrument than indirect subsidies.

**MONITORING AND EVALUATION (M&E) AND MANAGEMENT INFORMATION SYSTEM (MIS)**

A major shortcoming of the present social protection programmes is the absence of an effective M&E and MIS. There is no formal mechanism for regularly reviewing the aggregate, national performance of the overall social protection regime or the disaggregated performance of individual programmes. Some limited efforts aimed at studying the impact of programmes supported by development partners have been done in recent years. The findings of these one-off exercises illustrate the critical importance of institutionalizing a well-designed formal M&E and MIS for SP programmes.

**STRENGTHENING PROGRAM DELIVERY**

A strategic review of programmes shows that some 65% of the SSP are seeking to address life-cycle related risks. Yet, there are significant gaps. The SSN coverage of children aged 0-4 years is very small. Furthermore, only a small proportion of people with disabilities and elderly persons receive some form of benefit. Coverage is highest among children of school going ages but the transfers they receive are low in value, a problem that affects almost all of Bangladesh’s SSS.

**LIFECYCLE PROGRAMS**

The approach to delivering social benefits will also need to broaden from the concept of a safety net to a more inclusive concept of a social security strategy that is aligned to the life cycle and incorporates formal employment policies as well as social insurance schemes. This will fit more cogently with the needs of a modern urban-based economy, and the demand for this is already seen from the risks faced by the Readymade Garments (RMG) sector. The government wishes to strengthen the transformation towards a lifecycle system by consolidating programmes in a small number of priority schemes. The aim is
to identify which high priority schemes make the system more inclusive by incorporating a higher proportion of poor and vulnerable people within it. This will be achieved by gradually increasing coverage of priority schemes and ensuring that selection processes prioritise the inclusion of poor and vulnerable families.

The NSSS states that the benefits will be non-discriminatory and will be available to all poor and vulnerable people who satisfy the income criteria and other selection criteria relating to life-cycle or disability described below, irrespective of religion, ethnicity, profession, and location. The five core life cycle programmes suggested by NSSS include:

1. **Programmes for Children:** Child grant, immunization, childcare, and nutrition (up to age four), school stipend for primary and secondary, disability benefit, school meal, etc.

2. **Working Age:** Education and training programmes, workfare programmes, conversion of food into cash transfers, unemployment, sickness, maternity, and accident insurance

3. **Comprehensive Pension System for Elderly:** Old Age Allowance, Civil Service Pension, National Social Insurance Scheme (NSIS) with employee employer co-contribution for pension and other contingencies, Private Voluntary Pensions (PVP)\(^3\) open to all citizens irrespective of occupation and formal/informal employment.

4. **Programs for People with Disabilities:** A disability benefit for children with disabilities and a disability benefit for the working age population with disabilities.

5. **Special Programmes for the Freedom Fighters:** The schemes to support the freedom fighters and their families will continue under the consolidated Freedom Fighters’ Benefit Programme.

**INDEXED BENEFITS**

To prevent the value of transfers from falling, all cash transfers provided through the above life cycle based core schemes will be indexed to inflation. The above programmes will be available to those poor and vulnerable people who meet the other requirements of each specific programme.

**PROXY MEANS TEST**

Income eligibility will be determined on the basis of a Proxy Means Test (PMT) that is being developed by the Statistics and Informatics Division (SID). As mentioned above, in recent years there has been a rapid expansion in the number of small schemes. Much of this has been led by development partners, which are usually well intentioned as new approaches have been piloted and specific challenges addressed. However, with the formulation of core programmes of the NSSS, it is important that these schemes are adding value in terms of innovative ideas with prospects for scaling up and joining up.

**STRENGTHENING THE PAYMENT SYSTEM**

An effective payment solution in the context of Bangladesh is one that will empower

\(^3\) The Old Age Allowance and the Government Service Pension will be funded by the Budget. The NSIS and the PVP would be funded through employer and employee contributions.
the beneficiaries to be able to make informed choices, be cost-effective and transparent, and have robust MISs and system-driven budget management and accounting. It is highly recommended that a central hub be established within the Controller General of Accounts (CGA), which could be the principal component of the solution. This hub could provide a coordination mechanism between the Finance Division (FD), the CGA and line ministries (LMs) for social protection payments. This could also ensure that MIS are adequately designed and developed within all the concerned LMs for efficiently effecting the social protection payments. MIS at the LMs, and at the FD should be totally compatible with each other and have capabilities to ‘talk’ with each other in real-time. The National Identity Card (NID) system of Bangladesh can provide unique identifiers for the beneficiaries. All the bank and post office accounts of beneficiaries can be linked with their NID, which can also be part of the ‘know your customer’ (KYC) scheme for opening of bank/post office accounts for beneficiaries. The payment system may include channels such as mobile banking, mobile and postal transfers, etc. as per the convenience of the beneficiary.

VULNERABILITIES OF AGEING

Bangladesh is one of those 100+ developing nations where the population is extremely young (mean age in 20s or 30s) but is ageing rapidly with the proportion of senior citizens doubling over the next two to three decades. One of the contributing factors to this is also a higher longevity and greater life expectancy of 60 years. Life expectancy at birth in Bangladesh has increased from 55.1 in 1988 to 64.9 in 2002. Similarly, life expectancy at 60 has also shot up to almost two decades. More people are surviving to old age and they tend to live longer. Over the next four-decade global expectancy at age 60 is expected to increase from 19.6 years in 2005-2010 to 22.4 years in 2045-2050 (a 14% gain). It is also a country where the coverage of social security in general and pensions in particular is highly restricted and inadequate with pension being limited to civil servants only.

VULNERABILITIES PECULIAR TO BANGLADESH

The government understands that notwithstanding the past impressive progress with poverty reduction, there is a substantial population that remains exposed to poverty due to various vulnerabilities. This includes the population that remains under the poverty line and those that are just above the poverty line but could easily fall below this line because of certain vulnerabilities. These may range from natural or man-made disasters to vulnerabilities of old age poverty. Evidence4 shows that the poor and vulnerable group cannot cope with all the downside risks and shocks with their own resources. HIES suggests that poverty rates increase with ageing (32.5% at aged 80+). In the absence of an effective old age pension system – many older people in Bangladesh continue to work,
but often with insecure and vulnerable livelihoods. Rapid urbanisation and the growth of population in urban areas is mostly due to rural-urban migration with mostly young adults migrating, leaving the aged behind.

VULNERABLE WOMEN GROUP

With frequent breaks in their working age due to child birth and rearing, coupled with a higher life expectancy at the retirement age of 60 but little or no savings, exposes their vulnerability to old age income insecurity. By the time, they realize that they ought to have saved for their old ages it might be too late. The majority (68%) of older women are widowed compared to only about 7% of men. Widowed women have no security, are more dependent on family and face worse socio-economic conditions compared to men. Similarly, single women, especially adolescent girls and those with children, are among the most vulnerable category of the population. There is a need to focus on providing support to vulnerable women – in particular single parents – to provide them with a minimum income guarantee while also enhancing their ability to engage in the labour market.

RAPID URBANIZATION

Over the past few decades, Bangladesh has experienced demographic transformations, major amongst them being a rapid population growth in urban areas and lower fertility with higher longevity. With the increase of urban population, particularly in the larger urban areas, Bangladesh has also gone through the consequences of demographic transition affecting the age structure while also dealing with more aged people in rural areas. The population above the age of 60 recently crossed the 10 million mark. Increased life expectancy caused by improvements in living conditions, health care, education, and technology as well as the changing demographic structure of the country is resulting in an increase in proportion of elderly people.

DISMEMBERMENT OF JOINT FAMILY STRUCTURE:

The traditional joint family system prevailing in the country shielded the elderly within the family structure. However, modernization of society with the break-up of the joint family system, urban and out-country migration of youth, and economic degradation in the society are creating problems for the aged and hence elderly care has become a major concern for the society. The ageing issues are yet to be fully understood and receive policy level attention by the government and civil society including academicians. Majority of Bangladesh’s ageing working poor are also highly vulnerable to old age poverty since they are not only excluded from access to formal pension provisions, but are also unable to access any regulated insurance and retirement motivational savings product at an affordable transaction cost.

MIGRANT WORKERS

Every year, around half a million Bangladeshis leave the country to work abroad. Bangladesh’s economy to an extent, depends on the remittances. While problems faced by Bangladeshi migrants vary from high fees for migration to discrimination, exploitation, and abuse while overseas, there are major issues they face when either they return or retire
from work. This is a major challenge that this cohort shall be facing in future at the time of returning to their homeland with little or no savings for rehabilitation and retirement.

It is suggested that the government should seriously consider a return, rehabilitation, and retirement scheme for the migrant workers who travel abroad during their working lives. A portion of their remittances may be earmarked for crediting their individual account that could be used in the short or medium term to provide a return, rehabilitation, and settlement for them. Similarly, another portion of their remittances should essentially get parked into a retirement fund that the government should be creating for them by means of an individual retirement account. This account may be topped up by the employer or the government in the form of co-contributions so that there is constant encouragement and incentive for these workers to save for their old age.

LARGE EXCLUSION

Bangladesh has a 6.8 million workforce in the formal sector while more than 47 million in the informal sector. Most of the formal sector workers and all the informal sector workers are excluded from any formal mandatory provident or pension fund provisions that could enable them to save for their old age. Therefore, on average, these workers will need to accumulate enough savings during their years in the workforce to support themselves for nearly two decades post retirement. However, their fragile labour market attachments and low intermittent incomes, coupled with the absence of a low cost and easily accessible insurance and savings scheme puts retirement planning out of reach for most of these workers.

DEMOGRAPHICALLY AGEING

It would not be specious to state that the prima facie evidence of Bangladesh’s census suggests that the country might be heading for an old age poverty crisis over next few decades. The population is still young (93% below aged 60 years) and yet ageing rapidly. The phenomenon that has been observed across Bangladesh is that the while the proportion of Children’s (Aged 0 – 14 years) population has declined by over 16% (37.3% in 2000 and 31.3% in 2010), the proportion of youth (Aged 15 – 64 years) have grown by 9% (58.7% in 2001 and 64.1% in 2010). But to beat it all, the proportion of senior citizens (Aged 65 +) has exploded by more than 15% (4% in 2000 and 4.6% in 2010). Inclusion of the population aged 60 and above in the population is 6.74%. According to one estimate of a 32% decadal growth in senior citizens, Bangladesh is likely to have 31,208,778 senior citizens by 2050, which is more than three times what it is today.

ADVERSE INDICES AND RATIOS

While the Aging index\(^5\) for Bangladesh was 12.8 in 2000 it marginally rose to 16.7 (World 38.7) in 2007 and is likely to reach 32.4 by 2025 and 79.3 (World 107.4) in 2050 (UN, 2007). The Potential Support Ratio\(^6\) is likely to decrease from 18.6 in 2000 to 12.9 in 2025 and 6.2 in 2050. On the contrary the labour force participation has also decreased from 50.9 % in 1990 to 46.6 % in 2000 and it will further decrease to 42.9 % in 2010.

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\(^5\) Number of persons 60 years and above per hundred persons under age 15

\(^6\) Indicates the number of persons, aged 15 to 64 per every person aged 65 or older
Bangladesh depicts a fairly young population in the year 2010 with a normal pyramidal distribution of ages. More than 90% of its population was below 60 years age as depicted in Figure 4.1.

**Figure 4.1**
Population Pyramid – Bangladesh 2010

![Population Pyramid – Bangladesh 2010](image)

Source: U.S. Census Bureau, International Data Base

Fattening Top by year 2050 would swell the population of senior citizens to a whopping 31 million by 2050. And, as mentioned earlier, if more than 90% of them do not have any pension and they survive for two more decades, it might be heading for a demographic crises.

**Figure 4.2**
Population Pyramid – Bangladesh 2050

![Population Pyramid – Bangladesh 2050](image)

Source: U.S. Census Bureau, International Data Base
CURRENT SUPPORT AND SUSTAINABILITY

Following efforts have been made by the government to fight old age poverty.

OLD AGE ALLOWANCE (OAA)

The OAA is one of the country’s oldest SSN programmes, having been set up in 1998 to combat poverty and destitution among the aged, and now reaches around 3.15 million beneficiaries receiving BDT 500 (USD 6.41) per month.\(^7\) The eligibility for OAA is based on the minimum age of 62 for women and 65 for men. However, the scheme does not cover the entire eligible old aged population because of the limitation of the government’s financial capacity. In spite of this continual expansion, the OAA reaches just over a third (37%) of the population that is eligible in terms of age.\(^8\)

Therefore, priority has been set among eligible old aged persons who are more or most vulnerable than others and includes criteria such as — Impoverished, landless and evacuee/displaced persons. Similarly, those who are widows, divorced, widower, childless, separated from family are given priority as well.

HUSBAND DESERTED DESTITUTE WOMEN AND WIDOW ALLOWANCE (HDDWWA)

To address the particular vulnerabilities of widows and women who have been abandoned by their husbands, the program covers over 1.15 million beneficiaries who are also paid BDT 500 (USD 4.00) per month.

While both the schemes have largely benefitted the elderly in the country it also comes with certain challenges both, from the perspective of the design and implementation as well as demand perspective of the beneficiary recipients. The proportion of elderly in Bangladesh is growing rapidly, while the coverage of the scheme is unable to cope with the numbers and does not provide a universal coverage suffering from issues of exclusion as well as inclusion errors. While the eligibility criteria is well defined the selection of beneficiaries is highly biased, subjective, non-participatory, and discriminatory.

QUESTIONABLE SUSTAINABILITY

Future governments, however, may be unable to escape the fiscal burden of the elderly as low income workers might expect some financial support from the government in their old age. As per the last census nearly 7.5 million people would be eligible for OAA benefits. Assuming the pre-identified decadal growth rate of 32% for senior citizens, this number would soon multiply to 9.8 million by 2020, 13 million by 2030, and so on. At the

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\(^7\) The budgetary allocation for OAA in the year 2016 – 17 is BDT 18.9 billion (USD 242 million)

\(^8\) BBS Census report from 2011 (summing all women 62+ and men 65+), with projections from 2011 based on a 3.98% annual growth rate for the elderly population as provided by the report.
current rate of BDT 500 pm and at current prices, this would amount to approximately BDT 70 billion a year. Thus, the scheme might also turn out to be fiscally unsustainable in the long term and may not serve the purpose of the senior citizens as the amount of pension might not allow them to make both the ends meet.

COMPELLED TO WORK IN OLD AGE

Nearly four-fifths of Bangladesh’s working poor may be compelled to work well into their old age as they would be unable to accumulate enough savings to support themselves. Not surprisingly, most working poor have given no thought to their retirement income needs, including those over 40 years for whom old age income security should be a front of mind issue. Part of the explanation is that most of these workers expect their children to support them when they are no longer able to work. However, given the probability of their children also being in the low-income workforce coupled with migration and dismemberment of the joint family structure this strategy is tenuous at best.

RECOMMENDED STRATEGY OF GOVERNMENT

ADDRESSING PRIORITIES

The government may have to address certain priority areas that may range from improving social security systems to deepening the financial markets on one hand and strengthening financial inclusion on the other.

IMPROVING SOCIAL SECURITY SYSTEM

Against the backdrop of the review of past the SSS experience, the priority challenges that will need to be addressed over the next few years are:

1. A shift from the current discretionary system to a targeted universal approach to avoid leakages and under-coverage.

2. Expanding coverage of core schemes for the extreme/hard-core poor and most vulnerable people of society, focusing on mother and child, adolescent and youth, working age, the elderly, and people with disabilities. A basic objective for the next few years would be to support the elimination of hard-core/extreme poverty as much as possible.

3. Ensuring that the most vulnerable women are provided with income security and greater opportunities to engage in the labour market.

4. Initiating a social insurance system that enables people to invest in their own social security providing protection against the risks of old age, disability, unemployment, and maternity.

5. Expanding coverage to the residents of urban areas and to the socially excluded people.
6. Ensuring that the SSS supports an effective disaster response system.
7. Strengthening the delivery systems for priority transfers by establishing advanced MISs and professional staff and improving the payment system.
8. Expanding awareness of the social security programmes for the beneficiaries and motivating potential contributors.

STRENGTHENING FINANCIAL MARKETS

Bangladesh’s markets may be lacking the breadth and depth that may be required to satiate the appetite of a typical pension fund. However, efforts from the side of the government including the regulators and other stakeholders may help improve the situation in the medium and long term. Similarly, long term instruments may be required to provide for asset liability management (ALM). As of now, the financial market in Bangladesh comprises money markets – Taka Treasury Bond market, capital market, and the foreign exchange markets.

ADDRESSING INSURANCE PENETRATION

The Insurance Development and Regulatory Authority (IDRA) has been established for the insurance sector and has been entrusted with functions and responsibilities that include development and regulation of the insurance industry in Bangladesh. Going beyond the formal insurance sector, the government may have to address an important agenda for the insurance sector that may include developing micro-insurance products (with certain special characteristics relating to coverage, premiums, delivery channels, terms, and benefits) which could be of value to the poor. The challenge would be to design micro-insurance services (e.g. micro life insurance, micro health insurance, crop insurance, livestock insurance, and micro enterprise insurance), which would be risk shifting devices offered by the insurance companies/institutions especially suited to the needs of low income households in rural and urban areas and which would be affordable.

PROMOTING FINANCIAL INCLUSION

Bangladesh has made a broad social commitment for inclusive, equitable, and environmentally sustainable socioeconomic growth 'leaving no-one behind', as espoused in the new sustainable development goals. Bangladesh Bank, the country’s central bank, is supporting the government’s efforts with its own initiatives by promoting financial inclusion. Mobile financial services have become the key tool of financial inclusion initiatives. Bangladesh lies in a group of countries where only 17.6% - 38.6% adults are presently under the reach of the formal financial services. This is because the present banks and other formal financial modes consider the outcome and profitability in a way that, the rural and non-developed areas are always out of consideration. But these areas consist of the most populated parts of Bangladesh and hence financial inclusiveness may be a success in Bangladesh when people from these regions will be brought under formal financial services.
FIGHTING LONGEVITY RISK

For a majority of these low-income workers, and equally for the government, a vital issue is the management of the longevity risk with the cessation of earnings in old age. The first step is the advocacy – to raise policy makers’ awareness of the multiple issues related to ageing in the country. Professionals, politicians, NGOs, and the general public need to be aware of ageing problems. There are agencies that are advocating various policies for the betterment of the ageing population, policies on social networks, economic security, health, and housing for the ageing population will strengthen the demographic scenario of the country. A long-term policy option has to be considered to ensure affordable solutions of the future problems of the aged.

LONG TERM TARGETED SAVINGS

Preliminary findings including informal discussions with civil societies and focused group discussions (FGDs) with few workers/ farmers in and around Dhaka suggest that a significant proportion of these working poor might be interested in saving for their old age and can afford an average annual savings of a few dollars. However, people might be willing to save for their old age if and only if both sides, supply as well as demand side, are strengthened and a safe, secured, and regulated environment is provided for them to save and promote confidence. It is also important that to achieve an above poverty pension, they might need supplementary top ups from the government along with a secure environment where their modest savings are channelled to customized long term savings products and earn high real returns at a low transaction cost. However, without pension literacy, support from agencies, including the government, and access to customized retirement savings products that deliver high real returns at low transaction costs, most of these working poor will fall below the poverty line in their old age.

MOTIVATIONAL TOP UPS

Motivational top ups by the government and/ or development partners to kick start savings schemes amongst the younger population has worked well in neighbouring countries like India. And, similar co-contributions can be considered by the government in the initial years in order to kick start the scheme for poor and informal workers willing to save. The pension co-contributions from the government can provide the working poor with a powerful financial incentive to undertake disciplined voluntary retirement savings over multiple decades, and pension co-contributions can also supplement the modest savings of the working poor so that when they reach their retirement years, the value of their savings is sufficient to produce a pension to keep them above poverty.

Box 4.1
Rationale for Co-contribution Top Ups

Protagonists of conditional cash transfers (CCTs) for pension savings argue in favour of co-contribution top ups to low income workers to provide them equity and fairness in subsidising the tax treatment.
a. Affluent and salaried in Bangladeshis receive subsidies from the government in the form of tax breaks when saving for retirement under provident fund schemes. The tax subsidy could be as high as BDT 200,000 a year. On the other hand, a low-income worker who is not a tax payer receives none even if she wishes to save for old age through unregulated instruments. Similar motives of savings by the poor cohort provides them with a zero incentive to save for old age. Even a 10% subsidy in nominal terms offered to the affluent could serve the purpose of CCTs for this cohort.

b. In fact, in the longer run the cohort of poor workers is more likely to fall back upon the government in old age while the richer cohort would still manage to sail through. Moreover, there are multiple options available to the richer group for savings in medium, long, and retirement savings schemes, equities, etc. while the poor, notwithstanding the wonderful stories of financial inclusion, fail to save for old age despite wanting to do so.

c. Another rationale favouring co-contributory pensions is to avert the zero pillar freebies. Under the Old Age Pension scheme, the government is willing to pay BDT 300 per month, which is a paltry sum, at the age of 65 plus when this amount would not even buy two square meals a day for the old and destitute. There is no reason why the same Government should not consider paying one third of this, say, BDT 100 per month to the same poor men and women while they are in their working and earning age on a CCT basis.

d. This would encourage them to save in a regulated environment and free the government of their unfunded pension burden in the old age. In case the government fails to do so, this cohort that is young today is bound to remain poor throughout their lives and would consequently have to depend on the government in their old age. This could be disastrous for society as this liability could never be actuarially fair and accounted for in the future, meaning thereby creating an unfunded liability that would grow by leaps and bounds as the cohort of 60+ would grow to 31 million by the middle of the current century.

Source: Authors Own Opinions

POTENTIAL ROLE OF CIVIL SOCIETIES

Bangladesh has the distinction of having the largest development NGO in the world in terms of employees called Building Resources Across Communities (BRAC). Besides this, there are other NGOs and MFIs who have played an important role in providing access to money to the poor. Providing opportunities to the working poor to build up savings for retirement through thrift and self-help is an important public policy goal. In this context, NGOs, development partners and the government should be encouraged to consider a system of CCTs or co-contributions linked to retirement savings for the working poor. There is also a need for these agencies to impart financial and pension literacy.
GOVERNMENT COMMITMENT

The GoB is committed to bring in pension reforms that may vary from civil services parametric reforms for existing employees to a systemic reform targeting the vast private pension and informal sector as part of its inclusive pension policy. The government is also considering pre-funding its pension liabilities. The commitment is also visible in the following steps taken by the government from time to time.

STUDY TOUR AND EXPOSURE VISITS

The government is beginning to address reform of the SSNs of which pensions and related benefits are an integral part. To address the issues, the government has been considering a variety of options towards fighting the likely old age crises. One of the options that the government recently considered was on the lines of what India has done that has witnessed pension reforms with an emphasis on an inclusive pension system over the last two decades. The key officials of the FD had taken a study tour in India (March April 2016) with the objective to understand the policy, strategy, and implementation perspectives of social protection systems, and in particular, pension reform in India. The team also studied the regulatory framework and institutional arrangements that were aimed at experiential learning and applying the knowledge in designing a pension reform. The whole idea was that not only the pension system has to be pro-poor and inclusive in nature for the formal (employees) and informal sector but should also cover systemic issues related to civil services pension in Bangladesh.

Box 4.2
India Study Tour on Inclusive Pensions

The Government of Bangladesh is strongly committed to fighting old age poverty and hence mitigating the risk of longevity by providing pension provision to the vast formal and informal sector. The systems and provisions in Bangladesh are very similar to that of India, which has had a decent beginning in providing contributory and co-contributory pension schemes to the vast informal sector poor workers. India has also taken a bold step in introducing systemic pension reforms by switching over from a Defined Benefit (DB) to a Defined Contribution (DC) scheme and has started funding its pension liabilities for civil servants for over a decade now. Both these models, civil servants pension pre-funding as well as co-contributory pensions for the informal sector workers, are highly relevant in the Bangladesh context and hence the knowledge transfer and experiential learning from ‘what worked’ and ‘what failed’ in the Indian pension reform context was of very high value in Bangladesh.

Source: SPFMSP Project, Finance Division

COMMITTEE FOR PENSION REFORMS

The GoB has also formed a committee of senior officials in the FD to provide recommendations on pension reforms including providing suggestions on an inclusive...
pension system. The committee is working in close coordination with the Finance Minister and has submitted various reports to the Finance Ministry for onward decisions.

**BUDGETARY ANNOUNCEMENT**

While the India study tour was most timely and provided great learnings to the committee, the ministry acted swiftly after the tour and the next budget (FY 2016 – 17) witnessed the commitment of the government where the Finance Minister made a formal announcement for a what might turn out to be an inclusive pension system in Bangladesh.

**Box 4.3**

**Government’s Commitment**

The Budget Announcement FY 2016 – 17

**Para 155.** Pension: Currently, only 5% of our working age population are employed in government services who enjoy pension benefits. Although, about 8% of the remaining 95% people employed in the private sector receive gratuity benefits, there is no pension or gratuity scheme for the rest.

**Para 156.** Our demographic structure is changing due to the declining population growth rate and increasing life expectancy rate. As a result, the number as well as ratio of elderly people in the total population is slowly increasing. On the other hand, due to urbanization, the number of nuclear families is also rising, which increases future risks of financial and social insecurity for the ageing population. It will be difficult for the government alone to manage this risk. In this context, introduction of an inclusive and robust pension scheme for all working class people, including the aged, is now a demand of the day.

**Para 157.** To this end, we are considering bringing fundamental changes to our existing pension system. We will reform the existing pension system and introduce a contributory pension scheme for all government employees who will join in future. We plan to introduce, in phases, under an integrated government-run framework, a comprehensive pension system for all, including the self-employed as well as those formally or informally employed in semi-government organizations and the private sector. DPS system has created an opportunity for establishing a pension system in the private sector; the new universal pension plan will centre around this concept. On one hand, this system will guarantee financial and social protection of the ageing population, and on the other hand, provide additional resources to meet the long term investment demand along with deepening the financial sector.

*Source: Budget Speech of the Finance Minister*
E GOVERNANCE WITH EXTENSIVE USE OF NATIONAL ID

The NID is a compulsory document issued to every Bangladeshi citizen on attaining 18 years of age. This type of biometric identification has existed in Bangladesh since 2008 in a central biometric database, which is used by the Bangladesh Election Commission to oversee the electoral procedure in Bangladesh. Recently, mapping of the NID database has been achieved with that of the civil servants and pensioners’ database (see section on Employee and Pensioners database). Similarly, the Bangladesh Bureau of Statistics (BBS) is in the process of generating poverty mapping that would be linked to the NID.

The government has recently introduced the smart NID card that will put an end to forgery as it has 25 international certifications and standards as security features. A smart card is a kind of integrated circuit card (ICC) also known as a "chip card," and is a pocket-sized card with embedded integrated circuits that can be loaded with data. The machine-readable card will have 32 types of basic information of a citizen embedded in its microchip that could be used for a variety of governance and administrative functions by the government including cash transfers such as G2P and could also be used for P2G purpose. The government assumes that the card holders will get 22 types of services, including banking, TIN, driving license, and passport.

Box 4.4
Facilities under the Smart Card

Bangladesh Government is planning to include 22 facilities in one BD smart card: citizens ‘right and benefits’:


Source: Election Commission Bangladesh, National Identity Registration Wing (http://www.nidw.gov.bd/)

ACCESS TO INFORMATION (A2I) – PRIME MINISTER’S OFFICE INITIATIVE

The key driver from the Prime Minister’s office of the government’s public service innovation agenda with the primary goal to ensure easy, affordable, and reliable access to quality public services for all citizens of Bangladesh is the a2i. It is an effort to form the world’s first innovation lab nurturing a nationwide ecosystem to deliver service for all and enable millions to register for safe migration through digital centres. It has a strategy to establish both physical and online one-stop access points that scale innovative services and make them available to citizens easily, reliably, and in an affordable manner. It also
encourages and supports non-government actors, including small entrepreneurs, teachers, and the youth, to partner with government actors.

The 5,000+ digital centres and the national portal uniting 43,000+ government offices now deliver over 100 services – both public and private – to an average 4.5 million underserved citizens at a much lower TCV (the time, cost and number of visits it takes citizens to access services) than before. Services that previously required multiple trips to the district government office 20-30 km away are now available at the nearby digital centre within a walking distance of 3 km. On an average, time to receive services has come down by 85%, cost by 63% and the number of visits by 40 percent.

CIVIL SERVICES PENSION

Governments across the developing world are countering the fiscal problem of non-availability of resources for developmental activities largely owing to a committed drain of payments into the recurring expenditure like salaries, pensions, and interests. While Bangladesh is still grappling with the challenges of expenditure management on salaries and pensions, it has made rapid progress in the recent past over the identification and creation of a database of employees and pensioners. Over the last decade, expenditure on salaries and pensions has emerged as the single largest expenditure head for government. In the absence of any updated information and data on the number, demography, and entitlements of government employees and pensioners, the government has so far been unable to accurately compute or project the salary and pension expenditures across the country. The lack of reliable data on employees and pensioners also limits the ability of the government to undertake sound fiscal planning, and estimate the impact of Pay Revisions.

SYSTEM

Bangladesh has a civil services pension system that includes products and different processes that date back to pre-Independence days, with minor amendments and very limited reforms till date. The civil services pension is a DB forming an unfunded liability of the government and is paid on a PAYGO basis. The gross replacement rates are as high as 90% of the last drawn salary with benefits such as medical and festival allowances in addition. Till recently, the pensioners could commute as high as 100% of their pension, but the same has been recently reduced so that pensioners with higher longevity could live comfortably in their 80s and 90s. Recently, pension has also been provided with a fixed incremental rate so as to beat Inflation, though it is not linked to inflation or any other price index.

PRODUCTS

While the product portfolio has more or less remained unchanged, there is a strong need to revisit the same in view of the demographic changes over the past five decades. The World Bank, under a short-term TA, has recently highlighted such issues and challenges that pensioners as well as the government are currently facing or might have to face in
near the future due to certain demographic and socioeconomic changes and recommended a rationalization of various retirement products that add value to pension and are mostly budget neutral. The government is currently working towards rationalization of its pension products and working out methods by means of which it could be made suitable to the contemporary conditions and future demographics.

**PROCESSES**

It also diagnosed the archaic regulations that hamper the processing of pension cases of a number of pensioners, as a consequence of which there is a large cohort of former civil servants who have retired but have not been pensioned. It identified such issues and challenges and provided for the streamlining of certain processes and provided concrete recommendations to improve procedural aspects of pension processing, accounting, and payments besides the product portfolio itself. In fact, more than the pension products, it is the processes and implementation arrangements that pose a greater risk to the employees. Endorsement of family pension in the Pension Payment Order (PPO) are mostly missing as a result of which the family of the deceased has to run from pillar to post to get authorization for the pension. The pensions are processed manually and so is the payment system. There is no unified and/or centralized database of pensioners and there are extremely cumbersome and outdated processes for getting pensions.

However, the GoB has taken these issues very seriously and as mentioned earlier, have also formed a committee to look into these issues to recommend the most efficient and effective ways and means by which pension could be released and paid to deserving pensioners. One of the issues that has been resolved to a large extent by the government is the creation of the database for employees and pensioners as a result of which an efficient central processing and payment system could be achieved in the future. This would also reduce the risk of ghost pensioners and leakages to the exchequer due to double dipping and errors in payment processes.

**DATABASE OF EMPLOYEES AND PENSIONERS**

One of the great achievements of the GoB in recent times has been the building a robust and dynamic database of employees and pensioners. Efforts for this database had started in 2012 under the World Bank supported SPEMP Project and while a few hundred thousand employees had provided their information, it could not be updated on a real-time basis. It was also found that there was a lukewarm interest among government employees in filling up their own information as part of the database, even the GoB was not able to force them to provide the information.

It is an interesting lesson for other nations that are grappling with such issues towards creating a similar database. The announcement of the National Pay Scale Revision was a game changer in the employee database creation. The points below explain how this worked:
PENSION AND POPULATION ON RAZOR’S EDGE IN BANGLADESH

PROCESSES ADOPTED FOR DATABASE CONSTRUCTION - EMPLOYEES

The National Pay Scale Revision was announced in 2015 with the reference date of revising the pay scales with effect from 1st July 2015. Accordingly, all employees were supposed to prepare their pay fixation, get the same verified and forwarded by the Drawing Disbursing Officer (DDO) for approval by the Accounts Officer (AO). This posed a great opportunity for the MoF that sensed the employees’ need and desire for pay revision. The MoF announced a strategy that pay revision of employees shall be effected if, and only if, the employees provide all their demographic as well as pay related details on a web-based online system specially designed for the purpose of pay fixation. The system was also linked with the NID and thus the employees could feed in their NIDs and provide their existing details. Based on the inputs, the system would automatically fix the pay, to be verified by the competent authority. While accomplishing the task of making an employee database, this proved to be a milestone. Thus, while system driven IT was widely and mandatorily used for pay fixation, it resulted in the creation of the payroll database that is mapped to the National ID of each employee. It also promoted transparency and accountability in the system. Thus, it was a win-win situation for the system, the government, as well as the employees.

PROCESSES ADOPTED FOR DATABASE CONSTRUCTION - PENSIONERS

Building Pensioners’ database was not as convenient and easy as that of the employees’, especially in view of the opportunity of clubbing the database with that of pay fixation. Moreover, neither an accurate nor an exhaustive set of desired fields and information were easily available at any single or even decentralized location for personnel who retired decades ago. The information and data about pensioners was usually available in manual form at the pay points of the pensioners that could be banks or the AOs from where they received their monthly pension. The pensioners’ details were only available through the Disburser Half (D Half) of the Pension Payment Order (PPO). Though the PPOs were generated and issued at different accounts offices manually and bore no unique ID number, it primarily endorsed demographic and payment data. This was required to be captured to produce a robust and dynamic database essentially mapped to the NID.

Similar to the approach adopted in creating the Employee Database, MoF started building up the database for pensioners with effect from January, 2016. For pensioners, the process at the backend was similar to that of employees while at the front end, instead of the pensioners themselves performing the online entry, it would be the ‘Payment Points’ that were required to do so using a website, specially created for the purpose.

Pensioners receiving their monthly pension at payment points, were asked to get their NID endorsed. Again, as was the case with the employees with their pay fixation, pensioners were clearly informed that the pension fixation or the revision shall be effected only after they provide this information. Pensioners, to receive their revised pension from the month of February 2016, started approaching their pay points with these documents.
and information. The pay points including the AOs and the bankers were asked to provide for online data entry in the system using the web based application as mentioned above.

For futuristic pensioners, if the employee databases are well built, it should be possible to seamlessly transfer the demographic data of an employee who is retiring to earn pension from employee database to pensioners’ database.

CONCLUSIONS AND WAY FORWARD

PRIMA FACIE EVIDENCE

Prima facie evidence suggest that:

• While the population of the country is still young and can reap the demographic dividends, it is also showing the trends of rapid ageing.

• It is likely to double the population of its senior citizens in less than three decades from now.

• The coverage of social safety nets in general and social security and / or pension in particular is limited only to a few beneficiaries.

• A vast majority of working poor belong to the informal sector having no employee-employer relationship.

• Even those who are employed in the formal sector lack social security in terms of pension and insurance.

• While civil servants may have a bountiful pension that averages USD 3,614 per annum per pensioner, they are limited to more than half a million. The OAA to the poor and old is paid to as many as 3.15 million beneficiaries, but on the other hand the amount is merely USD 76.92 PA per beneficiary.

• While we don’t recommend any parity between the two, we certainly conclude that the rapidly ageing population will not be able to sustain on the OAA from the Government.

• Thus, there may be a need for supplementary savings for additional income that may emanate from long term dedicated savings of the people.

• While Bangladesh may have a higher incidence of poverty in the region, there may be a large chunk of the working class in the formal and informal sector that may be willing to save for their old age, if an awareness and pension / financial literacy is imparted well.

• The network and outreach of the NGOs and Civil Societies could be extensively used for imparting

• Confidence Building Measures (CBM) in the form of a well-regulated safe and secured environment is the necessary prerequisite.
• Long term savings for old age can be channelized using the existing outreach mechanism such as NGOs, MFIs, Mobile Banking, and Mobile Money penetration, Postal Cash Cards, etc. besides regular banking channels.

• While the volumes of transaction in numbers would be high, the ticket size of the transactions would be low and hence a low-cost solution of P2G will have to be designed for committed savings on a regular basis.

ADVANTAGE BANGLADESH

Should the GoB proceed in designing and implementing an inclusive pension system, there are some distinct advantages in Bangladesh that could be harnessed by the system without reinventing the wheel. This may include, but not limited to:

Robust National ID – Biometric identification has existed in Bangladesh since 2008 with all Bangladeshis above 18 years of age included in a central Biometric Database. A smart card is now being introduced with a kind of ICC. The Election Commission of Bangladesh is planning to include 22 different functions in one of its smart cards that could be used for G2P, P2G and in particular can facilitate opening up pension accounts using a single registry mechanism.

Well established distribution Channel – Since the origin of Bangladesh in 1971, it has seen some of the largest and top rated NGOs working here. The contribution of the civil societies and MFIs in the development of financial services and social protection in Bangladesh far outpaces any other nation. The NGOs / Civil Societies / MFIs can play an important role in not only creating awareness on savings for old age, but can also harness their model of collection of micro contributions from the potential members of the pension scheme spread across the rural and semi urban areas.

Employed and Contractual Workers – RMG is the leading sector of Bangladesh in terms of employment, production, and foreign exchange earnings. Bangladesh has a unique distinction of employing more than four million workers of which more than 80% workers are women across more than 5,000 garment factories. This group is large, though loosely covered under the labour laws of the country but has strong associations and could be targeted through these association of employers and employees towards expanding the coverage of the voluntary pension scheme. The government could also encourage employers to put up co-contribution top ups for this group while providing certain concessions and facilities.

Banking and Postal Financial Services – Bangladesh is uniquely placed in terms of remittances from people to people both from abroad as well as within the country. While the network of bank branches is limited in Bangladesh, the postal network is wide spread. The postal department has recently entered into providing financial services including that of G2P under SSN programs. A Postal Cash Card has been designed that provides for features such as the delivery of OAA payment at the doorsteps. Similarly, P2G services for collection of contributions could be harnessed to facilitate inclusive pension system.
Penetration of Financial Services – The origins of microcredit in its current practical incarnation can be linked to several organizations founded in Bangladesh. Thus, while it is a well-known fact that Bangladesh presented the micro financial services (micro credit) to the world, these services could quickly be tweaked towards collection of contributory savings from the poor. As mentioned, they are well spread and have penetrated across the country and, therefore, their services could easily be harnessed.

Modern Money Transfers – Bangladesh has recently progressed well in promoting mobile money, mobile banking, agent banking, etc. where a great deal of technology has been used to create low cost transfer of funds. This includes not only remittances P2P but also certain cash transfers G2P in the form of stipend payments to millions of students at a very low cost and at convenient locations.

High Speed Internet / Connectivity – This can help the IT based financial services to be harnessed for pension collection, non-cash transactions, issuance of real time account statements on tap, etc.

Initiatives from the Ministry of Finance – There have been several initiatives from the MoF that may go a long way in designing and implementing an inclusive pension system. The maiden efforts of mapping the employees and pensioners with the NID using a single registry mechanism, the idea of developing an MIS at the FD for all social protection schemes of different ministries, the coordination of a2i on financial inclusion and its appetite towards implementing pension reforms have been witnessed in recent times. The FD is also considering in principle designing a central processing and payment system that could be utilized for the G2P as well as P2G system.

Strong Political Will – Finally, nothing in the country could move if there is no political will to do so. However, the political economy of Bangladesh is well poised to design and implement an inclusive social security/pension system that has been well envisaged in the NSSS document. Moreover, the budget announcements by the Finance Minister towards designing an inclusive pension system would go a long way to serve the country, fight the risk of longevity as well as death and shall facilitate Bangladesh’s fight to overcome old age poverty in the future.

The Prime Minister’s Office’s a2i – As a2i drives the creation of a public service innovation ecosystem and delivery infrastructure from the Prime Minister’s Office working closely with the Cabinet Division, its model revolves around establishing delivery platforms enabling ‘Services for All’. With 5,000+ digital centres and the National Portal uniting 43,000+ government offices it now delivers over 100 services – both public and private – to an average 4.5 million underserved citizens in less time, cost, and number of visits to access services. These services could be easily tweaked into providing an inclusive pension and insurance funds as discussed.
CHALLENGES BANGLADESH

While the country has certain and distinct advantages as mentioned above, there are certain challenges and issues that it might face, going ahead. However, most of these challenges can be viewed as opportunities to provide an impetus to the inclusive pension system. Lack of Regulatory Authority on Pensions including the lack of a dedicated cell or wing in the FD for pensioners is a challenge the government has to reckon with in future. Manual practices of record keeping will have to be improved and brought under the purview of the single registry. The NID poses opportunities for creating a centralized record for every adult citizen in the country. Similarly, poor capacities and knowledge about data processing within the LMs including accounting practices will have to be overcome by the government. Lack of awareness on ageing and old age issues will have to be tackled by the government by creating pension and financial literacy and providing 100% financial inclusion. Lack of depth in capital and money markets for investments of pension funds poses challenges for fund management. However, it may be suggested that a larger forum such as the SAARC pension fund or an internationally diversified fund could be created where at most 50% investible funds could be parked. For the rest of the investment, it also poses opportunities for investment in long term infrastructure bonds and other investments. As a symbiotic effect the pension funds can promote and facilitate the development of the financial and asset markets.

WAY FORWARD

The government is currently considering the following options in the pension space:

1. **Parametric Reforms in Products** – certain reforms to be introduced for the existing civil servants as well as the pensioners where the existing products could be further rationalized to suit the contemporary requirement and demographic changes.

2. **Parametric Reforms in Processes** – in order to improve the standard of service delivery and smoothly implement the various processes of pension cases including clearing of pendency, there is an urgent need for reforming various processes to streamline the delivery.

3. **Extensive Use of MIS** – while the various processes are essentially streamlined at different levels there is a necessity for extensively using IT for systemic processing, unique PPOs, generating MIS, etc.

4. **Systemic Reforms** – there is a possibility that the government might consider prefunding of pension liabilities by creating a fund. This could be within the existing framework or may require switching the pension system from a DB to DC where new employees / civil servants could contribute along with the co-contributions from the government as the employer.
5. **Inclusive Pension System** – In case a co-contributory pension system is designed and implemented for the civil servants/new employees, the same could be easily accessed by the formal sector using the employer-employee mechanism of payroll deductions. Similarly, the system could also be accessed by the informal sector workers using multiple channels of P2G as described earlier. The scheme can also be attached with an insurance product that shall together cover the risk of death (insurance) and the risk of longevity (pensions).
THE PRIVATE PENSION REFORM
EXPERIENCE IN TURKEY

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SENIOR ECONOMIST, THE WORLD BANK
MACROECONOMIC CONTEXT

One of Turkey’s key macroeconomic weaknesses over the last fifteen years has been its wide current account deficits. Turkey’s growth model in the post-2001 period has relied heavily on external financing to bridge the gap between its investment spending and domestic savings (Figure 5.1). The average growth rate of 6.8% in the 2002-07 period has been associated with a 3.7% current account deficit. Following the global financial crisis-led contraction in 2009, the strong recovery generated even higher levels of deficit.

Turkey’s domestic saving rates are low and have been declining.1 The high levels of current account deficit are mirrored in the low levels of domestic savings in the 2000s. The average domestic saving rate declined from 16.4% in 2002-08 to 14% in 2009-14. Figure 5.2 shows that the decline in overall saving rates in the first half of the last decade was driven by a sharp drop in private savings, which more than offset the rise in public sector savings, which more than offset the rise in private sector savings — a result of fiscal consolidation in the early 2000s. Within private savings, household saving rates seem to have pulled down overall savings as measured by the data from the household budget survey.2 Since 2009, saving rates seem to have stabilized.

Figure 5.1
GDP Growth (%) and Current Account Balance (% of GDP)

Growth and Current Account Balance

![GDP Growth and Current Account Balance Graph]

Source: World Development Indicators

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1 A new GDP series for Turkey was announced after this chapter was written. In addition to a 20% increase in the level of GDP, saving rates were also significantly revised, however, further research is required to understand the revision to the composition of GDP.

2 Decomposition of private savings by corporate and household sectors were not available through national accounts data at the time of the writing of this chapter. The household saving rates presented here are calculated using the household budget survey from TUIK.
Reaching Turkey’s higher growth targets would require higher domestic savings. Low domestic savings adversely affect Turkey’s growth prospects in two ways. First, domestic saving finances investment and the impact on growth: cross-country data—especially for developing countries—suggest a positive association between saving, investment, and growth. Second, low domestic saving increases dependence on foreign financing, fuelling a rise in the external current account deficit and increasing vulnerability of the growth process. Increasing domestic savings to bring it closer to the 19% targeted in Turkey’s 10th national development plan, and thus narrowing the structural current account deficit, would put Turkey’s growth process on stronger footing to move from a middle-income country to one that is high-income.

Moving towards this goal, and to complement the existing first pillar pension scheme, Turkish policy makers introduced the voluntary private pension scheme in 2003. The rest of this chapter provides an assessment of Turkey’s experience in establishing the private pension system and policy initiatives aimed at expanding the coverage of the system. Section 2 provides further background by describing Turkey’s social security landscape and its demographic profile. Section 3 opens the door for discussion of the private pensions in Turkey and covers Foundation (employer linked) private pension schemes. Section 4 sets forth the experience of Turkey as regards the individual pension system, and includes details on the new auto - enrolment pillar legislated in August 2016 and being introduced from 2017.

Figure 5.2
Turkey’s Domestic Saving Rates
Public, Private and Overall Saving Rates

Source: Ministry of Development

TURKEY’S SOCIAL SECURITY SYSTEM AND DEMOGRAPHICS

Turkey’s First Pillar Social Security System is a pay-as-you-go system. Social security premiums of workers finance healthcare services of existing and retired workers as well as pension benefits of retirees. There is an income transfer from those who are currently employed to those who are retirees. As of 2016, the active/passive ratio is 1.91 which should be ideally 4 by international standards. The Social Security and General Health Insurance Law (No. 5510) introduced in 2008 unified the administration of social security benefits under a single agency known as the “Social Security Institution” (SSI – SGK in Turkish). Eligibility for retirement became stricter with the new law. The retirement age increased to 65, (it is 55 for women and 60 for men), and the replacement ratios or generosity of the benefits were cut – albeit from levels that are among the most generous in the OECD.

A. DEMOGRAPHIC PROFILE

Different age groups have different retirement requirements due to the phasing in of the higher retirement age. The proportion of the 15-64 age group in the general population in 2023 is higher than in 2013 as shown in Figure 5.3. It is expected that the ratio of people aged 65 and over to the population will rise to 10.2% from 8.3% over the same period.

Figure 5.3
Share of different age groups in Turkey, 2000-2025

![Graph](image-url)

Source: TURKSTAT (Turkish Statistical Institute)
As depicted in Figure 5.4, the percentage of the population aged 65 and over in 2013 in Turkey is between 2.5% and 3% on average for each five year age band in 2013 – compared to around 8% in each five year age band from 0 to 35. This is set to change dramatically when the share in each five year age band above 65 is generally around 6% in 2075 with the younger age bands falling to around 4.5%-6% on average. In other words, the elderly population will increase and there will be a decrease in active/passive ratio – with the population pyramid ‘inverting’. Therefore, Turkey’s social security structure will be adversely affected due to the decrease in the number of active workers.

**B. MANDATORY SOCIAL SECURITY SCHEME**

The first pillar retirement system is compulsory for all employees and is provided by the state. Before 2008, private sector employees were covered under Law No. 506; traders, self-employed individuals, and those who are active in agricultural activities were covered under Law No. 1479; and state employees were covered under Law No. 5434. As highlighted above, these three different groups began to receive social security service under a single law and from a single institution from 2008 – the SSI – under Law No 5510.

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*For more details of this phenomenon in Turkey and other countries in Europe and Central Asia see Schwarz and Arias (2014).*
Table 5.1
Insured, Retired Members, and Active-Passive Ratio Table (2015)

<table>
<thead>
<tr>
<th></th>
<th>Insured (i)</th>
<th>Pensioner (p)</th>
<th>Insured/Pensioner Ratio (i/p)</th>
</tr>
</thead>
<tbody>
<tr>
<td>4-a (Employee)</td>
<td>14,577,287</td>
<td>7,044,708</td>
<td>2.07</td>
</tr>
<tr>
<td>4-b (Self employed)</td>
<td>2,785,917</td>
<td>2,558,374</td>
<td>1.09</td>
</tr>
<tr>
<td>4-c (Civil servants)</td>
<td>3,042,243</td>
<td>2,026,541</td>
<td>1.50</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>20,405,447</strong></td>
<td><strong>11,629,623</strong></td>
<td><strong>1.75</strong></td>
</tr>
</tbody>
</table>

Law No. 5510 applied in general to new entrants to the labour market who become insured for the first time under this Law. The rights of those who had been already insured before the Law were generally protected, with some transition conditions applying. This means, the very generous provisions of the earlier laws have a long transition period before they finally disappear.

As of 2015, 85.5% of the population has been covered by the First Pillar Pension System. The ratio of insured people to pensioners and dependents is 45%.

As the ratio of active workers to pensioners and dependents is low, an increase can be expected in the share of transfers from the general budget to the social security system. The amount of transfers to SSI has been increasing since 2008.

Figure 5.5
The Population covered by SSI, 2004-15
Social Security Institution Budget Transfers (TL)
Increasing the premium rates, extending the scope and limits of earnings subject to the premium, extending the number of working days and the number of days for premium payments, expanding the labour force, decreasing unemployment and unregistered employment could help reduce the budget transfers. Some specific policy measures that have been aimed at promoting the fiscal sustainability of the system are:

- Social Security and General Health Insurance Law No. 5510 changed the retirement age and the premium payment periods to 65 and 9000 days, respectively. Also, the replacement rates were decreased although they remain generous relative to other OECD countries.5

- The upper limit of the daily earnings subject to insurance premium increased from 6.5 times of the daily gross minimum wage to 7.5 times,6 with an expected 15% increase in premium collection.

- In order to increase labour force participation, free courses and job placement services are provided, which are financed by the Unemployment Insurance Fund.

PENSION REPLACEMENT RATE

The pension replacement rate can be calculated over the gross and net wage. In OECD countries, the replacement rate calculated over the average gross wage is 57%. It can also be defined as the ratio of the pension amount to the average wages earned during the working life.

There are three pension allocation systems in Turkey: The period before 2000, between 2000 — October 2008 and after October 2008. The pensions before 2000 were calculated over the earnings of the last 10 years of working life. In the systems after 2000, the pension has been calculated over the updated earnings multiplied by the CPI and GDP growth rate concerning the whole period of employment.

For workers following Law No. 5510 since 2008, it is possible for individuals, who begin their working life at 18, to receive a maximum replacement rate of 94%. This is because of the annual accrual rate of 2%. (65-18 = 47 years x 2% = 94%). They receive pension equal to 90% of the updated average earnings at the maximum instead. Since a 47-year-working life does not seem possible given the circumstances in Turkey, if we assume that the average working life is 30 years, 60% (30 years x 2%) of the average earnings during the working life will be the average replacement rate.

On the other hand, the pension allocated to an individual who paid premiums over the upper limit for 30 years before the year 2000, equals to 65% of the average of the earnings, updated according to CPI. For the same individual, the corresponding percentage for his or her working life before the year 2000 is 65%, it is 72.5% between the

5 See OECD Pensions at a Glance 2015
year 2000 and October 2008, and it is 60% after October 2008. If he or she has worked 10 years in each of the three periods, the replacement rate is 65.8% = \( (0.65 \times 10 + 0.725 \times 10 + 0.60 \times 10) / 30 \).

The pension replacement rate for an individual who became insured before October 2008 for the first time and worked in the public sector for 30 years would be 80% of his or her salary when he or she retires. However, after October 2008, according to Law No. 5510, those who start working as government employees for the first time have a pension replacement rate of 60%.

Thus, replacement rates for the new entrants to the work force will be much lower than their pre-2008 levels. In order to address this income gap during retirement, a number of initiatives have been taken in Turkey, which will be discussed in the upcoming sections.

**C. ‘FIRST PILLAR’ OR SOCIAL SECURITY FOUNDATIONS**

Some large employers – such as banks, insurance, and reassurance companies established Pension Foundations that were required to provide benefits as generous, or more so, than the Social Security System. So they are effectively part of the First Pillar of Turkey’s pension system. There is a range of practices – with some matching the pension and health coverage of the SSI and some exceeding it. The members subject to these foundations are not required to pay social security contributions to SSI. Enrolment in such schemes are compulsory for the workers employed in the institutions that were allowed to offer these schemes. (i.e. banks, insurance/reassurance companies, and chambers of commerce).7

As of today, there are 17 Foundations, 10 of which have a relatively bigger size. By the end of 2015, there were approximately 250,000 members in total, approximately 150,000 of whom were active members while 100,000 were passive. At the end of 2015, the total assets under management (AUM) in these Foundations were approximately USD 3.5 billion.

These ‘first pillar’ Foundations are monitored by the Ministry of Labour and SSI. They have wide freedoms as to where to invest their assets. This allows well-run Foundations to design efficient portfolios – but it also allows a high degree of self-investment – for example, the employer can invest in his buildings.

**EMPLOYER SPONSORED PENSIONS**

In addition to the ‘First Pillar’ or Social Security Foundations there are a range of complementary pension plans that were established over the years to provide benefits in addition to Social Security. They were all established before the introduction of the

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7 Such Pension Foundations are schemes that were established before the introduction of the Social Security Law in 1974, and are allowed to be exempt from the provisions of the Social Security Law as long as they provide the minimum benefits required by the SS Law.
voluntary individual pension system in 2003. Many will become increasingly ‘legacy’ organizations, with some already transferring their members into the voluntary private pension system described in Section 4 below – a process that is likely to continue with the introduction of the new auto-enrolment pillar described in Section 5. However, some will endure – in particular OYAK (Army Solidarity Institution) which is the pension fund for the armed forces.

OYAK was founded in 1961 by Law no. 205 and its members were also compulsory members of the Social Security Institution. OYAK had 320,000 members at the end of 2015, and coverage had been rising steadily over the years, bringing its assets under management to USD 7.4 billion at the end of 2015.

Another complementary pension foundation defined by the law is the Union of Coal Miners. (Amele Birligi).\(^8\) The Union has been operating as an institution under the Ministry of Labour and Social Security since 14th December 1982. In this foundation, members contribute 2% of their salary and members who leave the Union can continue as voluntary members. It is a small size fund that has an AUM of approximately USD 10 million.

There are around 80 other Foundations set up by a range of employers – from large conglomerates such as the Koc Foundation to institutions such as the Central Bank. By the end of 2015, there were 266,844 members in total, 191,021 of whom were active and 75,823 of whom were passive. The total AUM amounts to approximately USD 7 billion. These institutions are subject to audit and have to register in the list of Pension Providers kept by the Undersecretariat of Treasury. They prepare an Actuarial Audit Report and send it to the Undersecretariat of Treasury. The actuarial requirements have recently been strengthened by regulations developed by the Treasury.

Transferring funds from such schemes to the individual pension system became possible in 2007 through Provisional Article 1 added to the Law on Individual Pension Savings and Investment System No. 4632. So far, 13 institutions have undergone transfers that accelerated after 2011. The sum of assets transferred to the system in this way was USD 601.2 million by the end of 2015. The time frame allocated for such transfers ends as of December 31st 2017.

THE INDIVIDUAL PENSION SCHEME (BES)

**A. INITIAL DESIGN**

As highlighted above, Turkey has a large First Pillar – and some employer based coverage for certain groups or companies – but before 2001 it did not have an individual voluntary pension system – known as a ‘third pillar’ in World Bank terminology. This was an

\(^8\) In the past, institutions similar to OYAK and AmeleBirligi such as MEYAK (Civil Servants Solidarity Institution) for civil servants and İYAK (Labour Solidarity Institution) were proposed. However, although MEYAK Law entered into force and a deduction of 5% from the civil servants’ salary was implemented for a while, it did not become permanent and İYAK remained only as an idea.
important gap that had to be filled in the multi-pillar framework. The initial reform efforts aimed to promote domestic savings to generate additional resources that could be invested in productive assets via the capital markets. This was done for another advantage, which was to increase the stock of domestic assets by providing a new channel for saving, with the aim of providing additional resources that could be invested in productive assets via the capital market. The third pillar pension system, i.e., the Individual Pension System, (BES in Turkish) was established by the Law on Individual Pension Savings and Investment System No. 4632, which came into force on 7th October 2001. Following the finalization of the secondary legislation and the necessary operational framework, the system became operational on 27th October 2003. The system is based on voluntary participation.

The contributions collected by the pension companies are invested in pension mutual funds founded by the pension companies. Members make their own decisions as to which fund or funds to allocate their contributions in accordance with their risk or return expectations. Pension mutual funds are managed by portfolio managers. It is possible to change the allocations up to six times a year.

Members' accumulations are held under an individual account opened in Takasbank (the custodian bank). Thus, members are not affected by the pension company's solvency and enjoy the benefits of a custodian in terms of fraud prevention.

The individual pension system is a Defined Contribution system based on individual pension accounts. Withdrawals at retirement age can be in the form of phased withdrawals or a lump sum. Early withdrawals are also allowed although with certain penalties, based on the duration of stay within the system. Early withdrawals have been used very extensively, with the average duration of holdings in the individual accounts being only around three years. At the retirement age of 56, assets can be withdrawn without any penalties – but can be left in for longer. In order to retire from the individual pension system, members have to stay in the system for 10 years and complete the age of 56.

As of November 2016, there are 6.6 million members in the individual pension system. The total assets are USD 17.2 billion – made up of USD 15.17 billion dollars directly from members, with additional funds from a state matching subsidy (explained below) totalling USD 2.04 billion. Both the number of members in the system and pension accumulations are rising steadily. So far, 43,114 members have retired from the system. Other primary indicators regarding the system are shown in Table 5.2.
The Private Pension Reform Experience in Turkey

INTRODUCTION OF MATCHING INSTEAD OF TAX-RELIEF IN 2013 TO EXPAND COVERAGE

The individual pension system membership grew quickly in the first 10 years of operation, but there was a desire to explore ways to expand coverage further. Hence, in 2013 the incentives to contribute were changed from a traditional use of tax-relief to the innovative use of state matching concept. For the case of Turkey, state matching has the potential to be more effective than tax relief for many reasons. First of all, it is easier to understand for many when compared to tax-relief. Also, it doesn’t require any additional operation from the member (such as having to submit the proof of pension contribution on a monthly basis in order to enjoy tax relief etc.). Moreover, it allows non-tax payers to receive incentives – and hence can be less regressive than traditional tax relief. Indeed, before the move to matching, only 33% of the members were able to make use of the tax relief. Thus, after 2013, the incentive structure changed into a direct cash contribution by the government (state matching contribution) at the rate of 25% of the contributions paid by members. Within the context of the new structure, all member contributions can benefit from state matching contribution within the statutory limits. The calculation of the state match is performed automatically by the system and no statement or notification from the member is required. The cap for the state match in a calendar year is for that year. So, the max. amount of state match that a member can receive annually is equal to 25% of the annual gross minimum wage.

THE IMPACT OF STATE MATCHING CONTRIBUTION ON INCREASING COVERAGE IN THE SYSTEM

The state match incentive system was extensively publicized before its initiation. As a result, in 2013, the number of new members increased by 64.6% compared to 2012, adding about 1.5 million people to the system in 2013. The number of members entered into the system in 2014 and 2015 was 1.5 and 1.7 million respectively. As set out in Table 5.3 this represented a very significant increase on the growth rates before the policy change.

### Table 5.2
Basic Indicators of the Individual Pension System (30.11.2016)

<table>
<thead>
<tr>
<th>Total Number of Members</th>
<th>6,566,391</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Amount of AUM (USD)</td>
<td>15,165,161,044</td>
</tr>
<tr>
<td>Total Amount of AUM (State Matching Funds) (USD)</td>
<td>2,041,858,832</td>
</tr>
<tr>
<td>Number of Retired Members</td>
<td>43,114</td>
</tr>
<tr>
<td>Number of Contracts</td>
<td>Individual Pension Contracts</td>
</tr>
<tr>
<td></td>
<td>Employee’s Group Contracts</td>
</tr>
<tr>
<td></td>
<td>Non contributory Group Contracts</td>
</tr>
</tbody>
</table>
State matching has also resulted in an important increase in the level of contributions. An analysis of contracts that made at least one payment in the year reveals that the average payment per contract rose from 186 TL (USD 103) in 2012 to 205 TL (USD 108) in 2013. The growth rate in contribution size rose from 6.9% in 2012 to 10.2% in 2013. Contributions then stabilized around this higher level – see Table 5.4.

Table 5.4  
The Average Contribution per Member (Regular Contributions)

<table>
<thead>
<tr>
<th>Year</th>
<th>Members’ Average Monthly Regular Contributions (TL)</th>
<th>Rate of Increase according to Previous Year (%)</th>
<th>Rate of Inflation - Consumer Price Index (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>165</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>2011</td>
<td>174</td>
<td>5.5</td>
<td>10.5</td>
</tr>
<tr>
<td>2012</td>
<td>187</td>
<td>7.5</td>
<td>6.2</td>
</tr>
<tr>
<td>2013</td>
<td>205</td>
<td>9.6</td>
<td>7.4</td>
</tr>
<tr>
<td>2014</td>
<td>204</td>
<td>-0.5</td>
<td>8.17</td>
</tr>
<tr>
<td>2015</td>
<td>213</td>
<td>4.4</td>
<td>8.81</td>
</tr>
</tbody>
</table>

Thus, the state matching reform proved to be effective in increasing participation in BES. However, further reform was still needed to reach the desired levels of private pension coverage in Turkey. It was in this context that preparations were made to develop the new auto-enrollment reform introduced in 2016. This reform is explained below – after a discussion of the history of fees in the individual voluntary system that was another driver for the auto-enrollment reforms.
FEES AND RETURNS

As set out above, contributions paid in the Individual Pension System are invested in pension mutual funds chosen by members. Members’ savings value is determined by the gains or losses of the assets included in the preferred funds. The system initially allowed a wide range of fees and deductions:

- **Entry fee**: An entry fee is a charge for the first contract of a member executed with a pension company (non-contributory group contracts excluded). Entry fees may be collected in advance or deferred (i.e. collected in case of early exit). It may also be collected in instalments provided to collect the advance payment within a year at most.

- **Administrative Expenses Fee**: Administrative expenses fee may be charged over members’ contributions paid to the individual pension account.

- **Additional Administrative Expenses Fees charged in case of a suspension**: If a contribution is not paid within three months following the due date of the contribution, the contract is deemed as a suspended contract. An additional administrative expenses fee may be charged from member’s savings throughout the period of suspension.

- **Fund Management Fee**: A fund management fee may be deducted from the fund.

These deductions have undergone several changes since the system was introduced. This was done to ensure a reduction in the members’ costs in order to encourage increased participation in the system and thus improve retirement income adequacy.

When BES was initiated, the entry fee was capped at the amount of the gross minimum monthly wage from the date of entry to the system, and the administrative expenses fee was capped at 8% of contributions. The fund management fee was limited to 10/100000 per day, calculated over AUM, (3.65% on an annual basis). In the event of suspension, an extra deduction was possible that was capped at 25% of the minimum monthly wage.

In 2008, the suspension fee was limited to only the fixed expenses paid by the pension company to the Pension Monitoring Centre and the Custodian/Takasbank.

In 2013, with the introduction of the state matching contribution system, certain amendments were made in all the fee items. The amount of entry fee was not changed, however, options of advance or deferred collections were brought in. It was stated that the advance part of the entry fee may not exceed 10% of the monthly minimum wage effective on the signing date of the proposal. It was indicated that the sum of the entry fee collected in advance and deferred form may not exceed certain percentages of monthly minimum wage effective on the signing date of the proposal as follows:

a. 75% for those members opting out or transferring within three years as of the effective date of contract,
b. 50% for those members opting out or transferring before six years of contract after fulfilling three years as of the effective date of contract,

c. 25% for those members opting out or transferring before 10 years of contract after fulfilling six years as of the effective date of contract.

However, it was also regulated that no deferred entry fee may be collected from those members who exit the system due to death, disability, or retirement.

There were also reductions in the fund expenses fee cap. Thus, the annual fee cap for: Capital Markets (cash-type) funds was reduced to 1.09%; government and private sector bonds and T-bills funds, international bonds and bills funds, precious metals funds and index funds was reduced to 1.91%; and equities and other equity-like funds was reduced to 2.28%. The suspension fee was reduced to a maximum of 2 TL for each complete month of suspension. Moreover, the administrative fee cap was reduced to 2% from 8%.

By a legislative amendment in 2016, new caps based on the contract tenure were introduced for all fees to be charged from members (including Entry Fee, Administrative Expenses Fee, and Fund Management Fee). A new legislation introduced in 2016 limited fees further in the Individual Pension System. In the first five years of the contract between the years 2016 - 2021, the total amount of entry fee and administrative expenses fee shall not exceed 8.5% of monthly gross minimum wage applied in the first six months of the respective calendar year for each contract year. On the other hand, on and after the sixth year of the contract, no entry fee and administrative expenses fee may be charged.

However, the part of such fixed amounts corresponding to the period until the end of the fifth year of the respective contract and yet uncollected by the respective pension company may be deducted as a deferred entry fee from a member’s savings at his individual pension account for those members opting out or transferring without fulfilling five years of the contract period. (Getting out of the pension system due to death, disability, or retirement are exceptions).

In addition, there is only a fund management fee in the practice of the automatic enrolment system to be applied to the large masses of employees, and it was indicated that maximum yearly fund management fee (FMF) for all funds will be applied at a maximum of 0.85% and in all conditions.

It was stated that in the event of exceeding some specified performance thresholds together with a total fund expenses fee, in the automatic enrolment practice, it will be possible to charge an additional FMF equaling to the 25% of the amount over the threshold. However, it was added that, any additional fee to be charged may not exceed the rate of 0.85%. All these arrangements aim to reduce the costs of the individual pension system for members.
The administrative expenses fee is taken from the contributions made by the participant. In an examination of these fees in terms of administrative expenses fees, it is observed that the administrative expenses fees charged on the collections made by the end of 2015 were 2.09% cumulatively. However, members who entered the system after 2013 saw this fee around 1 percent.

**Figure 5.6**

**History of Administrative Expense Fees**

As Figure 5.7 shows there is no correlation between higher fees and higher returns – with returns driven by market movements. This matches the evidence shown in Chapter 18 on cost.
C. DATA AND CITIZEN IDS

The collection of data and recordkeeping are very crucial aspects for the effective functioning of the Turkish private pension system. A member in the individual pension system might have more than one contract in the same or different pension company. Members are identified based on the Republic of Turkey ID number while contracts are identified on the basis of contract numbers given by pension companies. In this case, it is possible that there will be more than one contract number under an ID number. Pension companies can access the information of whether members have contracts in other companies through the Pensions Monitoring Centre (PMC). The PMC provides the daily supervision of pension companies’ activities in order to ensure the safe and efficient operation of the individual pension system and the protection of members’ rights and returns. The PMC has functions such as monitoring and supervising of the pension companies’ daily activities, keeping the information of members, informing the public and members, producing, and reporting statistics, etc. In this context, pension companies send data to the PMC each day and the PMC consolidates this data. The PMC requests pension companies to send data defined as “Enhanced Monitoring Activity Data”. They are sent on the basis of member, contract, and various other legislative subjects. The PMC consolidates the data and gives feedback to pension companies about errors in it, with the aim of collecting error-free data.
When a member wants to retire, the oldest contract’s enforcement date is considered as entrance date to the system and this is how time-dependent rights emerge. The member needs to merge savings in all pension contracts into one contract at the time of retirement. The operation is initiated when the member communicates his/her request to retire to one of the pension companies with which he/she has a contract.

**Figure 5.8**

**Distribution of Members According to Number of Contracts Owned**

- 1 Contact: 77.8%
- Other: 22.2%
- 2 Contracts: 15.5%
- 3 or More Contracts: 6.7%

Source: PMC Annual Progress Report of 2015

**IT AND ADMINISTRATION**

The Law on Individual Pension Savings and Investment System No. 4632 includes provisions for monitoring that are in compliance with the EU regulations and ensure high standards. The detailed framework for monitoring and supervising the system was established by the Regulation on Procedures and Principles Regarding Monitoring and Supervising Insurance and Private Pension Sectors based on Law No. 4632. The individual pension system includes a versatile and comprehensive supervision mechanism.

Aside from the Circulars, Notifications, and Resolutions published during the continuity of the system, all pension companies that will carry on business in the individual pension system are constantly monitored and audited by:

- Republic of Turkey Prime Ministry - Undersecretariat of Treasury
- Capital Markets Board of Turkey
- Independent external audit
- Company internal audit units
- Company actuary units.

**D. SUPERVISION**

A pension company’s pension activities are subject to supervision by the Undersecretariat of Treasury. The Undersecretariat of Treasury has prepared the “Individual Pension Procedures Audit Manual” in order to set out the minimum auditing areas and subjects without limiting the framework of the audit during the on-site audits conducted by the supervisors. This manual is updated in the scope of the new regulations when necessary.
The Undersecretariat of Treasury has commissioned to the PMC for daily monitoring of the system as highlighted above.

AUDITING BY THE CAPITAL MARKETS BOARD

The following are regulated by the Capital Markets Board of Turkey: the organisational structure; internal and independent auditing; accounting, documentation, and recording system of the private pension mutual funds; principles concerning fund member disclosure, principles pertaining to fund types, and portfolio limitations; issues on valuing and safekeeping of assets in the fund portfolio; rules for consolidation; and transfer of funds.

INDEPENDENT EXTERNAL AUDIT

Pension companies are subject to audits by independent auditing firms at least once a year. In addition, accounts and transactions of pension funds are subject to an independent external audit on a quarterly and yearly basis (Law No 4632, Article 21).

It is essential that independent audits conducted at pension companies’ requests are bound by a written audit contract. A copy of the contract is submitted to the Undersecretariat of Treasury by the pension company to be audited.

INTERNAL AUDITING

Internal auditing of pension companies is intended to ensure: reliable information flow; integrity and attaining on-time information on financial and administrative issues; improving productivity; and provision of pension companies’ activities in compliance with the legislation. Pension companies are required to put in writing all policies and procedures concerning the internal auditing system. Execution of these activities by pension companies in compliance with internal auditing procedures is audited by pension companies’ auditors.

Internal auditors of pension companies are obliged to act as whistle blowers in the case of any critical issues. In such cases, the relevant report should be to the board of directors of the relevant pension company, and a copy of the report should be submitted simultaneously to the Undersecretariat of Treasury.

THE NEW AUTO ENROLMENT PILLAR

The existing Individual Pension System (BES) allowed individual or group pension contracts. Group contracts set up via employers are often a way to significantly increase scale or reduce costs. Around 20% of the 6 million BES contracts were group contracts of one form or another. But this development, whilst useful, has not fundamentally changed the coverage of private pensions or their costs. Similarly as described above there were
important changes to incentives and fee caps which led to significant improvements on
the original design of the BES, but the government wanted to go further. Moreover,
the ultimate aim of the government to improve coverage of private pensions, as well
as its policy aim to increase the supply of domestic assets for investment and to
reduce dependence on foreign sources of investment funding have inspired the
Undersecretariat of Treasury to investigate new ways to improve coverage, reduce costs,
and increase returns.

Initial studies for the feasibility of auto-enrolment reform began in 2014. A pilot project
was conducted in 2014 with seven employers that revealed that making use of inertia
could work in Turkey. This was important because a fully mandatory approach was not
considered likely to be successful due to unfavourable experiences in Turkey in 1980s and
1990s with compulsory saving schemes. A ‘FIRST’ funded project with the World Bank
was launched in 2014 to investigate different options regarding the design and supervision
of the system.

The aim was to use the best international evidence tailored to the specific circumstances
of Turkey. This suggested that parts of the existing private pension system could be used
but that significant improvements would be needed as well. For example, it would be
possible to use the individual account structure and the investment in private markets, but
the employer would become the main channel into the pension system and be the one to
make a choice of the pension provider to remove the costs and complexity for members
of the individual/sales agent model. Default funds would be needed to ensure that
members who were not investment experts would have a well-designed asset allocation.
Also, the fees needed to be reduced further to ensure a rise in the net of fee returns in
order to help boost pension adequacy. The fees could be reduced further because the
design of the new auto-enrolment pillar removed some significant elements of costs –
although this will require some other investments as set out in more detail below.

Law No. 6740 laid down the framework for the reform. The law was enacted in August
2016 to be effective as of 1st January 2017. According to the law, all employees under
the age of 45 are required to be automatically enrolled into the individual pension system
by the employers. The contribution, which can be raised upon the employee’s request, is
equal to 3% of the gross salary. There is no mandatory employer contribution. Whilst this
is unusual compared to other examples of auto-enrolment and employer pensions more
generally, it was decided in the context of a recent 30% increase in the minimum wage,
which had already imposed significant costs on employers.

The Council of Ministers has the authority to increase the minimum contribution rate
from 3% to 6%. There is an opt-out period of two months. However, early withdrawals
are also allowed after the opt-out period – a feature that ideally would be revisited in the
future to help keep assets locked in for longer and allow longer term and more illiquid
investments to be targeted. The employers choose the pension company, whereas the
funds will be chosen by the employee among five different investment options. The
fund management fee is limited to 0.85% of the AUM on an annual basis. Also, there are short and longer term performance benchmarks for the funds managed with possible performance rewards or penalties.

The total number of employees that are subject to auto-enrolment is around 14.1 million. The employers will be enrolled between 2017 and 2019 according to the number of their employees.

There are many governmental incentives to induce people to stay in the system. First, even if they are already receiving matching contributions in the BES, automatically enrolled workers will receive an additional 25% state matching subsidy for their new auto-enrolment pension contract. Furthermore, employees who do not exercise their right of opt-out and continue to stay in the system will be granted an extra state subsidy (welcome bonus) of 1,000 TL (275 USD). When individuals reach the retirement age of 56 (assuming they have been in the system for at least 10 years) if they convert their savings into an annuity contract payable for a minimum of 10 years, they will be granted another supplementary state subsidy of 5% of their total assets. All of these incentives aim to decrease the opt-out rate, roll-out private pensions to the masses, and encourage them to take their pension as a stream of annuity income rather than as a lump sum.

The auto-enrolment pillar is expected to lead to an additional assets under management of USD 30 billion dollars in the next 10 years. Such a scale-up will benefit the pension companies in numerous ways:

- Reduction in expenses
- Facilitation of simpler processes
- Provision of services to more members with existing infrastructure
- Convenience of cross-sales
- Decrease in brokerage commissions

There may be some additional costs but the net effect will be to reduce costs and increase scale – and hence it is acceptable to reduce the fees further compared to the BES. Since, in the automatic enrolment system, employers are the sole decision makers in terms of sales, corporate sales channel will be part of the deal. Corporate sales units will have to encompass individual sales. Instead of individual pension brokers soliciting members generally on an individual basis in the existing system, in the new system the activities of marketing, promotion, and brokerage will be focused on workplaces. This, in turn, will make substantial changes in the number of brokers and variations of distribution channels in the near future.

This will be a very significant change. At the end of 2015 most contracts were still arranged through the individual sales distribution channel even though corporate or group plans were possible. As a result of the increases in corporate sales distribution staff by pension companies due to the automatic enrolment system, the number of contracts executed through corporate sales will increase.
In Turkey, under the BES, generally, each of the three traditional payout methods is utilized for the payout period. The methods used at retirement may be specified as:

1. **Lump sum payment**: This is the most frequently used method for the payout phase before and after the enactment of the BES in Turkey. Currently, the majority of total payouts in the BES are made as lump-sum payments. According to the BES Progress Report 2015 by the PMC, 92% of members leaving the system at retirement at the end of 2015 took their entire savings as a lump sum payment.

2. **Phased withdrawals (income drawdown)**: In Turkey, this option is usually deemed suitable for retirees wishing to receive payments as certain amounts for a specified period. In phased withdrawals, the member’s contract in the BES is transferred to the retirement income plan in the chosen pension company, and she/he may receive the payments monthly, quarterly, biannually, or annually. While receiving the payments, the rest of the total sum of savings continues to earn interest in pension funds chosen by the retiree based on the pension investment fund options in her/his retirement income plan. The retiree is entitled to change the distribution of the funds in which her/his savings are invested depending on the performance of the funds and her/his preference. The retiree is also entitled to cash out the savings remaining in her/his account any time. Also, it is compulsory to pay out the total accumulation as
a lump sum benefit to the beneficiaries upon the death of the retiree. In this context, there is no provision in the legislation for the transfer of phased withdrawal payments to widows and orphans. With phased withdrawals, the only cost element is the fund management fee which is charged daily on the AUM.

3. **Annuities**: Annuities are currently not pervasively used in Turkey. Before the BES system started in 2003, “endowment life insurance” policies were offering a lump sum payment or an annuity option at the end of the insurance period. Most insured chose lump sum payments instead of the annuity because fund balances were low, payouts were not considered to be very generous, and the life insurance companies were not eager to provide annuities either. Comprehensive legislation on annuities entered into force in October 2015. According to the legislation, the pension and life insurance companies were licensed by the Undersecretariat of Treasury before offering any annuity products. The Insurance Tariff, technical principles, and special conditions of the policy were not subject to any approval by the authority, but submitted to the Undersecretariat at least 15 days before the launch of the product. The mortality tables used to price and under-write the liabilities were limited and subject to the approval of the authority, and any charges/fees were also limited (withdrawal/surrender fees).

Currently, there is legislative segmentation for the offering of annuities. For the retirees aged 56 and over, only traditional single premium immediate lifetime annuities are allowed with a maximum of five-years deferral period. The annuities should be offered as inflation indexed annuities.

For the retirees under the age of 56, the product range is much more diverse.

Demand for annuities and phased withdrawals are expected to grow as members start to retire from the BES. One of the most significant motivations for people to participate in the BES in Turkey is the person’s desire for adequate retirement income that will allow them to be independent financially from their families during their retirement. In addition, the bequest motive is also quite strong. A combination between a phased withdrawal product and a deferred annuity product, which is activated well past retirement could be optimal. See Chapter 20 for more discussion on payouts.

The government has also enacted laws on the taxation side in order to stimulate demand for the annuities. In this context, Single Premium Annuity products sold upon retirement are excluded from income tax. In addition, as highlighted above, individuals who choose to convert their accumulations to an annuity from the new auto – enrolment pillar will receive a supplementary state match of 5% on their total amount of savings.

However, despite these positive developments, there are also factors impeding the growth of a strong annuity market in Turkey:

a. **Measurability and management of longevity risk**: Technical studies enabling the management of longevity risk have recently started in Turkey. Mortality tables
specific to Turkish population are recently available and are used by the insurance and pension companies. However, it is essential to update the mortality tables regularly and calculate the mortality improvements in the population – using dynamic mortality tables rather than static or period tables. Efforts in this regard are ongoing.

b. **Investment Risk Management:** Annuities are long-term financial products and should be supported with long-term investment vehicles (like 30 or 50 - year - long government bonds, treasury bonds or alternative investment vehicles). Currently, 30- or 50 - year - long financial investment vehicles do not exist in Turkey. However, the Undersecretariat of Treasury has stated that it will issue long-term investment vehicles (state bonds and bills) with the intention of promoting progress in this area. Accordingly, the Undersecretariat of Treasury published a CPI Indexed Annuity Government Bonds Investor Guidance on Annuities in December 2015. In this context, the required financial assets to back annuity sales will start to be supplied but this will be a long-term effort. The development of the economy, an increase in the savings rate and investment product ownership and improved products will hopefully lead to an acceleration in the size and viability of the annuity market.

c. **Reinsurance supply:** Insurance companies will need to make the necessary reinsurance agreements before the launch of annuity products. These arrangements were not well-developed before but should grow in the future as more people begin to retire from the BES and, in the future, from the new auto - enrolment pillar.

**CONCLUSION**

Turkey has continuously aimed to develop a more diversified pension system, so that private pensions work alongside public pensions. The aim was to increase the welfare of the working population at retirement, as well as increase the domestic savings rates. The development of the BES system generated a fund size of around USD 17 billion in around 13 years. Introduced in an inflationary environment, it was initially launched with a relatively high cost platform.— Since then, and reflecting changing economic environment, there has been an active process to improve upon the voluntary system: primarily its coverage, fairness, and cost-efficiency. These have yielded some positive results and include one of the most successful examples of the benefits of matching compared to tax relief in the world. But to go further, and ensure coverage beyond 30% of the workforce, a bold step has been taken to introduce an auto - enrolment pension system. In addition, it was important to use this development to change the model of enrolment into pensions – using the cost efficiency and governance benefits of having the employer as the primary route into a pension scheme. This increases coverage and allows cost savings that can be passed on to members in the form of lower fees and higher net returns. It should also be noted that prior efforts in building a governance body like the PMC and creating unique citizen IDs have significantly facilitated this transition. Going forward,
outreach into the informal sector will be the next big challenge. For this purpose, Turkey may consider creating a platform for broad-based coverage that could be cost efficient to informal workers – using the relatively sophisticated and broad based financial inclusion and payments infrastructure in Turkey.

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AN INCLUSIVE AND INTEGRATED PENSION MODEL FOR INFORMAL SECTOR WORKERS IN RWANDA

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INTRODUCTION

This chapter sets out the challenges and advantages faced by Rwanda that has led it to develop a leading-edge pension coverage initiative. This will leverage developments in national ID, financial inclusion, and understanding of pension administration and governance to provide an option for workers that does not exist in most developing countries. The Government is seeking to build on the lessons of both the pension and financial inclusion literature in order to develop an infrastructure that may be able to tackle the profoundly important challenge of offering access to pension saving for a rapidly developing but still highly rural low-income economy. This chapter helps to bring together a number of themes present in the thematic chapters of this volume. It shows how the right combination of ID and IT can work with financial inclusion and payments’ innovations to create the potential for a new generation style pension coverage program that has the potential to transform understanding of what can be achieved. This chapter sets out the socio-economic background of the country and then looks at developments in financial inclusion and pensions. It then sets out a new initiative to deliver digital pension inclusion.

RWANDA OUTLOOK

Rwanda has made good progress over the last two decades since the enormous challenges faced in the aftermath of a genocide that destroyed the entire social and economic fabric of the country. Rwandans have benefited from rapid economic growth (average 8%), reduced poverty, reduced inequality, and increased access to services including health, education, access to financial services, insurance and pension penetration, and Information Communication and Technology (ICT).1

Rwanda has for a long time tried to integrate population issues into development programs through various efforts. Since 2000, the government has embarked on the implementation of multidimensional population policies that include several features such as: land management; improving health conditions of the population; universal access to healthcare including reproductive health and family planning services; and interventions aimed at improving the levels of education, equal rights for girls and boys as well as gender inclusion at all levels.

The Rwandan labour market also registered a positive trend since 2000. Though the majority of the population works in agriculture, the number of young people entering the labour market is continuously increasing. Rwanda plans to create 200,000 new off-farm jobs each year by 2020. This is why the national development strategies concentrate on generating long-term employment by improving vocational training, strengthening the private sector, and implementing targeted labour market interventions.

Rwanda understands the role of the financial sector and inclusive access to finance to realize her socio-economic development goals. The overreaching goals are to develop a stable and sound financial sector that is sufficiently deep and broad, capable of efficiently mobilizing and allocating resources to address the development needs of the economy, and reduce poverty.

**POPULATION STATISTICS**

According to the population and housing census 2012, Rwanda recorded a total resident population of 10,515,973 people (composed of 5,064,868 males and 5,451,105 females). It indicated an increase of 29.6% in enumerated population from the third population and housing census of 2002 and recorded an average annual growth rate of 2.6%.

Of the entire population aged 16 and above, 74% were economically active. There were 4,152,682 employed people, representing 71% of all residents aged 16 and above. The Rwandan labour market was predominated by agriculture (73%). A higher percentage of employed females was employed in agriculture (82%) compared to males (63%) and a higher percentage of employed persons in rural areas was that of farmers (83%) compared to those in urban areas (21%). Concerning employment status, the results showed that the majority of the employed population in Rwanda were self-employed in the agriculture sector (60%), followed by employees (18%) while self-employed out of agriculture represented 8% of the total employed population. The proportion of males who were employees was twice as high as the corresponding figure for females, while the proportion of women contributing to family work was more than double that of men.

**LABOUR MARKETS**

A major actor in the labour market is government through its regulatory framework and its social protection framework to ensure equity and protection for all, both employers, those in the labour force and in the potential labour force. Government also influences the labour market through its macro-economic, fiscal, and microeconomic policies that enhance the environment for employers to create jobs.

**OCCUPATIONS**

The Rwandan labour market is predominated by agriculture. The Integrated Household Living Conditions Survey (EICV), 2012 showed that, 1,773,000 people were recorded as salaried or waged employees with 37% of them employed in farming activities. The majority of salaried/waged workers were daily workers (65%), followed by permanent workers (28%), and the remaining are temporary, casual and seasonal workers. A subsequent number of jobs carried out by salaried/waged workers are informal (87%). This means that their holders are not entitled to social security contributions or are not benefiting from paid annual leave or do not receive paid sick leave.

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2 The Republic of Rwanda, Fourth Population and Housing Census 2012 (NISR), P.9
3 The Republic of Rwanda, Fourth Population and Housing Census 2012 (NISR), P.34
4 The Republic of Rwanda, Fourth Population and Housing Census 2012 (NISR), P.34
EDUCATION AND NON-FARM WORK

Educational attainment has a large impact on a worker's ability to move out of agriculture. The completion of primary school and the participation in secondary or vocational training is a watershed in moving into non-agricultural work. Interestingly, 90% of those who have never been to school work in agriculture as are over three quarters of those who reached primary grades 6 or 7. On moving to post-primary education, only half are in agriculture. The percentage continues to fall as the levels of education rise.

RECENT JOB CHANGES

Around 240,000 people start a new job each year (excluding those responsible for family farms for whom we have no information). Workers have taken 1.45 million jobs in the last five years. The majority of new job takers are young, with the median age at 22 years. Those starting work on family farms are the youngest, and those starting a small enterprise are oldest, on average 28 years. New job holders in Kigali are older than their counterparts in other provinces. The majority of new work opportunities are on farms: it seems 45% of those taking jobs start work on family farms. Almost a quarter of jobs taken in the last five years are non-farm waged work, while 19% of jobs are in small enterprises. Newly started jobs were examined by the workers expenditure quintile, and compared with the quintiles for all job holders. The recently acquired jobs are held by people who are more prosperous than the national average. This slightly more affluent profile holds true for all job types.

DEMOGRAPHIC STRUCTURE OF THE POPULATION

According to the 2012 census, 5,015,128 persons out of the total resident population of 10,515,973 were under 18. In the child population, 2,486,716 are male while a slightly larger number of 2,528,412 were female. The child population represented 48% of the total resident population. The population share of children is higher in rural areas (49%) than in urban areas (41%).

EDUCATION LEVELS

As one of the Millennium Development Goals (MDGs) and reflected in the Rwandan Government’s Vision 2020 and Economic Development and Poverty Reduction Strategy (EDPRS 2), universal access to primary education (UPE) — for boys and girls recorded a remarkable progress. Findings from the fourth population and housing census 2012 revealed that, about 57% of the resident population aged three and above, had attended primary school, 12% had attended either post-primary or secondary school, and about 2% had tertiary education. While about 26% of the resident population had never attended school.

GENDER AND AVERAGE AGE MORTALITY

Findings from the population and housing census of 2012 indicated that 52% of the population were woman and 48% men. On average, women were older than men: the

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5 The Republic of Rwanda, Fourth Population and Housing Census 2012 (NISR), P.115
6 The Republic of Rwanda, Fourth Population and Housing Census 2012 (NISR), P.19
mean age for the female population was 23.5, while it was 21.9 for males with an average of 22.7. This difference was because male mortality was higher than female mortality. However, the population of Rwanda is young: half of the females are under 19 and half of the men under 18. Only 4% of the female population and 3% of the male population is over 65.7

PROFILE AND STATUS OF FINANCIAL INCLUSION

89% of adults in Rwanda are financially included (including both formal and informal financial products/services, around 5.2 million individuals) and 11% of adults do not use any financial products or services to manage their financial lives. About 26% of adults in Rwanda are banked according to a FinScope 2016 report. FinScope is a research tool used to provide a holistic understanding of how individuals generate income and how they manage their financial lives. It identifies the factors that drive financial behaviour and those that prevent individuals from using financial products and services. The growth of bank usage is driven by the number of bank branches and sub branches (177 and 187 in 2016 respectively), debit cards, loan from the bank, and high uptake of mobile banking (4,342 banking agents). In terms of banking product usage, 52% of bank clients used at least one banking product according to the report (increasing from 43% in 2012). Findings also showed a high level of “cross-selling” within the sector and as a result average banking products per client is 3.08, meaning that 92% of the banked population has three or more banking products, up from 2.36 in 2012.

DIGITAL PAYMENTS

The Rwanda Integrated Payments Processing System (RIPPS) operated smoothly by maintaining an availability rate of 99%. Electronic payment as compared to broad money significantly increased over the last four years from 22% in 2012 to 66% in 2015, reflecting gradual progress towards a cashless economy. The introduction of agent banking, and the modernization of financial services such as mobile money, ATMs, and Mobile banking have all helped to drive financial inclusion in Rwanda. Now, 6.7 million adults use mobile money accounts.

SHORT AND LONG TERM SAVING

Savings are the leading product type and one of the main drivers of financial inclusion for Rwanda. This is encouraging as savings enable adults to create wealth, pay for household furniture and equipment, and most importantly, can be used as collateral for accessing credit. According to the FinScope survey 2016, uptake of savings products has greatly improved. At present, 13% of adults save in banks (a decline is noted from 15% in 2008, to 14% in 2012); 45% of adults have a formal savings product from a non-bank (up from 25% in 2012) financial institution (this could be savings from Saving and Credit Cooperatives (SACCOs) and mobile money); 56% use other informal savings mechanisms.

7 The Republic of Rwanda, Fourth Population and Housing Census 2012 (NISR), P8
such as savings groups; 35% of adults claim to save at home or with someone in the household (up from 24% in 2012); and 14% of adults do not save.\(^8\)

**HEALTH INSURANCE, LIFE, AND OTHER NON-LIFE INSURANCES**

Currently, there are eight non-life insurers, four life insurers, two public medical insurers, fifteen insurance brokers, three hundred and sixty five insurance agents, and twelve loss adjusters. In general, the uptake of insurance in the Rwandan market is low. Only about 9% of adults have insurance products (around 0.5 million), showing an increase from 0.3 million in 2012. Product uptake is driven by medical insurance (excluding Mutuelle de Santé -- National Health Insurance) and the Rwanda Social Security Board. The main perceived barriers relate to the lack of consumer awareness and knowledge as well as suitable insurance products on the market.

**MUTUELLE DE SANTÉ**

Mutuelle de Santé is part of the Government of Rwanda’s social protection system introduced in 1999. The aim of Mutuelle de Santé was to enable members to access health care through all public and private non-profit health centres in Rwanda and to reduce the financial burden of health care particularly for the poorer groups of society. Membership is voluntary and open to all Rwandan residents for a modest annual payment. Households at the bottom two of the socio-economic or Ubudehe categories (i.e. the most vulnerable) are entitled to have the membership fee waived. FinScope 2016 findings indicated that 77% of adults were covered by Mutuelle de Santé, up from 71% in 2012.\(^9\)

**STATUS OF MORTALITY TABLES**

Rwanda has developed Mortality tables (May 2017), which are used in pricing and reserving life assurance products as well as for the management of pension liabilities. They are a key piece of insurance industry infrastructure which facilitates the pricing of life assurance and annuity contracts as well as more accurate reserving for future payments which may need to be made. This increases consumer confidence which could in turn stimulate product development to better meet the needs of policyholders; and aid credibility and growth in the sector.

**MOBILE PENETRATION**

By March 2015, operators offering mobile telephone services included; MTN Rwanda Ltd, TIGO Rwanda Ltd, and AIRTEL Rwanda Ltd, and those offering fixed telephone services were Liquid Telecom Ltd and MTN Rwanda Ltd. As of March 2015, there were 7,913,986 active mobile subscribers (according to the Rwanda utility regulatory authority report) relative to a total population of 10.5 million.

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\(^8\) The Republic of Rwanda, FinScope Rwanda 2016, P.50

\(^9\) The Republic of Rwanda, FinScope Rwanda 2016, P.57
EXISTING OUTREACH AND SERVICE DELIVERY INFRASTRUCTURE

Introduction and continued increase in the uptake of Umurenge SACCOs has been a success story in driving financial inclusion. There are 416 U-SACCO countrywide and 90% of Rwandans now live within a 5 km radius of Umurenge SACCO. The SACCO network has over 2.5 million adults as members with accounts.

Levels of financial inclusion in Rwanda (trend in service uptake by years between 2012-2016)

- The percentage of banked adults increased from 23% in 2012 to 26% in 2016. This increase was mainly due to new banking channels entering the market resulting in increased outreach of existing banks.

- The percentage of adults, who are formally served, although not banked, increased from 33% in 2012 to 65% in 2016. This shift was mainly due to the mobile money uptake and continued increase in the uptake of Umurenge SACCOs.

- In 2016 only 11% (0.7 million, down from 1.3 million in 2012) were financially excluded and 89% (5.2 million) of Rwandan adults had or used financial products or mechanisms.

- The increase in formal inclusion was caused by an uptake of products offered by nonbank formal financial institutions (such as mobile money, Umurenge SACCOs, and insurance companies).

PENETRATION AND ACCESS

In Rwanda, there are no significant infrastructural barriers to access financial service providers. On average adult Rwandans can access formal financial services on foot between 30-53 minutes. This is because of the introduction of Umurenge SACCO and modernization of payment especially mobile money development. However, as highlighted in Chapter 1 on India this can still be an important barrier to access and is something that should be progressively reduced through continued developments in financial inclusion.

The banking network development, especially the bank agency network, continues to increase access to financial services hence access to financial services increased significantly over the recent years.

- Banks increased to 17 in 2016 from 10 in 2010. (12 commercial banks, three microfinance, one Development Bank and one Cooperative Bank).

- The number of Micro-Finance Institutions (MFIs) increased from 125 in 2008 to 491 by December 2016, including 416 Umurenge SACCOs.

- The number of insurance companies has increased from nine (9) in 2010 to fifteen (15)

- The Non-Bank Financial institutions comprise mainly insurance companies and pension schemes. As on June 2016, the insurance sector was composed of 15 (13 private insurers; 2 public insurers) and 385 insurance agents.
CURRENT PENSION PROVISION AND NEW POLICY REFORMS

Rwanda is a relatively young country with nearly half of its population under the age of 15 years. The fourth population and housing census expects Rwanda's elderly population (60+) to double from the roughly 510,000 in 2012 to approximately 1,096,000 individuals by 2032. This is due to a combination of reducing fertility rates and improvements in life expectations.
expectancy. This aging population creates a public policy challenge for the Government and Rwanda cannot afford the high fiscal and social cost of a universal, tax-funded old age benefit (a pension of even USD 1 per day to one million elderly in 2032 will cost RwF 292 billion per year USD 365 million). The only sustainable policy option is for the government to establish a simple, secure, convenient, and affordable mechanism that enables citizens to accumulate savings for their old age.

Rwanda has one public pension scheme managed by Rwanda Social Security Board (RSSB) – known as the Rwanda Personal Pension Scheme and fifty-seven private pension schemes. The RSSB pension scheme is a mandatory Defined Benefit (DB) pension program and compulsory for all salaried workers (private and public) and active political representatives. It has contribution rates of 3% of gross salary, paid by the employer, and 3% by the employee, making 6% in total. The RSSB also has the option for individuals to enroll as voluntary members. This can be achieved by applying to join the scheme and paying the required contribution rate of 6% of salary. The RSSB pension scheme currently barely covers 10% of Rwanda’s workforce – focusing largely on public and private sector salaried employees.

The excluded 90% of the workforce is neither covered by a pension scheme nor a long term savings scheme. This has significantly affected negatively the national savings rates required to increase private sector investment and reach double digit GDP growth.

This situation has two implications:

i. The 10% of the total workforce are salary earners, with a pension scheme under RSSB, but they lack a supplementary long term saving scheme to cater for other needs like acquiring a house or paying for education in order to guarantee a decent retirement.

ii. The excluded 90% of the workforce is not served at all – they lack both, a pension scheme and a long term saving scheme.

The Government of Rwanda has hence designed a new scheme to create inclusive and equitable saving options. It aims to provide every Rwandan citizen and all Rwandans living outside Rwanda with equal rights and opportunities to achieve a dignified retirement in a secure, affordable, convenient, and well-regulated environment.

The scheme is proposed to cater for four population segments: (i) public sector salaried employees; (ii) private sector salaried and self-employed business owners; (iii) people involved in the informal sectors (earning irregular and low income); and iv) children (below the age of 16 years) without a national ID who will access the scheme through a sub account opened by the parent/guardian.

A scheme based on individual accounts is feasible in Rwanda because several key pieces of the required implementation ecosystem already exist – (i) national ID for every citizen; (ii) high financial access rates; (iii) a functional network of cooperatives; (iv) over 70%
mobile phone penetration including fast growing mobile payment services and; (v) strong mobilization via local Government administrative structures. These elements are all critical parts of the eco-system that can enable a new approach to delivering pension coverage – and mirror the content of many of the thematic chapters in this volume.

The proposed saving scheme is designed to be flexible vis-a-vis both savings levels and periodicity so as to allow all categories of subscribers to make pension contributions in line with their unpredictable cash-flows.

Members of the scheme shall be expected to keep savings in their assigned account for a minimum pre-defined number of years. Upon completion of the minimum period, a member may be authorized to withdraw part of his/her benefits as a pre-retirement package. The pre-retirement package may be invested in housing and education or/and any other investment (for those with sufficient savings under the RSSB mandatory scheme).

However, it should be noted that the amount of the authorized pre-retirement package will be capped to a maximum percentage of the total individual savings to ensure that the beneficiary retains sufficient funds under the scheme to cater for his/her retirement days.

It is important to note that encouraging mass-scale savings for old age may be challenging. Concepts of retirement, pension and insurance will not resonate with most excluded citizens, considering that the majority face modest, unpredictable incomes. At the same time, only tax incentives would be ineffective in motivating population-wide participation since the targeted group is not paying taxes. As a solution, the Government of Rwanda has offered an attractive package of incentives based on certain eligibility conditions and varying social and economic classifications of the population (Ubudehe categories). It includes fiscal and non-fiscal incentives like matching Government co-contributions and free life insurance, coupled with extensive public awareness to achieve early, mass-scale coverage, and sustained savings discipline over time. Aggressive information sharing, education and awareness campaigns and communication initiatives will be delivered through several channels and using various tools like field officers, videos, benefit calculators, with support from all Government administrative and private structures.

The scheme will harness the existing institutional capacity for regulation, outreach, service delivery, micro-payments, funds management, and insurance benefits.

**MANAGEMENT AND ADMINISTRATION OF THE SCHEME**

A System Administrator and Integrator is being established to manage the individual pension accounts. It will develop a central record-keeping system, integration and payments processing IT platform that will issue and manage portable, individual pension accounts, and record static and transactional data of each subscriber over multiple decades.

The trustee/board of directors of the scheme shall recruit independent fund managers (approved by the regulator) to carry out required investments.
LEGAL, TAX, AND REGULATORY FRAMEWORK

The scheme will be managed as a voluntary universal long term savings scheme by all residents and citizens in Rwanda. The National Bank of Rwanda will be the regulator of the Scheme. It will ensure establishment and enforcement of appropriate regulatory, institutional, technology, and administrative frameworks to ensure long term viability of the scheme.

As a way to motivate sustained voluntary retirement contributions/savings, it is proposed that for the tax relief option the Government adopts an Exempt contribution-Exempt interest earned-Taxed benefits income tax structure for the scheme (EET), which is very common internationally. However, as highlighted above there will be matching contributions to encourage participation for those contributors who do not pay tax. As well as, ensuring incentives for all potential contributors, matching has the advantage of being simpler to understand – and ensures that a pension system is not regressive, since tax payers tend to be the higher income segment of a population.11

The most important challenges envisaged during implementation of the scheme are related to income such as low/insufficient income, insufficient balances after paying for expenses and affordability issues. In addition, insufficient consumers’ awareness and knowledge is likely to slow down the uptake of the product. Whilst there is much still to do to launch and implement the new scheme, the design and structure should give it the best chance for success.

CONCLUSION

Rwanda is a young country but one that will see rapid aging if its current level of development continues. It will start this transition without widespread coverage of pensions – either public or private. Current income levels do not offer the option of providing a universal ‘social’ pension – even if some element of that may be introduced in the future. So the country has to plan proactively to expand coverage significantly if people are to improve old-age savings now and for the future. The Government has developed a new scheme that aims to incorporate best practice in both financial inclusion and pension design – and hence unify two strands of practice that are too often kept separate. The aim is to leverage the insights of both areas of practice in order to create an infrastructure that can help provide access to pensions in ways that were previously unattainable.

INCLUSION OF THE SELF-EMPLOYED IN THE PENSION SYSTEM IN CHILE

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INTRODUCTION

In 1981, Chile replaced its traditional pay-as-you-go (PAYGO), unfunded, public sector managed pension system, for a new and innovative national pension system based on individual accounts managed by private pension fund managers. When first introduced, it was assumed that if people spent enough time in covered employment (up to 95% of their working life) and pension funds obtained adequate returns (5% to 6% real annual return), a 10% contribution rate would be enough to achieve a replacement rate of 70% for participants in the new system. However, in reality observed replacement rates have been much lower, at around 50% for men and 35% for women on average.

Many factors contributed to the low replacement rates observed in the system, but one of the most important was the high mobility of workers in and out of the formal sector, which translated into a small percentage of working lives spent contributing to the pension system (defined as low ‘contribution densities’ in the literature).

Chile is characterized by a lower level of informal labour market compared to most other countries in Latin America. However, evidence has shown high mobility between the informal and formal sectors in Chile, coupled with short term contracts in formal jobs. Since pension contribution is mandated only for salaried workers, participation in the formal sector is key for pension coverage and for achieving high densities of contributions. On the other hand, although participation is open for the self-employed on a voluntary basis, in reality, only a minimal proportion of the self-employed contribute to the pension system in Chile (5% on average up to 2012).

To reduce disparities, in 2008, Chile introduced comprehensive reforms aimed at increasing coverage, improving adequacy, reducing costs, and strengthening the institutional framework of the pension system. While the privately managed individual savings structure of the system was retained, a new non-contributory pillar was introduced. Additionally, measures were taken to increase coverage, reduce fees, improve gender equity, reorganize the market and more effectively supervise pensions.

A key finding in the technical analysis that sustained the reform was that lifelong careers as salaried workers were increasingly rare and there was a lot of movement between formal and informal jobs as well as in and out of the labour force. Though many self-employed workers could save as much as salaried workers, they were not contributing or saving for retirement in any other way. Furthermore, making the transition into formal jobs was quite difficult for first time job seekers, which reduced their ability to start accumulating early retirement savings thus failing to gain the benefits of compound interest. This problem is seen in many countries. The U.K.’s review of auto-enrolment in 2017 will also aim to focus on ways to improve coverage and contributions from the self-employed.

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1 The 1981 reform was quite unusual in moving from a solely public to a predominantly private pension system, followed by other countries in the region such as Mexico in 1997.
While taking measures to increase the adequacy of pension benefits, it was important that the coverage of the contributory system should expand to the self-employed and young workers. As described later in this chapter, a relevant part of the periods that saw no contributions to the pension system can be attributed to self-employed workers, especially men.

An important challenge, when imposing mandatory contributions on the self-employed, is the enforcement of such a measure. In the case of formal salaried workers, payment of contributions and their enforcement is facilitated by payroll deductions and a collection mechanism that facilitates payment of contributions by employers in bulk for all their employees. In the case of many self-employed individuals, earnings are not easily observable and no such routine collection mechanism exists. In the case of the Chilean reform, it was decided that the target population would consist of some “formal” self-employed workers who are paid for services delivered to a third party and who issue an invoice or receipt called “boleta de honorarios”, against which a tax retention is collected. This portion of self-employed workers typically prepare an annual income tax declaration and receive a tax refund or pay additional taxes depending on their total annual income.

This chapter will describe and analyse the measure to introduce mandatory contributions for the self-employed in the context of the 2008 Pension reform, which consisted of a comprehensive package to improve coverage adequacy and efficiency in the Chilean Pension system. The next section will describe the labour market and provide a description of informal work, self-employed, and the target population for this measure. Section 3 describes the pension system and the 2008 reform. Section 4 will describe in detail the measures introduced to enforce mandatory contributions for the self-employed in Chile and in Section 5 we provide figures and an analysis of its impact. In section 6 we draw conclusions and policy recommendations from this experience.

CHILE’S PENSION INCLUSION CHALLENGES

Chile has one of the lowest rates of informal work in Latin America. Figures from the SEDLAC database show that Chile has the second lowest percentage of workers in the informal sector in the region, defined as those who do not have the right to a pension when they retire because they are not contributing to a pension system.²

² Rofman and Oliveri (2012) also show that this pattern is consistent within the region.
Among salaried workers, the vast majority have signed employment contracts, with less than 13% stating that they have not signed contracts. Therefore, the salaried portion of the labour market is significantly formal and should be covered by the mandatory contributory pension system.

Despite the low rate of informality, there is still a substantial proportion of the employed population that is self-employed or working under other non-formal arrangements. As per the National Labour Market Survey, more than 20% of workers are non-salaried. Although this proportion has decreased over time, it still constitutes an important part of the labour market.

Figure 7.1
Percentage of workers in informal jobs (2013-2014)

Source: SEDLAC (CEDLAS and The World Bank)
Figure 7.2
Distribution of employment among salaried and non-salaried employees

![Distribution of employment among salaried and non-salaried employees](image)

Source: Ministerio de Desarrollo Social, CASEN 2009 - 2013

Figure 7.3
Salaried workers by contractual situation

![Salaried workers by contractual situation](image)

Source: Ministerio de Desarrollo Social, CASEN 2009 - 2013
An analysis of lifetime labour histories contained in the 2002 Social Protection Survey carried out by Bernstein et al. (2006) indicated that while men spent on average 60% of their active lives working as salaried employees with contracts and 19% as self-employed, the corresponding figures for women were 46% and 7% respectively. It was seen that when men were mainly self-employed they did not make contributions, explaining 37% of the periods with no contribution. In the case of women, it only explains 8% of the periods with no contributions by them. The main reason for periods with no contributions for women is that they are not part of the labour force (69% of the time with no contributions).

Figure 7.4
Distribution of labour history by occupational status

For a sustainable pension system based on individual accounts, the key question that arises is whether the proportion of self-employed workers represents a core part of the population or not. And further, does that core have access to salaried and covered employment or are these workers shifting between covered and uncovered jobs, since the policy responses for either option are quite different. While some sort of alternative coverage arrangement would be necessary in the first case, initiatives to expand coverage of the existing pension system would be more effective in the second case.

There is evidence that suggests that a majority of self-employed workers are people transitioning between formal and informal jobs. In addition, some self-employed workers also hold salaried jobs at the same time. Several studies have documented high labour rotation in Chile (Pérez 2009a, 2009b; Gatica and Romaguera, 2005). According to a
longitudinal study carried out by Mauro and Yáñez (2005: 17) over 10 years (1993-2002) about 68% of workers had at least one experience of change in their labour situation and about 23% had experienced three changes in their employment status over 10 years. Henríquez and Uribe-Echeverría (2004: 30-31) show that the quarterly mobility of employment condition (passing during the quarter between employed, unemployed or inactive) is around 9% and mobility by occupational category (change in a quarter between being an employee, self-employed, employer, etc.) is 5% for a total 14% mobility within a quarter. Data from Bravo (2008) using the EPS 2006 show that 8.9% of workers are individuals who have spent their entire careers being self-employed, while the proportion of workers who have been both self-employed and salaried employees is 22.8%. In other words, rather than thinking of the self-employed and wage earners as two separate populations, it is necessary to analyse them as two states between which people move.

Another relevant aspect of the pension policy targeting the uncovered group is their position in the income distribution of the country. According to the household survey CASEN 2015, 20% of self-employed workers belong to households in the bottom quintile of income distribution, compared with 10% for salaried workers in the private sector and 6% for workers in the public sector.

Figure 7.5
Distribution of workers by household income quintile and occupational category

However, among the self-employed, the portion that provide service receipts is more concentrated in the top income quintiles. Forty seven percent of the self-employed who issue income receipts belong to households in the top income quintile, compared with only 11% of the self-employed who do not issue receipts (and therefore do not declare labour income taxes). On one hand, this finding suggests that a policy that uses the tax

![Figure 7.5](image-url)
declaration process to collect pension contributions would not be effective in capturing the lower income portion of the self-employed. On the other, this policy would be effective in mandating contributions from those who presumably have a saving capacity but do not exercise it because it is not mandated. This portion of the self-employed could potentially become a burden to the state if they end up qualifying for the non-contributory pension pillar, which became much more generous after the 2008 reform. Therefore, in the context of the overall reform, it makes sense to demand individual contributions from anyone who has the capacity to save, irrespective of their occupational category.

In the Social Protection Survey of 2009, 68% of the self-employed declared that they are not making pension contributions. When asked to explain this stance, 38% mentioned that they did not contribute because it was not mandated, whereas 18% each cited “lack of knowledge of the system” and “not enough money” as their reasons for the same. This is additional evidence that suggests that introducing mandatory contributions is an appropriate way of including the self-employed, with the capacity to save, into the pension system.

Figure 7.6
Main Reasons for Self Employed Not to Contribute to Pension System

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This overview of the labour market in Chile suggests a series of challenges for increasing pension coverage. Although informal labour is not extensive, there is significant mobility between informal and formal sectors, generating periods without contributions that have a detrimental effect for many in a pension system based on individual savings. A relevant
part of these periods is explained by self-employed workers that have a savings capacity but do not use existing mechanisms to contribute voluntarily to the pension system. While increasing pension coverage and adequacy in the Chilean system requires a series of measures, a mechanism to include the self-employed in the mandate to contribute is certainly part of that package.

THE 2008 CHILEAN PENSION REFORM

As soon as a new Government took office in 2006, a Presidential Advisory Committee was formed with the mandate of producing a reform package that would improve coverage, adequacy and equity, reduce costs and increase returns in the pension system. The Committee produced a report containing a package of measures that included:

- Creation of a “Solidarity Pillar” that would provide non-contributory pensions for individuals without pension savings and a complementary subsidy for low pension amounts.
- Extension of the mandate to contribute for self-employed workers, along with access to the benefits in the system, such as disability insurance and family allowance.
- Introduction of contribution subsidies for workers entering the labour force and a compensatory bonus for women for the birth of each child.
- Introduction of gender equity measures such as eligibility for survivor’s pensions, separation of disability insurance cost by gender and use of unisex mortality tables.

Based on these recommendations, the government issued a legal amendment that was approved by Parliament in 2008 and it started being implemented in March the same year. Among the most important measures, and the earliest to be introduced, was the creation of the “solidarity pillar”. This pillar replaced both the existing, means-tested Assistance Pension, and the minimum pension guarantee imbedded in the funded pillar, which required a minimum of 20 years of contributions.

The solidarity pillar consists of two benefits that are related. First, there is a basic solidarity pension, "Pensión Básica Solidaria" (PBS), that provides a benefit to those aged 65 years or older who do not receive a funded pension and belong to the 60% poorest households of the population. Second, there is a solidarity pension subsidy, "Aporte Previsional Solidario" (APS), that provides a complement to low funded pensions of those in the 60% poorest households. The subsidy is reduced as the amount of the funded pension increases, but at a rate that is lower than one for one, in order to maintain incentives to contribute to the funded scheme. Hence, the total amount of pension would always increase as the individuals contribute. Therefore, the APS is calculated as a linear relationship between the PBS and a maximum pension amount eligible for the subsidy as in the following formula.
where APS is the Solidarity Subsidy, PBS is the Basic Solidarity Pension, PB is the Pension calculated based on the individual’s account balance and PMAS is the Maximum Pension that qualifies for the subsidy.

In graphic terms, the relationship between APS and the funded pension is as follows.

Figure 7.7
The New Design of the Chilean Solidarity Pension System

The introduction of the solidarity pillar was a measure to increase coverage and provide a response to the situation of those who had inadequate or no pensions and were not poor enough to qualify for the few available Assistance Pensions or had not contributed enough years to benefit from the minimum pension guarantee. It effectively replaced a basic state pension and created a more harmonized system.

However, this extension of coverage and generosity of the non-contributory part of the pension system made it important to strengthen the incentives and the requirements to contribute into the funded part of the system. Otherwise, if incentives were not strong enough, individuals could reduce their contribution efforts and rely solely on the solidarity benefits and the premise of potential future increases of those benefits. This is one of the main reasons for the design of the Solidarity Pillar in the first place: A flat benefit that only guarantees a minimum pension would have been cheaper for the government, but would provide no incentive, to contribute, to those who expect to finance low pensions. The introduction of the “clawback” design increases the cost, but maintains some incentives to contribute. However, the design per se is probably not enough and other complementary measures are needed to strengthen the coverage of the contributory pension system.
One of the areas of weak coverage identified in the diagnosis was the relatively low participation of the youth in formal employment. It seems that, although formal employment is high in Chile compared with other countries in the region, the transition of the youth from school to work leads to longer than average unemployment periods, high turnover, and higher incidence of informal employment.\textsuperscript{3} This has consequences for pension levels in a system based on individual capitalization, since early contributions play an important role in the total balance at the end of a working life due to compounding returns. In addition, there appears to be inertia in labour mobility, where formal employees are more likely to remain formal, while informal workers are less likely to transfer to formal jobs. For these reasons, early inclusion of young workers into the contributory system is very important.

The package of measures in the 2008 pension reform included a contribution subsidy for young workers. The subsidy would cover 50\% of worker’s contributions calculated over the minimum salary for workers that earn up to 1.5 times the minimum wage. This subsidy would be given for the first 24 months that the worker contributes to the pension fund. The subsidy would cover workers between 18 and 35 years of age who are making their first contributions to the pension system.

Prior to the 2008 reform, the self-employed were not mandated to contribute. This was another reason for the lack of coverage because very few of the self-employed made voluntary contributions. The aim of increasing contributions from the self-employed was clear, but there were important deliberations within the Advisory Committee on how to design and implement this new feature. One option discussed was to increase incentives and introduce some kind of subsidy. However, international evidence shows that those type of incentives are not very cost-effective.\textsuperscript{4} Another option considered was to learn from the international experience and use “soft compulsion”, which meant the self-employed would have to make an effort to avoid paying contributions and replace the current situation in which the default is not paying and the effort should be made if the individual wants to contribute.\textsuperscript{5} However, such a mechanism would require a “contact point” with the self-employed which would be no different than introducing a simple mandate. In the end, the argument prevailed that if the non-contributory scheme became much more generous, then the contributory system should require a proportional effort to make contributions from all those who have some savings capacity, including the self-employed, to avoid a moral hazard problem.

As we saw in the analysis, there are many types of self-employed workers, with differing degrees of formality. The 2008 reform extended the mandate to contribute to a specific set of self-employed workers. As it happens, in the Chilean tax code, the individuals who provide professional services to a third party (but are not in an employer-employee relationship) have to register with the tax authority and issue invoices for those services.

\textsuperscript{3} See Fajnzylber & Plaza
\textsuperscript{4} See Hinz et.al (2013)
\textsuperscript{5} See Bernstein, Reyes and Pino (2006) for the proposal.
Upon submitting the invoice, the individual is paid, but the party that hired the services retains 10% of the payment to remit as a provisional tax payment to the Internal Revenue Service (SII). At the end of the fiscal year, the individual needs to file a tax declaration and, according to this, the 10% retention can be used to discount from any taxes that liability or it is returned to the individual if he or she falls into a tax-exempt income category.

Therefore, this group represents a portion of the self-employed who are relatively formal and for which the mandate to contribute could be implemented with relative ease, by adapting the existing procedures carried out by the SII. Nonetheless, this mechanism would cover only a portion of the self-employed, while those who are completely informal, with no tax registration, would fall outside the reach of this mechanism. However, the introduction of this measure provides an example of how existing administrative procedures can be adapted to reach a portion of the population that has some degree of “contact” with the government apparatus but who had not been previously included in the pension system. The next section of the chapter discusses in detail the design and implementation of the mechanism that allows self-employed individuals to make pension contributions through their annual tax returns.

MANDATORY CONTRIBUTIONS BY CHILE’S SELF-EMPLOYED

Once the decision to introduce mandatory contributions, for the self-employed using the annual tax return process, was taken, the actual structure had to incorporate several details in terms of its operation and coverage, as well as benefits to be provided to those making contributions.

In the first place, the traditional contributions to pension funds (both mandatory and voluntary) are monthly, while the new contribution system would be on an annual basis. This has implications in terms of the contribution ceiling and the coverage of disability and survivor’s insurance.

Second, the contribution is traditionally paid directly to the Pension Fund Manager, ‘Administradora de Fondo de Pensiones’ (AFP), or using existing collection mechanisms, such as banks or the online portal ‘Previred’. In this case contributions would be paid through the SII, which had not previously participated as a collection agent in the system. However, the SII had already a well-established track record of utilizing optimally an online process of tax declaration and collection from the self-employed. The same process was used for collection of social insurance contributions. Since SII would collect money that was destined for the individual pension account of a contributor, a communication mechanism had to be established between SII and the AFPs to transfer the funds.

A third issue that came to light related to cases where individuals had worked both as formal employees and were self-employed in the same year. Once again, in this case, the
contribution ceiling and coverage of disability and survivor’s insurance needed to be adjusted.

This section describes the tax payment process, coverage, benefits, and implementation of this measure.

COVERAGE

The groups mandated to contribute are individuals who receive payments for activities carried out as self-employed workers and who provide a receipt for those activities or receive rents for participation in Professional Societies. These are specific areas of work of income earners that are classified under Chilean tax law. Members of the old pension system that never transferred to the individual capitalization system and members that are less than 10 years away from retirement age (women above 50 and men above 55) are exempted from the obligation to contribute. Individuals who have already contributed up to the maximum ceiling of contributions through the year and those who have received less than the equivalent minimum salary for the year are also exempted from contribution.

BENEFITS

The benefits provided for the contribution include savings towards old age pensions, coverage for survivors and disability pensions, coverage for worker’s compensation benefits (work-related accidents and professional health) and other benefits such as family allowance and eligibility for membership in “Cajas de Compensacion”, which are non-profit private social security institutions that provide credit, savings, and other benefits to their members.

In the case of annual contributions made by self-employed workers, the coverage of a disability and survivor’s insurance was tagged to the amount of the contribution as follows:

- If the contribution is made for an annual taxable income that is equivalent to at least seven times the monthly minimum income, coverage will be provided for a full year starting 01 May of the year when contributions were paid up to 30 April of the following year.
- If the amount of the contribution is made for an annual taxable income that is less than the equivalent of seven minimum monthly incomes, the period of coverage will be proportional to the ratio between the annual taxable income and the minimum income.

CONTRIBUTION COLLECTION MECHANISM

The process for collecting contributions from the self-employed utilizes the existing procedure of the annual tax declaration. This procedure is available online on the SII website (http://www.sii.cl). In Chile, the Tax Identification number coincides with the national identity number and therefore each individual has such a number assigned at

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6 A Professional Society is an association of individuals that is constituted for the common exercise of a professional activity as established by the Law.
birth. The self-employed must register their “initiation of activities” with the SII for the person to be able to provide service receipts (boleta de honorarios). This is an online process that allows individuals to obtain and issue these invoices. Most of the self-employed covered by the introduction of pension contributions have already initiated their activities, as they need to have completed this step in order to issue receipts and subsequently present their tax declaration. Throughout the year, each time a self-employed worker is paid for services provided to a third party, the individual issues a receipt and is paid the agreed compensation for the service provided. The payer retains 10% of the payment and declares and pays it to the SII within the first 12 days of the month following payment to the individual. The self-employed individual has until the following April to declare all income received in the previous year. This annual tax declaration process is online and uses the individual Tax Identification Number (TIN) plus a secret password provided by SII to identify the contributor. Information on all rents, sources of income, provisional payments and deductions is filed using an online form. Since the individual has issued electronic receipts and retentions, and as payments have been made on his or her behalf online throughout the year, most of the information is usually pre-populated in the tax declaration form. This eases the overhead for an individual contributor, who usually needs to only review and confirm that the pre-populated information is accurate. Once this information is confirmed, the system automatically calculates the deductions, comes up with the annual taxable income, applies the contribution rate, and calculates any remaining tax debt or credit owed by or to the contributor. It then processes the payment to the contributor (in case a tax refund is owed) and to the Treasury, which in turn transfers the contribution resources to the corresponding AFP through established electronic collection mechanisms.

In the eventuality that a self-employed person makes monthly contributions on a voluntary basis or if the individual also has a salaried job during the year, the AFP must inform the SII about these contributions and the SII will take them into consideration when calculating the net pension contribution owed by the individual.

If a self-employed individual is not yet a member of any AFP, the first contribution constitutes his or her affiliation with the system and the self-employed person is required to join the AFP that has earned the right to manage the funds for all new members through the bidding process established under the 2008 pension reform. As a result, a new member joins the cheapest AFP in the market.

The contribution process using the annual tax declaration is schematically represented in Figure 7.8.

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7 In order to increase competition and price sensitivity in the AFP market, the 2008 Pension Reform introduced a bidding process mechanism under which all new members of the system would be assigned to the AFP that offered the lowest management fee for a period of two years, without the possibility of changing AFPs during that period. Three bidding processes have taken place so far, resulting in a new participant in the market and a reduction of fees from an average level of 1.65% of contributory salary to 1.16% net of the disability and survivor’s insurance premium.
CONTRIBUTION AMOUNT

The contribution base for self-employed is determined based on the annual taxable income that is indicated by an individual in his or her tax declaration. In Chile, 70% of the annual income from rents and compensations is considered for computing the tax liability of a self-employed individual. Self-employed individuals are allowed a 30% deduction on expenses including the cost of materials, transportation, etc. A contribution to a pension fund would therefore be 10% of this annual taxable income. On top of that contribution, a self-employed person would be required to also pay the fees charged by the AFP for managing the individual pension account, the premium for disability and survivor’s insurance effective at the time of the contribution, and the contribution for the worker’s compensation (0.9% plus a premium depending on the activity). Starting 2018, a contribution of 7% of the annual taxable income toward health insurance would become mandatory.

TRANSITION PERIOD

Policy makers recognized that mandatory contributions by the self-employed would cause a major change in the design and functioning of the pension system. A transition period was therefore introduced. For the first three years after approval of the reform, the mechanism to make annual contributions with personal tax declarations would not be introduced, but an information campaign and sensitisation activities would be launched.

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8 The deduction is capped at USD 12,000 approximately.
to inform the self-employed of the upcoming introduction of mandatory pension contributions. After this initial period, a second period of three years would be used to implement the measure gradually (which is similar to the phasing approach used in both the U.K. and Turkey’s auto-enrolment reforms discussed in Chapter 3 and Chapter 5). The gradual implementation would consist of two actions:

- A gradual increase of the annual contributory income. In the first year of implementation, the base salary for calculating the contribution would be equivalent to 40% of the annual taxable income, increasing to 70% the second year to reach 100% by year three.

- The possibility to waive the contribution (soft compulsion). During the three-year period, a self-employed individual would have a chance to opt out of the pension contribution. To this effect, the individual would need to submit a sworn declaration through the SII website prior to filing his or her annual tax declaration. If the sworn declaration for opting out of the pension contribution was not filed, the pension contribution would be automatically calculated and processed with the tax declaration form, without the option of opting out at that point. This process is to be repeated each year as the declaration is only valid for the same year in which the income tax is declared. Therefore, during the three-year period, while an individual could still choose to not make a contribution, the default mechanism would automatically kick in and require a pension contribution through the annual income tax filing process if the sworn declaration was not filed during the financial year.

Although in the original design, this transition period was to be in effect between 2012 and 2014, with the first year of mandatory contributions effective in 2015, the Chilean Parliament has postponed the implementation of mandatory contributions to 2018, together with the compulsory health insurance contribution that would become effective in that year. Therefore, what is currently in effect is the semi-mandatory 10% contribution rate for pensions calculated on the total annual taxable income for a self-employed individual. The results of this three-transition period will be discussed in the next section.

**OUTCOMES**

**THE FIRST FOUR YEARS**

In the first year of implementation of this measure, more than 300,000 self-employed individuals contributed through the system, which represented 33% of those eligible to contribute. This was seen as a significant improvement compared to the typical figure of around 100,000 self-employed that contributed on a monthly basis during 2012. However, both the absolute number of annual contributors and the proportion of those who opt to contribute, have declined over the years.

The total number of self-employed contributors in the last tax declaration process (April 2016) has declined to 227,096 while the proportion of individuals who have waived
contributions has gone up from 70% in 2013 to 75% in 2015. The value of contributions has increased during this period largely because the 10% contribution rate in the first year was calculated on 40% of the annual taxable income whereas the base income used for calculating the pension contribution was increased to 70% in the second year and to 100% in the third year. In addition, workers may have become more familiar with the contribution mechanism and more aware of the option to waive contributions, especially since it was announced that the implementation of fully mandatory contributions would be postponed, first by one year and then until 2018.

Figure 7.9
Total Number of contributors and effectiveness of default contribution mechanism

Source: Superintendencia de Pensiones “Seguimiento Reforma Previsional” various reports: 2013-2016

The Pensions Supervisor in Chile has produced a biannual report that follows up the implementation of the 2008 pension reform. This report contains a breakdown of the self-employed that have used the annual contribution mechanism through the tax declaration process. The majority of the effect seems to have come at the intensive margin, i.e. increasing the amount of contributions for the self-employed who were already members of the pension system and had made some contributions in the previous year. The number of new members who entered the system through this mechanism (extensive margin) represents around 14% of total contributors over the first three years of implementation.
Chile implemented a mechanism to collect pension contributions through the annual tax declaration process as part of a comprehensive pension reform approved in 2008. As such, this measure is better understood as part of a reform package that aimed at increasing coverage by both increasing the generosity of the non-contributory pillar and strengthening the outreach of the contributory pillar.

The results from the first few years of implementation, using a soft compulsion mechanism through default contributions with an opt-out option suggest that this measure had a stronger impact on increasing savings from existing participants rather than attracting new participants into the system. It may well be the case that the proposed fully mandatory contributions shall have a stronger impact on the extensive margin. However, as it stands, this measure will ultimately have a more important impact on the adequacy of pensions (by increasing saving accumulations and density of contributions) than on coverage.
There are several specific circumstances that other countries should take into account when examining the Chilean case of introducing mandatory (or semi-mandatory) contributions for the self-employed. At heart, it is a measure to include people who are currently outside the pension system because the mandate does not extend to them. However, the inclusion of the self-employed in the case of Chile has resulted in increased contributions by individuals who are already members of the system, including those who earn both salaried and non-salaried income (as self-employed individuals). This is the case for the self-employed who are either transitioning between salaried jobs or self-employed activities or who work as self-employed workers in addition to their salaried jobs. The result would perhaps be different in countries with a clearer segmentation in the labour market between self-employed and salaried workers.

The focus on self-employed activities that are visible to tax authorities resulted in a positive impact on increasing contributions from a section of workers who are relatively formal and have the capacity to save. While this has helped improve pension coverage and contributions by the middle class, it has not had any significant impact on expanding coverage to the low income informal workers.

Finally, it is important to note that there was an enabling environment that facilitated the implementation of this measure in the case of Chile. The individual capitalization pension system had been in place for more than 25 years. There was a clearly established regulation of activities carried out by self-employed individuals in the tax code, extensive use of such regulation by self-employed individuals (more than 1 million annual tax declarations out of an estimated universe of around 1.6 million total self-employed), and an existing unique national ID that enables matching the information between pension contributions and tax declarations. All these aspects meant that a mechanism for pension contributions using the annual tax declaration could be implemented with relatively minor changes. In other circumstances, the creation and use of national IDs, establishing online payment mechanisms, and so on can be important hurdles that should be addressed before such a mechanism is implemented. It also highlights the benefits of leveraging an existing infrastructure, that is already being used for a core function, to deliver another important policy – thereby improving the efficiency of both operations.
Table 7.1
Summary of key features and consequences in the case of Chile

<table>
<thead>
<tr>
<th>Specific Feature observed in the case of Chile</th>
<th>Consequence for Pension Inclusion</th>
</tr>
</thead>
<tbody>
<tr>
<td>High labour mobility between formal salaried, self-employed, and informal jobs.</td>
<td>New contributions by the self-employed mostly from current members of the system who were not contributing fully.</td>
</tr>
<tr>
<td>Target population is a subset of the self-employed who declare taxes.</td>
<td>Contributions by a section of the self-employed that is relatively more formal and has higher incomes and savings capacity (through not from low income informal workers).</td>
</tr>
<tr>
<td>Measure is part of a comprehensive reform package.</td>
<td>Relevant to understand the interaction with other measures, such as the new solidarity pillar and enrolment of new members in the lowest cost fund manager. Such a measure on its own may not be enough to increase coverage and adequacy.</td>
</tr>
<tr>
<td>Use of an existing platform and procedures for annual tax declaration and comprehensive use of national ID.</td>
<td>An existing mechanism needed to be adapted for collection of pension contributions by the Internal Revenue Service. However, no new mechanism needed to be developed from scratch. A strong track record on the use of national IDs also helps implementation of such a measure.</td>
</tr>
<tr>
<td>Use of existing regulation of self-employed activities and their tax treatment.</td>
<td>The existing regulatory framework provided a clear definition of the self-employed individuals who would be affected by the introduction of mandatory pension contributions. This also provided a basis for developing the mechanism and defining the target population for such a measure.</td>
</tr>
</tbody>
</table>

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PENSION REFORM CHALLENGES AND PROSPECTS IN NIGERIA

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INTRODUCTION

Pension reform in Nigeria was engendered by the imperative to examine the myriad challenges bedevilling the retirement benefit system in both the public and private sectors. The public sector’s hitherto Defined Benefit (DB) scheme had become unsustainable as a result of a paucity of funds and inadequate budgetary provisions for salaries and pensions. There were also several demographic shifts due to rising life expectancies in addition to weak, inefficient, opaque, and cumbersome administrative structures. The private sector schemes, which were akin to the Provident Fund (PF) schemes, had similarly been characterized by low coverage and compliance ratio as a result of ineffective regulation and supervision.

Upon the return to democratic governance in 1999, the Federal Government of Nigeria embarked on a holistic reform of the pension industry. A cardinal objective of this reform was to institutionalize a sustainable retirement pension system with the capacity to achieve the ultimate goal of providing a stable, predictable, and adequate source of retirement income for each worker in Nigeria. The reform also sought to establish a uniform set of rules and regulations for the administration and payment of retirement benefits for both the public and private sectors; stem the growth of outstanding pension liabilities; reduce the fiscal cost of pension to government; stimulate domestic savings; generate a pool of long-term funds for financing developmental projects; and promote private investments into the economy.

COUNTRY PROFILE

The Nigerian Government is a democracy comprising federal, state and local governments. The country’s estimated population of about 170 million makes it the eighth most populous country in the world. Nigeria’s population can be profiled as follows: 0 – 14 years (41.5%); 15 – 64 years (55.5%); and 65 years and above (3%). Located in Western Africa, bordering the Gulf of Guinea, between Benin and Cameroon, as well as the Niger Republic, Nigeria covers an area of 923,768 square kilometers, which is made up of 910,768 square kilometers of land and 13,000 square kilometers of water. Natural resources include natural gas, petroleum, tin, iron ore, coal, limestone, niobium, lead, zinc, and arable land. Periodic droughts, flooding, and erosion are the most common natural hazards.1

The total adult population stands at 94 million out of which 48.6% have access to financial services, whilst 36.3% of all adults have direct/indirect access to deposit money in banks in addition to banking products such as ATM cards, credit cards, savings, and current

accounts, mortgage, loans or non-interest banking products. In addition, 12.3% of all adults have access to other formal institutions and financial products, such as insurance, microfinance, pension, or equities.2

Mortality Tables representing the entire population were published by the National Population Commission (NPC) in October 20153. However, these projections are only useful when considering the population as a whole, and separate tables are needed for the insurance and pension industries to more accurately price retirement benefits and life assurance products since those benefitting from these products tend to be wealthier and live longer.

A REVIEW OF THE NIGERIAN PENSION SYSTEMS

PUBLIC PENSION SCHEMES

In Nigeria, the first public sector pension scheme was the Pension Ordinance of 1951, with retroactive effect from 1st January 1946. The law provided public servants with both a pension and a gratuity. Pensions Decrees 102 and 103 (for the Military) of 1979 were enacted, with retroactive effect from April 1974. These Decrees remained the operative laws on public service and military pension in Nigeria until June 2004. However, there were several government circulars and regulations issued to alter their provisions and implementations. For example, in 1992, the qualifying period for gratuity and pensions was reduced from 10 years to five years and from 15 years to 10 years (Report of the Vision 2010 Committee, 1997).

In 1997, State Owned Agencies and Enterprises were allowed to have individual pension arrangements for their staff and appoint Boards of Trustees (BOT) to administer their pension plans as specified in a Standard Trust Deed and Rules prepared by the Office of the Head of the Civil Service of the Federation. Each BOT was free to decide on whether to maintain an insured scheme or self-administered arrangement. Robust pursuit of pension reforms came as a result of a privatization programme embarked upon by the Federal Government under the supervision of the Bureau for Public Enterprises. It was noticed during the exercise that most public enterprises had huge pension liabilities, which eventually turned out to be the case with the mainstream civil service as well. Virtually all the bidders for these enterprises realized that there was no benefit to acquiring the assets as the pension liabilities would obliterate any gain that could be realized from the assets. Hence, the government was confronted with a huge pension challenge with an actuarially estimated liability of about 2 trillion of Nigeria’s local currency at that time (USD 6.6 billion at the prevailing exchange rate of NGN 305/USD).

3 Abridged Life Tables of Nigeria 2006 - 20017.
PRIVATE PENSION SCHEMES

The first private sector pension scheme in Nigeria was set up for the employees of the Nigerian Breweries in 1954, which was followed by United African Company (UAC) in 1957. National Provident Fund (NPF) was the first formal social protection scheme in Nigeria, established in 1961 for the non-pensionable private sector employees. It was largely a savings scheme, where both employee and employer would contribute a sum of NGN 4 (~ USD 0.013) each on monthly basis. The scheme provided for only a one-off lump sum benefit. The Nigeria Social Insurance Trust Fund (NSITF) was established by Decree No. 73 of 1993 to provide enhanced social protection for private sector employees. The NSITF took over the assets of the NPF and commenced operations in July 1994. Thus, all registered members of the NPF became automatic members of the NSITF. Similarly, all private sector employers and employees were mandated to register as members as soon as they commenced operations and assumed duty respectively (Report of the Vision 2010 Committee, 1997).

REGULATORY LANDSCAPE

Prior to the enactment of the Pension Reform Act 2004, there were three agencies of the government responsible for policies and rules governing the operations of the institutions providing pension services. The first was the Securities and Exchange Commission (SEC), which regulated asset management companies. The second was the National Insurance Commission (NAICOM), which regulated insurance companies that handled insured schemes. The third was the Joint Tax Board (JTB), which approved and monitored all private pension schemes with enabling powers from Schedule 3 of the Personal Income Tax Decree 104 of 1993 (Odia and Okoye, 2012).

INSTITUTIONAL CHALLENGES

PUBLIC PENSION SCHEMES

Nigeria had operated particularly in the public sector, a DB pension scheme, which was largely unfunded and non-contributory. The system was characterised by annual budgetary provisions by various organs of the government. Given the fact that this was, for the most part, unfunded, the DB system led to massive accumulation of pension liabilities, which by June 2004, was estimated at about USD 6.6 billion4. In addition, there were demographic shifts due to rising life expectancy rates, while administration of the scheme was weak, inefficient and cumbersome, inexorably causing a lack of accountability by those managing the system.

PRIVATE PENSION SCHEMES

Although the private sector schemes exhibited a higher level of organization, with some companies establishing structured retirement benefits for their employees, a good number had accountability and transparency issues, which resulted in the arbitrary dispensation of pension rights. Employees on short term contracts and daily wage earners did not have any

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retirement benefits extended to them. Coverage was not obligatory as there was no law mandating private employers of labour to establish pension schemes for their employees.

The schemes were also inundated with the problems of poor record keeping, lax supervision of the pension funds and delays in approving pension scheme applications. There was no mechanism for effectively assessing the technical and professional competence of institutions managing pensions.5

NEED FOR A REFORM

There were several attempts to reform the Nigerian Pension System. In this regard, a number of Committees were set up to look into the challenges of pension schemes and proffer solutions towards a sustainable pension system for the country.

During the privatization of public enterprises, the Nasir El-Rufai-led Bureau for Public Enterprises (BPE) realized the inherent difficulties in privatizing such companies due to their huge pension liabilities. The BPE drew the attention of the government to the urgency of tackling this public sector pension’s liability estimated at about USD 6.6 billion6.

In light of all the previous efforts and the discovery made by the BPE on pension liabilities, President Olusegun Obasanjo set up the Fola Adeola Pension Reform Committee (FAC) to collate all previous efforts made on pension reforms and work towards a workable and sustainable scheme for the country. The FAC recommended in its report, that a Contributory Pension Scheme should be established to cover both public and private sector employees. The Committee also drafted the bill that established both the recommended Scheme and the National Pension Commission.

THE PENSION REFORM ACT OF 2004

The Pension Reform Act of 2004 was, among other things, enacted to attenuate the challenges of Nigeria’s hitherto inefficient pension system. Given the status quo in the industry at the time, the federal government essentially had two policy options:

a. The introduction of parametric short-term measures that may have addressed the symptoms rather than the root cause of the problem.

b. The institutionalization of reforms that would address the underlying weaknesses of the previous schemes and entrench measures for the sustainability of the new framework.

In deciding to adopt the latter option, the Federal Government introduced the Contributory Pension Scheme (CPS) with fully funded, privately managed individual

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5 National Pension Commission was the first regulator and supervisor of all pension matters in Nigeria.
6 Nasir El-Rufai. Pension Reform: To be or Not to be?
Retirement Savings Accounts (RSAs), to ultimately engender the strategic objective of ensuring that every worker in Nigeria is covered by a retirement benefit arrangement that is easily accessible and pays periodic income at the end of an individual’s working career.

The main objectives of the pension reform were to:

i. Ensure that workers receive their retirement benefits as and when due.
ii. Assist workers to save in order to cater for their livelihood during old age.
iii. Establish uniform rules, regulations, and standards for administration of all pension matters in Nigeria.
iv. Establish a strong regulatory and supervisory framework for the pension industry.
v. Stem further growth of pension liabilities.
vi. Impose fiscal discipline in budgetary process as pension obligations would be accurately determined.
vii. Reduce fiscal cost to government, stimulate domestic savings, generate a pool of long-term funds for financing developmental projects and increase private investments.

**LEGAL FRAMEWORK**

**COVERAGE OF THE CONTRIBUTORY PENSION SCHEME**

The Pension Reform Act (PRA) 2004 stipulated that the CPS shall be mandatory for all workers in the Public Service of the Federation, the Federal Capital Territory, and in the private sector where the total number of employees is five or more. However, Judicial Officers whose pension was provided for under Section 291 of the 1999 Constitution of the Federal Republic of Nigeria were exempted from the CPS.

**MINIMUM RATE OF PENSION CONTRIBUTION**

The minimum contribution rate was set for 15% of the employee’s monthly emoluments, where employers and employees contribute 7.5% each. An employer may, however, elect to contribute the entire 15% on behalf of the employee. Furthermore, an employer is obligated to deduct and remit the employee’s pension contributions to his RSA through a Pension Fund Custodian (PFC) within seven days of payment of salary, and the PFC shall notify the Pension Fund Administrator (PFA) within 24 hours of the receipt of the contribution.

**LIFE INSURANCE POLICY**

Every employer was mandated to take a life insurance policy in favour of its employees for a minimum of three times their total annual emolument. Benefits were paid on death in active service.
WITHDRAWAL OF RETIREMENT BENEFITS

A holder of an RSA could only withdraw from his RSA upon retirement or at attaining the age of 50 years, whichever comes later. Payment of retirement benefits shall be either through programmed withdrawal (offered by PFAs) or purchase of life annuity from life insurance companies licensed by NAICOM.

ACCRUED PENSION RIGHTS

As part of the transitional arrangements, the accrued pension rights of federal government employees who worked prior to the commencement of the CPS were recognized. Accordingly, a fund known as the Retirement Benefit Bond Redemption Fund (RBBRF) was established and was maintained by the Central Bank of Nigeria. The Federal Government was obligated to pay, on a monthly basis, an amount not below 5% of its total monthly wage bill into the fund, to be used to redeem all established accrued rights. Payments into this fund were to cease after all accrued benefits had been redeemed.

SUBSIDIARY LEGISLATIONS

The PRA 2004 empowered the Commission to issue subsidiary legislations for the pension industry. Consequently, in order to ensure the smooth functioning of the pension industry as well as guide the operations of the licensed pension operators, the Commission issued a number of subsidiary legislations in the form of guidelines, regulations, frameworks, circulars, and codes. All the subsidiary legislations issued can be found on the Commission’s website: www.pencom.gov.ng.

INSTITUTIONAL FRAMEWORK

The National Pension Commission was established by the PRA 2004 to regulate, supervise and ensure the effective administration of pension matters in Nigeria. As the regulator of pension matters, it is statutorily mandated to approve, license, and supervise all pension fund operators as well as establish standards for the management of pension funds.

INDUSTRY OPERATORS

a. **Pension Fund Administrators (PFAs):** These are licensed by the Commission to register contributors and open an RSA for eligible workers. In addition, the PFA is responsible for investment and management of the pension funds; maintaining books of accounts on all transactions relating to the pension funds under its management; provision of regular information and other related customer services to the beneficiaries and payment of retirement benefits to contributors upon retirement.

b. **Pension Fund Custodians (PFCs):** These have the responsibility to receive contributions from employers on behalf of the PFAs, hold pension assets in safe custody, execute transactions and undertake activities relating to pension fund

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2 Under the old Defined Benefits scheme, the qualifying periods for gratuity and pension were five and 10 years. However, in the calculation of the accrued benefits, the benefits were prorated to allow employees who worked for shorter periods to be apportioned some amounts.
investments on behalf of the PFAs. Indeed, in line with the core of the pension reform law, the function of custody of pension fund assets has been separated from its management. In this arrangement, only PFCs can hold pension assets.

c. **Closed Pension Fund Administrators (CPFAs):** An employer may apply through a wholly owned subsidiary for a CPFA license to manage its own existing scheme provided that the scheme meets stipulated conditions. On issuance of the license, the Commission supervises and regulates the activities of the CPFA, which registers and manages the pension fund of the employees of the sponsoring organization only. In addition, select private companies were allowed to apply to the Commission for approval to continue with their pension schemes that were in existence prior to the enactment of the PRA 2004. However, the pension fund assets of the Approved Existing Schemes (AES) are managed by PFAs and are in custody of the PFCs.

**Pension Transitional Arrangement Directorate (PTAD):** The PTAD was established as an extra ministerial department under the Ministry of Finance to coordinate the administration of pensions for retirees and persons not transiting to the CPS. The Commission is empowered to regulate and supervise the PTAD that shall cease to exist after the demise of the last pensioner under the defunct DB scheme.

**AMENDMENT TO THE PRA 2004**

In April 2011, the PRA 2004 was amended to exempt personnel of the military and security agencies from the CPS. This followed a Private Bill sponsored by a member of the Committee on Pensions of the House of Representatives. These personnel are now exempted from the CPS.

**THE REFORMS OF 2014**

A national conference was organized in 2009 by the Commission in conjunction with the National Assembly to conduct a comprehensive review of the implementation of the pension reform initiatives and obtain inputs from stakeholders towards enhancing the implementation of the reform. The main objectives of the conference were to:

i. Determine the suitability and/or adequacy of certain provisions of the PRA 2004;

ii. Identify ways to fully integrate the informal sector, states, and local governments into the Scheme;

iii. Examine ways to diversify pension fund investments to support infrastructure development while providing adequate returns and guaranteeing safety of the pension assets; and

iv. Distil inputs from all stakeholders and professionals with a view to conducting a comprehensive review of the PRA 2004.

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CHALLENGES IN THE IMPLEMENTATION OF PRA 2004

The conference provided the Commission with the opportunity to identify the challenges in the implementation of the provisions of the PRA 2004. The key challenges are highlighted below:

i. The CPS did not adequately cover states and local governments, employers with less than five employees, and the self-employed.

ii. There was a dearth of investment instruments to facilitate the deployment of pension funds in financing infrastructure projects and intermediate in the real sector of the economy.

iii. The sanctions defined in the PRA 2004 were no longer sufficient deterrents against infractions by operators and eligible employers.

iv. There was no provision for protecting the pension assets against any losses or adverse effects.

v. The 5% of the monthly wage bill set aside by the Federal Government to pay the accrued rights for past service was no longer sufficient.

vi. Although the PRA 2004 made provisions for the payment of a Minimum Pension Guarantee (MPG) to RSA holders who have contributed for a number of years under the CPS, there was no provision for the funding of the MPG.

vii. Provision for tax exemptions were at the point of accumulation and payment of retirement benefits only. The Act was silent on taxation of income from investment of pension funds. This could prevent the achievement of real returns on the investment of pension funds with dire consequences on a retiree’s retirement benefits.

viii. Employees who lost their jobs had a waiting period of six months before accessing the balances in their RSAs.

PROMULGATION OF THE PENSION REFORM ACT 2014

Against the backdrop of consultations between the Commission and the executive arm of government, an executive bill for the enactment of PRA 2014 was transmitted to the National Assembly. The bill sought to address the challenges that characterized the implementation of PRA 2004. After a comprehensive review and legislative scrutiny, PRA 2014 was signed into Law on 1st July 2014. Some of the new key provisions of PRA 2014 are enumerated below:

i. In order to address the challenge of limited coverage, PRA 2014 expanded the eligibility criteria for employers to include those with at least three employees as against five employees in PRA 2004. In addition, the self-employed could also participate in the CPS. Similarly, states and local governments are now covered by the CPS.

ii. The sphere of permissible investment instruments was expanded to accommodate investments in infrastructure without compromising the safety of pension fund assets.
iii. New offences were addressed and stiffer penalties were introduced to serve as
deterrents against mismanagement or diversion of pension funds and assets under
any guise, as well as against other statutory infractions.

iv. PRA 2014 has provided that the 5% deduction of the monthly Federal Government
of Nigeria wage bill should be the minimum amount needed to fund the RBBRF
Account and the Commission should determine and advise the Federal Government
of Nigeria on appropriate rates, from time to time, that are sufficient to address the
projected yearly pension liability of the government.

v. A Pension Protection Fund (PPF) was established to fund the MPG as well as
compensate the pension funds in the unlikely event of adverse losses that may be
sustained from their investment activities.

vi. The waiting period to access a percentage of the balance in the RSA by persons who
lost their jobs and are unable to secure another job has been reduced from six to four
months.

vii. The rate of contribution has been increased from 7.5% by both employee and
employer to 8% by employee and 10% by employer.

viii. Tax exemption has been extended to the income from investment of pension funds.

ix. PRA 2014 provides for an enhanced regulatory authority and efficiency of the
Commission to provide greater oversight on the Pension Transition Arrangement
Directorate (PTAD). This was to ensure greater efficiency and accountability in the
administration of the DB scheme.

PLANNED IMPLEMENTATION

The National Pension Commission found it expedient to make contingency plans for the
successful implementation of the provisions of PRA 2014 in order to avoid the pitfalls
encountered during the implementation of PRA 2004. In this regard, the Commission
developed a corporate strategy, and in collaboration with the pension industry operators,
developed an industry strategy, to refocus the industry towards achieving the desired
objectives. Both strategies were designed on the following thematic areas that were
extrapolated from PRA 20149,10

i. Inclusive and expanded coverage

ii. Excellence in service delivery

iii. Safer and broader investment portfolio

iv. Positive real returns and visible impact on the economy

For each initiative identified towards the full achievement of the thematic objectives, a
team was set up between the Commission and the umbrella organization of the pension
operators, nominating one member each, as a co-champion, to ensure its successful

9 National Pension Commission, Corporate Strategy – Recommendations.
10 Nigerian Pension Industry in 2024: Positioning for the Next Decade
implementation. The idea was to have the full participation of all relevant stakeholders in the design of the implementation road map to ensure their buy-in and willingness to deploy all necessary resources as would be required by each initiative.

To drive inclusive and expanded coverage, the Commission established two functions in its organisational structure to facilitate the adoption of the scheme by states and local governments as well as by the informal sector employees.

In order to support economic development, it is fundamental that the pension fund portfolio is diversified to include investments in critical infrastructure, real estate, and other key aspects of the economy. Hence, both the corporate and pension industry strategies consist of initiatives and activities that would increase investment in infrastructure and other alternative assets from 4% in 2014 to 40% by the end of 2019.

As an initial step to diversification, the maximum allocation to Federal Government securities was reduced from 100% of the Assets under Management (AUM) to 80%. In addition, allocation to corporate debt securities was increased from 30% to 35% while infrastructure bonds and funds were introduced and allocated maximum 15% and 5% of the AUM. Private equity funds were also introduced and allocated a maximum 5% of the AUM. The focus is to allow investments in vehicles that could facilitate infrastructure financing and make a visible positive impact on the economy.

In line with global best practices, especially with a view to stimulating sustainability, the Commission, in collaboration with the University of Edinburgh, Scotland, has commenced work on the development of sustainable pension principles that would mainstream the tenets of sustainability, responsible investment, and Environmental, Social, and Governance (ESG) considerations in all investment decisions being undertaken by the industry. In addition, the Commission has inaugurated an impact investment workgroup to fashion out a road-map for the channelling of pension funds into investments that have both an economic and environmental impact.

THE MICRO PENSION SCHEME

To provide legal backing for achieving the objective of covering this category of workers that constitute the larger percentage of the working population in Nigeria, Section 2(3) of Pension Reform Act 2014 expanded coverage of the CPS to the self-employed and persons working in organizations with less than three employees. In addition, given their widely dispersed nature and generally low and irregular incomes, there was the need to provide a pension plan that would meet their specific characteristics. In this regard, the Micro Pension Plan initiative was conceived within the context of an industry wide strategy to bring pension products and services to this class of workers.

In implementing this initiative, the informal sector has been segmented into two broad categories: the low income and the high income earners. Each of these categories will be targeted with appropriate pension products and sensitization programmes that meet their respective peculiarities.
Similarly, the Commission has developed policy documents that set out the eligibility
criteria for participation in the Micro Pension Scheme; specified the minimum
documentation requirements and registration process for prospective micro pension
participants; defined the account services, covering contribution collection, rendering
account statement, resolution of issues and accessing the RSA; defined how the Micro
Pension Fund would be managed by PFAs; provided incentives for participants; specified
minimum technology requirements; and outlined how participants could switch between
the Micro Pension Scheme and the Formal Contributory Pension Scheme.

In order to ensure effective and efficient implementation of the micro pension initiative,
sensitization activities have commenced through print and electronic media as well as
town hall meetings, conferences, roundtable discussions, and seminars. The Commission
has developed working relationships with a significant number of relevant stakeholders
particularly trade unions, associations and chambers of commerce. This is targeted at their
existing memberships, which could easily give a boost to the efforts being made to extend
coverage to 40% of Nigeria’s working population. This strategy focuses on anticipated
quick access to the 37 million small and medium scale enterprises registered by the Small
and Medium Enterprises Development Agency of Nigeria (SMEDAN) out of which 5
million were already registered by the Corporate Affairs Commission. Similarly, obtaining
buy-in from trade unions and associations would significantly facilitate registration by their
members, who in this case are mainly self-employed.

As a consequence of their characteristics, most informal sector workers are less likely to
save or embrace schemes that require suspension of their current consumption rate. To
ameliorate this concern, the Commission has proposed some incentives that will encourage
their participation in the CPS. In this regard, any contribution made by micro pension
participants would be divided into two. One portion will be treated as savings for pension,
while the second portion, which shall be the smaller, will be treated as contribution
that could be withdrawn not more than once every quarter. However, eligibility criteria
have been established for accessing the latter portion of the contribution. In addition,
contributions under the Micro Pension Scheme would not be subject to tax when accessed
as they are viewed as contributions from the disposable income of the participants, which
are presumed to have been earlier taxed.

Following the provision of Section 89(2) of PRA 2014 and subject to guidelines to be
issued by the Commission, micro pension participants may apply a percentage of the
pension assets in their RSA towards payment of an equity contribution for a residential
mortgage.

However, it is evident that a robust technology platform that would support the
provision of customer services is necessary to effectively and efficiently register, collect
contributions, provide RSA support, pay benefits, and provide financial advisory services
to this class of workers.
The mode of registration for micro pension would be done via an electronic platform utilizing mobile devices and registration centers. The process, which includes capturing of basic bio-data and biometrics, would be user friendly. The registration module would have controls to ensure that there are no duplications of registrations. This would include sector codes that would serve as unique identifiers to enable micro pension contributors be assigned with Personal Identification Numbers (PIN). A special fund would be established for the participants of the Micro Pension Scheme. It will make adequate provisions for the itinerant nature of this group and create fair value for the investments whilst ensuring adequate security of their assets.

Consequently, the Commission has commenced discussions with service providers and relevant regulators as well as the targeted workers in the informal sector on the intended technology with a view to creating the enabling environment and buy-in. As highlighted in many chapters in this volume, this element will be absolutely vital to create a low cost and efficient platform that can ensure small contributions can be efficiently invested for the benefit of members. Interoperability and account portability will also be critical as will ensuring that the contributions can be invested at scale to ensure the best governance and the lowest implementation costs.

IMPLEMENTATION UPDATES

a. The Commission, as regulator of all pension matters in Nigeria, licensed 27 PFAs, five PFCs and seven CPFAs. However, following mergers and acquisition, there are currently 21 PFAs and four PFCs while the number of CPFAs remains seven.

b. The Industry has registered 7.24 million contributors from both the public and private sectors as on 30th September 2016. The public sector made up 46.41% while the private sector constituted 53.59%.

Figure 8.1
Distribution of Memberships of Various Pension Schemes as at Q3:2016

<table>
<thead>
<tr>
<th></th>
<th>Public Sector registered contributors</th>
<th>Private Sector registered contributors</th>
<th>Closed Pension fund administrators</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>3,356,875</td>
<td>3,883,321</td>
<td>24,043</td>
</tr>
<tr>
<td>FGN employees</td>
<td>1,860,449</td>
<td>1,496,426</td>
<td>40,951</td>
</tr>
<tr>
<td>State Governments’ employees registered</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Membership of approved existing schemes</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: National Pension Commission Statistics

11 All statistics were based on a database generated and maintained by the National Pension Commission
c. The value of pension fund assets grew from NGN 405.95 billion (USD 1.33 billion) in 2006, which was the year of actual commencement of investment activities, to NGN 5.96 trillion (USD 19.55 billion) as on 30th September 2016. All currency conversions were done at the official rate of NGN 305 per 1 USD.\textsuperscript{12}

The portfolio of the pension fund was skewed towards Federal Government Bonds and Treasury Bills due to the high interest rates.

**Figure 8.2**

**Distribution of Members According to Number of Contracts Owned**

Source: National Pension Commission Statistics

Traditionally, the PFAs ensure that their portfolios are revalued on a daily basis to ensure that risks are minimised while maintaining fair return on investments. However, investment decisions are taken based on the individual PFA’s strategy, which was developed based on the provisions of the regulations on investment of pension fund assets that were issued by the Commission.

The increasing relative importance of the pension sector is reflected by the proportion of the pension assets to Nigeria’s GDP, which grew from 1.4% in 2006 to 7% in 2010. It was estimated at 6.26% as on 30th September 2016 of the rebased Nigerian GDP estimated at an annualized value of NGN 97.4 trillion at the end of the third quarter of 2016.

\textsuperscript{12} Official exchange rates are issued by the Central bank of Nigeria.
A total of 174,820 contributors from both public and private sectors have already retired as at end of the third quarter of 2016 and are receiving their monthly pension as and when due. So far, a total of NGN 395.18 billion (USD 1.3 billion) has been paid as pension with an average monthly pension of NGN 6.39 billion (USD 21 million).

**IMPACT OF THE REFORM**

The CPS has stemmed the growth of pension liabilities as well as generated a pool of investible funds in Nigeria, which has deepened the financial sector and the economy in general. The scheme has also promoted the development of the corporate debt market with the collaboration of the World Bank/IFC. Provision was made for the pension funds to invest up to 35% of the total AUM into corporate debt.

The capital market is perhaps the highest beneficiary of the pension reforms among all the sectors in the financial industry. The reform has significantly increased the volume of trading and the size of the market capitalization of both the bond and stock markets. In addition, the pension operators, as large institutional investors, continue to demand high corporate governance standards and practices in investee companies. Indeed, a Pension Index had been created in the local stock exchange, which comprises stocks that qualify for pension fund investments.

The Investment Regulation provides that pension funds can only invest in debt instruments that have a minimum investment-grade rating. This has facilitated the development of the credit/risk rating industry as well as increased the capacity of local rating agencies.

The private equity industry was also under-developed. The Commission obtained the support of the Commonwealth Secretariat in organizing roundtable discussions towards developing the industry in Nigeria. Private Equity was made an allowable asset class for pension funds in 2010. The Commission has continued to organize seminars and workshops for the education of the board and management of the pension fund and there is an increasing appetite for pension fund investments in the asset class.

Provisions have been made in both PRA 2004 and PRA 2014 for Group Life Insurance (GLI) cover for all employees. This has deepened the GLI market in a country where not many people were even aware of GLI products. Similarly, the annuities market was very shallow. Also, given that there are provisions in both PRA 2004 and PRA 2014 for life annuity as one of the two options for accessing retirement benefits, the Commission had to organize a foundation course on life annuity in conjunction with the National Insurance Commission for both the regulators and operators in the pension and insurance industries. Presently, there are many insurance companies offering this product.

Previously, Nigeria did not have locally developed Life Tables. The A (55) Mortality Tables, which were based on the 1946 – 1948 experience collected from the U.K. insurance companies are currently in use, but are inherently non-comprehensive and
non-representative. This led the Commission to start championing a project to develop Life Tables for Nigeria so as to facilitate the accurate computation of pension benefits and insurance related benefits.

Education is the root to successful implementation, and as such, the pension industry is promoting the establishment of a Pension Institute that will drive capacity building for the industry locally. Already, there is a bill before the National Assembly to enable the emergence of the institute. Similarly, the Commission and other financial regulators in the country developed a curriculum to teach financial products and services, including pensions, to senior secondary schools across the country.¹³

The Nigerian Contributory Pension Scheme has been a subject of study by many African countries and the Commission has provided a platform for promoting the scheme across the Continent through the African Pension Awards (APA), an annual event established in 2015.

CHALLENGES

The Commission has encountered some challenges in the implementation of the reforms. The key challenges are highlighted as follows:

Lack of adequate understanding of the pension reforms by the general public, which was occasioned by inadequate resources to fund extensive public awareness campaigns. There is also the lack of a robust database of employers of labour and employment records as well as identifiable contact addresses in the country, which made enforcement activities of the Commission difficult. Similarly, the lack of unique identifiers has made it difficult to maintain a clean database of contributors for the provision of robust pension account services and the ever changing and demanding IT infrastructure tends to make running the scheme relatively expensive. Indeed, getting better unique IDs is critical to delivering the best long-term outcomes in pension provision.

Compliance by the private sector was found to be a challenge largely due to the fact that pension coverage in this sector was just about 1.3% in 2004 when the reform was introduced. Some of the employers viewed the employer contribution as an additional operational cost and were reluctant to comply. To mitigate this, the Commission had to engage recovery agents to follow up on defaulting employers and recover the outstanding contributions with interest penalties. In this regard, the Federal Government issued a policy that made the submission of a Compliance Certificate issued by the Commission a requirement for companies bidding for contracts in any of its agencies. These steps assisted greatly in ensuring compliance by eligible employers.

The maturity of the local financial industry is key to the success of the funded pension scheme. The experience in Nigeria still demands more depth of the financial system in terms of liquidity, availability of quality investment instruments, and adequate understanding of the workings of the financial system. The inflationary environment

¹³ MOUs were also signed with some select universities across the country in order to promote pension related courses in Nigeria through them.
and the dwindling value of the Naira against major currencies impacts the ability of the industry to meet returns on investment. There is also lack of adequate alternative asset classes in Nigeria that would facilitate diversification of investments.

The funded scheme has recognized the pension liability that accrued under the defunct DB scheme as of 30th June 2004. For the public sector, the financing arrangement to defray this liability is not robust, as a result, many retirees are facing delays in the payment of their full benefits as and when due.

**FUTURE OUTLOOK**

The Pension Reform Act 2014 expanded coverage of the Contributory Pension Scheme to the Organized Private Sector with three or more employees and the informal sector, which accounts for a greater percentage of the Nigerian labour force, as well as to States and Local Governments. Against this backdrop the Commission in conjunction with the Pension Industry operators developed strategic plans to advocate for compliance with the scheme from these sectors. The Industry would actively pursue an inclusive and expanded coverage, whilst also ensuring excellence in service delivery. This is expected to significantly increase RSA registrations from employees of these very important sectors of the Nigerian economy.

The Micro Pension Scheme has been developed and designed with certain incentives targeted at motivating employees in informal sector of the Nigerian economy and the self-employed to have retirement benefits. In this regard, strategic engagement is currently ongoing between the Commission and relevant key stakeholders including Trade Unions as well as other Associations, to enlighten them on how their members can participate in the Scheme. To drive this initiative, there are various incentives conceptualized including using a portion of the RSA balance to make an equity contribution for residential mortgage, accessing a certain percentage of the total contributions for personal use, Group Life and Health Insurance Schemes, etc. These would be pursued to ensure buy-in and sustainability of the scheme.

The guidelines for a Multifund Investment Structure for RSA Funds have been finalized and are awaiting necessary approval, before release and subsequent implementation. When operational, the guidelines would ensure that the pension assets are appropriately invested to align with the risk appetite of members as well as refocus the investment strategy of PFAs into long term impactful investments in infrastructure and housing/real estate development as well as the normal government bonds and listed equity. Consequently, initiatives have been developed in the Commission’s Corporate Strategy to grow the total pension assets under the management of Pension Funds to 10% of GDP as well as increase investments in identifiable infrastructure and other alternative assets to 40% by the end of 2019. These initiatives would continue to be pursued to actualize the anticipated positive impact of pension fund investments on the Nigerian economy.
The Commission is working to engage a service provider to develop and implement the Pension Administration System (PAS), which is expected to provide the platform for maintaining a robust database on pension matters in the country as well as allow the setting up of the necessary technology for provision of robust services to the micro pension participants. Efforts would be intensified to develop a database of employers and working population in Nigeria to enable full monitoring of compliance by all eligible employers. As highlighted in other chapters in this volume this will be absolutely critical to delivering the full potential of digital pension Inclusion in Nigeria.

These will be achieved through excellence in service delivery across all service levels and establishment of an enabling pension industry that is knowledge based and with highly motivated staff.

**LESSONS LEARNED**

**POLITICAL WILL**

The importance of political will cannot be overemphasized. Much cannot achieved without the express buy-in of the presidency. It was clear from the onset that the success of the Nigerian Pension reform and the introduction of the CPS was driven by the robust support from the highest office in the country. Indeed, in the face of prevalent policy somersaults and changes across the globe, the CPS remains the flagship for continuity as four successive governments have lent support to the implementation of the scheme.

**EDUCATION AND SENSITISATION**

Education and sensitisation of all arms of government, stakeholders, industry operators, and workers themselves is essential to douse controversies often generated by ignorance or misinformation by individuals with less than altruistic motives. Failure to so do will often result in lengthy, often very public, disagreements at best or an outright rejection of the scheme at the worst. The controversies that trailed the passage of the Nigerian Pension Reform Bills into law could have been avoided if adequate sensitisation was done before the transmission to the legislature. It was evident during the processes that led to the passage of both the laws, 2004 and 2014, that there was no avoiding crucial one-on-one engagements with diverse stakeholders to educate them on the workings of the scheme and the importance of seizing ownership of their future.

The Commission remained collaborative and consultative in rule making, facilitating the establishment of excellent working working relationships with other regulatory agencies. This entrenched the understanding of the CPS and prevented regulatory arbitrage in the implementations of the reforms.
SAFEGUARDS

A critical safeguard of the pension reform has been the segregation of administration and custody of the pension fund assets. Prior to the reform, a major concern was the weak and inefficient administration of the pension system. To address this issue, the reform designed an institutional framework that professionalized the administration of the scheme. A two-tier management system was established that gave full administration to the PFAs while the custody of the pension assets was given to the Pension Fund Custodians. Thus, there is full separation of administration and custody functions under the CPS, which has assisted immensely in addressing conflict of interest issues, promoted transparency and improved oversight over benefit and investment decisions.

The law stipulates that PFCs must provide a guarantee to all the pension assets under their custody. In addition, the custody is done in the name of the pension contributors, whose contributions are being credited into their personalized accounts, for which they receive regular statements. This ensured that the pension fund assets were ring fenced. Indeed, for the entire 12 years of the reform, there has not been any case of fraud in the system.

INDEPENDENT COMMISSION

The independence of the Commission as a regulatory body was firmly established with reporting lines going directly to the President and Commander in Chief of the Nigerian Armed Forces. In addition, appointments of the heads of the Commission are done by the President subject to confirmation by the Senate. The governance structure of the Commission was diversified to improve the quality of decision making and includes representations from the pensioner associations, labour unions, Ministry of Finance, head of the Federal Civil Service, Central Bank of Nigeria, the Securities Exchange Commission, the Nigerian Stock Exchange and the National Insurance Commission.

USE OF TECHNOLOGY

For a successful pension reform, it is pertinent to develop a robust database of all pension matters. This was one of the major pre-occupations of the Commission during the early days of the reform and remains a factor in its successful implementation. Without a robust database, it will not be possible to establish accrued and future benefits accurately and it will be very difficult to enforce compliance by all eligible employers. Technology continues to play a key role in both the operation and supervision of pension fund assets.

The Commission realized the importance of using technology to conduct off-site reviews of the activities of both the PFAs and PFCs, and as such, developed and deployed the risk management and analysis system. This enabled the PFAs and PFCs to send periodic returns on all required reports for review by the Commission. For investment activities, the reporting is done daily except for weekends when there is no trading. The daily reviews enables the Commission to note risky investments and intervene promptly to avoid major losses.
In addition, the process to implement a PAS has reached an advanced stage. The application was designed to, among other things, have an Automatic Fingerprint Identification System (AFIS) and Governance, Risk and Compliance (GRC) Modules, that would provide capabilities for unique identification of registered members and online real-time monitoring of all activities of the operators.

CONCLUSIONS

The reforms of the Nigerian pension system were embarked upon to address the challenges faced by the defunct DB scheme. The CPS, which was introduced by the reforms, has been successfully implemented within the last twelve years, during which time strong institutions, systems, and processes were established to ensure effective operations of the new pensions industry and meet the objectives of establishing a sustainable pension scheme for Nigeria.

The pension reform has simplified the process of payment of retirement benefits through the issuance of effective regulations and guidelines for accessing such benefits. It has gained public confidence and acceptability within the short period of its implementation. The private sector, which had just about 1.3% pension coverage before the reforms, had 54% of the total registered members by the end of the third quarter of 2016. Indeed, the pool of pension funds and assets generated by the CPS has aided the deepening of Nigeria’s financial sector and provided a platform for attaining strategic programmes of the government in the area of infrastructure, real estate, and the development of the real sector of the economy. The total value of pension industry assets is in excess of NGN 6 trillion as of 30th September 2016. Furthermore, the CPS has increased transparency and accountability in determining budgetary estimates for payments of pensions by the Federal Government and all the state governments that adopted the scheme.

In spite of the efforts, however, many challenges have arisen in the course of implementing the CPS, which need to be addressed in order to consolidate the gains of the scheme. These challenges are not insurmountable, and the Commission has been championing various initiatives by all relevant stakeholders in order to address them. These efforts have been yielding positive results, particularly, the promulgation of Pension Reform Act 2014 to provide the necessary legal basis for addressing the challenges. In addition, both corporate and industry strategies were developed to establish a roadmap for achieving the objectives of the provisions in the Act. With the Micro Pension Scheme as an initiative in the two strategic plans, the pension industry is set for exponential growth, both in terms of membership and asset size, and continues to contribute significantly to Nigeria’s economic development.
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DEVELOPING DIGITAL PENSION INCLUSION IN MEXICO

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* "The views and conclusions expressed in this chapter are strictly personal and do not necessarily coincide with those of Banco de México."
CURRENT STATUS OF THE MEXICAN PENSION SYSTEM

The Mexican pension system is fragmented, as there are several schemes run by different social security institutions, which do not operate in an integrated way. There are three main components. First, there is the non-contributory pillar. There are several non-contributory old-age pension schemes at the federal and state level. With respect to coverage and budget, the most important is the *Pensión para Adultos Mayores* (Pension for the elderly), financed by the Government and managed through the Secretariat for Social Development (SEDESOL). From 2012, this program was granted to all those people who do not receive an old-age pension from a social security institution. The amount consists of USD 30 per month, paid every two months, and a one-off payment of USD 77 if the beneficiary dies. In accordance with the National Council for the Evaluation of Social Development Policy (CONEVAL), in 2015 the program benefited 5.7 million elderly adults (which is 68% of the elderly population), with a total spending of USD 1,940 million.

Additionally, some states have implemented their own non-contributory pension schemes for elderly adults that vary in the type of benefits granted (monetary or in kind), the age of eligibility (between 60 and 70), and the amount paid (from 26 to 46 USD per month). In general, these programs require the beneficiary to live in the state for a number of years, from three (Federal District) to 20 (Veracruz), and to not receive any other pension. In 2011, the population benefiting from non-contributory state pensions was 1.4 million elderly adults. However, the amount of pension granted by most of these programs is lower than the cost of a basic food basket, which is equivalent to the minimum welfare basket defined by CONEVAL. The rules governing the national and local safety nets are independent from each other, and there is no coordination between state and federal programs – mirroring the situation between the Union and State Governments in India in relation to old-age income support. (see Chapter 1 on India).

Second, in the case of the mandatory contributory pillar, the main public pension systems are Defined Contribution (DC) schemes, with a private administration of funds by the Pension Fund Administrators (Afores). Currently, the main contributory pension systems cover around 42% of the economically active population (EAP), with the most important being the Mexican Social Security Institute (IMSS) for formal workers in the private sector, with a coverage of 36.2% of the EAP; and the Social Security Institute for Public Sector Workers (ISSSTE) for federal government employees, which covers 5.5% of the EAP. Both pension systems were reformed in 1997 and 2007 respectively.¹

In 2016, the Retirement Saving System (SAR)² administered USD 140 billion (14.5% of Gross Domestic Product, GDP) from the pension savings of 56.3 million individual

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¹ Mexico also has a mandatory 5% contribution to fund the purchase of a home, paid to an institution known as INFONAVIT.
² Combining the assets of both the private sector (IMSS) workers and the public sector (ISSSTE) workers.
accounts of IMSS, ISSSTE, and independent workers. Nevertheless, there are many Defined Benefit (DB) schemes for state governments, state-owned companies, and public universities, all of them covering 2% of the EAP, with no portability of entitlements between them or with the federal systems.

Finally, there is the voluntary contributory pillar to individual accounts that can be made by employees contributing to the SAR, self-employed workers, and informal workers. Unlike the situation in Chile (see Chapter 7) there has so far been no attempt to create any mandatory requirements for the self-employed to contribute. Also, some companies offer occupational pension plans to their employees. Additionally, insurance companies and financial groups offer personal pension savings with various modalities.

Independent workers are not legally obliged to contribute to any pension system, but are allowed to open an individual account in an Afore and make contributions for their retirement. However, it is not mandatory to contribute a fixed amount or percentage of their income, or with any regularity. Despite the tax incentives for voluntary pension savings, according to the pension supervisor (CONSAR), the amount of voluntary savings made in Afores as of 2016 is only 1.5% of the total assets managed by the SAR, and just 4.9% of individual accounts make voluntary savings.

In terms of the coverage of the Mexican pension system, the National Employment and Occupation Survey (ENOE) shows that in 2016 there were 51 million people who were occupied, and 42.6% of those were formal workers. Therefore, near 60% of the working population is excluded from the mandatory pension system, either because they are unemployed or work in the informal economy, with some never entering the formal sector at all. This put Mexico mid-way in terms of the case studies in this volume, with higher informality than say Chile or the U.K., around the same as in Turkey, but far lower than in India, Bangladesh, Kenya, and Nigeria.

The results of the 2012 National Survey of Worker’s Career Paths show that many workers switch between formal and informal sectors several times during their careers (a similar pattern seen in Chapter 7 on Chile), leading to low contribution densities in the pension system. Between 2007 and 2012, 17.1% of the workers had switched from formality to informality and 17.6% from informality to formality. Over the five-year period, 24% of the workers had worked in both sectors. A study from OECD (2015) points out that reducing the informal sector is, therefore, a key policy objective in order to increase coverage and contribution densities in the pension system. This is clearly important – but as set out in this volume, it is also necessary to improve the ease and extent of contributions from the informal sector as well.

The high level of informality in the labour market, as well as the limited financial literacy and retirement planning, have not encouraged the increase of coverage significantly over recent years. Therefore, there is an important challenge in order to include informal workers into contributory pension systems.
Regarding coverage in old age, according to CONEVAL and the National Survey of Household Income and Expenditure (ENIGH) of 2014, only 29% of the elderly population (65 years and older) has a pension. Thus, the pension coverage levels are far from ideal, and most of the labour force is without any old-age protection. In addition, the old-age poverty rate in Mexico was above 30% in 2013 (OECD, 2015). Therefore, the combination of low coverage, low contribution density, and low replacement rates in a country where poverty rates are already high, raises important social challenges (Villagomez, 2014).

Finally, in terms of pension adequacy, mandatory contributions to IMSS are the equivalent of 6.5% of an employee’s salary to their individual retirement account: 5.15% is paid by the employer, the employee pays 1.125%, and the government supplies the remaining 0.225%. Some studies forecast that the average worker making minimum contributions within this system will receive a monthly pension of less than 40% of their current salary during retirement. This figure could be optimistic, as many workers weave in and out of the formal employment system and, therefore, do not consistently contribute to their individual pension accounts. The main reason why coverage and contribution densities are relatively low in Mexico, despite the mandatory affiliation of employees, is due to the high level of the informal sector. So, under these conditions, successful retirement planning probably depends on individuals voluntarily making additional pension contributions. On the other hand, the government does pay a flat rate ‘social quota’ for lower income workers. This means that for a worker on one minimum wage salary this effectively increases the contribution rate to 13% of salary – a figure that tends gradually towards 6.5% as incomes rise and the relative impact of the social quota diminishes (and ultimately disappears completely above an income level equal to 15 times the minimum wage).

An important issue that deserves more attention in Mexico is the lack of interest in the pension system. According to the OECD (2015), the lack of interest in the pension system is linked to the low financial literacy of the Mexican population. The 2013 National Survey on the Knowledge and Perception of the Retirement Saving System, shows that 66% of the private-sector workers affiliated to the IMSS (aged 18 to 65) do not have a saving habit. Of those who save, around 70% do so to face emergencies and only 7.2% save for retirement in other institutions or channels different from Afores. More than half of the workers have not thought about what they are going to live on at retirement. About 56% of them hope they will get a pension replacing fully their salary, but only 27% actually save to reach that target. Finally, a large proportion of workers do not know the performance of their Afore (67.5%) or the administrative fees charged by it (74.2%). However, as argued in other chapters in the volume, levels of financial knowledge and understanding are often very low – and so many efforts in reforms aim to make it more mandatory to join or contribute, rather than depending on building an informed public who will actively seek out pension products.
What is an inclusive pension system? Following Cámara and Tuesta (2013), we define an inclusive pension system as the one that increases access and use (active participation), while at the same time, mitigates those barriers that limit people’s participation in saving systems. Access should be measured by the infrastructure developed by public and private providers of pension services in the cumulative and pay-out phase; usage should be measured by the current level of active participation in the pension system; while pension barriers are all the structural factors that limit the possibility to save for retirement, such as the presence of formal/informal markets structure, administrative costs of the pensions system, geographical limitations (rural/urban world), documentation requirement, trust in government, and financial institutions, among others.

In section one, we discussed some indicators that showed the lowest levels of access, use, and the enormous barriers that the Mexican economy faces for making a more inclusive pension system. The pension system can be effectively accessed by only those who belong to the formal sector. Usage, measured by the level of active contribution to the pension system is limited, only reaching approximately 40% of active workers. Likewise, the high level of informality, which makes up three quarters of the labour force, constitutes an enormous obstacle in the implementation of any Bismarckian or quasi-Bismarckian structure – that is to say a pension system based on workers making contributions with and assisted by their employers in a largely formal labour market context.

ENABLING FACTORS THAT CONDITION PENSION INCLUSION

According to Tuesta (2016), there are fundamental factors that could enable financial inclusion, in our case, pension inclusion (see Figure 9.1). First, there are long-term economic conditions that can be measured by variables such as the level of GDP per capita, poverty indicators, and income distribution. These variables define the capacity of a country to save. In this regard, if a country effectively implements sound long-term policies that increases its economic development it is very likely that, accordingly, its capacity to save in pensions increases.
Another enabling factor is the high level government commitment (Tuesta, 2016; Nair, 2016). This commitment could be reflected in a national plan for pension inclusion (as part of a financial inclusion strategy), which spur relevant actor’s engagement from the public and the private sector to deploy a coordinated effort to increase the current level of pension coverage. Accordingly, having a well-defined regulation for pension plans is fundamental in order to promote and protect retirement savings. Together with the importance of this national commitment, are two other enabling factors for increasing pension inclusion. The introduction of a comprehensive financial literacy program adequately designed to provide financial capacity and awareness about the importance to save for retirement is a first step to define the right incentives to contribute. Another important factor that can help to get effectiveness and efficiency to pension inclusion programs is the so-called digital transformation with its ability to permeate different activities.

**DIGITAL CONTEXT IN MEXICO FOR PENSION INCLUSION**

The use of digital appliances to foster financial inclusion has been extensively analysed and gradually applied in different contexts and geographies. However, a huge amount relates to banking and insurance, with a more limited focus on savings. The literature on financial inclusion and pensions coverage around the world is far more limited (Bhardwaj, 2016; Brodersohn, 2016; Karlan, 2016; Karlan et al, 2014; Karlan et al 2016; Banerjee et al, 2016; Benartzi, 2012, Madrian, 2013). According to Camara and Tuesta (2016) it is important to pay attention to the digital conditions a country presents in order to define the adequate actions to provide access to financial services. Digital tools have demonstrated interesting
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Evidence in terms of reducing transactions costs that now make it attractive to the supply side to offer financial products for low income clients and, at the same time, increase incentives to the demand side to save given more convenient and less costly channels. One of the central arguments of this chapter is that these advances need to be allied to a fuller understanding of the market structure, governance, and investment approach that can deliver the most value-added from the ‘traditional’ pension market. This volume highlights the importance of those who help people join a pension scheme channelling their contributions from the agency or company; one or the other which can most efficiently provide administration of the accounts over time and invest the assets, leveraging economies of scale and using member-focused governance.

In Figure 9.2, we observe the digital index developed by Camara and Tuesta (2016), which is a composite indicator that measures six digital dimensions: technological infrastructure, digital adoption, usage of digital products/services by individuals, usage of digital products/services by firms, cost for accessing, and digital contents and regulatory conditions of the digital context. We observe that Mexico is placed in the second quartile, with similar levels such as Morocco, Poland, China, or the Russian Federation. Other emerging economies such as Uruguay, Brazil, South Africa, or Chile, presented better digitization indexes than Mexico. Regarding this, it is clear that Mexico has a long way to go and, at the same time, has a great opportunity to improve current conditions.

Figure 9.2
Digitization index and Mexico

Source: Camara and Tuesta (2016)
However, if we analyse the digital index in more detail, we see that Mexico has interesting results in two dimensions: digital infrastructure and digital content. In Figure 9.3, we see that in both cases the indicator places the country in the third highest quartile. However, the overall index for Mexico is mostly penalized by low achievements in terms of individual and enterprise usage (the bottom quartile). In the case of the regulatory and affordability dimensions, the index places Mexico in the second bottom quartile.

**Figure 9.3**

**Digitization index by components in Mexico**

While focusing on specific digital products and services, we observe interesting and contrasting developments in Mexico. In the case of computer and internet usage indicators, we see in Figure 9.4 that, in both cases, the number of households with a computer and the number of households with internet access increased strongly between 2005 and 2015, reaching coverage of 40% approximately. The same happens in the case of computer and internet individual use, reaching coverage of 50% approximately.
Figure 9.4
Computer and internet: access at home and usage in Mexico

Although the size of the increases has been important, there are some notable difficulties that explain why the aforementioned indicators for Mexico have not yet achieved universal coverage. Observing Figure 9.5, it is noticeable that in the case of those not accessing the Internet in 2014 – 60% said that it was for lack of money, while, interestingly, another 30% considered access to the Internet as not relevant to them. There are other additional issues, such as lack of skills and insufficient equipment, which are less significant factors. Given these results, it is important that governments and regulators provide the necessary facilities to make Internet access affordable for more Mexican people.

Figure 9.5
Internet access barrier at home- Mexico

Source: INEGI
However, it is interesting to see that in the case of mobile devices, the indicators show better results. In Figure 9.6, we present some figures of Mexico compared, in some cases, to Spain’s numbers as a reference of a country that is better placed in the digitization index ranking. We observe that cell phones’ subscriptions have increased by 50% approximately since 2005 and that mobile phone traffic has also multiplied by five times in nine years. Besides that, both indicators are double the figures achieved by Spain. Unlike Internet access, mobile line access seems to be more affordable, being slightly cheaper than that in Spain. Finally, it stands out that the mobile population coverage network is 99%, practically providing universal access.

Figure 9.6

Mobile indicators for Mexico
Developing Digital Pension Inclusion In Mexico

In a nutshell, from the analysis of some digital figures in Mexico, we can conclude that mobile penetration has achieved a level of maturity that could make possible the introduction of digital mobile solution for long term savings, particularly the case of pension inclusion. In the following two sections we present a statistical analysis to measure likely impacts of digital variables on pension inclusion as well as the most relevant projects currently under development in Mexico in order to spur digital pension inclusion. Echoing one of the key messages in this volume of the synergies between the development of financial inclusion and the pension coverage infrastructure; these developments in mobile penetration and payments are so significant because they can link into an already existing individual account infrastructure for pensions in Mexico, which has been operating for nearly 20 years.

**Socioeconomic and Digital Aspects Affecting Pension Inclusion**

Since the reform of 1994, leading to the new private pensions in 1997, Mexico has been aiming to improve social protection for their citizens. However, the particular structural conditions that surround its economy have so far limited the possibilities to go further. The presence of the large informal economy constrained the scope of a pension system that mostly deals with those workers under a formal contractual agreement with their firms. The current setting of most pension systems in the world— including Mexico, relies on formal firms as their natural partners for collecting workers’ contributions. This structure definitively fails when firms are out of the reach of the State because of their informal condition. In all countries, when the informal economy is a significant factor, pension system participation is highly affected.
According to Levy (2008), the Bismarckian structure of the Mexican pension system is useless for the socioeconomic informal structure of the country. This situation challenges many emerging economies, which are experiencing the same limitations, and are in the process of improving the design in order to broaden worker's savings to pensions. According to different studies, (Benartzi, 2012; Holzmann et al, 2012; Karlan et al, 2016; Madrian, 2013; Tuesta, 2014), pension systems in developing economies need to take one or more steps further in order to find a more flexible design that reaches those currently uncovered, by using economic incentives and enabling them to use increasing popular channels, such as mobile devices, that facilitate their participation.

In order to find new pension designs that provide an impetus and make other facilitators work, it is important to have a better knowledge of countries’ socioeconomic conditions, particularly those variables that most likely explain the likelihood of active participation in a pension system. As Thaler (2016) and Benartzi (2012) mention, the incorporation of any mechanism to nudge people to change their economic attitudes – in this case to save for retirement – must naturally align valuable goals for them, their natural behaviours, and routines. In this case, for instance, digital devices could be an interesting focus for improving pension savings in cases where they are currently part of their daily and routine tasks.

In order to know better the effects of these socioeconomic aspects, we use the micro data obtained from the ENIGH which is developed by the National Institute of Statistics and Geography (INEGI) of Mexico. The results of the ENIGH are representative at the national level and, in some years, for rural and urban areas. This is published biennially. Years 2008, 2010, 2012, and 2014 have been considered, along with the different modules that compose the ENIGH for the period under study were: Households, Revenues, Population, and Jobs.

**METHODOLOGY**

We are interested to know which socioeconomic factors condition an individual’s likelihood to save for pensions in order to have better insights about how to go forward in defining a more inclusive pension system. In order to do that, we define a model where our dependent variable is the likelihood to contribute to pensions.

Because our dependent variable is binary (answer 1 or 0), it is not advisable to use a linear model such as ordinary least squares (OLS) since it is possible to fall into several errors. For example: model predictions will not necessarily be between zero and one; errors will not be distributed as normal; and will result in a heteroskedasticity problem.

Although these problems do not impede the application of OLS, some assumptions of the model are quite restrictive. As an alternative, it is proposed to use a nonlinear probability model such as the Probit model. This methodology allows quantifying the probability that an individual with given characteristics belongs or not to the study group, where both the variables explained are binary response (1 or 0). So, the decision to contribute or not
Developing Digital Pension Inclusion In Mexico
to pensions depends on a latent variable $y^*$ which is determined by a set of exogenous variables,\(^3\) collected in the vector (or group of variables) $x'$ such that:

$$y^*_i = x'_i \beta + u_i$$

$$y_i = \begin{cases} 1 & y^*_i > 0 \\ 0 & y^*_i \leq 0 \end{cases}$$

where the subscript $i$ represents individuals. The vector $\beta$ refers to the parameters of the model and $u$ is the error term which is assumed to be normal and independently distributed.

A critical threshold is assumed $y_i$ from which, if $y^*_i$ exceeds $y_i$ then an individual will belong to the group under study. Both $y_i$ and $y^*_i$ are unobservable, although under the assumption that they are normally and independently distributed with the same mean and variance, it is possible to estimate the regression parameters and thus obtain information about $y^*_i$ such that:

$$P_i = P(y_i = 1 | y^*_i = x') = P(y_i \leq y^*_i) = P(Z_i \leq \beta x') = F(\beta x')$$

where \(Z\) follows a standard normal distribution $Z \sim N(0, \sigma^2)$ and $F$ is the standard cumulative normal distribution function, $F = \frac{1}{\sqrt{2\pi}} \int_{-\infty}^{x'} e^{-z^2/2} dz$.

The model (1) is estimated by Maximum Likelihood. From the different coefficients estimated in the model, the marginal effects on the latent variable are calculated. The interpretation of these marginal effects is similar to that obtained by a linear regression model, where the coefficients represent the change in the probability of fulfilling or not the condition (e.g. remaining active) when a variable belonging to the exogenous vector $x'$ changes, whilst keeping the other factors constant and assuming that $E(y^* | x') = x' \beta$ is satisfied.

RESULTS

In Table 9.1 we provide the statistical results of different socioeconomic factors affecting the probability to actively contribute to a pension system. Details about the statistical characteristics of the data and the robustness of the regression analysis are presented in Appendix 1.

It is important to bear in mind that considering the characteristics of the survey, variables available, and the presence of idiosyncratic and unobserved country specific factors, the results should be considered as earliest findings to open new paths of research.

Let’s first discuss how important it is that people interact with technology for pension savings. We consider three indicators available in the Mexican survey: the access to mobile phones, computers, and the Internet. According to the Probit-model, people’s interaction

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\(^3\) These are variables that affect the dependent variable — in this case the choice of whether to save in a pension or not — but that in turn are not affected themselves by the dependent variable — that is there is no feedback from the decision to save that will impact the exogenous variable and create a feedback loop.
with mobile phones shows a statistically significant effect of increasing the likelihood to save in a pension system. Although, having access to a computer or to the Internet also show positive signs, in both cases the effect is not statistically significant. These results make sense in terms of the stylized facts we discussed in section 2, where we discussed the highest penetration of mobile phones (99% coverage) and less financial barriers to access, compared to computer and Internet access. Besides, we also discussed the greater variety of activities and daily interactions experienced by people using their mobile phones.

However, it is important to monitor other relevant variables that affect the likelihood to contribute to pensions. Gender seems to have a significant effect on savings for retirement. Being male rather than female increases the likelihood of contributing. In this regard, policies need to bear in mind the importance of tackling this issue in order to broaden pension coverage. Likewise, other socioeconomic issues such as having fewer years of education and being in the lowest quintile receiving labour income affect negatively the probability to pension savings. It is interesting to observe that when total incomes are considered — e.g. such as those received as government transfers — the probability of saving for retirement increases.

One aspect that needs further research is the role of families’ investments in real estate assets. It seems that being a property owner in the lower quintiles, with respect to the richest quintile, is a statistically significant variable affecting negatively the likelihood to save in pensions. In a context of limited resources, low incomes, and high labour informality, families seem to prioritize how to distribute their savings-investment portfolio. Given that a house also has a greater appeal for a family and considering that retirement is a far-distant situation when viewed from the active stage of the labour force, preferences for saving in housing are considered a priority. Moreover, the commitment to pay their mortgages or improving properties’ conditions is also a priority for them. Besides, being an owner could also be considered an alternative strategy to facing retirement. In this sense, it could be challenging for policy makers to think about new tools that align the valid motives that lead to saving for purchasing a house and to saving for retirement. Some financial products, such as reverse mortgage, could be an interesting mechanism, although further discussion is needed in order to implement them broadly (Hoyo and Tuesta, 2013). As highlighted in other chapters, it is not that one form of saving is necessarily right or wrong, but it is important to get the best balance.

Finally, it is interesting to find significant evidence about the importance of the age factor for pension savings. People in the earliest stage of the labour cycle are most likely not to save for pension, which contrasts with the attitude of those in the later stage of the labour cycle, who are most likely to save for retirement. Considering the importance of saving early for increasing the size of pension funds, it is also important that policy makers explore strategies to give incentives and attract younger cohorts to save as early as possible for retirement. In this regard, as discussed in the previous section, an active attitude of the government is fundamental, especially if these strategies are linked with financial literacy programs and the use of digital devices.
Table 9.1
Likelihood to save for pensions

| Variable                  | dy/dx | Std.  | z      | P>|z| | Min | Max | x   |
|---------------------------|-------|-------|--------|--------|-----|-----|-----|
| Mobile Phone              | 0.04  | 0.02  | 2.39   | 0.02   | 0.01| 0.07| 0.70|
| Computer                  | 0.01  | 0.02  | 0.65   | 0.51   | -0.03| 0.06| 0.28|
| Internet                  | 0.01  | 0.02  | 0.26   | 0.79   | -0.04| 0.05| 0.23|
| Labour contract           | -0.01 | 0.02  | -0.48  | 0.63   | -0.04| 0.02| 0.76|
| House ownership           | 0.00  | 0.02  | -0.03  | 0.98   | -0.03| 0.03| 0.73|
| Male                      | 0.07  | 0.01  | 4.54   | 0.00   | 0.04| 0.09| 0.63|
| Non studies               | -0.57 | 0.01  | -54.72 | 0.00   | -0.59| -0.55| 0.05|
| Primary school            | -0.48 | 0.02  | -27.65 | 0.00   | -0.51| -0.44| 0.26|
| Secondary school          | -0.17 | 0.02  | -9.06  | 0.00   | -0.21| -0.14| 0.49|
| Labour income q.1         | -0.80 | 0.03  | -25.19 | 0.00   | -0.87| -0.74| 0.21|
| Labour income q.2         | 0.16  | 0.16  | 0.98   | 0.33   | -0.16| 0.48| 0.19|
| Labour income q.3         | 0.03  | 0.15  | 0.21   | 0.83   | -0.26| 0.32| 0.19|
| Labour income q.4         | 0.04  | 0.12  | 0.29   | 0.77   | -0.21| 0.28| 0.20|
| Total income q.1          | 0.03  | 0.04  | 20.22  | 0.00   | 0.66| 0.80| 0.21|
| Total income q.2          | -0.17 | 0.17  | -0.97  | 0.33   | -0.51| 0.17| 0.18|
| Total income q.3          | -0.04 | 0.15  | -0.29  | 0.77   | -0.33| 0.25| 0.18|
| Total income q.4          | -0.05 | 0.12  | -0.38  | 0.70   | -0.29| 0.20| 0.21|
| Value of household q.1    | -0.08 | 0.02  | -3.38  | 0.00   | -0.13| -0.03| 0.22|
| Value of household q.2    | -0.07 | 0.02  | -3.11  | 0.00   | -0.11| -0.03| 0.28|
| Value of household q.3    | -0.06 | 0.02  | -2.47  | 0.01   | -0.11| -0.01| 0.17|
| Value of household q.4    | -0.08 | 0.02  | -3.29  | 0.00   | -0.13| -0.03| 0.17|
| 1 people household        | 0.01  | 0.03  | 0.29   | 0.77   | -0.05| 0.06| 0.10|
| 2 people household        | 0.01  | 0.02  | -0.26  | 0.79   | -0.05| 0.04| 0.16|
| 3 people household        | 0.01  | 0.02  | 0.30   | 0.77   | -0.04| 0.05| 0.18|
| 4 people household        | -0.02 | 0.02  | -0.73  | 0.47   | -0.06| 0.03| 0.23|
| 5 people household        | -0.02 | 0.02  | -0.81  | 0.42   | -0.07| 0.03| 0.16|
| Younger than 24y          | -0.22 | 0.04  | -5.49  | 0.00   | -0.30| -0.14| 0.16|
| Between 25 to 34y         | -0.03 | 0.04  | -0.65  | 0.52   | -0.10| 0.05| 0.25|
| Between 35 to 44y         | 0.02  | 0.04  | 0.46   | 0.64   | -0.06| 0.09| 0.26|
| Between 45 to 54y         | 0.07  | 0.04  | 1.87   | 0.06   | 0.00| 0.15| 0.19|
| Between 55 to 64y         | 0.06  | 0.04  | 1.51   | 0.13   | -0.02| 0.14| 0.09|

4 The figures of the table show us some relevant statistics of the regression. As an example, we may focus on the variable “mobile phone” (first row). The results of the Probit analysis tell us that pension inclusion in Mexico increases in 4% as a response of more mobile phone penetration alone. The results in this case is statistically significant at the 2% level.
SAVING THE NEXT BILLION FROM OLD AGE POVERTY : GLOBAL LESSONS FOR LOCAL ACTION

GOVERNMENT’S INITIATIVES FOR DIGITAL PENSION INCLUSION

Most of the financial inclusion efforts at a national level have been focused on banking, access to financial products, and formal institutions, as well as on short term financial services such as credits and savings options in bank accounts. Nonetheless, in recent years CONSAR has taken some measures to alert the population of the importance of saving for retirement.

In 2016, the first National Survey on Voluntary Savings (CONSAR, 2016 d) identified the factors that foster or inhibit voluntary savings for formal workers. The factors that would promote voluntary contributions are security and simplicity in making contributions, adequate communication campaigns, matching contributions from the employer or the government, as well as attractive yields. Most of the workers declared that they are not doing anything to prepare for their retirement because they cannot anticipate the amount of income that will be needed during retirement; moreover 75% of them say that they are willing to increase their mandatory contribution. On the other hand, the factors that inhibit voluntary savings are the lack of resources left for saving, and distrust of financial institutions.

CONSAR has developed an integrated strategy to promote voluntary savings in 2016, through: (i) expanding the channels in which voluntary contributions can be made; (ii) establishing non-monetary incentives to change the behaviour of the potential savers; and (iii) increasing the number of potential savers:

EXPANDING THE CHANNELS FOR MAKING VOLUNTARY SAVINGS

In an effort to ease the ways in which individuals can make deposits into existing Afore accounts, since 2015 voluntary contributions can be made at common retail outlets, branches of Bansefi (a development bank), and Telecomm (a state-owned company that offers telecommunication and financial services). It is worth mentioning that the aforementioned channels are also banking agents in the national strategy of financial inclusion.

Since 2016, voluntary savings can also be made through a mobile phone payment platform called Transfer, in which savers can open a basic bank account that requires only a cell phone number, and make deposits in their Afore without being charged any fee. The deposits can be made also via a SMS (short message service), which does not require a smartphone.

The next steps in the strategy of CONSAR for promoting voluntary savings are the following:

a. In August 2017 a mobile app was launched in Mexico and the United States of America (for Mexican workers living abroad), that allows independent workers to
open an Afore account, make one-time or programmed deposits linked to a debit card, and check the balances of individual pension accounts. The app will also send messages reminding users of the importance of savings, and show the nearest contact points of Afores. This examples shares similarities with the attempts of the Government of India to get Indians living and working abroad but that plan to retire in India – such as workers in the gulf states – to make contributions directly into the India Pension system from their earnings abroad.

b. On a second stage of this project (1st semester of 2018), the app will also permit withdrawals of voluntary savings and of the unemployment benefit considered in the social security law (from the Afore account).

According to Ideas42 (2015), these new accessibility initiatives address crucial structural issues. However, a more comprehensive approach informed by a nuanced understanding of how people behave and make choices about their finances in the real world is needed to increase voluntary retirement savings. Adopting nonmonetary incentives from a behavioural science approach will help to tackle the problem from an entirely new perspective. Therefore, CONSAR has taken some actions in this regard, as described above.

ESTABLISHING NON-MONETARY INCENTIVES FOR VOLUNTARY SAVINGS

The main measures that CONSAR has conducted in this regard are the following:

Since 2014, Afores are required to send an annual pension report with an estimate of the future pension level, as well as voluntary savings scenarios. This report has clear and simple indicators showing the amount of pension with and without additional savings.

In 2015, CONSAR launched two simulators on its webpage for IMSS affiliates and independent workers to allow them to calculate their pension with different scenarios of retirement ages, densities of contributions, and voluntary savings.

Also, CONSAR has developed easy communication campaigns focused on low income and workers with low financial literacy, with musical jingles promoting voluntary savings, even in small amounts (10 pesitos Campaign).

However, there is more work to be done. As the study from Ideas42 (2015) points out, current data show that only 0.3% of the 19 million active account holders make a contribution in a given year, not including the tens of millions of account holders with inactive retirement accounts. Low voluntary contribution rates could perpetuate the high rates of poverty among the elderly and continue the cycle of inadequate retirement preparation.

INCREASING THE NUMBER OF POTENTIAL SAVERS

In 2016 CONSAR upgraded its call centre service (SARTEL) to be available also in the United States of America, in order to give advice to the 13.8 million Mexicans living
in that country on basic aspects of the pension system and the benefits of saving and planning for retirement. Given that many of the Mexicans working abroad have already an inactive Afore account, this measure seeks to foster voluntary savings for this group.

In 2014 CONSAR conducted an Independent Workers Survey, in which one of the main findings was that this group declared that currently they are not saving for their retirement, but be willing to, if provided proper information and incentives. Thus, a microsite for independent workers was launched at CONSAR’s web page that gives easy and useful information on how to open a voluntary pension account and the benefits of doing so, including a calculator for the voluntary savings needed to reach a desired pension amount.

Another measure taken by CONSAR on June 2016 was a pilot test with a group of 120,000 workers who were sent a special version of their Afore account balance, based on visual stimulus using ‘behavioural economics theory’, never used before in Mexico in this kind of document, to increase the awareness of the workers in a graphic way about the impact of regular voluntary savings and their estimated returns in the future. The follow-up of this group will measure the results of this policy.

Additionally, since September 2016, all Afores can offer individual pension accounts for children, in which the parents can make voluntary savings on behalf of their children. Thus, the saving habit for retirement can also be promoted in early ages. Currently, there is only one Afore that permits this kind of account.

Finally, a new pension report with a personalized projection of the expected pension amount funded only with the current mandatory contributions, was sent in 2015 to workers with their Afore account balance, in order to disclose the estimated replacement rate of the pension (given that the majority of workers are not aware of this information), including different examples of the additional voluntary contributions needed to obtain a greater pension, and information about the channels and options to make voluntary savings.

CONCLUSION

The need to increase pension coverage in Mexico is enormous. Labour force participation is only 40% and old-age participation is barely 30%. Average replacement rates are also low, due to high informality, interrupted careers, and low contribution rates. Therefore, policy makers have the vital challenge to foster pension inclusion strategies in order to build a more participative social protection system.

This chapter defines an inclusive pension system as the one that fosters more access to long-term savings, promotes the use (participation) of the available financial tools for retirement and, which at the same time reduces the structural barriers that limit the participation in pension systems, such as labour informality, cost, trust, document
requirements, geographic limitations, among others. We identify important enabling factors to overcome these barriers and spur usage and access to pension systems. The literature identifies interesting evidence about the importance of digital tools to give incentives for financial and pension participation. The digital transformation is considered a trigger to face structural barriers by reducing transactions costs to the demand and supply side. In addition to the factors reviewed in this chapter, it is also essential to look at the whole pension value chain and understand the cost structure, and where costs can add value to the final retirement outcome – on which Chapter 18 on costs provides important evidence.

A Probit-model was designed in order to detect the statistical importance of digital variables in increasing pension inclusion in Mexico. We found that the use of mobile devices is a statistical significant variable that increases active pension participation in Mexico more so than access to the Internet or a computer. Policy makers should pay attention to this result and continue making efforts to develop digital tools to facilitate the access and participation to long term financial services for retirement. In this chapter we have examined the recent effort of the Mexican government to spur voluntary savings by using digital strategies. We anticipate that a continuous determination in this area should deliver interesting results for pension inclusion in the coming years.

REFERENCES


CONSAR (2016 b). Retos y mejores prácticas internacionales en la promoción del ahorro voluntario.


CONSAR (2016 d). Encuesta “Factores que promueven el ahorro voluntario”


### APPENDIX 1

Regression robustness and descriptive statistics of the variables used

<table>
<thead>
<tr>
<th>Variable</th>
<th>Obs</th>
<th>Mean</th>
<th>Std. Dev.</th>
<th>Min</th>
<th>Max</th>
</tr>
</thead>
<tbody>
<tr>
<td>Workers contributing</td>
<td>165.628</td>
<td>0.3440179</td>
<td>0.4750484</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Mobile phone</td>
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<td>0.6938685</td>
<td>0.4608891</td>
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<td>1</td>
</tr>
<tr>
<td>Computer</td>
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<td>0.2668163</td>
<td>0.4422995</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
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<td>0.2147463</td>
<td>0.4106499</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Labour contract</td>
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<td>0.4211382</td>
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<td>1</td>
</tr>
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</tr>
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<td>Male</td>
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<td>0.4998248</td>
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<td>1</td>
</tr>
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<td>Non studies</td>
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<td>0.3430201</td>
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<td>1</td>
</tr>
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<td>0.3518945</td>
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<td>1</td>
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<td>0.4072692</td>
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<td>0.2022421</td>
<td>0.4016809</td>
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<tr>
<td>Labour income q.2</td>
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<td>0.196074</td>
<td>0.3970341</td>
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<td>1</td>
</tr>
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<td>Labour income q.3</td>
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<td>0.194093</td>
<td>0.3955097</td>
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<td>1</td>
</tr>
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<td>Labour income q.4</td>
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<td>0.1985503</td>
<td>0.3989176</td>
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<td>1</td>
</tr>
<tr>
<td>Total income q.1</td>
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<td>0.2036305</td>
<td>0.4027009</td>
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<td>Total income q.2</td>
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<td>0.1951689</td>
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<td>Value of household q.1</td>
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<td>1</td>
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<td>Value of household q.4</td>
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<td>0.1556698</td>
<td>0.3625458</td>
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<td>55.071</td>
<td>0.0980008</td>
<td>0.2973184</td>
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<td>0.1627172</td>
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<td>4 people at household</td>
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<td>0.2220951</td>
<td>0.4156585</td>
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<td>5 people at household</td>
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<td>Younger than 24y</td>
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<td>0.1677201</td>
<td>0.3736184</td>
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<td>1</td>
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<td>Between 25 to 34y</td>
<td>211.531</td>
<td>0.1442153</td>
<td>0.3513087</td>
<td>0</td>
<td>1</td>
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<tr>
<td>Between 35 to 44y</td>
<td>211.531</td>
<td>0.1368452</td>
<td>0.3436847</td>
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<td>1</td>
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RETHINKING PENSION INCLUSION IN JAMAICA

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BACKGROUND

DEMOGRAPHIC CHARACTERISTICS

Jamaica is a developing independent island state in the Caribbean, with an estimated population of over 2.7 million (July 2016). Population growth rates have tapered to less than 0.5% in recent years, primarily due to the impact of net emigration and declining birth rates. Over the past 50 years, life expectancy at birth has increased from 67 to 76 years, while fertility rates have declined from six to two births per woman. The World Bank projects that in Jamaica, as in many other developing nations, factors such as increasing life expectancy and declining fertility rates will transform the population profoundly over the next few decades.

By 2050, the number of elderly (65 years or older) is expected to more than double, crossing the half million for the first time in Jamaica's history. By that time, the number of persons aged 80 years or above is expected to more than triple. To illustrate the scale of the demographic shift, consider that in 1970, Jamaica had less than 16,000 persons aged over 80 years. By 2050, this group is expected to increase 10-fold to 163,000 persons.

In line with historic demographic trends observed in Jamaica and elsewhere, it is anticipated that most of this growing population of the elderly will be female. The gender difference is expected to continue to be particularly acute in the highest age brackets. For example, very elderly women (80 years and older) are estimated to outnumber their male counterparts by more than 1.5 to 1.

Increasing prevalence of chronic diseases among the elderly in Jamaica is expected to amplify the impact of these shifting demographics. A recent study (Eldemire-Shearer, 2012) revealed that the majority of Jamaican senior citizens suffer from at least one of the following chronic diseases -- high blood pressure, diabetes, stroke and heart disease. Therefore, there has to be prudent retirement planning to reflect the associated health care costs.

The trends in birth, mortality, and migration rates suggest that the aged population of the future may have different experiences than those faced by seniors, past and present. Jamaica’s senior population will be larger in absolute and relative size than ever before. The elderly will be less likely to have the support of a large family unit than their counterparts did in the past. Their children (if indeed they have any) are quite likely to be overseas, instead of living nearby. They will live longer on average, despite their health challenges but with an increased need for means of income and financial support.

LABOUR MARKETS

FORMAL LABOUR MARKET

As of July 2016, the Jamaican labour force stood at 1.4 million. The number of people of working age outside the labour force was 0.7 million. The pool of female workers has
increased marginally more quickly than the pool of male workers in recent years; currently, almost half the labour force is female.

The agriculture industry is the largest employer of male Jamaican workers; in contrast, most females are employed in the services sector, particularly in the wholesale and retail trade; hotels and restaurant services; and in private households. Of critical concern is that the industries that are the largest employers of Jamaican workers (such as agriculture and tourism) are particularly susceptible to natural disasters such as hurricanes, which present annual risks to the country. The vulnerability of these industries can, in turn, harm the earning (and saving) potential of workers who rely on them for their livelihood.

Women are a significant part of the Jamaican work force (46%) and since 1975 have enjoyed protection from pay discrimination under the Employment (Equal Pay for Men and Women) Act. Statistics related to education suggest women are doing relatively well with respect to measures of literacy for adults aged 15 years and over (female: 93%, male: 83%), completion of lower secondary school features similar differentiation (female: 65%, male: 57%) and attainment of at least a bachelor's degree or its equivalent (female: 8%, male: 5%).

Approximately 40% of the labour force is classified as self-employed; whereas 60% is classified as salaried or wage workers. Women are more likely to be salaried or wage workers (self-employed female workers: 33%, salaried female workers: 67%). However, men are almost evenly split between both categories (self-employed male workers: 47%, salaried male workers: 53%).

As in the future most of the very elderly will be females, the question of the inclusion of the female worker in planning and preparing for retirement is a profound practical consideration.

UNEMPLOYMENT RATE

The national unemployment rate, as measured and reported by the Statistical Institute of Jamaica, as of July 2016, is 13%. Unemployment is particularly acute among the youth and females. Despite the relatively promising educational statistics for Jamaican women, the unemployment rate for female workers stands at 17%, almost twice as high as the corresponding figure for males, which is 9.5%; the unemployment rate among young workers aged 20 – 24 years is 27%; and workers under 20 years old have an unemployment rate of almost 40%. Unemployment rates are highest among youth who have left school without attaining any qualifications.

INFORMAL LABOUR MARKET

Jamaica’s informal economy is significant and has been reported by a 2006 Inter-American Development Bank (IDB) Economic and Sector study1 to represent over 40% of the overall national economy. The Ministry of Labour and Social Security (MLSS) reported the lack of employment opportunities in the formal sector as a major reason for informal employment.

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employment. The International Labour Organization (ILO) also cites low levels of formal education as a cause of ineligibility for formal employment and a reason for informal employment.

INCOME DISTRIBUTION

As of 2004, the lowest 20% of the Jamaican population was estimated to hold 5% of the national income, while the highest quintile held 52%. In 2001, Haiti’s corresponding figures were 2% and 65% respectively; in 2004, the Dominican Republic featured figures of 4% and 57% respectively. The most recent income inequality distribution data reported by the International Monetary Fund (IMF) using the GINI coefficient was 59.9 in Jamaica, 59.2 in Haiti and 48.9 in the Dominican Republic.

At a global level, some characteristics of the labour market that may adversely affect the outcome of retirement planning or pension inclusion efforts are:

- **High Unemployment.** Planning a smooth stream of pre-retirement and post-retirement income is moot when there are extended periods of no income at all.

- **Sizable Informal Economy.** Informal workers are often excluded from tools that promote inclusion in the pension market including: access to information; automatic enrolment in the social security system or other pension schemes; and predictable, periodic payroll payments that can be deposited directly to a pension fund. Furthermore, general information such as the pension needs and level of preparation of informal workers is difficult to monitor because their data is not necessarily captured through official means – this is precisely why the ideas in this book are so important.

- **Significant Level of Self-Employment.** Non-salaried workers do not have employers who may set up a pension plan or contribute to a pension on their behalf. A different approach is needed to reach out to this large share of the Jamaican labour force.

- **Seasonal Major Industries.** Agriculture, hotel and restaurant services are among the largest employment industries in Jamaica. Workers in these large sectors are subject to periods of unemployment or reduced income due to, for example, low hotel occupancy or natural disasters. Therefore, in these industries incomes are less predictable.

- **Income Inequality.** There is a large income gap between the richest 20% and poorest 20% of the labour force. In terms of size and administrative expenses, pension products that are appropriate for the highest income earners are not the right fit for the lowest income earners.
Rethinking Pension Inclusion in Jamaica

INCOME TAX INCENTIVES

Members of private pension plans have additional saving benefits via tax exemptions on contributions (up to 20% on pensionable salaries) and on investments to facilitate accumulation of funds. Upon retirement, tax is charged on pension payable with the exception of a tax free lump sum payment. Tax exempt vehicles are offered by deposit taking institutions; however, this may be subject to a minimum amount and other restrictions that do not provide universal access.

FINANCIAL INCLUSION

The World Bank reports that just over three quarters of Jamaicans aged 15 years or older have an account at a financial institution.² This helps create the potential for a digital pension coverage initiative. However, only about 30% of the same group responded that they actually saved at a financial institution in the previous year and about 45% of the cohort has a debit card.

Also of importance is the “partner” system, which is an informal collective savings scheme comparable to the West African "sou sou". In this, one member is selected as the banker and each member contributes a specified amount at an agreed frequency to the banker. Then, in the order determined by the banker, each member receives a disbursement.

LIFE AND NON-LIFE INSURANCE

There are currently six life insurance and nine non-life insurance companies that are active in the Jamaican market. Motor and property are the two largest classes of non-life business, while Universal Life is the largest class of life business. In aggregate, Gross Premium Written is trending upwards; also, the industry’s loss ratio remains below 100%. As of December 2015, all fifteen companies satisfied the regulatory capital adequacy requirements of the Financial Services Commission(FSC), the integrated regulator of insurance, pension and securities industries in Jamaica.

A 2012 study examining the risk management practices taken from a sample of Caribbean agriculture and tourism workers confirmed the vulnerability of its participants to financial losses that stem from events influenced by the weather. The study also found that Jamaican respondents were most likely to handle financial losses that resulted from such events by depleting their savings. A significant percentage of respondents did nothing or adopted a “wait and see” strategy. Other popular coping mechanisms identified in the study included borrowing and using remittances from overseas. The use of insurance as a

² World Bank Development Indicators
risk management tool was not widespread among respondents. These findings highlight, among other things, the adverse impact of retained risk exposures (such as weather risk) on long term savings, including retirement.

ANNUITY MARKETS

Old-age incomes may be supported by pension plans that provide legally required streams of payments. Trustees of pension plans may either pay a pension directly from the plan or purchase an annuity from an insurance company on behalf of the member. Other forms of pension payments such as programmed withdrawals have been recently introduced to the Jamaican marketplace. Where pensions are purchased from an insurance company, the normal form of pension is commonly an annuity paid for a guaranteed period of five years and life thereafter.

STATUS OF MORTALITY TABLES

Currently, the actuarial community relies on actuarial tables from larger jurisdictions, modified to reflect the experience observed in the Jamaican market. The Caribbean Actuarial Association has begun work on the development of a Caribbean life table.

FINANCIAL SERVICES AND MOBILE PENETRATION

Mobile cellular telephone technology has proliferated in the Jamaican market. Between 1995 and 2005, the mobile penetration rate increased more than forty-fold from 1.8% to 73.9%; and by 2008, the penetration rate had surpassed 100%. The majority of cellular subscribers are connected on a prepaid basis. Air-time minutes, commonly called credit, is easily accessible for purchase from businesses or individuals and may be transferred between subscribers. Credit is often used as a means of exchange between users.

The high level of mobile penetration has created opportunities to deliver financial services via this platform. In 2013, the Bank of Jamaica (BOJ) published Guidelines for Electronic Retail Payment Services which became effective in April of that year. By 2015, the BOJ had approved five mobile money pilot projects, including mobile wallets. Since the publication of the Guidelines, at least two mobile money solutions have been launched in the Jamaican market.

EXISTING OUTREACH AND SERVICE DELIVERY INFRASTRUCTURE

Jamaica features a rich array of traditional financial services with significant customer support and assets. Jamaican deposit taking institutions are regulated by the BOJ. These include but are not limited to: Commercial Banks (2015: assets JMD 906 billion (USD 7 billion)), Building Societies (2015 assets: JMD 248 billion (USD 2 billion)) and Credit Unions (2015: assets JMD 89 billion (USD 0.7 billion)).

Commercial Banks constitute the largest category of deposit taking financial institutions, as measured by assets held. There are six banks in operation, with over 100 branches across the island. The BOJ reports there are 19 ATMs and 896 point of sale terminals per 100,000 inhabitants.
Non deposit taking institutions that are regulated by the Financial Services Commission include but are not limited to: Insurance Companies (2015 assets: JMD 347 billion (USD 3 billion)), Pension Plans (2015 assets: JMD 397 billion (USD 3 billion) and Securities Dealers (2015 assets: JMD 531 billion (USD 4 billion)).

HISTORICAL INFLATION LEVELS AND INVESTMENT RETURNS

Competing with the savings efforts has been the challenge of high historical inflation rates. In 2015, the annual inflation rate was 3.7%. However, the ten year average annual inflation rate was 9.8%; the twenty year average annual rate was 10.5%; and over the last thirty years, the average annual inflation rate was 16.1%. Thus, the Jamaican economy has experienced multiple decades of high inflation that has only declined in recent years.

This period of prolonged high inflation has eroded the purchasing power of fixed income pensions and has lessened the value of pension benefits that are based on career average salaries, as opposed to final annual incomes. This has also increased the cost of inflation-indexed pensions.

The impact of decades of eroding purchasing power has also had an adverse effect on the national savings culture. Due to the high inflation rate environment, a generation of Jamaicans has found itself worse off in real terms by saving in financial vehicles that did not provide a positive real return rather than consuming immediately. This is exactly contrary to the need to promote a culture of long term savings.

PENSION AND SOCIAL SECURITY ARRANGEMENTS

In Jamaica, as in other jurisdictions, the financial vehicles used to provide for retirement income can be categorized into three tiers: a compulsory public pension scheme, namely the National Insurance Scheme (NIS); occupational pension plans, including the public sector pension plan as well as voluntary private superannuation funds and retirement schemes; and other private pension arrangements such as real estate or personal savings.

TIER ONE: NATIONAL INSURANCE SCHEME

The foundation of pension inclusion in Jamaica is the NIS, a compulsory, contributory funded social security scheme. It covers employed, self-employed, and voluntary participants whose contributions are used to fund a range of benefits including an old age pension and NI Gold, a pensioner's health plan. The NIS provides the greatest reach to Jamaicans in preparing for retirement as it requires mandatory participation whereas other contributory arrangements are voluntary.

The NIS old age pension is earned by members who have made at least 156 weekly contributions and consists of a flat component (that is the same for all persons regardless of salary) and a wage related component (based on career average salary). At the time
of writing, the NIS benefit is JMD 2,800 (approximately USD 20) per week, which is equivalent to approximately 50% of the minimum wage.

NIS pension benefits are generally progressive, providing greater replacement rates to low-income earners than all other contributors. The benefits are not calculated to be actuarially equivalent to members’ contributions. A recent actuarial study has pointed out that the cost of NIS benefits exceeds the contributions made by NIS members. In addition, they are increased in an ad hoc fashion that is not a function of the funded objectives of the plan.

A report by the IDB highlights that, despite the compulsory nature of the NIS, only 40% of the employed labour force (i.e. 34% of the total labour force) contributed to the scheme as of 2012. This coverage is below comparable statistics for several Caribbean neighbours.

The social security programmes, referred to as the NIS across the Caribbean, are largely similar in design with variations in certain countries. Based on an IMF working paper on National Insurance Scheme Reforms in the Caribbean, membership in the social security programmes is compulsory for salaried workers and the self-employed (with the exception of Trinidad and Tobago). The paper noted that enforcement of contributions for self-employment is not as stringent as for salaried workers. It was also noted that the benefits being offered under these arrangements have increased over the years to include, for example, unemployment (Barbados and the Bahamas) and partial health benefits (Belize, Jamaica, and the Bahamas).

The paper attributes the low NIS contribution level in Jamaica to the large informal labour force. In contrast, coverage in Barbados, the Bahamas, Trinidad and Tobago, and Jamaica are reported to be relatively high. Notably, in Barbados, 90% of employed workers contribute to the scheme.

The paper concluded by recommending certain actions that could be taken to improve coverage that include increasing the retirement age, freezing benefits, and increasing contribution rates. The implications of these actions were also noted and depended on the specific circumstances of each country. It was also highlighted that Jamaica may have to expand coverage prior to implementing the suggested actions.

**TIER TWO: OCCUPATIONAL PENSION PLANS**

**PUBLIC SECTOR PENSION SCHEME**

Jamaica’s public sector pension system is governed by more than thirty pieces of legislation. A range of pension schemes exist for public sector workers: both contributory and non-contributory; both defined benefit (DB) and defined contribution (DC). Most of the schemes within this category are non-contributory DB plans. Some public sector workers (such as police officers, parliamentarians, and councillors) participate in contributory DB plans, but their contributions bear no relation to the benefits received.

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3 Koffie Nassar, Joel Okwwoke, Mike Li, Timothy Robinson, and Saji Thomas, IMF Working Paper- “National Insurance Scheme Reforms in the Caribbean”-WP/16/206
Pension benefits are paid from the consolidated fund. The cost of these benefits as a percentage of GDP has been climbing sharply and, in its current form, the public sector pension plan is unsustainable. The unsustainability of this current system is a major reason for the reform of the public pension system that will be further discussed.

SUPERANNUATION FUNDS

A superannuation fund is a voluntary arrangement established by an employer on behalf of the employees under a trust that is administered by a board of trustees in accordance with a trust deed and rules as well as applicable legislation. Superannuation funds may be either contributory or non-contributory; DB, DC, or a combination of both.

As of June 2016, the Financial Services Commission (FSC), the regulator of the private pension industry, reported that of the 412 active pension plans in the private pension industry, approximately 97% represent superannuation funds. These superannuation funds account for 95% of the assets in the private pension industry. However, they include only 58% of the 105,832 active members in private pension plans.

RETIREMENT SCHEMES

Retirement Schemes are voluntary pension arrangements that provide a broader reach to Jamaicans who are self-employed and who are not in a pensionable post to provide for their retirement. Persons upon termination of pensionable employment may also transfer pension refunds to a retirement scheme. Members are required to contribute to the retirement scheme at least once per year up to a predetermined maximum amount. Employers may contribute on behalf of employees, however, this is not mandatory as in the superannuation fund.

The retirement scheme is set up under a master trust deed and rules and, similar to superannuation funds, is regulated by the FSC. Only registered life insurers or licensed investment managers may set up a retirement scheme. Retirement schemes are accessible throughout the island at the head offices or branches of these entities.

SPECIALIZED RETIREMENT PLANS

Currently, only 6% of tourism workers are covered by a pension plan. Therefore, the overwhelming majority of one of the largest employment sectors is excluded from the voluntary private pension market. To address this, the establishment of a tourism workers’ pension scheme is anticipated by September 2017.

Other industries that are large employers of Jamaican workers -- such as agriculture, manufacturing and construction – also reflect low membership in the private pension industry and are, therefore, target industries for pension inclusion.
TIER THREE: OTHER PRIVATE PENSION ARRANGEMENTS

PERSONAL SAVINGS

The third tier of the pension system represents personal savings by Jamaicans through sources such as real estate or other types of retirement savings approved under the Income Tax Act. Some people use the equity from real estate to leverage retirement savings. Acquiring a house may take precedence over retirement savings in a financial institution. Others may save through bank accounts and, with the exception of tax free savings accounts, will not benefit from favourable tax treatments offered in a retirement scheme.

SOCIAL SECURITY

The ‘Programme of Advancement Through Health and Education’ (PATH) provides payments for elderly persons who meet the specified financial need criteria. This acts as a pension of last resort. Like the NIS, this programme is administered by the Ministry of Labour and Social Security, however, it is non-contributory.

REMITTANCES

Remittances from Jamaicans living out of the country (the Jamaican Diaspora) remain one of Jamaica’s main sources of foreign exchange earnings and contributed 16% to the GDP in 2015. This alternative income stream, which is accessed by many Jamaicans, presents an interesting aspect of financial inclusion via external support. As in India, it should be possible in theory to allow the diaspora to contribute directly into a family members’ pension plan if they wanted to be sure the finances were being saved for a specific purpose – or to contribute to their own pension plan if they planned to retire in Jamaica.

PENSION SYSTEM REFORMS

PENSION REFORM ACROSS THE CARIBBEAN

The countries of the Caribbean and wider region are at various stages of reform in the private pension industry. Jamaica, Barbados, Belize, Bermuda, Cayman Islands and Suriname have enacted specific legislation to monitor and supervise the pension industry. Trinidad and Tobago and the Bahamas are in the process of proposing or have proposed legislative reforms. The rest of the Caribbean countries, including those that have proposed legislation, continue to operate under legislation enacted over decades ago. The Eastern Caribbean Countries are actively working on implementing a unified pension legislative reform.

PENSION REFORM IN JAMAICA

Before delving further into the context of Jamaica’s pension infrastructure, it is important to note past events that have influenced reforms in the pension industry and subsequently
the development of the current pension system. In this vein, the reform of the private pension industry cannot be mentioned without reference to the financial sector meltdown in Jamaica in the 1990’s. This period of instability within the financial sector culminated in significant liquidity and solvency issues among Jamaica’s indigenous financial institutions; these led to the implementation of tighter regulations and may have also weakened the confidence of some Jamaicans in the security of the financial system.

As the indigenous market consisted of groups that housed banks, insurance companies and pension funds, adversities within the banking arm affected the entire conglomerate. An extract from the Financial Sector Adjustment Company Limited (FINSAC) states that “by late 1996, the Jamaican Government recognized that the whole indigenous financial system had reached a state of such considerable distress, that the investments of Jamaican depositors, policyholders and pensioners were now at risk.”

Consequently, FINSAC was established in 1997 to restore stability to Jamaica’s financial institutions given the financial state amongst banks and insurance companies in the 1990s that were experiencing solvency and liquidity problems as well as low consumer confidence.4

REFORM OF THE PRIVATE PENSION INDUSTRY

The financial crisis led to the birth of various regulatory reforms in the financial sector. Subsequent to FINSAC, the FSC was established on 2nd August 2001 to monitor and supervise the insurance, pension, and securities industries. The FSC was given broad powers to supervise, investigate and sanction entities falling under its jurisdiction in order to fulfil its main objective of protecting consumers of the financial services. This includes the approval and registration of superannuation funds, retirement schemes, trustees, and responsible officers; and the licensing of administrators and investment managers.

In addition to the FSC Act, the FSC relies on the Pensions (Superannuation Funds and Retirement Schemes) Act, 2004 (the “Pensions Act”) and its attendant regulations (the “Pension Legislation”), which came into effect in 2006. Similar to other jurisdictions, Jamaica’s private pension industry had previously been largely unregulated with limited oversight from the tax authorities; legislation pertaining to the pension industry was contained in the Income Tax Act, which was concerned mainly with the tax treatment of pension cash flows. Neither were issues such as fund sustainability, pension coverage, and benefit adequacy considered by the legislation of the time; nor were specific matters affecting members’ benefits such as late or outstanding contributions, non-disclosure to members, and incorrect benefits.

Neither was there evidence of a strong demand for pension products amongst the wider labour force, nor was it apparent that there was an understanding of the nuanced issues of retirement planning. Coverage by voluntary pension plans was anemic at 5%. Covered persons were mainly salaried workers who participated in employer plans. Self-employed persons and members of the informal economy did not have the same access to pension products.

4 FINSAC website, (http://www.finsac.com)
Phase I of the pension reform subsequently became effective in 2006. The drafting of provisions to conclude Phase II of the pension reform is now at an advanced stage of completion. Since the first phase of pension reform, pension coverage has increased from 5% to 10% of the employed labour force.

With the reform of the private pension industry, requirements such as: the registration of plans, trustees and their agents; disclosure of pertinent information to members; the inclusion of a member trustee on the board of trustees; broad investment limits; and prescribed reports to be submitted to the FSC have contributed to the industry becoming more transparent and accountable in pension plan management. The FSC uses the submitted reports to monitor and supervise the plans on an ongoing basis for risk assessment of the industry. Trustees and investments managers are now required to prudently invest plan assets within broad investment guidelines prescribed in the Investment Regulations, which among other things minimize related party transactions and encourage diversification of assets. Specific governance regulations are also in place, which guide the behaviour of trustees, sponsors and their agents, with respect to information disclosure to members and matters such as conflicts of interest and complaints resolution. The FSC also conducts onsite examinations of pension plans and licensees and reviews, amongst other things, the governance and operational activities of both plans and their agents.

Although the management of private pension plans has improved over time as a result of pension legislation and the supervision of the FSC; substantive provisions, such as vesting and locking-in that are intended to preserve the adequacy of pensions are excluded from the current legislation. The adverse effects of the exclusion of these provisions from the pension legislation on members’ benefits will be discussed in detail as a challenge that may inhibit pension inclusion efforts, if not properly addressed.

REFORM OF THE PUBLIC PENSION INDUSTRY

Jamaica is currently in the process of reforming the government funded pension system that emerged from the recognition that the pension system was fiscally unsustainable. Amidst the economic challenges and in keeping with commitments made to the IMF under Jamaica’s Economic and Financial Policies, the implementation of the reform was scheduled to become effective on 1st April 2016. However, the implementation date was revised to 1st April 2017.

Some proposals of the reform include: compulsory contributions of 5% of an employee’s salary; the establishment of a segregated fund held in trust; special contributions by the government for a span of 40 years to fund the shortfall; triennial actuarial review; and retirement age increases (with the exception of the security forces).

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5 Ministry of Finance and Planning, White Paper, “The Reform of the Public Sector Pension System”.
6 McIntosh, Douglas, “New Public Sector Pension Scheme by April 2017”.
7 Ministry of Finance and Planning, White Paper, “The Reform of the Public Sector Pension System”. 
NATIONAL FINANCIAL INCLUSION STRATEGY

In 2015, Jamaica embarked on a national financial inclusion strategy under the sponsorship of the central bank, the BOJ, with the assistance of the World Bank, acting as consultant to the project.

The rationale for the national financial inclusion strategy is:

• Promotion of economic growth and greater participation in the formal sector and
• Creation of an environment for delivery of cost effective and regulated financial services and products to underserved Jamaican individuals and Micro, Small and Medium Enterprises (MSMEs)

The intended target beneficiaries are low-income Jamaicans, MSMEs, businesses, and individuals operating in the informal sector. The main pillars of the strategy are as follows:

• Financial access and usage through electronic transaction instruments such as card networks, electronic bank transfers, and mobile financial services;
• Financial resilience through introduction of targeted savings, insurance (micro-insurance), and retirement products (micro-pensions);
• Financing for growth through micro-financing, agriculture, and housing finance and
• Responsible finance through enhancement of consumer protection and financial capability.

It should be noted that several pieces of legislation are currently being developed to support the financial inclusion strategy:

• Payments, Clearing and Settlements Act that provides guidelines for new payment services such mobile financial services.
• National Identification System (NIDS) that is set to roll out in January, 2018. This strategic priority comprises a cradle-to-grave biometric identification system with a unique identification number to be used for every Jamaican with appropriate anti-fraud features. It is expected that NIDS will result in improved governance and management of social, economic, and security programmes. As highlighted in other chapters in this volume this will be a critical step in enabling a new approach to digital pension inclusion.
• Develop the legal and regulatory framework and infrastructure to facilitate investment in private equity and venture capital
• Agency banking whereby other non-financial entities may act as agents for banks to extend the reach of financial services
• Micro-Insurance – Up to May 2016, Jamaica had participated in an 18 month long inclusive insurance project. The project, jointly sponsored by the Inter American Bank and the Access to Insurance Initiative, aimed to promote insurance regulations that are conducive to encouraging increased insurance access by the wider population. As a direct outcome of this work, Jamaica is drafting micro-insurance legislation; partnering with the industry through an Inclusive Insurance Committee; and hosting a range of capacity building events targeting industry and members of the micro-insurance target market.

Action items include pension products designed for low-income and informally employed workers (micro-pensions), development of lending programmes by banks and credit unions to serve the agricultural sector, development of a consumer protection framework inclusive of dispute resolution, broadening of the financial literacy programme, data protection, and credit reporting.

### CHALLENGES AND KEY LESSONS

#### DEFICIENCIES IN THE EXISTING PENSION SYSTEM

**NATIONAL INSURANCE SCHEME (NIS)**

Based on the results of an Actuarial Analysis of the Sustainability of the NIS as of 31st March 2013,\(^8\) the scheme was in a deficit position and will be exhausted by 2033 if no actions are taken. The report further highlighted that NIS benefits are inadequate with a replacement ratio of 10% to 11%. It was also noted that, although the plan is considered to be mandatory, it is effectively only applicable to employed people who have to pay income tax. The report concluded that for the scheme to be considered successful, it should have wide coverage, adequate pensions, and be sustainable over the long term. Increases in contribution rates were recommended as a means to bolster the viability of the scheme.

The NIS is intended to contribute to only a part of an individual’s pension at retirement. Therefore, contributions to other retirement vehicles are required to promote pension adequacy at retirement. Financial education would alleviate misconceptions regarding expectations surrounding the contribution of NIS to an individual’s retirement.

Jamaica has begun to take steps to address some of the deficiencies of the NIS, including the modernization of operations (including new software to reduce processing times) and the establishment of a Reform Committee (comprising representatives of the Ministry of Labour and Social Security and the Ministry of Finance). Additionally, the actuarial report highlights the need for compliance to ensure that all employed Jamaicans contribute to the scheme, as well as comprehensive governance and financial management if the NIS is to

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\(^8\) Constance Hall, Eckler, “Actuarial Analysis of the Sustainability of the National Insurance Scheme in Jamaica” (2014).
support the retirement needs of Jamaicans and remain a worthwhile building block for retirement planning.

SUPERANNUATION FUNDS

Despite the strides made in Phase I of the pension reform, substantive provisions have been proposed in Phase II of the private pension reform in order to safeguard and preserve the level of benefits to be received by members (such as vesting, locking-in and solvency, and funding regulations). The implications of the absence of some of these substantive provisions and the effect upon the accumulation of pension by members are quite evident.

Effectively, the small minority who participate in Superannuation Funds are not necessarily lifetime participants in the pension market. It is commonplace for employees, upon leaving employment, to accept a refund of their accumulated contributions. These amounts are often not invested for retirement as originally intended and may be used for consumption purposes. After a lifetime of repeating this practice, it is not unusual for a retiree to find himself/herself with a pension benefit accumulated only during the last few years of employment rather than over his/her entire life.

Additionally, sponsors of Superannuation Funds currently determine the vesting period by which a members will become entitled to the employers’ portion of the contributions made on their behalf. On the basis that the vesting period is not set by legislation, the vesting period varies widely; consequently a member may not qualify for the employer’s contribution upon termination of employment. Additionally, in some cases, a vested member may forfeit the benefits derived from employer’s contributions if the member opts to take a refund of his own contributions upon termination.

In effect, even those workers who were initially counted as members of Superannuation Funds can be included as a members of a Superannuation Funds for only a portion of their working lives due to their own practices. Consequently, a reference to pension coverage statistics at any point in time may not necessarily be reflective of the future but rather a short period of pension inclusion. These loopholes in the current legislation will only serve to stifle pension coverage and inclusion efforts overtime if not properly addressed.

RETIREMENT SCHEMES

The statistics indicate that retirement schemes are grossly under utilized as a means of retirement savings despite their seeming benefits. To promote the importance of retirement planning to the general public, the FSC has been airing advertisements on major television networks and the print media. The ‘FSC Minute’ which is also aired on television is geared at educating the general population on pension matters. Coupled with the FSC’s advertising, licensed entities also advertise the retirement products being offered.
The FSC has refined the provisions governing retirement schemes in its proposal to the Act (Phase II) as described below:

- Allow members of retirement schemes to have concurrent membership in both a superannuation fund and a retirement scheme subject to income tax limits. Currently, members of superannuation funds cannot make contributions to retirement schemes;
- Allow the portability of funds from other jurisdictions; particularly, acceptance of accrued benefits from other jurisdictions; and
- Provide a pension to members under specified circumstances; withdrawal of funds is currently not permitted under any circumstances. Although prohibiting the withdrawal of contributions will encourage the accumulation of contributions to assist in providing an adequate pension, the flip side may be the reluctance of Jamaicans to participate, particularly self-employed persons, who may be in need of funds when faced with extenuating circumstances such as terminal illness.

The retirement scheme, although open to the general Jamaican public, by the nature of the product, may also deter participation for the following reasons:

- The benefits of saving in a retirement scheme may not be understood by the majority despite the advertisements;
- People in the informal sector may not want to be identified by the tax authorities and thereby may opt to save under the radar per se;
- Low confidence in the ability of the financial sector to secure pension benefits may still exist; and
- Fear of providing disclosure requirements as required by the Anti-Money Laundering Act (AML) which requires retirement schemes to request certain detailed information under the Know Your Customer (KYC) requirement such as source of funds and the nature of a customer's business.

The retirement scheme has the capacity to provide widespread benefits to Jamaicans and may be improved upon as a major retirement vehicle in pension inclusion efforts.

THE PUBLIC SECTOR PENSION SYSTEM

In addition to the unsustainability of the public pension system on a whole, the White Paper also cited the erosion of pensions due to consistent high inflation rates, administrative inefficiencies, and legal inconsistencies as specific challenges. Given the current reform initiatives, the challenge lies with how well the implementation will be handled in terms of administrative capabilities (staff and systems) and acquiring or training staff to carry out the technical functions required to manage the operations of the pension plan. High inflation rates affect all pension benefits and any effort by the government to control these rates will be beneficial to all members of pension plans.
PERSONAL SAVINGS

Statistics are limited regarding how effectively Jamaicans, who are not members of a pension plan, are saving for retirement. If the recommendation of the FSC to allow members of superannuation funds to also become a member of retirement schemes is approved, the retirement scheme may also be a means of voluntary savings among these persons.

Given the low pension coverage, Jamaica has to grapple with how best to improve upon the current pension system in order to reach the underserved sector (informal sector and persons who are not in a pensionable job). Additionally, cultural behaviour, low financial knowledge, and the lack of confidence in the financial sector may be underlying factors to be considered.

A look at Jamaica’s overall pension system highlights the need for a cohesive approach in addressing the deficiencies noted and to progress towards ensuring that all sectors/persons on the island are considered in the retirement planning process. Jamaica has gone through or is in the process of reforming both the private and the public systems with a view to addressing deficiencies, promoting sustainability, affordability, adequacy, and compliance with the IMF requirements, in some cases.

FINANCIAL EDUCATION

In 2012, the FSC in association with the Organization of Economic Cooperation and Development (OECD) conducted a survey that aimed to measure the financial literacy of Jamaicans, specifically their financial knowledge, behaviour, and attitudes. The study revealed that Jamaicans possess less than an average level of financial knowledge and exhibit even less knowledge on more complex issues. When compared to other countries, Jamaicans scored above average on financial behaviour (approximately 60%), as this relates to long term planning but less so for short term purposes such as payment of bills on time and the use of credit cards as additional income. Overall, the findings highlight that out of four Jamaicans, only one would be considered to possess above-average financial knowledge, behaviour, and attitudes. In comparison to other countries, the report found no distinction between genders in the responses provided.

In 2010, the Caribbean Regional Technical Assistance Centre (CARTAC) partnered with Jamaica’s central bank, the BOJ and the FSC to launch its Regional Financial Literacy Programme website and Public Education Programme.

The national financial literacy programme was launched as a means to educate Jamaicans on the importance of financial matters and thereby positively influencing the culture. In keeping with its objective of advancing financial education in Jamaica, the FSC implemented the School’s Financial Education Programme in association with Junior Achievement Jamaica in 2011. The programme is largely funded by the FSC in collaboration with other partners who make major contributions towards non-financial activities. The FSC also collaborates with Child & Youth Finance International and
Global Money Week; the programme is structured to provide consistency with these international initiatives. The FSC partners with the central bank, BOJ and the Stock Exchange to facilitate educational tours as part of the curriculum.

The Ministry of Education in 2015 announced its intention to make financial education a part of the school’s curriculum, which will allow for widespread infiltration across the island. This is a major boost to the initiative; however, the challenge lies with funding and motivating current workers and the wider community to plan for retirement, to insure properties or self against loss and to utilize credit responsibly.

Other regional financial literacy initiatives have taken place in Trinidad and Tobago and the Eastern Caribbean Central Bank (ECCB). Trinidad and Tobago launched its National Financial Literacy Programme in 2007.9 The programme covers a broad cross section of the country including financial classes in primary and high schools; employer sponsored “lunch and learn” sessions; financial management conducted by trade unions in instances where employees may have received lump-sum or retroactive payments; financial interventions at the community level and through advertisements in the print and electronic media aimed at providing basic financial information to consumers.

The ECCB spearheads financial education programmes with the view to promoting the understanding and importance of money matters and investing, stimulating discussion on economic and financial matters, creating awareness and interest in emerging financial matters, as well as to encourage the public to take advantage of investment opportunities. The ECCB collaborates with financial institutions, Ministries of Education and Finance, the media and community groups during the month of October to celebrate Financial Information Month. The month forms part of the ECCB’s initiatives to promote financial educational programmes for its citizens.10

JAMAICANS’ COMPETING ECONOMIC PRIORITIES

It remains a challenging prospect to convince constituents – in developed and developing economies alike -- to postpone immediate consumption in order to save for retirement. Recent research into the applicability of the tenets of behavioural economics to this problem is instructive. However, in developing economies, there exist additional challenges that compound common human biases that discourage appropriate retirement preparation.

Notably, for significant numbers of the population stretching their income to span one’s working lifetime is not an urgent concern merely because there is not enough to meet even immediate needs. Between 1997 and 2007, Jamaica’s national poverty rate declined from 20% to 10%. However, by 2012 this rate was restored to 20%, primarily due to the impact of the global financial crisis. At the time of writing, the poverty rate is near 20% and is highest in the rural areas.

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9 Ewart S Williams: National Financial Literacy Programme of Trinidad and Tobago (2008)
10 Central Bank of the Eastern Caribbean Countries: http://www.eccb-centralbank.org/publicawareness
The very poor, when faced with satisfying their urgent basic survival needs, may not consider saving for old age as one of their highest priorities. After all, the requirement for food and shelter is immediate, while survival to old age is statistically uncertain and, further, the likelihood reduced by poverty. In addition, by saving for a pension, these citizens would actually render themselves ineligible for needs-based social security programs such as PATH, which is payable to recipients over 60 years old who are not in receipt of a pension.

Besides this, maintaining pension savings at the forefront of the minds of the Jamaican middle class is not without its own difficulties. Years of high inflation have eroded the earning power of the Jamaican worker resulting in stagnant and declining real wages over select periods. This in turn has forced prioritization of expenditure that only serves to amplify the fairly common human habit of valuing current consumption more highly than delaying consumption to provide for future needs.

ATTRACTION MEMBERS OF DIFFERENT SUB-SETS OF THE INFORMAL MARKET

Jamaica’s informal economy is not at all homogenous: the diverse range of participants includes peddlers to sophisticated entrepreneurs. The IDB’s study11 that estimated the informal sector to be 40% of GDP in 2001 also highlights that work in the informal economy provides its participants with the benefit of a livelihood and hypothesizes that the rapid growth in Jamaica’s informal economy in the 1990’s likely contributed to the poverty reduction observed during the period. On the other hand, the tax evasive nature of the informal market deprives the government of funds which could ostensibly be used for social benefits. Also, due to the nature of this market – including the lack of formal contracts and full-time work – informal workers are sometimes financially excluded and exposed to hardships as they have no legal protection.

Recommendations to address the informal economy, such as implementing stricter compliance measures and ongoing monitoring of corrective actions were provided. The study concluded that the characteristics of the informal sector should be considered when prescribing new policies or programmes.

THE WAY FORWARD

Jamaica has made great strides in strengthening the financial infrastructure around retirement savings, increasing transparency and accountability as well as improving overall education of the general populace with regard to preparing for retirement. Recent reform initiatives in the public sector pension system, the insurance industry, and the national financial inclusion strategy signal Jamaica’s ability to respond to the dynamic economic environment and its commitment to improving the quality of lives of Jamaicans.

11 The Informal Sector in Jamaica-Inter-American Development Bank—December 2006-RE3-06-010
The foregoing discussion, however, highlights the colossal challenge Jamaica faces in closing the pension gap, that is, to address the issues that are preventing underserved Jamaicans from preparing for retirement and to improve upon the existing pension systems.

In rethinking pensions, the nuances of the various underserved groups indicate that a “one size fits all” approach may not work.

Better distribution, or pay-out products, is also important to encourage Jamaicans to become more involved in the retirement saving plans. It is clear that retirement products have to address these factors by giving Jamaicans more control over accumulated savings.

The misconceptions that Jamaicans have toward retirement savings such as perceiving pension as a tax or relying on children as a source of pension should be addressed in order to widen the net of pension participation. It is, therefore, essential that incentives are provided to motivate them toward retirement savings.

It will be important to fully capitalize on the benefits to be gained from implementation of the national financial inclusion strategy as a means of empowering the population to lift itself from poverty, tackling income inequalities, and improving access to finance. Additionally, the financial education programme may be expanded to encourage people to be “pension-smart”. When these needs are met, they will begin to see a future that involves retirement planning.

As a part of the solution, policies should be developed to create new pension products that are attractive to all Jamaicans; that will be less expensive to administer, less cumbersome and more convenient than the existing mechanisms of superannuation funds and retirement schemes.

Any proposed system should reward good savings practice. The other chapters in this volume and country case studies provide much food for thought on how best to design simple enrolment, portable and low cost administration, investment at scale with low costs, and good governance that will together build the foundation of the next generation of pension policies in Jamaica.

As in India, solutions that incorporate mobile telephone usage may be employed to encourage the accumulation of pension amongst the underserved. Jamaicans already have a propensity to communicate by mobile phones and have implemented a similar strategy with great success to promote universal internet access. Instead of creating a new network to facilitate pension accumulation, the existing system could be co-opted to efficiently avoid additional infrastructure costs. This would require some modification to the existing legislation and methodology of accounting. It would require the full implementation of the national identification system working closely with assigned individual phone numbers/accounts in order to facilitate an agreed portion of money being accumulated for pension savings, each time mobile credit is applied or by call usage. Since, mobile credit
is already recognized as a form of currency, the idea of pension credit may be readily accepted by the population.

Overall, any solution to pension inclusion must take into account the behaviour and economic circumstances of the average Jamaican. It is a tall order but one that may be tackled through a cohesive holistic approach. As discussed throughout this chapter, some jurisdictions in the Caribbean and the wider region may experience similar challenges as seen in Jamaica, particularly regarding the implementing the mechanisms required to include and motivate underserved citizens to participate in deliberate retirement savings. The detailed analysis of Jamaica’s pension landscape should encourage other countries to identify unique challenges in their particular country and develop innovative ways of addressing these issues. Through the Caribbean Association of Pension Supervisors, member countries will be able to share and collaborate to find practical solutions that will work within each jurisdiction. Moreover, as this volume shows, there are also important lessons to be learnt from countries near (such as Mexico – Chapter 9) and far (such as India – Chapter 1 and Pacific Island States – Chapter 11) who face unique challenges but may, perhaps, have common solutions.

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11

RETHINKING PENSION INCLUSION IN THE PACIFIC ISLANDS

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GOVERNOR, CENTRAL BANK OF SOLOMON ISLANDS

KRISHNAN NARASIMHAN
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This chapter focuses on the status of pension inclusion in the Solomon Islands (SOI) and Fiji, with allusions to several other South Pacific Island Countries (PICs). References and inputs in this chapter have been drawn from the ongoing work on expanding pension inclusion to the informal sector undertaken by the Pacific Financial Inclusion Programme\(^1\) (PFIP) in partnership with the respective Provident Funds\(^2\) of Fiji and the Solomon Islands. These respective partnerships present an innovative proposition for bridging an important gap in access to finance, and old age pension coverage in these countries in particular, wherein the vast majority of employment exists in the informal economy.

In both Fiji and the Solomon Islands, like many other Pacific island countries, strong traditional cultural mores emphasise the precedence of ‘community’ over ‘individual’ as a result of which, in times of individual hardship (such as illness or old age), it is incumbent on the community to provide support. This traditional system is breaking apart as a result of globalization and modernization and, coupled with increasing life expectancies, points to the necessary creation of an alternative social protection system for the elderly.

The pilot projects that will be presented in this chapter are presently underway in Fiji and the Solomon Islands and should deliver clear evidence on the savings behaviour of adults in the informal sector (particularly low income earners) with regard to voluntary pension accounts and provide insights as to the behavioural ‘nudges’ that can encourage them to make regular contributions for their retirement. The pilot projects underway now in the two countries follow feasibility studies conducted during 2016 that clearly established the demand for voluntary contribution pension among the informal sector respondents. The validation trials will establish operational feasibility, business viability and sustained client interest.

This chapter details practical and achievable steps that could be taken by any country wanting to start the journey to increase financial inclusion and pension coverage.

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1 PFIP is jointly managed by the United Nations Development Programme (UNDP) and United Nations Capital Development Fund (UNCDF) and presently operates in six Pacific countries -- Fiji, Papua New Guinea (PNG), Samoa, Solomon Islands, Tonga and Vanuatu. For more information, see www.pfip.org.

The South Pacific Ocean is the geographic home to several small island states together called PICs. Australia and New Zealand are not included in this grouping because of their size, population and overall developed status. All the PICs are archipelagic with dispersed populations.

The Pacific Small Island Development States (SIDS) have significant variations in size, populations, cultural backgrounds and resource bases. Factors such as geographical remoteness, small populations, limited market access and economies of scale, limited governance structures, inadequate infrastructure and high cost of transportation, impact of climate change, natural disasters as well as economic shocks all constitute key development challenges in the region. The total population of the Pacific Islands countries (excluding Australia and New Zealand) is around 10.5 million with nearly 8 million living in Papua New Guinea. Of the remaining 2.5 million, 75% live in Fiji, the Solomon Islands and Vanuatu.

Countries in the Pacific are among the poorest in the world with Samoa, the Solomon Islands, Kiribati, Tuvalu and Vanuatu currently classified as Least Developed Countries (LDCs) by the United Nations. South Pacific countries are unique in their own ways with distinct cultural identities and social structures that need to be properly understood before any meaningful development intervention can be administered. The use of financial inclusion as a development tool in this region has been chartered to include all of the above and is explained in greater detail later in the chapter.

Most Pacific countries are also characterized by perpetual customary inalienable tribal land ownership, a binding social structure that ensures basic hygiene needs for the individual through community based support and subsistence affluence (no hunger or starvation) due to access to land and ocean resources. Consequently, there exists a lack of incentive or motivation to save by individuals especially for the long term and old age. However, there is relative poverty, a ‘poverty of opportunity’ characterized by lack of access to higher tertiary education (most PICs provide free education up to secondary level), proper medical care, permanent housing, etc. Village level economies in PICs are still largely subsistence and monetization is a relatively new phenomenon. In the words of a former Premier of a province in the Solomon Islands “money has slowly crept into our lives in the last decade or so. During my school days, my father used to pay for my boarding with pigs and kumara (a root crop). Now to send my children to higher education, I need to find cash.”

The Pacific, while unique in many ways, is now changing and adapting to the rest of the world with the advent of technology and access to information. Life styles, especially among the youth, are rapidly changing, and consequently, the new expectations of the current and

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3 The UNDP publishes an annual Human Development Report categorizing countries on the basis of a Human development index.
future generations have to be addressed. With the traditional cultural systems breaking down, urban migration and increasing nuclear families, improving social protection and the need to finding innovative solutions is catching the attention of policy makers and development partners.

**FINANCIAL INCLUSION IN THE PACIFIC**

Until a decade ago, the South Pacific was one of the world’s most unbanked regions with only an estimated 15% of the adult population owning a formal bank account. Access was, and continues to be, a major issue and availability of financial services at proximate locations for people living in rural areas is a big challenge. Financial inclusion is defined as individuals and businesses having access to a range of appropriate and affordable financial products and services that meet their needs. (Consultative Group to Assist the Poor). Financial inclusion is an important development tool and has been linked to improved quality of life at a household level, as well as improved economic growth and reduced income inequality at a macroeconomic level.

Given that all these countries have dispersed islands surrounded by a vast expanse of ocean, logistics in terms of reaching remote populations is the biggest hurdle to financial inclusion. The remoteness also adds to the cost of doing business and hence most financial service providers do not operate beyond urban centres. Since 2008, PFIP has been working closely with Central Banks in the region to chart out a financial inclusion road map for the respective countries. The financial inclusion landscape in the Pacific region has undergone significant development as a range of initiatives have looked to address the challenges of geography, low population density, low levels of technical expertise and vulnerabilities to natural disasters.

**PENSION INCLUSION IN THE PACIFIC**

While a number of PICs have a national superannuation fund that has been formed through appropriate legislation to cater for old age pensions, their mandate and coverage largely caters only to those in the formal employed sector. These provident funds offer the mandatory employer-employee type schemes and benefits, and while they also offer voluntary schemes, these have been largely unsuccessful. Given that less than 20% of the adult population in these countries is engaged in the formal sector, the number of Pacific Islanders with some form of formal old age financial security is limited. Most PICs do not have any other social protection schemes given their weak resource base and lack of serious government policy towards providing financial security for those in the informal sector.

The National Financial Inclusion Strategies that have been developed in the recent past include looking at providing voluntary superannuation schemes and micro pension services. In order to meet this objective, there is a need to revisit some of the National Provident Fund legislations to make amendments to expand their mandate, increase the suite of

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4 UNDP estimates based on a study in 2005. Subsequent Financial Service Sector assessments have confirmed the levels of exclusion especially among low income households (http://www.pfip.org/our-work/work-streams/market-information/financial-services-sector-assessment)
products offered and look at covering the population segments in the informal sector economy. Legislative reforms are currently underway in some of these Pacific Island countries.

A more detailed summary of superannuation funds in some of the Pacific countries where PFIP presently operates is provided in Annex I under the title “Social and Pension Inclusion in the Pacific”.

THE FOUR DIMENSIONAL APPROACH TO FINANCIAL INCLUSION

Financial Inclusion as defined in the Pacific (and indeed globally) has four dimensions diagrammatically represented in the Figure 11.1.

**Figure 11.1**

**The Four Dimensions of Financial Inclusion**

The access dimension deals with proximity of financial services to customers and includes the physical distance. Given that PICs are maritime countries with vast expanses of ocean, covering physical distances often involves travel by boat involving long hours of travel and costs. The primary focus till date has been on increasing access points and bringing financial services closer to people by adopting technology enabled services including mobile and branchless banking.

The access dimension also includes looking at barriers to entry and identifying factors inhibiting people from accessing financial services. These include legal and regulatory guidelines (for example anti-money laundering or AML compliance and Know Your Customer or KYC requirements), cultural barriers, administrative barriers (forms, compliance) as well as financial literacy. Much progress has been made by all PICs in improving access to financial services over the last few years by allowing innovative technology driven financial services although there is ample scope for increasing the footprint of access points.

In the recent past, some of these countries have started issuing biometric voter registration cards with photo identification (Fiji, Samoa and the Solomon Islands) while in
Tonga, there is a National ID for all citizens. These forms of ID are increasingly used for opening new bank accounts and enrolment in superannuation funds.

The quality dimension covers the appropriateness of financial products to customers and their affordability. The key questions to be answered here are ‘Is the product or service suitable for the target segment’ and ‘Is this what clients want’. The quality dimension also considers pricing of the products, fees and charges, exit conditions, and assesses whether the products are nondiscriminatory and fair from a consumer protection angle, including whether appropriate complaints resolution mechanisms are in place. A key challenge is around linking the ‘last mile’ with well-run pension funds that have the scale and longevity to deliver a complex product in the standard financial inclusion toolkit. This is a key message in Chapter 17 on Governance and Investment and Chapter 18 on Costs.

It is expected that if there is adequate access of appropriate financial products, clients will start using the services in a more meaningful manner and the overall objectives of financial inclusion will be met. The usage dimension deals with frequency and regularity of usage of financial services by clients. However, in reality, it has been found that while there has been good uptake (or registration) of financial services in the last five years, usage rates remain low. In many markets in the Pacific, usage rates are between 7 to 15%, indicating that a lot of work remains to be done to increase adoption and usage by clients. This creates a significant challenge for pensions given the need to accumulate small payments over many years in order to develop a meaningful amount of money that can help to improve life in old age. Hence, building on existing infrastructure can be important to increase economies of scale and reduce the costs of delivery.

Finally, the impact dimension examines how financial services are improving the well-being of the individual and households especially those at the bottom of the pyramid.

Key questions in assessing impact include:

- Does the individual or household move out of poverty?
- Does the individual or community improve their standard of living?
- And what is the resultant impact on the local as well as national economy?

Given the complicated and long-term nature of ‘well-being’, it is too early to assess the impact of financial inclusion. Despite attempts at mapping customer journeys through randomized control trials, successfully isolating and attributing improvements in well-being to financial inclusion alone has proven elusive and hence is not yet an accepted development result.

In its current phase (2014-2019), PFIP is looking at fostering financial innovation to improve usage rates and increasing transaction volumes of digital financial services through a “Design Lab” approach – by adopting a human centered approach to product and services development and deployment. This will be explored in-depth later on in the chapter.
SCOPE AND SCALE OF FINANCIAL EXCLUSION

Despite promising developments in financial inclusion over the last few years, significant challenges remain. UNDP estimates that around 6.5 million people, or nearly 65% to 70% of the people living in the Pacific, lack access to financial services including savings, credit, insurance, remittances, pensions, transfers and investments from both regulated and non-regulated institutions. Consequently, and as we see in Table 11.1, those who are excluded from the financial sector are not able to achieve their full economic potential and continue to be denied opportunities to attain a productive and dignified living.

Table 11.1
Excluded groups and the impact of exclusion

<table>
<thead>
<tr>
<th>Excluded Groups</th>
<th>Estimated Scale of exclusion</th>
<th>Impact of exclusion</th>
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<tbody>
<tr>
<td>Women and men living in rural villages and remote islands engaged in subsistence work with intermittent income.</td>
<td>60-70% of the population</td>
<td>No safe means to save what little is earned, no access to credit to smooth consumption or create income earning opportunities, and no means of saving for long term and old age.</td>
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<tr>
<td>Women, men, youth and children across the Pacific with low levels of financial knowledge and competencies.</td>
<td>70-80% of these cohorts</td>
<td>Financial competency surveys conducted in Fiji, Samoa and the Solomon Islands show that low income households have low competencies in managing cash flow, financial planning and budgeting, managing credit, understanding the cost of money and hence struggle to meet current and future financial needs.</td>
</tr>
<tr>
<td>Public employees out-posted to rural locations.</td>
<td>It is estimated that one worker supports up to 20 persons including extended family members.</td>
<td>Financial services demand side studies have established that public employees can end up spending 20% to 30% of their wages on travel to the nearest cash-out point, usually a bank branch or ATM. Erosion of income affects their quality of life and that of their dependents. In addition, it also affects delivery of public services and benefits.</td>
</tr>
<tr>
<td>Households receiving remittances from relatives living and working in other towns or abroad.</td>
<td>Pacific island nations especially Fiji, Samoa and Tonga receive significant overseas inward remittances. Estimates put the figure of remittances into Pacific SIDS at USD 600 million in 2014.</td>
<td>Transfer and remittance costs borne by the sender are high and can deplete nearly 15% to 30% of the amounts transferred. Consequently, this reduces the available cash at the receiver’s end. The ability to transfer directly to a pension account at low cost is critical — see Chapter 14 on Data and ID for examples of promising developments in Mexico.</td>
</tr>
<tr>
<td>Both male and female informal sector micro-entrepreneurs lack access to financial services.</td>
<td>Significant given that urbanization is increasingly becoming a problem in many Pacific islands and urban poverty is emerging as a significant social problem.</td>
<td>Even while living close to financial service points, many in the informal sector do not qualify for access to finance due to lack of documentation and/or collateral. Lack of awareness further inhibits them from using a full suite of financial services, especially micro-insurance and savings for old age.</td>
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Women in the Pacific are especially excluded and recent research in Fiji, PNG and the Solomon Islands shows that women own less financial products and are less financially competent than men.6

With weakening traditional social safety nets, the inadequacy of public and private sector pension schemes and very low capacity as well as propensity to save for old age, social protection for the vulnerable, and poverty in old age, are growing significant concerns. Unexpected financial expenditures related to deaths, health emergencies, floods and crop losses from natural disasters threaten Pacific households. Given low financial competency, the inability to manage household budgets further reduces resilience and increases vulnerability. While abject poverty as it exists in sub-Saharan Africa or South Asia is not prevalent in the Pacific, there is a “poverty of opportunity” resulting in lack of access to higher education, better health, sanitation and general family well-being. Cultural obligations like funerals can cost Pacific households thousands of dollars and at present insurance protection for such risks are limited. Overall insurance penetration is also significantly low with the recent demand-side studies showing that even in a relatively developed country like Fiji, the total insurance coverage is only 12% of the adult population while in the Solomon Islands it is only 7 percent.

**UNCDF/ PFIP ROLE IN FINANCIAL INCLUSION IN THE PACIFIC**

The UNCDF (www.uncdf.org) is the United Nations’ capital investment agency for the world’s 47 (latest 2017) least developed countries. With its capital mandate and instruments, UNCDF offers ‘last mile’ finance models that unlock public and private resources, especially at the domestic level, to reduce poverty, and support local economic development.

**Figure 11.2**

Pacific Islands

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6 Sibley, Jonathan: The financial competence of low income households in Fiji, PNG and the Solomon Islands.
UNCDF’s finance models work through two channels:

1. **Financial Inclusion** expands the opportunities for individuals, households, and small businesses to participate in the local economy, providing them with the tools they need to climb out of poverty and manage their financial lives.

2. **Local Development Finance** shows how localized investments, through fiscal decentralization, innovative municipal finance and structured project finance, can drive public and private funding that underpins local economic expansion and sustainable development.

In the Pacific, UNCDF is represented by the PFIP tasked with fulfilling its core mandate of financial inclusion. PFIP was formulated in 2007 by the UNDP and the UNCDF to achieve greater financial inclusion among one of the least banked regions in the world. PFIP began operations in August 2008 with an initial mandate for five years (2008-2013), extended for a further five-year, second phase in June 2014 (2014-2019). PFIP receives financial support from UNDP, UNCDF, the Australian Government (through the Department of Foreign Affairs and Trade), the European Union and the New Zealand Government (Ministry of Foreign Affairs and Trade).

In the first phase (2008-2013), PFIP was engaged in laying the foundation for an enabling regulatory environment across the Pacific region while at the same time strengthening institutional capacities and incubating the infrastructure of payments. PFIP played a critical role in elevating the policy engagement to Government level by supporting the establishment of the Regional Money Pacific Goals endorsed by the Pacific Islands Forum Economic Ministers Meeting (FEMM) in 2009. The regional goals to be achieved by the participating countries by year 2020 include:

1. All children to receive financial education through core school curricula,
2. All adults to have access to financial education,
3. Simple and transparent consumer protection to be put in place, and
4. Halve the number of Pacific Islanders without access to basic financial services.

PFIP’s second phase (2014-2019) focuses on three work streams:

1. Financial Innovation,
2. Policy and Regulation,
3. Financial Competency and Consumer Empowerment.

PFIP has also been working closely with the regional Central Banks in developing National Financial Inclusion Strategies and providing assistance in implementing these strategies. A summary of the key engagements and achievements of PFIP to date is presented in the Table 11.2.
### Table 11.2
**Developments in financial inclusion between 2008 and 2016**

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<tr>
<td><strong>Most Pacific Island countries lacked regulations and policies focused on financial inclusion</strong></td>
<td>• National Financial Inclusion strategies in place in five countries: Fiji, PNG, Samoa, the Solomon Islands, and Vanuatu. Fiji, PNG and Solomon Islands are into their second phase financial inclusion strategies (2016-2020).</td>
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<tr>
<td></td>
<td>• National Financial Inclusion Taskforce (NFIT) formed in all the above countries and is the apex level coordinating body comprising key stakeholders and is chaired by the Governor of the Central/Reserve Bank.</td>
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<td>• Samoa and the Solomon Islands have amended their Central Bank Act to include financial inclusion and financial literacy as a core mandate.</td>
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<td>• Six PICs (Fiji, PNG, Samoa, SOI, Tonga, and Vanuatu) have implemented branchless banking/mobile money pilots through a proactive approach taken by the respective Central Banks.</td>
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<tr>
<td></td>
<td>• Five PICs have relaxed their KYC protocols to allow low income households access financial services.</td>
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<tr>
<td></td>
<td>• Many PICs are reviewing several financial sector related legislations.</td>
</tr>
<tr>
<td><strong>Lack of stakeholder coordination, little knowledge generation, exchange and dissemination within the region</strong></td>
<td>• National, regional, and international level stakeholder coordination mechanisms established through NFITs, Access to Finance (A2F) Pacific donor group, Pacific Islands Regional Initiative under Alliance for Financial Inclusion (PIRI/ AFI).</td>
</tr>
<tr>
<td></td>
<td>• Financial service sector assessments completed in Fiji, PNG, Samoa, the Solomon Islands (SOI), and Vanuatu.</td>
</tr>
<tr>
<td></td>
<td>• Micro-insurance action plans in place in five PICs. Micro-insurance pilots launched in three countries.</td>
</tr>
<tr>
<td><strong>No PIC had any financial service provider offering low cost, technology enabled solutions</strong></td>
<td>• Over a dozen mobile, branchless banking pilots &amp; deployments implemented across six Pacific countries - Fiji, PNG, Samoa, SOI, Tonga, and Vanuatu.</td>
</tr>
<tr>
<td></td>
<td>• Nearly 1.6 million clients across the Pacific provided access to new financial services through PFIP supported projects.</td>
</tr>
<tr>
<td></td>
<td>• First ever micro-insurance pilots tested across three markets. One micro-insurance project scaled up.</td>
</tr>
<tr>
<td></td>
<td>• First digitised Government-to-person (G2P) banking pilot in Fiji. Now G2P/Person-to-government (P2G) work is underway in several PICs.</td>
</tr>
<tr>
<td></td>
<td>• First ever informal sector voluntary superannuation feasibility study conducted in Fiji and SOI. Following feasibility study, validation field trials underway in both countries.</td>
</tr>
<tr>
<td><strong>Little focus by Government and service providers on building financial competencies of low income households in the region</strong></td>
<td>• Developed low income adult financial competency framework for the Pacific region</td>
</tr>
<tr>
<td></td>
<td>• Adult financial competency baseline study prepared for four PICs (Fiji, PNG, Samoa, and SOI); replicable methodology to measure adult financial competency introduced.</td>
</tr>
<tr>
<td></td>
<td>• Four PICs have developed national level financial literacy strategies (Fiji, Samoa, SOI and PNG).</td>
</tr>
<tr>
<td></td>
<td>• Integration of financial education is also underway in Solomon Islands and Vanuatu while piloting the same with Technical and Vocational training institutions is being done in PNG and Solomon Islands</td>
</tr>
</tbody>
</table>
As members of AFI’s PIRI, the region’s Central Banks have also committed to achieving various financial inclusion goals under the Maya Declaration. The Reserve Bank of Fiji was the recipient of the inaugural 2012 Maya Award for fulfilling and achieving its commitments while the National Reserve Bank of Tonga is the most recent winner in 2016. This amply demonstrates the seriousness of intent of the regional Central Banks towards greater financial inclusion in their respective countries.

FINANCIAL INCLUSION AND PENSION COVERAGE THROUGH THE CUSTOMER’S LENS

PIRI is a regional grouping of Central Banks in the region representing Fiji, PNG, Samoa, the Solomon Islands, Timor Leste, Tonga, and Vanuatu. They have developed financial inclusion progress tracking indicators for the region and member countries report on a half-yearly basis. In order to develop robust indicators covering client side access and usage, it was decided by PIRI to conduct nationally representative customer demand side surveys. During 2015, the exercise was completed in Fiji, Samoa and the Solomon Islands, followed by Tonga and Vanuatu in 2016.

The surveys across the five countries were conducted by their respective National Statistics Offices supervised by the Central Banks. Financial support for the project was provided by AFI and PFIP. Bankable Frontiers Associates provided technical assistance in developing the survey instruments, analysis of the data and preparation of the final report.

The summary of the findings from the financial inclusion demand side surveys across the five countries is provided in Table 11.3.

Table 11.3
Findings from Financial Inclusion Demand Side Surveys

<table>
<thead>
<tr>
<th>Financial inclusion strand</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Banked</strong></td>
<td>The respondent currently has a formal bank account.</td>
</tr>
<tr>
<td><strong>Other formal</strong></td>
<td>Over the past 12 months, the respondent used the services of a credit union, microfinance institution (MFI), pension, investments (stocks, bonds and others), and insurance or owns a mobile money account.</td>
</tr>
<tr>
<td><strong>Informal only</strong></td>
<td>Over the past 12 months, the respondent has used a savings club or other non-regulated financial instrument, such as taking credit from a shop, moneylender, or hire purchase.</td>
</tr>
<tr>
<td><strong>Excluded</strong></td>
<td>Over the past 12 months, the respondent has not used any of the services mentioned for the other three categories, but may have borrowed from or lent to friends and family, saved money in the house, pawned goods, borrowed from an employer, saved with a money guard, or trusted person, etc. This category would include respondents who only use money transfer services, as well.</td>
</tr>
</tbody>
</table>

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7 The Maya Declaration was launched in 2011 at the AFI Global Policy Forum in Riviera Maya, Mexico. It represents a global commitment from Central Banks to making concrete financial inclusion targets and championing financial inclusion.
Section 11.3

**Overview of the demand side survey**

<table>
<thead>
<tr>
<th>Country</th>
<th>Banked (%)</th>
<th>Other Formal (%)</th>
<th>Informal Only (%)</th>
<th>Excluded (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fiji (2015)</td>
<td>60%</td>
<td>4%</td>
<td>9%</td>
<td>27%</td>
</tr>
<tr>
<td>Tonga (2016)</td>
<td>41%</td>
<td>11%</td>
<td>14%</td>
<td>34%</td>
</tr>
<tr>
<td>Samoa (2015)</td>
<td>39%</td>
<td>12%</td>
<td>15%</td>
<td>34%</td>
</tr>
<tr>
<td>Vanuatu (2016)</td>
<td>37%</td>
<td>10%</td>
<td>21%</td>
<td>32%</td>
</tr>
<tr>
<td>Solomon Islands (2015)</td>
<td>26%</td>
<td>8%</td>
<td>35%</td>
<td>31%</td>
</tr>
</tbody>
</table>

The levels of formal financial inclusion among adults in the Pacific varies from as high as 60% in Fiji, to only 26% in the Solomon Islands. Significantly, in all these countries, 30% of the adults are excluded and a substantial percentage are still accessing only informal services. While Fiji has a relatively high level of inclusion, a lot of ground remains to be covered to bring the excluded into the formal financial sector.

**DEVELOPING NATIONAL FINANCIAL INCLUSION STRATEGIES**

UNCDF/PFIP started broad engagement with the regional Central Banks to organize national level stakeholder consultations followed by workshops to discuss and chart out a financial inclusion road map for each country. Starting with Fiji in 2009, these national level consultations, followed by strategy development, were then completed in the Solomon Islands (2010), Vanuatu (2012), PNG (2013) and Samoa (2015). Medium-term national financial inclusion strategies were developed first in Fiji followed by the Solomon Islands. These two countries have since developed their second phase (2016-2020) national strategies and launched the same for implementation. PNG has recently completed developing its second phase strategy, launched it during December 2016, and will take it up for implementation from 2017 to 2020. Samoa and Vanuatu have in place their first phase national strategy, while Tonga has scheduled its stakeholder consultations for the first quarter of 2017. PFIP has played a crucial role in supporting the respective Central Banks in strategy development and implementation through relevant technical advice and financial support.

The formulation and adoption of a National Financial Inclusion Strategy is usually done with a vision statement, strategic objectives, key performance areas, tracking indicators, responsible institutions, and definitive timelines for implementation. The

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National Financial Inclusion Strategies in the various PICs have been developed through a consultative process covering several stakeholders including Government, private sector financial service providers, telecommunication service providers/mobile network operators (MNOs), civil society and non-governmental organisations (NGOs). The implementation mechanism includes the formation of a National Financial Inclusion Taskforce (NFIT), usually under the chairmanship of the Governor of the Central Banks, and comprising members representing commercial banks, Government, NGOs, MNOs, development partners and civil society.

The NFIT is mandated to oversee the implementation of the national strategy and is supported by working groups that work on specific key result areas and implement their annual plans in order to achieve the broader national goals. The NFITs in the respective countries meet quarterly, or as and when required, to review progress towards the national strategic objectives.

**FINANCIAL SERVICES INDUSTRY IN THE PACIFIC**

The financial services industry in the PICs is rather small with limited participants. With the exception of Fiji and PNG, most Pacific countries have a poor supply of financial services available, with the few providers in each market offering a limited suite of products/services. The distribution of financial institutions and service providers by country is shown in Table 11.4. As mentioned earlier in the chapter, the national provident funds in each of the PICs discussed, offer mandatory employer-employee pension schemes, as well as voluntary schemes, which have not received much traction.

Table 11.4

<table>
<thead>
<tr>
<th>Country</th>
<th>Banks</th>
<th>Insurance Companies</th>
<th>MFI/ Micro banks</th>
<th>Super-annuation Funds</th>
<th>Credit Unions</th>
<th>MNOs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fiji</td>
<td>6</td>
<td>8</td>
<td>2</td>
<td>1</td>
<td>10</td>
<td>2</td>
</tr>
<tr>
<td>PNG</td>
<td>4</td>
<td>22</td>
<td>5</td>
<td>4</td>
<td>21</td>
<td>2</td>
</tr>
<tr>
<td>SOI</td>
<td>4</td>
<td>3</td>
<td>1</td>
<td>1</td>
<td>17</td>
<td>2</td>
</tr>
<tr>
<td>Samoa</td>
<td>4</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>6</td>
<td>2</td>
</tr>
<tr>
<td>Tonga</td>
<td>4</td>
<td>5</td>
<td>1</td>
<td>1</td>
<td>4</td>
<td>2</td>
</tr>
<tr>
<td>Vanuatu</td>
<td>4</td>
<td>4</td>
<td>2</td>
<td>1</td>
<td>5</td>
<td>2</td>
</tr>
</tbody>
</table>

Source: Respective Central/Reserve Banks. Data for Vanuatu incomplete and hence not presented.
NATIONAL PROVIDENT FUNDS IN FIJI AND THE SOLOMON ISLANDS

Presently, in both Fiji and the Solomon Islands, only the respective National Provident Funds are mandated by law to provide superannuation and pension services. A brief overview of the respective institutions – the FNPF and SINPF – is provided below:

**Fiji National Provident Fund (FNPF):** The FNPF is Fiji’s largest financial institution, established in 1966 under the FNPF Act. It is the only superannuation fund in Fiji mandated to collect compulsory contributions from employees and their employers to save for workers’ retirement, and also allows voluntary membership. A key pillar of the FNPF Strategic Plan is to add value to members through enhancing quality of life apart from building savings for retirement.

Presently, under the compulsory scheme, employers contribute 10% while employees contribute a minimum of 8% of gross wages. Employee contributions are deducted through their payroll. In addition to the 18% mandatory contribution rates stated above, the Fund also allows for additional voluntary contributions of 12% by both employees and employers. Hence, a total contribution of up to 30% of wages is permitted by the FNPF. Voluntary members must pay a minimum of FJD 7 per month[^9] to get full FNPF benefits. There is no upper limit for contributions but sources of any large contributions made have to be declared for tax clearance purposes. Apart from retirement savings, the FNPF also provides its members other financial services such as housing, medical and education assistance.

As at 30th June 2016, FNPF’s total assets were valued at FJD 5.1 billion (~USD 2.56 billion) and total membership stood at 406,065 – comprising of 372,594 compulsory members and 33,471 voluntary members. Voluntary membership makes up 8.2% of the total membership. Approximately two-thirds (67%) of Fijian residents aged between 16 and 55 years contribute to the fund. ([www.myfnpf.com.fj](http://www.myfnpf.com.fj))

According to the 2010-2011 Fiji Employment and Unemployment Survey[^10], there were 226,242 people who reported they were in some form of employment but not contributing to FNPF. Out of this number, 140,232 were either self-employed (93,262) or had worked for wages (46,970). It would appear that there is considerable justification and potential to extend responsive pension coverage to the informal sector.

The 2012 Fiji Financial Competency Survey (PFIP) highlighted the very pervasive reliance by low income households on family or community support during retirement. Most respondents in households who were currently working did not think the forms of

[^9]: The UN official rate of exchange for August 2017 is One US Dollar = 1.99 Fiji Dollar
[^10]: Fiji Bureau of Statistics conducted the survey
retirement provision available to the household (including family and community support) would be able to meet all household expenses when they were no longer working.

Most respondents who were no longer working, similarly, stated that the forms of income available to them were inadequate to meet all household expenses. Between 20 – 25% of respondents did not know how they would meet household expenses when they were no longer working. The indigenous Fijian community appears to be less aware of the issue and continues to consider family support to be the primary means of support during old age. This raises fundamental policy, regulatory and product related issues that need to be addressed as the requirement for cash based retirement provisions supersede social support.

**The Solomon Islands National Provident Fund (SINPF):** SINPF is the sole provider of superannuation services by Law in the Solomon Islands. Established in 1976, SINPF runs a basic superannuation scheme that caters largely to the formal sector, employer-employee groups and by the end of June 2015, had an active contributing membership of 55,000. The mandatory scheme requires employers to contribute 7.5% of wages from their own income, deduct 5% of gross wages from employees and remit the total contribution of 12.5% to the SINPF. The Act also provides for an additional contribution of up to 10% either by the employer or employee, thereby fixing the maximum contribution limit at 22.5% of gross wages. The total assets of SINPF are SBD 2.6 billion (~USD 340 million)\(^{11}\) – making it the largest financial institution in the country.

The present SINPF scheme has limited benefits for members. A one-time lump-sum payout of all contributions, together with accumulated interest, is made upon the death, permanent disability, retirement, or severance of employment of a member. This means that SINPF members get all their contributions paid out with accumulated annual interest at a time, and not as an annuity, which ideally should be the overarching objective of superannuation funds. Loans and partial withdrawals are not allowed; however, exceptions can be made in case of an emergency. SINPF has just three branches to serve its members, and this again, is a serious hurdle for both present and prospective members. The payout phase is clearly an area where improvements are needed to ensure that accumulated assets help to provide an income in old age rather than risk spending them very quickly and hence leaving people exposed to avoidable poverty later on. Chapter 20 on the payout phase offers some practical and simple steps that can be taken to improve payout policy – even where the capital market may be relatively under-developed and where annuities and similar products are not possible.

While the SINPF also runs a voluntary contribution scheme with a benefit structure similar to the mandatory scheme, its uptake is limited (just 460 active members) due to lack of awareness, poor marketing, and, importantly, access and entry restrictions. The review of the NPF Act is aimed at addressing all these issues and making the voluntary savings and contribution scheme attractive and accessible by a larger section of the informal sector. As highlighted in Chapter 16 on digital solutions for micro-pension inclusion, it is absolutely critical to design a market structure and an inclusive, electronic payments and pension coverage infrastructure that can operate at the lowest possible costs to ensure that it is

\(^{11}\) SINPF annual report 2015
worthwhile for people to put their money into a longer-term saving product – not only to protect their money for later use, but also to obtain superior rates of return compared to other products.

EXPANDING PENSION INCLUSION - CHALLENGES AND OPPORTUNITIES

As discussed above, social security in the Pacific is mostly limited to superannuation funds and hence is largely restricted to those in formal sector employment. With nearly 80% of the population in the informal sector, often living in remote rural areas, the vast majority of the population is presently excluded and do not have any form of old age financial security or provision – a level of informality and exclusion that mirrors that seen in Chapter 1 on India. The challenges surrounding expansion of pension benefits to cover the entire adult population, including those in the informal sector, such as subsistence workers, marginal farmers and other vulnerable sections, are many and some are detailed below.

1. **Policy and Regulation:** An enabling regulatory and policy environment is a prerequisite for robust pension market development. Most PICs (with the exception of PNG) have a single superannuation service provider, which is usually Government controlled. These institutions cater largely to the formal sector. Current regulations also place restrictions around age, contribution limits, investment options and benefit structures at the time of payout, thereby inhibiting the reach of full membership potential.

2. **Distribution Infrastructure:** Since the present schemes offered by the superannuation service providers are mostly mandatory, member contributions are largely received through payroll deductions from wages and salaries. The national provident funds in the PICs presently operate with a limited branch network and distribution outlets. Although some of them do offer voluntary contribution products, access to these services is limited to making contributions in person at the few branches, and hence access is a big inhibiting factor. In countries like India, there is a potential distribution infrastructure for saving and pension schemes that can be accessed through designated post offices and commercial bank outlets and thereby offers extensive access to people who want to join voluntary contribution schemes. Such models do not exist yet in the Pacific. However, as Chapter 1 on India shows, there is a need for much more than these possible outlets to ensure success in the informal sector.

3. **Investment opportunities:** The PICs offer little by way of long term investment opportunities. Governments are the biggest domestic borrower, usually through Treasury bills or bonds that offer limited returns. Pension funds usually require long term investments (over 20 years) and such options are non-existent in the Pacific. Investment management capacity is also limited within these institutions and this places further restrictions on fund performance. Additionally, provident funds face restrictions on offshore investments. Consequently, almost all the superannuation funds in the region have invested heavily in property (land and buildings), state owned enterprises and the few private sector companies that exist locally. As Chapter 17 on Governance and Investment shows, the ability to maximize (scarce) governance capacity can have a powerful impact on performance. It can also give the authorities the confidence to allow
some external investment that will benefit pension fund members and help to achieve the primary purpose of the pension funds.

4. **Customer Awareness and Financial Literacy:** The study on financial competency of low income households across four Pacific countries\(^\text{12}\) came up with the following cross-cutting results. As we see in Table 11.5, while there are marginal variances between countries (with Fiji scoring better in some of the competency areas and the Solomon Islands faring lower in many areas), the overall averages reflect low, or low to moderate competence, in 12 out of 13 competency areas.

The studies also revealed that, although low income households are monetised, they have limited understanding of financial terms and conditions. Most low income households are unable to undertake money management tasks and financial services activities they consider necessary. They are generally better able to manage short-term financial activities than long-term financial planning, including planning for life cycle events, such as education, marriage and funerals. Lack of financial knowledge and skills, and lack of access to safe and affordable financial services, are among the key reasons for this low competence. Urban households are generally more financially competent than rural households. In part, this is due to greater engagement with the formal financial system for transactions, savings, borrowing, and retirement provision.

As highlighted earlier in the chapter, Pacific Islanders are bound by strong cultural ties to their villages and tribal affiliations that customarily provide necessary social

<table>
<thead>
<tr>
<th>Competency Score</th>
<th>Competency Area</th>
</tr>
</thead>
<tbody>
<tr>
<td>HIGH</td>
<td>None of the Competency Areas were scored as High</td>
</tr>
<tr>
<td>MODERATE – HIGH</td>
<td>Competence with managing essential expenditure</td>
</tr>
<tr>
<td>LOW-MODERATE</td>
<td>Managing regular and one-off expenditure</td>
</tr>
<tr>
<td></td>
<td>Setting household goals and plans</td>
</tr>
<tr>
<td></td>
<td>Managing household income</td>
</tr>
<tr>
<td></td>
<td>Managing savings</td>
</tr>
<tr>
<td></td>
<td>Non-cash transactions</td>
</tr>
<tr>
<td></td>
<td>Managing long term savings</td>
</tr>
<tr>
<td>LOW</td>
<td>Keeping household records</td>
</tr>
<tr>
<td></td>
<td>Household budgeting</td>
</tr>
<tr>
<td></td>
<td>Managing borrowing</td>
</tr>
<tr>
<td></td>
<td>Identifying and recording household expenditure</td>
</tr>
<tr>
<td></td>
<td>Managing requests for financial assistance</td>
</tr>
<tr>
<td></td>
<td>Managing cost of money</td>
</tr>
</tbody>
</table>

\(^\text{12}\) Financial Competence of low income households study 2012 was conducted in Fiji, SOI, Samoa, and PNG by Jonathan Sibley and was financially supported by PFIP [http://www.pfip.org/our-work/work-streams/market-information/pacific-financial-competence-studies/](http://www.pfip.org/our-work/work-streams/market-information/pacific-financial-competence-studies/)
security, as well as access to basic living needs. Therefore, the motivation and incentive to save, and, more importantly, save for the longer term, are not very prevalent in PIC culture. This is confirmed by financial competency studies and, therefore, there is a compelling need to have mass education programmes targeting adults, especially on the need for long term and old age savings. This is not to say that these sources of income and security are not important – delivering income for old-age is such a challenging goal that all sources of income are useful. But it highlights that other elements of an old-age income system are going to have to work harder in the future if one element is reduced (quite apart from the challenge of rising longevity, meaning that the task at hand is getting more difficult).

5. **Operational Feasibility:** The traditional provident funds in the region have limited technical expertise and technology to cater to the demands of a dynamic pension market. Existing IT systems and business processes are tuned more to mandatory schemes and need to be revisited to make them compatible with modern technology interfaces through mobile phones and tablets. Cost considerations have so far inhibited these institutions from migrating to newer technology and consequently their operational readiness to expand their target market segments has to be addressed. However, making progress here will be absolutely essential to delivering on the promise of matching improvements in financial inclusion and payments with a pension infrastructure that can create new possibilities for savers going forward. A more detailed discussion on digital micro-pension solutions and platforms in Chapter 16, and related case-studies provided by the authors, are relevant, not only for the Pacific, but equally for other developing countries.

6. **Financial Feasibility:** Any financial product or service is only good in as far as it is financially feasible for the client. Voluntary micro pension products require delivery costs to be built into the product fee structure and borne by the end client, which could make the scheme too expensive. Alternatively, if the costs are kept low or borne by the service provider, returns to clients will suffer, jeopardizing their old age security. At present, such financial feasibility models are yet to be tested on a commercial scale and efforts are underway in this direction. These critical issues are discussed in greater detail in Chapter 18 on Costs.

There are of course several opportunities that exist to expand pension inclusion in the Pacific, particularly to those in the informal sector. Some of the opportunities are discussed below.

1. **Market Size:** The size of the populations engaged in the informal sector in most PICs is much higher than those in the formal economy. This offers an opportunity to reach out to a large number of potential voluntary pension scheme clients. With little expansion in the formal sector due to government down-sizing and lack of new private sector initiatives, the member base through conventional mandatory schemes is expected to reduce over time. Therefore, for the future viability of the funds, it is necessary to look at new market segments.
2. **Social security as a development tool:** Faced with an increasing ageing population, PICs will soon need to look at alternate forms of social security. With limited resources, governments in the region cannot afford to fully fund any welfare schemes aimed at providing old age financial and social security. Introducing and supporting voluntary contribution schemes would provide a development tool to mitigate old age poverty and associated risks, with the added benefit of facilitating pension inclusion.

3. **Investments:** Provident funds in the Pacific region are large financial institutions and are a primary source of investment for both public and private sector businesses. However, given their limited investment opportunities, these funds are saddled with huge liquidity, thereby diminishing returns to members. The region has immense potential in developing tourism, fisheries, sustainable forestry and agriculture-based value-added manufacturing. If superannuation funds are able to build their investment management capacities and align with prudent investment policies by Government, there is scope for long term debt financing by the funds to the corporate sector. Infrastructure investments like roads, ports, village solar electricity grids, etc. are also viable options through targeted lending by the provident funds.

4. **Insurance Industry as Pension providers:** The current legislations limit provision of superannuation (pension) services to the national provident funds (except in PNG). In many developing countries, life insurance and pension services are complimentary and are often offered by the same provider. Life insurance companies typically adopt good investment practices and have in-house skills that can be leveraged for the pension market. Insurance companies also have good distribution networks and often use technology to serve clients. Allowing insurance companies to offer defined contribution micro pension schemes could be one route towards opening up the industry for new players, allowing healthy competition and offering customers options for retirement savings. Additionally, micro-insurance products covering life, health, property, etc. can be offered to both mandatory and voluntary subscribers of superannuation as value added services. This may, however, involve reviewing current legislation, requiring sensitization of the Government and other stakeholders. There is also an opportunity to provide pension services on a regional basis, covering multiple PICs – this is discussed later in the chapter. As highlighted throughout this chapter, this model also has to meet the demanding requirements for efficiency – and to provide something that can fit over a person’s lifetime as they move from formal to informal or urban to rural environments. The key focus should be to include any providers who are able to deliver good quality outcomes but to avoid mistakes of relying on a model whose cost dynamics may prevent the delivery of a quality product (see for example Chapter 19 on Inclusive Insurance and Chapter 7 on Chile and 9 on Mexico).

5. **Annuity Options:** Current members of superannuation funds in the Pacific have limited options, with benefits usually provided as a one-off lump sum payout at the
time of retirement or on attaining a certain age (55 or 60), or upon earlier death. Partial withdrawals by members, even for emergencies, is at present restricted in many countries. This is an appropriate time to look at providing different annuity options. Offering members’ the flexibility of using a part of their savings for premature withdrawals, while allowing a defined percentage to accumulate as corpus for the long term, will provide members incentives for increasing contributions. See Chapter 20 on Payout options for more in this area.

FIJI AND THE SOLOMON ISLANDS
MICRO PENSION FEASIBILITY STUDY

During 2015, PFIP / UNCDF started engaging in discussions with the National Provident Funds of Fiji (FNPF) and the Solomon Islands (SINPF). Both institutions are key players in the financial sector of their countries, sole providers of superannuation services, as well as important stakeholders in financial inclusion. Concurrently, at this time, PFIP was experimenting with several branchless/ mobile banking pilots, as well as with other innovative financial services including mobile micro-insurance and remittances in partnership with commercial banks, MNOs and other providers. Studying the potential for voluntary, contributions based superannuation and pension schemes offered a new avenue for expanding innovation and this also fitted well with the next phase of financial inclusion strategic objectives adopted by Fiji and the Solomon Islands.

After getting board and management level commitment of the two National Provident Funds to collaborate on a feasibility study, PFIP offered technical and financial support through a performance-based grant agreement that included identifying an appropriate consultancy firm to conduct the study and based on the results, develop a validation plan to establish feasibility, sustainability and build a robust business model.

The actual study and field surveys were conducted in Fiji and the Solomon Islands between February and April 2016. The research team conducted a qualitative and quantitative study of the need for extending pension services to the informal sector in each market. The work entailed in-depth research into the informal market segment to determine the attitudes, perceptions, motivation, willingness, and financial capacity to join a voluntary contribution superannuation (pension) scheme that would provide old age micro pensions. The evidence clearly suggested that there was a considerable need and demand for such a scheme by a large share of the informal sector. The study also identified key assumptions about demand, feasibility, and profitability that should validated in the next phase of the test.

Based on the assessment of the Fiji survey, it was seen that more than 72% of respondents depended on their own savings (or pension) to provide for old age income. Nearly 80% of those interviewed indicated that they have monthly savings in the bank. A significant

13 Blue Print Pension Services, a Netherlands consulting firm was selected through a competitive process.
number of people (43%) were mainly saving for old age. The outcome of the survey also showed that only about 40% of the respondents defined their current income as sufficient for meeting their current consumption needs. Three quarters of the respondents (77%) showed interest in a voluntary micro pension product, where half of the contribution would be saved for the long-term and the other half could be accessible in an emergency. Most respondents indicated they were willing to save 5 to 10% of their current income for such a micro pension product. Going by average household income, this would produce a weekly saving of between FJD 19.50 and FJD 38.60 (~USD 10-20). The actual willingness of people becoming FNPF voluntary members is yet to be tested.

The study also revealed some obstacles that could inhibit the development of a micro-pension model for the informal economy including the challenge of achieving sustained voluntary contributions and savings persistency, operational and outreach constraints for the FNPF in terms of feasibly providing adequate customer support, and the overall viability and profitability of this product. These deterrents form the key assumptions that are now being tested in the pilot validation phase to justify the appropriateness of a voluntary pension model.

Although a similar study was taken up in parallel in the Solomon Islands, the results were quite different – given the differences in the economy, state of progress of the financial sector and the general level of awareness of people. Evidence from the Solomon Islands also clearly suggested a considerable need and demand for a voluntary, DC pension scheme by a large share of the informal sector workforce. The study also identified key assumptions about demand, feasibility and profitability that need to be validated and is presently being tested through pilot field trials. Results from the Solomon Islands Study also showed that for informal sector workers, saving for children’s education and a house were the two most important saving priorities. More than 70% of respondents expected to receive financial support from their families in old age. Some respondents expected to rely on family and communities for old age support and only about 12% planned to survive on their own savings after retirement. About 10% of those interviewed believed that their income in old age will come from a Government allowance. This belief could be based on the fact that they are already members of SINPF or expect the Government to introduce social security for older residents at some point.

The majority of the respondents believed that at age 60, they would be too old to earn a proper income. Many respondents arrived at the conclusion that by 50 to 55 years of age, they would already be suffering from health problems. The cohort of respondents who were aware that they were inadequately prepared for their old age, were targeted for deeper, qualitative research through focus groups discussions. Most of them were willing to join a voluntary micro-pension scheme provided through the SINPF and indicated that they could save up to 5% of their current income (approximately SBD 40 per week). In essence, the research identified and validated opportunities to offer workers in the informal economy of the Solomon Islands a pension product to support their financial needs.
VALIDATION PHASE: FIELD TRIALS

The feasibility study identified opportunities for introducing voluntary, contributions-led micro pension schemes in both countries. As mentioned earlier, Fiji’s voluntary scheme currently has around 33,000 members while the one in Solomon Islands has only 460 subscribers. The estimated potential target market based on population and household income expenditure data\textsuperscript{14} is around 140,000 and 110,000 adults respectively in Fiji and the Solomon Islands. This represents the adult population in the informal sector who are economically active either by way of earning wages or are subsistence workers. The informal economy in both countries includes small and marginal farmers, farm labourers, casual workers, taxi drivers, market vendors, etc. In Fiji, a study of women market vendors across 11 locations conducted in 2013 revealed that their annual contribution to the informal economy was in excess of FJD 300 million (~USD 150 million). Following this, a project called “Markets for Change” was initiated by UNDP targeting women market vendors across several markets in Fiji and was extended to the Solomon Islands and Vanuatu. The project involves collaboration with the respective town councils and municipalities to provide basic amenities to women market vendors (market stalls, storage, toilets, etc.) and includes a component on financial literacy. Under the micro pension validation trials underway, the women market vendors in Fiji and the Solomon Islands have been identified as potential target segments.

MICRO-PENSION PILOT PROJECTS

Pilot projects are currently underway in both Fiji and the Solomon Islands with their respective National Provident Funds as lead implementing agencies supported by PFIP and with technical support provided by consultants. Special teams comprising senior staff of the provident funds drawn from marketing, operations and information and communications technology (ICT) led by a senior executive, have been formed to run the pilot field trials during the current validation phase that will run for around six to nine months. These design lab teams headed by a Project Manager are dedicated to the pilot field trials and will work closely with the technical consultants. The teams will be supported by other department staff where necessary, as there is a clear mandate provided by the relevant board/ executive management. The pilot field trials underway will validate the hypotheses derived from the feasibility study to establish the following:

- What is the willingness and ability of various potential client groups in the informal sector to save for a micro pension product?
- Under what conditions are these potential client groups able and willing to opt for a micro pension product?
- How to make a micro pension product feasible in terms of cost-efficiency and a communication and distribution strategy?

\textsuperscript{14} Population and Household Income Expenditure Data in both countries is published by their respective National Statistics offices
More certainty about a full-fledged product launch will be established through the validation phase where proven client demand, issues around organisational readiness and financial feasibility for the client and business viability for provider are assessed.

The pilot project currently underway in both countries is part of PFIPs new “Innovation Design Lab” approach to rapidly test product prototypes, validate hypotheses around customer adoption and usage, and build a business case for the providers.

**VALIDATION PHASE**

The validation phase presently underway in Fiji and the Solomon Islands should deliver clear evidence that people recurrently save in their pension account and what effort is required to get clients from the informal sector to save recurrently.

The aim of the validation phase is to induct up to 500 clients into the newly developed voluntary pension scheme in the Solomon Islands and Fiji and motivate them for a period of six to nine months to make regular contributions into their pension accounts. Outreach will involve reaching out to about 1,000 targeted clients in the informal sector covering market vendors, small and marginal farmers, and casual workers through relevant associations or community groups. Outreach will include sustained awareness campaigns, field marketing and road shows. During the validation phase, client insights will be obtained, which will be used to further develop the pension product and the market approach based on specific client savings profiles. These client insights and tools might in future also be applicable to members from the formal sector. Dedicated project teams have been formed in both countries with substantial resource investments by both provident funds.

The following assumptions (hypotheses) will be validated during this trial period:

1. Customers are more interested in a product with general and preserved accounts than only a preserved account
2. Flexible payment options rather than a fixed rate of payment are preferable
3. A 50:50 split between general and preserved fund contributions will be acceptable
4. Increasing age at entry to 55 (in the case of the Solomon Islands) leads to increased adoption
5. Clients prefer yearly, half-yearly, quarterly, or monthly annuity payments instead of a one-time payout
6. A 10-year minimum contribution period to build the pension corpus (or assets) with options to go up to 15 or even 20 years is feasible
7. Distribution partners will play a crucial role in increasing client outreach and channelling contributions on a regular basis
8. In the Solomon Islands, the role of women’s savings groups as a channel partner will be tested
9. Distribution through financial literacy service providers will lead to greater adoption
10. KYC/AML norms and identification requirements can be complied with
11. Biometric ID by way of fingerprinting and issuing all members a photo ID card is feasible
12. Customers are more likely to adopt the pension product if it is combined with financial education on long term savings and pensions. A comprehensive financial literacy package would also include budgeting to reduce household costs and training on increasing income (though this would add costs to the program delivery)
13. Technology interfaces like using a mobile App attracts customers given the growing use of smart phones
14. Regular SMS reminders to remit voluntary contributions will increase savings and persistency
15. Adding a micro-insurance component to the product will be attractive to clients

The validation pilot phase has been further broken into three distinct blocks with specific deliverable as highlighted in the Table 11.6

<table>
<thead>
<tr>
<th>Deliverables of Block 1</th>
<th>Deliverables of Block 2</th>
<th>Deliverables of Block 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>2. Pilot product</td>
<td>2. Product calculations</td>
<td>2. Organisation structure and requirements</td>
</tr>
<tr>
<td>4. Customer journey</td>
<td></td>
<td>4. Implementation costs</td>
</tr>
<tr>
<td>5. Report on findings on block 1</td>
<td></td>
<td>5. Report on findings on block 3</td>
</tr>
<tr>
<td></td>
<td></td>
<td>6. Validation report</td>
</tr>
</tbody>
</table>

Each block will run for three months and it is expected that the full pilot will be completed by end of 2017. The different thematic activities and actions that will be undertaken and completed in the three blocks are listed in the Figure 11.4.
The technical consultants, after extensive field studies and interviews, have come up with a product design for the voluntary contribution scheme in both countries. Given the low literacy rates among the informal sector it was decided to keep the product simple and easy to use. However, since FNPF had a voluntary product already in place their management decided to adopt the same for the pilot with only minor modifications. In the case of SINPF the existing voluntary contribution product was not popular and, therefore, a new savings product was designed, with 50% of the member’s contributions going into a preserved fund (long term accumulation) with the remaining 50% in a general fund, which members can access to meet short to medium term financial needs. This is akin to the model for example in Malaysia’s Employee Provident Fund – although there 70% goes to pensions and 30% is available for a range of specified (short-term) uses.

The preserved fund will accumulate over the longer term or up to age 55 of the member at which time the annuity payouts, in the form of a micro pension, will commence. The annuity payments will continue during the lifetime of the member and on his/her death the remaining corpus will be paid to the legal heirs/beneficiaries. In the event of the death of a member before commencement of the annuity, the accumulated funds will be paid out to the beneficiaries.

The general fund is proposed as a measure to allow members to withdraw funds to meet short to medium term goals such as children’s education, house construction, and medical emergencies. Since the present SINPF mandatory contribution scheme does not provide these options, allowing only a one-time payout at the time of retirement or premature death, the benefits under new product developed for the informal sector may later be extended to the existing mandatory scheme members after due approvals by the Board of SINPF. In the case of FNPF both the mandatory and voluntary products have the option of premature withdrawals for specified purposes like medical treatment, education, and house building and hence it has been decided to use this existing product while adopting a new distribution strategy involving external partners.
FINANCIAL BUSINESS CASE DEVELOPMENT

The validation plan envisages activities covering developing a financial business case during block 3 of the pilot phase that is likely to be implemented during Q3 of 2017. The following assumptions will be validated during this period:

- Distribution costs at “USD xx” per client
- Revenue assumptions of “USD yy” per client per year
- Administrative costs of “USD zz” per client per year
- That there is a viable business case for the provider

Activities during this block will include identifying cost structures, building revenue models, defining the business model canvas and calculating the financial business case using different scenarios. The development of robust business models and building a strong financial viability case is a precursor to full scale implementation. And, there is a strong commitment from the respective National Provident funds to invest substantial resources if a well-defined strategy is developed at the end of the pilot phase.

DISTRIBUTION PARTNERS

One of the limiting factors at present in both countries is the weak marketing and distribution infrastructure. While FNPF does have a good voluntary scheme, it is poorly marketed and available only through FNPF branch offices. Therefore, for the pilot field trials, new distribution arrangements have been thought out, discussions held with potential partners and service agreements signed. Distribution partners include MFIs, MNOs, associations (including market vendors and taxi drivers’ associations), post offices, and commercial banks. Along with being involved in awareness campaigns, marketing and publicity, these institutions will also serve as outlets for collecting member contributions.

Many of the distribution partners identified have evinced keen interest in partnering with the National Provident Funds. This offers them an opportunity to use their existing infrastructure, technology and personnel to earn an additional fee-based income, as well as a means of increasing their own client base and business.

Identified staff of distribution partners have been trained on product, marketing, customer onboarding processes, collecting member contributions, and remittances to the provident funds, and client servicing. Each distribution partner will be supported with a technology interface that will be extensively tested during the validation phase.

TECHNOLOGY INTERFACE

It has been highlighted earlier in the chapter that the Pacific has severe geographical challenges that can be best overcome by adoption of appropriate technology. This has already been demonstrated by the increase in uptake of bank accounts since the advent of mobile and branchless banking across several Pacific countries. Expanding micro pension inclusion in the region will also require technology adoption and the validation phase has
factored this as an important critical success factor. Accordingly, after due discussions with
the Information Technology (IT) departments of both Provident Funds and identifying
appropriate interface platforms, mobile, and tablet-based software applications have been
developed for customer on-boarding, channelling member remittances, providing regular
updates and balances to clients, and other interactive services.

As both FNPF and SINPF are presently undergoing a strategic restructuring, revamping
their internal business processes including upgrading their IT systems, the new initiatives fit
well from both the organisational and customer point of view. Also, growth in mobile phone
penetration in both countries is facilitating the use of mobile apps for allowing easy access to
clients in remote locations that in the past was not comprehensible. During the pilot phase,
the new voluntary scheme customer database is expected to be ring-fenced and maintained
separately (without integrating with the Funds’ existing member databases). Thereafter,
and once a decision on scale up and full-fledged implementation is taken in early 2018, it is
envisaged that there will be total end-to-end integration of all IT systems and processes for
existing mandatory as well as newly-acquired voluntary members.

GOVERNMENT COMMITMENT

The direct involvement of the Governments of Fiji and the Solomon Islands is limited at
this stage as the respective National Provident Funds are the lead implementing agencies.
However, the results of the feasibility study as well as the validation plan have been
discussed at NFIT meetings where government ministries as well as the private sector and
civil society are duly represented. The national development strategies of the PICs have key
elements including Government commitment to providing old age and social protection
through pension reforms. The National Financial Inclusion strategies are usually aligned with
the national development plans of the respective countries in order to get full Government
support and budgetary allocations for implementation. Therefore, it is expected that once
the pilot phase is completed, and the above-mentioned hypotheses validated and presented
to the national level stakeholders including the respective governments, support will be
forthcoming for an eventual pension market expansion and inclusion.

REGIONAL PENSION SERVICE PROVIDERS
A NEW APPROACH

The market size within individual PICs is limited and one of the important long term
considerations will be whether the provident funds can sustainably offer varied pension
products. A new approach could be to open up the pension market to new providers. There
are a few insurance companies and commercial banks that have a pan-Pacific presence
and are therefore ideal candidates to take up this responsibility. The commercial banks
especially have several physical branches as well as a growing agency network of ‘branchless
banking’ outlets throughout the PICs. This low cost ‘brick and mortar’ structure will lower
distribution and administrative costs and will be tested during the validation phase.
Through appropriate legislative reforms to allow new providers to take up provision of superannuation and pension services, the private sector potential can be unlocked. Along with this, diversifying investment options by allowing overseas investments and developing internal fund management capacity will provide competitive returns to members.

This idea is still in its infancy and requires further discussions within the respective countries before being elevated to appropriate regional and/or global platforms for implementation. If this is to be pursued, the established regional collaboration forum of National Provident Funds can be used as a platform to consider futuristic options. Efforts are currently underway by PFIP to elevate the dialogue to the CEO’s Forum of the Pacific Provident Fund and Social Security Forum.

**UPDATE ON THE VALIDATION FIELD TRIALS (AUGUST 2017)**

Dedicated Innovation hub teams within the two NPFs have been operationalized under a Project Manager who is responsible for liaising with PFIP and the technical consultants (Blue Print Pension Services) and reports to the senior executive management of the respective funds. While the actual field implementation has been delayed in Fiji by FNPF due to an overhaul of its management team and restructure of its operations, the progress in Solomon Islands is on schedule with regular updates being provided to the Board of SINPF, PFIP, the NFIT and the Central Bank besides key stakeholders.

The Innovation Hub team with the support of the consultants has completed all the deliverables under Block I (refer Table 11.6) and part of the deliverables under Block 2 as well. As on date, the special product targeting the informal sector named “You Save” has an active membership of 468 since the date of its launch on 2nd May 2017. More details on the outreach is provided in the Table 11.7 below. Out of the total 468 members 282 (60%) are female. A significant 225 (48%) are in the age group 20 to 40 and are likely to save for a longer duration and accumulate a large corpus over the earning life-time and provide adequately for their old age. The propensity among female members to save more is also well established thus far although more in-depth client profiling and research about their motivations, perceptions and attitudes will come out during the ongoing work in the field.

**DISTRIBUTION PARTNERSHIPS:**

The Solomon Islands National Provident Fund (SINPF) has established distribution partnerships with the Solomon Post Office, Honiara Market Vendors Association and is actively pursuing other institutions including some interested provincial Governments.

**TECHNOLOGY INTERFACE DIMENSION:**

SINFP has also established a technology interface protocol with ANZ Bank (Australia & New Zealand Banking Group) which is one of Australia’s leading commercial banks having global operations in 36 countries including across the Pacific. Through the “Bill Pay” option in the bank’s mobile banking service, ANZ goMoney and SINFP You

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15 **ANZ goMoney** is the patented branding for the USSD based mobile application of the bank presently available in four Pacific countries- PNG, Samoa, Solomon Islands and Vanuatu as well as Australia and New Zealand
Table 11.7
SINPF Informal Sector (YouSave) Update 4th August 2017

<table>
<thead>
<tr>
<th>Age Group</th>
<th>Number</th>
<th>Balance</th>
<th>Annual Contrib</th>
<th>Count Male</th>
<th>Count Female</th>
<th>Balance Male</th>
<th>Balance Female</th>
</tr>
</thead>
<tbody>
<tr>
<td>20 and less</td>
<td>19</td>
<td>3290</td>
<td>3290</td>
<td>12</td>
<td>7</td>
<td>2050</td>
<td>1240</td>
</tr>
<tr>
<td>21-25</td>
<td>37</td>
<td>7240</td>
<td>7840</td>
<td>18</td>
<td>19</td>
<td>1920</td>
<td>5320</td>
</tr>
<tr>
<td>26-30</td>
<td>49</td>
<td>12995</td>
<td>13370</td>
<td>15</td>
<td>34</td>
<td>4220</td>
<td>8775</td>
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<tr>
<td>31-35</td>
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<td>22925</td>
<td>22925</td>
<td>30</td>
<td>33</td>
<td>11100</td>
<td>11825</td>
</tr>
<tr>
<td>36-40</td>
<td>76</td>
<td>18915</td>
<td>18912</td>
<td>30</td>
<td>46</td>
<td>5412</td>
<td>13500</td>
</tr>
<tr>
<td>41-45</td>
<td>93</td>
<td>21695</td>
<td>21695</td>
<td>33</td>
<td>60</td>
<td>6775</td>
<td>14920</td>
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<tr>
<td>46</td>
<td>18</td>
<td>4450</td>
<td>4450</td>
<td>5</td>
<td>13</td>
<td>680</td>
<td>3770</td>
</tr>
<tr>
<td>47</td>
<td>12</td>
<td>3640</td>
<td>3640</td>
<td>8</td>
<td>4</td>
<td>720</td>
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<td>4020</td>
<td>4020</td>
<td>2</td>
<td>10</td>
<td>850</td>
<td>3170</td>
</tr>
<tr>
<td>50+</td>
<td>78</td>
<td>73457</td>
<td>73457</td>
<td>31</td>
<td>47</td>
<td>10182</td>
<td>63275</td>
</tr>
<tr>
<td>Totals</td>
<td>468</td>
<td>174204</td>
<td>175179</td>
<td>186</td>
<td>282</td>
<td>44009</td>
<td>130195</td>
</tr>
</tbody>
</table>

Save members can pay their recurring savings free of fees by quoting their membership number as reference. They receive a text message for confirmation of payment and NPF also allows members to receive their total balance and a statement through their mobile phone. For smart phone users, there is also the option of member login and viewing their account balance through the NPF web portal.

Very recently, NPF has also trialed payment of voluntary member savings through designated Post office counters as well as over the counter ANZ goMoney merchant counters. Both these options are receiving encouraging responses from members especially for remitting recurring savings. The percentage of recurrent savers has gone up from 40% a month ago, to 46% at the end of July’17. A significant 83% women are recurrent savers showing once again their adopting the product and seeing it as a vehicle for their future savings and overall household welfare. Customer feedback loops are being established that will shed more light on their adoption, usage behaviours and the Innovation Hub is also fine tuning its marketing and promotion strategy.

**CONCLUSION**

There are no state-supported social security schemes in the PICs. The current status of public finances does not offer scope for such schemes in the medium term. With increasing longevity and rapidly changing social structures in both Fiji and the Solomon Islands, there is an imminent need for introducing voluntary savings-linked micro pensions with defined contributions targeting the informal sector to meet the needs of the population.
post retirement. At the same time there is also a need to revamp the existing mandatory superannuation scheme of the FNPF and SINPF to provide members annuity benefits and flexible withdrawal options.

The validation field trials currently underway (following extensive research) are expected to provide valuable insights into client behaviour, adoption and usage patterns, operational feasibility as well as financial viability. At the end of the pilot phase, a blueprint for full scale up with detailed implementation plans and budgets will be developed. At that stage there will be a need for more in-country dialogue involving both public and private sectors as such a nation-wide implementation will have wide ranging implications on the economy and will require political, economic, and social considerations to be factored in decision making. Government support in the form of facilitating legislative reforms and that of development partners in supporting innovation and underwriting initial implementation risks will be vital for pension inclusion to take deep roots in the Pacific.

Digital Financial Services are set to be a game changer for low cost service delivery and reaching remote locations. However, compelling customer usability cases need to be developed, tested, and rolled out for stickiness and usage. Advocacy for tax incentives on select financial products aimed at increasing savings, especially for insurance and pensions is an area requiring attention. A coordinated approach and action by relevant stakeholders with the end customer in mind is the need of the hour.

**PENSION PROVISION IN THE PACIFIC**

**A SNAPSHOT**

**SUMMARY**

Social welfare for elderly persons in Fiji, the Solomon Islands, Vanuatu, Tonga, Samoa and Papua New Guinea is at a nascent stage, largely limited to mandatory contributory superannuation schemes administered by one or at most two institutions. Previously, cultural norms had placed the responsibility of looking after the elderly or disabled on able-bodied family members and the wider village community. However, the erosion of such values has led to governments stepping in with mandatory retirement savings schemes.

Several of the above-mentioned countries (Fiji, Samoa, and Tonga) have also initiated a national social pension scheme. However, such payments are small and are intended to provide a degree of independence and support to the elderly, but is far from sufficient to survive on. Papua New Guinea is considering implementing such a scheme, after the success of a universal pension in one province.

National provident funds or mandated superannuation funds in each country typically make up the largest financial institutions in the country and cater largely to private and public formal sector salaried workers. Member benefits are typically limited. Given the large informal economy in each country, this tends to exclude a significant percentage of the
population from retirement savings. While voluntary membership for the informal sector is possible, take-up has not been high due to lack of infrastructure, marketing and awareness. Additionally, in several PICs (particularly Papua New Guinea and Vanuatu), provident funds have faced significant mismanagement and corruption scandals in recent years, causing significant financial instability and mistrust of in institutions that is likely to continue.

**THE SOLOMON ISLANDS**

Social policies in the Solomon Islands focus on education and health, rather than providing for old age through welfare payments. The social security system is limited to SINPF. The Ministry of Commerce, Industries, Labour and Immigration aims to expand the capacity of social protection in the Solomon Islands where pension schemes will cover all nationals that are above a certain age (International Labour Organisation). It will also create a Health Insurance Scheme that will envelop all Solomon Islanders, and hence increase access to specialized health care overseas. The SINPF was established in 1976 as a compulsory retirement savings scheme for salaried workers, excluding Parliamentarians, eligible for a government pension and is the sole provider of superannuation benefits to the public in the Solomon Islands. On top of mandatory contributions, SINPF also allows an additional contribution of 10% either by the employer or employee, thereby fixing the maximum limit at 22.5% of gross wages. The total assets of SINPF is SBD 2.6 billion (~USD 340 million) (Solomon Islands National Provident Fund, 2016) making it the largest financial institution in the country. The present SINPF scheme has limited benefits for members. A one-time pay out of all contributions together with accumulated interest is made upon the death, permanent disability, retirement, or severance of employment of a member. Loans and partial withdrawals are not allowed; however, exceptions can be made in case of emergency. SINPF has just three branches to serve its members and this again is a serious hurdle for both present and prospective members. The Solomon Islands Provident Fund population coverage is minimal and it will only expand if the private sector expands.

**VANUATU**

The elderly in Vanuatu mainly benefit from family-based safety net arrangements and there is no government or donor supported social assistance program, with superannuation confined to the Vanuatu National Provident Fund (VNPF) (Rotuivaqali, 2013). The VNPF was established in 1986 as a compulsory saving scheme for employees earning more than VUV 3,000 (USD 33) per month. VNPF member accounts are divided into three sub-accounts: Retirement (50%), Medisave (25%), and Investment (25%). Under the investment sub-account, members can access microloans for housing, home maintenance or furnishing, or school fees; or pledge their contributions as collateral for other financial
service provider loans. On retirement, members receive a lump-sum payout, as well as a direct lump sum severance allowance from their employer. In the event of a member’s death (prior to retirement age), a member’s nominees receive their contribution plus a Special Death Benefit of VUV 230,000 (~ USD 2,600). VNPF has had a controversial history, with a number of scandals leading to the near-collapse of the Organisation. During 1992-95, the fund faced mismanagement of its housing loan scheme due to corruption involving politicians demanding loans with no intention of repayment. Following an Ombudsman’s report disclosing this situation, riots in 1998 prompted the government to allow members to withdraw their savings from VNPF, causing instability in the financial system. As a result, the Reserve Bank of Vanuatu instituted the Comprehensive Reform Programme to stabilize the economy. Further controversy occurred in 2012, with public outcry over alleged mismanagement of funds which that saw the management team being replaced (Seke, 2013). The last audited Annual Report published (2013) explains the need to get the institution back on track behind providing a rate of return to members of 0 percent. It is unclear what the current public sentiment around VNPF is. Despite its checkered past, the government’s position is to maintain VNPF but ensure better management, and also explore the wider implications of allowing retirement savings to be invested with institutions outside of VNPF.

FIJI

Fiji provides for its elderly through the Fiji National Provident Fund (FNPF), government pensions (for civil servants and dependents) or through the Social Pension Scheme (SPS). Since 2013, the Fiji government has been running the Social Pension Scheme (SPS) targeting elderly citizens aged 66 years and over who do not have FNPF or benefit from a government pension, with an allowance of FJD 30 per month since increased to FJD 50 during 2016 and planned to be increased to FJD 100 from 2018. This SPS benefits approximately 15,000 elderly citizens who are currently not receiving any pension or any source of income (Rotuivaqali, 2013). FNPF is Fiji’s largest financial institution, established in 1966 under the FNPF Act. It is the only superannuation fund in Fiji mandated to collect compulsory contributions from employees and their employers to save for workers’ retirement, and also allows voluntary membership. FNPF allows partial withdrawals for housing, health and education expenses assistance on the death of an immediate family member; and members

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16 ILO, Vanuatu Council of Trade Unions and Vanuatu Chamber of Commerce, 2014
17 Vanuatu National Provident Fund
18 Prasad & Kausimae, 2012
19 Vanuatu National Provident Fund, 2013
20 ILO, Vanuatu Council of Trade Unions and Vanuatu Chamber of Commerce, 2014
can choose to receive either lump-sum or a monthly pension. A Special Death Benefit of FJD 8,500 (~ USD 4,200) is provided to beneficiaries. In addition to 18% mandatory contribution rates, FNPF also allows for excess voluntary contributions of 12% which is offered to both the employee and employers, hence the total contribution rates a member can contribute is 30% of income. While the majority of FNPF’s investments are within Fiji, offshore investments are made with the Reserve Bank’s approval.

PAPUA NEW GUINEA

The government announced in 2013 that it intends to consider introducing old age pensions for those aged 65 and over (Pope, 2013). In 2009, the province of New Ireland began implementing a universal pension scheme named ‘One Kina’ for the elderly and for persons with disabilities, that provides one kina per day (PGK 360 or ~ USD 135 per annum). Despite several implementation challenges, the scheme has been successful. A 2014 review by The World Bank and the Australian Department for Foreign Affairs and Trade concluded that the New Ireland social pension scheme can provide a suitable basis for the old age component of the national social pension. At present however, it is unknown whether the Government of Papua New Guinea has made any progress with this national social pension scheme.21 The only form of social insurance offered in PNG, the contributory pension plans mandated by the government, have a limited coverage. PNG has a contributory pension scheme provided through National Superannuation Fund (NASFUND) and the Nambawan Super Fund (NSF). Both funds offer defined contribution retirement savings plans to members, with NASFUND being geared towards private sector employees, while the NSF targeted at public sector employees. Employees must contribute a minimum of 6% of their salary to a superannuation fund and employers of over 20 persons are required to contribute 8.4%. Apart from death or retirement, members of either fund can withdraw for reasons of unemployment and medical expenses; and both funds have affiliated Savings and Loan Societies offering a complementary savings vehicle as well as low-interest loans for members to cover common expenses such as funerals, bride price, motor vehicle registration, and school fees.22 NASFUND was established in May 2002, as the privatized successor entity to the National Provident Fund (NPF) following severe financial losses in the 1990s as a result of fraud, corruption, and mismanagement. It is the largest private sector superannuation fund in PNG, and also offers housing advances to members. NPF is a trustee of the Public Officers Superannuation Fund, set up in 2000 to administer superannuation for public sector employees. In 2015, 12% of NASFUND’s portfolio was invested in international equity, property or cash, while international investments made up 16% of the NPF portfolio.

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21 Sibley, Ivaschenko, Pagau, & Tanhchareun, 2014.
SAMOA

Samoa provides for its elderly through a mandatory National Provident Fund as well as a universal monthly pension. In 1990, it introduced a monthly pension for every person at the age of 65, due to changes in Samoan culture, with Samoans moving away from the practice of family members supporting their elders. The policy is directly funded from the government budget and executed by the SNPF, whereby payments are made directly to bank accounts. In March 2009, about 8,500 pensioners were in the scheme. Each pensioner receives WST 135 (~ USD 60) per month and other benefits, such as free consultation at government hospitals, free medicine from a government pharmacy and inter-island travel. The Samoa National Provident Fund (SNPF) was set up in 1972 as the sole fund for collecting compulsory savings in the country. Additional voluntary contributions of up to WST 2,000 per month are allowed. Members can access loans including for vehicle, education, housing and land, etc. through SNPF, and may withdraw funds early if they develop a serious medical condition. Upon reaching retirement, a 4% bonus is added to the member’s withdrawal balance, given 15 years’ contribution. Upon death of a member, a Death Benefit of WST 5,000 (~ USD 2,100) is provided to beneficiaries. An additional member benefit is a separate voluntary education savings fund. Other superannuation products exist such as Samoa Life Assurance Corporation’s superannuation fund. It is unclear how this is different to the mandatory SNPF fund.

TONGA

Under the National Retirement Benefits Scheme (NRBS) Act 2010, Tonga began providing elderly citizens with social pensions, and also mandated contributions towards superannuation funds for employees and employers. Apart from such schemes, overseas remittances remain the most important form of social protection in Tonga. However, these flows are impacted heavily by the global economy (World Bank, 2015). Tonga operates two separate provident funds: The Retirement Fund Board (RFB) for central government employees, and the National Retirement Benefits Fund (NRBF) for both private and public sector employees. The funds operate on similar principles. The National Retirements Benefits Fund (NRBF), established in 2011, operates as a mandatory superannuation scheme for the non-government sector. It has a voluntary scheme, but the number of contributors is unknown. In 2015-16 NRBF had TOP 26 million (~USD 13 million) under management. The RFB is the corresponding mandatory scheme for public servants and the military, operating since 1999, replacing the previous non-contributory pension fund. In addition, the NRBF also manages the universal social welfare payments for retired Tongans over the age of 75, of TOP 65 (~USD 33) per month, paid directly into bank accounts.
Table 11.8
Pension Provision in the Pacific - A snapshot

<table>
<thead>
<tr>
<th>Institution</th>
<th>SINPF</th>
<th>VNPF</th>
<th>FNPF</th>
<th>NAS FUND</th>
<th>Nambawan</th>
<th>SNPF</th>
<th>NRBF</th>
<th>RBF</th>
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</thead>
<tbody>
<tr>
<td>Country</td>
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<td>Vanuatu</td>
<td>Fiji</td>
<td>PNG</td>
<td>PNG</td>
<td>Samoa</td>
<td>Tonga</td>
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<tr>
<td>Members</td>
<td>55,000 active members</td>
<td>24,366 active members</td>
<td>403,316 members</td>
<td>177,252 active members</td>
<td>116,039 active members</td>
<td>31,744 active members</td>
<td>9,596 members</td>
<td>4,864 members</td>
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<tr>
<td>% Of Working Population</td>
<td>32% (2008)</td>
<td>21% (2008)</td>
<td>N/A</td>
<td>4% (2012)</td>
<td>3% (2012)</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Mandatory Employee Contribution %</td>
<td>5%</td>
<td>4%</td>
<td>10%</td>
<td>6%</td>
<td>6%</td>
<td>7%</td>
<td>5%</td>
<td>5%</td>
</tr>
<tr>
<td>Mandatory Employer Contribution %</td>
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<td>4%</td>
<td>8%</td>
<td>8.4%</td>
<td>8.4%</td>
<td>7%</td>
<td>7.5%</td>
<td>10%</td>
</tr>
<tr>
<td>Return over Inflation</td>
<td>-1.1% (2012)</td>
<td>-2.5% (2013)</td>
<td>4.6% (2015)</td>
<td>-2% (2015)</td>
<td>-0.2%</td>
<td>6.4%</td>
<td>4.3%</td>
<td>4.9%</td>
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<td>No. of Branches</td>
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<td>8</td>
<td>17</td>
<td>18</td>
<td>3</td>
<td>3</td>
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<tr>
<td>Payout options</td>
<td>Lump-sum only</td>
<td>Lump-sum only</td>
<td>Lump-sum &amp; allocated pension</td>
<td>Lump-sum only</td>
<td>Lump-sum &amp; allocated pension</td>
<td>Lump-sum only</td>
<td>Lump-sum &amp; allocated pension</td>
<td></td>
</tr>
</tbody>
</table>

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PENSION REFORMS AND VOLUNTARY COVERAGE EXPANSION IN ALBANIA

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INTRODUCTION

This chapter provides an example of how the development of a system of voluntary private pensions (Pillar 3) has built upon a reform to the system of state pensions (Pillar 0 and 1) to improve the sustainability of the system and to benefit the poorest in society. Establishing and expanding a voluntary pensions system has proved far from easy in a country that has no prior experience of such saving, together with a lack of trust in financial institutions and limited disposable income. Central to this chapter, therefore, is a project to try and boost coverage of voluntary pensions. This case study illustrates the actions that can be taken to help increase coverage, the importance of Pillar 1 and tax incentive alignment, and the inherent constraints and limitations of relying on voluntary pension saving. It also indicates some future directions for further system development – bearing in mind that the potential of bringing together the pension coverage and financial inclusion agendas has not yet been realized.

Putting in place the foundations for a more stable and diversified pension system, as outlined in this case study, can be an essential pre-condition to moving to the next phase of leveraging the potential synergies between pension coverage and financial inclusion. Pushing too far too fast before the pension system was more stable would have been risky – an important message for policy makers seeking to design the most effective reform path for their country.

BACKGROUND TO ALBANIA

Albania, in Eastern Europe, had a communist government prior to 1991 and since then has been a democracy. It is a European Union (EU) pre-accession country. It has 4.2 million citizens, however, with substantial outward migration over the last 20 years, there are 2.82 million persons currently living in Albania. The average age of the population is 35.3 years. Life expectancy at birth for females is 79.7 and for males is 76.1 according to the Albanian Institute of Statistics (INSTAT). The total fertility rate is 1.5 children born per woman. The population at or above retirement age is 15.5% of the total of resident population and is expected to reach 35% in 2080 (INSTAT, 2015).

1 The terminology of ‘Pillars’ relates to the World Bank terminology where a Zero pillar is a basic poverty alleviating payment financed from the government budget and sometime called a Social Pension, Pillar 1 is a state contributory pension, Pillar 2 is a mandatory privately invested contributory element, Pillar 3 is a voluntary privately invested contributory pension and Pillar 4 combines alternative forms of providing retirement income such as (shorter-term) savings, housing, and other assets (see Holzmann and Hinz 2005). Other terminology exists, for example with a first pillar relating to state provision, second pillar relating to employer based provision and a third pillar being individual provision.
2 2011 Census.
GDP per capita is USD 11,900 (at purchasing power parity) with a substantial balance of trade deficit (imports are 2x of exports). Unemployment in March 2017 was estimated at just over 4.5%. There is a large informal economy and substantial rural poverty. The annual inflation rate (CPI) was 2% in June 2017, having fluctuated 0.2-2.1% over the previous 2 years. The Bank of Albania benchmark interest rate reduced from 2% to 1.25% during 2016. The capital market is at a relatively early stage of development. Investors can put money into bank deposits, fixed term investments and government bonds, and have access to international investments (principally in the Euro area) via investment funds. There is scope for the capital market to develop further, but there are sufficient instruments to allow members to put their money into products that will yield a positive real rate of return.

**INITIAL CONDITIONS AND PENSION REFORM CONTEXT**

Since 2009, Albania has had a two pillar pension system. This includes a long-standing contributory (Pillar 1) pension system, which started in 1947. This first pillar is operated on a pay-as-you-go (PAYGO) basis and is administered by the Social Insurance Institute. Pension benefits under this pillar are determined by the years of insurance contribution, average wage during the beneficiary’s working career and an eligible social pension. Albania also has a newly created system of voluntary, funded pensions (pillar 3) using defined contribution individual accounts, offered either to individuals directly or to employees through their employer. This voluntary system is managed by three pension management companies, and supervised by the Albanian Financial Supervisory Authority (AFSA).

**PILLAR 1 PENSIONS**

A December 2006 World Bank policy note concluded with the following findings:

- The level of benefits and the coverage rate for the population at risk would be at low levels in the future, implying inadequate coverage of the elderly in the long run, arising from the low number of working age individuals actively making contributions, so that 40% of the elderly would be left without access to the pension system;

- The system did not provide sufficient incentives to participate, because the maximum pension was limited to twice the minimum pension even though the maximum wage was five times the minimum wage;

- Even though the population was young, contributions in respect of pensions were at a very high level (29.9%), of which 71.2% were paid by the employer. High contribution rates provide disincentives to formalisation of the labour force. In July 2009, the pension contributions level decreased to 24.5%;

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2 Raiffeisen Invest, Sigal-Life Uniqo Group Austria and Credins Invest.
• There were disincentives in the benefit formula for people to declare their full wages or to work throughout their working age; high evasion and the declaration of income lower than the real income resulted in a reduced contribution base;
• There was an increasing number of the current pension beneficiaries, most receiving full pensions;
• There was a lack of benefits in the long term for those who did not pay contributions. Only about 46% of the current workers paid contributions; half of them were from the rural areas, and their contributions were nominal, not substantial;
• There would be an increasingly sharp decline in the maximum benefit stemming from linking of the maximum pension to inflation;
• There was relative over-generosity with respect to rural workers and pensioners; and
• The system was in deficit, even though 85% of the contributions with respect to farmers’ pensions were subsidised by the State budget.”

By 2012 it had, therefore, become clear that the Pillar 1 pension system was in urgent need of reform. The dependency ratio in 2012 was 1.18 contributors for each pensioner. The deficit of the scheme was very high with the likelihood of it increasing further in short and long term.

**VOLUNTARY PENSIONS**

The Albanian voluntary pension system, created by Law number 10197, dated 10 December 2009, comprises three pension funds, each of which are managed by a pension management company (PMC). PMCs are required to be subsidiaries of other financial institutions licensed in Albania. For the first few years, the Albanian voluntary pension system grew fairly slowly and had, by 2014, gained a little under 10,000 members and around USD 5 million in assets. The system has grown more rapidly thereafter. By September 2016, coverage stood at 15,957 members (54% of whom are females) while assets under management (AUM) had grown by nearly 80%, to USD 9.25 million.

Individuals could either join on their own account or be enrolled by their employer through a ‘professional pension fund’. By September 2016, 106 public and private sector employers were offering this option. Individual accounts were held under the custody of licensed pension depositories and pension savings were administered and invested by PMCs. Given the small size of pension assets, investments have thus far comprised only Albanian Government bonds and bank deposits.

The voluntary pension system is based on sound governance and a strong risk management framework for pension management companies. The custodian depositories use modern technology that enables the use of the national ID system. The scalable IT-based pension architecture is fully capable of servicing a large proportion of the population. The legislation has also been ‘future-proofed’ by harmonising it with the EU pension directive.
The slow growth of the voluntary pension system during its first five years was partly due to low employer and employee awareness, trust, and serious obstacles with claiming tax relief incentives. The more important reason for the initial slow growth of the voluntary pension system was the existence of the Pillar 1 system. Employers who were under-declaring employees or salaries for contributions to Pillar 1, were reluctant to participate in Pillar 3, as voluntary contributions to Pillar 3 could draw attention to non-compliance under Pillar 1. Hence, a reform to strengthen Pillar 1 compliance became a pre-requisite for expanding Pillar 3 coverage.

Without significant scale and a modest asset base, the voluntary system suffered from both high charges and low net returns that were only a little better than those delivered by bank deposits. However, with regulatory caps, the level of fees and charges in the initial years were lower than the fees achieved through similar reforms across Latin America, Europe and Central Asia (Price and Rudolph, 2013). Given the low returns available, the continuing involvement of sponsors of pension management companies in loss-making enterprises could not be guaranteed. After a review of the system in 2014, the World Bank and the Albanian Financial Services Authority (AFSA) concluded that low coverage was the biggest risk to the system in terms of delivering the outcomes that would be needed to ensure a decent old-age income for the people of Albania (Price, 2014).

THE REFORM PROJECT
AIMS AND ACTIONS

PILLAR 1 PENSIONS

Having recognised the fundamental challenges in the Pillar 1 system, the Social Security Institute, with support from the World Bank, embarked on a project to re-design the system and improve the prevailing system parameters. This reform would consolidate the contributory principle of the system, and, to some extent, reduce its high redistribution rate. It would do this by providing more incentives for individuals to join and be part of the social insurance system, as well as to improve their contributions by declaring their real wages. This was also expected to reduce the deficit of the pension scheme. The implementation of the Pillar 1 Reform commenced in January 2015 and comprised the following key elements:

1. Improving the current system parameters,
2. Revising pension arrangements for special groups of workers, and
3. Changing the retirement age.

Starting with the modification of parameters, the following changes were proposed, and in due course, enacted:

a. The pension formula was changed to \( P = B_a + S \), where ‘\( P \)’ is the amount of the monthly pension and ‘\( B_a \)’ is the basic amount, calculated as a product of the social
pension and individual years of insurance, divided by the necessary number of insured years defined in the law. In 2016, the necessary insured years stood at 35 years and eight months. These would increase by four months every year till they reached 40 years. ‘S’ is a supplement calculated at 1% of the average indexed wage over the entire career for every insurance year.

b. Indexation of pensions was limited to the inflation rate.

c. The administrative maximum pension ceased to be the pension ceiling.

d. The minimum contributory wage was unified with the official minimum wage, with the maximum contributory wage indexed to average wage increases.

e. The social insurance period was increased from 35 to 40 years, in phases, through 2025.

f. The retirement age for women would gradually increase by two months per year, to reach age 63 by 2032.

g. From the year 2032, the retirement age for men would be increased by one month per year, while for women it would continue to be increased by two months per year. Thus, the retirement age for both men and women was intended to be 67 years by 2056.

h. For women, privileges were eliminated with regard to the equivalent insurance periods without paying contributions by recognising the period of university studies as a period of insurance.

i. The retirement age was to be increased by five years for mothers with many children as well as for the widows who benefit from survivors’ pensions, with the retirement age for these categories fixed at 55 years.

j. The pension calculation and eligibility criteria for rural and urban pensioners was harmonised.

k. Actions were taken to discourage early retirement and to encourage postponed retirement by providing 0.5% of monthly pension as a bonus for every deferred month.

l. The eligibility criteria for the invalidity pension linked to work invalidity were strengthened, by requiring that the person must have made at least one year of insurance contributions within the previous five years.

m. All individuals who did not qualify for a contributory pension were to be entitled to a means-tested, State funded social pension. This social pension would be provided to those aged over 70 years and who were residents in Albania for at least the last five years. The social pension amount would be equal to the partial pension calculated by 15 years of insurance pegged to the minimum wage.

Second, the State supplementary pensions for constitutional functionaries including, among others, academics and military personnel, were revised in order to adjust the link between contributions and benefits as well as to reduce the State subsidy. The retirement age for members of parliament and ministers was increased from 55 to 60 years, with an
increase in the supplementary contribution rates by one percent of gross wage as well as modification of the benefit calculation formulae and methods.

Third, the retirement age for underground miners was reduced by five years (from 60 to 55) but with an increase in the contribution rate by 5% of the gross wage.

This reform guarantees the maintenance of benefits at a normal level and provides an important improvement, compared to the pre-reform scheme, with regard to financial sustainability and adequacy. In the pre-reform scheme, the replacement rate would have been decreased drastically from 36% to 6.2% by 2080. By contrast, the reform guarantees a replacement rate that would never fall below 30 percent. While this pension is not generous, it is expected to keep the elderly out of poverty while remaining affordable. Those who wish to receive a higher pension can do so by saving additionally through voluntary pension funds. Hence, voluntary pension funds can compensate for a reduction in pension entitlements, and thus make the reform more palatable to the general population.

VOLUNTARY PENSIONS

While supporting the reform of Pillar 1, a review by the World Bank in 2013-14 (Price, 2014) recognized that private pensions needed attention if they were to play the intended role of complementing the first pillar. In considering solutions, it was recognised that:

• Necessary individual, market and employer consensus, and experience did not yet exist to move quickly to any form of mandatory private pensions.

• Employers were seen as the most effective channel to raise voluntary coverage and enable a possible move to auto-enrolment. Employers were in a better position to negotiate lower fees and claim tax incentives. Also, PMC marketing to and through them would be more cost-effective.

• Increasing voluntary coverage would require higher public awareness and confidence in pensions – as developing an understanding and consensus for change would be central to durable reform.

On the basis of this analysis, the World Bank and the AFSA agreed to establish a two-year project, funded by the FIRST Initiative, to assist the Authority. This project was completed in May 2016 and had two components:

1. Strategies for expanding voluntary pension coverage, and

2. Improving supervision to enhance public trust in the voluntary system by implementing a risk-based oversight methodology, drafting amendments to regulations and the legislation, and providing guidance to the AFSA to support Outcome and Risk-Based Supervision (ORBS).

The project identified low coverage as the biggest risk in the pension system and that creating trust was a necessary, though not sufficient requirement for tackling this risk. It was essential to use the employer as a channel if an efficient voluntary (or mandatory in
the future) pension system was to be built. Individual voluntary pension accounts were commonly charged a fee of 3% of AUM – which was the upper limit prescribed by the law. While these fees were not very high, especially for a small, young pension system, it did not make much financial sense for many to use this system to save for their old age. However, one pension management company decided to levy a lower fee of 1.5% on assets – which was more acceptable to employer-sponsored pension plans. Combined with an employer contribution and reformed tax relief, this provided a ready platform for expanding voluntary pension coverage in Albania.

By focusing on employers, the strategy was to focus on widening the participant base so as to include a broader range of workers instead of only the higher income individuals who are the normal early-adopters of voluntary private pensions. Moreover, there was an explicit aim to develop an effective and secure voluntary pension system that would provide the experience, rationale, and credibility for bolder steps in the future. This is in contrast to some reform efforts where pension reforms were approved in advance of developing the regulatory and supervisory foundations (for example Mexico’s 1992 ‘SAR’ reforms)\(^4\).

The starting point for the project was the need for better information on the potential market. This was achieved through a ground-breaking survey, designed jointly by the project team, AFSA and the INSTAT. This survey provided statistics on the market and information on the understanding of employers and employees about pensions in general and voluntary pensions in particular. To expand coverage efficiently, it was essential to segment the market. The survey, therefore, provided the average annual salary (including bonus) per employee for each business activity be split into four size classes, with a range of the number of employees per company, highlighting those with a salary above the overall average salary.

Based on the survey, the following conclusions were drawn:

1. The level of knowledge of private pensions, among both employers and employees, was very limited, due to limited marketing of voluntary pensions.
2. Trust in financial institutions in Albania was below average.
3. The business climate and cost factors were important elements in limiting the demand for voluntary pension products.
4. The difficulty in claiming tax benefits on contributions prescribed under law had impeded the pensions’ market development, especially up until January 2015.

It was concluded that PMC’s needed to develop more proactive marketing campaigns and increase their efforts on acquiring new private pension participants, primarily through employers. An improvement in the delivery of fiscal incentives for pension products would also stimulate demand. Also, steps should be taken to raise public awareness of the

\(^4\) The 1997 reforms in Mexico were subsequently based on secure regulatory foundations.
security and benefits of pension products especially among individual employees. This would require a combined effort by the Government and AFSA.

The survey (AMF, 2016) was published, and its results were presented at a well-attended and publicized national conference organized by AFSA as a first step to raising employer and public awareness. Stakeholders at the conference highlighted the importance of building on the past reforms to public pensions with new measures to expand coverage of private pensions. This was expected to build a diversified pension system that would help Albania tackle more effectively important demographic and development challenges. The conference achieved its objective of raising awareness through extensive media coverage, including substantial coverage in national television and print media. In addition, the employers who attended the conference gained an improved understanding of the business case for private pensions.

The survey findings, coupled with the conclusions from the conference, enabled the project team and the Authority to prepare a voluntary pension coverage expansion strategy. This strategy identified several initiatives for increasing public awareness and coverage, including:

1. Increasing resources within the Authority dedicated to coverage expansion;
2. Commissioning a new, follow-on survey, including smaller, focused surveys aimed at specific groups of employers, employees, and professional groups;
3. Information dissemination sessions targeting employers and professional groups comprising 5 to 10 persons. (The first three of these were piloted as part of the project, and were well-attended and well-received);
4. Improved communication outreach and information dissemination through the Authority's website, including the publication of conference proceedings to highlight key issues, coupled with debriefing meetings with journalists, successfully piloted during the project;
5. Encouraging targeted interventions by pension management companies for expanding voluntary pension coverage using acquisition plans based on the 2015 survey results. Guidance material to facilitate marketing plans was provided to the PMCs;
6. To measure the success of such initiatives, outcome measures and targets were established and agreed upon including a focus on meaningful long-term outcomes for members, expanded coverage and an increase in AUM.

It was agreed that the Authority had to act decisively to enable the effective application of the law and administrative provisions governing tax relief on pension contributions which, when the project started, were not working effectively and had adversely impacted coverage expansion goals. The project team held several consultations with the Finance Ministry on relevant issues and the minister was invited to address the October 2015 conference. The project team also provided information on the structure of tax incentives as well as related administrative and implementation arrangements to the ministry. In early
2016, the Finance Ministry made relevant changes to the tax code so as to align it with the pension law. These changes were related to the ceiling on contributions eligible for tax benefits and the processes by which employers could obtain tax relief for their employees.

The Authority also adopted an Outcomes and Risk-Based Supervision model for pensions, based on a new manual for supervision, so as to build greater trust in the security of voluntary pensions and to improve system efficacy. The Risk-Based-Supervision Manual of voluntary private pension funds was approved by the Authority Board on 29 September 2016.

A recent change to the social security law, designed to stimulate private pension savings, has further streamlined and strengthened the relationship between the Pillar 1 reform program and voluntary pensions. This legislative change permits private and public sector employers the right to create co-financed professional pension funds that are based on collective agreement, closely akin to the occupational pension plans found in many other jurisdictions. These would take the form of professional (work-based) pensions as are already permitted by the voluntary pensions law. The Supervision of these schemes will be carried out by the Albanian Financial Services Authority.

**ACHIEVEMENTS AND EARLY OUTCOMES**

**PILLAR 1 REFORM RESULTS**

Implementation of the new Pillar 1 pension reform began in January 2015. The results over the following two years have been positive and in accordance with the prognosis and projections made in the design process. Some of the results are:

- Pension entitlements can now be accrued at a higher level than was possible under the previous law. For the first time, the entitlements are higher than the maximum administrative ceiling set under the previous law, thus providing a more equitable return in terms of pension entitlements from contributions paid over the years;

- The newly introduced social pension has been provided to around 2,300 people aged over 70 years who have zero or minimal other income. Social pensions for this cohort improve their finances and consequently their lives, and also reflects the care provided to the elderly by the social security system.

- The number of new pensioners in 2015, the first year of the reform, decreased by 1,632, due to the increase in the retirement age for women by two months per year and the change to the invalidity pension requirements.

- For the first time, the past trend of an increasing deficit has been reversed and a moderate reduction in the Pillar 1 pension scheme deficit was achieved. Although the reform effects will become more visible in the long-term, an immediate positive
impact on the scheme deficit is a very significant and promising signal for its future success and sustainability.

- Crucially, within a short period, the number of contributors has increased by around 180,000 members (20%). A corresponding improvement in declaration of real wages has been observed also, reflecting the importance of transparently linking contributions and pension entitlements.

- An overall improvement in the sustainability and transparency of the Scheme.

**VOLUNTARY PENSION RESULTS**

Between late 2014 and September 2016, the voluntary pension scheme had also witnessed a quantum jump in terms of both voluntary coverage (by 88%) and AUM (by 90%). This was largely due to an increasing number of employers (106 till date) that have established professional (work-based) pension schemes. There is also some evidence that PMCs have increased their own marketing efforts.

Anecdotally, trust in the system appears to be improving – employers and management companies that were spoken to at the end of the project said this was less of a barrier.

The employer tax reclaim system is now working effectively and in accordance with the law that stipulates that the contribution of the fund member, as well as contributions made by the employer, are considered deductible from taxable income up to a specified limit. Returns on investment are exempt from tax, while benefits are taxable under personal income tax law. Feedback from PMCs and employers indicates that the administrative improvements needed to make the law effective have worked as intended. Difficulties, however, remain for self-employed and other individual contributors trying to reclaim tax on contributions. Actions in this regard, including steps to improve access by the informal sector and other desirable enhancements have been the subject of continued dialogue between the Authority and Ministry of Finance.

**REMAINING CHALLENGES**

Although the Pillar 1 reform has addressed many of the problems originally identified, certain immediate and some longer-term challenges for the first pillar remain.

For example, participation in the compulsory social insurance scheme by the self-employed in the agricultural sector is low. This is due to several factors including small farms, which are often non-productive, and behavioural issues around retirement savings. Another obstacle is the rules that require a gradual increase in the requisite contribution amount from farmers, until it equalizes the urban self-employed contribution levels.

Another important challenge is related to emigration that had been denied to the Albanian population during the prolonged communist rule. In the 1990s, upon dissolution of the
state enterprises and agricultural cooperatives, extensive migration served as a safety-valve to ameliorate the grave social and economic problems of the country. A third of the overall population, mostly younger workers registered in the National Registry, have now emigrated. As the financing of the first pillar is based on a PAYGO principle and inter-generational solidarity, a high level of youth emigration has created significant problems in financing the scheme. Under these circumstances, it is very important that social security coverage be extended to migrant workers and appropriate mechanisms be established so that pension benefits accumulated in different countries can be aggregated for entitlement to pension benefits. Yet, instituting such mechanisms is difficult.

The Albanian Government has, therefore, been actively involved in negotiating bilateral social security agreements and processes with several countries. These would provide the acknowledgement and aggregation of the social insurance periods of migrants. Albania already has effective social security agreements with Turkey, Belgium, Hungary, Macedonia, and Luxembourg. In addition, there are agreements with countries that have entered the ratifying process, including the Czech Republic, Germany, and Romania. Agreements concluded with Austria and Canada are presently under the signature procedure. The government has also initiated negotiations with Kosovo. Accession to the EU will, along with the rights as a Member State, entitle Albania and oblige EU countries, to establish bilateral social security agreements between them, and, consequently, enable the aggregation of social insurance periods required for the provision of entitled benefits to migrant workers and their households.

The work-related disability benefit provisions need to be revised in order to provide this benefit to people who genuinely are too disabled to work and to reintegrate them in the labour market after training and rehabilitation. This challenge encompasses also the equal treatment of all disabled persons. Invalids, who have been in employment and have paid contributions into the social security scheme (that in turn helps determine their level of eligible benefits), may sometimes receive lower benefits than disabled persons who have never worked and who could receive a more generous, flat-rate benefit financed from the State budget.

For voluntary pensions, the major residual challenges are centered on (a) overcoming the continuing lack of awareness and resistance to participating in voluntary pensions and; (b) delivering higher risk adjusted returns by reducing the fees charged by PMCs and improving their investment sophistication and diversification especially as the volume of pension assets grows. The Authority will, therefore, need to continue its efforts at voluntary coverage expansion and on maintaining the security of the system as well. As voluntary participation and public confidence in the system grows, the foundations are being laid for further coverage expansion – either through auto-enrolments or by mandate. The challenge will be to make such an initiative publically acceptable. Improved returns on pension assets may also have a positive impact on coverage and persistent contributions. However, improving net returns would depend in part on the development of effective domestic financial markets and other suitable investment opportunities. All this would take
time. And it would involve sustained efforts on changing public attitudes.

The high level of informality in Albania places a fairly modest upper limit on voluntary pension coverage through employer-sponsored private pensions. This problem has been arrested to a certain extent as recent Pillar 1 reforms, that have addressed the traditional challenge of employers under-declaring employees and salaries, have helped reduce informality. However, sluggish economic growth restricts the funds available for pension contributions by employers. The current ceiling on tax relief for contributions (USD 1,600 a year) also makes voluntary pensions less attractive for employers. A higher tax-relief on contributions, as well as a removal of tax on pension benefits during the pay-out phase is now being considered and is expected to have a positive impact.

As highlighted in Box 12.1, it is important to integrate pension coverage and financial inclusion initiatives. Going forward, it will be necessary for the voluntary pension system to actively leverage digital financial inclusion infrastructure in providing secure and convenient access, as well as lower costs of contributions collection and benefits delivery. Equally, the Albanian pension system could benefit vastly from the experience, expertise, and innovation of mainstream financial institutions in asset management, distribution, and governance. Such a strategy would enable Albania to address the challenges of low coverage and informality more effectively than would be possible with a more ‘traditional’ approach to pension reforms and implementation. In this context, the ideas reviewed in the thematic and country chapters in this volume provide a road map that could be taken forward in Albania.

**Box 12.1**

**Financial Inclusion in Albania**

Financial inclusion in Albania is significantly lower than in the surrounding countries. In 2014, only 38% of the adult population had a bank accounts (and 8% had some formal savings) compared to 60% and 72% of adults with a bank accounts in Montenegro and Macedonia respectively. Banking access has even higher rates in some neighbours such as Greece and Italy. This is in part a reflection of relatively low levels of formal employment and places limitations on the scope for work-based pensions to gain wide coverage. A mobile payments platform like M-PESA could serve as a vehicle for extending financial inclusion, especially given that mobile penetration is 100% in Albania. M-PESA was launched in Albania in May 2015. Mobile payments could be a more effective tool for collection and disbursement of pension contributions and benefits if a sufficiently accessible electronic payments infrastructure was supported and integrated with a biometric national ID.

**DATA AND ID**

Albania has implemented a national ID with embedded biometric data (finger-print recognition) to help uniquely identify citizens. In addition, the Social Security Institute has now digitised its records, putting all the previously paper-based records in an
online system that allows members to view their records. This means that important ground-work has been laid for the kind of unique identification, tracking and interoperability that will ultimately be needed if some of the innovations highlighted in other chapters in this book volume are to be introduced in Albania.

BANKING AND PAYMENTS

Albania has been developing its banking and payments infrastructure in recent years. Vodafone and its M-PESA mobile payment platform have recently begun operations in Albania. Thus far however, bank charges for payments and transfers have remained relatively high with minimum charges of USD 1.60-3.90 for inter-bank transfers and cash withdrawals within Albania. However, electronic banking is becoming increasingly important as 14 out of 16 banks offer this service to their customers, which provides encouragement for further digital finance innovations.

FUTURE DEVELOPMENTS

The pension inclusion strategy pursued thus far has been to develop a more robust foundation for the pension system, and focusing on coverage expansion through employers and tax incentives. Building on such foundations makes sense as a precondition for a broader expansion. Leveraging digital financial inclusion infrastructure for pension coverage expansion could be pursued in the next wave of reform. However, the issue of high transaction charges and the continued difficulty for individuals (as opposed to employers) claiming tax relief on individual contributions, could prove to be important obstacles.

LESSONS LEARNED

The key lesson to be learned from Albania’s pension reform is that improving pension inclusion will often involve a range of complementary initiatives. In this case, sustainable improvements to pension inclusion depended on parametric changes that potentially limited Pillar 1 retirement incomes for higher income workers. This change could only be made publically acceptable because of the availability of voluntary pension products to supplement Pillar 1 pensions for higher earners. This strategy has so far proved effective. However, the adoption of voluntary pensions by employers has been slow because of issues related to awareness, trust, domestic financial markets, and resistance from employers due to difficulties in claiming tax benefits. Each of these issues had to be addressed for the whole system to work effectively.

The current and future demographic challenges faced by countries such as Albania, along with slow economic growth and consequent budget constraints, make it difficult
Pension Reforms And Voluntary Coverage Expansion In Albania

for a Pillar 1 pension system to adequately fulfil the retirement needs and expectations of all citizens. It is necessary that working age citizens should, as far as possible, start to save money during their active years for a better life in old age. The best way to save money and to maximise returns is to participate in both the public and privately funded pensions. Such behaviour would improve the life of plan participants, reduce the cost for society as a whole and avoid over-burdening the State budget. Everyone, and especially governmental agencies, need to work hard to communicate this message.

Albania’s voluntary pension program has demonstrated that an approach based on robust evidence, coupled with awareness raising activities, can improve voluntary pension coverage despite strong adverse factors. It also shows that tax relief incentives for pension saving will only work if the practicalities of implementation receive sufficient attention and that achieving this may require a multi-agency approach drawing on international experience. A strong pension system needs well-functioning financial markets. The voluntary pension proposition is much easier to communicate if funds are seen to be delivering attractive net investment returns.

Finally, trust is the prerequisite for any pension system. Trust takes significant time and effort to build but is very easy to lose. Employees and employers need to trust that contributions to a Pillar 1 system will result in increased retirement income and that private pension funds are secure regardless of the survival of the fund administrators. Otherwise, there will be wide-scale avoidance of mandatory contributions that in turn impacts any complementary occupational system. The development of this trust required changes to Pillar 1 to make it fairer, coupled with visible measures to enhance private pension security.

REFERENCES


PENSION INCLUSION IN INDONESIA

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SENIOR INTERNATIONAL SOCIAL SECURITY EXPERT

STEVEN TANNER
CHAIRMAN SOCIETY OF ACTUARIES OF INDONESIA (FSAI), INDONESIA
INTRODUCTION

Indonesia is the fourth most populous nation with approximately 260 million people, of which about 100 million are living cheek by jowl on the island of Java and the rest scattered between 7,000 inhabited islands north and south of the equator. There are 34 provinces and 415 districts over a distance of 5,120 kilometers from east to west, comprising three time zones.

A new law (40/2004) was adopted in 2004 to create a National Social Security System (NSSS or SJSN) stipulating five programs: Universal Health Coverage (UHC), Defined Benefit Life Pensions, Old Age Savings (OAS), Workers Accidents & Disability benefits (WC), and Funeral benefits. The implementation has been a long process and the first program was launched on 1st January 2014 providing UHC benefits. The other four programs were launched on 1st July 2015. This chapter focuses on the Pension and OAS programs that are relevant to pension inclusion.

The demographic context is favourable, the IT infrastructure and financial services are well developed and widely accessible. However, various factors contribute to a low pension inclusion level, in particular a large informal sector and within the formal sector the dominance of micro and small business units.

In this chapter we first document the context in which Law 40/2004 was adopted; then the context in which the programs were designed before implementation in 2014-15; third, the history that explains the long path to implementation; before looking at the results; and finally, what lessons we can learn from both the successes, or lack thereof.

DEMOGRAPHIC AND ECONOMIC CONTEXT

Demographic data points to decreasing fertility, increasing life expectancy, slowing population growth, and gradual ageing, all of which makes pension inclusion a timely challenge. Fertility has decreased from about 5.5 children in the 1950-70 period to less than 2.5 at the turn of the century. It is expected to stabilize at 2.1, barely enough to renew the population. According to 2010 UN medium projections the total population is expected to rise slowly to about 300 million by 2050, peak and then remain close to that level.

Decreases in infant mortality were an important boost to longevity but in recent years the increase is more from mortality reductions at older ages. Life expectancy at birth jumped from 67.3 to 73.9 between 2000-2005 and 2020-2025 but is only expected to increase to 77.4 in 2045-2050. The difference between male and female life expectancy increased from 4.5 to 4.7. However, for pension programs mortality and life expectancy at higher ages are more important. At age 65, life expectancies for the same period increased from 13.5 to 15.1 and 16.8. The male/female differential increased from 1.5 to 2.3 and 3.6 respectively due to lower increases in life expectancy for males.
THE EXPECTED DEMOGRAPHIC BONUS

At the time pension design was a work in progress and the net results of these forces had built a favourable demographic outlook.

In the short term there is a beneficial effect because the reduction in child dependency ratio reduces the burden that the working population must support before longevity impacts kick in. For a few years the country could afford to take care of the older vulnerable people and invest in infrastructures more easily that will help a decreasing active population, support future higher dependency ratios. Indonesia is burdened by low pension ages and thus has lots of room to reflect on increasing longevity and further increase the GDP as needed to care for a larger elderly population.

THE GROWTH OF OLDER AGE GROUPS

As a matter of fact, the changing shape of the pyramids and the increasing elderly dependency ratio points also to a rapid increase in the number of people surviving to higher ages. The pyramid then morphs into an ice cream cone! The evolution of the fraction of the population at higher ages is further examined in Table 13.1. Other countries faced with the same challenge have responded by increasing the retirement age, (better called the entitlement age), to encourage people to remain longer in the work force. In short, living longer calls for working longer. It has potential impacts not only on the

<table>
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<td>2.3</td>
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</table>
work force, the dependency ratio, and the growth of the economy but also on poverty and inequality since in the absence of inclusion, people leaving the labour force are exposed to a decrease in their purchasing power.

**POSITIVE ECONOMIC INDICATORS**

Economic indicators for the period following the adoption of Law 40 in 2004 to the years where the design of the SJSN programs took place show a generally positive context.

**Figure 13.1**

**Economic indicators 2004 - 2013**

![GDP Growth %](chart1.png)

![% Inflation](chart2.png)
GROWING MIDDLE CLASS

In the period leading to discussions on the design and implementation of social security programs, employment in the formal sector has been growing and unemployment decreasing. The labour force varied from 115 to 121 million and only about 35% is in the formal sector, but that percentage is increasing with urbanization. So when the UHC program was launched on 1st January 2014 and the pension program on 1st July 2015, they benefitted from a favourable context despite the 2008 economic crisis. In 2011 the World Bank estimated that between 2003 and 2010 about 50 million people joined the middle class. A majority of them (38.5 m) were from the lower middle class with average per capita expenditures between 150% and 300% of the poverty line.

INCREASING MINIMUM WAGES

Rising incomes put high pressure on minimum wages and large increases have been negotiated in key regions. A low level of scolarization has an impact on the distribution of
wages, which is very concentrated at the low end, with most workers receiving little more than the stipulated minimum wages and sometimes less.

INCREASING DISPARITIES

In 2011, the national poverty rate was estimated at 11%, but this hides major inequalities. Thanks to higher minimum wages the poverty rate was only 4% in the capital, Jakarta, but 28% in the distant easternmost Papua province. 43% of Indonesians live on less than USD 2 a day. So while growth across the board has reduced poverty it has also increased inequality. Available data on poverty and inequality shows mixed results but since 2008 all measures of poverty have declined.

Table 13.2
% In higher ages increasingly rapidly

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<td>30.02</td>
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<td>12.86</td>
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<td>P1</td>
<td>2.77</td>
<td>2.50</td>
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<td>P2</td>
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<td>18.97</td>
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<td>Poverty rate (PO)</td>
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<td>P1</td>
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<td>10.65</td>
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FINANCIAL INCLUSION
INFRASTRUCTURE

Indonesia has clearly entered the digital era and is progressing rapidly towards digital maturity both in the public and private sectors. The country took advantage of good timing to skip the cheque era and go directly from rolls of cash to electronic transfers
and online banking. There are no paper invoices for electricity or telephones – one simply
inserts the bank card in an ATM, check the amount due, and transfer the payment online.
Similarly, cellular phones have pre-empted the need for expanding what would otherwise
be an inadequate landline network.

THE PALAPA RING
The Palapa Ring has been on the agenda of Indonesian authorities since the late 1990s.
The project, which is the first government-to-business cooperation scheme within the
nation's telecommunications industry, involves a vast undersea fiber-optic cable network
that stretches across some 13,000 kilometers as well as an onshore network of nearly
22,000 kilometers.

The main aim of the project is to provide fast broadband Internet to all Indonesians, in
both urban and rural areas. The whole project (west, central and east sections) should be
completed by 2019.

UTILIZATION
According to the Indonesian Internet Service Provider Association (APJII) there are
currently 132.7 million Internet users in Indonesia, or approximately 51.8% of the total
Indonesian population. These figures, which are the result of a survey, are much higher
compared to 2014 when APJII data showed that there were 88 million Internet users in
Indonesia. Meanwhile, APJII confirmed that about 70% of Indonesian Internet users use
mobile devices to access the Internet.

FINTECH PEER-TO-PEER (P2P) LENDING
Building on the high penetration and robust network the Palapa Ring will provide, the
financial regulator, Otoritas Jasa Keuangan (OJK), has issued a state-of-the art regulation
in December 2016 to provide a clear legal framework supporting the growth of digital
financial transactions, Fintech and Peer-to-Peer (P2P) Lending, to ensure their security and
protect the consumers. This development is particularly important to support inclusion
given the geography of Indonesia.

FINANCIAL AND OTHER RESOURCES

Once Law 24, creating the implementing bodies, was adopted in 2011 the focus shifted to
the design of the programs. Despite some limitations, Indonesia offered a very favourable
ccontext for achieving pension inclusion. The macro-economic indicators were positive
and have remained so until now. Inflation was also under control and the MoF inflation
assumption for the 2017 budget is 4% down from 4.7% in 2016.

1 Regulation 77/PJLK.01/2016.
More importantly, from the point of view of capacity to contribute, the data on the growth of GDP per capita is a strong positive indicator. The 2017 macro-economic assumptions for the national budget by comparison with 2016, sum up a review of macro-economic indicators. Thanks to a healthy GDP growth and a good fiscal discipline limiting the growth of debt, the debt to GDP ratio was down to 23.2% in 2013. It has increased to 27% in 2015 and the 2017 MoF budget projects a range between 27% and 30% in 2020 depending on GDP growth and infrastructure investments.

FINANCIAL SECTOR

Looking back to 2004, when the National Social Security System law was drafted, financial markets were still under-developed. Banks dominated the financial markets comprising almost 80% of assets that in aggregate amounted to IDR 1,844.5 trillion, 67.6% of GDP. Figure 19 summarizes the structure. Comparative figures in 2015 demonstrate significant growth, but the continued dominance of the banking sector still controlling 78.3% of assets, (IDR 6,021 Trillion) versus IDR 1,669 Trillion for NBFIs. In terms of percentage of GDP the total was 66.6% versus 67.6% in 2005.

Indonesia’s equity market was also, relatively small, highly concentrated and relatively illiquid. By the end of 2005 the number of companies listed on the Jakarta Stock Exchange had reached 336 versus 238 10 years earlier. Market capitalization stood at IDR 801 trillion, 29.4% of GDP, which is a lower level by comparison with other Asian countries.

Thus, there was great interest in the development of the non-bank financial sector and pension funds were deemed a potential contributor. The decision to create a new integrated financial regulator had been taken and the supervisory role of Bank Indonesia was about to be transferred to the new Supervisory Market Authority, OJK. The central bank, Bank Indonesia, continued to carry a three-fold responsibility as the monetary authority, regulatory, and supervisory authority for the banking system and payment system.

BANKS

There are 120 commercial banks in Indonesia (four state owned banks and 117 private banks). There are probably more banks than necessary in Indonesia but the small depositors are well protected by a Deposit Insurance Institution (LPS) that guarantees deposit of up to IDR 2 billion (about USD 150 000). Many banks offer both conventional and Islamic banking units (syariah products.)

Banking services are accessible through branches and ATMs that are now widely distributed outside the bank’s own premises. In addition to these banks, Indonesia also offers access through 1,631 rural banks comprising 6,081 branches. The IMF Financial Access Survey compares the number of points of service per 100,000 adults and the latest survey shows that Indonesians enjoy relatively good accessibility.

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2 The monthly average exchange rate for the USD in IDR varied between 13,871 and 13,020 in 2016 and 13,366 to 13,303 in 2017 up to August that shows a monthly average of 13,336. At that rate IDR 1 million equals USD 75 and IDR 1,000 trillion equals USD 75 billion.

3 Unlocking Indonesia’s domestic financial resources, World Bank Jakarta Office, December 2006.
OJK, THE INTEGRATED FINANCIAL SUPERVISORY AUTHORITY

OJK is an autonomous Indonesian government agency that regulates and supervises the financial services sector to ensure it is working in an orderly, fair, transparent, and accountable manner. It protects the interests of customers and society. Stability and growth are its two key objectives. It is self-financing from levies payable by supervised financial institutions, and designed to be free from interference. It succeeded Bapepam-LK in 2011 when it took over the role of regulating and supervising the capital market and financial institutions, as well as that of Bank Indonesia a few years later, in regulating and supervising banks. Its role includes protecting consumers of the financial services industry. Financial inclusion is an express mandate and a key performance criteria.

In addition to banks, the main financial institutions are the Jakarta Stock Exchange, the insurers comprising Life, non-Life and Re-insurance companies, Finance companies, Asset management, Pensions Funds, Mutual funds, and two major social security administrative agencies (BPJS).

Scope of OJK Supervision:

- Financial soundness
- Implementation of good corporate governance
- Investment management and performances
- Risk Management and control system
- Financial fraud detection
- Asset Liability valuation
- Compliance and law enforcement
- Transparency and public disclosure
- Customer protection
- Collectibility ratio
- Systemic impact monitoring

INDONESIA STOCK EXCHANGE

Prior to 2007, Jakarta Stock Exchange or, Bursa Efek Jakarta, was a stock exchange based in Jakarta, Indonesia, before it merged with the Surabaya Stock Exchange to form the Indonesian Stock Exchange. (IDX or BEI)\(^4\).

The 2015 annual report shows that the IDX comprises 521 equity issuers and the stock market capitalization was recorded at IDR 4,872.70 trillion by the end of the year, down 6.8% compared to 2014 when it had reached IDR 5,228 trillion.

Figure 13.2
Market Capitalization and Jakarta Composite Index (JCI)

**(dalam trilliun Rupiah)**
**(in trillion Rupiah)**

![Market Capitalization and Jakarta Composite Index (JCI)](image)

Table 13.3
Trade Summary December 30th 2016 16h00 WIB

<table>
<thead>
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<th>Description</th>
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<th>Value</th>
<th>Frequency</th>
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<td>40</td>
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<tr>
<td>Stock</td>
<td>16,958,450,459</td>
<td>9,551,001,927,583</td>
<td>211,750</td>
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<tr>
<td>Warrant</td>
<td>228,923,376</td>
<td>76,390,075,366</td>
<td>835</td>
</tr>
<tr>
<td>Total</td>
<td>17,190,089,435</td>
<td>9,629,086,666,249</td>
<td>212,625</td>
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</tbody>
</table>

INSURANCE COMPANIES

It is important to note that 45 life insurers and 85 non-life insurers compete to serve Indonesian business units and other entities. Contrary to bank deposits there is no institution guaranteeing insurance products or the solvency of insurers. However, insurers are subject to public supervision by OJK and must comply with quarterly reporting requirements.
All insurers must maintain assets equal or greater than their liabilities plus a risk-based capital minimum as a safety margin both calculated in accordance with sound actuarial principles by an actuary who is a fully qualified member of the recognized Indonesian professional association that is a full member of the International Association of Actuaries.

The penetration and density of insurance products in Indonesia is growing rapidly but is still low, not for lack of accessibility but for cultural and other reasons. According to a survey presented at the OECD Asia Regional Seminar in Bangkok in January 2012 the utilization has evolved as follows:

Figure 13.3
Insurance Penetration and Density

PROFESSIONAL SUPPORT

An essential element of pension inclusion is of course pensions, more precisely life pensions that provide an income as long as the retiree survives and often a continuing reduced pension to surviving dependents, especially the spouse. Life pensions in Indonesia are technically life annuities, a product based on the probability of surviving (longevity) and interest returns. Annuities are a more efficient way to provide income for life by pooling mortality experience and channelling the funds to income rather than inheritance. Pricing of annuities must take into account future decreases in mortality and fluctuation in returns on assets, that should be based on sound actuarial calculations. Actuaries play an essential role in design and pricing of pension programs, private or public. They are responsible for reporting on the solvency and sustainability of the programs.

The association of actuaries in Indonesia called Persatuan Aktuaris Indonesia (PAI) comprises over 224 Fellows and 256 Associates. Over 700 students pursue actuarial studies and a few universities offer such courses. PAI was established in 1964 and became a full member of the International Association of Actuaries (IAA) in 2006. Actuaries are bound by professional standards, a code of ethics, and must follow a Continuing Education Program.
MORTALITY TABLES

The PAI in Indonesia, has been promoting the preparation and updating of mortality tables for individual and group life insurance policies. The most recent is TMI 2011 updating TMI II released in 1999. It is based on wider experience data and was developed at the request of the Association of Life Insurance companies by a team of Indonesian actuaries, coordinated by the PAI with the support of Swiss Re and Bapepam-LK the predecessor of OJK. However, there is not yet a specific table for Indonesian annuitants. The annuity market is still in development and insurers have been using external mortality tables like the US GAM83 with adjustments. Although a large amount of experience has been gathered from the Civil Service Pension (CSP) program created in 1969 it seems that no reliable data is available for recent retirees. For the 2012 study of the CSP the table used has been the United Nations Population table that includes projections of future decreases in mortality that result in increased longevity. 

Mortality is highly correlated with education levels, income, as well as access and proximity to medical services. On these three accounts Indonesian civil servants are largely favored over the general population. They are better educated, have higher and more regular income than the average Indonesian worker, and live mainly in urban areas where hospitals and other medical care facilities are generally accessible. Civil service working conditions are generally healthier than that of many other categories of employment.

In-house mortality tables have been prepared by both PT Taspen and PT Jamsostek, as administrators of large pension and savings programs, respectively covering public and private sector workers, but the process has not been documented and the tables have neither been validated nor reviewed by peers. The PT Jamsostek mortality experience comes from the savings program. Since the program only pays a lump sum at termination or retirement, thus mainly before age 56, no data is available for ages above the pension age. It is expected, however, that in the near future mortality tables for Indonesian annuitants based on an analysis of the progress of longevity in Indonesia will become available. Recent trends point emphatically towards the inclusion of an analysis of mortality by level of income.

TAX COVERAGE AND TAX INCENTIVES FOR SPECIFIC FINANCIAL PRODUCTS

Income tax levels are low in Indonesia especially at low income levels. There has been a significant reduction from 2015 to 2016 due to an increase in basic exemption most likely related to significant increases in minimum wages. Indonesia uses a “final tax” system whereby employers withhold tax and employees do not submit tax returns unless they have other income or can claim a reimbursement. This is an efficient modern approach but there were only 27 million registered tax payers for a labour force numbering about 120
Pension Inclusion In Indonesia

As demonstrated by the review of the demographic and economic context, and the existence of a robust infrastructure facilitating access to financial products, pension reform in Indonesia benefitted from a favourable context. However, there were a few impediments to overcome.

LEGACY ISSUES

The OAS administered by PT Jamsostek on a profit making basis was a savings program that paid no retirement pension, only lump sums at the termination of employment, retirement being the last termination. Since the Old Age Savings program was not providing social protection in old age there was no real social security programs in place in 2004. Thus, there was no legacy of unfunded liabilities since the benefits were a return of accumulated contributions. Contrary to many other countries, the drafting team did not face the challenge of reforming an existing system having accumulated a large Implicit Pension Debt (IPD).

However, it did not start from an entirely clean slate:

• very low pension ages embedded in public programs and in the public savings program for private sector workers

For a registered pension program the EET rules apply meaning contributions are deductible, returns on assets non-taxable but payments taxable. The same rules should apply for the SJSN pension and savings program. In comparison with developed countries the preferential tax treatment does not provide a very strong incentive to contribute:

• tax rates are 0% for a large tranche of workers due to high basic exemptions
• the “final pay” approach does not make the tax deduction very visible.
• transfers out of a pension program to purchase an annuity are taxable

The reality is a bit more complex in that some payroll divisions do not bother with adjusting the withholding and not all assets are eligible for the exemption on returns. But on the positive side PP No68/2009 stipulates a special lower tax rate for pension payments as follows:

• 0% until IDR 50 million
• 5% above IDR 50 million.

That does not create a tax preference at low levels of income but it may motivate higher paid taxpayers to contribute.

IMPEDEMENTS TO PENSION REFORM

million. Less than 10 million taxpayers filed an income tax return in 2014 and less than 1 million paid tax.

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• 0% until IDR 50 million
• 5% above IDR 50 million.

That does not create a tax preference at low levels of income but it may motivate higher paid taxpayers to contribute.
• the existence of a public program paying lump sums was an insuperable precedent, especially in the regional ASEAN context
• the legacy of an existing SOE administering similar benefits proved to be a serious organisational impediment to a clean start for the administrative bodies tasked with implementing the new National Social Security System;

In addition to legacy issues there are two external impediments worth mentioning:
• high severance pay on termination including retirement
• a large number of very small business units.

LABOUR LAW #13 SEVERANCE PAY

Severance benefits are payable under several articles of the Labour Law. In the absence of pension programs or unemployment insurance, electoral cycles in 1996, 2000, and 2003 pushed severance benefits to expensive levels, increasing significantly payroll costs. Although it is not mandatory to capitalize the promises, accounting rules require an evaluation and the reporting of liabilities in financial statements, adding to the compliance burden.

While these are not pension benefits, they represent a substantial long term financial burden for employers. Estimates of the average incurred expenses converge around 7 or 8% of the payroll but actual costs can vary depending on the causes of termination and the distribution of the labour force.

Moreover, much like the National Old Age Benefits Scheme, they provide lump-sum benefits at termination of employment, including retirement. Workers complain that in many cases they are not paid. It could have been a win-win situation to address the issue of harmonization or integration of these benefits within the new national system but contrary to earlier expectations Law 40 did not.

The difficulty was left for the design stage as anticipated in the White Paper in these terms: “When the SJSN pension program is introduced, the severance pay program under Labour Law No. 13 should also be amended. Currently the severance pay program is being used to provide unemployment compensation and a lump-sum pension benefit. Once the SJSN pension program is introduced, the severance pay program will be needed for unemployment compensation only.” 7

SMALL & MICRO BUSINESS UNITS

Official data allocates over 1/3 of the labour force to the formal sector. However, the distribution includes a very large number of workers in micro/nano business units. And, from the practical point of view of collection and enforcement these very small business unit workers, even if salaried, are like informal sector workers or self-employed. The split between employee and employer contributions would be virtual especially for an owner/spouse business unit.

Table 13.4
Labour force fragmentation

<table>
<thead>
<tr>
<th>Category</th>
<th>Business Units</th>
<th>Workers</th>
<th>Workers/ unit</th>
<th>Percent Workers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Micro</td>
<td>57,199,292</td>
<td>104,624,466</td>
<td>1.8</td>
<td>88.90</td>
</tr>
<tr>
<td>Small</td>
<td>654,222</td>
<td>557,023</td>
<td>8.5</td>
<td>4.73</td>
</tr>
<tr>
<td>Medium</td>
<td>52,106</td>
<td>3,949,385</td>
<td>75.8</td>
<td>3.36</td>
</tr>
<tr>
<td>Large</td>
<td>5,066</td>
<td>3,537,362</td>
<td>698.3</td>
<td>3.01</td>
</tr>
<tr>
<td>Total</td>
<td>58,900,787</td>
<td>117,681,244</td>
<td>2.0</td>
<td>100.00</td>
</tr>
</tbody>
</table>

Source: State Ministry of cooperative and small and medium-size enterprises. Author calculations

HISTORY OF SJSN PENSION REFORM UNTIL JULY 2015

Although the 1945 constitution as amended (articles 28H & 34) did promise social security for all, the pension programs created in 1969 covered, for decades, only government employees (civil and military), employees of state-owned enterprises, and a few large employers. The pension age for most civil servants remained frozen at 56 until 2014 when it was raised to 58, a timid adjustment still short of reflecting longevity increases.

For good reasons priority was given to health coverage. A basic program was started in the 1960’s but it was only in 1984 that it was expanded to cover employers of 10 or more workers for health, accident, life insurance, and some retirement coverage in the form of Old Age Savings (JHT). Performance did not meet expectations and compliance remained extremely low even after it was reorganized, made mandatory, and renamed Jamsostek in 1992. It barely covered 25% of private sector salaried workers and a lower percentage of payrolls due to under reporting. There was no real attempt to implement OAS in the informal sector except for construction workers.

A modern pension law was also adopted in 1992 that included tax incentives for voluntary pension programs in the private sector. It was opened to both formal and informal sector workers via defined contributions programs managed by financial institutions, but it never achieved a satisfactory level of coverage even in the formal sector. This was due in part to

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8 Article 28H: (1) Each person shall have the right to live in physical and spiritual prosperity, to have a home and to enjoy a good and healthy environment, and shall have the right to obtain medical care. (2) Each person shall have the right to receive facilitation and special treatment to have the same opportunity and benefit in order to achieve equality and fairness. (3) Each person shall have the right to social security in order to develop oneself fully as a dignified human being.
competition with the Jamsostek mandatory old age savings program providing lump sums, Law 13 severance benefits, more favourable tax treatment for mutual funds, and in part due to the financial crisis that hit Indonesia in 1997-98. Other contributing factors were, the low retirement age and generous benefit formula enjoyed by the public sector created expectations that could not be matched in the private sector while confidence in long term financial promises was low due to prior currency devaluations.

The participation estimated for mid-2015 can be seen as a baseline from which to measure future growth in coverage or progress in the inclusion. However, the data is a mixed bag of Defined Benefits (DB) and Defined Contributions (DC) programs offering different levels of benefits, in majority payable as a lump sum, thus offering no real social protection in retirement. Only a minority of participants had pension coverage: the 5.4 million civil servants plus a majority of the 3.6 million members of Employer Pension Funds.

A LONG ROAD TO PENSIONS FOR ALL

The origin of the current legal framework is a Multipartite Committee created at the request of the Parliament in 2001, hosted by the Office the Vice-President and mandated to draft a new National Social Security Law. The formation of the Committee created a climate of uncertainty not conducive to the development or even the continuation of existing pension and private savings programs.

In the context of 2001, developing the financial sector was a priority and the mandate was expanded to include pensions as well as old age savings for both the formal and the informal sectors. A draft law was submitted to Parliament in January 2004. It stipulated five programs, hotly debated and amended several times but remained incomplete. It became an electoral tool and was signed into law by the President on 19th October 2004 in an unprecedented high-profile ceremony on her very last day in office.

A VERY SPECIAL CONTEXT: DESIGN COMES LAST

The original draft SJSN law, as it is known by its Indonesian acronym, empowered existing state monopolies to collect and administer assets but had been watered down for political convenience. Although it was meant to provide “social” programs for the population it was an empty framework neither stipulating contributions nor, except to a limited extend for health coverage, benefits and eligibility conditions. There had been no preliminary studies or actuarial estimates and no White Paper circulated to help with the building of a national consensus.

Thus, implementing Law 40 required the drafting and adoption of a number of Presidential and Government regulations to stipulate the amount of benefits, the eligibility rules, and the required contributions for each of the five programs. Clarifications were needed with regards to the transition from existing programs and the harmonization with continuing private occupational programs. But more importantly it required the adoption of a law, latest in 2009, to create the administrative body (ies) that would manage programs yet to be designed.
For the new President who took office in 2005 the SJSN programs were not a priority and the Advisory Council was not appointed until 2008. Although some work continued to be done, little progress was being made on the critical issue of drafting the law to restructure the entities that were granted a monopoly by Law 40 to become the administrative bodies in compliance with the new legal requirements. The source of the difficulties was the infighting for the control of the funds and the political difficulties since the newly decentralized districts saw the creation of national monopolies as an indirect way to re-centralize delegated powers. Thus, the law creating the implementing bodies, known as BPJS, was not adopted before 2011. The programs were to be stipulated by Government Regulations yet to be drafted and retrofitted to the newly created administrative structure.

This long period that lasted over 10 years, during which the economic and political context evolved, was not used to reach a consensus on the benefits packages and the way to finance them. Even though actuarial studies became available as early as 15th May 2005, much of the debate focused instead on how to split the expected contribution cash flows and the resulting assets. It was a long period of uncertainty for enterprises already sponsoring a private pension plan and it obviously provided no incentive to expand or to launch a private pension program.

PUBLIC SECTOR PARTICIPATION STILL AT PLAY

In 2004 it was clear that civil servants and armed forces would join private workers in the national programs. Article 1(13) of Law 40/2004 defines Employers as follows: "Employers are individuals, entrepreneurs, legal entities, or other entities employing workers or state agencies employing civil servants that provide salaries, wages, or other forms of remuneration." The preamble of Law 49 affirms a number of basic principles including compulsory participation, portability, and more importantly the “Principle of Mutual assistance (gotong royong). This principle shall be implemented in a mutual assistance mechanism whereby the able participants are to assist the less able in the form of compulsory membership for all people; the low risk participants are to assist the high risk; and the healthy participants are to assist the sick. Through these principles, the social security may improve social justice for all Indonesian people.”

The way the pie was sliced in Law 24 of 2011 was due to a political decision that did not meet the expectations of PT Taspen named as a Social Security Administrative Body in Article 5(3)b. of Law 40 and to which, for decades, the GoI had out sourced the management of the civil servants occupational pension program. The civil servants pension formula was more generous than what could be expected for a public program, thus, PT Taspen could still expect to continue to administer a significant complementary occupational pension program. Nevertheless, carving out the portion to be provided by the new public program would significantly reduce contribution flows. In the end the arrangement made was that civil servants would not join the national public program until 2029! The reality check has thus been postponed for another 15 years.

9 Pisani, “Health policy and planning”, (2016) 1-10, page 6: “Though dozens of studies had examined actuarial needs, the burden of disease, the fiscal implications of financing models and other technical aspects of policy options, these were barely considered in the negotiation process; this was a source of considerable frustration to some of our interviewees. Instead, the focus was on institutional arrangements”. 
How the transfer will be implemented has not been settled as well as the continuing coverage for civil servants. The pension program for civil servants is governed by a law adopted in 1969 and the creation of a national pension program has been the trigger for a reform of the program that is still pending. Two key issues that exacerbate the difficulty are:

• Will the reformed program apply only to new hires or to those as well who have participated for years after the reform for all civil servants, since eligibility for pensions under the public program requires 15 years of participation how will Civil servants who will be less than 15 years from retirement in 2029 be dealt with. Obviously if existing civil servants remained covered by the current formula and only new hires eventually join SJSN, the flow of contributions would be drastically reduced for a few decades.

• Which financing method will apply for the civil service pensions is undecided and which financing method will apply for the public program is still debated. Thus, depending on how the quandary is resolved for the civil servants can make a huge difference in the amount of assets generated and deciding which entity will administer the larger pie. The significance of the financial impact becomes more obvious when comparing the number of civil servants, 5.4 million, with the number of mandatory participants from the private sector, 7.5 million, as estimated above: it means 72% more participants, with stable earnings, low turnover, and a reliable solvent employer!

Since the civil servants are not a vulnerable group and are not victims of exclusion, those litigious issues will be left out of this chapter. But it makes even clearer that the driving forces in the debate are not the pursuit of an optimal design, serving “social justice”, balancing adequacy, and affordability but how fast and where the pension assets would accumulate.

As it damages the credibility of the principles of fairness, equal treatment, and solidarity on which compulsory participation for all has been sold, it obviously does not facilitate the enrolment of participants from the private sector. If harmonization had been done immediately it would have given the proper signal to the private sector: private programs can be maintained with proper adjustment rather than terminated or closed to new employees.

LAST BUT NOT THE LEAST: DESIGN ISSUES

While the focus was on assets, not enough attention was paid to design issues that are of major importance for the country, the government, and the population. There had been no cost estimates made prior to the adoption of the law and no comprehensive White Paper circulated to guide the building of a consensus on major issues. The demographic, labour, and economic context in which design decisions were to be made had been a moving cloud. In an effort to fill the vacuum the MoF took the initiative to get a White Paper drafted and published it on its website in 2009 but it did not get much traction.
In the end Law 24 was promulgated on 25th November 2011, two Social Security Administrative Bodies (BPJS) were created, and the Presidential Regulations for the UHC program were signed on 18th January 2013 stipulating 1st January 2014 as the inception date. The Presidential Regulations for Pensions was signed on 30th June 2015 that is 10 years and eight months after promulgation of the SJSN law, literally hours before its effective date of 1st July 2015.

**IMPLEMENTATION OF SJSN PROGRAMS (LAW 40/2004)**

The transition to the new National Social Security System was completed over a period of 18 months - between 1st January 2014 when the UHC program was launched and 1st July 2015 when the remaining four programs also came into effect. However, the implementation is gradual since full coverage for the UHC is targeted for 2019 while the other programs are phased in over a 10 year period ending in 2029. However, for civil servants the transition may extend until 2029 as well.

As was the case with the Old Age Savings program administered by PT Jamsostek that provided only lump sums, voluntary private pensions programs registered under Law 11/1992 as well as termination allowances under Labour Law 13 will continue to exist in parallel as supplementary programs. However, sponsors of private pension programs may, subject to labour contracts, wish to “harmonize” their pension design or benefits formula taking into account SJSN contributions and pension benefits by adjusting parameters or by direct offset. Previous attempts to harmonize the benefits of Law 13 with private pension programs have produced mixed results and it is doubtful it will be done now that the overlap has become a “vested right”.

**SEGREGATION OF PROGRAM ASSETS**

Jamsostek was a taxable SOE paying dividends to the GoI as owner, and all the assets of the program were coming led with corporate assets. Though, for many years it was a source of profits for the Government, in recent years it, in effect, was operated as a non-profit program.

Thus, an important objective of Law 40 in line with best practices, was the separation of program assets from assets of the implementing agency. A second objective was that each program would be self-supporting, that meant no transfers between programs. That is what the new structure is achieving in a transparent manner.
The program of particular interest from the point of view of pension inclusion is obviously the Pension Program. However, since 1992 Indonesians have considered the Jamsostek OAS/THT program as social security for lack of a better model, even though it provided no financial security in retirement. Unfortunately, the old OAS, a DC savings program, was maintained as a legacy and integrated in SJSN even for future participants, pre-empting fiscal space for more pension.

Another consideration is that the pension program is available only to salaried workers, whereas all workers can participate in the OAS program though at the very low levels of a 2% contribution.

The tabular approach facilitates the comparison of the programs but requires explanations. The OAS/JHT program is simpler: workers and employer contributions, if any, plus compounded accumulated returns are paid out at termination of participation by death, disability, retirement as early as age 56, or leaving the country. After 10 years of participation there is a one-time option to withdraw 10% plus another 30% through a housing program. A worker that simply ceases to participate must wait until age 56 to get the lump sum.
<table>
<thead>
<tr>
<th>Effective 1st July 2015</th>
<th>Pension For Life</th>
<th>Old Age Savings (JHT)</th>
</tr>
</thead>
</table>
| Participation           | • Salaried in Large and Medium enterprises;  
                          • Civil Servants, Armed forces no later than 2029;  
                          • Salaried in Micro and Small enterprises can opt in | • All workers in Large and Medium enterprises;  
                          • Civil Servants, Armed forces no later than 2029;  
                          • Workers in Micro and Small business units can opt in |

<table>
<thead>
<tr>
<th>Benefit Formula</th>
<th>Monthly pension for life = 1% Indexed career average monthly wages times years of contributions*</th>
<th>Lump sum** accumulated contributions with returns</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maximum salary</td>
<td>IDR 7,000,000**</td>
<td>none</td>
</tr>
<tr>
<td>Maximum benefits</td>
<td>IDR 3,600,000/ month*</td>
<td>none</td>
</tr>
<tr>
<td>Minimum benefits</td>
<td>IDR 300,000/ month*</td>
<td>none</td>
</tr>
<tr>
<td>Contributions</td>
<td>Adjusted actuarially every 3 years up to 8%</td>
<td>fixed until modified</td>
</tr>
<tr>
<td>Worker</td>
<td>1/3</td>
<td>2%</td>
</tr>
<tr>
<td>Employer</td>
<td>2/3</td>
<td>3.7%</td>
</tr>
<tr>
<td>Calculation base</td>
<td>Wages plus regular allowances</td>
<td>Wages including regular allowances otherwise table based on 2% of earnings</td>
</tr>
</tbody>
</table>

| Age of entitlement     | 2015-2018  
                          56             | Fixed  
                          56             |
| Age of retirement      | 56                                                             | None                                             |
| Deferral option        | Up to 3 years                                                     | Until actual retirement                         |

Benefits

- Termination before eligibility | Lump sum* accumulated contributions with returns | 100% formula at age 56 |
- Retirement                   | Monthly Payments | Lump sum |
- 15 years or more             | 100% formula | n/a |
- Prior withdrawals            | none | after at least 10 years  
                          10% + 30% housing |
- Total disability             | after 15 yrs contribution or 1 month & 80% yrs  
                          100% formula*** | 100% formula |
- Surviving spouse             | after 15 yrs contribution or 1 yr & 80% yrs  
                          50% formula*** | 100% formula |
- Surviving child              | after 15 yrs contribution or 1 yr & 80% yrs  
                          50% formula*** (Max 2) | 100% formula |
- Surviving parents            | after 15 yrs contribution or 1 yr & 80% yrs  
                          20% formula*** | 100% formula |

* Indexed annually according to inflation.  
** Indexed annually according to GDP.  
*** Formula to be calculated using 15 years as minimum.  
Notes: Spousal pension ceases on death or remarriage.  
Children pension payable only if no spousal pension.  
Parents pension payable only if no spousal and no children pension.
INDEXED CAREER AVERAGE (ICA) PENSION FORMULA

While the description of the pension program may look more complex it is reasonably simple. In words it is a 1% per year of participation to an Indexed Career Average (ICA) program payable for life at a pension age that increases to catch up with longevity. However, in case one retires before 15 years of participation the only benefit is a lump sum equal to contributions plus compounded accumulated returns.

An ICA pension program is a modern formula that has been replacing final pay formulas. The risks of manipulation are lower since all years are taken into account. This reflects in a fairer manner the economic contribution of the worker during the whole career and adjusts automatically for fluctuations in income or interruptions. The indexation continues after the pension becomes payable and before retirement it maintains the purchasing power of the accruing benefits by “revaluing” the accumulation each year to compensate for inflation. A worker that contributed on average wages over the entire career will get a pension based on the average while someone who contributed on lower or higher wages will get a correspondingly lower or higher pension.

A LEGACY ISSUE PARTIALLY RESOLVED: THE PENSION ENTITLEMENT AGE

Another legacy issue to resolve was the entitlement age. For most civil servants the mandatory retirement age had been 56 since the creation of the Civil Service Pension (CSP) program in 1969. However, for some categories it was 60, and even higher for top officials. With the CSP having been the model, most private sector programs stipulated a low pension age, as low as 55 in many whereas others using age 60, at least for males.

Actuarial and demographic studies were persuasive. The Indonesian population was ageing rapidly. Pushing able and willing workers into retirement at low ages in a context of increasing longevity was expensive for a pension program and catastrophic for the economy.

Unfortunately, age 56 was carried over for the OAS program which weakens the message “Live longer, work longer!” Nonetheless, it being a defined contributions program, the direct financial consequences are supported by the individuals. Some see merit in the availability of lumps sums to facilitate the transition from the earnings level of an active worker to lower retirement income. As the lump sum is available at age 56, in the medium term, it can help bridge the gap between actual retirement and the age of entitlement to an age that will gradually reach 65.

With regards to the pension program’s costs and benefit levels, strategic considerations led to hard coding, increasing entitlement ages in the regulations. The experience of other countries demonstrated that increasing a set pension age was challenging. The precedent of countries that linked the pension to longevity was considered but deemed complex and more vulnerable to interpretation. So a scale of periodic increases of one year of age per three calendar years was built in.
The objective was to control the dependency ratio by moving up the pension age since the financing of public pension programs is directly related to that ratio. As a rough approximation, if the dependency ratio is around 20% then providing a replacement ratio of 40% will require a contribution of 8% from the active workers assuming full participation. Building in increases of one year every three years, pushing the pension age to 65 for 2043-2045 is not a perfect fit with the projections but a reasonable approximation. No further pension age increases are stipulated after 2045 but the precedent will have been established and at that point if longevity has increased significantly, there will be more countries, than currently, that will have adopted ages higher than 65. Starting with age 60 would have been a better fit but it was deemed necessary to show the initial pension age as 56, aligned with the CSP but as no pensions were payable before 2030, de facto the initial pension age was 60!

**HOW MUCH INCLUSION HAS BEEN ACHIEVED?**

**PENSION AND OAS PROGRAMS**

Before July 2015 only about 1 million workers, outside the civil service and armed forces, could look forward to the financial security in retirement that a wages indexed life pension can provide. As of the end of 2016, 18 months after implementation on 1st July 2015, pension coverage had reached around 9 million formal sector workers, 21% of salaried formal sector workers. However given the 15 year eligibility requirement, improvements in pension inclusion will come slowly since no retirement pensions will become payable before 2030.

Particular attention must be paid to the description of participation. For practical reasons the program is implemented gradually starting with larger employers, and for GoI employees it may be delayed until 2029, since they are already covered by more generous programs that need to be reformed to become complementary occupational programs. Participation is still voluntary for workers in micro and small enterprises: this is of the utmost importance because as recently as 2013 these two categories included over 93% of the workers. Participation is, thus, mandatory only for 6.4% of the private sector work force, about 7.5 million workers in medium or large business units assuming all these workers are salaried. Consequently, the 9 million participants should include about 1.5 million workers in small and micro enterprises. Salaried workers in the small and micro enterprises have a strong incentive to join since the employer contributions represent an immediate return of 200% on the 1% contribution to the pension program and 185% on the 2% contribution to the OAS program.

Participation in the OAS program includes participants who are a legacy of the PT Jamsostek program. It has increased by 9% from 13.1 to 14.4 million, 33% of the formal
sector workforce but has expanded very modestly into the informal sector remaining as low as 360,000 workers, about 0.5% of informal sector workers.

BPJS-TK has launched a pilot project called Perisai (modelled on Sharousi in Japan) in 11 branches to stimulate enrolment of workers in smaller business units. Success with salaried workers would help with enrolment of the larger number of non-salaried workers in the informal sector.

PENSION COVERAGE FOR VULNERABLE GROUPS

Participation is mandatory for the formal sector workers in large and medium business units. Even though vulnerable workers should be found mostly in the informal sector, they include formal sector workers at low wages employed in micro and small business units. Employees of large and medium size enterprises may also include vulnerable workers. In 2013, assuming the formal sector made up 35% of the labour force (123 million including 5.3 million civil servants) the formal private sector should have reached over 37.7 million workers. Large, medium, and small enterprises comprised only 13 million workers thus there should have been almost ¼ of the workers in micro enterprises, nearly 25 million, who were salaried but for whom participation was optional. Vulnerable groups in the informal sector have no pension coverage since only salaried workers are eligible.

OLD AGE SAVINGS COVERAGE FOR VULNERABLE GROUPS

The Presidential regulations for Old Age Savings apply to both formal and informal sector workers. They reproduce essentially the pre-existing Jamsostek design providing lump sums, whereas combining pensions and a partial lump sum option in a single retirement program would have been simpler and offered individuals more flexibility in the allocation of resources between pension and lump sum.

The contributions are set at 2% of earnings for the workers plus 3.7% from the employer, if any. Thus, informal sector workers not only do not benefit from the safety net of a pension income for life but accumulate only 35% of the Old Age Savings accruing to formal sector workers.

At the end of 2016, 14.3 million salaried workers (about 33%) were contributing to the JHT program. Since the program started to be implemented on 1st July 2015 and is voluntary in the informal sector, participation at the end of 2016 is still not significant: only 359,785 informal workers (less than 0.5%). The Health Program was launched on 1st January 2014; three years after the start of its implementation, it is comforting that the number of non-salaried workers and dependents that are covered, has reached 19.3 million. On the basis of two dependents per worker, that would mean 6.4 million non-salaried workers participating voluntarily, almost 18 times the number having joined OAS so far. The significant level of voluntary participation in the health program indicates that there is a potential for the expansion of the OAS program to non-salaried workers.
CRITICAL REVIEW OF OUTCOMES

Contrary to the recommendations in the 2009 White Paper there is no recognition of past service or provision for social pensions for the existing old age population nor for active workers born before 1970. They will not be eligible to a pension and will receive only a lump sum equal to accumulated contributions since 2015. Assets accumulate quickly until 2030 but the first retirement pensions will be paid for July 2030, almost 26 years after the adoption of Law 40!

NO SOCIAL PENSIONS, NO PAST SERVICE

The appetite for accumulating assets contributed also to the rejection of the White Paper recommendation to provide social pensions for the older segment of the population and accelerate the transition to full pension by crediting past service for active workers already close to the retirement age. That would have increased disbursements in the early years but not ultimate costs. In combination with a gradual increase in retirement ages it would have reduced ultimate required contributions from 9.8% to 8.3% almost in line with the “8% dream”. More importantly, “social justice”, solidarity, and redistribution were the key justification for the Government mandate. Even in 2015, 70+ represented only 6% of the people in the age-group 20-69 of the population. Providing these people who built Indonesia through its difficult years with a modest social pension, recognition, and dignity for their remaining years of life would have given a deeper meaning to the promise of social justice.

Many countries accelerated the maturity of newly created social security programs by crediting years of participation to workers already close to retirement as a social bonus. Given the large amounts of Law 13 benefits accumulated by workers reaching pension age, an option to purchase years of past service to meet the 15 years requirement would have been an efficient way to put these assets to a good use.

FINANCING PATH AND CONTRIBUTION RATE

In a defined contribution program like the OAS what needs to be stipulated is the contribution rate. For the Pension Program Article 39(3) of Law 40 clearly stipulates a defined benefit formula, thus the contributions that can be collected are limited to what is for “fulfilling its future payments obligations” as per the elucidation of Article 50(1). BPJS actuarial simulations indicated that a low rate of 1.5% shared ½ % by participants and 1% by employers would be more than sufficient initially. A practical approach to future contribution increases was to make small increments every three years, synchronized with the increase in pension age. An increase of 0.3%, split 0.1%/0.2%, every three years would not be heavy on enterprises, would keep the rate above Paygo outflows, and was sufficient to finance the program well past 2050.
Given the uncertainties about the participation of civil servants and workers in small and micro enterprises as well as the compliance rate for large and medium enterprises it was deemed preferable to provide more certainty to individuals and enterprises while gradually moving up the rate towards a range that would facilitate a smooth transition to rates based on reliable actuarial estimates for a more mature program.

The fact that even before the design was finalized a rate of 8% had been proposed without regard to actuarial estimates and endorsed by the BPJS became a source of difficulties that have not yet been resolved. It was obvious to many that 8% was not justified in 2015 nor desirable in the economic circumstances. Employers and other groups challenged the 8% proposal, pointing out that a defined benefit program does not entail the right to collect an arbitrary amount of contributions. Also, an arbitrary decision was seen as a dangerous precedent. The debate on PERPEM 45 escalated up to the President who signed it on 30th June 30th 2015. The compromise was an initial contribution rate of 3% split 1%/2% to be revised in the future.

The next revision is due on 1st July 2018. An actuarial estimate of Paygo costs will obviously be still very low, well under 3%, as will be the case for the next few triennial actuarial valuations, despite the margin of uncertainty. Increasing the rate of contributions faster than necessary may choke the expansion of coverage whereas keeping it flat at 3% too long can create false expectations that will have to be overcome when catching up becomes necessary. So a sound financing strategy is necessary.

EXPLAINING THE INDONESIAN PARADOX: FINANCIAL VS SOCIAL VISION

How come Indonesia, a reasonably prosperous country, having adopted, over 12 years ago, a law creating a National Social Security System still has to overcome a pension inclusion challenge? The history of social security in Indonesia, since 2004 in particular, is still developing but is already rich in lessons to be learned.

The political process is well adapted to balancing affordability and adequacy in order to achieve the redistribution necessary to support the social contract. The justification for using the coercive power of the state is the need to achieve risks reduction through wider pooling and provide benefits that could not be sold for a fair premium on a competitive basis by the financial institutions licensed and supervised by the state itself. A pension program providing minimum benefits, socially designed survivor benefits, mandatory life annuities to pool mortality risks, and financed on an open group basis by taking advantage of the continuity of a sovereign government is a good example of intervention serving the public interest.

Management of assets and benefit administration require different skill sets and appropriate governance. A better practice is to have the management of assets done separately and independently on a competitive professional basis. The independent OAS program has little justification. The flexibility added by the availability of lump sums could

10 Dr. Chazali H. Situmorang, Reformasi Jaminan Sosial di Indonesia, June 2013.
have been achieved more efficiently through a partial commutation option in the pension program letting individuals decide the balance between pension and lump sums subject to appropriate limits to control financial myopia.

**CHALLENGES AND TAKE AWAY**

**LESSONS LEARNED**

As summarized above there are still wide gaps to be filled to achieve reasonable pension coverage for vulnerable groups in Indonesia. Some lessons to be learned from the historical development include:

- Universal Health Coverage is easier to achieve than pension coverage and can be a useful locomotive to pull pension coverage forward;
- Deadlines can help prevent political procrastination that delay social benefits until it is too late for many vulnerable individuals;
- Old Age Savings lump sums programs are easier to sell but can draw attention and pull resources away from the financial security in retirement that pensions can provide;
- Legacy can become an impediment to optimal design and tend to preserve fragmentation; it may interfere with the social purpose of risk pooling and redistribution;
- Assets are a tool to finance income protection, but should not become an objective and pre-empt the original mission of social security bodies. There are normally multiple financial institutions in a country but for a given segment of population only one public program;
- Competition for the management of assets can dominate the social purpose, entail exposure to conflicts of interest, and distract attention from pension design and delivery issues that require different skill sets; a better approach is to allocate the responsibilities for assets and benefits to different institutions each with appropriate governance structure;
- Design that fits the needs for salaried workers of large enterprises well may not be an optimal model to extend to other groups of workers; more consultation with the stakeholders could lead to a better fit and easier enforcement;
- Generous pension coverage for public sector workers entails a double handicap for inclusivity:
  - It creates targets that cannot be extended to the general population especially at low retirement ages
  - It reduces the incentive for the leadership to address the needs of people that are not in the privileged groups
ACTIONABLE OPTIONS FOR ENHANCEMENT

Rethinking the structure would be a long term objective but other initiatives can be considered to achieve inclusion of more vulnerable groups.

SOCIAL PENSIONS FOR VULNERABLE GROUPS

Given that the 3% pension contribution rate is redundant in the short term modest social pensions for the older segments of the population is easily financeable. It would put excess assets to a useful purpose, increase the credibility of pension promises and thus promote participation and compliance.

The negative impact of the 15 year waiting period has already been mitigated by waiving it in case of death or total disability. Instead of returning accumulated contributions to workers reaching the pension age within the 15 year period, the accrued pension for the year contributed since July 2015 could be payable and a social pension added for the gap to 15 years. That would create a smooth transition between workers already retired and those just about to retire. Those workers could also be offered the option to fill the gap between social pensions for the missing years and a full ICA pension by “purchasing” the difference using Law 13 payments.

INTEGRATING THE OAS PROGRAM WITH PENSION

Managing two separate programs is an inefficient legacy that increases administrative costs, communication difficulties, and limits the flexibility workers could be offered in balancing life income and lump sums. It would also pre-empt difficulties that implementing the two asset management policy can generate. The pension formula could be increased to reflect the addition of a contribution of 5.7% but a commutation option made available from age 56 upwards to amounts comparable to current OAS accumulations.

STRUCTURED SETTLEMENTS

The OAS legacy program could be repaired by the BPJS offering structured settlements as a more efficient option than a lump sum. Alternatives would include paying over a five year or 10 year period for example so that workers used to manage a monthly pay are not suddenly pushed into irrational spending.

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INTRODUCTION

In this chapter, we will examine why it is critical to establish the identity of an individual, how identity varies in robustness across countries, and how different countries included in this volume have dealt with establishing identity. We will discuss also how important national identification cards or numbers (national IDs) are, and how they deliver benefits far beyond their core purpose of identifying individuals.

After looking at the issue of identity itself, this chapter will look at the role of a national ID in defined benefit (DB) and defined contribution (DC) pension programs based on individualized accounts targeted at formal sector salaried workers. We will briefly examine how a national ID is used by pension systems, how it significantly increases efficiencies in all the different stages of the provisioning of pensions, and how it can be leveraged to reduce costs and, in turn, help improve pension system performance and replacement rates.

We will also discuss the role of national IDs in voluntary pension programs targeted at informal or semi-formal workers. Some specific examples will be discussed to illustrate how the national ID and technology has been combined in some countries covered in this volume to achieve mass-scale voluntary enrolments and for integrating informal and formal sector pension programs.

Finally, we will look at how national ID-based universal auto enrolment has been used to address some of the challenges in informal sector pension programs, how it has been implemented, and the synergies that can help consolidate a national pension agenda.

OVERVIEW OF IDENTIFICATION SYSTEMS

While the development of civil registration and identification has a long history, it has evolved much more rapidly throughout the world over the last few decades. The adoption of a national ID by countries has followed suit due, in part, due to a clearer understanding of the needs to establish the identity of individuals for a larger national agenda. The global movement toward establishing a national ID has been spurred also by the adoption and use of new and more recent technology solutions, including the integration of national databases with electronic services. This has helped countries leverage identity registries for providing a number of other essential services to citizens. Figure 14.1 shows how civil registration has had a long steady growth, and how national IDs, especially digital, or e-IDs, have been evolving rapidly in recent decades.
Although countries have adopted different strategies in terms of establishing a national ID, there is usually a national entity in-charge of administering the national ID. National IDs (or “foundational” IDs) can be used by themselves or can underpin “functional” IDs that can then be used for providing a variety of services to the general population. The term “foundational IDs” was suggested by Gelb and Clarke in order to distinguish it from ‘functional IDs’ that are program or purpose specific.3

Table 1 compares the basic features of the identification systems of the countries covered in this volume. With the exception of the United Kingdom, which rejected a proposed national ID, all countries have adopted some form of a national ID. Many have gone the route of digital or e-IDs. Mexico is an exception in that while it does issue a number to all individuals (known as the CURP), it does not biometrically deduplicate this number.

3 See Gelb and Clarke (2013).
As a result, some individuals in Mexico have received multiple numbers. Technically, the Mexican number is not a national ID in the most commonly understood sense. This is also the case for India’s Aadhaar number. Although the Aadhaar number is based on biometrics (both fingerprints and irises – as well as a photograph) and is, therefore, highly likely to be unique for each individual, it only establishes identity. Aadhaar does not automatically establish citizenship as the number may be issued to residents who need not be Indian citizens.

Several other developing countries have similarly moved to a biometrically based national ID system and have increasingly opted for digital IDs where credentials can be used for either online or offline authentication. The majority of Asian countries in particular have introduced digital IDs. In the case of Bangladesh, what began as a voter ID in 2008, is currently being replaced by a national ID using biometric smart cards. Indonesia and India introduced their new digital IDs at about the same time in 2010. While Indonesia chose to issue a biometric smart card, India decided to not issue such a card.

Interestingly, the U.K. is one of several higher income countries that have rejected proposals for national IDs. Despite significant efforts during the mid 2000s, U.K.’s national ID project faced stiff opposition due to difficulties faced at that time by a number of government projects that had a large IT component, as well as a general lack of clarity on benefits. Newly issued passports in the U.K., however, do have some biometric features – these are focused on facial recognition rather than irises or fingerprints. Australia, Germany, and the United States have also, so far, rejected the idea of a national ID. Japan introduced a national ID only in 2015.

A national ID by itself does not necessarily improve the delivery of government programs like pensions and social insurance. As Table 14.1 shows, national ID coverage in some African countries is low. This may reflect poor implementation but could also reflect a lack of demand for a national ID. In Nigeria for example, the voter ID has much higher coverage than the national ID and can be used as a form of identification for many transactions. The last column in this table indicates the extent to which the national ID has been integrated with public and private sector systems such as banking or health insurance. In Indonesia for example, the unique identifier has only recently been incorporated in major formal sector databases such as pensions. In Rwanda, in contrast, the unique ID number is incorporated in all major government databases and is required for financial sector and mobile phone transactions. Rwanda also plans to integrate its new national Long Term Savings Scheme (LTSS) with national IDs issued by NIDA.
In countries like Mexico, a de facto national ID card has existed for a longer period of time. The voter identity card, along with the national ID number, can, in combination, provide the basis for a process to identify an individual. The introduction of biometrics would provide a higher level of robustness and lay the ground for Mexico’s national ID system. It is important to note that regardless of the stage at which a country’s national ID effort stands, the identity efforts and solutions have a natural evolution that can be thought of in terms of a level of maturity of institutions within the country. We will address some of the challenges around the use of a national ID within the pension system in later sections of this chapter.

Table 14.1
Basic comparison of ID systems in the countries covered in this book

<table>
<thead>
<tr>
<th>Country</th>
<th>National ID</th>
<th>Biometric</th>
<th>Coverage</th>
<th>Integration</th>
</tr>
</thead>
<tbody>
<tr>
<td>Albania</td>
<td>Yes</td>
<td>Yes</td>
<td>High</td>
<td>High</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>Yes</td>
<td>Yes</td>
<td>High</td>
<td>Moderate</td>
</tr>
<tr>
<td>Chile</td>
<td>Yes</td>
<td>Yes</td>
<td>High</td>
<td>High</td>
</tr>
<tr>
<td>Ghana</td>
<td>Yes</td>
<td>Yes</td>
<td>Low</td>
<td>Low</td>
</tr>
<tr>
<td>India</td>
<td>Yes</td>
<td>Yes</td>
<td>High</td>
<td>Moderate</td>
</tr>
<tr>
<td>Indonesia</td>
<td>Yes</td>
<td>Yes</td>
<td>High</td>
<td>Low</td>
</tr>
<tr>
<td>Jamaica</td>
<td>Yes</td>
<td>Yes</td>
<td>High</td>
<td>Moderate</td>
</tr>
<tr>
<td>Kenya</td>
<td>Yes</td>
<td>Yes</td>
<td>Moderate</td>
<td>Moderate</td>
</tr>
<tr>
<td>Mexico</td>
<td>Yes</td>
<td>No</td>
<td>High</td>
<td>Moderate</td>
</tr>
<tr>
<td>Nigeria</td>
<td>Yes</td>
<td>Yes</td>
<td>Low</td>
<td>Low</td>
</tr>
<tr>
<td>Rwanda</td>
<td>Yes</td>
<td>Yes</td>
<td>High</td>
<td>High</td>
</tr>
<tr>
<td>Turkey</td>
<td>Yes</td>
<td>Yes</td>
<td>High</td>
<td>High</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>No</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
</tr>
</tbody>
</table>

Source: ID4D Statistics, World Bank

In countries like Mexico, a de facto national ID card has existed for a longer period of time. The voter identity card, along with the national ID number, can, in combination, provide the basis for a process to identify an individual. The introduction of biometrics would provide a higher level of robustness and lay the ground for Mexico’s national ID system. It is important to note that regardless of the stage at which a country’s national ID effort stands, the identity efforts and solutions have a natural evolution that can be thought of in terms of a level of maturity of institutions within the country. We will address some of the challenges around the use of a national ID within the pension system in later sections of this chapter.

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4 The U.K. does not have a national ID as highlighted earlier. For paying national insurance and tax, a ‘National Insurance’ number is issued to all U.K. citizens. However, it is subject to some issues with duplication. Payment of personal income tax includes the addition of a “UTR” — a unique tax reference that allows online access to a number of tax portals. Identity (and residence) proof for bank accounts, house purchase or other major transactions is usually provided through a mixture of passport, driving license, and utility bills.

5 Brodersohn, Palacios, “Working towards UID — a Maturity Model”.

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A lack of some form of identity has several important implications for contributory pension systems. If a citizen is not in the ID system of a country, or cannot be assertively identified, it is difficult to verify and accurately track contributions and accrued benefits in any form of pension over a multiple decade horizon. The identification of an individual is crucial to establishing the rightful ownership of pension contributions and benefits. In this section, we will discuss some of the hurdles of identifying individuals in general, and examine the role for a national ID in formal sector pension systems.

HURDLES OF IDENTIFYING INDIVIDUALS IN PENSION SYSTEMS

An individual is traditionally identified through some form of official ID, physical appearance, and a signature (when available). This process of establishing the identity of an individual, however evident, is often based on a subjective evaluation by a citizen-facing operator. A subjective identification process may thus achieve very different results simply if:

- an operator is unable to assess the physical similarity of the individual with a photograph presented in a document,
- an operator is unable to assess the similarity of a signature by an individual to a signature on a document provided by the individual, or
- an operator is unable to definitively identify if a particular official ID document provided by an individual is legitimate or not.

The risks that result from this subjectivity may materialize at every point where a service is provided. The risks may be accidental (as part of an intrinsically subjective identity verification process), or deliberate – where an individual takes advantage of the subjective identification process. This may also lead to fraud, where an internal agent and perpetrator collude and seek opportunities to perpetrate identity theft with an intent to commit fraud.

As a result of the risks in identification, most service agencies tend to establish additional compensatory controls to more confidently identify an individual. For example, an agency may require service users or clients to furnish a variety of additional documents to establish their identity, or establish data exchange with other service agencies to minimize identity risks. Such risk mitigation techniques may often result in additional investments and costs that may be transferred directly to users or clients. These additional physical identity verification processes are also often cumbersome for individuals and may dissuade service users and clients from joining or continuing to engage with the product or program.

Within each one of the pension provision processes, the identity of an individual is crucial over the accumulation period, often spanning 20 to 40 years of contribution history, as
well as the pay-out phase that can occur over a period of another 20 to 30 years or more. In the following section, we will describe in more detail how important using a national ID in pension systems is, as well as some of the challenges faced if a national ID is not adequately incorporated in the different phases of the pension process.

As an example of the importance of data management during all stages of the pension life cycle, the Pension Regulator of the U.K. launched a major campaign to improve record-keeping in pension schemes in 2010. During consultations on the proposals, it highlighted evidence that poor records of members could add 5% to the total cost of a quote from an insurance company to buy-out the liabilities of a pension scheme and pay pensions in the future.6

USING NATIONAL ID IN PENSION SYSTEMS

As we see in Figure 14.2, accurate identification of beneficiaries through the different stages of pension provision, including enrolment, record-keeping, and benefits delivery, is a key element of any pension system. This is equally true for countries with DB or DC programs. In this section, we discuss how an ID infrastructure can be harnessed to overcome some of the basic challenges in any pension system and how a strong national ID can provide the foundation for a nationwide pension inclusion program.

Figure 14.2
Pension Provision Stages

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6 The Pension Regulator Consultation Record-Keeping (2010)
Pensions are easily the longest tenure financial instrument. It is conceivable for a person to begin contributing into a pension scheme at age 18 and become eligible for drawing benefits at age 60. It is equally possible for the person to then receive pension benefits for another 30 years – implying a 72 year relationship with the pension account. During this long tenure, the person is very likely to experience significant change. There would be several job or occupation changes. The person could also face temporary or permanent, domestic or overseas migration. She might look very different and her handwriting could also change significantly over time.

Through this process, and at various stages over the multiple decades of her relationship with her pension account, the pension system would need to accurately identify the subscriber. Verification of her identity would be especially crucial during the three main stages of pension provision described below and outlined in Figure 14.2: (a) enrolment, (b) collection and investment of pension contributions and recording of accrued savings, and (c) delivery of pension benefits. Each of these stages has particular challenges related to beneficiary identity establishment and need to be effectively addressed. We examine the specific challenges of identifying an individual pension beneficiary and the risks that may materialize should identity not be correctly established at each stage. We will also discuss leakages or financial burden on plan participants in situations where the establishment of identity fails.

IDENTIFICATION AND PENSION LIFE CYCLE STAGES

A. Enrolment Stage

Establishment of a subscriber’s identity is obviously crucial at the time of enrolment into a pension system. This is even more important where an individual, whose pension account has become inactive over a period, wishes to resume contributions. In this situation, it would be essential for a pension administrator to have the ability to uniquely identify each subscriber in order to ensure that the same person is not enrolled multiple times by the pension system.

Without an effective mechanism to accurately verify a subscriber’s identity, a person may end up with multiple records or pension accounts that would inevitably cause several undesirable outcomes.

These are some examples of problems that could arise if identity is not correctly addressed at the enrolment stage.

i. Subscribers with savings fragmented across multiple pension accounts may ultimately receive a lower pension. This could in turn lead to a reputational challenge for the pension system and an erosion of public confidence as subscribers may perceive dishonesty or poor performance by the administrative entity.

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7 As highlighted below this is not only a theoretical issue – the case of Indonesia showed that one third of people had duplicate accounts.
i. Multiple accounts may also impose multiple instances of account opening or other administrative fees and charges on an individual leading to a lower aggregate pension value.

iii. The challenge of unique identification of subscribers is important also for DC pension systems that provide government co-contributions or conditional fiscal transfers linked to pension contributions. In such programs, it is essential to ensure that an individual is unable to open multiple accounts and, therefore, receive multiple fiscal transfers. This is an equally important concern in DB systems that provide a minimum pension guarantee. Multiple accounts in both situations and resultant leakages could significantly increase government expenditure on such programs.

iv. It may equally be possible for an individual to forget about an old pension account especially during a multiple-decade working tenure and hence lose a part of the accrued benefits.

B. Contributions Stage

This stage is usually of the longest duration and could span a period of 30 to 40 years during the work life of an individual. During this period, both formal and informal sector subscribers may face significant changes in their occupation or employment status. There may also be short or even extended periods during which no contributions are made by a subscriber into her pension account. Accurate identification is especially important in identifying a subscriber throughout the contribution payment lifespan and in ensuring that all pension contributions, as well as accrued savings in a pension account, are correctly recorded.

These are some examples of problems that could arise if identity is not correctly addressed during an extended accumulation stage.

i. Multiple pension accounts could impose significantly higher ongoing servicing costs for a pension service provider or administrator including costs in managing multiple records and verifying identity and rightful ownership across multiple accounts. This could in turn impose higher administrative fees and charges on the subscriber ultimately leading to lower terminal benefits.

ii. In a pension system with decentralised administration, where account administration is undertaken by an employer or an administrator or trust appointed by the employer, the lack of a unique identifier like a national ID could cause significant challenges for employees in transferring their pension accounts and accrued past contributions when they face a job change. This could in turn lead to the employee opening a new pension account with each job change. At retirement, an employee could easily forget a pension account opened several decades ago and thus receive lower benefits.
iii. The benefits or contributions may not be correctly attributed or kept in the rightful owner’s name, which could lead to a payment of higher than due benefits to one individual and lower than due benefits accruing to others.

iv. Additionally, in the case of DC plans, inefficiencies in the identification of funds flowing into individuals’ accounts could lead to potential losses in the yields provided by the individual accounts. Data requirements for DC pension systems are more extensive than for DB systems. However, the consequences of poor data and deficiencies in establishing the rightful identification of individuals would be devastating for both types of pension systems.

v. Countries that have DB systems without accurate identity verification mechanisms may end up providing dual benefits to the same individual, increasing fiscal expenditure at the cost of other government programs, including minimum pension guarantee benefits.

C. Pension Pay-out Stage

This is a crucial phase as it involves promised pension benefits flowing back into each individual’s bank account without any identity errors. It is essential that a program administrator is able to correctly identify each individual beneficiary as the rightful owner of the retirement benefits or savings collected over an extended contribution phase. This is even more important as it is often impossible to reverse or recover incorrectly transferred benefit payments.

Once a pension beneficiary has been correctly identified and retirement benefits begin flowing back into the beneficiary’s bank account, identity verification would remain crucial for proving that the beneficiary is alive and is, therefore, eligible to continue drawing pension benefits. This is essential to mitigate the risk and high costs of paying benefits to “ghost pensioners” especially in DB systems.

These are some examples of problems that could arise if identity is not correctly established during an extended pension pay-out stage.

i. Accurate identification of a beneficiary during the pay-out phase is essential to prevent errors in establishing rightful ownership as well as to prevent fraud by ensuring that benefits due to an individual are not misappropriated.

ii. Without a (preferably biometric) national ID as a unique identifier, a pension administrator, as also subscribers, could face significant challenges (and higher costs) while accurately verifying identity when benefits are due – usually several decades after enrolment.

iii. An error in identity verification could also lead to significant administrative and legal burdens on the institutions responsible for delivering pension benefits. For this reason, an administrator may impose several onerous provisions on subscribers for proving their identity and rightful ownership of benefits.

8 Barr and Diamond 2008.
iv. The absence of a national ID as a unique identifier could also cause multiple pension accounts. This could in turn impose higher costs on an administrator in verifying identity and rightful ownership across multiple accounts, as also in unifying multiple records in order to reconcile, aggregate, and pay out accrued benefits to the rightful beneficiary. This could in turn impose higher aggregate administrative fees and charges on the subscriber ultimately leading to lower terminal benefits.

The above challenges are especially relevant for countries in Latin America, Asia, and Africa that are contemplating inclusive pension arrangements but are yet to establish (or integrate their pension system with) a universal, digital national ID. For example, and as we see in Table 14.2, only 58% of the Mexican population have some form of pension. Around 5% of the population presently receiving a formal pension scheme benefit are also receiving a government subsidy meant explicitly for those who are living below the poverty line and are presumed to be excluded by existing pension provisions.

### Table 14.2

**Example of possible leakages in Mexico’s Pension System**

<table>
<thead>
<tr>
<th></th>
<th>National</th>
<th>Rural</th>
<th>Mexico City</th>
<th>Quintile I</th>
<th>Quintile V</th>
</tr>
</thead>
<tbody>
<tr>
<td>Only Pension</td>
<td>20.9</td>
<td>6.1</td>
<td>8.1</td>
<td>2.6</td>
<td>39.9</td>
</tr>
<tr>
<td>Only Program Adulto Mayor (AM)</td>
<td>22.4</td>
<td>41.3</td>
<td>46.3</td>
<td>36.6</td>
<td>11.4</td>
</tr>
<tr>
<td>Only Opportunidades</td>
<td>3.9</td>
<td>7.6</td>
<td>0.0</td>
<td>10.7</td>
<td>0.5</td>
</tr>
<tr>
<td>AM + Pension</td>
<td>5.8</td>
<td>6.0</td>
<td>32.5</td>
<td>0.1</td>
<td>10.1</td>
</tr>
<tr>
<td>Opportunidades + AM</td>
<td>4.5</td>
<td>11.0</td>
<td>0.2</td>
<td>7.9</td>
<td>0.2</td>
</tr>
<tr>
<td>Opportunidades + Pension</td>
<td>0.4</td>
<td>0.8</td>
<td>0.0</td>
<td>0.0</td>
<td>0.2</td>
</tr>
<tr>
<td>AM + Opportunidades + Pension</td>
<td>0.3</td>
<td>0.7</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>None of the Above</td>
<td>41.8</td>
<td>26.4</td>
<td>12.9</td>
<td>42.0</td>
<td>37.7</td>
</tr>
</tbody>
</table>

Source: CEPAL – Social policy series Num. 161, May 2010\(^9\)

\(^9\) CEPAL – Gloria M. Rubio, Francisco Garfias, 2010
THE ROLE OF ID IN INFORMAL SECTOR PENSIONS

The ability to uniquely identify informal sector workers is, if anything, even more important for implementing pension schemes targeting informal sector workers. It is also typically more challenging since these workers are less likely to have any foundational forms of identification.

As is the case for formal sector workers, the absence of a unique identifier creates the possibility of multiple pension accounts and consequent difficulties in tracking and recording pension contributions over an individual’s working life. Processing and payment of claims also becomes problematic if the pension fund administrator is unable to accurately authenticate the identity of the beneficiary at the vesting or pay-out stage.

The national ID as a unique identifier can serve as a strong foundation for a national pension system that allows portability of accrued savings across jobs and locations as well as between formal and informal sector pension schemes. As long as the pension system is part of the formal financial sector, compliance with standard Know Your Customer (KYC) rules would apply irrespective of whether scheme targets formal or informal sector workers. Succeeding at scale with pension coverage among non-salaried informal sector workers may require proactive measures on facilitating KYC through a foundational ID. As the chapters on Mexico, Chile, India and Turkey clearly show, individuals may frequently move between formal and informal employment over the course of their working lives. Even though countries may aim at increasing labour-force formality, the reality is that portable pension schemes that connect both types of labour markets will have to be a core policy requirement for many if not all developing counties.

There are at least two important aspects of identification that are particular to the implementation of pension schemes for informal sector workers. Unlike their formal sector counterparts, the role of employers in the process of enrolment and collection of contributions is either non-existent – e.g., for self-employed workers – or very weak, as in the case of micro-enterprises. This has led some countries to focus their efforts on groups of informal sector workers targeted through ‘aggregators’, such as microfinance institutions, cooperatives, and self-help groups (SHGs). In countries like India, with a large landmass and a huge informal sector workforce, such aggregators help significantly reduce the cost of participation by increasing access and outreach without the need for new investments into creating national level sales and distribution networks.

Although a group model can be used for reaching a significant percentage of excluded informal sector workers with a pension scheme, it may not work for all occupational segments, including subsistence farmers and landless agriculture labourers – many of whom may have low variable incomes. Low income non-salaried individuals who face unpredictable incomes require flexible contributions and low transaction costs.
Technology allows for both of these features in the contribution collection process. Kenya’s MBAO scheme is a good example. Using M-Pesa, individuals can easily and conveniently make small pension contributions in line with their own cash-flows without incurring the high cost and overheads of physically interacting with a bank or pension fund.

Mexico offers another example of a country where technology is harnessed to allow individuals to make voluntary contributions to their individual account from over 6,000 convenience store branches. These branches serve as correspondents to all pension fund administrators operating in Mexico. This solution makes use of the unique ID which is incorporated into a centrally managed database, facilitating the process of collecting the funds for the branch operator who does not need to know which pension fund administrator is holding the individual’s account in order to receive the funds. The central record keeping agency allows the general population to save by simply providing their unique ID and the amount that they want deposit. The central record keeping agency processes the payment independent of which pension fund administrator is holding the investments. Additionally, since the funds flow into the same individual account where mandatory contributions flow from the formal sector pension system, this solution has allowed an integration of informal sector savings (or pension) with the formal sector pension system. As highlighted above, given how many people experience both sectors over their working life, this is an essential element of stitching together a more complete contribution record and hence delivering additional income in retirement.

E-payment solutions, which can be used for much more than pension contributions collection, rely on good identification so that these contributions can be tracked. In Kenya, mobile banking accounts are linked to the national ID. In India, as described in Chapter 1, the Aadhaar national ID number and authentication infrastructure built around it, also allows for low cost and convenient contribution collection even in rural areas with limited financial sector infrastructure. The rapid spread of mobile money in Africa and parts of Asia has created the potential for mass financial inclusion of which the ability to save for old age is but one example. All of this, however, requires confidence that an individual will always be able to access these savings, which, in turn, implies robust identification systems are in place.

The second important aspect of identification as it pertains to informal sector workers is what can be referred to as ‘integration’. The existence of a unique identifier is a prerequisite for integration that involves the ability to link various databases in order to implement certain policies. However, in order for this exchange of data to take place, the unique identifier must be present in each of the relevant registries. In countries that have only recently introduced unique IDs, existing legacy program databases will not have this ability. The unique number will have to be retroactively inserted into individual records. In India, this process is called “seeding” alluding to the ‘planting’ of each Aadhaar number.

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10 This central administrative platform is known as PROCESAR. It was established by the Pension Fund Administrators known as AFORES to simplify their joint administration problem – akin to the way in which a central check clearing process works between banks. It is not a standalone centralized administrator such as the Central Records Agency in India or the record keeping and account management function of the Swedish Pension Agency.
against an existing individual record. In India hundreds of millions of Aadhaar numbers have been seeded in half a dozen major databases, including those held by programs for public works, social pensions, food, unemployment benefits (MGNREGA), fuel subsidies, and banking, to name a few.

While this seeding itself improves targeting and delivery of these programs in several ways, when achieved across all areas of government interactions with individuals, it opens up informational possibilities that allow for new and sophisticated public policy measures. This is especially relevant in countries where the informal sector is large, a real situation in most of the countries covered in this volume.

In high income countries, progressive income tax systems along with payroll tax based social insurance have wide, almost universal coverage. This allows them to differentiate between subsidy levels and condition benefit eligibility for various social programs. In the US for example, the earned income tax credit pays a subsidy to low income workers that is phased out as their income increases.

The tax system in richer countries also allows for policies such as auto-enrolment as in New Zealand or the U.K.. This is only possible because most individuals and most of the income information is available through the tax system. That said, even in the U.K., there were challenges in establishing a robust tracking and enforcement operation in the early stages – as highlighted in Chapter 3 on the U.K. experience and Chapter 23 on the role for a Mission Office. The simple use of tax records is not possible in most developing countries where the vast majority of the population falls outside the income tax net.

Chile provides an example of a pension policy that uses integrated identification to overcome the problem of unobserved income. With a significant informal sector, it is not possible to rely on the tax system to differentiate between workers and households at different levels of income. The solution was to gather detailed information on households that allowed a ranking of socioeconomic status of households. This allowed the government to implement a policy that supplemented contributory pensions in low income households (those found to be in the bottom three quintiles of the distribution). The reason that this was possible was that unique identifiers were available in both databases (see Chapter 7 on Chile and the ability to identify and target the self-employed population).

Turkey provides an interesting example of integration as applied to health insurance. By linking more than 20 databases through the unique identifier of Turkey’s national ID, the government has been able to differentiate between the levels of subsidy for health insurance premium that it pays for different segments of the informal sector. The linked registries cover land and property holdings, vehicle ownership, income and social insurance tax payments, among others. Differentiating the poor from the non-poor informal sector in this way has increased health insurance coverage to close to 90% of the population.
How would this approach apply for expanding coverage of informal sector pensions in developing countries? Take the case of Indonesia: The biometric national ID that was introduced in 2011 covers the vast majority of adults, ensuring uniqueness and allowing for authentication through a smart card that contains biometric data. There is also a population registry that contains basic demographic information for almost the entire population including children which is constantly being updated. These two databases are linked through the unique ID number of the adults and both are managed by the Ministry of Home Affairs. The unique ID number is being ‘seeded’ in two important databases. When incorporated into the formal sector pension scheme database, more than one third of the accounts were found to be duplicates. The exercise not only gave a more accurate figure for pension scheme coverage, it also allowed for individuals to merge their accounts, which will make the claims process more accurate and efficient. The number is also being incorporated into the other social insurance databases and the wage and pension system for civil servants. Together, these databases cover 15 to 20% of the labour force.

In parallel, the government of Indonesia has produced a registry that ranks around half of the households by socio-economic status for purposes of targeting anti-poverty programs. In particular, it is used to determine which households will have their health insurance premium paid for by the government. In the latest round to update this database, the unique ID number was collected, thereby ‘seeding’ the poverty registry.

Linking these two databases through the unique identifier is useful for monitoring eligibility for these programs. The government should not be paying the premium for workers in the formal health insurance system, for example. More importantly however, when combined with the existing population registry, the Indonesian government is able to create a list of the non-poor informal sector by subtracting the formal sector and poverty registry individuals. This in turn allows the government to offer a partial subsidy to the non-poor informal sector workers. Indonesia could also follow the Turkish example in terms of linking to other databases such as property and vehicle registries as a way to differentiate the subsidized contribution for households according to their ranking in the poverty register. Turkey also provides an interesting example of improving compliance by linking access to utilities to adoption of a compulsory insurance product. The government has improved compliance in adopting compulsory earthquake insurance by requiring utility companies to obtain a customer’s insurance number as a condition for supplying the utility.

There is at least one concrete proposal to achieve universal coverage that takes the logic of integration one step further. In their 2009 study, Anton, Hernandez and Levy, propose automatic enrolment of all adults in both pension and health insurance with the premium financed by the government through consumption taxes. While the specifics of the proposal were applied in the Mexican context, the basic concept could be applied anywhere in principle. The aim was a basic level of protection against old age, disability and health care for the entire population in a way that eliminated labour market distortions that arise when informal and formal sector provision is separated. This seamless approach
would still allow for additional consumption smoothing for formal sector workers but would allow for the elimination of part of the payroll tax that falls primarily on low income workers. Clearly however, it would require robust, secure and unique identification of every adult\(^1\). Importantly, the developments on the financial inclusion side in terms of accounts and access mean that these kinds of innovations are more and more feasible in ways in which they simply could not have been even five or 10 years ago.

**CONCLUDING THOUGHTS**

The identification system, along with payments and information systems, is part of the basic infrastructure required to efficiently implement all government programs that involve individuals. Pensions are especially dependent on identification since they involve a long and continuous relationship from the time a worker enters the labour market until death, a period spanning multiple decades. The ability to ensure the uniqueness of the identifier and to authenticate effectively is increasingly dependent on a country’s foundational ID, typically a database that has used biometrics to deduplicate and has created an authentication ecosystem. Failure to properly identify can lead to losses and inconvenience for pension fund members and leakages in terms of misallocated fiscal resources.

The current global focus on universal social insurance coverage is even more dependent on good identification systems. The failure of payroll tax based systems to reach most workers in developing countries during the last century has led to new ways of collecting contributions from informal sector workers that is the subject of this volume. These collection mechanisms in turn, are increasingly reliant on technologies that allow flexible and low cost e-payments (or collections). These in turn, require robust mechanisms for identifying the contributors and authenticating those receiving pension benefits.

Integration of ID-linked databases also opens up possibilities for public policy to differentiate among the large informal sectors that exist in low and middle income countries. In the absence of robust income tax systems for most of the informally employed population, supplementary information collected from households and shared between other registries can help achieve this differentiation so that those with the capacity to save can be connected to efficient collection and investment mechanisms. In the extreme case where all potential contributors are identified and included in a population registry, the entire population could be auto-enrolled with full or partial government subsidies for basic health and pension coverage. Simply put, universal coverage is only possible when one knows the individuals that make up the ‘universe’.

\(^1\) At this point, it is important to note that integration or data-sharing of individual and household data increases the need for a good personal data protection framework, (something that should be in place even without integration). Such a framework would follow well established principles of international good practice such as those produced by the OECD. They involve important safeguards such as data minimization (collect only information required for a specific purpose), data access protocols, consent and the ability to contest, and correct personal data, among others.
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15
PENSION INCLUSION AND DIGITAL PAYMENTS

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Disclaimer: "The views and conclusions expressed in this chapter are strictly personal and do not necessarily coincide with those of Mastercard."
BACKGROUND

The ability to secure for seniors enough resources with which they can enjoy a dignified retirement, after a life spent at hard work, caring for their family, is a litmus for measuring the moral quality of any human society. This is the purpose of pensions. And when pensions are not restricted only to a handful of rich people but are truly inclusive, including the poorest, then it measures also the quality of a country’s governance.

Until very recently, world leaders and UN policy-makers regarded this prospect of universal access to pension (“pension inclusion”) as completely commendable, though unachievable. It was not included in the Millennium Declaration listing the eight Millennium Development Goals (MDG)¹ and was not mentioned in the knowledge platform of “sustainable development goals”.² Why? This is because the world leaders weren’t aware enough of the extraordinary potential of Information and Communication Technologies (ICTs) as tools for global development. This awareness came with the World Summit for the Information Society (WSIS, Geneva December 2003), when the world’s leaders adopted a Declaration of Principles that states.³

"8. We (the representatives of the peoples of the world, assembled in Geneva from 10-12 December 2003 for the first phase of the World Summit on the Information Society), recognize that education, knowledge, information and communication are at the core of human progress, endeavour and well-being. Further, Information and Communication Technologies (ICTs) have an immense impact on virtually all aspects of our lives. The rapid progress of these technologies opens completely new opportunities to attain higher levels of development. The capacity of these technologies to reduce many traditional obstacles, especially those of time and distance, for the first time in history makes it possible to use the potential of these technologies for the benefit of millions of people in all corners of the world.

9. We are aware that ICTs should be regarded as tools and not as an end in themselves. Under favourable conditions, these technologies can be a powerful instrument, increasing productivity, generating economic growth, job creation and employability and improving the quality of life of all. They can also promote dialogue among people, nations and civilizations.”

As a result of the WSIS, several global multilateral initiatives were launched to achieve universal connectivity (access for all to telecommunication networks and to the Internet), by leveraging the progress of the so-called “digital revolution”.⁴ Today, thirteen years

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¹ c/f: resolution 55/2 adopted on September 18, 2000 by the United-Nations General Assembly. The word “pension” is mentioned not once in this resolution, not even in section III “Development and Poverty Eradication” (www.un/docs.org/A/RES/55/2). Even the July 1, 2015 UN-MDG report does not mention the word ‘pension’.  
² c/f knowledge platform of “sustainable development goals” (www.sustainabledevelopment.un.org).  
⁴ The essential initiative was ITU-led “Connect-the-World”.
after WSIS, 7.2 billion users across the world are connected to a mobile network (2G, 3G and 4-5G) and among them, 4.8 billion use personal smartphones allowing high-speed connection to the Internet. Within just ten years, digital illiteracy has been almost fully overcome, quite easily, including in places and among communities where traditional illiteracy has been a standard for over fifteen centuries and continues to be so. The lesson drawn from this situation as far as pension inclusion is concerned is that if universal connectivity has been achieved in 13 years using digital technologies, universal access to pension can be achieved in 10 to 15 years using the same technologies. Hence, universal access to pension is no more to be considered a dream, but instead, a truly attainable objective that can be achieved even in the least-developed countries.

As set out in the other chapters of this book, this critical advancement in inclusion can be allied to the evidence on how best to deliver administration and investment in the interests of members, thus bringing together best practice in achieving historic levels of financial inclusion with the knowledge to maximize pension outcomes for some of the most vulnerable segments in the world.

**USING DIGITAL TECHNOLOGIES FOR PENSION INCLUSION**

**DIGITAL TECHNOLOGIES AS ENABLER**

Extending pension coverage to non-salaried informal sector workers, inclusion, in every country, is but one dimension of the country’s national pension policy. Several countries still do not have such a program under actual implementation. Even among those countries where such a program exists, where a pension system is already established and receives contributions, not all countries are determined to achieve comprehensive pension inclusion, leave alone giving it a ‘national priority’ status.

Contributors to pension schemes are typically found among higher income ‘formal sector’ salaried employees from both private and public sectors. In many countries, there is usually a second, much larger group of workers who are non-salaried or ‘informal sector’ workers. They face precarious incomes from odd jobs (as domestic workers, small shopkeepers, street vendors, warehousemen, agricultural workers) and experience frequent migration across jobs, occupations and locations. Many informal sector workers spend their entire life having low and intermittent incomes and sometimes no income at all. As pension benefits are usually provided through employers, non-salaried informal sector workers are often excluded from access to formal social security, pensions, healthcare, insurance and housing benefits, putting immense pressure on the government, or on their children and families, to take up the slack, especially as these workers age. In more than 100 countries across the world, statistics available about workforce show that workers belonging to the informal sector represent well over 50% of the country’s total labour force.
Table 15.1
Distribution of Labour Force between Formal Sector Employees and Jobless or Workers in the Informal Sector

<table>
<thead>
<tr>
<th>Country</th>
<th>Population</th>
<th>Labour Force (Active population)</th>
<th>Formal (%)</th>
<th>Informal (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>India</td>
<td></td>
<td>838,703,739</td>
<td>37</td>
<td>63</td>
</tr>
<tr>
<td>Nigeria</td>
<td>Formal</td>
<td>100,637,413</td>
<td>27</td>
<td>73</td>
</tr>
<tr>
<td>Egypt</td>
<td>Informal</td>
<td>142,340,602</td>
<td>49</td>
<td>51</td>
</tr>
<tr>
<td>Brazil</td>
<td>94,666,993</td>
<td>56,734,504</td>
<td>41</td>
<td>59</td>
</tr>
<tr>
<td>Congo (D.R.)</td>
<td>81,331,050</td>
<td>44,852,336</td>
<td>21</td>
<td>79</td>
</tr>
</tbody>
</table>

Source: www.indexmundi.com and www.data.worldbank.org

The Table 15.1 focuses on five large countries from three continents (Africa, Latin-America and Asia), comparing each country’s labour force\(^5\) with the total population and shows how the labour force is distributed between salaried employees working in the formal sector (public and private) and non-salaried, self-employed, informal sector individuals. As highlighted in the last column, the second group is the most significant. In Brazil, the distribution between the two groups appears to be equal. In India and Egypt on the other hand, around two in every three workers are employed in the informal sector while their proportion is even higher in Democratic Republic of Congo and Nigeria.

This calculation, when conducted at a global level by aggregating the same data for all the countries in the world, would show that workers belonging to the informal sector total 3.2 billion individuals – a significant figure that measures the extent of how the world’s global economy is affected by non-formal employment and exclusion. Data provided by the World Bank or by research centers conducting studies about poverty, shows that a very large proportion (87% or 2.88 billion individuals) of these informal and oftentimes unpaid workers live in developing countries. Among them, around 2.57 billion individuals are unbanked and have never been part of the formal financial sector. The use of digital technologies can help change this situation, dramatically and rapidly.

Like many OECD countries, several developing economies too are experiencing a sharp demographic shift where a combination of declining fertility rates and rapid progress in medical research and healthcare is leading to increased life expectancy and an ageing society. In such a context, there is a serious risk of an increasing population of unemployed and financially excluded elderly. With limited fiscal resources, a large pension coverage gap and a rapidly growing population of dependent elderly, most developing nations therefore have no option but to encourage thrift and self-help for retirement by their economically active young informal sector excluded workers.

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\(^5\) Labour Force means all potential workers, women and men aged between 15 and 65. Source: Index Mundi (www.indexmundi.com) + WB (www.data.worldbank.org)
This chapter examines the critical role for mobile technology and digital payments in providing low income excluded citizens with a convenient, simple, secure and affordable mechanism to transmit periodic retirement savings to contributory micro-pension programs. It also presents some real life examples to demonstrate how digital payments have effectively addressed traditional governance and logistical challenges with targeted delivery of government benefits without the risk of leakages or errors.

With a rapid growth in telecom and mobile penetration (both in absolute terms and in relation to the pace of bank penetration) and increasingly lower costs of handsets and mobile transactions, an incredibly large number of people, including those with modest literacy and income levels in remote rural locations, are already using mobile phones for communication, information and financial transactions. Awareness of the transformative power of mobile transactions is becoming universal.

In view of this reality, it appears very reasonable for a country’s leaders, lawmakers, and pension program managers to expect a significant number among the unbanked to open and operate their personal pension accounts and thus secure their old age after they take the critical first step of obtaining a payment instrument. This may occur very rapidly as the power of ICTs translates into greater trust in the pension system. Excluded citizens may be more easily convinced that joining the pension program is indeed in their own interest as they understand that they will be able to use their personal digital devices to interact with their pension account and with digital payment platforms whenever they want to. A fully ICT-based digital pension model can therefore alter public perception of a complex pension system. In other words, people need to understand, see and verify by themselves that the system is simple, precisely because it is completely digital.

As highlighted in other chapters, part of the trust in the system is also due to the existence of well-designed products and funds that are run with strong member-focused governance under effective regulation and supervision. These necessary features for good pension outcomes are far easier to demonstrate to everyday citizens if the process for putting savings into their pension accounts, or for receiving claims and benefits, is both transparent and easy.

For the majority of pension subscribers therefore, a simple, automated mechanism for making periodic pension contributions, without any risk of fraud or reconciliation errors, is perhaps the most essential aspect of a pension system. This is particularly important as the majority of pension scheme subscribers (90% or more in most countries) simply choose the ‘default’ product option offered to them once they join. Thus, the majority of pension subscribers, and especially non-salaried informal sector workers, would greatly value a mechanism for automated, digital contributions but may prefer to have little other day to day interaction with their pension accounts in practice.

*Targets for Pension Inclusion: The ‘25-35-25’ Formula and the “Culture-of-Thrift”*

Salaried employees in the formal sector who receive a regular income, are often bound by law and regulations to contribute to a pension or provident fund and typically their savings
are protected. If the country has mandatory contribution requirements, then in theory, these workers do not need to be targeted by pension inclusion programs. However, in many countries, even formal sector workers are not always covered because there are no mandatory requirements, or quasi mandatory requirements. Chapter 3 on the U.K. shows that this can lead to declining coverage that is only reversed when coverage becomes at least quasi-mandatory through auto-enrolment.

However, informal sector workers are clearly the more challenging group to cover and hence are targeted by pension inclusion programs. Among them, the youth (those under 25) are the main target. The ‘culture-of-thrift’ should spread among the youth and that is a difficult task. But in reality, even in developed countries with long histories of broad coverage, it was not some innate notion of thrift that led to high coverage. It was the existence of mandatory requirements and a strong role for (large) employers as a channel into pensions.

Table 15.2 keeps the focus on India, Nigeria, Brazil, Egypt and Democratic Republic of Congo. While Table 15.1 highlighted the fact that the informal sector forms the largest proportion of the country’s labour force, Table 15.2 also shows that in those same countries, the youth (under 25 years of age) forms the largest proportion of the population:

Table 15.2
Youth Demographics 2016 in Five Countries

<table>
<thead>
<tr>
<th>Country</th>
<th>Population</th>
<th>25+ (%)</th>
<th>0-25+ (%)</th>
<th>Pension Inclusion Priority Target Population</th>
</tr>
</thead>
<tbody>
<tr>
<td>India</td>
<td>1,266,883,598</td>
<td>54.30</td>
<td>45.70</td>
<td>595,435,291</td>
</tr>
<tr>
<td>Nigeria</td>
<td>186,053,386</td>
<td>37.73</td>
<td>62.27</td>
<td>115,855,444</td>
</tr>
<tr>
<td>Brazil</td>
<td>205,823,665</td>
<td>60.78</td>
<td>39.22</td>
<td>80,724,042</td>
</tr>
<tr>
<td>Egypt</td>
<td>94,666,993</td>
<td>47.55</td>
<td>52.45</td>
<td>49,652,838</td>
</tr>
<tr>
<td>Democratic Republic of Congo</td>
<td>81,331,050</td>
<td>36.56</td>
<td>63.44</td>
<td>51,596,418</td>
</tr>
</tbody>
</table>

Source: Index Mundi / www.indexmundi.com

As the youth forms the largest proportion of the population in most developing countries, it is desirable for authorities in such countries to specifically focus pension inclusion efforts on the younger segments who clearly have several decades to retirement and may thus be able to achieve meaningful pension accumulations even with modest contributions.

This is not an easy objective to achieve nor is it an easy task to conduct. By themselves, the young may prefer current consumption to retirement savings simply because old age poverty is not a clearly visible risk. It is too far into the future. The ‘25-35-25’ formula seeks to address such lack of foresight through the following strategy:

- Every youth should join a pension scheme before the age of 25;
• The person will regularly save money during the following 35;
• When the person is 60 years old, and exits from active work, or is unable to work, her savings would pay her a monthly pension for the next 25.

**Incentives.** Fiscal incentives guaranteed by law and regulations can play a powerful role in making the ‘25-35-25’ formula successful. Young people who first join the formal financial system, by opening a bank or digital payment account, must be recognized by the pension system (multi-stakeholder management) as part of the ‘circle-of-trust’ and immediately encouraged to simultaneously subscribe to the pension inclusion program and start a virtuous saving cycle to last till their old age. Those incentives must be determined in a way that the earlier the youth joins the pension program and the longer they last there, the greater the rewards will be.

**Awareness.** In addition to incentives, the matter is also about building greater awareness. Such awareness should be built up through education and promotion, activities into which partners, sponsors and enablers of the pension inclusion program together must get involved, conducting workshops, explaining the benefits attached to thrift, and conducting follow-up surveys. All players involved in such thrift awareness-building programs will spread, promote and advocate the “thrift” message amongst the youth, not by distributing brochures but by using interactive digital portals and cloud-based digital platforms empowered by telecom operators or by social media channels to which the young are often connected permanently. They may engage in thousands of opportunities to interact with the youth in a manner that rewards those who participate actively in the thrift awareness-building program (a free ticket to a movie, a password for free downloading of a song, etc.). Some innovative ideas for doing this are presented also in Chapter 16 and Chapter 22 on financial inclusion and communication initiatives.

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6 c/f Robert de Niro in “Meet The Parents”
Figure 15.1 suggests the following:

- Unbanked youth should be convinced of the personal benefits of joining the formal financial system by opening a banking or digital payments (example mobile wallet) account;

- Thereafter, the youth should envision that this banking or digital payment account will empower them to manage their pension savings account, and should understand that being a client of a pension system comes with attractive incentives and benefits (legal and practical);

- The new pension scheme subscriber with a bank and/or digital payment account receives information and awareness about the benefits and virtues of long-term “thrift” (circle-of-virtue);

- The subscriber should understand how a secure digital process for making pension contributions protects her against errors and fraud and thus increase trust in the overall pension system (circle-of-trust); and

- The subscriber should then be offered other virtuous life, health and non-life insurance products that address various lifecycle risks and emergencies including health shocks, death and income interruptions.

Remaining on the existing path of financial and pension exclusion, without remedy, would be no less than cataclysmic. Let us give one example about India, a country that is in all respects one of the most advanced countries in the developing world and yet: “In 2014, about 6.2 million people have ‘retired’ in India, and around 88% of them were lacking formal pension provisions. The same year, 16.1 million entered the country’s labour force while the economy created only 4.7 million new jobs.” (Source: The World Bank).

Financial exclusion of the unbanked must be reduced and as a follow-up, pension exclusion of the poorest must be reduced, in every country, despite the ageing trend observed almost everywhere across the world. To do so, there is no other way than to target the youth, to encourage them and educate them. The youth have to be the main target. They also need to be convinced that they have ground to trust the pension system and that they will be empowered, using ICTs, to securely manage their retirement savings. Last, youth will understand that whatever one’s income is, there is always a way and profit in saving a part of it, even a small part. This ‘culture of thrift’ needs to be spread and encouraged, advocated and promoted by the country’s lawmakers, pension fund managers and last, by financial and pension inclusion program partners, sponsors, and enablers.
Figure 15.2 shows how a pension inclusion program can be structured within the implementation of a country’s national pension system. It highlights the fact that pension fund core clients (contributors/beneficiaries), meaning employees (both public and private formal sectors) and job-seekers, represent 40% of the country’s labour force while those targeted by the pension inclusion program typically represent 60 percent. The figure suggests how critically important the use of digital payments and the conduct of education and training programs is to achieve the following objectives: financial inclusion of the unbanked; increased trust in the pension system; the spread of the culture of thrift.

To achieve all these objectives, no tools are more powerful than ICTs, provided they are properly used, within an effective legal framework and for the right purposes. Young people,
have a natural inclination towards innovation and have natural connection with smart digital personal devices. Young people are like that: they may forget to have breakfast prior to leaving the house in the morning; they may also leave improperly dressed; they may leave without money in their pocket, and yet, life for them would go on for the day. However, a young person who leaves the house having forgotten the smartphone would probably go back home to pick it up whatever the consequences may be.

A key objective for any country’s leaders, lawmakers and pension fund managers is to therefore reduce financial exclusion by encouraging and enabling the youth to save a part of their incomes for their old age while they are still young. The next section of this chapter shows how this approach could work between 2020 and 2050, in every country, and shows the potential effects of this approach on the global financial system and macroeconomics.

A pension system subscriber can interact with three different interconnected interoperable parties using a personal smart digital device (or through a third-party service outlet). She could interact with the pension fund, of which she is a subscriber; the bank where she has opened a banking account; and the payment platform that the bank is bundled with to operate the subscriber’s financial transactions.

**Figure 15.3**

**Pensioner Interaction Model**

Interaction (1) is operated via a digital connection established between the personal device used by the subscriber and the pension system e-portal. The connection is active on a login basis and the subscriber would need to go through an e-identification procedure and follow security instructions (c/f below). Subscribers with feature phones could interact with the pension system through a secure, OTP-based interface through a third-party service outlet or agent.
Interaction (2) is operated via a digital connection established between the personal device used by the subscriber and the bank’s e-portal. The connection to be active will require the use of an e-identifier device supplied by the bank and the use of a so-called ‘payment-card’, also supplied by the bank on behalf of the digital payment platform. The connection is active on a login basis and for security purposes, the subscriber will need to go through the e-identification procedure and follow safety instructions (c/f below). Depending on whether the subscriber only desires to check his/her account or if he/she needs to execute a payment operation, these instructions will bear different levels of severity and may require the use of an additional device supplied by the payment platform or by the bank on behalf of the payment platform.

Interaction (3) shall only serve, for the near future at least, as the data collection interface and not for executing financial transactions.

Some more options for digital pension contributions are described in the case-studies in Chapter 16.

FINANCIAL INCLUSION AND PENSION ENROLMENT

PROCEDURE FOR ENROLMENT IN A PENSION PROGRAM

1. Awareness about the importance of saving for old age. Let us take the case of a young, unbanked 23-year-old woman, with a modest income and no formal education, who works on a farm (or perhaps as a housemaid). This young woman has participated in sessions of a national thrift awareness-building campaign focusing on pension inclusion, conducted across the country by pension program stakeholders, and targeting primarily workers from the informal sector. She is unsure of her future and wants to feel secure during her old age. As a result of her participation in the sensitization campaign, she eventually decides to join the pension program. She already has been informed about the details of the pension scheme and knows that the procedure for enrolment in the pension program is fully digitized and hence simple, and would be completed within a very short period.

2. Opening a bank account. Her first step is to open a bank account, which in her case, would be the first bank account she has ever operated. She visits the branch (or agent) of a bank she has chosen and carries her national ID card (and other necessary

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8 For simplification purposes, this paragraph (and subsequent paragraphs) assumes that the candidate is a female, knowing however that the procedure works exactly same as described if the candidate is a male, not a female.

9 Note that it is not necessary for the banks to be the sole providers of a pension product. Indeed, as highlighted in the examples related to digital micro-pension solutions in Chapter 16, Chapter 17 on Governance and Investment and the introductory chapter of this book, a critical feature for success will be having scale providers of investment management with strong member-focused governance. Moreover, the enrolment and payment aspects have to work over a lifetime with multiple job and location changes. Therefore, separating out the different elements of the value chain can prevent the creation of multiple small accounts with many different providers which can be a consequence of the ‘vertically integrated’ provider model where the access point to the pension system also tries to deliver the account management, payments and investment services.
documents, if any, prescribed by the banking regulator) for opening a bank account. The bank employee or agent would simply use the young woman's fingerprint for biometric-based authentication of her identity. Alternatively, the agent could use a one-time-password (OTP) based process for authentication of her identity. Her national ID would serve as her KYC (Know-Your-Customer) and her personal information residing with the national ID authority would be used for digitally completing her bank account application form.

3. **Opening a pension account:** Immediately after this key first step of opening a bank account based on her national ID as her digital or electronic KYC, she would have an option to open her individual pension account without being required to visit any pension fund premises. Her national ID would again serve as a valid KYC for her new pension account. She would understand that most of the operations she may need to conduct, including the overall monitoring of her pension account, involve essentially the use of her personal device (smartphone), and that such operations are discrete, safe and secure. Therefore, once she is a member of the pension system, she would have secure access to information on her pension account and savings data through her smartphone or through a designated third-party service or agent outlet.

4. **Automating digital pension contributions:** She would submit a standing payment instruction to her bank for periodically debiting a specified amount from her bank account and transferring the same on her behalf to a pension fund manager. Once her standing instruction (or auto-debit) mandate has been registered on her bank’s CBS (core banking system), she would not need to make any further visits to the branch or indulge in any further paperwork for effecting periodic pension contributions. Instead, she would simply need to deposit money into her bank account, on the basis of her own cash-flow, and her bank would automatically debit her account and transfer her contribution, as per her standing payment instruction, to the pension fund manager.

5. **Depositing money into her bank account:** As she could move across jobs or locations over the years, she would be able to use a variety of outlets and digital mechanisms to securely deposit money into her bank account. This could include a Mastercard prepaid card issued by her bank. Since her bank account, her pension account and her Mastercard digital payment instrument are all linked to her unique national ID, her contributions would be easy to reconcile. The bank and the pension fund would thus be able to ensure that her future pension contributions are always accurately reconciled, transferred and invested on her behalf. This mirrors the examples set out in Chapter 9 for Mexico where many points of sale are now feasible as payment channels into the pension as long as the person has a bank account, a payment method and a unique ID.

6. **Digital process for direct delivery of pension benefits:** When she is old and her pension benefits become due to her, her national ID would again serve as a unique identifier for digital verification of her identity as the rightful owner of the pension
benefits and for linking her identity also to her bank account and with her digital payment instrument. The pension fund would therefore simply transfer her retirement corpus and her periodic pension benefits directly into her own national ID-linked bank account. She would not need to visit her bank to withdraw her pension benefits. She would simply use her Mastercard payment instrument to withdraw money from any ATM or bank agent location, or use the same card for making purchases towards her consumption expenses in old age.

The entire process of putting an end to the candidate’s financial exclusion - transforming an unbanked, illiterate, fragile person, working in the informal sector, with low and intermittent income, into an active banking client and a pension subscriber - has been completed within a few minutes, at a very modest cost. This is possible only because of the use of ICTs all along the process at every step. This inspires the pensioner to trust the system, and to take active part in it.

By adopting fully digitized procedures, the pension funds and the banks partnering in the pension program could reach out to 3 billion low-income unbanked people who prior to joining the pension inclusion program were excluded from the formal financial system.

Figure 15.4
The Substantial Growth of the Unbanked and Underbanked
Nearly 2.2 billion financially unserved adults live in Africa, Asia, Latin America and the Middle East

<table>
<thead>
<tr>
<th>Region</th>
<th>Percentage</th>
<th>Number of Adults</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sub-Saharan Africa</td>
<td>80%</td>
<td>326 million adults</td>
</tr>
<tr>
<td>Middle East</td>
<td>67%</td>
<td>136 million adults</td>
</tr>
<tr>
<td>East Asia, Southeast Asia</td>
<td>59%</td>
<td>876 million adults</td>
</tr>
<tr>
<td>South Asia</td>
<td>58%</td>
<td>612 million adults</td>
</tr>
<tr>
<td>Central Asia &amp; Eastern Europe</td>
<td>49%</td>
<td>193 million adults</td>
</tr>
<tr>
<td>Latin America</td>
<td>65%</td>
<td>250 million adults</td>
</tr>
<tr>
<td>Middle East</td>
<td>67%</td>
<td>136 million adults</td>
</tr>
<tr>
<td>East Asia, Southeast Asia</td>
<td>59%</td>
<td>876 million adults</td>
</tr>
<tr>
<td>South Asia</td>
<td>58%</td>
<td>612 million adults</td>
</tr>
<tr>
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<td>49%</td>
<td>193 million adults</td>
</tr>
<tr>
<td>Latin America</td>
<td>65%</td>
<td>250 million adults</td>
</tr>
</tbody>
</table>
It is generally estimated that around 2.5 billion adults do not have a formal banking account. Among those unbanked, it is estimated that 82% live in developing countries (Africa, South-East Asia, Central Asia, Latin-America) where the number of banked adults is around 40-41% of the total adult population (compared to 89% in OECD countries). This divide affects women twice more than it affects men.

Financial exclusion might be reduced in 2050 down to a level of 255.02 million unbanked people across the world versus 2,350 million in 2020. Such a result can be achieved through pension inclusion programs as shown in Figure 15.5.¹⁰

Figure 15.5
Pension Inclusion Reduces Financial Exclusion
Evolution Correlation Between Pensions and Diminution of Financial Exclusion

When the number of new subscribers to a pension system grows, the number of unbanked excluded from the financial system goes down mechanically because the new pensioners are now operating and managing a personal banking account.

A second and equally major effect of the growth in the number of new pension subscribers is the corresponding potential growth of stable, long-term retirement savings. As we see in Table 15.3, pension contributions by new pension subscribers could grow from USD 10 billion per year in 2020 to USD 257 billion per year by 2050 (assuming a monthly contribution of just USD 10 per subscriber) resulting in an aggregate pension contribution of over USD 4.5 trillion by 2050.

Table 15.3  
Reduction of Financial Exclusion through Pension Inclusion (World)

<table>
<thead>
<tr>
<th>Year</th>
<th>Financially Excluded (M)</th>
<th>New Pension Subscribers (M)</th>
<th>New Pension Subscribers (M)</th>
<th>Aggregate Annual Retirement Contributions ($Bn)</th>
<th>Aggregate Cumulative Retirement Corpus ($Bn)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2020</td>
<td>2350</td>
<td>80</td>
<td>80</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>2021</td>
<td>2270</td>
<td>81</td>
<td>161</td>
<td>19</td>
<td>29</td>
</tr>
<tr>
<td>2022</td>
<td>2189</td>
<td>81</td>
<td>242</td>
<td>29</td>
<td>58</td>
</tr>
<tr>
<td>2023</td>
<td>2108</td>
<td>82</td>
<td>324</td>
<td>39</td>
<td>97</td>
</tr>
<tr>
<td>2024</td>
<td>2026</td>
<td>82</td>
<td>407</td>
<td>49</td>
<td>146</td>
</tr>
<tr>
<td>2025</td>
<td>1943</td>
<td>83</td>
<td>489</td>
<td>59</td>
<td>204</td>
</tr>
<tr>
<td>2026</td>
<td>1861</td>
<td>83</td>
<td>573</td>
<td>69</td>
<td>273</td>
</tr>
<tr>
<td>2027</td>
<td>1777</td>
<td>83</td>
<td>656</td>
<td>79</td>
<td>352</td>
</tr>
<tr>
<td>2028</td>
<td>1694</td>
<td>84</td>
<td>740</td>
<td>89</td>
<td>441</td>
</tr>
<tr>
<td>2029</td>
<td>1610</td>
<td>84</td>
<td>823</td>
<td>99</td>
<td>539</td>
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<tr>
<td>2030</td>
<td>1527</td>
<td>83</td>
<td>906</td>
<td>109</td>
<td>648</td>
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<tr>
<td>2031</td>
<td>1444</td>
<td>81</td>
<td>987</td>
<td>118</td>
<td>766</td>
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<tr>
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<td>1363</td>
<td>79</td>
<td>1066</td>
<td>128</td>
<td>894</td>
</tr>
<tr>
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<td>1284</td>
<td>76</td>
<td>1142</td>
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<td>1031</td>
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<tr>
<td>2034</td>
<td>1208</td>
<td>74</td>
<td>1216</td>
<td>146</td>
<td>1177</td>
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<tr>
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<tr>
<td>2037</td>
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<td>1426</td>
<td>171</td>
<td>1666</td>
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<tr>
<td>2038</td>
<td>924</td>
<td>66</td>
<td>1491</td>
<td>179</td>
<td>1845</td>
</tr>
<tr>
<td>2039</td>
<td>859</td>
<td>64</td>
<td>1555</td>
<td>187</td>
<td>2032</td>
</tr>
<tr>
<td>2040</td>
<td>795</td>
<td>62</td>
<td>1617</td>
<td>194</td>
<td>2226</td>
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<tr>
<td>2041</td>
<td>733</td>
<td>60</td>
<td>1676</td>
<td>201</td>
<td>2427</td>
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<tr>
<td>2042</td>
<td>674</td>
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<td>1734</td>
<td>208</td>
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<tr>
<td>2043</td>
<td>616</td>
<td>56</td>
<td>1791</td>
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<td>2850</td>
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<tr>
<td>2044</td>
<td>559</td>
<td>55</td>
<td>1845</td>
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<tr>
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<td>505</td>
<td>53</td>
<td>1898</td>
<td>228</td>
<td>3299</td>
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<tr>
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<td>452</td>
<td>51</td>
<td>1950</td>
<td>234</td>
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<td>2000</td>
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<tr>
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<td>302</td>
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<td>2095</td>
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<td>4270</td>
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<tr>
<td>2050</td>
<td>255</td>
<td>46</td>
<td>2140</td>
<td>257</td>
<td>4527</td>
</tr>
</tbody>
</table>
The numbers in Table 15.3 are global, describing the situation for the entire world and are based on the following assumptions:

1. Eighty million presently excluded informal sector individuals across the world open a pension account in 2020 as a result of an intensive global awareness campaign which would start in 2017 (supported by multilateral multi-stakeholder initiatives such as the pinBox Book Project). This would be supplemented by national awareness campaigns and policy roadshows conducted in countries showing a greater commitment to establish inclusive pension programs and extending pension coverage to the majority of excluded informal sector non-salaried workers.

2. The program starts slowly and in 2021, the number of new pensioners is only 1% higher than it was in 2020. In 2022, we assume a 7% growth in coverage relative to the number of new subscribers in the previous year. Coverage continues to grow till 2029, although the pace of growth is slower (down from 7% in 2022 to 1% in 2029), and

3. Between 2030 and 2050, while new subscribers continue to open pension accounts, the number of new subscribers per year progressively declines.

4. It is presumed that each pension subscriber saves on average USD 10 per month over the entire period (2020 to 2050). For some countries, this may be an extremely conservative contribution assumption, while for others, the likely monthly contribution levels could be less. In almost all cases however, an assumption of regular pension contributions over multiple decades may be highly ambitious. Hence, on balance, an average contribution of USD 10 per month may be an appropriate assumption.

Importantly, the simulation in Table 15.3 above does not assume any corpus growth on account of investment returns. Also, it is very likely that subscribers will tend to increase their contributions in step with inflation and wage growth over time. However, no such increase is assumed in the above projections and we assume that all subscribers continue to contribute only USD 10 per month in nominal terms.

If we assume that individual subscribers increase their contributions by only 3% per year on account of wage increase, the potential aggregate contributions by 2050 would be USD 623 billion per year (compared to USD 257 billion per year without any indexation).

Similarly, if the pension contributions earn a nominal investment return of even 7% per year, the cumulative aggregate value of the retirement savings corpus would be USD 17.6 trillion by 2050 (compared to the aggregate cumulative contributions of USD 4.5 trillion by 2050).

Such monthly savings not only are life-changing for subscribers, but also a blessing for the global financial system per se, which goes through, from time to time, periods of volatility.
and turmoil. Reducing financial exclusion through pension savings would positively impact a country’s macroeconomic environment – it could generate a large pool of long-term retirement savings that could fuel economic development and investments in infrastructure, and in turn spur entrepreneurial engagement and employment growth.

**DIGITAL FINANCIAL TRANSACTIONS**

**BENEFITS AND CHALLENGES**

1. **Deposits.** Clearly, there is a strong case for cashless, digital payment solutions – both for collecting pension contributions and for delivering pension benefits (see 2. below). For some years to come however, and while the world continues its march ahead towards becoming completely cashless, a pension subscriber/pensioner would need to continue making pension contributions by periodically depositing cash into her bank account. In the immediate to short term, and in a situation where many citizens in developing countries may not have a bank account or a digital payment instrument, it may be necessary to establish secure mechanisms for collecting pension contributions in cash. This could be achieved by using a digital (prepaid) card or a mobile wallet.

2. **Benefits.** With digital payments, a subscriber is not required to depend on an intermediary to carry out transactions and would rarely need to make a trip to the bank. All transactions are processed online, following a procedure that is 100% digitized. Transactions are processed at no cost, with no delay (extremely important in an emergency situation, i.e. natural or human catastrophe or a disaster). Physical distances pose no barriers and small or large (debit or credit) transactions can easily reach the entire world within seconds.

3. **Accounting of contributions** for bundled products: A subscriber of a pension system may be offered other risk management financial products such as life, health or disability insurance. A digital payment mechanism would easily allow aggregated collection of pension contributions along with multiple insurance premiums as a single amount at the front-end with the facility to accurately account the precise payment for each underlying product in the basket and effect disaggregated transfer of reconciled payments to the relevant financial institutions – pension funds and insurers.

4. **Security:** Pension contributions using digital payment mechanisms are 100% secure from the risk of theft or reconciliation errors, thanks to the combination of security features any user is required to go through before making a payment. A bank e-identifier requires a PIN; payment requires a PIN + biometric identification (fingerprint). Soon, smartphones will come equipped with a “push-to-sign” touch, allowing users to apply a digital signature procedure for special transactions such as transfer orders (e-signature is digitally stored on the device). A member of a pension system may use her Mastercard payment card, and the payment devices provided by the bank and her personal smartphone, to access both her bank and pension accounts, check her financial activity and personal data. The same operation is feasible from a connected personal computer.
BIOMETRIC IDENTIFICATION MANAGEMENT SYSTEMS (BIMS): ADVANTAGES

The reference to the use of biometric technology tools for identification and authentication purposes in the context of a pension system is focusing mainly on how such technology would protect and benefit a subscriber of a pension system. However, it is worth noting that the advantages of biometric technology go far beyond the subscriber, as it benefits the entire pension system; and beyond even the pension system, reaches across the whole board of the national economy. For example, both the public sector (ministries, public agencies) and the private sector (banks, financial institutions, large industries, large business corporations) will potentially save billions of dollars when they rely on the operation of Biometric Identification Management Systems (BIMS) for their global security strategy, instead of traditional security systems. Security issues which today are very complex to solve and very costly, such as undocumented access to secured building (or to a secured office inside a building), unauthorized access to secured computer files, to a computed system (bank account, pension account, etc.), ID swapping (for instance when ID documents are stolen), manual badge check, credential replacement and several other issues falling within security system requirements, would be easily solved through biometric feature-based solutions like iris scanning, fingerprint identification, voice identification (or hybrid mechanisms combining those features). Large-scale hacking will become more difficult and when occurring, would be circumvented to parts of the attacked system but not harming the entire system. Such biometric features (iris scanning, fingerprint identification, voice identification) are unique and cannot be copied, which means that only the authorized person can access an account associated with these features. For banks and platform payments associated with this pension system, this represents a tremendous comfort in terms of operational security and has potential for saving a great deal of money.

It may also ease accountability and audit processes. Any security breach occurring in the system will be identified and the person responsible for this breach will also be identified. Assuming that sooner than later, all pension systems in the world would be hosted on a dedicated cloud marketplace, it will be possible, easy and very cheap to have the corresponding BIMS associating a pension account to biometric features, and allowing the system to (a) regroup all files involving this account (including every single financial transaction, or complaint files; or special request files) or any related accounts (relatives, family members) around one single access-channel; (b) allow the pensioner, for their lifetime, to access any of their files and to be the only individual able to do so; (c) empower the system to track any activity on any pension account and connect any event to a date, a place, number, figure, nature of a transaction etc. BIMS will contribute in making the pension system user-friendly. It is quick and easy to activate and operate. It is convenient to use. It is easy to manage, easy to scale and easy to upgrade. It is cheap while having the potential for saving a lot of money. Last, but the least, it is secure, and for that, contributes in increasing public confidence in the pension system.
In conclusion, digitizing pension contributions and benefit payments makes the pension system safer, and allows subscribers and pensioners to feel more in control of their own savings and consequently, of their retirement outcomes. Digital payments also ease the entire process, at various levels of the chain. But they do more.

- Digital payments when used in the context of pension inclusion, coupled with efforts that help put an end to exclusion from the formal financial system more generally, can hugely empower informal sector workers and especially women. The benefits of digital payments go well beyond greater pension account ownership – they enable personal asset accumulation, mitigation of a range of lifecycle risks and instill greater inclination for entrepreneurship.

- Digital payments are more transparent for users and yet help maintain confidentiality – a feature that many women in developing counties may find valuable. Equally, a digital payment infrastructure can be leveraged by governments, public agencies, businesses, employers and NGOs for direct transfer of benefits and payments to beneficiaries without any risk of leakages or errors and at a fraction of the cost of cash transfers.

- For citizens more generally, digital payments serve as a powerful incentive for increased thrift and savings and boost trust and confidence in the overall economic system.

**ROADMAP FOR PENSION INCLUSION AND REDUCING FINANCIAL EXCLUSION**

Every country in the world is ready to engage in programs aimed at reducing financial exclusion in the homeland, and at expanding pension coverage. Many OECD countries have already walked a long way on that path. During the past decade, several developing countries have also started contemplating or implementing inclusive pension programs while several others are now looking forward to do so in the nearest possible future. For developing countries, achieving such objectives is essential to maintaining (or gaining) stability at home, protecting their people’s safety, enforcing civil peace and fostering a society that is harmonious when it is inclusive.

Through the G20 summit framework, richer countries have expressed the will to cooperate with developing nations, offering them support and resources to help them overcome their pension exclusion challenge. A framework of solidarity has been set out in this respect to govern the modalities for such cooperation. The international community, all UN institutions starting with the World Bank and members of the NGO community involved in fighting exclusion and poverty, are partners in this cooperative framework. It is also very well understood that pension inclusion cannot be achieved unless financial exclusion is reduced.
The global financial community is committed to fighting financial exclusion across the world. Yet, as this chapter illustrates, technology companies operating payment platforms, such as Mastercard, see that a bond exists between achieving pension inclusion and fighting financial exclusion simply because the population targeted in both tracks are the same. Achieving pension inclusion will lead to reducing financial exclusion and to rechannelling huge amounts of money coming for savings into the global economy through the global formal financial and banking systems. This pool of long-term retirement savings in turn, could be used for new investments which will end up creating dozens of millions of new jobs, raising the global amount of salaries employees are receiving, and thus, pouring more money into the consumption market and in the household market which will contribute to reducing global poverty. Lastly, when poverty is reduced, part of the surplus generated by this virtuous economic and financial cycle, will go back to the pension program, reinforcing it and bringing the entire program to an even higher level.

Such virtuous process, when engaged would probably, if not certainly, guide payment platforms to partner in every country, with local or global banks that are already involved with the government for the implementation of their national pension program, and to increase their global commitment for the cause of pension inclusion. Because it will be economically profitable, and easy to put in place, such global partnerships would then appear eminently desirable and would have greater chance to become reality, with potentially immediate benefits, advantages and results for the pension system. From there, payment platforms associated with pension system, could start planning for more strategic long-term viability commitment.

Achieving, at minima, the results indicated in Table 15.3 of the previous section, requires the adoption of a clear roadmap centered around one goal: Optimize the use of digital ICTs in every country where a pension program is under implementation, by all stakeholders and players involved in such implementation. For all players involved in this action aimed at enabling pension inclusion and reducing financial exclusion, the importance of using digital ICTs to that effect is no more disputed. However, the question “what is to be done to optimize such use?” remains a valid one, and still requires answers.

It is certainly possible to rely on the ability of people to use their personal digital devices as tools for their personal development, and to conduct activities they would not be able to conduct without using those devices. Today, in 2017, universal connectivity is a reality. Digital illiteracy has largely been overcome and when it comes to use of such advanced digital devices, neither education nor age nor social stature nor gender really matters. It is therefore natural and necessary, in the context of pension inclusion, to rely upon such awareness.

The global financial community needs to follow a strong roadmap, first at the global level, to properly organize the multilateral action aimed at vanquishing exclusion and to distribute with clarity the roles of global players and stakeholders involved in the global
action. Such a roadmap could be, in every country, enforced with a strong plan of action that leverages the results achieved at the global level. It could be extremely useful, for instance, for the global multilateral, multi-stakeholder forum involved worldwide in the support of pension inclusion, to ally with the International Telecommunication Union (ITU) and leverage ITU’s experience in achieving universal connectivity. Regarding African countries, pension inclusion global partners would find great benefit in allying with “Smart Africa”, in particular for a better and more precise definition of the member countries’ plans of action for pension inclusion.

In very large countries like India and China, as well as in developing countries with large populations, such as Pakistan, Indonesia, Nigeria, Brazil, Ethiopia, Democratic Republic of Congo, Bangladesh, Egypt, Iran or Turkey, pension inclusion ‘national plans of action’ will probably include hundreds of new ventures that may be brought to life, as a result of the new entrepreneurship spirit induced by the implementation of the national pension program. A typical partnership that may take place everywhere, and a very relevant one indeed, would be a partnership between stakeholders involved in the country’s pension program and all telecom operators (telcos) operating a mobile network in the same country. Through such partnerships, telcos can make their cloud platforms available for hosting pension program data, facilitate bank-to-bank interoperability by allocating required space within their own data centers to provide banks with enough resources that can cover their data storage needs. Also, considering that citizens who have subscribed into the pension program are also systematically subscribing to mobile services, telcos’ involvement as a partner of the pension program will enforce the inter-operability between banks and their client-pensioners by facilitating the transfer and use of data between a bank’s computer and a pension subscriber’s smart-phone and vice versa.

Moreover, telcos often have a mandatory obligation to ensure nation-wide coverage; they usually have, in many ways, direct or indirect presence (base-station locations, commercial officers, retail shops) in almost every neighborhood of each country and they could easily leverage such universal coverage to the benefit of the pension program. Last, telcos could leverage their expertise and their wide commercial presence across the country to assign qualified experts to attend the sessions of the awareness-building program and contribute with great efficiency to educate the candidates about pension programs and how to optimize the use of their smart device to that effect.

Another example of a relevant partnership would be the one involving telecom vendors, meaning corporations which fabricate the devices and more specifically “glo-cal” vendors who could also dispatch some of their experts to get involved in the multilateral awareness-building program for pension.

11 “glo-cal” stands for global-local referring to corporations such as Microsoft, Samsung, Cisco, Apple with presence in almost all the world’s countries
CONCLUSION

The pension inclusion objective, associated with reducing financial exclusion, is an objective with several virtues, benefits and advantages for everyone starting with those most-in-need people. Also, in our converging world, achieving this objective will provide stakeholders with a seamless consumer experience. The pension inclusion objective needs to be strongly supported by the international community, at a global level. United Nations institutions and bodies, with the World Bank at the top, should extend their full support and provide resources on the ground to achieve these objectives. The global financial inclusion community stakeholders (NGOs and businesses), should show strong commitment towards building a truly inclusive world, through their participation in pension inclusion programs.

Several multilateral initiatives targeting pension inclusion are presently ongoing, across the five continents. This Book Project, aims to get country leaders, and national and international policymakers, to better understand that most of the factors and inputs that are required to make any ‘universal pension program’ successful, anywhere across the world, are already there. The hope is that they will be convinced that the ground is slipping in the face of a rapid global demographic shift and that no country can today afford the cost of further delays or failure to implement universal pension programs.

Now that the objective of granting universal access to telecommunications has been achieved, and since digital illiteracy is being vanquished, there is no technical ground for any country across the world to delay any further, the implementation of an inclusive, national pension program. It is also vital that leaders, lawmakers, and executive managers of pension funds in low or medium income countries understand that pension inclusion is a top priority in the context of fiscal and social policy. It is essential to understand that achieving pension inclusion will mechanically lead to a drastic reduction in the financial exclusion of the unbanked. The effects on global economics will be immense and the entry into the global formal financial system of those who had always been excluded will make this system stronger and safer.

A strong commitment towards continuous action in favor of pension inclusion is required at the global level, based on a clear roadmap centered on the optimization of the use of digital ICTs across the line. ICT-type alliances are required at a global level. At a country level, ICT-based opportunities must be encouraged, leveraging on the fact that the use of digital personal devices is increasingly universal – and that smartphones are not required for the core transactions that are necessary to engage in pension saving.
IT AND DIGITAL SOLUTIONS FOR PENSION INCLUSION: SOME CASE STUDIES

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BACKGROUND

In 2006-07, and as India waited for its Parliament to approve a legislation that would establish a new regulator for the National Pension System (NPS), pinBox promoters commissioned a national-level primary data survey on the incomes, savings, financial behaviour and retirement outlook of working age Indians.

The survey indicated that as many as eighty million working age Indians with incomes at that point were willing to participate in a contributions based pension scheme. If this latent demand for pensions from these groups were fully harnessed, they could contribute an estimated INR570 billion (USD13 billion in 2006) to the NPS in its first full year of operation and produce cumulative long-term retirement savings of over USD300 billion within a decade. Lying beyond this pension-ready informal sector population were 37 million government and private sector salaried workers who were already covered by mandated pension schemes. Interestingly, a significant number of them believed that their mandated pension entitlements would be inadequate and were therefore interested in voluntarily contributing to a DC pension program to supplement their work-based pension benefits.

Table 16.1
Income Distribution*

<table>
<thead>
<tr>
<th>Annual incomes (INR)</th>
<th>Percent share of those who would be making retirement savings for the first time</th>
<th>Percent share of those who are already making retirement savings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 50,000</td>
<td>47</td>
<td>4</td>
</tr>
<tr>
<td>50,001 - 100,000</td>
<td>31</td>
<td>37</td>
</tr>
<tr>
<td>100,001 - 200,000</td>
<td>11</td>
<td>43</td>
</tr>
<tr>
<td>200,001 - 500,000</td>
<td>6</td>
<td>11</td>
</tr>
<tr>
<td>Over 500,000</td>
<td>5</td>
<td>5</td>
</tr>
</tbody>
</table>

Age Distribution*

<table>
<thead>
<tr>
<th>Age in years</th>
<th>Percent share of those who would be making retirement savings for the first time</th>
<th>Percent share of those who are already making retirement savings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Below or at 25</td>
<td>8</td>
<td>2</td>
</tr>
<tr>
<td>26-35</td>
<td>32</td>
<td>20</td>
</tr>
<tr>
<td>36-45</td>
<td>33</td>
<td>40</td>
</tr>
<tr>
<td>46-55</td>
<td>27</td>
<td>38</td>
</tr>
</tbody>
</table>

1 The Invest India Incomes and Savings Survey 2007 was based on a listing sample of 1.1 million households. From this, a stratified random sample of some 107,000 respondents was selected for detailed interviews. Nielsen was contracted for the fieldwork and data collection.
Occupation Distribution*

<table>
<thead>
<tr>
<th>Occupation</th>
<th>Percent share of those who would be making retirement savings for the first time</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture producers</td>
<td>34</td>
</tr>
<tr>
<td>Wage labourers</td>
<td>16</td>
</tr>
<tr>
<td>Salaried workers</td>
<td>13</td>
</tr>
<tr>
<td>Government contractual workers</td>
<td>3</td>
</tr>
<tr>
<td>Businessmen with employees</td>
<td>12</td>
</tr>
<tr>
<td>Shopkeepers</td>
<td>10</td>
</tr>
<tr>
<td>Self employed - non professionals</td>
<td>5</td>
</tr>
<tr>
<td>Street vendors</td>
<td>3</td>
</tr>
<tr>
<td>Self employed professionals</td>
<td>3</td>
</tr>
<tr>
<td>Others</td>
<td>1</td>
</tr>
</tbody>
</table>

*Percent rounded to the nearest whole percent
Source: The Sleeping Giant: Private Pension Markets in India, 2007-08

The income, demographic and labour market characteristics of the excluded workforce, as well as their financial behaviour, savings capacities, locational distribution and knowledge of formal finance strongly suggested that delivering a DC pension scheme, even to the pension-ready market, could be hugely challenging. And yet, this was a problem that was clearly worth solving.

In 2007 therefore, pinBox promoters collaborated with a large public sector asset management company (AMC) and an all women's cooperative bank to jointly establish Invest India Micro Pension Services (IIMPS) -- the first global “micro-pension” social enterprise focussed exclusively on encouraging and assisting low income, non-salaried informal sector citizens to accumulate micro-savings for their old age.

Over the next few years, IIMPS enrolled nearly 2 million low income individuals for a government notified pension scheme. Subscribers included street vendors, head loaders, home-based workers, subsistence farmers, daily wage earners, construction workers, blue-collar workers in garment export factories, small shopkeepers, micro-entrepreneurs and other non-salaried informal sector individuals based in both urban and remote rural locations across nearly 100 districts of 14 Indian States.

During this period, several things changed. Our original micro-pension operating model evolved from a somewhat clumsy and expensive process involving cash collections and

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2 Kindly contact info@pinboxesolutions.com for a free electronic copy of this Report
physical, paper application forms, to an entirely digital (cashless and paperless) product and process architecture. The federal and several state governments stepped forward with significant fiscal commitments to both financial and pension inclusion. India launched an ambitious national ID program that has already issued over one billion IDs. The Parliament approved the PFRDA legislation and thus established the new pension regulator. And fund managers stopped viewing voluntary pensions as a social cause and began seeing even the “micro” market as a potentially significant mainstream business vertical.

Over the years, IIMPS remained focussed on keeping transaction costs to the bare minimum so as to ensure that micro-pension charges did not erode the tiny contributions or modest account balances of our clients. A large part of our time and resources were devoted to developing systemic, process and technology driven solutions to lower operating costs, mitigate operational risks and overcome important challenges around behavioural finance, client protection and regulatory compliance.

Many countries, including several nations represented in this volume, are already contemplating or attempting the expansion of pension coverage to non-salaried citizens. In this context, this chapter presents a view from the trenches on specific, real-life obstacles and risks that were faced in growing voluntary micro-pension coverage in India. It also discusses specific examples of how the non-profit microPension Foundation, leveraged technology and digital finance infrastructure to (a) overcome important challenges and mitigate risks, and (b) build new, non-linear distribution and access platforms capable of exponential voluntary coverage.

DIGITAL MICRO-PENSIONS

THE EARLY YEARS

The first few years of the new micro-pension enterprise were spent largely on achieving a better understanding of the target demographic and in imagining and building a robust and low cost product and process architecture. Many months were spent on developing, rejecting, redesigning and refining new sales and distribution channels and approaches. Wholesale fees and charges were negotiated with retail finance product providers. New and innovative training materials, retirement literacy toolkits and promotional strategies were created, translated into 14 national languages and field-tested.

To keep outreach and service delivery costs down, a non-linear business-to-business-to-customer (B2B2C) sales and distribution model was developed. This involved commercial contracts with a range of outreach partners – large micro-finance institutions, cooperatives, rural banks and NGOs, who were already delivering thrift, credit and livelihoods related services to our target demographic. This also helped harness the incredible goodwill and credibility of these field partners – an essential raw material when
introducing alien concepts like pensions and retirement, or motivating adoption and sustained behavioural change by low income informal sector individuals.

In parallel, we began developing a proprietary, central micro-pension administration IT platform from scratch (subsidised by a rather generous grant from a large global donor). This technology platform was capable of issuing and managing hundreds of thousands of unique, individual micro-pension accounts, tracking and recording individual pension contributions, digitally interfacing with product providers to unitize savings and update individual account balances in line with daily NAV changes, etc. The platform’s capabilities naturally evolved over the years – in line with implementation experience, field-level stakeholder feedback, evolving client needs, changes in the financial inclusion and regulatory environment as well as necessary improvements in the core product and process architecture.

Thus, a small but committed team, a robust IT platform and strong partnerships with some exceptional entities that already had a large retail footprint helped us reach thousands of low income informal sector individuals through hundreds of branches across multiple districts in India at a near zero capital cost.

The customer-facing field staff of outreach partners were subjected to intensive classroom and on-field training on concepts, product features and processes. These trained and certified micro-pension counsellors were expected to first enrol as micro-pension customers before they were permitted to discuss the program with their own clients or members. Partner field-staff conducted group meetings on pensions using standard retirement literacy tools, including films, calculators and FAQs, to educate and on-board their clients or members for the micro-pension program.

A national-level, multi-lingual, micro-pension helpline was established. The helpline served as a simple, direct, two-way link between IIMPS and individual subscribers. It helped verify subscriber knowledge, field process compliance and service quality through call-backs to new clients. It also served as a simple and direct channel for addressing subscriber queries, recording and resolving complaints and delivering reminders to subscribers with infrequent contributions or dormant accounts.

Over the next few years, as we went into the trenches supported with a consortium of highly credible partners, and armed with the sincere commitment of succeeding at scale, we came across a number of challenges, risks and obstacles and many new ideas – each of which we had failed to imagine while we were still on the micro-pension drawing board. Some of these are encapsulated in the following 4 case-studies.

We hope that these case-studies will deliver an important advantage that our team did not have when we embarked on the micro-pension inclusion journey a decade or so ago – that of learning from someone else’s mistakes.

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3 This was outsourced to a unique, Bangalore-based BPO named Vindhya E-Infomedia that employs 1400 differently abled persons for its data processing and call centre services. See http://vindhyainfo.com
CASE STUDY 1
CASHLESS PENSION CONTRIBUTIONS BY UNBANKED CITIZENS

INITIAL CONDITIONS

Within a few months of going live in 2009, thousands of individual micro-credit clients and members of thrift and credit cooperatives and SHGs began to willingly step forward and voluntarily open micro-pension accounts. Clearly, the demand for retirement saving products among low income individuals was not a major challenge.

However, most of our clients did not have a bank account. And none of them were using mobile wallets or any other payment instrument. We were therefore constrained to collect micro-pension contributions in cash. This was done by partner field staff — on a designated date and simultaneously with the collection of micro-loan repayments. Collecting tiny, intermittent contributions in cash from thousands of individuals spread across scores of urban and rural districts, and then correctly reconciling and recording each individual contribution became our number-one bottleneck to expanding voluntary micro-pension coverage.

Although we worked only with highly credible field partners, and had painstakingly designed and implemented a process to prevent cash fraud, we could never be really sure that the risk had been fully mitigated. Hence, while linking the collection of voluntary pension contributions with cash loan repayments did help lower transaction costs, the increased risk (and costs) of cash fraud and an equally high cost of preventing cash misappropriation probably wiped away any such benefits. The cash-based process for unbanked clients imposed similar risks when insurance claims or pension benefit pay-outs become due.

The risk of reconciliation errors as also errors in correctly recording each contribution in each subscriber’s account was equally problematic as field officers simultaneously collected both loan repayments and pension contributions in cash from many individuals.

Cash collections imposed two other important challenges for our clients. First, all micro-pension clients faced uncertain, intermittent and very different income flows. Often, many of them missed making a pension contribution simply because they did not have enough cash in hand on the date on which their loan repayment was due. As pension contributions were voluntary (while loan repayments were mandatory), this had an important adverse impact on persistency. Many clients ended up missing pension contributions even though they had the money to save — albeit on a different date in the month, simply because no one was able to collect their savings on that day.

A second and equally important challenge for our clients was the mismatch between the tenure of their relationship with our field partner (MFI for example) and the tenure
of their relationship with their pension account. When a micro-pension client enrolled by an MFI had repaid her loan, the MFI was unable to collect future micro-pension contributions without the subsidy generated by the collection of loan repayments. This often led to dormant accounts and a demand for premature withdrawals.

Clearly, a national level micro-pension operation could not be scaled on the back of cash transactions. We needed a payment solution for unbanked micro-pension clients that was simple, convenient, portable, transparent, secure and affordable.

The R&D lab set up within the non-profit microPension Foundation spent the next few months working with a team from Visa on fixing the problem. This team developed a closed-loop prepaid card based payment solution with an auto-debit or standing instruction facility for automating pension contributions. This micro-pension prepaid card was launched as a pilot among tribal communities in the Nilgiri mountains in Southern India in 2012. Not only was this digital payment solution accepted with astonishing ease, the prepaid cards and the auto-debit facility caused savings persistency to nearly double over the next six months.

MICRO-PENSION PREPAID CARDS OPERATIONS

As we see from Figure 16.1, the prepaid cards process was simple and easy for an individual to comprehend and use. An unbanked micro-pension client would be provided a bank-issued magnetic swipe prepaid card. The client’s micro-pension account number would be mapped to her 16-digit prepaid card number.

Thereafter, the client could periodically “load” small sums of cash onto her prepaid card as per her own income and cash-flow. These cash-in transactions was facilitated by an authorised field officer of an outreach partner by swiping the client’s prepaid card on a micro-POS device attached to an ordinary mobile phone.

With this transaction, a mandatory “float” in the field-officer’s account would be debited in real-time and the client’s account (in escrow) would be simultaneously credited with the amount of cash received by the field officer. The client would receive an instant, system-generated SMS from the bank confirming the credit.

In this way, a client’s contribution was accounted for, reconciled and digitized in real-time and instantly credited into her prepaid card escrow account in her name with zero risk of theft or reconciliation errors.

If the client moved to a new city, she could use a designated BC outlet in her neighbourhood to periodically load cash onto her prepaid card.

The accumulated balance in the client’s prepaid account was periodically debited as per her own standing instruction or auto-debit mandate, and transferred directly to the regulated product provider on her behalf. This auto-debit feature was managed by a customised prepaid card program management platform developed with VISA’s support. This platform also kept track of prepaid card balances in escrow.
This digital micro-payment process was simple, scalable, secure, portable, convenient, transparent and affordable. Importantly, it was feasible to convert these closed-loop prepaid cards into an open loop card and use them for secure and direct delivery of insurance claims and pension benefits to micro-pension clients.

The time to market, capital cost and operating expenses of this solution, both in relation to the high cost of cash transactions and the cost of fraud prevention, were extremely modest. Field officers already had mobile phones. The mPOS dongle cost around USD 30 per device. The capital cost of this device per client (assuming a field officer serviced even 150 micro-pension clients) was near zero. The cost of each payment transaction, involving around 2 kbps of data used for connecting with the bank server and for the bank to send an SMS to the client was also modest.

**WHY DID THIS WORK?**

- This prepaid cards based micro-pension contribution collection process was simple and easy to use. It was identical to loading talk-time on a prepaid mobile – a process that all micro-pension clients already understood well.
- It enabled real-time, automated reconciliation and cash digitisation and therefore effectively mitigated the risk of fraud and reconciliation errors.
• The process was based on a sound governance framework – the prepaid cards were issued by a commercial bank regulated by the Reserve Bank of India. Periodic contributions by each micro-pension client were kept securely in escrow pending transfer to the fund manager on her behalf and could not be used by any other entity for any reason.

• It provided full portability and convenience to a client. Persons with prepaid cards could walk up to any of thousands of third-party outlets for loading cash onto their prepaid cards. If a client lost her card, she would never lose the money in her account and would simply be issued another card attached again to her unique pension account number.

• The prepaid cards based system was flexible and allowed each subscriber to save any amount that she could afford and in line with her own cash-flow.

• The standing instruction or auto-debit mandate feature enabled automated and therefore regular micro-pension contributions even by subscribers with irregular incomes. Savings were automatically deducted from each micro-pension client’s escrow account and transferred on her behalf to the pension fund manager without requiring any interventions by the client. This helped increase persistency.

• The prepaid mechanism was affordable – the cash-in fee was a small percentage of the contribution value and hence did not penalize the poor (as flat transaction charges would).

• This prepaid cards based payment solution could also be used by outreach partners for other purposes – for example, for cashless loan disbursement and collection of loan repayments from clients; and

• Open-loop prepaid cards could be used also for secure and direct delivery of insurance claims and pension benefits to micro-pension clients without any risk of fraud or misappropriation. A beneficiary could then use an ATM or bank agent to withdraw the benefits or claim payment transferred directly into their prepaid card.

CASE STUDY 2
NID AND DIGITAL (PAPERLESS) ENROLMENTS

INITIAL CONDITIONS
A typical micro-pension client faced significant challenges in providing valid Know Your Customer (KYC) documents to prove identity, age and address, often due to frequent migration across jobs and locations. Also, different financial regulators prescribed different KYC for financial products regulated by them. As a result, a number of low income informal sector workers are unable to easily enrol for an integrated micro pension program that combined a pension, payment and insurance solution.

KYC requirements also led to a very cumbersome and expensive application and documentation verification process involving the collection of multiple photographs along
with multiple copies of physical KYC documents and handwritten application forms for an integrated product solution.

Figure 16.2

The micro-pension enrolment process with physical forms and KYC

As we see in Figure 16.2, the enrolment process for a typical micro-pension client could take up to 18 days to complete and cost us roughly 20 percent of the year-one pension savings by the average contributor.

Each set of application forms would also impose additional costs and time overheads for our clients as they would need to submit multiple copies of colour photographs along with multiple photocopies of multiple KYC documents – as any one document was usually unable to provide proof of address, age and identity.

The field staff of a partner institution would then need to fill in, by hand, individual application forms for each product (although each product application required nearly identical information). This very often caused overwriting, errors and oversight. In the normal course, it could take around 45 minutes to complete one set of application documents for a micro-pension client. If a field group meeting resulted in (say) 12-15 enrolments, the documentation process could consume a major part of the day for both clients and the field staff concerned. And field staff obviously expected to be adequately compensated for their time and significant effort.
These documents were then deposited in the link branch office for local inspection — where someone in the branch would verify that the data in each application form exactly matched the information in the supporting KYC documents in each product application of each client.

The branch would then courier (or post) all verified applications collected for the day to a central data processing hub where each set of application forms and KYC went through another round of scrutiny before the forms were digitised. The data in application forms that were correct in all aspects was entered into the system — which led to occasional data entry errors and the forms being rejected by the product partners at the last stage.

The R&D team at the microPension Foundation developed an innovative technology-led solution to this problem. As we see in Figure 16.3, this new digital solution helped cut back the processing time for each set of multiple product application forms from 18 days to under 3 minutes. And helped in achieving an equally dramatic reduction in cost by 97.5 % (to INR 5 or 10 cents per application from the earlier INR 200 or USD 4 per application).

Figure 16.3
The new eKYC - based digital (paperless) micro-pension enrolment process

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4 Forms that contained errors were couriered back to the branch where the field officer would need to track the client and correct the application documentation set before restarting the process.
HOW DID THIS WORK?

- Aadhaar was uniformly recognised as a valid KYC for all financial products by all financial regulators. This national ID-based KYC was also accepted as a valid document under PML (Prevention of Money Laundering) regulations. In 2013, the Unique Identity Authority of India (UIDAI) launched an eKYC service that allowed financial institutions to electronically access the national ID data of a potential client provided the transaction was duly authorised by the client using a biometric authentication process. UIDAI would provide an API based secure access to client data for this purpose.

- IIMPS, through the microPension Foundation, was among the first batch of institutions in India to be licensed by the UIDAI as an eKYC authentication and user agency (AUA and KUA). We modified our micro-pension IT platform for eKYC.

- In the new process, represented in Figure 16.3, a person who wished to open an integrated micro-pension, insurance and payment account would no longer need to carry any documents or photographs to a field meeting. She would simply place her thumb on a tiny biometric reader attached to a web-enabled tablet or laptop. The biometric information and Aadhaar number would be transmitted to UIDAI and her identity would be verified in real time.

- Basis a biometrically verified request by the client, UIDAI would deliver her full eKYC data, including her photograph, to the micro-pension enrolment application on our IT platform. The raw eKYC data and the photograph was instantly poured into the relevant fields in the multiple product application forms.

- The system would instantly convert each application form into a high resolution PDF file, complete with photograph and a digital signature (which was a unique eKYC transaction ID issued by UIDAI for each eKYC transaction). The client would place her thumb once more onto the biometric reader to “sign” her application and permit transfer of her forms to the relevant finance product providers.

- In this way, the full set of product application forms could be electronically filled and transferred to a product provider, along with the client’s first electronic contribution (collected using the prepaid cards based process described earlier) in under 3 minutes from any field location.

- Importantly, the data in each digital application form was filled using the national ID data received from UIDAI. As a result, there was no longer a need to attach any KYC documents with the application forms. No courtiers needed to be sent and digital applications were completed and transferred in full compliance with KYC and PML guidelines to multiple product providers.

By integrating this process of on-the-spot, digital micro-pension enrolments with the prepaid card solution described earlier, we were able to achieve instant, cashless and paperless enrolments for an integrated micro-pension program involving multiple regulated products from any field location in India in under 3 minutes at a fraction of the earlier cost faced by us.
CASE STUDY 3
DIGITAL OUTREACH: GIFT-A-PENSION

INITIAL CONDITIONS

Roughly 40 million individuals are employed as cooks, maids, drivers, security guards, gardeners and errand staff, mainly by middle and upper-middle income households across super-metros and other large cities in India. In addition to being one of the oldest occupations, paid domestic work is also a rapidly growing profession in India. Traditionally regarded as an invisible-working class, domestic workers are often undervalued and lack access to basic forms of worker protection including minimum wages and social security.

Although the majority of India’s domestic help have reasonable, regular incomes capable of supporting regular pension contributions during their years in the workforce, the majority of this population continues to be excluded from banking and formal financial services. Most of them direct a majority of their incomes to fund the consumption needs of their families back home – often leaving them with very little with which to secure their own future. Without a meaningful financial and pension inclusion intervention, this cohort will remain starkly exposed and highly vulnerable to a range of insurable lifecycle risks including the risk of old age poverty.

Not surprisingly, surveys by government agencies and focussed group discussions (FGDs) with domestic help conducted by the microPension Foundation found clear evidence of a high latent demand for both pension and insurance solutions among this population. Interestingly, parallel interviews with employers of domestic help across multiple cities revealed an almost universally high level of commitment among them to support pension and financial inclusion of their home help.

Conversations with our financial sector partners (pension funds and large insurers) indicated a very strong interest in the clearly significant aggregate demand for retirement and insurance products that this cohort represented. But domestic workers are difficult for formal finance firms to locate, access, educate and enrol through their traditional sales and distribution models at an affordable transaction cost. Neither can they be targeted through the traditional micro-pension “group” model as these individuals are scattered across millions of urban households across the country. The high incidence of both inter- and intra-city migration among this cohort imposed significant additional challenges in providing uninterrupted access to information, payment services and benefits over long-term savings horizons, especially in the context of insignificant banking access among this group.

Against this background, the microPension Foundation R&D team developed a simple, web-based platform that enabled middle and upper-middle income households anywhere in India to enrol their own domestic help for an integrated micro-pension and micro-insurance solution. This first global P2P micro-pension inclusion platform is named “Gift-a-Pension”.
Gift-a-Pension was soft-launched as a pilot in 2015 and resulted in enrolment of a few hundred maids and drivers for an integrated pension and insurance product within a few months. The platform provided simple online financial literacy tools including animated films, videos and calculators that could be used by employers to inform and educate their domestic help regarding complex financial concepts, product features and processes and to encourage them to join the pension and insurance program.

Figure 16.4
How the Gift-a-Pension P2P Platform Worked

The gift-a-pension process is encapsulated in Figure 16.4. Employers used a standard, secure and simple online payment gateway for making the first contribution on behalf of their home help. Domestic help used a standing instruction on their bank accounts or prepaid cards for periodic contributions. Employers were encouraged and able to co-contribute towards the pension and insurance solution for their domestic help and many employers did so. Some used this to implement a philanthropic motive while some did this as a retention or reward strategy for an individual who clearly played a profoundly important role in the household.

Savings of home help and co-contributions (if any) by an employer would flow directly from the domestic help’s bank or prepaid account to the regulated financial product provider chosen by her at the time of enrolment as per her own standing instruction mandate. The national, multilingual micro-pension helpline provided ongoing information and assistance to both employers and domestic help.
Coverage expansion under Gift-a-Pension was driven entirely by satisfied and happy users of the platform and relied heavily on social media. This naturally also imposed a stringent and healthy level of quality control on services as unhappy employers were likely to be very visible and vocal.

WHY DID THIS WORK?

The Gift-a-Pension concept and platform was based on the following strong foundations:

- Non-linear outreach and distribution model. Capable of instantly reaching millions of individual home help across the country through their employers without incurring the traditional finance sales and distribution costs;
- Financial literacy and knowledge delivery by well educated employers using standard, web-based tools. Employers had zero incentives to miss-sell. The process for financial literacy and knowledge transfer was neither time-bound nor “transaction” related;
- Digital application forms for an integrated social security solution imposed near zero overhead on the employer. Digital application forms, and data entry and verification by employers mitigated the risk of data errors in the forms received by product partners;
- Near zero non-linear sales and distribution costs through a web-based outreach. Costs could collapse further with product bundling, negotiated fees from product partners, risk pooling through demand aggregation and scale;
- Unique, portable, client-centric individual pension and insurance accounts issued and administered using a central IT platform. This platform integrated and managed the full ecosystem (products, payments, helpline, services, complaints), produced persistency MIS and stored individual client-level static, transactional and financial data over time across all products.

CASE STUDY 4
HARNESSING G2P INFRASTRUCTURE FOR DIGITAL PENSION INCLUSION

INITIAL CONDITIONS

Since its launch in late 2014, the Indian Prime Minister's Jan Dhan Yojana (PMJDY) has already provided banking access to nearly 250 million excluded Indians while a parallel insurance program has delivered accident and life insurance cover to some 120 million low income citizens. In comparison, by early 2017, India’s National Pension Scheme (NPS) had managed to attract barely 12 million voluntary, informal sector subscribers (or roughly 3% of the target workforce). Of course, voluntary pension coverage is certainly more challenging to achieve than access to bank accounts or a low-cost one-off insurance cover. Even so, market research and evidence from recent pension coverage expansion pilots
conducted in three Indian States and co-sponsored by the World Bank FIRST Project and PFRDA, clearly show that pension coverage in India hugely lags both latent demand and policy intent.

This case-study encapsulates the effort and outcomes from one of these three pilots. This pilot was conducted in collaboration with the District Collector’s office at Krishna — a rural district in Andhra Pradesh in southern India. The pilot helped assess and address important process, access, incentives and knowledge related barriers to expanding pension coverage in remote rural locations. More generally, this FIRST funded project was expected to assist the PFRDA and the Indian Government in designing scalable and replicable field-tested strategies for expanding voluntary NPS coverage, especially among the more vulnerable and lower income sections of the workforce. This involved, among other things, recommendations related to the product, processes architecture, sales and distribution strategies, commercial incentives for distributors, field promotions and retirement literacy interventions.

In the many months preceding the pilot, the Government of Andhra Pradesh (GoAP) had already established a transparent, NID (Aadhaar) enabled and technology-led public infrastructure and digital process for direct delivery of a range of government-to-citizen (G2C) benefits including fertiliser subsidies, old age pensions, employment guarantee payments (MGNREGA) and subsidised food grain. This included 26,200 evenly spread and easily accessible Aadhaar-enabled public distribution (fair-price or PDS) shops that deliver subsidised food-grain to some 13 million low income beneficiaries across the 13 districts of Andhra Pradesh.

Starting with the Krishna District, the State had also launched an Aadhaar-enabled Payment System (AePS) in collaboration with the UIDAI, the National Payments Corporation of India (NPCI) and the National Informatics Centre (NIC). This AePS infrastructure enabled digital payments by PDS beneficiaries for goods and services procured through PDS outlets and also enabled direct, secure delivery of G2P transfers to identified beneficiaries without any of the traditional risks of reconciliation errors, fraud or leakages. In mid-2016, the state government decided that all PDS outlets shall also serve as bank correspondents (BCs) — a step that was intended to significantly increase retail banking and digital payments access and utilisation and simultaneously increase the transaction fee-based income for PDS shop-keepers.

This Aadhaar-linked digital public distribution and payments infrastructure could readily serve as a credible and low-cost channel for delivering a range of financial services including pensions to low income excluded households. Against this background, and under a FIRST funded Project, The World Bank, supported by a team from pinBox, launched a pilot to assess, for the first time in India, the ability of village-level Fair Price Shops to provide access to the National Pension System. This pilot was expected to test the demand for voluntary pensions (and specifically for the new, defined benefit Atal Pension Yojana or APY) among PDS beneficiaries, as well as the interest and capacity of
PDS shopkeepers to deliver knowledge, enrolment assistance and ongoing support for collecting pension contributions from PDS beneficiaries enrolled for the APY.

REASONS FOR LOW HISTORICAL APY COVERAGE IN KRISHNA DISTRICT

The World Bank and pinBox project team worked in mission mode, in close collaboration with Babu Ahmed, then Collector of the Krishna District, on this digital pension inclusion pilot. The stakeholder consortium included PFRDA, Department of Financial Services, UIDAI, NPCI, NIC and Andhra Bank. Four fair-price (PDS) shops, recently appointed by Andhra Bank as bank correspondents (BCs), were chosen to participate in the pilot.

The project team conducted a baseline sample survey among PDS beneficiaries attached to the pilot PDS outlets to assess their incomes, demography, financial literacy, financial capability, outlook towards retirement savings and their level of trust in PDS shop owners. Detailed consultations were held also with a number of PDS shop owners including the 4 outlets selected for the pilot to assess their interest and capacity to deliver retirement literacy, their expectations on commercial incentives, and opportunities for delivering knowledge, enrolment assistance, reminders and ongoing information and services to APY clients enroled by them. The team also met with other existing BCs of Andhra Bank who were already authorised to enrol bank clients for APY and NPS in order to understand why so few bank clients had opened APY accounts.

Preliminary findings from the survey and interviews with key stakeholders were followed by a detailed evaluation of the process adopted by Andhra Bank for pension enrolments. This process is outlined in Figure 16.5.

From the survey on PDS beneficiaries and BC clients, it was obvious that the demand for pensions was not the primary challenge. It was equally obvious that enrolments for APY were low mainly due to low public awareness and due to the inefficient, cumbersome and expensive enrolment process.

As per the prevailing process, a BC would normally need to spend around 20 minutes in completing the enrolment documentation formalities for an APY client. This involved keying in the person’s contact information and other required data onto a digital application form using a tiny hand-held POS device. In addition to this electronic data entry, the BC was expected to fill up a physical APY application form and submit the same at the nearest branch of Andhra Bank. The BC would typically be paid around INR 40 (~70 Cents) for each valid enrolment and the payment would normally be received 3 to 4 months after an enrolment was completed.
The Andhra Bank branch would usually take a few days to review the application form, confirm that the data in the form was identical to the client’s data residing already on the Bank’s core banking system (CBS), allot a new pension account number (from a basket of pre-generated pension account numbers) and register a standing instruction or auto-debit mandate for automated deduction and transfer of periodic APY contributions from the client’s bank account on the CBS. Much of this process was expensive, cumbersome and avoidable. For example, each client that walked into an Andhra Bank BC outlet to open an NPS account was, by definition, already an Andhra Bank client. In which case, all data of the client that was required to complete an APY application form was already residing on the Bank’s CBS.

In consultation with the District Collector, Andhra Bank’s financial inclusion department, UIDAI and NIC, the Project team designed a new, digital, straight-through-process for APY enrolments by fair-price shops serving as Andhra Bank BCs. This new process
leveraged the existing Aadhaar-enabled IT infrastructure at PDS outlets. A small APY application software patch was developed and downloaded onto the Aadhaar-enabled PDS POS device already in use by PDS shops. With this new digital process, and as we see in Figure 16.6, a PDS beneficiary with an Andhra Bank account could open an instant APY account at any PDS BC outlet.

**Figure 16.6**
**The new digital APY process for AePDS Outlets in Krishna District**

**HOW AND WHY THIS WORKED?**

The PDS BC would first scan the client’s iris or fingerprint using the Aadhaar-enabled PDS POS device to verify her identity. The BC would then key in the client’s bank account number onto the POS device.

The POS device would instantly pull the client’s full static data from the Bank’s CBS to automatically populate a blank digital APY application form on the POS. Then the BC would simply key in the nominee’s name, and the amount and frequency of future APY contributions by the client.
This digitally completed application form was uploaded onto the bank’s server and triggered three automatic, simultaneous and immediate actions: (a) the client’s first NPS contribution was debited from her bank account, (b) she was allotted her permanent retirement account number (PRAN), and (c) her auto-debit mandate for future contributions was flagged on her bank account and registered on the bank’s CBS.

The client’s first pension contribution value, her PRAN number and the date and amount for periodic auto-debits was displayed on the POS screen at the BC location. The BC would simply provide the client a thermal print of a receipt that contained this information. This full process took less than 5 minutes to complete, did not require any physical application form or the BC to visit the bank branch.

There were positive indications also that using village-level access boosted the gender balance – from 65:35 in the general population of APY accounts to 50:50 in Krishna district. The 4 PDS shops opened around 130 new APY accounts over a 3-month period — which was roughly 20% of the total PDS beneficiaries with Andhra Bank accounts attached to these 4 outlets.

If all 26,200 Fair Price Shops in Andhra Pradesh enrolled just 10 PDS beneficiaries for APY per month (well below the coverage levels achieved per outlet during the pilot) this would translate into 3 million accounts a year – a 75% increase on the national total that had then been achieved for APY by early 2017.

Importantly, fair-price/ PDS shop owners had a clear opportunity to deliver regular reminders for persistency when clients visited them for their monthly rations. And as BCs, they had the ability to help load savings into the bank accounts and thus ensure successful auto-debits for pensions.

The World Bank Digital Pension Inclusion Pilot in collaboration with the Krishna District Administration clearly demonstrated a significant latent demand for APY among PDS beneficiaries. Equally, the pilot clearly demonstrated that Aadhaar-enabled PDS outlets are a secure and trusted channel for targeted delivery of the APY and NPS to vulnerable, low income informal sector citizens excluded by formal pension programs. The most striking aspect of this pilot however, was the path-breaking work that has already been done by Krishna District’s highly proactive and visionary District Collector and his equally committed and energetic team who laid a powerful foundation for pension and financial inclusion through the digital, Aadhaar-linked public infrastructure for government services to citizens.

Overall, the Krishna pilot provided invaluable evidence of what works, and what can work going forward. The potential is unprecedented.
The important interlinkages between pension inclusion, ID, IT and digital payments were not clearly visible when we were in the trenches, looking out at an unchartered horizon. Connecting the dots is obviously easier with the benefit of hindsight. Therefore, and as we apply past learnings to the design of future pension arrangements in South Asia and East Africa, we would do well to be guided by the following fundamentals.

First, most of the key supply-side pieces of a solution needed to achieve comprehensive pension inclusion already exist in most countries — strong political will and policy commitment, a dedicated regulator, digital national ID infrastructure, third-party sales and service outreach, well regulated financial institutions including fund managers and insurers and broad-based access to banking and/or digital payments. However, in most countries and for most citizens, this supply rarely comes together as a single-window solution for excluded citizens. In this situation, technology can play a powerful role as the glue that can bind the supply and deliver it through a simple, convenient and affordable single-window to excluded citizens.

Second, a clear, fundamental understanding of the risks or challenges that our clients are facing or could face, and just being able to imagine a radically different and better outcome is an important part of the solution. As we saw with Gift-a-Pension, or even when faced with the challenges of cash or KYC, it was easy to build a solution once it had been imagined. In fact, it may actually be difficult thereafter, to continue to accept suboptimal outcomes and to not implement the better idea.

In this context, we must perhaps never cease to imagine a simpler, cheaper, easier and more secure way to do everything that we can to improve lives and deliver better outcomes to the citizens whom we have chosen and committed to serve.
Governance is an important ingredient in both Pay As You Go (PAYGO) and funded pension provision. Governance is the means to create trust, integrity and efficiency. It is the resource that enables an institution to maximise its performance. A well-governed pension fund performs in an effective and equitable way. It delivers added value and needs less attention by the regulatory authorities. A well-governed pension fund is a welfare institution its members can trust in. And, members do need trust to place their money in an institution that promises them a pay-back in the remote future. This holds true especially for low-income workers in the informal sector who face a low level of social protection, are mostly financially illiterate and lack prior experience with pension savings. As Ambachtsheer (2016) points out, good pension design, good pension governance and good pension investing need to be well aligned to make funded pension provision work well for the many people who entrust their savings to them.

The over-riding purpose of a pension fund is to provide retirement benefits to their members. We observe many different organisational structures with different plan designs and different sets of stakeholders, which we will summarise later in this section. But notwithstanding the organisational structure, investment is a core function at pension funds. Pension funds collect contributions, invest the money in (global) financial markets and finally pay-out pension benefits. These are long-term concerns, supported by the mechanism of compound interest. As pensions are accrued over long periods of time, one percentage of additional performance (net of fees) translates into approximately 20-30% higher pension benefits or alternatively 20-30% lower costs. Investment decision-making needs to be well governed. The formal mechanisms by which an institution makes decisions, is held accountable to its stakeholders and beneficiaries, and acts in accordance with public and private standards (Clark 2004), have a significant impact on how well the institution achieves its target.

This chapter is organised as follows: It first sets the stage by explaining the concept of governance in the broader organisational context of the pension institution, and, then focuses more closely on the investment process in terms of pension investment governance. It will lay out the theoretical framework, drawing mostly on the seminal paper from Jensen and Meckling (1976) in order to provide a deeper understanding of the principle of conflict of interest and the information asymmetries fundamental to the importance of governance. Second, it will summarise the principles of best-practice governance as developed by a wide range of authors from Ambachtsheer, Clark, and Urwin, through to the International Social Security Association (ISSA) and the work of many practitioners collaborating on this volume. Theory will be followed by practical experience. Third, the chapter will provide evidence from both developed countries and the developing world. In doing so, it aims to provide examples of good governance.

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1 See for example Price, Ashcroft, and Hafeman (2016) and Ashcroft, Inglis, and Price (2016), ISSA (2013) and International Organization of Pension Supervisors Risk Based Supervision Toolkit.
or experience to show which should be avoided. It tries to derive insights and best-practice principles based on the long-standing experience of the developed world with funded pension provision that can be transferred to the developing world. In doing so, it recognises the significant differences in the two settings. Finally, it draws some conclusions of potential applicability to pension inclusion initiatives.

GOVERNANCE IN CONTEXT

The following section sets out the theoretical issues of the principal-agent conflict and regulatory approaches to help resolve inherent problems. It further describes various governance models pension funds apply and sets out the key elements of best-practice pension governance.

THE PRINCIPAL-AGENT PROBLEM

The starting point for considering the nature of good governance is to consider how it enables the institution to overcome the principal-agent problem that is inherent in all organisations that are characterised by delegated decision-making (Ross 1973). As the members of the pension fund (the principals) are unable to manage the pension fund themselves, pension fund managers (the agents) are engaged to perform this task on their behalf, which in some jurisdictions, are formally recognised as trustees. In any event, the agents shall act in the best interest of the principals. The pension fund managers have delegated decision making authority. Moral hazard results when the management does not act in the best interest of the principal. The problem is that it cannot automatically be assumed that an agent will always seek to maximise the welfare of his principal rather than his own. This is partly a problem of monitoring as the principals cannot properly observe the actions of the agent. This holds true for the active, deferred, and retired members of a pension fund whose level of financial literacy is mostly low and understanding of pensions or investment very limited, in both developed and developing countries. Furthermore, asymmetric information between the principal and agent gives rise to adverse selection.

To resolve the potential principal-agent conflict, incentive mechanisms need to be implemented to properly align the decisions of the agent(s) with the interests of the principal(s) and an authority needs to be installed which can monitor the agent(s). This task can be performed in principle by any legal entity that is separated from the decision-making of the pension fund. One standard form of mitigation is the two-tier model of governance in which the operational and oversight responsibilities of a pension fund are identified and separated (OECD 2009). In pension funds, the board of trustees (or other form of top-level board) assumes the oversight responsibility while the pension fund management is responsible for fund operations. But, this assumes that there are effective mechanisms to ensure that the top-level board’s oversight is effective and decisive.

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2 See Jensen & Meckling (1976).
A pension fund is, like any company, an institution, which can be seen as a web of contracts allocating property rights. Contract theory assumes that individual behaviour is informed by contracts. Some claims have priority over other claims. The residual claimant is the stakeholder whose claims are only settled after the legal claims of all other stakeholders. In an employer-sponsored plan, the employer has the position of the residual claimant under-writing the pension promise, which for a Defined Benefit (DB) plan, can be a heavy burden, either as a legal obligation for full contractual discharge, as in the U.K. and USA, or as a partial legal obligation coupled with a moral obligation and often societal expectations as they are obliged to settle the final bill. If they have to pick up any shortfall, then in theory, the employer has a strong interest to monitor the pension management to make sure the investment is efficient but risk-controlled, while administration costs are low, primarily by appointing governing board (trustee) members of sufficient diligence and expertise. The ability of employers to be effective in protecting their interests in this way is, however, variable.

But, in many pension arrangements, property rights are often diffusely distributed between different groups of stakeholders whose interests may diverge. The Netherlands have established a set of rules to clarify the pension deal. Under a collective defined contribution arrangement with fixed employer contributions, potential loss-taking is distributed between active and retired members. When the solvency ratio of the pension fund falls below a defined level, accruing rates and pensions in payment have to be cut following ex-ante defined and communicated rules. On the other hand, Defined Contribution (DC) plans with minimum guarantees, but decision-making by the individual, might give rise to speculation or conservatism depending on the risk attitude of the individual. DC plans without guarantees, where any losses are borne directly by the individual member, but with collective investment decision-making by the management of the pension fund, place very high demands on governance and control because of the poor alignment between the principal's interests and the agent's incentives.

Where for-profit corporate funds are concerned (and many DC plans are of this kind), one approach has been to rely at least partly on the disciplinary forces of the markets. Pension systems in Latin America and Eastern Europe were therefore designed with strong competitive elements in their pension systems, while Australia introduced fund provider choice. The theoretical case is built on the assumption that members of such individualised DC systems will switch funds in case of under-performance and thus provoke an optimal result. A high level of financial literacy is required to make decisions that are in the best long-term interest of the individual, especially if the individual is required to choose an optimal portfolio between many options. There have been plentiful examples of excessive intermediary costs and mis-selling, as well as poor choices governed by behavioural biases and low financial literacy. Research in Latin America (Berstein 2002, amongst others)

3 In the USA, the Employee Retirement Income Security Act (ERISA) requests that the sponsor of a terminated single-employer plan pays the Pension Benefit Guarantee Corporation (PBGC) the amount of any unfunded benefit liabilities (ERISA §4062). But in many countries with Defined Benefit systems, the employer does not always have a legal obligation to pay all the benefits even if there is a shortfall in assets — but do so as part of custom and practice. When there is a major event, such as a bankruptcy or a major financial crisis, it then becomes clear that there are no actual legal requirements to make good the shortfall.
has shown that intense and expensive sales effort by intermediaries is needed to induce significant switching. Furthermore, competitive pension fund systems with high switching options for members have been found to provoke herding behaviour on behalf of the involved commercial asset managers, as well as requiring additional liquidity.

Even if competition were to provide effective discipline over pension fund managers (agents), which has increasingly shown to be doubtful and not cost-effective, it has no relevance in pension systems that give members no choice. Members of the traditional employer-sponsored DB pension funds, which are often mandatory for employees, cannot just ‘walk away’ in case of mis-management, and hence no reliance on market forces to ensure good performance could even be contemplated. Some other way is need to ensure over-riding fiduciary responsibility.

REGULATING GOOD GOVERNANCE

From the previous section, it can be seen that there is no certain resolution of principal-agent risks without some effective monitoring from outside the pension funds themselves. Hence, the need for sound regulation is undisputed, especially given the long-time horizons involved in pension provision and the societal need for consumer protection, and hence pensioner welfare. Not surprisingly, the regulation of governance has become one of the leading principles of pension fund regulation – not only across the OECD but increasingly in developing countries – not least as a result of the sharing of best practice on successes and failures in pensions from a range of organizations from the OECD, International Organization of Pension Supervisors (IOPS), World Bank and the Toronto Centre for Global Leadership in Financial Supervision.

In trust law countries, such as the United Kingdom, the United States and Australia, the guiding principle of fiduciary responsibility is enshrined in the long-established law of trust. A pension fund is legally a trust guided by trustees. Trustees are requested to act in the best interest of the beneficiaries and are bound by the highest standard of care known as a fiduciary duty standard. The principle of prudence governs the investment decision making of fiduciaries (Vine 2010). This principle of moral suasion is usually underpinned by the power of law. Comprehensive pension laws and regulation supplement and elaborate on trust case-law. For instance, in the U.K. the Pensions Act 2004 clarified that individual trustees should have sufficient knowledge and understanding whereas some pension funds had assumed that it was enough for the board to have such knowledge and understanding corporately.

Especially in the United States, courts can rule harshly in cases of breaches of fiduciary duty – although it can also be very challenging in practice to take a case through the courts. Often, cases are settled outside court. Recent years have seen an increasing number of law-suits focussing on excessive fees in 401(k) DC plans. In 2015, for instance Boeing

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4 In the US, the Employee Retirement Income Security Act (ERISA) requests that ‘a fiduciary must discharge his or her duties with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and aims’ (ERISA §404(a) (1)(B)).
and Lockheed Martin paid USD 57 million and USD 62 million respectively to settle lawsuits in which employees accused the companies of mis-managing their retirement plans. The extensive and long-standing case law regarding fiduciary trusts has a strong disciplinary impact on trustees that affects decision making, including on investment.

The establishment of fiduciary responsibility for governing boards is limited to explicit legislation in civil law countries found in Continental Europe and Latin America. When neither the legal structure of a trust nor the principle of fiduciary duty is embedded in legal history, equivalent legal requirements need to be implemented. It has been very much a trend, encouraged by OECD Principles for such frameworks to seek to find a country-specific way in which to achieve the same long run aims of good outcomes from well-run pension institutions. This often involves focusing on the licensing, regulation, and supervision of those running pension institutions. For simplicity, the language and concepts of a trust overseen by a board of trustees guided by fiduciary duty are often used here, recognising that similar intentions exist, and are regulated for, in civil law countries – with a Governing Board/Managing Board distinction often used to distinguish different roles.

**THE BOARD OF TRUSTEES**

Trustees carry a broad responsibility for the pension fund including that investment accords with their fiduciary responsibility: They are hence responsible for determining the mission and beliefs of the pension fund and ensuring that an effective investment governance model is implemented. This requires them to be able to answer questions like: What is the long-term goal of the pension fund? What is the vision for the pension fund in 30 or 40 years? The fund’s liabilities and status will help provide the guidelines to the answers. Mission and beliefs of a mature pension fund which is closed to new contributions and is planning for the end game will be fundamentally different from the mission and beliefs of a young and going concern pension funds with an indefinite time horizon. Plan population and time horizon are also the starting point for the development of the investment beliefs (in DC as well as DB funds).

The trustees are further responsible for the strategic asset allocation of the pension fund and managing investment risks, often through a risk budget. This role is often delegated to a specialised investment committee of the board. The board should not be responsible for the implementation of the investment strategy, although they should monitor it, and are responsible for choosing asset managers. Portfolio construction and reporting are the responsibility of the management of the pension fund if the investment process is managed internally or otherwise it is the task of the external asset managers. But the responsibility for the high-level policy decision remains with the board. Questions like, should the fund invest internationally (if permitted by regulation), should it invest in equity and to what extent, and how much risk can be taken, need to be jointly agreed. It is good

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5 The primarily Anglo-Saxon term ‘board of trustees’ is used in this chapter, but this is interchangeable with any entity overseeing the management of a pension arrangement – for example the Governing Board compared to the Managing Board. In a one-tier-governance system management and oversight are blended into one function. In any event, good practice requires that governing board members act as de facto if not de jure trustees.
practice, and in most countries a regulatory requirement, to have these broad guidelines articulated within a written Statement of Investment Policy, or Principles, which is regularly reviewed, preferably annually.

So, how can the system be regulated to ensure that the board of trustees properly performs this important function? The board of trustees needs adequate representation to gain legitimacy and trust. It is good practice to have trustees representing the different stakeholders of the pension fund. This often includes trustees representing the members who may be elected at a general meeting of members. In many cases, such as the Netherlands, there can be specific representatives of the retirees on the board. In employer-sponsored and financed plans, the sponsoring employer usually appoints one third or even a half of the trustees. An increasing trend in the United Kingdom is for independent trustees, who may be investment professionals, to be appointed to supplement the board’s expertise and reinforce its impartiality.

The next requirement is for the trustees to apply the strategic oversight over the pension plan. This demands knowledge, expertise, and competence on behalf of the trustees. Not every trustee needs to be an investment professional, but they need sufficient understanding of the issues to manage and control their investment professionals, whether this might be external or internal asset managers. This profile of qualifications can be – and often is – at odds with the requirement of representation. Especially in pension fund systems, which had historically been built on lay (or non-expert/member representative) trustees, the necessary professional expertise of trustees can be a challenge. Indeed, the Kenyan regulator has gone so far as to make passing a specific trustee qualification a condition of remaining on a trustee board, while the U.K. regulator offers an on-line trustee training tool-kit and has in addition the power to remove trustees considered as not fit for purpose and to replace or augment them with their own nominees. In the Netherlands, the regulator has been proactively interviewing and assessing existing trustees, some of long-standing, to see if they are fit for the higher standards to which the regulator aspires. If they are not, then they are no longer allowed to act as a pension fund trustee.

Particular issues may arise where government representatives are included on the board of trustees. In any public pension system, the government is a legitimate stakeholder being the plan sponsor and probably a major contributor. A government also has interest in funds enabling the achievement of governmental welfare objectives, and hence their representatives could be legitimate members of a board of trustees. In principle, the requirements for governmental appointed trustees should not differ from the requested qualifications of all trustees. In practice, shortcomings in public plans’ governance have been found (Fitzpatrick and Monahan 2015, Impavido 2002, Useem and Hess (2001) that resulted in underperformance (Andonov et al 2016, Iglesias 2000). There are some reasons why a government representative may not be well suited to perform as a pension fund trustee as: (1) it has law-making powers and is thus able to escape control; and (2) usually has a broad and economically conflicting agenda.
On the other hand, there are many examples of well-managed public pension funds with excellent performance, as for example the large Canadian pension funds or Norway’s Government Pension Fund. The Canadian model operates with a governance structure that is insulated from the political process with an independent and professional board. The Norwegian fund on the other hand is an example of a public fund managed by the central bank, thus fully integrated into the political system, but with strict governance procedures and controls (Rozanov 2015). Also, the DC fund of the Federal Civil Service – known as the Thrift Saving Plan is probably the world’s most efficient pension fund (with all in costs well under 10 basis points or 0.1% of assets under management a year) and an enviable reputation for governance. As shown in the chapter in this volume on Costs, the strongest net of fee performance in the CEM database up to 2016 shows that the strongest performers can be public pension funds. There is a broad range of examples from both the developing and developed world as we will demonstrate in more detail in the next section.

To ensure that public funds achieve or surpass the performance of their private sector counterparts, the challenge is to ensure that the right mixture of legitimate representation and proficient decision-making is found, while avoiding a detrimental politicisation of the institution and its processes or operational decisions.

INVESTMENT BELIEFS AND RISK MANAGEMENT

Pension funds are usually conceptualised as long-term investors. A going concern pension fund has to invest the assets with the goal of paying pension benefits over the next decades. There is widespread belief that for these reasons pension funds can invest in asset classes with a higher short-term volatility but higher long-term returns such as equity and in illiquid assets such as infrastructure. This statement needs to be caveated: The idea that the long-term investor can ‘take a hit’ in short-term volatile markets draws on the concept of mean-reversion of financial markets, especially stock markets, on which investment theory and evidence is mixed. Financial economic theory whose domain it is to provide investors with investment concepts and strategies unfortunately does not provide unambiguous solutions (Orszag and Sand 2006). A related key question is whether the higher expected returns of non-bond asset classes justify the additional risk. In the USA, the debate whether the Social Security Trust Fund should be invested entirely in bonds or diversify into equity and beyond has been led over decades. The fund still invests entirely in bonds. These contentious issues strengthen the importance of board clarity regarding investment beliefs and good governance more generally.

The board of trustees needs to take a view in particular on whether:

- They believe in the out-performance premium net of fees of active asset management or consider that low-cost passive investments deliver a more reliable net return, or indeed chose different styles for different asset classes. Often, pension funds use passive investment in deep and liquid markets where due to price-efficiency, outperformance may be very difficult to achieve, but use more active management in
smaller markets or particular asset classes such as real estate and private equity, that are less transparent.

- They should out-source the investment function to professional external asset managers or seek instead to build investment know-how and competency in-house, or a mixture of the two.

The optimal answer to these questions is usually closely related to the size of the pension fund. Internal investment has been found to be significantly cheaper than out-sourced solutions but the former is economically viable only at a certain size of assets under management (see in particular Chapter 18 on Costs for a detailed examination on this point). Investment expertise is an expensive and scarce resource. Only large funds have the financial resources to cover all asset classes themselves. Many U.K. pension funds have traditionally outsourced the complete asset management to external managers, which are selected on the advice from investment consultants. Often, core asset classes are covered within the fund but satellite asset classes such as alternatives are out-sourced to specialised asset managers. Dutch pension funds with assets of less than EUR1bn work entirely with outsourced solutions. Fiduciary investment solutions are also becoming much more common with the pension funds in the U.K., which rarely have sufficient size to gain economies of scale. On the other hand some of the largest U.K. pension funds have robust internal investment operations.

In any event, the governance model must be well aligned to missions and beliefs. Internal investment functions require the necessary investment expertise both at the level of the fund management and at the level of the board for strategic supervisory purposes in cases where a two-tier system is implemented. It would not be prudent to extend investments into complex asset classes when there is no adequate knowledge in the fund.

Intrinsically tied to the Statement of Investment Policy is the risk budget framework. Investment risk needs to be permanently managed and controlled. Asset-Liability-Management is today a basic and essential risk management tool for DB plans and, in a modified form being adopted by DC plans. At large institutions investing tens of billions of US Dollars on global financial market, risk management becomes a highly-sophisticated exercise often involving explicit risk consultants or operating sophisticated risk models in-house. But even a small fund with a limited number of asset classes which are totally or mostly invested locally, needs to clarify its risk bearing capacity and its risk appetite. How much money can the fund afford to lose in the short term? This is the very basic question underlying the Value-at-Risk (VaR) concept which is used extensively in risk strategies, alongside other strategies from Conditional VaR and non-parametric techniques that aim to move away from standard statistical models. Who takes responsibility for a loss? How is this communicated to the members? And if they decide not to take an investment risk: What are the consequences of this decision for plan members in terms of their future pension benefits? Can the members afford not to take investment risk?
INVESTMENT GOVERNANCE MODELS

Pension investment governance is the key resource to improve pension fund performance measured as long-term risk-adjusted rate-of-return. Delivering excellent performance is the responsibility of the management of the pension fund and its supervisory board. Pension funds organise themselves in many different ways, informed by their respective legal and regulatory framework. We can find a broad range including all combinations of in-sourced and outsourced organisational forms observed at small and large pension funds. We focus here on three distinct models of pension fund investment governance and elaborate on further forms of collaboration.

THE HUB-AND-SPOKES MODEL

In the hub-and-spokes model of pension fund governance (Clark and Urwin 2016), investment advice, investment management, risk controlling, and performance evaluation are completely or partly outsourced to external agents that need to be managed and controlled. Investment consultants advise the management of the pension fund on the strategic asset allocation that best fits the liabilities of the plan and reflects the investment beliefs of the board, and select external asset managers. A specialised risk manager might consult on the risk management frontier and implement overlay strategies aimed at hedging unwanted risk. The custodian produces the complete reporting including those requested by the supervisor. This is, for example, the most common governance model in the U.K.

The investment consultant is the key intermediary between the trustees as the asset owners and the international asset management firms. This model evolved in the markets and, in the U.K. (at least) it was firmly anchored by regulation that requires pension funds to seek advice on investments. The role of the investment consultant has been subject to some criticism. While some doubt the innovation capability of consultants (Knight and Dixon 2011) others question the added value of consultants more fundamentally based on their manager selection capabilities (Jenkinson et al 2016). It is crucial that the trustees understand this and can critically appraise the advice.

THE INTEGRATED SOLUTION

Large pension funds have increasingly built complete investment organisations in-house. The in-sourcing of pension investment management is a trend that can be observed since at least the 2000s. As the pension funds’ size continued to grow, the cost advantage of in-house management has been increasingly recognised. As some asset managers – and in particular hedge funds claiming to offer returns uncorrelated with the market, risk advisers and investment consultants failed to achieve the promised results in the Global Financial Crisis, more institutional investors decided to bypass the traditional intermediaries. These models can significantly reduce the agency problems of the hub-and-spokes model but involve challenging implementation issues. In-sourcing pension investment management requires building a complete investment
organisation in-house. This includes not only the obvious investment function but, equally important, also risk management and performance measuring. Furthermore, it requires a vibrant learning organisation to constantly adjust investment strategies to rapidly changing financial markets and changing expectations from stakeholders and regulators and to innovate the organisational design. Research found this model to be able to deliver out-performance if the necessary best-practice factors, process, people, and resources are in place (Clark and Monk 2012).

FIDUCIARY INVESTMENT SOLUTIONS

Fiduciary investment, which is also known as the Delegated Chief Investor Officer is an out-sourced investment model that evolved in the Netherlands in the early 2000s and is now becoming more widespread in the USA and the U.K.. It is a concept of managing mid-sized investment portfolios. It can be seen as an alternative to the integrated solution, which is only economically viable for the largest institutions. Under a fiduciary arrangement, the complete investment process is outsourced to one (or more) fiduciary manager who selects and controls the asset managers, is responsible for risk management, and the ever more complex reporting. Only the fiduciary control, the setting of mission and goals, the strategic asset allocation, and the risk budget oversight remain with the pension fund board. The proponents of this approach were initially large pension funds that had separated the pension fund from their pension investment organisation which then took over the investment management for smaller pension funds. Thus, it creates scale, lowers investment costs, and relieves the pension fund from the regulatory reporting duties. Increasingly, investment consultants and international asset managers moved into this new market segment. The management of Chinese walls and of conflict of interests within these organisations is essential.

FURTHER FORMS OF COLLABORATION

Pension funds co-operate at various frontiers. Alternative asset classes such as infrastructure provide a good example for collaboration between pension funds, due to its illiquid and opaque nature, and the large investment requirements of the single projects. Shared investment proves a viable route for pension funds where the minimum asset tranche would otherwise be too large for their investment needs and who do not have the specific research skill to properly evaluate the projects. Co-investment along with fund managers was found to be problematic due to adverse selection biases (Fang et al 2014). Cooperation between peers has become more widespread and more promising. Pension funds bypass traditional fund managers in a drive to lower fees and to better align interests. Pension funds may jointly buy solar or wind power stations. For instance, three Danish pension funds started in 2009 to jointly invest EUR 100 million in renewable energy projects. One pension fund might have an excellent private equity team that is opened to provide also for other funds.

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4 Source: https://www.ipe.com/danish-schemes-invest-100m-in-renewable-energy/33632.article
Furthermore, platforms for institutional co-investment by pension funds have been set up, some market-led, some government-led. The Global Strategic Investment Alliance (GSIA) is an example of a market-led initiative. It was launched in 2012 by the Ontario Municipal Employees Retirement System (OMERS) for joint investments in infrastructure by pension funds. The Government of the Philippines initiated the Philippine Investment Alliance for Infrastructures Fund (PINAI) with co-investments from large public pension funds such as the Dutch APG to attract private capital to Philippines infrastructure investments (OECD 2014). The boundaries between the traditional suppliers of asset management, investment consultant, and pension fund are blurring.

**GOVERNANCE**

**BEST PRACTICE**

Increasing attention is being paid to the performance of pension institutions. This holds true for the mostly relatively large public pension funds as well as for the myriad of often very small privately sponsored funds we observe across the world. The trend to move away from reliance on a single public pension pillar to deliver retirement income, and to have a more multi-pillar or tier arrangement that has both public and private pensions elements, is common across Central and Eastern Europe, Asia and Latin America, and many other jurisdictions. This requires a focus on those institutions that produce pension benefits by investing contributions on capital markets. Their performance assumes responsibility for the well-being of many.

As the following section of this chapter shows, governance has been found to be closely related to the long-term performance (net of costs) of pension funds, in a risk-adjusted context. It is undisputed that the investment performance is of central importance in funded pension arrangements. Many studies have confirmed the link between governance and performance, which was first established by two separate research projects in the 1990’s led by Mitchell and Ambachtsheer whereas, Clark and Urwin developed the models of best-practice pension fund governance.

In this section the literature is summarised, starting with Ambachtsheer’s empirical observation that good governance can increase the risk-adjusted performance of a pension fund by at least one percentage per year (1998) – this translates into 20 to 30% higher pension benefits over the long accumulation periods involved in pension provision. The critical success factors are then identified, following Clark and Urwin (2008, 2010) who conducted an international research project involving case studies on pension funds around the world. Such consideration of best-practice pension governance can be separated into:

- Institutional coherence
- People
- Process
INSTITUTIONAL COHERENCE

The institutional structure of an organisation needs to be aligned to its purpose and tasks. The management of the pension fund needs a clear mission to which all stakeholders are committed. This involves the often very difficult task of clarifying and reconciling often diverging interests of different groups of stakeholders. Hence, the policy of the pension fund must be clearly stated, documented, and adhered to. Clark and Urwin found it very helpful when the general mission, to maximise the welfare of the beneficiaries, is specified with a target of an annual risk-adjusted return. Clear specification and accountability of responsibilities are further characteristics of best-practice governance. War-gaming can be a helpful tool in reviewing the soundness of processes. Notwithstanding whether asset investment is conducted internally or outsourced to an external manager, the pension fund needs a competent investment official, who is capable of selecting, overseeing, and controlling the asset managers. The fiduciary responsibility rests with the pension fund and cannot be outsourced.

PEOPLE

Talent is the most valuable asset in all organisations. Choosing the ‘right’ people for managing and controlling pension funds is of vital importance for the performance of pension institutions. Nevertheless, Ambachtsheer (2007) found that the process and the rules by which pension funds selected management and trustees varied significantly. Clark and Urwin list as best-practice factors: Leadership that has been shown to have a measurable impact on fund performance; Numeric skills; Capacity for logical thinking; and Knowledge in theory and practice of probabilities are preferable qualities for selecting trustees. Competitive compensation of the management and key staff of large pension funds is strongly advocated, although it has become a disputed arena. In some jurisdictions, such as Canada, pension fund management and staff are paid in comparison to the management of large financial institutions, as pension funds compete with asset managers for exceptional investment talent. On the other hand, public pension funds are often seen as part of the government sector with remuneration more aligned to the remuneration of public servants. That said, the Swedish government that oversees large mandatory pension funds that operate as part of the public pension system withdrew a regulation proposing to align the pay of pension fund staff with the public sector in general.

Trustees (and management) must be selected based on their expertise and experience they bring to the board table and their ability to focus on long-run member interest and not based on political connections or other outside or conflicting interests. And, finally, a pension fund needs the required competencies in terms of an educated staff that is effectively paid.
PROCESS

According to Clark and Urwin, once the first two factors are in place, the process of investment decision-making proves to be the most important factor in delivering performance. A best-practice investment process is centred on strong investment beliefs that are shared and supported throughout the institution. It is rather an understanding of temporary over- or under-valuation of asset prices than a belief in the ubiquity of the efficient market hypothesis that enables a fund to find opportunities and to outperform compared to its peers. The selection of asset classes for the portfolio construction depends also on the available skills and knowledge. Knowing your advantages and disadvantages is an important competitive edge. It is not prudent to decide to invest in asset classes for which there are no skills in the pension fund. Good governance requires goals, investment beliefs, and investment decision-making to be well aligned.

Figure 17.1 outlines how the mission and beliefs and objectives should translate into the strategic investment policy and allocation, underpinned by rigorous analysis and risk management. This in turn translates into portfolio construction, asset class, and investment style decisions together with the selection of appropriate fund managers. They should implement the strategy in compliance with the fund’s investment principles (mandate), and there should be objective monitoring and reporting of their performance, which should in turn feedback into reviews of the fund objective and strategy.

Figure 17.1
Schematic of best practice investment governance

A quantitative risk budgeting framework is seen to be an essential instrument constraining and controlling the investment decision-making process. At pension funds, investment goals are often formulated in an absolute return context, or relative to the fund’s own liabilities if it is a DB fund, and not relative to a short-term market benchmark, which is a more widespread practice in the asset management industry. Aligning the investment
goals of the pension fund with the benchmark customs of asset managers is an important exercise. Effective control of external asset managers who have been given a clearly defined mandate is a further best-practice factor. These asset managers should report in a cost-transparent and control-enabling way – something that can be very challenging to do and requires very clear and full cost disclosure that might need regulatory backing. Furthermore, the high volatility of international financial markets requires fast decision-making that can be at odds with long-term fixed board meeting schedules. Up-front agreed contingency plans that can be implemented by the management without further authorisation have been found very helpful, as has out-sourced fiduciary management. Finally, innovation and thought leadership characterises best-practise institutions.

**EVIDENCE FROM DEVELOPED COUNTRIES**

The correlation of pension fund governance with net investment returns has been the subject of some considerable research in recent years, primarily using the databases of investment portfolios and performance created by CEM Benchmarking Inc. (reviewed extensively in Chapter 18) and the Australian Prudential Regulatory Authority (APRA). The CEM database includes data, some dating back as far as 1990, from over 900 large globally selected pension funds and other institutional investors with aggregate assets exceeding USD 8 trillion. The APRA database covers all the nearly 400 significant pension funds in a series going back to 1996 (although recently modified) with assets, now, of some USD 1.5 trillion. Both, therefore, provide large enough samples for robust research.

The already earlier cited study (Ambachtsheer and Ezra 1998) of the governance practices of 80 North American pension funds compared performance from the CEM database to statements regarding governance practices made by senior pension fund executives in response to a research survey. Their research demonstrated “...a positive correlation between proxy metrics for pension fund governance quality and for pension fund performance. High-quality funds outperformed low-quality funds by about 1% per annum”. They also identified a number of specific fund oversight and management factors as important performance drivers, and in particular were concerned about the effect of poor scores for a haphazard trustee selection processes, no trustee self-evaluation processes, lack of delegation clarity between the board and management, and board micro-management. Interestingly, performance correlated better with general governance statements than with more specific investment governance process statements. However, there is the possibility of some bias, since the better performing funds might rate themselves better governed.

Analysis of the findings of a 2005 follow-up survey on pension fund governance (Ambachtsheer, Capelle and Lum 2006), to which an international group of 88 senior pension fund executives responded, compared the responses with net value added data
from the CEM database. This again gave a generally positive statistical association between governance quality and net investment performance. This time the analysis suggested that the ‘poor-good’ governance gap could be ‘worth’ as much as 1-2% of additional return per annum, as measured by CEM. They found also a positive correlation with expenditure on fund costs allocated to the internal governance, management, and control. In essence, high-scoring funds spent an average four basis points more per annum on the internal governance, management, and control functions than low-scoring funds.

Another study in 1996 had already used the database to show that there were strong positive correlations between net performance and pension fund size, a finding confirmed by other studies, and there was also a positive correlation with the degree of passivity, a conclusion that since has become more nuanced by further research.

Another study (Dyck 2011) used CEM data for 1990-2008 covering 370 pension funds across the USA, Canada, Australia, and Europe split into five size-related quintiles with the smallest being assets under USD 340 million and the largest with assets over GBP 33 billion. Their findings included:

• Larger plans outperformed smaller plans by 43-50 basis points per year in terms of their net abnormal returns, defined as gross returns minus actual costs minus plan-specific benchmarks for each detailed asset class.

• Compared to the smallest quintile, the largest quintile plans deployed 39% more of their assets using approaches other than external active management. Hence, large plans manage 13 times more of their active assets internally, which lead to substantial cost savings. While delivering similar gross returns, external active management was at least three times more expensive than internal active management. But, other factors were needed to explain more than half of the positive economies of scale.

• Larger plans shift towards asset classes where scale and negotiating power matter most and obtain superior performance in these asset classes, in particular devoting significantly more assets to alternatives, where costs are high and where there is substantial variation in costs across plans. The authors’ regression estimates suggested that the greatest impact of size came from the private equity and real estate components of alternatives, where a move from the smallest to largest size quintile is associated with a 6% and 4% increase in net abnormal returns per annum, respectively. There was evidence of positive economies of scale in both gross returns and costs for both private equity and real estate.

• Finally, they found that stronger governance provided higher returns and a greater ability to take advantage of scale economies.

7 Summarized in Ambachtsheer “How all pension funds should be measured” Ambachtsheer Letter #130 November 2006 KPA Advisory Services Toronto
8 Analysis presented by Mike Heale of CEM in 2011 of a 21-year series across the CEM database showed that active management produced a small but significant net out-performance relative to passive, of 12 basis points a year. As this effect as smaller than recorded scale effects, for instance, the same showed that for a ten-fold increase in size, net value added increased by 18 bps, it might be reasonable to infer that active management is likely to be worthwhile only above a certain scale. See further consideration in Chapter 18.
In essence, the research confirmed the benefits of scale, suggesting that this partially arises from the plan’s ability to employ more cost-effective internal management of active investments and efficiently undertake investment in expensive to manage but lucrative alternative asset classes. The larger the plan, the more it can afford to harvest liquidity premia and exploit expert knowledge. Once again governance and performance correlate. Another study suggested that effective internal management increases gross as well as net risk adjusted returns (Koedijk, Slager and Bauer 2010).

It should be noted at this point that most pension funds on the CEM database are not-for-profit defined benefit occupational funds, with a captive market. There is significant evidence that such funds out-perform mutual funds, which have none of those characteristics.

Research using APRA data in Australia raises similar issues with the commercial mutual fund type model. A 2012 study (Cummings 2012) computed gross risk adjusted rates of return, investment expenses and operational expenses for 280 DC pension funds across the not-for-profit and retail (i.e. for-profit) sectors during the period 2004-10. The analysis showed that for the not-for profit sector, there was a small but statistically valid correlation between the three larger fund size quintiles and gross investment returns and larger inverse correlations with the two expense measures. There were stronger correlations between size and net returns. No such statistically valid correlations were found for retail funds, which across all quintiles had lower gross investment returns, higher investment fees and higher operational fees than not-for-profit funds.

There could be several explanations for the lower gross (and net) investment performance of retail funds. The same research team had already found that not-for-profit funds had on average allocated more of their portfolios to illiquid assets than retail funds (Cummings 2011). Not-for-profit funds with more illiquid investments experienced higher risk-adjusted returns, which suggested that they captured a return premium for investing in these assets. Allocations reflected fund size, net cash inflows and member age - factors relevant to a fund’s liquidity requirements. Furthermore, the allocations reflected the extent of the fund’s in-house investment management. Reasons for lower allocations (and higher costs) could include differences in participants, with retail funds having to compete (at some cost) for new business and not enjoying the loyalty arising from the linkage to an employer sponsor of not-for-profits. Hence, there is a greater likelihood of participants switching funds, which would increase liquidity requirements. The older age profile of retail funds may also result in less adventurous investment. On the other hand, the absence of a scale correlation may well be evidence of an agency problem or that marketing costs increase with scale.

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9 For instance, Bauer (2008) showed that over the period from 1996 to 2004, the Canadian equity components of Canadian pension funds out-performed their Canadian equity market benchmark by an average +1.2% per annum, net of expenses. Over the same nine-year period, Canadian equity mutual funds with domestic mandates under-performed their Canadian equity market benchmark by an average -2.6% per annum, net of management fees, but before any applicable sales charges, which would reduce mutual fund net returns even further. Chapter 18 refers to further relevant evidence.

10 Funds in the largest quintile had assets in excess of AUD 3 billion. Funds in the third quintile had assets below AUD 1 billion.

11 Except maybe for operational expenses which did appear to fall with size, although not so smoothly as for not-for-profit funds.
It is unclear from the evidence how much of the performance differential in Australia relates to differences in fund governance and how much to the market structure. In other words, have sub-optimal features of the market reduced fund net performance, has governance done so or has it been a combination of the two? That the market has been sub-optimal was presented very clearly in the 2014 ‘Murray’ report (Australian Government, The Treasury 2014) which concluded from research evidence that “substantially higher superannuation [DC pension fund] balances and fund consolidation over the past decade have not delivered the benefits that would have been expected; these benefits have been offset by higher costs elsewhere in the system rather than being reflected in lower fee”. This research too found that over the past 10 years the for-profit retail funds consistently performed worse than the different types of not-for-profit fund. The not-for-profit funds\textsuperscript{12} outperformed the retail for-profit structures by on average around 150-190 basis points a year. Market forces within the for-profit market were not leading to lower costs being passed on to members due to the well-known problem of the lack of an effective demand side in mass market private pension provision.

Other APRA research (Sy 2009) found evidence of persistency of superior investment performance across 115 Australian DC pension funds in terms of risk-adjusted value added. This ability of some funds to persistently out-perform others appears to provide evidence of linkage with governance. The study also showed that higher operational costs correlated significantly with lower net investment performance, which one might expect to be un-correlated. This suggests that general governance quality, as a driver of operational efficiency, correlates with investment performance.\textsuperscript{13}

That the governance of commercial fund managers may be sub-optimal is supported by a study (Sy 2008) which took as a given other APRA research evidence that retail funds have higher fees than other types of fund,\textsuperscript{14} and explored differences in their governance arrangements found from a survey of trustees. The findings included:

- Retail trustees spent much less time undertaking their functions.
- Most non-profit trustees performed the investment fiduciary duties including portfolio construction, whereas for-profit trustees within conglomerate structures mostly passed the portfolio construction task to related executive fund managers, related financial advisors or individual pension investors themselves.
- Retail funds are much more likely to use service providers that are related parties, and often had investment managers as executive directors on their boards, impairing the negotiation of best terms for investment management services.

\textsuperscript{12} Note that not-for-profit effectively describes the long-term objective or orientation of the funds – they can and do contract with the private sector for services.

\textsuperscript{13} The authors ascribed the finding to the possibility that pension funds with higher visible costs also had higher hidden investment costs, for instance, from sources such as investment returns declared net of costs to the fund by hedge funds or funds of funds.

\textsuperscript{14} For instance, Bateman (2001) found that retail fund costs were around 50% higher on an assets under management basis than was the case in other types of fund.
• Trustee directors of retail funds were much less likely to save with their own funds than other trustee directors.

Research into performance data for 1999-2010 from Polish DC pension funds (Jackowicz 2011), which are subsidiaries of financial institutions, showed that boards with independent (outside) board members were associated with improved pension fund performance.

The annual survey of pension fund governance undertaken by the Pensions Regulator in the U.K. has repeatedly found a correlation between attributes of good governance (such as frequency of board meetings) and fund performance (self-assessed and through metrics such as documenting internal controls and reviewing risk management) – although not actually the fund returns themselves. In the 2014 report found that scale also correlates with fund performance as well as with specific aspects of good practice such as with managing conflicts of interest and obtaining formal assurance reports on out-sourced fund administration, and trustee knowledge and understanding.

In summary, developed world evidence highlights the importance of pension fund scale, the design of the pensions market and governance.\footnote{For example see Bicker (2011)}

• Scale is a necessary requirement, first, to construct highly diversified portfolios and, second, to replace expensive external asset management with in-house teams which in turn requires professional investment expertise. Furthermore, investment, administrative and operational unit costs, all of which can decline with scale, can have a significant impact on pension benefits. Scale can also correlate with governance quality.

• Funds that are obliged to compete for participants often incur high sales costs to achieve the aspired penetration. In some countries, such as Switzerland and the Netherlands, the regulatory authorities have requested pension funds to detail their investment costs per asset class. Large funds with highly-diversified portfolios incurred up to 80% of their investment cost in illiquid asset classes such as private equity, real estate and infrastructure. Cost opacity by asset managers induced some funds to restructure their portfolios. The for-profit (and mutual fund) model brings with it the further risk of conflicted or non-aligned interests, which may deflate net investment returns, although this risk may be mitigated by the presence of independent directors.

• Finally, good governance, as already defined, can result in substantial out-performance of less effective governance, as indeed can investment in good governance.

A key question, however, is the applicability of this evidence to less developed markets which tend to have significantly different attributes. Developed market pension funds are more likely to be employer sponsored, hence with captive markets, and governed by fiduciary trustees or directors. While there may be many small funds, experiencing issues...
from lack of scale, the funds subject to research are mostly relatively mature and large. Pension funds employ specialist asset management companies, partly complemented or completely substituted by internal fund management if large enough. Developed market pension funds have readily accessible, deep and liquid financial markets, limited regulatory restrictions on investment and in general good availability of investment professionals. Sophisticated investment strategies and risk management techniques are available). Figure 17.2 illustrates their investment environment.

The developed world investment environment

<table>
<thead>
<tr>
<th>ORGANISATIONS</th>
<th>INVESTMENT PEOPLE</th>
<th>INVESTMENT PROCESS</th>
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<tbody>
<tr>
<td>• High diversity of historical grown pension fund systems</td>
<td>• Traditionally:</td>
<td>• Traditionally:</td>
</tr>
<tr>
<td>• Often diffuse pension arrangements</td>
<td>» Often laymen instead of professionals</td>
<td>» All forms from complete inhouse management to completely outsourced investment</td>
</tr>
<tr>
<td>• Recent restructuring:</td>
<td>» No or low compensation</td>
<td>» Increasingly:</td>
</tr>
<tr>
<td>» Gaining scale</td>
<td>» Increasingly:</td>
<td>» Outsourcing to professionals (fiduciary management)</td>
</tr>
<tr>
<td>» Improving performance</td>
<td>» Retreat of lay persons</td>
<td>» Stronger focus on risk management</td>
</tr>
<tr>
<td>» Lower costs for employer</td>
<td>» More investment professionals</td>
<td>» Faster decision-making</td>
</tr>
<tr>
<td>• Retreat of the employer, stronger involvement of state</td>
<td>» Efficient compensation</td>
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Source: The authors

The developing world’s governance and investment environment

The developed world environment has significant differences from those found in most of the countries covered by this book. While some of the countries have the concept of not-for-profit fiduciaries (trustees), employer sponsorship of (as opposed to contributing to) pension funds is limited and falling, often being replaced by extensive State involvement in establishing and regulating pension systems (although greater governmental involvement is seen in some developed world countries too) as they try and move beyond the outcomes achieved only with a voluntary private pension market. The developing world funds use a very wide range of approaches from DC individual accounts (e.g. Mexico) through to individual accounts with a return guarantee (e.g. Malaysia), through to continued DB provision in employer based plans, which are often still large due to their longevity.
Pension Investment Governance

(e.g. Egypt). Governance ranges from trustee-based, sometimes excellent, sometimes with competence issues, to commercially-based with the potential for conflict issues. The investment function in commercial pension fund management companies is often vertically integrated and small, managing relatively lesser amounts of assets. But there are also examples of an ‘unbundled’ architecture with fund managers separate from administration (e.g. India) and of large not-for-profit pension funds with strong in-house management capabilities, e.g. Malaysia and Oyak in Turkey.

Furthermore, in the earlier stages of pension system development (at least) domestic financial markets have tended to be thin, shallow, and illiquid, while access to global markets has often been limited by regulation, ‘patriotism’ or concerns about un-hedged foreign exchange exposure resulting in simple un-diversified investment strategies. Consequently, (see for instance Iglesias 2000) the value-added has sometimes been minimal, with negative real rates of return common. On the other hand many countries, or well-run funds within countries, have seen very strong real rates of return that are in excess of those seen in developed countries – with Chile and Mexico for example having consistently shown strong returns.

Other problems have arisen from pension market structure and design in various developing countries. For instance:

- Excessive activity by sales agents has increased the costs of pension systems and participant churn, which in turn can substantially increase liquidity requirements. As an extreme example, in Costa Rica the churn climbed to around 10% of participants switching the fund provider each year before regulatory intervention reduced the attractiveness of the market for sales agents – an action that was shortly followed by fee reductions reflecting consequential cost reduction. The effects have been less dramatic elsewhere, but other countries with similar pension systems experience higher costs and liquidity requirements due to sales agent activity.

- Where there is limited restriction on exit prior to retirement, this has substantially constrained the ability of pension funds to utilize longer term investment strategies, or less liquid investments. For instance, in Turkey participants can withdraw money from their fund after just six months, and the average duration is only three years. This has placed substantial liquidity requirements on the funds, which are inevitably short term focused, depressing net investment returns to a level currently lower than bank deposits.

- Regulatory minimum return guarantees, as found, for instance in Slovakia and Slovenia, have had the effect of driving investment towards low volatility and low return strategies – indeed the introduction of guarantees in Slovakia was followed immediately by divestment in equities.

- Even where penalties for low returns have been related to the average performance of pension funds rather than an absolute target, as is the case of some Latin American countries, they have affected investment behaviour by encouraging herding behaviour.
While good quality governance could potentially mitigate the effects of constraints on investment performance imposed by the system, or its regulation, it would evidently be beneficial for the structures established to support expanded pension to avoid the types of problems referred to above. Developed world evidence that could be particularly relevant includes:

- The value of good governance in driving performance along the complete value chain from investment up to reporting and administration.

- The importance of scale to enable better access to investment expertise and in lowering unit costs.

- Bearing in mind that the scale available to pension inclusion projects is likely to be insufficient to make in-house expertise cost-effective, at least early on unless an already existing structure is used, ensuring that investment expertise is available and applied through out-sourcing that is undertaken and monitored by a board and executive with sufficient expertise to act as an intelligent customer.

- Enable and encourage long-term focused strategy – minimise design features that apply liquidity constraints.

- The agency risk evident in ‘for-profit-structures’, which leads to a conclusion that ‘not-for profit’ structures are to be preferred where feasible, or at least that for-profit fund boards should include an independent board member.

- Costs and fees should be restrained (or at least very closely monitored) but not at the expense of real rates of return or the governance budget.

Governance theory and experience would indicate that the pension funds for pension inclusion initiatives should ideally have a two-tier structure comprising:

- A top-level fiduciary board responsible for oversight and strategic direction, including investment strategy.

- An executive, maybe with a committee structure, responsible for managing operations, which may well out-source functions so as to take advantage of the expertise and scale available in the market.

How far a jurisdiction or initiative can move in this direction depends on local circumstances. In particular:

- The governance arrangements are affected by the legal system and market structure. In particular in civil law countries, trust law concepts such as fiduciary duty and prudent-person rule need to be embedded within the law, and even then the element of moral suasion inherent in trust law may need to be replicated in other ways such as closer supervision.

- Acting, and especially investing, in the best interests of participants can prove to be challenging for commercially owned funds where there is a competing profit motive.

- There is in any case a question as to how much fiduciary duty and prudent-person
principles can be enforced in practice, and hence the design of the market structure can be critical. They need strong and clear regulatory articulation (as indeed has proved necessary even in ‘trust law/ countries).

- The extent to which fiduciaries and investment professionals have the expertise to implement good practice investment governance, strategies, and process, or indeed suitable locally available financial instruments, can substantially constrain investment diversification, risk management, and returns.

In practice, much of the focus in implementing new pension systems in emerging economies has been on providing a governance and legal framework that ensures that pension assets are secure and well administered so as to build trust in circumstances where trust in reliability of financial institutions is far from assured. Hence, features such as specially instituted independent custodianship, fund sponsorship by large reputable corporations, and robust and detailed supervision are almost universal. Such understandable caution commonly extends to detailed regulatory limits on investment classes and instruments which embed risk aversion into investment governance.

**APPLYING GOOD GOVERNANCE PRACTICES TO PENSION INCLUSION INITIATIVES**

Some pension inclusion initiatives covered in this volume have used existing pension funds, with the benefit of enabling immediate scale benefits and leveraging already proven trust-worthiness. In such cases, however, care will be needed, going forward, to ensure that the interests of inherently small-scale investors are protected, in particular from high costs or limited investment returns. Several of the examples covered in this volume and elsewhere have, however, sought to develop or harness market structures in a way that is consistent with the lessons learned regarding pension fund governance.

The Mbao pension fund in Kenya provides an example of adopting existing structures. The administration of the fund has been entrusted to a trust-based (not-for-profit) pension fund established especially for the purpose, under existing pension law and within a long-standing, and hence trusted, framework of pension trusts. The trustee is a corporate trustee established by a Kenyan bank, which is also the custodian, and is totally separate from the out-sourced investment management function provided by a large local asset manager. The trustee has duties in trust and statute law to act in the interests of the beneficiaries. Being a fund specific for the initiative the trustee is not distracted by having also to focus on a pre-existing participant base. Obviously as a new fund, it has not started with scale benefits, but has sought to overcome this by out-sourcing to a large investment fund with substantial pension fund investment experience, which should therefore deliver scale benefits albeit requiring effective oversight by the trustee and managers of the pension fund. Whether the trustee has the ability or motivation to oversee effectively
the investment strategy implemented by the asset manager is an issue for the future, but Kenyan law is clear that the ultimate responsibility for investment is not delegated.

In India, governance arrangements for the National Pension System have been established so as to maximise scale with fiduciary oversight and un-bundling of functions for efficiency. The Pension Funds Regulation and Development Authority (PFRDA), the governmental regulator, and supervisor, has established and sponsors the National Pension System Trust to administer the fund, with record keeping out-sourced to the Central Record-keeping Agency. Investment is managed by pension fund asset managers contracted to and overseen by the trust, along with independent custodians. Five distinguished independent trustees are appointed for this purpose.

The arrangements are designed to keep costs low by unbundling of services that are allocated to appropriate specialists – and it has done this very successfully with PFRDA calculations of the long run equivalent asset under management cost being 0.18% a year. Unusually, the PFRDA remains responsible for guiding the overall strategic asset allocation of the funds, by means of regulation, leaving the asset managers responsible for more tactical aspects of asset selection, under the oversight of the NPS Trust, supported by the independent auditors that it appoints to monitor compliance with the strategy and regulations on costs. Hence, the Trust shares strategic oversight responsibilities with its sponsoring regulator. There is some reliance on competition between fund managers to secure good net returns, and it remains to be seen how effective this proves, and whether the large number of separate investment funds significantly dilutes scale benefits. The cost control has contributed clearly to the superior returns from the NPS pension funds compared to mutual fund providers of similar asset allocations. Furthermore, best practice would suggest that the Trust should assume the responsibility for letting out-sourced contracts currently allocated to the PFRDA.

Achieving the scale needed for strong investment governance and low costs is a particular challenge in smaller countries. This challenge has been addressed in Kosovo, a relatively poor country with a population of under 1.9 million, where after independence a new mandatory contributory (DC) pension system was established. The Kosovo Pensions Savings Trust was established from 2002 by the Assembly of Kosovo as a not-for-profit entity to administer the funds, with a governing board comprising expert trustees appointed from within and outside the country. The trustees are responsible for the investment strategy and appoint the board of directors, independent custodian, and professional fund managers to execute the investment strategy. Given the limited opportunities for local investment most of the fund has been invested globally. Because there is only one fund, and contributions are mandatory (albeit only from the formal sector) the fund has accumulated assets under management of some USD 1.4 billion,

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16 A second record keeping agency has been licensed to increase competitive pressure on costs and fees — early indications are that it is achieving this objective.

17 Two separate voluntary funds have also been established for additional savings which are administered by the Slovenian-Kosovar Pension Fund, a more conventional commercially owned organization, which also benefits from the scale economies associated by being the single provider.
enabling some sophistication and diversification within the strategy. The trustees have implemented a clear long-term and diversified strategy that has generally performed well—problems have been caused by gaps in re-establishing the governing board at a change of mandate.

Pension inclusion initiatives are not confined to developing countries. The developed world is also struggling to cope with insufficient penetration of pension plans in voluntary pension systems. We have learnt from behavioural finance that financial decision-making is characterised by inertia and behavioural biases. Increasingly, initiatives are implemented to cope with these shortcomings—particularly if there has been a large role for individuals—which some countries have but many others do not.

The US experience has seen a shift from DB to DC and a number of shortcomings of individualised DC plans. The main problems have been seen in the low penetration, agency issues, and financial illiteracy. In response, employers are now legally allowed to auto-enrol all employees within the existing fiduciary governance structure. Addressing the agency problems, The Department of Labour issued a new fiduciary rule, the Regulation of Financial Advice, extending the circumstances under which investment managers, investment consultants, advisers, and intermediaries are treated as fiduciaries. And the investment industry developed target-date concepts that are implemented as the default option and shall ensure much better results for the gross of individuals who do not make a financial choice. Pension penetration has increased significantly (Choi 2015).

In the U.K., the National Employee Saving Trust (NEST) was also established by the government but one that works at an arms-length from it and is a trust-based (not-for-profit) pension fund. This operates as a master-trust within a well-established trust and pension law framework. The fund maintains a clear distinction between the strategic oversight role of the trustees and the managerial role of the executive. In view of the rapid expansion of membership and funds under management anticipated, and achieved, there may in the future be a change from the initial strategy that focused on largely passive out-sourced investment management under clearly defined asset class mandates. It also is able to focus its attention and strategy on the needs of its target market of relatively low paid participants with little or no prior experience of pensions. Its innovative approach to target date investment reflects this—in addition to volatility reduction towards retirement there is also low volatility investment for the youngest participants who, because of their minimal experience of pension funds or market investments, might be apprehensive of the system with regards to a capital loss in their fund.18

NEST’s approach to investment governance transparently reflects the good practice outlined earlier in this chapter, coupled with a strong emphasis on communicating their approach to employers and participants. The board of trustees are responsible for the investment strategy, taking advice from the Chief Investment Officer, ensuring that he/she has sufficient expertise. The written advice considers the suitability of the investments;

18 While NEST’s main competitors have not emulated this approach, which runs counter to much existing theory, this may well be because of differentiation in the markets targeted by the different funds.
the need for diversification; the suitability of NEST’s fund managers; the investment risk management framework; and investment beliefs (principles). The trustees have an investment committee, supported by expert advisors, with clear delegated decision-making responsibilities, who in turn appoint, monitor, and dismiss the professional asset managers responsible for day-to-day investment. NEST currently invests through investment funds provided by leading fund management companies. Each of these funds has a clear investment objective and generally invests in a single asset class. NEST diversifies its scheme members’ money across different 13 different asset classes by investing in each of these funds in varying proportions. As assets under management grow, the expectation is that they will move into direct investments.

NEST’s trustee board has set an overarching investment objective for the default funds “to target investment returns in excess of inflation after all charges over the long term”. The investment policy statement explains how this objective is quantified in the different phases of saving. NEST’s investment beliefs are subject to an evidence-based review at least every three years and are currently stated as:

1. Understanding scheme member characteristics, circumstances, and attitudes is essential to developing and maintaining an appropriate investment strategy.
2. As long-term investors, incorporating environmental, social, and governance (ESG) factors is integral to the investment management process.
3. Taking an investment risk is usually rewarded in the long term.
4. Diversification is the key tool for managing risk.
5. Risk-based asset allocation is the biggest driver of long-term performance.
6. Taking account of asset values and asset prices, economic conditions, and long-term market developments enhances long-term performance and informs strategic decisions.
7. Indexed management, where available, is often more efficient than active management.
8. Good governance, including an appropriately resourced in-house investment function, is in the best interests of NEST members.

Germany provides a further example. Following a significant pension reform in 2000/01, which reduced future benefits from the first pillar PAYGO pension and aimed at encouraging funded occupational pension provision, unions, and employer associations founded new pension funds. The largest is MetallRente, the pension fund for the metal and electrical industry with 580,000 members as of 2015. It was set up as a two-tier arrangement, with the institution itself led by a managing director overseen and controlled by the supervisory board. Its mission is to achieve the highest possible penetration of low-cost pension plans in the metal and electrical industry (and some associated industries) in Germany. Aligned with the traditional market structure and savings behaviour in Germany, MetallRente offers mostly insured products but, additionally, also a pension fund. An investment committee consisting of three representatives, of the employer
association and the union respectively plus one independent investment professional, sets
the strategic asset allocation and the investment policy of the pension fund. The complete
organisation is outsourced to four insurance companies and asset managers in Germany.
MetallRente itself is not an institutional investor; its task is mainly to negotiate the plan
design and to control, especially cost-control, the consortium. MetallRente has reached a
high penetration based on its reputation and the trust generated by unions and employer
associations.

Finally, all these pension inclusion initiatives, and indeed other examples in this volume,
are subject to a framework of robust regulation and supervision, which should ensure the
security of good administration of the assets and records. The main regulatory drivers
for investment efficiency have related to market structure and requirements for fiduciary
responsibility. Supervisory techniques to help ensure efficient outcomes are less well
developed, beyond setting limits on fees and asset concentration, and supervising the
propriety of fund management, which places the onus on fund governance to be diligent
in implementing high performing strategies in accordance with best practice.

SUMMARY
CONCLUSIONS

An essential underpin of any significant process of expanding pension inclusion is that
the population new to this concept have good reason to trust the system and the entities
concerned. This means that assets need to be held securely and invested efficiently at low
cost, which in turn necessitates a suitable pension governance model. The ‘traditional’
DC model where participants are expected to choose funds or investment portfolios is not
appropriate, and therefore, strong emphasis needs to be placed on an effective and expert
fiduciary role, in a context where there are (usually) no sponsoring employers to represent
participant interests.

Pension regulatory frameworks commonly provide strong asset security arrangements,
especially in developing countries, but less attention may be given to investment efficiency
and effectiveness. There is no shortage of literature on how the pension fiduciaries of
large pension funds with ready access to liquid deep financial markets should organise
investment governance, and there is research evidence that supports many of the
prescriptions made. Applying these to many of the pension systems covered in this book
is more challenging. But, some lessons appear to be applicable and have been reflected in
some of the cases in this book. In particular:

- Scale is vital, not just because it lowers unit costs, but also it avoids spreading limited
  expertise too thinly and can enable more sophistication and diversification within the
  investment portfolio. This means restricted (or no) competition between fiduciary
  organisations, compensated for by a separation between the fiduciary entity and
  service providers, especially asset managers through which fiduciaries can impose
  some competitive discipline.
• There are strong arguments for improving the consequent structure if it becomes two-tier with fiduciaries being responsible for strategic oversight, executives for in-house elements of administration and for overseeing the asset managers and guiding the fund’s investment strategy.

• Where practicable, not-for profit fiduciary boards should be established, maybe by regulatory governmental agencies, to ensure there is sufficient expertise while minimising agency risk.

• Cost and return transparency is essential – and not easy to achieve.

• The limited diversification, and hence scope for risk management, provided by the assets available to pension funds needs to be addressed, at least in the longer term once there is confidence in investment governance. On the other hand, investment governance can only be expected to mature once significant diversification is possible, and regulatory restrictions on asset classes may need to be relaxed.

• Regulatory and supervisory vigilance and pro-activity is needed to establish high standards.

REFERENCES


MANAGING COSTS AND
OPTIMIZING OUTCOMES

MIKE HEALE
PRINCIPAL, CEM BENCHMARKING

PAUL MARTINIELLO
DIRECTOR, CEM BENCHMARKING
1. **FOCUS PROGRAM DESIGN ON MAXIMIZING VALUE FOR PLAN MEMBERS.**
   - Pension plans should have one overriding design objective: long term savings for retirement security. Micro-pension programs with multiple savings goals may improve financial inclusion but they are unlikely to generate much retirement income.
   - High cost models that reward financial intermediaries but do not add value for plan members should be avoided.
   - Carefully targeted and simple government financial incentives, such as contribution matching, can be powerful motivators for attracting members and keeping them enrolled.

2. **AIM FOR ECONOMIES OF SCALE.**
   - Big pension funds generally outperform small funds – in large part due to lower costs.
   - Micro-pension programs should target broad segments of the population using multiple channels that are effective in the informal economy (examples include, industry associations, self-help groups, and micro-finance institutions).
   - New pension plans can take a long time to attain scale. Programs in small countries will be too small to be cost effective even when universal coverage is targeted. Consideration should be given to utilizing existing domestic institutions such as social security and civil service pension funds.

3. **ASSET MIX DRIVES RETURNS. IT SHOULD BE MANAGED BY PROFESSIONALS.**
   - Stocks should be part of the asset mix. Equities generate significantly higher long term returns than fixed income investments.
   - Asset mix constraints, such as limits on equity weights and foreign holdings, will not produce the best long-term outcomes for plan members.
   - Limit or eliminate investment choices by plan members. Individuals do not make optimal asset mix decisions. Life-stage, target-date, and similar balanced fund programs that members are automatically directed to, based on their age, will produce better outcomes.
4. **UNDERSTAND HOW ACTIVE MANAGEMENT CAN ADD OR SUBTRACT VALUE.**

- Market returns, less a small cost drag, achieved via passive investing, should produce ‘good’ long-term outcomes, especially relative to typical retail investments such as bank savings accounts.

- However, many pension funds in the CEM database have added significant additional value by employing cost-effective active management strategies (often using in-house management teams). In contrast, many funds utilizing high-cost active management strategies have generated negative net value added.

5. **EFFECTIVE MEMBER SERVICE AND COMMUNICATION PROGRAMS IMPROVE PERFORMANCE.**

- If members appreciate the value of their plan, contributions will be higher and withdrawals lower. Communications should focus on simple reinforcing messages delivered repeatedly through multiple channels.

- The micro-pension environment will not support costly high-touch personal service delivery. Technology and innovation are required to provide effective and lower cost communication and service alternatives.

**INTRODUCTION**

Expanding pension coverage to include informal economy workers is incredibly important. Today, over 1 billion excluded workers worldwide face the bitter prospect of abject poverty in their old age. Thus, eliminating unnecessary costs and optimizing performance is vital for success in expanding pension coverage in the informal economy. However, there are many formidable challenges. People with low incomes must be persuaded to think long-term, and invest for their old age while they are faced with considerable and pressing immediate needs. Therefore, plan contributions can only be expected to be low and intermittent. The term ‘micro-pensions’ is a well-suited generic description. Relative to pension plans in developed countries, account balances will be extremely low. Eliminating all costs that do not produce value for plan members is essential. The innovative use of technology will be vital for overcoming these challenges and driving out unnecessary costs.

This chapter will focus on applying lessons learned in developed pension systems to the challenges of expanding coverage in the informal economy. These lessons include high cost practices to avoid as well as approaches that can be replicated successfully. The focus will be on pension fund characteristics and operating strategies that have been proven to create value and how these might be applied to micro-pensions.
CEM Benchmarking (CEM) is an independent benchmarking company that has collected detailed cost and performance data from defined benefit (DB) and defined contribution (DC) pension plans, social security buffer funds, and sovereign wealth funds (SWF) since 1991. CEM collects annual cost and performance data from these organisations. Pension funds work with CEM to benchmark their costs, performance, and risk levels and to demonstrate their value proposition.

Comparisons of detailed investment and pension administration operating costs are central to the benchmarking exercise. However, costs are neither inherently good nor bad. Performance metrics are also evaluated in order to answer the fundamental question: “do you get reasonable value in return for what you pay?” Figure 18.1 illustrates this ‘value for money’ benchmarking model for a typical pension fund in the CEM database.

Figure 18.1
CEM Pension Benchmarking Model

Governance and Oversight costs are split between the Investment and Administration Operations:
Senior Management
Trustee boards/ Governing bodies, Actuarial, legal, audit fees
The CEM benchmarking databases have become increasingly global over time. Countries with participating funds during the past three years – from North America, Europe, Latin America, the Caribbean, the Middle-East, Africa, and Asia-Pacific – are shown shaded in blue in Figure 18.2. More than a thousand unique funds have participated at some point in the past 25 years and 452 funds, representing almost USD 9 trillion\(^1\) of assets under management (AUM), provided data for the 2015 data-year.\(^2\) Average fund size in 2015 was USD 27 billion of AUM and the size range was wide: from USD 50 million to over USD 800 billion.

**Figure 18.2**

*Global Representation in the CEM Pension Fund Benchmarking Database*

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The CEM benchmarking databases include detailed investment and pension administration performance and cost data from a wide range of countries and individual plans. Here is a brief description of the various CEM database cohorts drawn from in this chapter:

- 25 years of investment performance and cost benchmarking data for global DB funds (mainly), buffer funds, and SWF’s (Global IBD). This database is a robust source of detailed investment performance and cost data and has been used extensively by CEM and academics for investment research studies. More details about the Global IBD as well as key investment performance and cost insights are included in Appendices A, B, and C.

- 19 years of investment performance, plan structure, and demographics, as well as cost data, for DC plans in the United States (U.S. DC).

- Three years of investment performance, plan demographics, and cost data for DC plans in Latin America (Latin America DC).

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\(^1\) Unless otherwise noted, all AUM and contribution amounts are reported in U.S. dollars in this chapter.

\(^2\) Unless otherwise noted, 31st December 2015 is the end date for all time periods cited in this chapter.
- 17 years of plan structure and demographics, transaction volume, service levels, and cost data for global DB plan administrators (Global DB pension administration). The most robust cohorts represented are: U.S., Canada, the Netherlands, and the United Kingdom.
- Plan structure and demographics, transaction volume, service levels and cost data for Australian DC plans over an eight-year period (Australian DC pension administration).

Most CEM database participants are large, mature pension plans from OECD countries.

**CHALLENGES IN THE MICRO-PENSION ENVIRONMENT**

Plan design, size, and operating structures reflect their varied economic, demographic, tax, and regulatory environments. Their experiences can provide important lessons for developing countries — some of which are practices to emulate and some that are best avoided. However, there are also profound differences between OECD countries and developing nations on many of these dimensions. Lessons from OECD experiences are, therefore, not easy to apply directly to a developing country context.

Most pension funds in the CEM database are not-for-profit organizations with public sector, corporate, or industry-sector (for example, multi-employer construction industry funds) sponsors. Plan sponsors have an implicit or explicit fiduciary duty to manage their plan in the best interest of their members. Typically, plan members are employees of the sponsoring organization or group and participation in the plan is often compulsory. Plan contributions are also typically defined, sometimes with voluntary supplemental components, and contributions are made via the sponsor’s payroll system. Most members pay tax on their income and there are generally tax advantages for saving via pension plans. These tax breaks make plan participation more attractive and additional voluntary contributions more appealing. There are also typically tax benefits for keeping money in the pension plan until retirement. This pension delivery model, as well as general economic and commercial conditions, gives funds in OECD countries distinct advantages relative to developing countries.

There is a clear global trend favouring defined contribution plans. Worldwide, many corporations have replaced their DB plans with DC plans. For many years most new global pension systems and plans have been DC in nature. It seems likely that DC will be the primary plan type chosen for initiating micro-pension plans in the developing world — although see Chapter 19 on Inclusive Micro Insurance for examples of experience with different product features.

The key features of two well-established defined contribution systems will be examined:
- the United States employer-sponsored system, and
- the government-approved provider system utilized by several Latin American countries.
Their plan features, operating environments, and performance will be compared to available micro-pension plan data.

In addition to the DC data, the CEM databases include a large amount of DB performance data for both investment and pension administration operations. Many of the performance and cost insights derived from this DB data are also directly relevant in a DC context. Therefore, the Global IBD and Global DB pension administration databases will also be used for comparisons and analysis.

**DEFINED CONTRIBUTION PLANS IN THE UNITED STATES**

The U.S. DC database includes 19 years of detailed cost and performance data from a robust sample of plans. These plans are ‘sponsored’ by corporate and public sector employers. Plan membership is linked to employment and coverage is not universal – employers are not required to establish plans. Key demographics for the U.S. DC database for the 2015 data-year were as follows:

- 137 plans: 114 corporate; 23 public sector
- Total AUM: USD 859 billion
- Plan Size: Average of USD 6.3 billion; Median of USD 4.2 billion; Range from USD 64 million to USD 46 billion
- Average number of plan members: 53,327
- Average annual contribution to member account (combined employer and employee): USD 12,000
- Average individual member account balance: USD 138,000
- Average annual total plan cost, including investment management and record keeping/member services:
  - 0.32% of AUM
  - USD 393 per plan member

A few observations on these results and the key factors that drive them:

- Annual contributions averaged about USD 12,000 per member in 2015, reflecting relatively high wages and savings capacity of plan members; the willingness of employers to contribute on their behalf; and, the tax advantages of plan contributions. Workplace centred communications are used to encourage participation and higher contribution levels. Common plan features such as auto-enrolment and auto-escalation of contributions are also effective strategies for improving participation and contribution rates.

- Balances accumulate tax-free in plans and there are limitations or tax disadvantages for withdrawals prior to retirement.

- Plan costs are much lower than the cost of comparable retail savings products available to individuals in the United States. Delivering below standard ‘retail’ price is essential for
the coverage expansion envisaged in this volume to be successful. Plan members benefit from scale economies and the negotiation power of plan sponsors. In addition, the market for investment and record keeping services for employer sponsored DC plans is large and competitive.

- These employer sponsored DC plans are not-for-profit organizations and generally have defined, ‘captive’ members. They do not incur costs for sales, marketing, and profit margins. Competing for members and generating profit for shareholders increases the cost drag of pension schemes.

**DEFINED CONTRIBUTION PLANS IN LATIN AMERICA**

Nine countries in Latin America have mandatory DC systems. These countries ‘charter’ pension providers who compete for plan members. The providers are commercial, for-profit organizations. This system was first implemented in Chile over 35 years ago and subsequent versions of it have been implemented in Colombia, Costa Rica, the Dominican Republic, El Salvador, Mexico, Panama, Peru, and Uruguay. The mandatory nature of these systems means that pension coverage is very high in the formal sector of their economies. However, pension coverage is generally very low in the informal sectors of their economies.

Key aggregated demographics for the DC systems in these nine Latin American countries for 2014 were as follows:

- 47 fund providers with an average of five in each country
- Total AUM: USD 470 billion
- Total plan members: 82 million (47% active)
- Provider Size: Average of USD 10 billion; Median of USD 4 billion; Range from USD 100 million to USD 43 billion
- Average number of plan members per provider: 1.7 million
- Average annual contribution to member account: USD 1,000
- Average individual member account balance: USD 6,000 (includes active and inactive accounts)
- Average annual total plan cost, including investment management, record keeping/member services, as well as marketing, sales, and profit margin:
  - 1.16% of AUM
  - USD 60 per plan member

A few observations on these results and the key factors that drive them:

- The providers are large – average size of USD 10 billion and 1.7 million members – this helps to keep costs low.
- Annual plan contributions are far lower than for the U.S. DC plans and reflect lower wages and savings capacity.
• Average member account balances reflect contribution levels and the maturity of some of the pension systems – that have existed for only a few years. Contributions accumulate tax-free in the plans and withdrawals are generally only allowed for prescribed life events (e.g. partial withdrawals are allowed when purchasing a home in some countries).

• The average cost of 1.16% of AUM is considerably higher than the 0.32% average plan cost reported for U.S. DC plans. Part of this cost differential is due to the additional costs associated with a for-profit system where providers compete for members.

MICRO-PENSION PLANS

Pension coverage in developing countries involves the considerable challenges of a predominately informal labour market. The vast majority of people are not permanent employees of a corporate or public sector employer. Income or wages are typically received in cash and are generally low and uncertain. Immediate needs are pressing and savings capacity is limited. There are very low levels of financial literacy. Many people do not have bank accounts. Immediate tax incentives for pension savings are not relevant as most people do not pay income tax. The micro-pension environment is formidable. There are many challenges to overcome.

Contribution levels for informal economy workers can only be expected to be much lower than plans in developed countries. One issue for micro-pension plans with low contribution levels is how to achieve real scale, especially if established on a stand-alone basis. Size is important, therefore, bigger funds generally outperform smaller funds, largely due to lower costs. Partnering a micro-pension system with an existing pension fund, such as social security or civil service pension funds, should be considered as an immediate way to realize scale economies.

The U.S. DC and Latin American DC plans described above benefit from meaningful tax incentives to get money into plans and to keep it there until retirement. Full or partial matching of individual contributions by a plan sponsor is also a powerful financial incentive for individuals to increase contributions in voluntary plans. Targeted government subsidies or matching programs should be considered to encourage workers to enrol in micro-pension systems. Keeping the money invested in these plans until retirement will also be challenging. Vesting periods for government-matched contributions is one approach that could be helpful.

Micro-pension systems globally are in their infancy. Several new programs are being planned. Very few plans are operational and these were implemented recently. Consequently, there is a scarcity of published data available about micro-pension operating experiences. Recently established programs in Kenya and India, where published data is available, will be explored next.
KENYA MBAO PENSION PLAN (MBAO)\(^3\)

In June 2011, the Retirements Benefits Authority of Kenya (RBA), along with the National Federation of Jua Kali Associations launched Mbao, an innovative program using cell phone technology for extending pension savings plan coverage. Jua Kali is Swahili for ‘informal sector’. In Kenya, about 80% of the labour force is in the informal economy, including agriculture, tradespeople, and many small businesses.

Investment management, administration, custody, and money transfer services for Mbao are provided by separate private sector companies. See Chapter 2 on Kenya for more details.

Mbao is a voluntary individual savings plan which is open to all workers in Kenya over 18 years. It is designed to provide a defined contribution program that is tailored to the specific needs of the informal sector. There are two simple requirements for joining: a copy of a National Identification Card or Passport and a registered mobile phone. Contributions are made electronically by loading cash onto a mobile phone and remitting to Mbao. A key feature of mobile money for pensions and other transactions in the informal sector is its convenience. Mobile phone companies in Kenya have established very successful mobile money systems. In 2012, there were more than 70,000 mobile phone company agents throughout Kenya, compared to about 800 bank branches. Only 24% of Kenyans had bank accounts but 75% of the adult population had mobile phones in 2012. The mobile phone companies charge transaction fees for Mbao transfers, but these are relatively low, especially considering the low dollar amounts involved.

Contributions are very flexible and can be made as frequently as daily. The minimum amount is only 20 Kenyan Shillings, which is about USD 0.20.\(^4\) Mbao has tax exempt status and money is not generally taxable at exit. To discourage withdrawals, benefits are accessible after a minimum number of years that are tied to a member’s age. Member contributions are directed to one balanced fund that is invested in a mix of Kenyan government bonds, bank fixed-term deposits, corporate bonds, and cash. Up to 60% of a member’s Mbao account balance may be used as security for a mortgage loan on a house. Mortgage lending in Kenya without this backing generally requires a down payment of 10% of the purchase price of the house. This plan feature is a key incentive for attracting members. When the Mbao pension plan is used for this purpose, the member cannot make a withdrawal from the plan until the mortgage is paid off. Costs incurred by members include mobile money transfer charges and an annual account charge of 0.95%. However, as an added incentive for joining the plan, the annual account charge is waived for the first three years.

As of 30th June 2015, Mbao pension plan membership had reached 65,301 with a fund value of just over USD 1 million and an average account balance of about USD 16.

\(^3\) Sources for Kenya Mbao Pension Plan descriptions and data are:

\(^4\) Conversions of Kenyan shillings to USD were done using official rates posted by the Kenyan Central Bank for 30th June 2015.
INDIA ATAL PENSION YOJANA (APY)\(^5\)

The informal sector represents 88% of India’s total labour force. The Government of India (GOI) first introduced a DC plan, Swavalamban, for the informal sector in 2011. The Swavalamban scheme was discontinued though, partly because of a desire in the target market for a guaranteed pension benefit at retirement. At that point, in 2015, the GOI introduced a new scheme called Atal Pension Yojana (APY). Swavalamban subscribers aged 18-40 are automatically migrated to the APY Scheme (with the ability to opt out). For more details see Chapter 1 on India.

APY is a defined benefit plan that is administered by the Pension Fund Regulatory and Development Authority (PFRDA) utilizing the architecture of the Indian National Pension System (NPS). Under the APY, a monthly pension that is guaranteed by the GOI is paid to subscribers at retirement. Required contributions are tied to a subscriber’s age at plan entry and the targeted annual pension (in INR): 12,000, 24,000, 36,000, 48,000, or 60,000 (from USD 675 to USD 3,374).\(^6\) APY is open to all bank account holders and regular contributions must be done through automatic debits. The APY forms part of a wider push to expand participation in bank accounts and insurance known as PMJDY – which has seen over 250 million bank accounts opened and over 120 million insurance policies issued. So it is able to leverage important advancements in financial inclusion for informal economy workers – which is an important objective of the GOI. The minimum age for joining APY is 18, the maximum age is 40 and the pension is payable at 60. Therefore, the minimum contribution period for an APY subscriber is 20 years.

With the launch of APY, the GOI announced a ‘time limited offer’ to incent enrolments. Subscribers who joined in the first six months were eligible for a GOI co-contribution of 50% of their annual contribution amount, up to USD 56, for five years until 2020. This offer window was later extended for three months to 31st March 2016. Though the eligibility for the central government co-contribution has now expired, a few Indian state governments have announced a matching co-contribution for subscribers joining the scheme in the next three years.

At 31st October 2016, APY had attracted more than 3.6 million subscribers and total AUM exceeded USD 706 million. The Indian pension fund regulatory authority, PFRDA, is reviewing strategies to increase coverage into the scheme.

The micro-pension plans and DC systems described above are clearly at various stages of maturity and operate in environments that range broadly across the economic spectrum: from the high living standards and wages in the U.S. to the poorer informal sectors in Kenya and India. Available key summary metrics for U.S. DC plans, Latin America DC plans, Kenya Mbao, and India APY are compared in Table 18.1. Comparisons of contribution levels and account balances clearly illustrate a key challenge for micro-pension systems: the

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\(^6\) Conversions of Indian rupees to USD were done using OECD Purchasing Power Parity (PPP) rates for 2015.
imperative to deliver investment management, plan administration, money transfer, and other services at low cost. Note that the USD 393 average annual total plan cost per member for U.S. DC plans is much higher than the average member account balance for Mbao and the AUM per plan member for APY! Even with much lower business costs in India, Kenya, and other developing countries, it is clear that low cost delivery of these services in a micro-pension environment is a necessity.

Table 18.1
Comparison of Selected Pension Metrics across Regions

<table>
<thead>
<tr>
<th>Pension System</th>
<th>U.S. DC¹</th>
<th>Latin America DC²</th>
<th>NPS Lite/ APY DB³</th>
<th>Kenya Mbao⁴</th>
</tr>
</thead>
<tbody>
<tr>
<td>Years since inception of system</td>
<td>35</td>
<td>8-35</td>
<td>1</td>
<td>5</td>
</tr>
<tr>
<td>Total AUM</td>
<td>$859 billion</td>
<td>$470 billion</td>
<td>$706 million</td>
<td>$1.1 million</td>
</tr>
<tr>
<td>Total plan members</td>
<td>5.0 million</td>
<td>82 million</td>
<td>3.6 million</td>
<td>65 thousand</td>
</tr>
<tr>
<td>Average assets per member</td>
<td>$138,000</td>
<td>$6,000</td>
<td>$196</td>
<td>$16</td>
</tr>
<tr>
<td>Average contribution per member</td>
<td>$12,000 avg.</td>
<td>$1,000 avg.</td>
<td>$28 to 981</td>
<td>$60 minimum</td>
</tr>
<tr>
<td>Average annual total plan cost % of AUM</td>
<td>0.32%</td>
<td>1.16%</td>
<td>Unknown</td>
<td>Unknown</td>
</tr>
<tr>
<td>Average annual total plan cost $ per member</td>
<td>$393</td>
<td>$60</td>
<td>Unknown</td>
<td>Unknown</td>
</tr>
</tbody>
</table>

2. Source: CEM database and International Association of Super visionary Bodies of Pension Funds (AIOS). Total plan cost as of December 31, 2014.
5. Unknown is used because of uncertainty about the completeness and comparability of available cost data.

ASSET MIX IN U.S. DEFINED CONTRIBUTION PLANS

Asset mix – essentially the split of the portfolio between equity and fixed income – is by far the biggest driver of long-term investment returns. The asset mix decision represents 96% of long-term total returns for funds in the CEM Global IBD. In contrast, the contribution of active management is quite small. This underscores the critical importance of asset mix to pension plan outcomes.
In U.S. DC plans, individual plan members make their own asset mix decisions by selecting from an investment option menu. As outlined earlier, the CEM U.S. DC database includes 19 years of detailed data from a robust sample of corporate and public sector plans.

The average number of investment options offered by U.S. DC plans in 2015 was 16 – typically including a range of equity, fixed income, term deposit, money market, and balanced fund options (e.g. target retirement date, life stage, and risk tolerance based). Target retirement date funds (TDFs) are counted as ‘1’ option.

As Table 18.2 illustrates, U.S. DC plans have under performed their DB counterparts over the 19-year period where CEM database comparisons are possible. The main performance differentiator is asset mix: average annual policy returns were 0.93% lower for the DC plans. For the DB plans, the policy asset mix is set by fund professionals. For these DC plans, asset mix is the result of individual investment option choices and the plan default option for members who prefer not to make a choice. Therefore, DC policy return is calculated as equal to the weight of actual asset class holdings multiplied by asset class benchmark returns.

Table 18.2
U.S. DB versus DC Performance Comparisons

<table>
<thead>
<tr>
<th>Pension System</th>
<th>DB</th>
<th>DC¹</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Return²</td>
<td>7.57%</td>
<td>6.44%</td>
<td>1.13%</td>
</tr>
<tr>
<td>- Policy return</td>
<td>6.99%</td>
<td>6.06%</td>
<td>0.93%</td>
</tr>
<tr>
<td>- Costs</td>
<td>0.49%</td>
<td>0.40%</td>
<td>0.09%</td>
</tr>
<tr>
<td>= Net value added</td>
<td>0.08%</td>
<td>-0.02%</td>
<td>0.10%</td>
</tr>
</tbody>
</table>

1. DC policy return = weight of holdings times benchmark returns.
2. Returns are the geometric average of the annual average of all database participants.

In Table 18.3, we compare average asset mix and annual asset class returns for the U.S. DB and DC plans for this 19-year period. Both DB and DC plans invest in five of the public market asset classes (e.g. fixed income). In these asset classes, DB and DC returns are generally quite similar. They are not the source of the DB out performance. Rather, the performance differential is driven by two factors:

1. Private equity and real assets (mainly real estate) are the two top performing asset classes over the 19 year period. DB funds invested an average of 9% of AUM in these two asset classes. These two asset classes were not available to DC plan members – they were not offered as investment options and they were generally not part of balanced funds offered to members over this time period.
2. DC plan members invested 24% of their holdings over the period in the two poorest performing ‘safe’ asset classes: guaranteed investment certificates/stable value funds; and cash. In contrast, DB funds invested only 2% of their AUM in cash over the period.

Table 18.3
U.S. DB vs DC Asset Mix Comparisons

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Asset Mix¹</th>
<th>Returns²</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Ranked returns)</td>
<td>DB</td>
<td>DC</td>
</tr>
<tr>
<td>Private equity</td>
<td>4%</td>
<td>n/a</td>
</tr>
<tr>
<td>Real assets</td>
<td>5%</td>
<td>n/a</td>
</tr>
<tr>
<td>Small cap stock</td>
<td>6%</td>
<td>8%</td>
</tr>
<tr>
<td>Employer stock</td>
<td>0%</td>
<td>20%</td>
</tr>
<tr>
<td>Fixed income</td>
<td>32%</td>
<td>10%</td>
</tr>
<tr>
<td>Hedge funds</td>
<td>3%</td>
<td>n/a</td>
</tr>
<tr>
<td>Stock U.S. large cap or broad</td>
<td>24%</td>
<td>30%</td>
</tr>
<tr>
<td>Stock non U.S. or global</td>
<td>25%</td>
<td>8%</td>
</tr>
<tr>
<td>Stable value/GICs</td>
<td>2%</td>
<td>7%</td>
</tr>
<tr>
<td>Cash</td>
<td>2%</td>
<td>7%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100%</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

1. Asset mix = arithmetic average of annual asset class weights
2. 19 year returns are the geometric average of the annual average of each asset mix.

These asset mix comparisons also reveal that DC plan members do not diversify their holdings to the same extent as professionally managed DB funds. Total DC plan exposure to U.S. equity was 58% of holdings whereas non-U.S. stock was only 8%. In addition, 20% of holdings were invested in one non-diversified asset: employer stock. In contrast, DB funds were more diversified: 24% of holdings were invested in non-U.S. stock and employer stock was not an asset class for such funds.

The implication of a 1% per annum lower return due to asset mix for a DC plan member is a 20% lower account balance after 19 years. This clearly points to the importance of taking asset mix decisions out of the hands of individual DC plan members and placing it in the hands of investment professionals whose interests are aligned with members. To ensure alignment, investment managers should be selected in a rigorous process by trustees who are focused on the long-run health of the fund and ensuring that adequate benefits are paid to members.

Fortunately, U.S. DC plan sponsors now recognize the problems associated with investment option menus and individual choice and are taking corrective action. TDFs are increasingly the plan default option for members who don’t want to make a choice.
and are featured prominently in plan communication material. There has been a material improvement in portfolio diversification in recent years due to these developments.

**ASSET MIX IN LATIN AMERICAN DC PLANS**

Certain Latin American DC plans take the investment decision out of the hands of individual plan members. For example, Chilean pension member account balances are invested in a life-stage balanced fund that reflects a generally accepted risk/return profile for their age. Pension members’ funds are subsequently shifted from higher risk/higher reward options to lower risk/lower reward options as members get closer to retirement. In Mexico, Colombia, and Peru there are default options for undecided members during the accumulation and de-accumulation phases.

A distinct bias towards less volatile fixed income and cash is the norm amongst Latin American pension providers as illustrated in Figure 18.3 Latin American DC plans hold 60% more in fixed income assets relative to U.S. DC plans. This bias is likely to result in lower long-term returns and pensions compared to asset mixes with higher equity holdings. Consider, for instance, passive investments in global equities and bonds for the 20-year period ending 31st December 2015. Global equities as represented by the MSCI All Country World Index returned 6.4% while global bonds as represented by the broad based Barclays Global Aggregate Index returned 4.5% in U.S. dollar terms. Monies invested in the global equity index over this 20-year period generated 44% more than monies invested in the global bond index. While equities are significantly more volatile than bonds, younger members with long investment horizons are able to take on higher risk levels.

**Figure 18.3**

*Average 2014 AUM% in Fixed Income and Cash*

Diversification by asset class and region is another important principle for optimizing long-term reward/risk trade-offs. A lower level of diversification increases risk. Constraints limit the investment opportunity set and have negative performance
In addition, in several Latin American countries, pension providers are required to generate a minimum annual rate of return that is tied to the returns of other providers in their country. Examples are, Chile, Colombia, El Salvador, Peru, and the Dominican Republic. This requirement moves each provider’s investment focus away from optimizing long-term risk and returns for their plan members. Instead, the focus becomes the return providers think they have to deliver in the short term and the consequence is a very similar asset mix and returns across providers (also known as ‘herding behaviour’).

**Figure 18.4**
**Average 2014 AUM% in Non-domestic Holdings**

<table>
<thead>
<tr>
<th>Region</th>
<th>2014 AUM% in Non-domestic Holdings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Latin America DC</td>
<td>15%</td>
</tr>
<tr>
<td>U.S. DB</td>
<td>24%</td>
</tr>
<tr>
<td>EURO DB</td>
<td>50%</td>
</tr>
<tr>
<td>Canada DB</td>
<td>37%</td>
</tr>
</tbody>
</table>

Foreign market holdings averaged 15% across the nine Latin American pension systems in 2014, ranging from 0% in several countries to a high of 43% in Chile. As illustrated in Figure 18.4, this is a low level of diversification by international standards: Canadian DB funds had 37% and European DB funds had 50% in non-domestic holdings. The general trend across the Latin American countries has been a gradual relaxation of these constraints. This is a positive trend for plan members.

**ASSET MIX CONSIDERATIONS IN THE MICRO-PENSION CONTEXT**

The nominal returns realized by the various pension systems represented in the CEM databases translate to real returns ranging from 2% to 5% over most time periods. Similar real rates of returns are possible for micro-pension systems if reasonably similar investment approaches are applied. The reality of current saving choices and returns typically experienced by poor workers in developing countries is very different. Many informal economy workers do not have a bank account. For them, savings mean hoarding cash or gold. Over the past twenty years, CPI has averaged about 7% in India and about 4% globally. Hoarded cash guarantees a negative real rate of return,
absent deflation. Those with bank accounts do somewhat better. Savings accounts and short-term deposits are common savings choices, especially for unsophisticated savers. However, real rates of return on these products are generally quite low, in the 0 to 1% range, and in the current low interest rate environment they are now negative in many countries. Clearly, micro-pension plans have the potential to deliver far better retirement savings outcomes for poor workers.

Capital markets in developed countries are generally efficient and robust, in the sense that it is easy to invest in them (including through a range of index funds) and that clear episodes of market dislocation do not appear to be related to systemic factors. Available investment vehicles cover a wide spectrum of opportunities: domestic and global equity; large cap and small cap equity; private equity; government and corporate bonds, both domestic and global; real estate, both public and private, etc. In contrast, many small and developing countries do not have robust capital markets. Public market domestic investment opportunities may be quite limited or nonexistent in some asset classes. For example, investable domestic equity indices do not exist in all countries. In these countries, regional or global equity and fixed income indices are possible alternatives.

Constraints – on asset mix and proportions of foreign holdings – can be another challenging issue. These constraints are typically applied via regulation with goals of fostering the development of domestic financial markets and providing capital for domestic investment programs such as government debt. In new pension systems, negative impacts from ‘early-days’ market downturns and lack of initial pension investment expertise are additional factors supporting constraints. However, investment constraints have negative long-term implications for pension fund portfolio returns and risk diversification. They should be avoided or relaxed over time. In countries where such constraints have existed (e.g. Latin America), there is a gradual trend towards reducing them.

As the results for U.S. DC plans demonstrate, individuals do not make optimal asset mix decisions, even when they have a reasonable degree of financial literacy and plan sponsors invest in educational communication programs. This financial literacy problem is extreme in the micro-pension environment. General education levels are low and many people have no familiarity with financial services such as banking and insurance. Many poor workers have no experience with any form of savings other than hoarding cash or gold. Opportunities to engage and educate such workers about investment choices are limited. In these circumstances, eliminating or limiting investment decisions by plan members is a better approach. Contributions could be directed automatically to life-stage balanced funds that are typical in the Latin American mandatory DC systems, or perhaps to target date funds.

Individual loss aversion is another important consideration in investment program design. Poor workers will be wary about taking a leap of faith by contributing, given their economic position and low levels of financial literacy. They will not likely react well to losses, particularly in the early years. This is the reason that some countries have
experimented with products that bundle insurance alongside savings (see Chapter 19 on Inclusive Insurance) and others have introduced a rate of return guarantee in defined benefit format for pension savings (see Chapter 1 on India).

The National Employment Savings Trust (NEST)\(^7\) DC plan in the United Kingdom has a well-designed investment program and an interesting approach to the loss aversion problem. When a worker enrols with NEST, their contributions are defaulted to a NEST Retirement Date Fund (RDF), unless they pro-actively select another of the investment options offered. The RDF is based on the year they are expected to retire. For example, if 2050 is the expected retirement date, the member’s contribution is directed to the 2050 Retirement Fund. NEST aims to maximise members’ accounts by taking appropriate investment risk at different times throughout their saving period. There are three general phases: Foundation – about five years; Growth – about 20 years; and, Consolidation – about 10 years.

The Foundation phase is for people who join NEST when they are many years away from retirement. The aim is to help younger workers develop the pension saving habit and establish their retirement account. The investment focus is on steady growth and trying to avoid the sharp falls in account balances that can shake member confidence. Investment goals in the Foundation phase are described by NEST as follows:

- Keep pace with the cost of living
- Significantly reduce the likelihood of extreme investment shocks
- Take appropriate risks at appropriate times, taking account of economic and market conditions
- Target a long-term volatility average of 7% per annum

The idea is that avoiding early losses and realizing growth in account balances helps to build trust and encourages novices to stay in the program and ideally increase contributions as they gain confidence. Similar low volatility transition approaches seem well-suited to micro-pension programs.

**ACTIVE MANAGEMENT AND COST CONSIDERATIONS IN THE MICRO-PENSION CONTEXT**

Observations here are based on key empirical evidence from the CEM Global IBD that is outlined in Appendices B and C. Here is a brief summary of these key insights.

On average, passive policy or ‘market’ returns have generated 96% of long term net returns. Asset mix is very important. More volatile equity asset categories have historically generated significantly higher long-term returns than less volatile fixed income categories. Individuals generally do not make optimal asset mix decisions. Outcomes are likely to be better if contributions are directed or guided to professionally-managed balanced funds.

\(^7\) National Employment Savings Trust (NEST). 2016 http://www.nestpensions.org.uk/
On average, net value added (NVA) contributed a rather modest 18 bps, or only 4%, to total returns. NVA is the contribution from active management. Fund characteristics associated with higher NVA are all closely tied to cost advantages and include the following:

- Fund size: Bigger is better. Large funds benefit from economies of scale.
- Internal management outperforms external management net of costs. Large funds use more internal management than small funds.
- Low cost active management has outperformed, but high cost active management has under performed passive management. Better performing funds are typically large and implement active management cost effectively (more internal/less external; less fund of funds in private markets).

Two possible scenarios for a new micro-pension plan investment operation are discussed below. A key assumption under both scenarios is that the investment operation must be economically viable in its own right. In other words, a third-party subsidy is not available to the investment operation. The two scenarios are:

1. A micro-pension plan is established as a standalone start-up enterprise, and
2. A micro-pension fund start-up is integrated into an existing investment operation such as a social security fund or civil service pension fund.

The absence of scale is a limiting factor for any investment operation start-up. This challenge is extreme for a stand-alone micro-pension start-up for informal sector workers. As the Kenya Mbao example above illustrates, individual contribution levels can be very low. The number of members required to generate significant AUM relatively quickly is in the millions with very low contribution levels. Very large population segments would have to be targeted, and in many countries these membership levels are not viable. Reaching the USD 10 billion threshold where pension funds typically start to manage assets with internal staff could take many years and may not be realistic.

High cost external active management does not generally produce the best outcomes, especially for funds with low AUM and weak bargaining positions. Therefore, it seems that implementing low cost out-sourced passive management is the best strategy for a standalone start-up micro-pension fund. The expected investment cost for such a fund is calculated here by applying median external passive costs from the 2015 CEM Global IBD to widely used public equity and fixed income asset classes and median costs for the investment oversight functions (includes senior fund staff, governance, custody, consulting, etc.). The resulting expected annual investment operation cost is about 9 bps.

The NVA for a 100% passively managed fund will be zero less cost. Therefore, the NVA for this standalone fund with investment costs of 9 bps will be -9 bps. What does this mean in terms of outcomes for plan members? The first and most important perspective is that equity and fixed income market returns will be far better over the long-term than
cash hoarding or returns on retail saving products. The second perspective is that NVA of -9 bps places this micro-pension fund at the 23rd percentile level of funds in the CEM Global IBD with 20 years of continuous data. Figure 18.5 illustrates the range of NVA results for these funds. This is a reasonable expected outcome for plan members.

Figure 18.5
**Net value added distribution (bps) for funds in the CEM Global database with 20 years of continuous data**

Integrating a start-up micro-pension fund into an existing investment platform, perhaps a social security fund or civil service pension fund, eliminates the economies of scale problem, at least partially. Micro-pension fund assets could be co-mingled in asset class pools already managed by the existing fund’s investment operation. Active management opportunities could be implemented more cost-effectively. Ideally, low cost internal active management would be viable. A wide range of long-term NVA outcomes are possible in this scenario, as shown in Figure 18.5 by results for funds in the Global IBD.
with 20 years of continuous data. The median NVA result in this group was +18 bps; the 75th percentile was +54 bps; and the 90th percentile was +79 bps. Of course, it is also possible to under perform a low cost passive implementation approach: the 10th percentile NVA result was -40 bps. Positive NVA from active management improves long-term outcomes for plan members. Top quartile funds in the CEM Global IBD have added significant value and materially improved outcomes. Most bottom quartile funds under perform low cost passive implementation approaches. Cost-effective implementation of active management is the key differentiating factor.

PENSION ADMINISTRATION AND MEMBER SERVICE

Pension administration activities are also vital to pension plan success, although they do not typically receive the same public scrutiny as investment operations. Pension administration operations encompass the plan activities that support the core mission of all pension plans – the eventual delivery of a pension to individual plan members. The key activities performed include:

- Collecting and allocating contributions from employers and/or members
- Data maintenance and reporting
- Processing transactions: examples include enrolments, withdrawals and transfers in and out of the plan, retirements, and deaths
- Member and employer communication and service delivery: examples include answering queries, online information and tools, issuing member statements, plan and financial education, retirement counselling, and reporting to stakeholders
- Marketing and sales
- Governance, strategic oversight, and financial control

ADMINISTRATION AND MEMBER SERVICES COSTS

In the CEM global universe, estimated total pension fund costs in 2015 varied widely from about 15 bps of assets under management for a European USD 80 billion fund to 200 bps for a USD 4 billion fund. Table 18.4 breaks down total fund costs as a percentage of total assets under management for various regions where CEM has data.
Table 18.4
Total Fund Costs as a % of Total Assets under Management

<table>
<thead>
<tr>
<th>Cost Classification</th>
<th>DB</th>
<th>DC</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Global average</td>
<td>Netherlands average</td>
</tr>
<tr>
<td>Investments¹</td>
<td>55 bps</td>
<td>58 bps</td>
</tr>
<tr>
<td>Administration and Members Services²</td>
<td>7 bps</td>
<td>7 bps</td>
</tr>
<tr>
<td><strong>Total Fund Costs</strong></td>
<td><strong>62 bps</strong></td>
<td><strong>65 bps</strong></td>
</tr>
</tbody>
</table>

1. Investment costs include internal and external asset management costs, oversight, custodial and audit costs. Transaction costs are excluded.
2. Administration costs include member transactions, communication, collections/data maintenance, governance and major projects. IT and support service (e.g. HR, Legal, Audit) as they pertain to pension administration. For DC systems, marketing costs are also included.
3. Total costs as represented here differ from the 1.16% average presented on Table 18.1 the latter included operating profit of pension providers.
4. CEM conducted a study of the 46 pension plan administrators operating Mexico, Chile, Peru Colombia, Uruguay, Costa Rica, Dominican Republic, El Salvador, and Panama. Data is as at December 31 2014. Administration costs are drawn from public financial statements as well as those reported by AIOS (including sales and marketing). Investment management costs include estimated internal asset management costs taking into consideration the mix of investments invested in foreign and domestic assets as well as implementation style of these investments (i.e. active or passive) for each of the respective pension providers in the 9 Latin countries studied by CEM. Investment costs include estimated costs for 3rd party asset management such as mutual funds.

As illustrated, there is wide variation in the breakdown between total investment and administration costs for pension systems structured as DB versus those structured as DC. As discussed briefly in the previous section and further detailed in Appendix C of this chapter, the primary driver of cost differentials for these systems are related to the investments chosen and their respective implementation styles. Additionally, DC systems managed by competitive entities in Latin America and Australia incur sales and marketing costs that can be quite high whereas DB systems in North America and Europe generally have captive member bases. It is generally agreed amongst leaders of the Latin pension industry that sales costs in particular do not add value to members in helping them choose a ‘better’ pension plan provider. In Latin America, it is estimated that sales costs are approximately 30% of total costs.

Table 18.5
Key factors driving cost differences and the related impact on costs in the different markets studied

<table>
<thead>
<tr>
<th>Implementation Style</th>
<th>DB Global</th>
<th>U.S.</th>
<th>DC Global</th>
<th>Australia</th>
<th>Latin America</th>
</tr>
</thead>
<tbody>
<tr>
<td>High exposure to costly assets (e.g. private markets)</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td></td>
</tr>
<tr>
<td>High exposure to external active investment management</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td></td>
</tr>
<tr>
<td>Sales and marketing costs</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td></td>
</tr>
</tbody>
</table>

¹ Sales and Marketing costs in Latin America have been estimated based on publicly available financial statements of the Latin American pension providers studied by CEM.
Establishing and maintaining a cost-effective yet adequate pension administration system in developing micro-pension systems is critical. These systems will not be able to sustain high cost marketing programs and sales channels.

COSTS OF PENSION ADMINISTRATION PER MEMBER

Pension administration costs are driven by plan members, rather than assets managed. Therefore, CEM Benchmarking assesses costs for both internal and outsourced member services/benefit administration operations on a per-member basis. CEM has conducted annual cost effectiveness comparisons between participating pension plans in Canada, the U.S., Australia, and the Netherlands since 1998. As Figure 18.6 illustrates, pension administration costs per member in 2015 ranged widely, from USD 10 to over USD 450 in the CEM global database (includes 80 unique plans). Average administration costs for DB plans were USD 134 versus USD 101 for DC plans. Median costs were USD 98 and USD 87 for DB and DC funds respectively.

Figure 18.6
Global Pension Administration Cost Per Member
CEM has estimated administration costs per member in the Latin pension markets it has studied as at December 2014. These costs, as illustrated in Figure 18.7, are calculated based only on the number of members actively contributing to pension accounts (which on average, amount to approximately 45% of all registered members). Average Latin American pension administration costs of USD 55 and median costs of USD 49 per active member are notably lower than those exhibited by pension administrators in more developed markets. This is partially due to the substantially higher number of members and related economies of scale advantages found in systems operating in Latin America. Other reasons for lower costs may be explained by the generally less expensive operating environments in which these pension systems operate in (i.e. lower salaries and infrastructure costs).

Costs for pension administration of DB plans in developed markets have been trending upwards since 2012. Costs have gone from USD 105 per member in 2012 to USD 117 per member in 2015, an increase of about 4% per annum. This increase is mostly due to investments in technology.

In Latin America, CEM anticipates that pension administration and member services costs for activities such as governance, marketing, financial education, and IT systems will also see some upwards pressure. Hopefully, efforts to reduce non-value add costs related to sales and account transfers between competitors will continue in Latin America. Additionally, continually improving efficiencies and minimizing costs related to people, processes, and technology are key considerations for established DC pension systems in Latin America as well as micro-pension markets everywhere. As previously illustrated in Table 18.1, micro-pension systems such as NPS Lite/APY in India and Kenya Mbao have low average contribution levels and account balances that will not support much in the way of costs.

Figure 18.7

<table>
<thead>
<tr>
<th>Cost Level</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Median</td>
<td>$49</td>
</tr>
<tr>
<td>Average</td>
<td>$55</td>
</tr>
<tr>
<td>Low</td>
<td>$5</td>
</tr>
<tr>
<td>High</td>
<td>$109</td>
</tr>
</tbody>
</table>


Costs per member have been calculated as a percentage of active members only. Active members are defined as only those who are contributing to their plans. In Latin America, approximately 45% of total members registered in the private pension system actively contribute to their plans.
KEY OPERATIONAL COST DRIVERS

CEM has developed a cost model that identifies key cost drivers for pension administration and helps to explain differences in costs between plans. The remainder of this section breaks down some of these key cost drivers with a focus on implications for developed markets and considerations for developing markets.

Figure 18.8
Straight through Processing (STP)

1. LEVERAGE TECHNOLOGY

Operating costs in developed market pension systems have been on the rise primarily due to large investments in modernizing their legacy pension administration systems. These systems have become dated and costly to maintain. They are unable to effectively support increasingly complex transaction processing and client service needs. Micro-pensions can benefit by avoiding these costs with the implementation of current, less expensive, more flexible and effective technology platforms. This includes use of online services accessed via mobile devices.

Straight through processing (STP) has many advantages for pension systems, including the potential to reduce costs, increase productivity and improve members’ service experience.11 However, there is a big difference between a process that is fully automated and one that is simply initiated online. CEM has found that many systems enable online initiation for numerous transactions, but very few have STP. For example, Figure 18.8 illustrates that just over 40% of systems allow members to start the process of retiring themselves online but only 4% of these systems have automated the full process. The

11 CEM Research (2013), “The Paperless Pensions Office; How and why the World’s leading pension administration teams are moving to a paperless environment”
main barriers to fully automating transactions include: security concerns, system issues, and legal concerns such as obtaining digital signatures. Complex transactions are less likely to be processed straight through and are more likely to require a physical signature. Additional considerations for the successful implementation of STP in pension systems include: 1) Data quality – fundamental to delivering effective STP; and 2) Online functionality – successful use of STP requires members to effectively process transactions online. Members will not use online services otherwise.

The growing importance of online capabilities in developed pension markets is supported by CEM data as illustrated in Table 18.6. Micro-pension administrators are in an excellent position to harness online technology to communicate with and provide services to both existing and potential members.

**Table 18.6**

**Online Transactions**

<table>
<thead>
<tr>
<th>Online Tool</th>
<th>% Offering Tool</th>
</tr>
</thead>
<tbody>
<tr>
<td>Benefit calculator in secure area linked to member’s salary and service data</td>
<td>85%</td>
</tr>
<tr>
<td>Service credit purchase calculator</td>
<td>73%</td>
</tr>
<tr>
<td>Register for counselling sessions</td>
<td>37%</td>
</tr>
<tr>
<td>Register for presentations</td>
<td>64%</td>
</tr>
<tr>
<td>Live chat</td>
<td>6%</td>
</tr>
<tr>
<td>Change address</td>
<td>84%</td>
</tr>
<tr>
<td>Change beneficiary</td>
<td>47%</td>
</tr>
<tr>
<td>Change email address</td>
<td>81%</td>
</tr>
<tr>
<td>Reset password</td>
<td>53%</td>
</tr>
<tr>
<td>Change banking information for direct deposit</td>
<td>60%</td>
</tr>
<tr>
<td>Download or print duplicate tax receipts</td>
<td>77%</td>
</tr>
<tr>
<td>View annuity payment details</td>
<td>83%</td>
</tr>
<tr>
<td>Apply for retirement</td>
<td>46%</td>
</tr>
<tr>
<td>View status of online retirement application</td>
<td>50%</td>
</tr>
<tr>
<td>Apply for a refund or transfer out</td>
<td>31%</td>
</tr>
<tr>
<td>Download member statements</td>
<td>86%</td>
</tr>
<tr>
<td>Upload documents</td>
<td>27%</td>
</tr>
<tr>
<td>View pensionable earnings and / or service without downloading</td>
<td>86%</td>
</tr>
</tbody>
</table>

There are some good initiatives underway that are effectively leveraging technology platforms. Examples include Mexico where the pension regulator (CONSAR) has worked closely with pension administrators to establish increased access to member services
Managing Costs and Optimizing Outcomes

via the use of digital platforms and biometrics utilizing voice, fingerprint, and digital signature

see also Chapter 9 on Mexico for more details. Representatives from each plan administrator are equipped with the required technology to capture new member enrolment information in a process that takes only a few minutes.

Mexican pension plan members also have access to several transactions and services online (including via mobile devices). The level and quality of online services will continually improve with the support of CONSAR. Recent enhancements include the implementation of a clear operational framework and supporting regulations, and a sound online electronic payments platform.

In India and Africa, micro-pension plan administrators are looking to leverage customized, ready-to-deploy IT platforms and tools for administering portable individual micro-pension accounts. These systems also rely on the latest biometric technology (i.e. fingerprints) and, critically, a link to government-maintained data files through a citizens National ID system or ‘NID’ number. This enables a very efficient member enrolment process. Work conducted by pinBox Solutions in India has demonstrated that using this process for account opening has reduced processing time from 18 days to three minutes thereby substantially reducing costs from 20% of first-year contributions to 0.5%, a drop of close to 98% (see Chapter 1 on India, Chapter 2 on Kenya and Chapter 14 on Data and ID for more details).

Another key member activity that has been successfully automated in micro-pension markets is pension contributions. As mentioned earlier in this chapter, micro-pension administrators have successfully leveraged ‘mobile money’ technology. Africa has become a leader in the use of mobile money services amongst developing countries. The success of mobile money is due to the relatively low cost of the technology involved in implementation and maintenance of these platforms as well as the ubiquitous nature of mobile phone ownership. It is estimated that more than 50% of the global adult population is ‘unbanked’. Approximately 67% of adults in developing markets do not have bank accounts. However, it is estimated that over half of the world population now has a mobile phone and these phones are increasingly used for accessing the internet and processing financial payments.

In Africa, 82% of the total population had a mobile connection as of January 2016. The Mbao Pension Plan in Kenya has leveraged this technology successfully as have some systems in India. Real-time accounting for contributions, a next-to-zero risk of theft or reconciliation errors, and modest cost are

large benefits of this technology. This same technology can be used for the eventual payout of a member's pension at retirement.

2. **SCALE MATTERS**

Similar to investment management operations, member services/administration costs per member also decline with size as fixed costs are spread over a larger base. Based on a sample of 63 pension plans, a 200,000 member system has a USD 57 per member cost advantage relative to a 100,000 member system. A 400,000 member system has a USD 29 per member cost advantage relative to a 200,000 member system. The benefits of economies of scale are not linear; they diminish as systems get larger. Examples of fixed costs are those required to run the facilities that house the pension administration services.

Micro-pension systems in many developing countries are well positioned to benefit from economies of scale given potentially large member bases.

3. **MAXIMIZE OPERATIONAL EFFICIENCY**

Operational efficiency and cost effectiveness are key objectives for any pension plan administrator. This dynamic is even more important in a pension scheme where plan contributions are mandatory. Plan members should expect plan providers to maximize efficiencies, minimize costs, and ultimately increase retirement payouts. In other words, strive to ensure human resources providing pension administration services are productive and adding value for members. Efficiencies should be maximized by continually implementing operational strategies that make the best use of people, processes, and technologies.

The number of transactions processed to support pension administration is a major driver of costs. Often a pension administrator does not have much control over transaction volumes. For example, as plans mature, more transactions are required to support putting a pension into pay, processing of pension terminations, and possibly survivor benefits at death. Plans with a growing and young member base (such as in developing markets like Latin America) will have to process more transactions for activities such as an account opening and collection of contributions.

Generally, the complexity of transaction processing due to legislative and compliance requirements has increased. This has an impact on costs of adapting processes, systems, and people (knowledge). Recent examples include the introduction of more complex marriage breakdown rules in Canada, a transitory commission structure in Peru, and stricter plan transfer rules in Mexico. Regulatory and benefit complexity of micro-pensions should be minimized. This will reduce workloads and costs.

Differences in the number of full-time-equivalent staff (FTE) used to serve members are a key reason for differences in costs between systems. Generally the more FTE used to serve members, the higher the costs. The past few years have seen a shift in the skill sets required in developed markets to accommodate an increased focus on member service and
the push for operational efficiencies. The following activities have required new thinking around talent management:

- Processing Member Transactions – the rise of the “knowledge worker”. Increased automation and STP means less back-office staff required for processing simple, high-volume transactions. More knowledgeable staff are required to process transactions that are more complex and require more manual intervention, problem-solving, and direct communication with members.

- Client Service and Marketing – requires unique skills and some pension plans have been hiring from outside the pension industry (i.e. banks, mutual fund companies, insurance, and telecommunications).

- IT/IS – the increasing level of complexity in managing IT projects such as system modernizations (which are happening more frequently) as well as the increased focus on data science and data security require specific skill sets.

- Leadership and Governance – an increasing emphasis on more educated, professional, and experienced management teams and board members overseeing pension administration.

Lastly, data quality is a key element that impacts operational efficiency. Data supports all of a pension administrator’s business processes and functional operations. Data quality impacts operational efficiency and productivity (e.g. by reducing the amount of rework). Poor data quality also has very real consequences in terms of member service levels (e.g. transaction turnaround, online transaction capabilities) as well as compliance and legal issues. Micro-pension systems need to ensure high-quality data management and governance procedures are in place.

4. OUTSOURCE WHERE AND WHEN IT MAKES SENSE

Outsourcing of all or parts of pension administration functions is common in countries such as Australia, Europe, and Latin America. Of the nine private pension systems in Latin America studied by CEM, all use some form of outsourcing for parts of pension administration. In Europe, administration and service delivery are often entirely outsourced to a commercial supplier.

Outsourcing is also prevalent in Canada and the US for employer sponsored DC plans. These plans tend to outsource all or part of the administration and member services activities (as well as asset management).

Pension administrators in Mexico have partnered with several large retail channels such as 7-Eleven, and Circle-K, to provide members with approximately 5,000 additional channels across the country. Members can make convenient voluntary contributions to their pension plan via these outlets. Retail outlets throughout Africa and India also play a large role in facilitating the convenient processing of small contributions cost effectively. These retail outlets act as agents of the local mobile companies and accept cash that can then be transferred using mobile money technology.
Outsourcing has its challenges of course. For example, there is evidence that plan administrators in certain systems maintain duplicate record keeping functions. Additionally, managing of third-party relationships and monitoring of outsourced service providers entails a cost.

Building the administration architecture for a micro-pension solution from scratch could be extremely costly and difficult to justify in terms of the fees members might need to pay to cover the build cost (absent any subsidy). Outsourcing or partnering with experienced suppliers or other pension plans could provide a relatively low-risk and cost-effective means to get started, at least until the micro-pension system has the assets to justify building its own administration platform.

5. MEMBER SERVICE IS CRITICAL TO ADDING VALUE

Evaluating the reasonableness of pension administration costs and assessing the value proposition delivered requires careful consideration of a plan’s operating context and environment. The member service goals and capabilities of pension plans can be quite different and this will impact costs. For example, one pension plan may choose to provide more individualized services (‘high touch’) versus another that may primarily rely on automated services, perhaps delivered on a ‘self-serve’ basis through a web site. The number of members on the administration platform is also an important cost factor. In addition, member mix and demographics will impact activity and service levels. For example, active (contributing) and retired (withdrawing) members are more costly to service than members who are inactive.

More focus on a client-centric approach in developed market defined benefit plans has resulted in an increased need for member communication. Plans have invested in people, training, and material to support client communications related to financial literacy, more complex administration requirements (e.g. marriage breakdown rule changes, disability, service purchases), and changing member demographics (e.g. increased number of retirees, higher frequency of career changes – more transfers, terminations).

Figure 18.9 illustrates how DC systems in Australia have increased their investment in client service, marketing, and financial planning services since 2011. Similar trends have been seen in some Latin American countries, driven by the need to communicate more complex products and investment options as well as to respond to general member distrust and misunderstanding of the value of their pension plans.
Service levels offered to plan members are a critical element of a pension plan’s value proposition. The mission of pension fund administration extends beyond merely maintaining records, processing transactions, and managing related costs.

CEM defines service from a member’s perspective. Figure 18.10 illustrates the CEM pension member service model. Higher service means more choice of delivery channels, more availability of services, faster turnaround times, better content in communication material, and higher quality. CEM utilizes numerous service metrics across services provided for members, and the delivery channels available, to rank pension plan administrators. A higher service score is not necessarily better as better service may not always be cost effective or optimal. For example, it is clearly higher service for members to have a contact centre open 24 hours a day, seven days a week but few administrators would be able to justify the cost. Comparing service scores is most useful for identifying service gaps as well as for generating ideas for improving and optimizing service levels.
Table 18.7 provides a more detailed breakdown of selected key service metrics delivered by pension administrators between 2013 and 2015. The data shows that between 2013 and 2015, pension administrators have generally improved member service by focusing on enhancing the member experience through their call centres and online platforms. Administrators are also putting pensions into pay more efficiently and enhancing the quality of information on member statements.

One channel for member communication that has grown rapidly amongst pension plan providers recently is social media platforms. While initially these were set up as an additional channel from which to ‘push’ messaging to clients, these platforms are now increasingly used for dynamic two-way conversations with clients. Some pension providers are allowing for confidential information to be shared via ‘personal messaging’ features (i.e. on Facebook). A study conducted by CEM in 2015 of 72 pension providers supports the adoption of these platforms.17 Although social media platforms themselves will evolve, usage rates will continue to increase. This will force pension plan providers to fully embrace their use as a key communication channel. Micro-pension administrators have an opportunity to leverage the rapidly expanding adoption of social media by individuals in developing countries. For example, in Africa only 11% of the population was active on social media as at January 2016. However, year-over-year growth rates of social media adoption are 25% which is aligned with the fact that the majority of Africans have a

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17 CEM Research (2016), “Social Media and CEM Pension Plan Administrators: What are systems up to these days?”
mobile phone, which is the primary medium for access to social media. A similar pattern
is seen in India albeit at slightly lower rates of penetration and growth of 10% and 15%
respectively.\textsuperscript{18}

Table 18.7
Examples of Key Services Metrics

<table>
<thead>
<tr>
<th>Select Key Service Metrics</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Members Contacts</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>% of calls resulting in undesired outcomes (busy signals, message, hang-ups)</td>
<td>13%</td>
<td>10%</td>
<td>11%</td>
</tr>
<tr>
<td>Average total wait time including time negotiating auto attendants, etc.</td>
<td>153 secs</td>
<td>129 secs</td>
<td>137 secs</td>
</tr>
<tr>
<td><strong>Website</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Can members access their own data in a secure environment?</td>
<td>95% Yes</td>
<td>91% Yes</td>
<td>94% Yes</td>
</tr>
<tr>
<td>Do you have an online calculator linked to member data?</td>
<td>84% Yes</td>
<td>81% Yes</td>
<td>85% Yes</td>
</tr>
<tr>
<td># of other web site tools offered such as changing address information, registering for counselling sessions and/or workshops, viewing or printing tax receipts, etc.</td>
<td>10</td>
<td>10</td>
<td>11</td>
</tr>
<tr>
<td><strong>1-on-1 Counselling and Member Presentation</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>% of your active membership that attended a 1-on-1 counselling session</td>
<td>5.4%</td>
<td>4.7%</td>
<td>4.7%</td>
</tr>
<tr>
<td>% of your active membership that attended a presentation</td>
<td>4.9%</td>
<td>4.7%</td>
<td>4.9%</td>
</tr>
<tr>
<td><strong>Pension Inceptions</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>What % of annuity pension inceptions are paid without an interruption of cash flow greater than 1 month between the final pay check and the first pension check?</td>
<td>86.6%</td>
<td>87.5%</td>
<td>90.2%</td>
</tr>
<tr>
<td><strong>Member Statements</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>How current is an active member’s data in the statements that the member receives?</td>
<td>3.1mos</td>
<td>2.8 mos</td>
<td>2.9 mos</td>
</tr>
<tr>
<td>Do statements provide an estimate of the future pension entitlement?</td>
<td>85% Yes</td>
<td>87% Yes</td>
<td>88% Yes</td>
</tr>
</tbody>
</table>

**COST VERSUS SERVICE**

Higher service levels do not necessarily mean higher administration costs because:

- Costs are driven much more by the volume of service transactions (for example, the number of telephone calls, counselling sessions, etc.) than they are by their timeliness, availability, or quality.

- Service is partly a function of the historic investment in data quality and information technology. These historic costs are not always reflected in current pension administration costs.

The ideal value proposition for a pension administrator is to have high relative service and low relative costs. The administrators in the top left quadrant of Figure 18.11 have achieved that result. As the data illustrates, results support the fact that high service does not necessarily mean high costs.

**Figure 18.11**

**Pension Administration Cost versus Service Score by Fund in 2015**

In conclusion, the need for pension plans to manage costs and optimize performance is critical to maximizing ‘value for money’ for pension members. Plan administrators should aim to: 1) achieve economies of scale; 2) understand the cost effectiveness and value generating capability of their investment management operations; 3) leverage technology and resources to maximize operational efficiencies; and 4) provide the right balance of service and information that is valued by members at reasonable cost.
ACKNOWLEDGEMENTS

Thank you to pinBox Solutions for the opportunity to contribute to this important and exciting initiative. The guidance and support of Gautam Bhardwaj and Parul Khanna from pinBox, as well as Will Price from the World Bank, was very helpful and is much appreciated. Thank you also to our CEM colleagues – Edsart Heuberger, Kam Mangat, Maria Parra, Jason Luo and John Simmonds – for their hard work and valuable contributions to this chapter.

APPENDICES

APPENDIX A

CEM Global Investment Benchmarking Database (IBD)

CEM has been providing investment benchmarking services since 1991. Most participants are DB funds, but there are also sovereign wealth funds and DC investment platforms in the IBD. The 2015 database comprises 315 funds representing about USD 8 trillion. Participating funds range in size from USD 50 million to over USD 800 billion, with an average size of USD 27 billion. The breakdown by region is as follows:

- 167 U.S. funds with aggregate assets of USD 3.3 trillion.
- 75 Canadian funds with aggregate assets of USD 1.2 trillion.
- 57 European funds with aggregate assets of USD 2.8 trillion.
- 16 funds from other regions including Asia-Pacific, Africa, the Caribbean, Latin America, and the Middle-east, with aggregate assets of USD 0.9 trillion.

The Global IBD includes the following metrics. All data elements are defined and standardized.

- Total fund and asset class holdings by implementation style: Implementation style is defined in terms of who makes investment decisions and whether or not there is an attempt to add value. Active management is any attempt to add value relative to a market index (such as the S&P 500 for U.S. stocks). Passive management is replication of a market index. External means that security level buy-sell decisions are made by investment managers external to the pension fund. Internal means that pension fund staff make the security level buy-sell decisions. There are four major implementation styles: internal/passive; internal/active; external/passive; and external/active.
- Policy/reference portfolio weights and total fund policy return: Policy or reference portfolio return is what funds would have realized by investing passively in their strategic asset mix. It represents asset mix index returns and isolates the contribution of the asset mix decision or ‘market’ returns to total returns.
• Fund and asset class returns by implementation style.
• Asset class benchmarks and returns.
• Detailed costs for both externally and internally managed assets as well as investment oversight and administration activities.

APPENDIX B
Summary of Investment Performance Research Insights from the CEM Global IBD

KEY TOTAL FUND RESULTS
1. Asset mix is by far the most important driver of total returns. Policy, or ‘market’ returns represent about 96% of long-term net return in the Global IBD.

2. Active management added positive but modest value added after investment costs. NVA is the difference between total fund return and policy return. It captures the after cost contribution of active management. Annual NVA has averaged 0.18% over the 25-year history of the Global IBD.

3. Costs need to be managed. Costs reduced value added from active management by 70%: from 0.60% before costs to 0.18% after costs.

ASSET CLASS PERFORMANCE
1. Equity asset classes, both publicly listed and private market, have generated higher long term net returns than fixed income asset classes. Equity asset classes have also experienced higher volatility.

2. Private markets are not a panacea. Diversification benefits are minimal after adjusting for reporting lags and smoothing. High cost implementation approaches, like fund of fund structures, under perform public market alternatives.

3. Pension funds should carefully consider their capabilities and implementation choices before investing in private market asset classes and hedge funds.

ACTIVE MANAGEMENT AND VALUE ADDED
1. Active management has been rewarded. Funds in the Global DBI have generated positive, but modest, average long-term NVA from active management.

2. Size matters: large funds have generated higher NVA than small funds.

3. Internal management outperforms external management after costs.


5. Large funds have lower costs due to economies of scale.

6. Paying more does not get you more. CEM’s cost benchmarking analysis reveals that paying more than others for what you do is not rewarded. It makes sense to manage costs.
7. Low cost internal active management outperforms high cost external active management for both public market and private market asset classes. High cost fund of fund structures perform poorly.

Research studies that are the basis for these investment performance insights are available on the CEM website: www.cembenchmarking.com

**APPENDIX C**

Investment Cost Insights from the CEM Global IBD

**MANAGING INVESTMENT COSTS**

Value creation in pension investment programs is closely tied to cost-effective implementation. Unfortunately, capturing total investment costs is challenging because of diverse reporting standards, incomplete reporting (especially in private market asset classes) and the industry practice of netting some costs from fund assets and not reporting all netted amounts as costs. For several years, Dutch pension funds have been required to report all costs in their annual financial statements using standard cost definitions. Therefore, we will use cost data from the 33 Dutch DB funds in the 2015 CEM Global IBD to illustrate total investment cost and its main components.

<table>
<thead>
<tr>
<th>Select Key Service Metrics</th>
<th>Average cost (bps)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public market assets</td>
<td>20.6</td>
</tr>
<tr>
<td>Private markets and hedge funds²</td>
<td>20.3</td>
</tr>
<tr>
<td>Transaction costs³</td>
<td>11.3</td>
</tr>
<tr>
<td>Oversight, custody and other costs</td>
<td>5.5</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>57.7</strong></td>
</tr>
</tbody>
</table>

1. Average size fund € 28.58; Median size: € 4.6B. Average asset mix: 26% Stocks; 63% Fixed Income; 7% Real Assets; 2% Hedge Funds; 2% Private Equity.
2. Base fees and performance fees are included.
3. Includes transaction costs for all asset classes.

The average Dutch total investment cost was 57.7 bps in 2015. However, the range of total costs reported by Dutch DB funds in the CEM database was very wide: from a minimum of 15 bps to a maximum of 125 bps. What drives such large differences in total fund costs? One important factor is fund size, which cannot be controlled directly by fund management. Large funds benefit from scale economies. On average, a fund with USD 10 billion of AUM has about 15 bps lower costs than a fund with USD 1 billion of AUM. However, there are three important cost drivers that can be managed: asset mix, implementation style choices, and paying more or less than others for similar services.
ASSET MIX COST DIFFERENCES

Asset mix differences are a big driver of total cost differences between funds. Private market investments are much more expensive than public markets. Table 18.9 shows the median external active costs in 2015 for two major public market and two major private market asset classes. The median Private Real Estate cost was about double that of U.S. Stock and the median Private Equity cost was about eight times higher than U.S. Stock.

Table 18.9
2015 Asset Class Costs¹ for Global DB Funds

<table>
<thead>
<tr>
<th>Cost category</th>
<th>Median cost (bps)</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. Fixed Income, external active</td>
<td>18</td>
</tr>
<tr>
<td>U.S. Stock, external active</td>
<td>46</td>
</tr>
<tr>
<td>Private Real Estate, external active</td>
<td>79</td>
</tr>
<tr>
<td>Private Equity, limited partnership and co-investment</td>
<td>324</td>
</tr>
</tbody>
</table>

¹ Cost basis is NAV. Base fees, performance fees, and internal oversight and monitoring costs are included. Transaction costs are excluded. Co-Investment is included with LPs because it can only be done alongside LPs.

IMPLEMENTATION STYLE COST DIFFERENCES

Implementation style choices are also a big driver of cost differences between funds. Table 18.10 shows median 2015 U.S. Stock costs for the four major implementation styles for Global DB funds. Cost differences between internal active, internal passive, and external passive styles are relatively small. External active management is much more expensive than the other three implementation styles. This is the typical pattern for public market asset classes.

Table 18.10
U.S. Stock Costs¹ by Implementation Style for Global DB Funds

<table>
<thead>
<tr>
<th>U.S. stock implementation style</th>
<th>Median cost (bps)</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. stock, internal passive</td>
<td>1</td>
</tr>
<tr>
<td>U.S. stock, internal active</td>
<td>7</td>
</tr>
<tr>
<td>U.S. stock, external passive</td>
<td>3</td>
</tr>
<tr>
<td>U.S. stock, external active</td>
<td>46</td>
</tr>
</tbody>
</table>

¹ Transaction costs are excluded.

Passive investing is not an option in private market asset classes. There are three active implementation style choices: internal, limited partnerships (LPs) and co-investment, and fund of funds. Median private equity costs for these three implementation styles for Global DB funds are shown in Table 18.11. Fund of funds added additional costs of 136
bps relative to LPs and co-investment. Median internal private equity cost was 294 bps lower than LPs and co-investment and 430 bps lower than Fund of Funds.

Table 18.11
Private Equity Costs\(^1\) by Implementation Style for Global DB Funds

<table>
<thead>
<tr>
<th>Private Equity implementation style</th>
<th>Median cost (bps)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internal</td>
<td>30</td>
</tr>
<tr>
<td>LPs and co-investment</td>
<td>324</td>
</tr>
<tr>
<td>Fund of funds</td>
<td>460</td>
</tr>
</tbody>
</table>

1. Cost basis is NAV. Base fees, performance fees, and internal oversight and monitoring costs are included. Transaction costs are excluded. Co-Investment is included with Direct LPs because it can be done alongside LPs.

Implementation style choices are clearly influenced by fund size. Below USD 10 billion AUM the amount of internal management is minimal for Global DB funds. External management is prominent with most assets in public markets managed actively, and over 50% of assets in private asset classes and hedge funds managed via high cost Fund of Funds. The use of internal management climbs steadily from the USD 10 billion AUM threshold. Internal management for funds in the USD 100 billion range reaches the following average proportions by asset class: fixed income 60%; public equity 40%; real assets 30%; and, private equity 10 percent. Some large funds manage considerably higher proportions of their public market assets internally. Large Canadian public sector funds manage a high proportion of both public and private market assets internally.

PAYING MORE OR LESS THAN OTHERS

Most people expect a rational relationship when purchasing goods and services: the more you pay, the more you get. Unfortunately, the investment management business is not rational. Paying more than others does not get you more. This relationship is illustrated for Global DB funds in the cost effectiveness chart in Figure 18.12 Pension funds in the top left quadrant are low cost after adjusting for their size and asset mix and have achieved positive net value added from active management. Funds in the bottom right are the mirror opposite. They are high cost with negative net value added. If paying more got you more, the data should align from the bottom left to the top right. Instead, the distribution is random. The pattern is the same for every group of funds and every time period tested by CEM. This underscores the importance of managing investment costs.
Figure 18.12
Investment Cost Effectiveness Chart: Net Value Added vs Excess Cost for Global DB Funds in 2015
INTRODUCTION

The market for voluntary long term contractual savings products aimed at low-income clients appears beset by market failure. There seem to be large numbers of low-income clients willing and able to pay for [these] products, but yet are unable to obtain them. When they do manage to make a product purchase, the products, often prove to be of disappointingly poor value.

Roth, Rusconi, and Shand (2007)

As the quote above indicates, offering long-term savings products to low-income workers, particularly those in the informal economy, is a worthy aspiration fraught with seemingly intractable challenges. This chapter will introduce the experiences of five insurance companies that have endeavoured to provide insurance and savings services to the low-income market to illustrate the challenges involved, while extracting lessons that are relevant for voluntary contributory pension and retirement products.

This chapter begins with an introduction to endowment products, a type of insurance product that has a savings component. The second section presents the five case studies in some detail in order to highlight relevant lessons from their efforts to serve the low-income market. The third section then synthesizes the key lessons, particularly focused on product design and distribution. The chapter concludes with a set of recommendations for the development of micro-pension products.

WHAT ARE ENDOWMENT PRODUCTS?

An endowment product is a life insurance contract that includes both a risk and a savings component. It pays a lump sum when it reaches maturity, which is usually after 10 or 15 years. The lump sum typically includes a guaranteed amount, the sum assured, plus some form of return or bonus based on the insurer’s investment returns. If the policyholder dies before the end of the term, then the product pays the face value of the policy to the beneficiary plus any bonuses earned to that point. In some cases, the insured event also includes the diagnosis of a critical illness such as cancer.

There are several features of these products that are potentially attractive for the low-income market. In contrast to pure risk insurance products, like term life, an endowment product accumulates value over time, which enables the poor to have something to show for their premiums if the risk event does not occur. Indeed one of the main challenges in selling insurance, especially to persons with limited disposable income, is that they feel as though they have wasted their money if they do not claim. With an endowment product, they actually do have something to show for their premium payments at the end of the term. As such, these products are often marketed for a particular savings purpose such as
education or marriage, as these are savings objectives for which the policyholder would like a lump sum at some point in the future, and even if they die they want to make sure that the sum is available.

Another potentially attractive feature is that endowments can be cashed-in before the end of the term for its surrender value, which depends in part on how long the policyholder has had the policy, whether premiums have been paid regularly, and any investment returns accrued. Often, it is not possible to cash-in the product during the first two years, and during the early years of a policy, the surrender value is very low because the sales commissions and perhaps administrative costs are typically front-loaded. But once the product has some value, if the policyholder needs money but does not want to surrender the endowment, they can often borrow against the surrender value. This creates a potentially versatile financial instrument that combines savings, credit and insurance.

Despite these attractive features, endowment products are also exposed to significant criticism, particularly about the lack of value that they might provide to low-income households. These criticisms include the following issues:

- **Vulnerable to lapses:** An important characteristic of low-income households, particularly those with breadwinners in the informal economy, is that they have irregular incomes. Consequently, they may have difficulty making regular premium payments, and therefore their policies frequently lapse. Once they lapse, some endowment policies are difficult to bring back into force.

- **High administrative costs:** Because this is typically a product that needs to be actively sold, it requires an agent to explain the product, provide advice and enrol policyholders. A big portion of the agent’s compensation is in the form of a commission, which is paid up front. As these expenses are front-loaded, there is often no surrender value for the product during the early years of the term.

- **Mis-selling:** Related to the structure of sales commissions, is the risk of mis-selling, to which less educated market segments are particularly vulnerable, but which is also seen repeatedly in developed markets.

- **Opaque (and confusing) benefits:** Mis-selling is also exacerbated by the fact that endowment policies are complicated products. Usually the product’s value is not guaranteed, but rather depends on the investment returns that the insurer manages to earn. The results can appear capricious, as policyholders have difficulty discerning why they receive higher bonuses in some years than in others.

- **Economic inefficiency:** Because of the high administrative costs, and low-risk investment strategies typically undertaken by insurers, a savvy investor would likely be better off separating the two elements, putting aside savings on a regular basis and spending a small piece of that for term insurance. For low-income households, however, such solutions might not be readily available.
Tackling these challenges is one of the core motivations of this volume – setting out how the best insights of financial inclusion and pension coverage, governance and investment can be combined to create a powerful new approach to some of the toughest questions in tackling old-age poverty.

**CASE STUDIES**

This section considers five examples of endowment products, or similar savings plus insurance schemes, which have been offered to low-income households. In several of these examples, the products were designed to overcome some of the criticisms associated with endowment products. Unfortunately, none of these experiences could be labelled an unqualified success, and some were failures. But each of them generated valuable insights that are quite pertinent to the provision of micro-pension products.

**CASE STUDY 1**

**DELTA LIFE, BANGLADESH**

When it started in the mid-1980s, Delta Life’s initial products consisted primarily of endowment policies targeted at Bangladesh’s middle and upper classes. However, the organisation’s founder, Shafat Ahmed Chaudhuri, soon recognised that Delta needed to innovate if it was going to be relevant to the majority of the population in Bangladesh. Inspired by the growing success of the Grameen Bank and other microcredit schemes, Delta launched its own experiment, Grameen Bima or village insurance. Initially, the design for Grameen Bima called for collaboration with a microcredit organization that provided the delivery structure for Delta’s endowment product. This partnership dissolved after a short time because of a difference in objectives. Delta then developed its own delivery network and quickly realised the benefits of selling its own policies. Subsequently, it developed a similar endowment product, Gono Bima, for low-income households in urban areas.

In 1991, imitating the country’s microcredit industry, the company began introducing loans to complement the endowment policy. Unlike loans against the surrender value of the product, these loans were unsecured through a group lending format. These “project” loans were intended to stimulate additional income for policyholders, which would help to promote their economic development and thus make it easier for them to pay their insurance premiums. Over time, this approach proved disastrous. Repayment fell to about 50% and Delta was left with a significant loan loss.

In the mid to late 1990s, Delta Life’s microinsurance programmes experienced astonishing growth, fuelled in part by the market’s interest in accessing a project loan. Together, Grameen and Gono Bima grew from less than 40,000 new policies issued in 1994 to more than 450,000 policies issued in 1998. As the decade came to a close, however, Delta felt

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1 This case study was adapted from McCord and Churchill (2005).
the effects of this reckless growth. The rapid expansion revealed significant weaknesses in information systems, internal controls and administration.

Profits were also slow to come, or at least that was the impression. In 2002, Delta’s board decided to spin off Gono and Grameen Bima into a non-profit company. However, after an actuarial report later that year showed that the microinsurance projects were actually contributing to profits, in part due to high lapse rates, it was decided to retain the projects and reorganise them for greater efficiencies. A reengineering of the microinsurance operations in 2002 and 2003 included improving internal controls, upgrading information systems to provide better analytical information, developing staff incentive schemes, implementing variable premium payment frequencies, decentralizing claims processing, and eliminating the micro-lending activities.

Over the years, Delta’s social motivation evolved into a commercial motivation, benefiting the company as well as its roughly one million poor customers. Along the way, Delta Life learned a number of valuable lessons, many of them the hard way.

INSTITUTIONAL ISSUES

- Delta has shown that it is possible for an insurance company to create its own distribution network to sell voluntary, individual insurance policies directly to the low-income market. This distribution approach has not been replicated elsewhere, with the possible exception of the Life Insurance Corporation (LIC) in India, which had the advantage of being a state-owned monopoly for many years.

- Insurers have to focus on their core competencies. Although Delta’s project loans were heralded as an accomplishment in the late 1990s, after a few years of reflection (and mounting bad debts), they are now seen as a major failure.

- Microinsurers should not overlook the critical importance of leveraging technology, especially to manage large volumes of small policies. Effective management of an insurance business depends on timely and accurate information to price products appropriately, pay claims expeditiously, manage staff effectively, and monitor performance carefully.

- When money is involved, fraud will not be too far behind. Careful attention should be given to internal controls, ideally before an organisation pursues exponential growth.

PRODUCT DESIGN AND DELIVERY

- Endowment policies may be appropriate for the risk-management needs of the low-income market as they provide life insurance protection while allowing the poor to gradually build up assets. However, persons with limited means have a short term outlook. Products that allow policyholders to access savings sooner and more regularly (though still in the medium term) are most popular.

- The assumption that microinsurance policyholders must pay weekly premiums proved not entirely correct. The cash flows of low-income households are not just variable;
they are also heterogeneous. To meet the needs of the market, it is necessary to offer a range of premium payment options and face values.

• It is difficult to have simultaneous savings, credit and insurance relationships with customers. For example, field workers who sell endowment policies approach premium collection in a softer and less aggressive manner than when collecting loan repayments, creating confusion for those who experience both.

• Distribution through other organisations means that the insurer does not have control over the priorities of the agents. An alternative—direct distribution—requires the insurer to have its own army of field operatives and the corresponding infrastructure, which significantly increases operating costs. The relative effectiveness of different distribution approaches requires additional analysis.

DISTRIBUTION AND MARKETING

• Effective staff compensation systems remain elusive. Microinsurance requires a unique sales culture that effectively marries a concern for clients’ welfare with the commercial interests of the insurer. But how exactly can that be achieved? Delta’s microinsurance division relies heavily on part-time workers who sell insurance occasionally on a commission basis. It is not clear that this is the most effective approach. This is why the Indian Fair Price Shop example set out in Chapter 16 is so compelling, showing that it is possible to leverage a payments infrastructure created for purchases of everyday household supplies and, hence, providing a way to cut through one of the fundamental barriers to effective distribution.

• Reward systems need to avoid causing undesirable behaviour, such as spurts of new policies at the end of a sales period, splitting one policy into two smaller ones to increase volumes, or the provision of unofficial rebates to new clients.

CASE STUDY 2

ALLIANZ, INDONESIA

In India, all insurance companies are required by the regulator to have a portion of their business in the rural and social sectors, which often translates into microinsurance. Bajaj Allianz, the Indian joint venture between the German multinational insurer Allianz, and the Indian conglomerate, the Bajaj Group, embraced this requirement by designing relevant products for the low-income market. One of its most successful products was a five-year endowment product, Sarva Shakti Suraksha (securing and empowering everyone), that was introduced in 2008. By 2013, this product provided savings and insurance to more than seven million policyholders, before it was pulled from the market due to regulatory changes.

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2 This case study is adapted from the learning journey of Allianz Life Indonesia published under agreement with the ILO’s Impact Insurance Facility.

3 Concerns about exposing low-income households to higher risk investments cause the Indian regulator to stop insurers from issuing unit-linked products, which caused Bajaj Allianz and other insurers to withdraw products from the market.
Seeing the excellent results in India, Allianz’s office in Indonesia decided to introduce a similar product in 2010. Target customers in Indonesia were expected to pay a premium of IDR 10,000 (USD 1) per week for 50 weeks per year. Two weeks per year were premium holidays. Over the five-year term, customers would thus accumulate IDR 2.5 million (USD 250) in premiums. When the policy matured, this IDR 2.5 million premium was returned to customers in full without interest or deductions, as long as no claim had occurred in the meantime. Customers were free to use the maturity benefit for any purpose, although it was marketed as a product to support children’s education. The product name, TAMADERA, alludes to this objective as it is an abbreviation that means “building a prosperous future”.

During the policy term, customers were insured for death due to all causes except suicide, and they were also covered for five critical illnesses: cancer, heart attack, stroke, kidney failure and major burns. Life insurance cover started after the first premium payment; the critical illness cover had a 90 day waiting period. To keep things simple, the benefit for death and critical illness was also IDR 2.5 million (USD 250). After a claim, coverage stopped and paid premiums were not returned.

TAMADERA was a voluntary product. Only active borrowers of the distribution partner, a local MFI named VisionFund Indonesia, and spouses of borrowers were eligible to join the program. Customers had the option to surrender their policy from the second year onwards whereby all paid premiums minus a 15% surrender fee are returned. The policy would lapse automatically after two consecutive non-payments of premiums.

Many of these design features were intended to overcome the low-income market’s challenges with endowment products. For example the premium holidays were introduced to accommodate irregular cash flows of the target market; and the five year tenor was a recognition of the difficulty of the target market to plan for the long term. The very transparent and simple approach to the product features was an important effort to make the product easy to communicate, even by people who are not insurance specialists.

Despite these innovative and well-conceived efforts, the product was not successful. After 18 months on the market, less than 400 policies were sold, largely due to distribution challenges. The low volumes, and lower than anticipated returns on investment, forced Allianz Indonesia to discontinue TAMADERA. The effort, however, generated valuable insights that Allianz made publicly available through its collaboration with the International Labour Organization’s (ILO) Impact Insurance Facility.

**ON DISTRIBUTION**

- The insurance distribution partner must have the capacity and willingness to make changes to accommodate the insurance products. An endorsement and verbal support from the distributor’s management is not enough. The management must integrate the product into their vision, performance indicators and staff promotion criteria.
• Insurance must be properly integrated into the distribution channel’s core business. Loan officers at VisionFund Indonesia were unsure when to best explain TAMADERA and when to push for enrolments. Moreover, loan officers reported that their workload was already high, which left little time for insurance.

• Tangible and meaningful incentives for sales staff must be in place. The insurer cannot bank on the intrinsic motivation of the distribution partner’s field staff. Unfortunately, the client-centric design of TAMADERA resulted in very thin margins that did not allow for staff incentives. Allianz estimated that it would have had to pay at least 10% of the premium as commission to allow for meaningful incentives. Since that was not available, the staff perceived insurance promotion as an additional burden without seeing any benefits for themselves.

• Selling voluntary insurance requires different skills than selling credit or compulsory insurance. Despite intensive training, many loan officers did not feel confident about discussing insurance matters with their customers. Credit is in high demand and is thus much easier to distribute than either insurance or savings products that require multiple engagements to cultivate a demand.

• To sell long-term products, one must have the trust of potential clients. Clients indicated that they were not confident that VisionFund would be able to serve the community in five years, as many non-governmental organizations (NGOs) come and go.

FACTORS INFLUENCING PERSISTENCY

• Even simple processes will not be effective if they are not accepted by the staff. The majority of lapses with the product were due to problems in premium collection and data entry by the distribution partner and not due to the unwillingness of customers to pay the premium. This is why creating an auto-debit facility is an essential element in creating persistency – much in the same way that creating auto-enrolment into pension plans can be transformative where an employer-employee relationship exists.

• Frontline staff need on-going training to ensure that they understand and follow processes; just an introductory course is not sufficient.

• A strong connection between the payment of the loan instalment and the premium can negatively influence persistency when the loan terms end. VisionFund’s average loan term is six months, whereas TAMADERA required a five year contribution flow. If customers did not take a follow-up loan, they may decide to lapse premium payments as well.

• Encouraging the sales staff to enrol had a positive influence on sales and persistency. By enrolling in the product, loan officers became a live testimony and credible ambassadors, as they had undergone the purchasing decision and enrolment process themselves.
• High account balances decrease the likelihood of lapses and increase persistency. Most lapses tended to occur after only a few premium payments. Once customers developed a premium payment routine and became proud to have accumulated a tangible account value, they valued the product more and continued to pay premiums.

ON PRODUCT DESIGN AND POSITIONING
• The capital guarantee and critical illness component made the product more attractive to clients. The rationale for adding the features was not only to offer customers absolute clarity about what to expect, but also to offer a living benefit. In Indonesia, talking about death touches on taboos, which make it difficult to sell life insurance. Critical illness coverage was meant to address this. The five illnesses included in the coverage were chosen because they are well known and easily understood.

• TAMADERA differentiated itself from informal savings mechanisms, its key competitors, through the critical illness component. Rotating savings and credit associations (ROSCAs), locally called arisan, are very common among VisionFund customers. Demand research and product acceptance testing revealed that at least 75% of prospective policyholders were members of one or more arisans, and that on average they paid more than IDR 100,000 (USD 10) per month into such savings. Clearly, affordability was not an issue.

BENEFITS AND CHALLENGES OF TECHNOLOGY
• A web-based administration system can reduce transaction costs by automating manual tasks, such as paperless claim underwriting and premium payment reconciliation. Such a platform can handle huge volumes of data quickly and seamlessly.

• Automatic underwriting increases processing speed but can decrease underwriting quality. One feature of the platform used by Allianz was an automatic underwriting engine. If one or more of 18 health questions (Yes/No answers only) were answered “Yes”, then the system rejected the application. This rule was not communicated to loan officers. However, after high initial rejection ratios, they figured it out and rejections based on health issues became rare thereafter. Consequently, automatic underwriting based on predictable rules without proper onsite crosschecks did not enhance risk management, and actually decreased underwriting quality.

• An enrolment questionnaire with fewer questions would have been more effective. The length of the health questionnaire was prescribed by the reinsurer company. The project team reduced the number of questions from a much more extensive questionnaire, but it was still probably too long.
CASE STUDY 3
MAX NEW YORK LIFE (MNYL), INDIA

As with Bajaj Allianz, another Indian joint venture, between Max Financial Services and New York Life, embraced the challenge of meeting its rural and social sector obligations with an innovative approach. In mid-2008, the company launched Max Vijay, an “unlapsable” endowment product that provided complete flexibility to policyholders as to when and where to make premium payments.

Max Vijay was a 10-year endowment policy with a minimum initial premium payment of INR 1,000 (~USD 15) and a maximum death benefit of five times the premium payments received in the case of natural death and ten times the premium received in the case of accidental death, up to a maximum of INR 50,000 (USD 750) for the cheapest variant. The Max Vijay policy specified that 60% of the initial payment and 90% of subsequent payments be invested in government securities and equities by Max New York Life, with the rest covering the premium for the life insurance component. Investment earnings were added to the policyholder’s account each year and were guaranteed by Max New York Life. Policyholders could start withdrawing funds after three years. Policyholders were required to pay surrender fees if they closed the policy completely, with fees declining over the life of the policy. After 10 years, the policy terminated and the account balance was paid to the policyholder as a maturity benefit. If the policyholder died before the end of the term but after six months of the effective date of coverage, the beneficiary received the account balance and the death benefit amount.

Market research on insurance purchasing revealed that the four main reasons cited by Indians for not purchasing insurance were: (a) high regular premiums, (b) fear of policy lapses, (c) aversion to health check-ups, and (d) dependence upon an agent (i.e. when the client moved or the agent departed, the link was broken).

Max Vijay was designed to overcome each of these challenges. The policy could be “topped up” periodically at the policyholder’s discretion, with amounts as low as 10 rupees. The clients were not linked to a specific agent and could recharge their policies in many outlets in their vicinity such as small “mom and pop” retailers, microfinance institutions, and government kiosks. In addition, the policy did not lapse, allowing irregular contributions to accommodate the target market’s irregular cash flows.

By mid-2010, the insurer had 90,000 active policies and a gross written premium of approximately USD 1.2 million, numbers that were below the company’s ambitious targets but still impressive nonetheless. However, there were significant challenges in encouraging clients to top up their policies, with only 20% of the policyholders adding to the initial INR 1,000 premium. While the insurer was trying to tackle this challenge, major changes in regulation made it difficult to use retailers as referral agents. The new regulations necessitated a consequent change in Max New York Life’s overall strategy, in which it

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4 This case study is adapted from the learning journey of Max New York Life published by the ILO’s Impact Insurance Facility.
5 In 2012, New York Life sold its stake in the company to Mitsui Sumitomo Insurance and the company was renamed Max Life Insurance.
decided to withdraw from the mass customer market segment altogether. Despite this unfortunate turn of events, the Max Vijay experiment provided valuable insights on a range of issues.

**ON CLIENT VALUE**

- The product was designed to provide value to clients and be viable for MNYL only if regular savings were sustained. Regular savings increase value for clients from both savings and insurance perspective. Moreover, the entire business model was built on this assumption.

- The upfront premium mechanism was an obstacle to buy the product, especially for poorer households. Max Vijay was built upon a careful rationale for the initial premium payment. The company’s actuaries believed that this amount could not be set any lower since 40% of the payment is required to cover administrative costs and risk premium. According to the actuaries, the only way to make this product sustainable was in fact to charge a higher amount upfront.

- One way to make the premium payment affordable was to bundle insurance with credit. MFIs and NGOs that sold Max Vijay often increased loan amounts to accommodate the initial premium payment. However, when insurance is embedded in a loan, clients are less aware of the insurance details. Credit providers also have a major dilemma about how to deal with clients who default on their loans as their insurance policies are still in force and it is difficult to cancel them from the regulatory perspective.

- The policy was more flexible than traditional endowment policies because customers were free to make top-ups as they chose, and regular premium payments were not required to keep the policy in force. MNYL expected the flexible structure to encourage savings. But only 22% of the policies were ever topped up, suggesting that perhaps the product was too flexible and whether additional structure, such as requiring a quarterly top-up, would have been more effective in promoting savings. Although top-ups increased by 51% during a three-month intensive marketing campaign, the number of top-ups dropped significantly after the campaign, demonstrating that customers save more often when given reminders.

**ON MARKETING AND BRANDING TO RAISE AWARENESS FOR MASS PRODUCTS**

- Building an aspirational brand with well-known celebrities to raise awareness can be effective, especially for mass products. To this end, Max New York Life hired a Bollywood star to serve as a spokesman for Max Vijay. This celebrity endorsement – together with a complex marketing strategy including advertising, mobile vans, and contests – meant that the company incurred significant expenses to promote this scheme. In the pilot site, product awareness reached approximately 65% over three months after the investment in the brand ambassador. According to MNYL managers, building an aspirational brand is the only way to get attention in India today.
• Finding a hook to start communicating with the target audience is key. Fuelled by strong branding, MNYL found that focusing a marketing campaign on the benefits of regularly saving was more effective in engaging low-income populations than introducing an abstract idea like life insurance.

• To build a mass market for this product, MNYL moved away from print heavy campaigns to initiatives with greater focus on outdoor activities, such as community events, contests, and quizzes, coupled with point-of-sale visibility. The Max Vijay team realized that these components were more effective in supporting sales than brochures, billboards, or even TV and radio advertisements. On-the-ground marketing created a buzz and interest in the product that could be more easily converted into sales. MNYL has found that when there was no communication, sales outcomes were reduced by half.

ON DISTRIBUTION AND CUSTOMER CARE

• Besides an innovative product design, Max Vijay involved a new distribution model. MNYL experimented with selling insurance and encouraging saving top-ups using informal retailers including small shops that target customers regularly visited to buy groceries or to top up their mobile phones. MNYL learned that it needed to be selective in identifying the right retailers; a scorecard developed for this purpose builds on best practices in fast-moving consumer goods (FMCG) distribution. For example, the retailers would need to be large enough to have at least four to five employees, so if one employee was involved in a 20 minute enrolment process, it would not undermine the service provided to other customers.

• Training costs were very high to get retailers sufficiently up to speed so that they were able to speak the Max Vijay language and feel like they belonged to the Max Vijay family. The insurer estimated that retailers needed at least two years of support through regular coaching and a peer-to-peer forum.

• Mobile technology and hand-held devices provide insurers with new ways to reach consumers. However, when the process to operate technology is complex, distribution partners and customers prefer a simpler and more familiar solution. MNYL installed handheld terminals that could be used by sales outlets to top up policies. Distributors, however, found the terminals to be cumbersome and felt that the commission (3% of the top-up amount) did not justify the time required to complete a transaction. In response, MNYL offered top-ups with scratch cards. Clients bought the cards from retailers and called a toll-free number to record the top-up amount. Scratch cards provided several benefits: the sales process was faster and easier for distribution partners; cards were familiar to clients, who were already using them to buy mobile talk time; and MNYL could update the contact information for clients when they called.

• With advancements in mobile telecommunications, call centres can play a major role in educating and servicing clients. Call centres can ensure that clients understand the
basic features of the product at the time of purchase, and allow clients to confirm that deposits have been credited to their account. Max Vijay clients had access to a toll-free call centre which enabled the company to stay in touch with the client, update data, and ensure that the client understood the product. As a result, the call centre served to build trust in the insurer.

CASE STUDY 4
COOPERATIVE INSURANCE COMPANY, KENYA

CIC Insurance Group is the third largest insurer in Kenya. It has a strategic focus on microinsurance and has a vision of becoming a household name for the microinsurance market in Kenya and the region. CIC ventured into microinsurance in 2001, piloting microcredit life insurance with a leading MFI. It later expanded distribution through numerous other MFIs and credit unions.

In 2010, CIC developed a new technology platform called M-Bima (mobile insurance in Kiswahili) to strengthen the scale and efficiency of its microinsurance operations. The platform uses a money transfer service such as M-Pesa for the collection of premium. The M-Bima platform can be also used for customer relationship management functions, such as checking account balances, sending reminders, or educating clients through mobile phone applications.

The first product on the M-Bima platform, launched in 2011, was Jijenge Savings Plan. The product provides clients with a convenient and safe way to build savings. It is a 12-year endowment plan with monthly instalments of minimum KES 600 (USD 6.00) for a minimum cover of KES 50,000 (USD 500). There is a six-month waiting period for natural death, and no waiting period for accidental death. An exit benefit is available at the end of the third year with a surrender value of KES 20,000 (USD 200). Clients can save on a daily basis using M-Pesa and receive SMS reminders to stimulate savings.

M-Bima is marketed and distributed through organized networks of small shopkeepers, mobile money outlets, and other large networks such as cooperatives and retail stores. The sales structure and processes are organized similarly to the FMCG retail model. Distributors and agents play an active role in promotions and are incentivized to attract new customers as well as to ensure persistency of savings. The M-Bima distribution network is supported by a CIC sales team headed by a National Sales Manager. Distributors have access to a menu-based information services protocol used by mobile phones to communicate with the CIC system.

The ILO supported CIC to strengthen and monitor its marketing and evaluate its new distribution strategy. Based on its initial experience, additional market research and business analysis, CIC developed a new marketing strategy for its Jijenge Savings Plan. Product design remained the same, while promotion, distribution, and customer care

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6 This case study is adapted from the learning journey of CIC published by the ILO’s Impact Insurance Facility.
strategies were revised significantly to improve scale and persistency and to position the product differently, targeting it at good savers.

The strategy was pilot tested from March to June 2013 in two zones in Nairobi with 99 new outlets, mostly small shopkeepers involved in mobile money transactions, but results of the pilot were unsatisfactory. To make the offering work for CIC and clients, the following targets were identified: persistency at 75% or above, misunderstanding below 15%, and agent productivity of at least 0.6 new policies per day. The results from the pilot were however not encouraging. Persistency levels were poor at 30% to 40%, misunderstanding about the product was evident among 60 to 70% of customers and agent productivity (at 0.13 policies sold per day) was insufficient to deliver any real value to agents. The piloted model was not scalable and the product and processes went back to the drawing board.

The pilot proved that the current distribution model (mostly mobile money outlets) is difficult to execute at the current stage of market development in Kenya. Agents do not have enough awareness of insurance and seem to have other better business opportunities. Despite poor pilot results, opportunities remain huge. Based on the following lessons, CIC will try different options to pursue its strategy to tap into the low-income market through a savings-linked offering.

ON PRODUCT DESIGN

• The high demand that was evident from the market research did not translate into sustained, systematic saving behaviours. Persistency remained low despite a number of different strategies tried during the pilot. Low persistency was mostly driven by poor client understanding, which was partly caused by an inappropriate distribution strategy and gaps in its execution, but more importantly by the complexity of the product. Clients felt cheated because they did not understand lapses and surrender conditions, which fuelled mistrust.

• Despite investments in training, agents did not understand the policy much better than clients, which proved just how difficult it is to explain an endowment product. Significant investments in more effective agent training would be required, perhaps coupled with simpler product features.

• A functional savings product for low-income people needs to deliver a mix of immediate rewards with no lapses and less severe penalties, underpinned by simplicity and transparency. The promotion of savings requires a transparent mix of ‘sticks’ and ‘carrots’. Given irregular cash-flows, low income savers need some flexibility. Policyholders also need to see more immediate benefits because they appreciate the present value of cash more than value of their savings in the future. Therefore, small penalties combined with frequent, more immediate rewards might yield better results.
ON MARKETING AND DISTRIBUTION

- A retail model without a strong brand and local presence cannot build enough trust to sustain saving behaviours. M-Bima Jijenge clients made it clear in focus groups that they tried the new product, but abandoned savings as there was no local presence. Even if some appreciated an option to call the customer service centre, they still would prefer to get more ‘physical’ confirmation from a CIC branch, branded outlet, and regular contact with a CIC agent.

- The risk of clients not understanding the product is very high if the retail model is not properly managed. A complex product, bundled with an aggressive commission structure, encouraged agents to catch any client who had shown the slightest interest. This led to 70% of the policies being mis-sold during the pilot – meaning that policyholders did not have full information or a good understanding of the product, which contributed directly to low persistency.

- Targeting is difficult to implement within a mass-market strategy, but can have a positive impact on quality. One of the strategies to improve quality was to target groups of good savers. The core target groups for the pilot were: self-employed and casual workers (and transfer receivers) aged either 26 to 35 years or those aged over 46 years with small families and children and earning a monthly income of between KES 5,000 and KES 20,000. This product positioning was informed by data mining of the management information system, focus groups, a phone survey, and findings from secondary sources.

- Above the line (mass media) promotion is required, and cannot be substituted by activation campaigns. Activation campaigns attracted a reasonable number of clients, but resulted in limited ongoing sales. To this effect, CIC ran one-day activation campaigns in pilot sites and refresher campaigns in the same zones four weeks later. These were carried out by outsourced marketers operating in tents, supported by a van with a disk jockey. The initial assumption that the campaigns would replace above-the-line marketing (as the pilot was limited to certain zones) was not correct as they did not create enough visibility to support continuous sales and persistency.

- A text message, or a short message service (SMS), is a cost-effective way to remind clients that they are in arrears on contributions. Although only 10% of those who received a weekly SMS reminder paid their arrears within the next two days, the strategy was cost-effective as it cost less than 0.5% of the weekly premium. While an SMS was marginally useful as a reminder, this was not an effective medium to educate clients about product features and the value of long-term savings. CIC research also showed that too many text messages could create confusion.

- Call centre out-bound calls do not add much value if other more basic issues are not solved first. The results of welcome calls came as a surprise. They were well executed,
using a good script, and were appreciated by the few clients who participated in focus
group discussions and had received the calls. But calls to clients were ineffective in the
face of the more fundamental problems with the value proposition.

• The pilot proved that the distribution model through mobile money agents is difficult
to execute. These outlets were not sophisticated enough to sell insurance products
and seemed to have better business opportunities than insurance sales. Given the
transactional nature of mobile money business, the retailers appreciated present
revenues much more than future ones. Hence it was difficult to build the quality of
their Jijenge portfolios over time. This discouraged sales agents from investing time in
an ongoing service after the initial sale.

ON TECHNOLOGY

• A wireless application protocol (WAP) app is a must to improve the quality of
customer data capture and to build persistency. Good quality customer data is key
for a product with frequent transactions like Jijenge. The WAP app should collect the
same customer data as other enrolment channels. Agents should be able to use the
Internet or WAP apps to check account balances in real time.

• Developing a phone application is a must to build trust and sustain savings. Clients
showed a strong preference to have an M-Bima menu on their mobile phones to be
able to check their balance in real time.

CASE STUDY 5
TUW SKOK, POLAND

Among the five case studies, TUW SKOK is quite different as it is based in a middle
income country, and because it does not provide an endowment product per se, but rather
a savings-linked insurance product that may help to overcome some of the challenges one
finds with endowments.

As the primary insurance provider of the Polish credit unions (CUs), TUW SKOK’s
history is linked to the re-emergence of the credit union movement after the fall of
communism. Not long after the new credit unions began collecting savings, the National
Association of Cooperative Savings and Credit Unions (NACSCU) planned for the
provision of insurance as well. Soon thereafter, TUW SKOK was born, with initial
services focused on deposit insurance and loan protection for the credit unions. In 2000,
the insurer received additional licences allowing it to reach out to CU members themselves.
In subsequent years, TUW SKOK unveiled numerous personal insurance products for
credit union members, including a variety of accidental death and disability policies,
homeowners or tenant’s coverage, protection against debit card fraud and robbery, and
savings completion insurance.

7 This case study is adapted from Churchill and Pepler, 2004.
The savings completion insurance is designed to encourage members to develop a regular savings programme through a contractual savings account. The member determines the savings goal and time period, up to a maximum of ten years. The credit union has software that will then calculate the amount of the monthly deposit to achieve the savings target, taking into consideration the interest rate and the monthly premium for insurance coverage. In the event of the accidental death of the member, TUW SKOK will pay the beneficiary the difference between the savings target and the savings balance at the time of death. There is also a disability component that supplements the member’s salary if the member is unable to work for more than 30 days.

**ON DISTRIBUTION AND INCENTIVES**

- This insurance product is particularly attractive to the credit unions because it is closely integrated into their core business. Savings completion coverage helps the CU to achieve its own goals by making the contractual savings product more attractive. It is also easier for CU staff to sell because while setting up the account they ask if the member wants the additional insurance coverage. An early lesson from TUW SKOK’s experience with products for CU members is that it is easier for staff to sell insurance that is linked to their core services (savings and credit) than stand-alone insurance products.

- TUW SKOK believes that it will have greater sales success if the credit unions earn greater fees, at the expense of commission to individual agents. The logic behind this approach is to get greater management buy-in, which means the managers will more actively encourage staff to sell insurance. The credit union can then decide how much to pass on to the individual agent.

- Besides commissions, TUW SKOK has introduced additional incentives for achieving volume thresholds. When a credit union sells 1000 policies, the insurer pays it a lump sum bonus. To stimulate competition among its agents, TUW SKOK rewards the top 20 salespersons with a long weekend trip to Rome or Paris for two.

**ON PRODUCT DESIGN**

- Because TUW SKOK does not offer an endowment product, it is difficult to know how the endowment would be perceived in the market compared to the savings completion insurance. Typically insurers prefer to offer endowment products because then they manage the investments, but because TUW SKOK is owned by the credit union federation, its raison d’être is to serve the CUs and their members, and in this situation, savings completion makes more sense.

- Although the contractual savings accounts can be structured for as long as 10 years, most accounts are in the three to five year range, reflecting the target market’s preference for more short to medium term savings goals.
• Product design is kept simple for ease of administration, training of agents, and member understanding. Insured amounts and benefits are suited to the demographics of the credit union membership.

• Although most products are priced on a per annum basis, every attempt is made to provide a monthly premium alternative to facilitate affordability.

• The partnership between TUW SKOK and the credit unions greatly facilitates premium collection. All credit union members have savings accounts, so each month the CU deducts the relevant premium amounts from the members’ accounts and forwards it to TUW SKOK. Since this is an electronic transaction rather than a physical financial transaction, the transaction costs are dramatically reduced.

• For disability claims, the benefit varies depending on the degree of disability. This assessment tends to be subjective, and the findings between doctors can vary significantly, causing delays in claims processing. In fact, the number one cause of claims complaints stems from disagreements regarding the extent of the disability. TUW SKOK is exploring ways of further simplifying its disability products.

LESSONS LEARNED

Although none of these examples provides an unqualified success story, they all offer keen insights into the design and delivery of savings and insurance that could inform efforts to extend contributory pension plans to low-income workers. This section synthesizes the main lessons, particularly with regard to product design, distribution and technology.

PRODUCT DESIGN

One of the main drawbacks of endowment products is that they are quite complex and often opaque. Therefore, the first lesson that emerges from these examples is about the importance of designing products that are simple and transparent. Unfortunately, that is often easier said than done. As soon a financial institution starts to engineer a product to increase sales and enhance persistency, it starts to add whistles and bells that increase complexity. The product engineering process involves the consideration of numerous trade-offs between simplicity (less choice) and flexibility (more choice). As Rusconi (2012) notes, “Simplicity is helpful to gain customer trust and improve understanding of the most important product features, while flexibility allows customers to respond to unexpectedly changing circumstances.”

Long vs short term

Micro-pensions are very long term savings products. However, from the case studies, it seems that shorter term products resonate better with the low-income market, which has
difficulty planning too far into the future. One possible solution that could be considered for pensions would be a short or medium term contract, perhaps three to five years. When the term comes to an end, part of the savings becomes available for immediate use, while the remaining corpus is rolled over into the retirement account, and then the process begins again.

Access vs illiquidity

A long-term savings product should have restricted access so that an account holder is able to start withdrawing funds only once they have reached the retirement date. Such an arrangement may not be very attractive to low-income households with more pressing immediate needs. Besides the idea of liquidating part of the contractual savings at the end of the contract period, it also may be possible to borrow against the retirement account if the account holder has an urgent need for funds. The case study experiences, however, caution that this should be structured to ensure that the right skills are involved.

Incentives vs penalties

With a savings product, one thinks of interest rate as the primary incentive to increase account balances, and exit charges on early withdrawals as the main penalty for account closures. From the experiences with endowment products, where the savings and insurance components are quite inter-related, there is considerable confusion among policyholders about incentives and penalties. Perhaps the TUW SKOK approach, where the two pieces are clearly separated, is a more transparent and understandable approach. Another dimension to consider is whether the insurance itself could actually be positioned as an incentive, as illustrated in Box 19.1.

**Box 19.1**

**Rationale for Co-Contribution Top Ups**

Microensure is a U.K.-based brokerage that provides insurance to un-served market segments in developing countries. In 2011, MicroEnsure launched a savings-linked product with a bank in Ghana that had been experiencing low account balances and limited transactions. Although the bank had over 100,000 depositors, more than 85% of them held a balance of under USD 60. Each of these customers imposed an administrative cost of around USD 0.24 per month on the bank. The bank wanted to provide an incentive to customers to increase their savings balances. Interest rates had proven to be ineffective, as a few cedis each month were not enough to encourage people to save.

MicroEnsure and its partner StarLife Assurance launched an insurance product that was tied to the savings accounts. Depositors who held a minimum balance of USD 60 each month were entitled to free life insurance with benefits of up to USD 180. Clients with a balance of USD 120 were entitled to life insurance for their spouse and children as well.
The bank paid the premium to StarLife Assurance instead of a portion of the interest that clients would have received, although no interest was deducted for clients with higher deposits. StarLife marketed the product via SMS, in-store marketing, posters, and telemarketing at a cost of less than USD 0.50 per client.

The results were surprising. In the first five months after product launch, the bank’s deposits increased by 19 percent.

Deposits from clients with balances below USD 60 increased by 207% over five months as clients saved more to access the free insurance benefit. This increase, along with anecdotal evidence from interviews with depositors, suggests that many customers changed their savings behaviour as a result of the additional insurance cover.

*Source: Gross, 2012.*

**Discipline vs flexibility**

Results from behavioural economics indicate that people may prefer products that offer structured savings to products with more flexibility. Studies have also shown that reminders that create a mental link between contributions and a personal savings goal can promote savings (Dalal and Murdoch, 2010).

While bundling insurance with saving may seem attractive, these case studies show that the big challenge is to sustain savings. CIC and Max New York Life managed to reach persistency levels of only 20% – 40%, not enough to create any real value for customers. A savings product for low-income people needs to strike a balance between discipline and flexibility. The Max Vijay product was perhaps too flexible – and as a result, very few policyholders actually saved. The disciplined approach adopted by Allianz, with weekly payments, but with two payment holidays per year, seems on paper to strike the right balance, although the actual results do not back this up, perhaps for other reasons than the design of the product. The main message is to align premium payments to cash flows. Therefore, for people with highly seasonal income, such as agricultural or tourism industry workers, premiums should be collected during the narrow windows when these cohorts may have surplus funds.

**DISTRIBUTION**

Distribution is perhaps the most critical issue that needs to be addressed, and some interesting insights emerged from the case studies, as a range of different approaches were attempted. The same are summarized in Table 19.1
The experience with using small local retailers and mobile air-time distributors to sell insurance was unsuccessful. Delta’s approach of using an army of agents certainly seemed successful in terms of their ability to reach significant scale, although at the expense of client value. However, Delta’s experience does suggest the importance of specialized sales expertise and a face-to-face sales experience.

Financial institutions seem to be the channel with the best potential, but one that was still problematic. Delta initially tried to partner with an MFI, but they could not align their strategies, which was similar to Allianz’s challenges in Indonesia. Yet Allianz in India was very successful distributing through MFIs, and TUW SKOK also had success with the credit unions.

One of the common challenges in distributing through banks, credit unions, and other financial institutions is that insurance is not always well aligned with the financial institution’s core business. Therefore, for example, as soon the bank experiences a delinquency problem, insurance sales plummet as loan officers focus on collecting loans, as explained in Box 19.2. This was not a problem with TUW SKOK because insurance reinforced and supported the credit unions’ core business, and insurance enrolment was integrated into the process of opening the savings account.

<table>
<thead>
<tr>
<th><strong>Channel</strong></th>
<th><strong>Example</strong></th>
<th><strong>Advantages</strong></th>
<th><strong>Disadvantages</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Own agents</td>
<td>Delta</td>
<td>Specialized in insurance sales</td>
<td>Expensive business model</td>
</tr>
<tr>
<td>Local retailers</td>
<td>CIC and MNYL</td>
<td>Enhances access</td>
<td>Hard to prioritize insurance sales and service; requires significant investments in training</td>
</tr>
<tr>
<td>Financial institutions</td>
<td>Allianz, TUW SKOK, Delta, MNYL</td>
<td>Leverages existing credit and/or savings relationships</td>
<td>Most effective when insurance reinforces the core business</td>
</tr>
</tbody>
</table>

**Table 19.1**

**Advantages and disadvantages of distribution models**

**Box 19.2**

**Who sells voluntary insurance in a financial institution?**

An important decision to be made when introducing voluntary insurance in a financial institution is who will be selling the products. It might seem logical that if field staff or loan officers were already known in the community and interacting with the target
market, then it would be cost-effective for them to also sell insurance. However, this approach has not been particularly successful, in part because selling insurance and selling loans requires different approaches, training and skillsets.

More importantly perhaps, unless insurance sales are prioritized and incentivized by senior management and branch managers, loan officers are unlikely to give sufficient attention to insurance. This is particularly true when their core business starts experiencing problems. For example, if their portfolio at risk starts rising, they will stop selling insurance and focus on collecting loan repayments.

Such practices have been noticed repeatedly by insurance companies around the world, and have discouraged them from distributing voluntary products through MFIs. For example, in Haiti, the insurance company AIC had a limited uptake of a voluntary funeral insurance product when it was sold by the employees of a local bank. But when the insurer put its own staff in the bank branches, in one month it had reached 80% of the sales that the banks’ staff were able to reach in a year and a half (Guarnaschelli et al., 2012).

An alternative to integrating insurance sales into the responsibilities of loan officers and tellers is for the financial institutions to hire specialized insurance agents. For example, UNACOOPEC, a network of savings and credit cooperatives (SACCOs) in Côte d’Ivoire serving 800,000 members, recruited 150 specialized insurance agents to distribute its funeral product, and they had sold around 66,000 policies by the end of 2011. UNACOOPEC conducted a break-even analysis to estimate the annual premium amounts for branches that would be needed to sustain the cost of the specialized agents. It estimated the product would break even at premium levels of USD 13,000 for SACCOs with no insurance agents (smallest branches), USD 37,600 for SACCOs with one agent and USD 79,000 for SACCOs with two insurance agents.

Financial institutions may find this specialization more palatable if there is a sufficient volume of premiums, but it may be harder to rationalize at the outset, creating a chicken and egg scenario: how can the bank or MFI achieve sufficient scale without specialized insurance agents? How can it justify hiring specialized agents without the premium income to cover their salaries? An interim arrangement might be for an MFI to invite the insurance company’s representatives to sell insurance to its clients, and then transition the portfolio to its own specialized staff once there is a sufficient premium flow.


Based on these experiences, if micro-pensions are distributed through financial institutions, then it might be useful to have specialized salespersons rather than trying to integrate the responsibilities into jobs of existing staff. It is important to note that financial institutions that mobilize deposits could see a micro-pension product as competition for the finite resources of low-income depositors unless the financial institution was able to retain (and
Building a mass-market for Micro-Pensions: Learnings from MicroInsurance

on-lend) the pension balances. This is why a number of the other chapters in this volume emphasise the use of other delivery mechanisms than a traditional vertically integrated financial company delivering all aspects from customer acquisition through collection, account administration, investment, and pay-out.

Distribution can be broken down into four aspects for endowment products: financial education, sales, premium collection, and servicing, with the latter involving several sub-activities such as claims processing, reinstating lapsed policies and borrowing against the cash value. Typically, one might expect the distribution channel to be involved in all of these roles, but in practice, it may make sense to separate the functions. The emergence of e-money in many countries makes it a more effective tool for premium collection, as CIC has done, than to have agents collecting premiums door-to-door, as was the case with Delta Life. In the case of MNYL, it was found that MFIs were more effective in selling policies than the local retailers by bundling an upfront premium into a loan, but retailers were used more for top ups.

A distribution channel that was not in any of the case studies but is still worth mentioning is the banking correspondent network, which is like a cross between a local retailer and a financial institution. Located in geographies that are more convenient for low-income households than typical bank branches, a banking correspondent would have a specific window to manage financial transactions and a technology platform that links into the financial sector. Such a channel might be useful for depositing micro-pension contributions in environments where e-money is not available, but would probably have the same challenges as the retailers with initial enrolments.

In many of the examples, the on-the-ground distribution was supplemented by a call centre, which could fulfil a number of roles, including verifying that the policyholder received correct information from the agent and answer any additional questions that the client might have. The availability of a call centre to verify account balances and answer questions is also an important factor in building the public’s trust in the programme. Chapter 16 highlights the use of call centres, and the importance of thinking about them, and establishing the capability, early in the process. This is something that could easily be forgotten by policy officials focused on the overall design and legislative agenda.

COMMISSIONS

The effectiveness of the distribution channel depends on many factors, including how well trained they are, whether the additional service (e.g. insurance or pension sales) is integrated into their core business processes, if success is integrated into performance reviews, whether there is buy-in from middle and upper management, and so on. But the one factor that tends to get the most attention is commissions – what is in it for the agent?

There were many reasons why VisionFund was not an effective distribution channel, but an important one is that loan officers were not sufficiently incentivized. This is clearly
in contrast with the Allianz experiences in India where the insurer was able to provide meaningful incentives, and consequently the MFI distribution channel had millions of policyholders.

One of the reasons why endowment products are so opaque is that policyholders are not aware that most of their early premium payments are going to pay the agent’s commission. Micro-pensions will not have the luxury of obfuscating commission payments. As micro-pension systems need to be more transparent, they will need to find a way of compensating sales staff that is acceptable to the public. Importantly, micro-pension products will need to involve not just an upfront sales commission, but trail commissions on persistency over time – an aspect that is missing from most endowment products.

MIS-SELLING AND FRAUD

Unless the pension product has a lot of whistles and bells and incentives and penalties, it is likely to be much easier to sell than an endowment product, and therefore less vulnerable to mis-selling. However, it is still a risk, particularly for schemes with massive scale, and needs to be managed, for example, through call centre follow-ups to a sample of new account holders and through mystery shopping as well.

Fraud remains a huge risk for all financial services, and where every possible effort should be made to avoid cash payments to agents or sales staff. This is possible in environments with e-money and banking correspondents. But it must also be coupled with public education campaigns to tell current and prospective account holders not to make cash payments to agents, otherwise fake or former agents will go around collecting pension deposits from people and pocketing the proceeds. This would ultimately undermine the credibility of a contributory pension programme.

TRUST

Unlike lending, where the financial intuition has to trust that the borrower will repay, with savings and insurance, a policyholder or depositor needs to trust that the bank or insurer will fulfil its promises. With short term savings or a current account, it is quite easy for a depositor to make sure that his or her money is still available, but for long-term products like pensions, it is much harder to do so. Consequently, micro-pension schemes will need to find other strategies to secure the public’s trust, including strong regulatory oversight and government guarantees, plus effective branding. In this context, the above case studies highlight the importance of a solid and reliable local presence to secure trust, along with a facility for checking account balances in real time.

TARGETING

Successful distribution involves a segmented approach, targeting subsets of the population with products that are relevant for them. It is useful to consider not having a one-size-fits-all approach, but rather different solutions for segments. For example, a voluntary pension scheme will probably not be relevant for the poorest households who have very little or no saving potential.
FINANCIAL EDUCATION

Financial education is widely seen as an important component to ensure that consumers understand and use long-term financial services correctly, but there is little consensus as to the most effective means for providing the education, who should be responsible for it, and who should pay for it as well. There is general agreement, however, that financial education is an on-going process and not just a one-off activity.

Box 19.3
Ad-hoc financial education efforts are a waste of money

A long-term, comprehensive approach is important to develop and deliver effective consumer education to improve risk-management capacities of low-income households. Careful identification of topics crucial to develop insurance and product awareness is required, along with ongoing use of consistent, integrated messages delivered by multiple channels. The experience of SAIA provides a useful reminder of why one-time activities are not an effective way to build insurance culture. As part of a broader consumer education initiative, SAIA supported a project that provided financial literacy through a series of well-designed one-day workshops in rural areas. After one year SAIA found that only 57% of the participants interviewed ever remembered participating in the workshop. According to the staff, one of the main reasons for the poor recall rate was that the education was delivered in a stand-alone workshop rather than a continuous learning process facilitated by refresher messages in various forms and integrated with access to microinsurance products. On a similar note, in partnership with Bajaj Allianz, CARE India found that certain topics, such as risk pooling and claims procedures, need continuous emphasis and repetition.

Source: ILO Impact Insurance Emerging Insight #1

Some experts advocate a separation of duties between an educator and the sales agent on the premise that if the agent is also supposed to educate, there is a risk that the agent will cut corners and not ensure that clients are fully informed. From the experience with insurance, however, one finds that financial education raises awareness and perhaps even understanding about insurance, but generally has no impact on uptake unless education is coupled with sales. Therefore, instead of artificially separating sales and education, and adding additional costs, the recommendation would be to integrate them and manage the risk of education shortcuts.

After the initial education, advice and sale, an important part of on-going education is to remind account holders to make their next payment. From case studies, the primary means of reminding clients about their past or pending payment was through SMS, but this needs to be managed carefully to avoid an information overload, as illustrated in Box 19.4.
One of the main reasons why it is now possible to have a conversation about endowment products for low-income policyholders or even micro-pensions is that technological advancements are creating new opportunities and business models. The most important advancement is the emergence of payment platforms that are the backbone of branchless banking. This development dramatically lowers the transaction costs of premium collection, while concurrently reducing potential fraud or errors with manual systems, as experienced in Burkina Faso (see Box 19.5).

**Box 19.5**

Use of technology in Burkina Faso

Replacing the manual, paper-based recording of premium collections with a mobile phone-enabled solution allowed UAB Vie, a life insurance company, to simplify administrative processes and enhance data quality for its savings-linked life and disability insurance product. The product consists of a contractual savings scheme that features daily collection of premiums by UAB Vie staff.

Previously, the staff collected and recorded premiums manually, at the client’s business location, and later deposited them at UAB Vie’s central office. These premiums were
first recorded in a ledger and then recorded in the information system, typically one to two months later.

The implementation of mobile phone technology has resulted in an improved process and better data quality. Field staff still face connectivity issues in the field from time to time, but the mobile phone solution allows them to record premiums in real-time, and without paper, through an application on their phone. The central office knows the premium amount to expect when the field staff come to deposit the daily collection. A new auditor’s post has been created to validate the premiums recorded online with those actually brought in by the field staff.

Real-time monitoring enables UAB Vie to keep policy status and savings balance current, and helps to identify errors immediately, instead of allowing errors to accumulate as under the previous system. Further, up to date information on premiums paid per client makes it possible to more accurately calculate the financial reserves needed for the scheme.

**UAB Learning Journey**

The ultimate objective, to minimize transaction costs for the clients as well, is to take cash out of the process all together, and electronically deduct payments from an income source or another account. Besides making it easier for the clients, such a solution also increases persistency. A problem can arise if the account being deducted from does not have sufficient funds, in which case the system should send a reminder to the client and try to deduct again the next day.

In addition to reducing transaction costs, technology has also made great progress in facilitating the identification of policyholders and/or beneficiaries. When processing a claim, say for life or health insurance, one first needs to verify that the policyholder (or beneficiary) really is who they say they are, and the technological developments with identification cards and biometrics greatly facilitates this step in the claims process.

One of the key lessons about technology is that it is not going to make a bad product better or solve already flawed processes. Often, managers want to throw technology solutions at problems without diagnosing what the problem is to begin with. And, importantly, companies that are making big investments in technology need independent advice. It is also important to test user acceptance of the technology. It was interesting, for example, that at MNYL, retailers preferred using scratch cards instead of the hand-held devices, especially since the latter required a bigger upfront investment by the company.

**CONCLUSION**

The world of financial inclusion largely began with microcredit, which was eventually followed by savings and then insurance. The evolution to micro-pensions is a natural next step, but it will not be an easy one, as illustrated by the experiences with endowment products for low-income
households. Manifold challenges in designing and delivering relevant voluntary micro-pension products need to be overcome to provide a viable and valuable service to the working poor. Fortunately, technological innovations with payment platforms and identification systems are creating new opportunities to tackle these challenges. But before advancing into the future, it is imperative that we scrutinize the past, both the successes and challenges of other financial products, like endowment products, to learn from the experiences of the pioneers.

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INTRODUCTION

This chapter looks at when to retire, developing effective market structures and retirement income products and the different options for those products. The discussion is focused on achieving the best long run outcomes for the pension system and its members. How can broad coverage of adequate income in old age be delivered in a way that is sustainable, secure and efficient? The chapter also aims to integrate the insights for the payout phase from other parts of this book. The insights to improve and make more efficient the process of joining, contributing and investing in the accumulation phase have very direct parallels for the payout phase. If costs can be dramatically reduced and the benefits of digital financial inclusion used to expand coverage of pensions, these same insights may help new or better ways to deliver retirement income.

The chapter also highlights considerations related to allowing withdrawals from pension assets before retirement – and to setting the age at which people can gain access to their assets. Whilst advice to push this age later in most countries is well-taken, it is important to address the frequent (if misplaced) concern that raising retirement ages will reduce employment for younger workers as older workers keep ‘their’ jobs for longer.

It is only when the benefits are paid or accumulated assets are drawn down that the key objectives of the retirement system are truly fulfilled. Accumulating assets may have many benefits but it is only the retirement income that people draw that creates the possibility of greater financial security and well-being for the aged with greater stability in consumption patterns. For the low-income in many countries this will not initially be the ‘traditional’ hope for a fixed retirement from age 60 or 65 until death – it may initially be more realistic to think of it as buying retirement one year at a time. The challenge of delivering income and consumption in old age is ideally tackled by taking multiple slices of income, however small, and adding them to make something meaningful. A basic payment from the government that alleviates poverty is important. But people need strategies to apply when such a ‘zero pillar’ does not exist, or government payment is below the poverty line.

For governments faced with ever-expanding populations at older ages, the clear lesson from successes and failures in developed countries is the need to create a diversified system with multiple sources of income in old-age to avoid unsustainable fiscal burdens or unacceptably low total incomes for the older segments of the population.

Many retirement systems around the world have been reformed in the past 30 years. So they often still have little experience with the payouts provided by their current framework, particularly the private and/or funded parts. Even in countries with many decades of experience approaches to the payout phase are still evolving – not least in response to persistence of very low interest rates for nearly a decade since the global financial crisis. Behavioural issues, the right market structure to maximize the benefit providers can deliver for members, governance, investment strategies and technology all play important roles in the payout (decumulation) phase just as they do when members are accumulating their benefits.
A system can have good coverage during the contributory phase, but if the assets are paid in lump sums which are spent rapidly, effective coverage will be poor. High costs for decumulation products reduce financial efficiency and therefore make adequacy more difficult to achieve. Barriers to drawing pensions while continuing to work may increase the burden on the pension system and impact labour market efficiency as well. The security of retirement income streams will vary depending on whether payouts are insured, uninsured from the government or uninsured from financial institutions or employers. Risk-sharing arrangements which adjust benefits based on investment or mortality experience may improve sustainability but compromise adequacy.

There are a number of issues and questions to address to maximize achievement of the retirement system’s objectives, including:

- What is the policy on early withdrawals in the light of the impact on final balances?
- When should members be able to start their retirement payouts?
- What market structure, entity or entities should be involved in payouts?
- Should payments be made as annuities, lump sums or systematic withdrawals?
- Will income options keep pace with inflation?
- Will annuities be insured or paid directly from a fund or tax revenue?
- How will retirement income payments be taxed?
- How should assets be invested during the retirement phase?
- Will longevity risk be borne by government (taxpayers), members or financial institutions?

**WITHDRAWING MONEY BEFORE RETIREMENT**

Withdrawing assets before retirement obviously reduces retirement income but offering early withdrawals is usually justified by the idea that more individuals will contribute more money if they know that, that option exists. There is not a lot of evidence that this behavioural response exists – indeed as highlighted in Chapter 3 regarding auto-enrolment in the U.K. and in numerous studies, people do not make classically ‘rational’ economic decisions regarding putting money into a pension compared to other uses. However, for low-income people the ability to access the funds will be a real concern. This raises the dilemma that allowing access may be needed to get people to enter the system in the first place, but that using access to draw down the assets means that the policy objective of creating assets for retirement income is achieved at a lower level. One potentially interesting approach to this dilemma is to allow pension assets to be used as collateral for small short-term hardship loans that must be paid back. This gives people the reassurance their assets can be useful to them if there is a short-run emergency but makes it more
likely that the money will be repaid. In theory it may make more sense to withdraw assets and avoid any interest rate on a loan. However, there is evidence that the loan is likely to be paid back, leaving the assets untouched, whereas people are less likely to raise their future contributions to make up for the withdrawal – an idea that has been popularized by, among others, Microsave.¹

WHEN IS IT TIME TO RETIRE?

Ideally the payout phase can begin once a member has accumulated enough savings or benefit to have adequate income during the full period of retirement. For many in developing countries the stark fact is that the current choice is between working until ill health or death intervenes and suffering poverty. So ‘retirement’ is a more flexible concept. However, this current necessity may help to avoid a critical mistake in many developed country retirement systems where retirement becomes an all or nothing decision. This makes it difficult for countries to adapt to rising longevity – unless the retirement age is linked to life expectancy in legislation, which is ideal. It also reduces the total years for accumulation and reduces the labour market participation of older workers. The target population in many developing countries will be in the informal sector where it is a challenge to make sufficient contributions over a career, which will certainly include years where no contributions are possible, with changes in occupation, income level and different regions.

Despite this unpredictable labour market participation, a focus on target income levels can be an important consideration in the design of a system. Popular approaches to determining appropriate target income include:

- Replacement rate targets (e.g. 80% pre-retirement income)²
- A nominal level of income or one linked to a national poverty line – and determined with other sources of income taken into account including from government pensions.
- Rules of thumb for safe spending such as spending x% of savings (x is typically 3% - 5%), or spending age-divided-by-x % of savings (x is typically between 10 and 20 so that one spends 5% at 50, 6% at 60 and so on), or savings equal to X * pre-retirement income (X is typically 20 to 35 although may be lower in developing countries). [point to literature on spending guidelines]³

Another consideration is whether or not a member may continue working while receiving income from the system and, if so, whether the amount of retirement income is to be coordinated with the amount of working income. Phasing out of work over time and

¹ Microsave is an international financial inclusion consulting firm that aims to develop ‘market led solutions for financial services’ — see www.microsave.net
² See for example AON Consulting’s Replacement Ratio Study, 2008 prepared in cooperation with Georgia State University
³ See for example The Feel Free Retirement Spending Strategy, Inglis, 2016
phasing in use of savings, even if small, greatly simplifies the old age income equation. It also helps to align decreasing workloads with declining health. Particularly in developing countries where people may have access to a small amount of land to grow basic necessities, this mixed approach to delivering consumption has significant advantages over the ‘traditional’ approach of retiring at 60 or 65 which then requires savings or accrued rights to fully fund an individual’s remaining lifetime.

One issue that causes resistance to raising retirement ages is the fear that doing so will increase unemployment for the young population as older workers keep their jobs longer. Incentives to retire and increasing the retirement age do impact the employment rate of older workers, but unfortunately do not actually boost to youth employment. Countries with lower employment for higher ages, typically have lower employment for the young as well. There is a wealth of evidence on the issue – known as the ‘lump of labour’ fallacy - in the economics literature. The same phenomenon also holds, for example, in relation to (increasing) female employment. In other words, increasing female employment does not reduce male employment, as labour markets that are effective see higher employment for all groups. Figure 20.1 shows one example from the literature based on a case study of reforms over a 40-year period in Germany to encourage early retirement – which was successful - with the aim of increasing youth employment – which was unsuccessful. When later reforms reversed course on retirement age, employment for both groups improved – reversing the early declines.

Figure 20.1
Changes in employment rates for old and young workers and youth unemployment rates in Germany 1972 to 2006

It is a truism that life expectancy is rising rapidly almost everywhere – but the numbers faced by some developing countries are quite remarkable. Figure 20.2 shows how rapidly different countries moved those aged 65+ being 7% of the population to 14% of the

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population. As the chart shows, this change is now happening over 20 years while it took place over 50 or even 100 years in many European countries. This reflects positive developments but is also one that adds significant challenges for pension and retirement income solutions.

**Figure 20.2**

*Years for age 65+ share of population to move from 7% to 14%*

One constant need for making informed choices amongst the options presented below is better data on mortality. In countries with no insured annuity market, appropriate actuarial tables for mortality may not be available. Even though tables used for life insurance may be helpful, mortality experience will be lower for those receiving annuities than for those receiving life insurance. Tables from other countries can be used for an interim period while local experience data is built up. For example, Chile used U.S. mortality tables when they established their system in the 1980s. Another adaptation is the Swedish approach to adjusting benefits gradually as experience develops for population-wide mortality experience. Chapter 2 describes Kenya’s efforts to proactively improve the data and other countries have also undertaken similar initiatives.

Good mortality data is vital, not only for the population as a whole but also for particular groups. This enables accurate pricing of annuities for different groups, based on health or income for example, which makes annuities more cost effective and more attractive to...
retirees. Annuities priced based on population mortality will tend to be regressive – those with higher incomes, who also live longer, will get the most value from purchasing them. Indeed, the situation is compounded if annuity providers offer better pricing for larger balances, which also favours the well-to-do. This is particularly important in developing countries which often have far higher levels of inequality than the markets that were pioneers in the development of annuities.

HOW TO DELIVER
RETIREMENT INCOME PRODUCTS

Other chapters have focused on the significance of market structures. Who will help the member join the system? Who will collect the contributions? How will the accounts be administered and who will invest the assets? The answers to these questions are profoundly important to the outcomes. Chapter 17 on governance and investment and Chapter 18 on costs explain why it is vitally important to focus on generating scale, expertise and good governance in the management of the pension assets. These market structure issues are just as important for the payout phase, but typically receive less attention. Some countries have seen important innovations such as the introduction of the ‘SCOMP’ auction system in Chile. Even countries that have created very powerful pro-member market structures, such as in India’s NPS, the advantages of the large-scale default investment funds under contracts negotiated on the members’ behalf is not replicated in the payout stage. Instead, individuals currently need to understand complex products and choose from amongst competing providers.

These market structure issues are just as important as decisions about the choice of products. Individuals can always be given choices, but as with the accumulation phase there is a great deal of value in a simple default pathway for the member who does not want to make an active choice at retirement. Part of the issue is that modern evolution toward Defined Contribution plans has encouraged more choice in payout options. Under many defined benefit plans the payout was, as the name suggests, defined. The member simply received their pension until they died. Defined benefit plans paid life annuities, with a range of practice as to whether these fixed amounts, increased at a fixed percentage, increased with investment return, or guaranteed to increase with a the rate of inflation. The advantages and disadvantages to a structure providing choice or one providing defined default payouts are important to understanding the overall value of the pension promise. In countries where it is possible for members to transfer from a Defined Benefit pension to a Defined Contribution pension it is important to have clear regulations and good practice so that members understand what they may be trading away or giving up.

It is the shift to Defined Contribution pension plans in many countries that creates the need to focus so clearly on the payout phase. To be sure some traditional ‘Defined Benefit’

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plans would pay out the full value of the pension in a lump-sum at retirement – for example as seen in Egypt and other countries. But at the heart of most Defined Benefit plans is the ambition to pay an income for the lifetime of a retiree. Defined Contribution plans, by design, often separate the structures for decumulation and accumulation. This makes the accumulation phase easier to administer, but it means that the decumulation phase has to be explicitly added. This full design of this element has typically lagged the development of the accumulation phase. Annuity payouts may be described as part of the system design but the fact that this is written in the law does not create the market that enables the actual production and sales of annuities. As highlighted in Chapter 5 on Turkey for example, the legislation and practical underpinnings for an annuity payout have only developed in recent years despite the individual pension system being in existence for nearly 15 years.

Enabling the advantages of large scale to individuals in the system is an important consideration. The payout option can be delivered from large scale pension fund(s) used for accumulation – as with many large employer based plans. Auction mechanisms can be used where private providers compete to provide payout products for groups of workers. This provides individual members, or those working for small firms, with buying power that otherwise benefit the wealthy or those who work for large employers. Improving scale can allow lower income workers to access an insured annuity in a cost-effective manner due to the benefits of group pricing. Tackling fixed administrative and sales costs associated with individual retail options makes insured annuities more financially efficient for a broader group of workers.

These cost effective solutions mimic good practice in the accumulation stage. Reducing the number of options not only makes it less challenging for members to make informed choices, but it should reduce the cost of providing annuities for annuity providers. Typically, 3-4 different annuity options can cover the diverse needs of retirees. Ideally there is a default option for the payout just as there is for investment options in the accumulation phase. In addition to limiting the number of options, standardizing the contract provisions such that products and prices can be compared on an “apples-to-apples” basis is important. Cost is reduced by reducing the need for extensive marketing and product development efforts.

Finding the best supplier can be done via electronic market places. In addition to SCOMP in Chile there is an electronic quotation system in operation in Mexico. In other markets, the trustees of large pension plans run auctions or tenders among potential suppliers to deliver annuities as a bulk contract – for example in the U.K. or Canada. Developing countries are at no particular disadvantage in this area. The bulk auction approach is used in India for the accumulation phase, in Kosovo there are tenders for the mandates in the accumulation phase and in Malaysia the Employees Provident Fund runs a bulk investment capability to implement a standardized investment strategy. The real issue is that such

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7 See www.efsa.gov.eg
approaches have typically only been implemented for the accumulation phase even though they are just as important for decumulation.

Another source of cost or price efficiency can come from mandatory annuitization. When annuitization is mandatory annuity prices are not impacted by adverse selection. Adverse selection arises when only those who expect to live longer buy annuities, forcing the price of the annuity up to account for the longer-than-average lifetime of those who are purchasing them. This effect can be on the order of 10% of the cost of a typical retirement annuity. In addition, mandatory annuitization enhances the impact of economies of scale which reduce administrative and sales costs.

An example of a country considering replicating the insights from accumulation in the payout phase is Australia. Figure 20.3 shows the existing model for the very limited involvement of pension funds (“superannuation” funds) in an individual’s transition from accumulation to payout phase. The recommendation from a recent authoritative report is for the superannuation fund trustees to select a default Comprehensive Income Product for Retirement or ‘CIPR’. Choice would still be allowed for members that want it, but as with the accumulation phase there would be a default option selected by trustees acting in the member interest. This option works well because of the large scale of the typical superannuation fund and the strong focus on governance from the regulator and supervisor APRA. The model depends on having institutions with scale, expertise and good governance to deliver the best outcomes, just as in the accumulation phase.

Figure 20.3
Recommended change to retirement advice model in Australia

<table>
<thead>
<tr>
<th>CURRENT</th>
<th>RECOMMENDED</th>
</tr>
</thead>
<tbody>
<tr>
<td>Notify fund of retirement. Fund recommends obtaining advice</td>
<td>Before retirement: receive details of CIPR preselected by fund</td>
</tr>
<tr>
<td>Obtain advice</td>
<td>Proceed with CIPR. Notify fund of commencement date.</td>
</tr>
<tr>
<td>Do not obtain advice</td>
<td>May seek advice</td>
</tr>
<tr>
<td>How to manage multiple risks and objectives?</td>
<td>Higher income stream, with longevity risk protection and some flexibility</td>
</tr>
<tr>
<td>Account-based pension</td>
<td>Elect to take benefits in another way</td>
</tr>
<tr>
<td>Lump sum payment</td>
<td>No longevity risk management and potentially lower retirement income</td>
</tr>
</tbody>
</table>


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The financial efficiency of annuities, often labelled the ‘mortality credit’ or pooling benefit, allows more income to be delivered to a large pool of individuals than if the individuals try to create their own income stream from their savings. This is illustrated in Table 20.1 below comparing different types of Comprehensive Retirement Income Products with a common drawdown from a personal account. The potential benefit of the approach was shown in an experiment illustrating the impact of setting a default for the retirement phase. The power of defaults is well known and acknowledged in the accumulation phase.

Table 20.1
Comprehensive Income Products for Retirement compared to individual account draw-down
For a 65-year-old male with a USD 400,000 accumulated balance (excluded Age pensions)

<table>
<thead>
<tr>
<th></th>
<th>Expected income throughout retirement (NPV)</th>
<th>Increase over account-based pension</th>
<th>Increase over account-based pension</th>
</tr>
</thead>
<tbody>
<tr>
<td>Account-based pension drawn down at minimum rates</td>
<td>$275,000</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>CIPR 1</td>
<td>$314,000</td>
<td>$40,000</td>
<td>14%</td>
</tr>
<tr>
<td>CIPR 2</td>
<td>$357,000</td>
<td>$82,000</td>
<td>30%</td>
</tr>
<tr>
<td>CIPR 3</td>
<td>$359,000</td>
<td>$85,000</td>
<td>31%</td>
</tr>
</tbody>
</table>


PRODUCT OPTIONS: FROM ANNUITIES TO DRAWDOWN TO RULES OF THUMB

The next section reviews some of the main options for how to turn the stock of pension assets into an income. It starts with annuities and then looks at systematic or phased withdrawals and rules of thumb. The aim is to provide a brief summary of some key issues and provide some simple but practical approaches that work when the option to annuitize income effectively is not available. The literature on this area is vast, and the interested reader should supplement this chapter with the reviews of product options found for example in Rocha and others (2011) and Mitchell and others (2011) cited below. The chapter does not focus extensively on the supervisory issues in relation to payouts as these are treated in Chapter 21 on Regulation and Supervision.

PAYOUT STRUCTURES

Most payout systems will need to use a combination of different types of payouts to meet the diverse needs of retirees. One key issue is that savings cannot be paid systematically or as an annuity until a certain level of scale has been achieved. Minimizing the impact of the need for large scale in the payout phased is one key goal for any system. Table 20.2 shows the basic hierarchy of payouts from very small payouts where a lump sum is the only practical solution to annuities as the most desirable form of payout, but with the freedom to annuity income plus additional amounts as a lump sum to members who have very high levels of savings.

Table 20.2
Linking saving amounts to most effective payout option

<table>
<thead>
<tr>
<th>Savings level</th>
<th>Payment approach</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very low</td>
<td>Lump sum</td>
<td>Cost of systematic payouts or annuity is too high</td>
</tr>
<tr>
<td>Low</td>
<td>Systematic payments</td>
<td>Cost of annuity is too high</td>
</tr>
<tr>
<td>High</td>
<td>Annuity</td>
<td>Most secure and cost-efficient mechanism</td>
</tr>
<tr>
<td>Very high</td>
<td>Annuity + lump sum</td>
<td>Once basic needs are secured, a lump sum payment provides spending flexibility and reduces longevity risk in the system</td>
</tr>
</tbody>
</table>

ANNUITY INCOME

Perhaps the most important issue to address regarding payouts is whether and how to make annuity payments – payments that are guaranteed to be made for the life of the member.11 Annuity income has several advantages, including:

- Financial efficiency – more retirement income can be delivered for each dollar contributed to the system because the “savings” that result from ending payments to those who die earlier can be used to fund the extra payments needed for those who live longer lives. Those who live longer earn “mortality credits” from those who die earlier. In actuarial terms, longevity risk is pooled and this enables each member to achieve retirement security for a lower cost. The financial efficiency gained from longevity pooling has been estimated at 15 – 25%.12

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11 The term “annuity” is not used in the same way in every country. In some countries products that provide a way to accumulate assets to be taken as a lump sum when the person retires are called annuities. In other countries a lump sum payout would indicate the opposite of an annuity which is thought of as a stream of income payments. In this chapter we link the payout category to the income stream it creates – hence an annuity pays an income until death in the standard form and a phased or systematic withdrawal allows periodic payments but no guarantee of income until death.

12 Longevity Risk Pooling – Opportunities to Increase Retirement Security, Daniel Bauer, 2017
• Higher levels of spending – from an individual’s standpoint, higher spending levels can be maintained since there is no fear of running out of money due to living longer than expected.

• Consumption – from a policy standpoint, more stable consumption or higher levels of spending may be achieved with consequent benefits for the economy.

• Members are relieved of the burden of managing both spending and investments during retirement, which is likely to be especially beneficial if at older ages when the willingness and/or intellectual capacity to deal with such risks declines.

However, annuities also have a number of disadvantages.

• Illiquidity - the stream of income may be viewed negatively by members who prefer the full value of retirement savings available for spending objectives such as starting a business to provide retirement income, paying off debt, supporting children, or passing on a bequest after death. On the other hand knowing that a lump sum is available in the future may make people less likely to properly provision for these expenses, and encourage excessive borrowing by parents or their children.

• Availability of funds - in some countries the economic benefits attributable to having retirement funds immediately available may outweigh the benefits of more stable levels of spending.

• High cost - insured annuities are seen as ‘expensive’ since even if they are competitively priced with reasonable profits annuities include additional costs that an insurer must charge to offset the longevity and investment risk they have taken on, including a regulatory requirement for capital.

• Inefficient markets - insured annuities are expensive when the market is not efficient - weak competition, excessive profits or sales costs, complex products and mis-selling linked to commissions may all contribute to higher cost annuities.\textsuperscript{13,14}

• Regressive distribution of wealth – because those with low incomes are likely to live shorter lives than those on higher incomes, annuity income may be viewed as inequitable. In this case the annuity product is regressive. This reinforces the importance of accurate mortality tables for the appropriate populations as highlighted in Chapter 2 on Kenya.

RISKS AND GOVERNMENT GUARANTEES

Annuities are the major product that insures an individual against longevity risk – the potential that a retiree lives longer than expected so that retirement savings are depleted while the retiree is still living. Governments may intervene and reduce or eliminate the risks some of the key retirement risks, but consideration must be given to the potential cost of this kind of guarantee.


Longevity risk is one risk where market instruments that hedge the risk are not as likely to exist. Thus, government guarantees in this area (e.g. by providing lifetime income) may be valuable, but also potentially expensive. On the one hand, annuity income provided by a government is financially efficient since every retiree does not need to save enough to provide for themselves in case they live to a very old age. On the other hand, if the government is the guarantor ensuring that income is paid for each retiree’s lifetime, they take on the risk that the average lifetime of the population will increase more than expected – called “systematic” longevity risk. Systematic risk is very hard to assess since unexpected medical innovations or other developments could significantly extend lifetimes.

Governments take on systematic longevity risk when they pay any form of public pensions – poverty alleviating ‘zero pillars’, contribution-linked first pillars, or even pensions for civil servants. When the government also underwrites longevity risk in an employer-based system it eliminates some of the positive effect of diversifying the pension system amongst both government and employer-based systems.

One approach to combining public and private delivery of pensions is to split the retirement period into two stages. Public pensions start low for the first phase of retirement, with the gap being filled by private savings, continued work, family members and so on. Private savings only need to fill a certain period – say 10 or 15 years, which is a much simpler product to deliver than an annuity that needs to be priced to deliver a certain income for up to 40 years.

Figure 20.4

Two stage public pensions enable higher payouts to the very old

A schematic illustration of the payout phase - state pension and private pension payouts operating more sequentially to allow higher high-age state pensions to mitigate end of life poverty


15 These two stages — the early retirement years and then very old age — have been termed by some authors the 3rd and 4th age or life stage (after youth and working years) — see for example work by Berstein and Larrain. It is useful to separate these two stages since the earlier stage is experienced by almost everyone who reaches age 55 or 60, while the later stage is not. Funding the later stage is more akin to an insurance problem that many people will not have to face. Some of the oldest pension programs in the world — for example the 1909 reforms in the U.K. — were designed to cover the oldest ages that only a minority of workers would be expected to reach.
In this approach the government takes on the burden of longevity risk by paying the entire old age pension after a certain age (e.g. 75, 80, or 85). By focusing public funds on the oldest ages, the societal goal of alleviating poverty is fulfilled at lower costs and the private sector is left to manage the transition from working career to retirement in the most effective way possible. Workers can be encouraged to work as long as they are productive without the full effect of legislated constraints on retirement timing. This has the potential to reduce the overall need for public funding of retirement. The idea is developed in greater detail in Price 2017.16

In this approach the private sector retirement payout solutions can be relatively straightforward. Typical payout solutions in this framework might be:

• Annuities with a maximum term defined by the age at which the public pension increases. For example, one might receive payments until death or until reaching 85 whichever comes first. Payments could be fixed, inflation-linked or variable (increasing or decreasing with investment returns).

• Systematic withdrawals could take the form of instalment payments equal to the remaining account balance divided by the years remaining until the age at which the public pension increases. This would allow for bequests for those who do not receive payments for the entire period.

• The ability to take some portion of an account out as a lump sum would be enhanced by the extra security of the public pension at older ages. Lump sum withdrawals would likely be limited so that at least a certain minimum amount would be paid out through one of the payout solutions described above.

Countries adopting this approach will need to do careful population projections to understand the full cost of the program and how it will change as a population develops and, in most countries, the number of people at the oldest old ages increases. Although the overall cost of the public portion of retirement costs will be reduced with a thoughtful implementation of this type of system, the uncertainty of the reduced cost will be increased since improvements in longevity are likely to change mortality at the oldest ages more than younger ages. Governments are exposed to this uncertainty in any event but it is a smaller share of a larger overall programme cost.

**ALTERNATIVE FORMS OF ANNUITIES**

Annuities may be offered in fixed amounts – flat in nominal terms over time, amounts which are indexed to inflation, increase at a certain percentage each year, or amounts which are variable depending on the investment returns provided by the assets.17 Fixed amounts are a reasonable solution in countries where inflation is not high, but in countries with high inflation, inflation-indexed annuities would provide significantly more retirement security. However, if the supply of inflation-indexed bonds is not adequate, inflation-indexed

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17 This section does not go into great detail on all the different annuity options which can be found in a range of publications — for example Rocha and others (2011) cited above, or Brown, J. R., O. Mitchell, J. Potterba, and A. Warshawsky. 2001. “The Role of Annuity Markets in Financing Retirement”. MIT Press, Cambridge.
annuities may not be viable the short-term. But this is an area where pension reform and capital market development can work hand in hand as the demand created by a retirement solutions market may be the right catalyst to encourage the Ministry of Finance or Debt Management Office of a country to develop the supply of inflation-linked bonds.

If inflation-linked annuities are not practical, payouts can still be set to rise at a given percentage each year – say 4% - that will help to offset inflation. This is a simpler liability to insure, backed with standard government (and corporate) bonds. Variable annuities with benefit payouts that increase or decrease as investment returns materialize above or below a target rate, will allow for higher initial payouts and are likely to generate higher future payouts throughout retirement as they enable investment in riskier asset classes which should generate higher returns – but this of course includes the risk that the payouts could fall which may not be a risk members are able to take. The correct course will depend in part on whether the payouts are an addition on top of a relatively generous public pension (e.g. Australia) or a major source of retirement income where public pensions are less generous as a share of average wages (e.g. the U.K.) or where the payment may be the only source of financial income or the public pension floor is very small (e.g. India).

In countries with a viable annuity market various considerations arise:

**Minimum amounts** – However efficient the payout and payments system is it won’t be cost effective to annuitize all smaller balances and systematic or phased withdrawals (or even lump sum payments) may be the only options below some minimum level of savings.

**Risk classification** – Age, gender and income level are typically used by insurance companies to classify members’ longevity risk and create pricing levels that are appropriate for each classification. The more detailed the classification mechanism, the more efficient, and potentially the more equitable, the provision of retirement can be. For example, higher levels of income can be provided to those who are certifiably less likely to live a long life due to health or lifestyle factors such as smoking which can counter-act the potentially regressive nature of annuities when a single conversion is used across the whole pensioner population. In some countries – including across the EU – gender-based annuity factors are not permitted on discrimination groups. This has the effect of creating the same payout to men and women with similar other demographic characteristics. Given that women typically live longer than men this means that for a given level of assets women will receive greater total income than men over time because they will receive the annuity for more years.

**Capital requirements & insurance regulation** – Retirement income products provide security over a decades-long time frame. The uncertainty related to reinvestment risk and longevity requires special attention to all aspects of capital requirements, such as assumptions underlying reserve levels including mortality, investment return and reinvestment rates. While capital requirements that ensure the financial stability of insurance companies are desired, the more stringent the requirements, the costlier the

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18 Reinvestment risk refers to risk that future yields, after current fixed income investments mature, are uncertain. Because retirement periods may last 30 years or more, it is not possible to lock in yields for the entire period.
annuity products will be and/or the less profitable the insurance companies will be. So an appropriate balance must be sought and be constantly monitored. When longevity is uncertain and interest rates are very low as in many developed countries after the Global Financial Crisis, this can make annuities look ‘expensive’ even if they are priced competitively. This creates a challenging environment to offer annuities which appear to be a good value relative to the other options that members may see. This has increased attention on intermediate solutions such as variable annuities, or re-pricing annuities, where the payouts can be adjusted over time as investment returns or mortality experience becomes known. This is discussed in more detail below in relation to the example used in Sweden.

Price risk – Annuity prices depend on interest rates (bond yields) at the point in time of purchase. Because interest rates fluctuate and are uncertain, retiree income is subject to market risk. The same level of account will purchase less when bond yields are at 5% than when bond yields are at 7%. One approach to mitigating this risk is to allow annuity purchases to happen gradually – for example ½ on retirement, and the other half within 2 years. Another approach is to set up investment portfolios to hedge this risk. For example, a portion of lifecycle investment allocations can gradually be moved into bonds similar to the bonds invested in by annuity providers during the 10 years prior to retirement. Where the accumulation and decumulation phases are delivered by the same provider – for example in an employer sponsored Defined Benefit trust in some countries, or through a Provident Fund - the asset allocation can be exactly matched to the payout solution.

Commission levels – As with any financial product, aggressive sales incentives can lead to both overselling and inappropriately high costs. Regulation of commission levels and sales practice is desirable. However, some countries have concluded that the existence of commissions create such an inherent conflict of interest between the sales agent and the consumer that they have been banned (e.g. the U.K.). But, as argued above, there are strong arguments for creating a market structure where the cost of multiple sales agents chasing individual consumers do not arise because the selection of the payout options is made at scale and in bulk, even where there is some ability for individuals to tailor their options.

Product comparison – If insurers are free to design and market products without constraint the number of features and overall design can become too complex for members to make informed decisions about what products are best suited to their needs and cost comparisons become difficult. Electronic exchanges for products with standardized features are used in some countries – or a standard product is mandated by regulation. As highlighted above, in a standard Defined Benefit pension, the payout is not subject to multiple choices and hence there can be a bulk buy-out market operating at a group level. This market has traditionally involved insurance companies offering large scale buyouts of the liabilities of large employer sponsored plans. But as argued throughout this volume, it is possible to offer low-income individuals the same advantages by aggregating their assets and contracting directly on their behalf with the providers.
Societal issues – Most payout solutions should offer at least the potential to cover a spouse who survives a retiree. Not all retirees need to cover their surviving spouse in case where the spouse has his or her own retirement income, however in some countries it has been found desirable to require coverage of surviving spouses to eliminate situations where a spouse might leave their survivor with no provision for support.

Annuity structures which provide for a surviving spouse include:

**Joint and survivor.** Some percentage of the original annuity income continues to a spouse that survives after the retiree’s death. Levels of pension continuance to a spouse typically range from 50% to 100%. For example, in the U.S. a minimum continuance of 50% is required for private pensions unless a spouse signs off. In Chile, male retirees must make provision for a surviving spouse, but women must only provide for a disabled spouse.

**Refund annuity.** Some lump sum amount is paid out to a surviving spouse or other beneficiary on death. This amount may be some portion of the original premium or it is sometimes defined as an amount that decreases as more of the annuity is paid out. For example, a lump sum equal to the original premium paid, minus the annuity payments made, may be returned to a retiree’s beneficiaries on death of the retiree.

**Period certain.** Annuity payments are made for a period, e.g. 10 years, no matter how long the retiree lives.

Although providing annuity income may be desirable, practical barriers may exist as a lack of an insured annuity market or desire to avoid taking on longevity risk. While longevity risk for individuals can be nearly eliminated with pooling, the population life expectancy (systematic longevity risk) may still increase, leaving either the government or financial institutions exposed to significant unexpected costs.

An ideal system for many countries might provide annuity income as a base level of income with higher levels of savings being available as a phased withdrawal or even a lump sum to be managed and spent as the member sees fit. The base level of income provided through an annuity arrangement could be defined by a percentage of the value of a member’s account or by a certain level of base income for all members linked to a poverty metric so that the pension system can achieve its core mission of sufficient adequacy to prevent poverty. Using the same level of annuity income for all members is based on the idea that a core objective is to ensure a base level of income for all so that there will be no further calls on the state budget from people who use up their other savings.

**SYSTEMATIC OR PHASED WITHDRAWALS**

Many countries must operate a retirement system without the benefit of guaranteed lifetime annuities. There may be no market for insured annuities or insured annuities may not be cost-effective for modest levels of income because fixed administrative and sales costs are too high. Ideally, some base level of income will be provided with a lifetime guarantee through a social security type system. While such guarantees take advantage of longevity pooling as described above, governments, insurers or employers all must
be careful not to take on a level of longevity risk which may be unmanageable. This will usually leave a substantial portion of payouts to be managed in the context of longevity and investment risk.

Systematic withdrawals create income with the objective of making the retirement savings account last a lifetime but without a guarantee that it will. Typically, a systematic withdrawal will be managed by the retirement system with payments from the retirement system being delivered to members or their bank accounts and not eligible to be invested back into the retirement system. This alleviates the problem of members needing to make important decisions in an area where the vast majority of them have little or no confidence or expertise – a problem which increases significantly as retirees reach the later stages of their lives. Systematic withdrawal strategies offer some of the benefits of annuities but will also generally allow for a bequest, and for the ability to change the payout scheme at some point in the future.

Figure 20.5 illustrates the payout pattern for some typical forms of systematic withdrawal and compares those payouts to the payout from a standard annuity. The annuity is assumed to be paid by an insurance company but could also be paid by a government willing to take on the longevity (and any investment) risk. The Annuity Factor Withdrawal amount is recalculated each year by dividing the current account balance with the cost of an annuity for the remainder of the retiree’s life. The Life Expectancy Withdrawal is calculated in the same way but divides the account balance by the remaining life expectancy instead. The instalment payments divide the current account balance by the time remaining in the instalment period. For example, after 10 years, the remaining account balance is divided by 5. In reality these payment patterns would not be smooth like the lines in the figure since asset returns would still be somewhat volatile.

Figure 20.5
Comparison of payout patterns for annuities and systematic withdrawals

Source: Authors’ own estimates. Assumptions: 2% real rate of return used to calculate payouts; systematic withdrawals & instalments are assumed to earn 3% real returns during payout period; mortality based on U.S. RP-2014 male adjusted to make life expectancy = 18; annuity costs and profit are assumed to reduce annuity payment by 5%.
Systematic withdrawal strategies require that asset allocation is determined, monitored and maintained throughout the payout period. The vast majority of participants will not have the inclination or Systematic withdrawal strategies require that asset allocation is determined, monitored and maintained throughout the payout period. The vast majority of participants will not have the inclination or expertise to determine an appropriate asset allocation, but some value the opportunity to do so. Standard asset allocations, potentially with the flexibility to opt out of the default, are likely to be appropriate with systematic withdrawal schemes. Allowing members to determine asset allocation with no constraints may lead to inappropriate levels of risk.

Note that the annuity enables the highest payouts overall due to the efficiency of pooling longevity risk such that “savings” from retirees who die early are available to cover the extra cost for those who live longer. The systematic withdrawals necessarily decrease during the retirement period and will finish with retirement funds left over to pass on to other beneficiaries than the retiree. Although these approaches are less cost efficient when viewed from the perspective of enhancing retirement security, the decreasing payments and the potential to pass on savings to a spouse or children may be desirable for many individuals. The instalment payment approach pays more than an annuity if the instalment period is shorter than the life expectancy. Instalments will not provide lifetime income but do continue to pay benefits for the full instalment period, with payments after a retiree’s death continuing to a designated beneficiary.

There are methods available that allow a retirement system to make systematic withdrawals payments in a pattern closer to that of the fixed annuity (the black dashed line in Figure 20.5). This approach requires the system to utilize funds left when retirees pass away and allocate them on an actuarial basis to the accounts of living retirees. This approach leaves nothing to beneficiaries (although provision can be made for spouses if desired) and thereby increases the level of retirement security delivered by the system. It naturally increases the administrative complexity of the system and is beyond the scope of this volume.

Table 20.3 shows the remaining account balance and divisor for each approach up until age 90. In the chart and table, the real rate of return is assumed to be 3% each year, whereas returns would actually vary such that the income amounts would increase and decrease more and be less predictable than shown in these examples.
Another payout approach combines systematic withdrawals with a deferred annuity. This may be a practical approach in countries where no insured annuity market exists and the government wishes to provide full longevity protection but also leave the management of the retirement system primarily to the private sector. For example, the government might provide a fixed amount stipend to all members starting at age 85, while leaving the payout of savings balances to the private system. A levy on private system balances could be used to finance the late life payouts. It should be noted that this approach will leverage the risk related to improvements in life expectancy – i.e. when life expectancy increases the percentage increase in the cost of a deferred annuity will be more than the percentage increase in the cost of an immediate annuity.

**CHOOSING THE ASSET ALLOCATION IN SYSTEMATIC AND PHASED WITHDRAWALS**

As people enter retirement and begin to spend their assets, a new perspective on investment risk is required. Since it may be hard to reenter the workforce, there is no longer the potential to offset bad investment performance with additional labour income. Because assets may be gradually spent down, sequencing risk – where returns early in the retirement period have a bigger impact than later returns – becomes an issue and retirees will be more sensitive to investment risk. Generally, it will be appropriate to move from growth-oriented assets into more fixed income and to reduce the reliance on diversification amongst asset classes for reducing risk in favor of aligning asset income with spending needs, but the investment horizon for the assets may still be 30 years or

<table>
<thead>
<tr>
<th>Age</th>
<th>Annuity Factor</th>
<th>Life Expectancy</th>
<th>Instalment</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Account Divisor</td>
<td>Account Divisor</td>
<td>Account Divisor</td>
</tr>
<tr>
<td>65</td>
<td>100,000 14.66</td>
<td>100,000 18.0</td>
<td>100,000 15.0</td>
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<td>70</td>
<td>79,511 12.04</td>
<td>85,044 14.3</td>
<td>71,455 10.0</td>
</tr>
<tr>
<td>75</td>
<td>57,579 9.52</td>
<td>66,086 10.9</td>
<td>38,363 5.0</td>
</tr>
<tr>
<td>80</td>
<td>36,071 7.18</td>
<td>44,640 8.0</td>
<td>-</td>
</tr>
<tr>
<td>85</td>
<td>17,803 5.14</td>
<td>23,935 5.6</td>
<td>-</td>
</tr>
<tr>
<td>90</td>
<td>5,787 3.51</td>
<td>8,559 3.7</td>
<td>-</td>
</tr>
</tbody>
</table>

Table 20.3
**Comparison of Drawdown Rules**

Source: Authors’ own estimates. Assumptions: 2% real rate of return used to calculate payouts; systematic withdrawals & instalments are assumed to earn 3% real returns during payout period; mortality based on U.S. RP-2014 male adjusted to make life expectancy = 18; annuity costs and profit are assumed to reduce annuity payment by 5%.
more. Lifecycle portfolios for the accumulation phase should be coordinated with this perspective on payout phase portfolios which suggests that the portfolio is actually going to include some element of return-seeking assets for a further 20 years.

Inflation is an issue to be considered for any retirement portfolio. Some developing countries already have inflation-linked bonds that directly address the risk of inflation eroding a retiree’s purchasing power. In countries without inflation-linked bonds, higher allocations to equities may need to be maintained to protect against loss of purchasing power over time. This requires a functional domestic equity market or the legal ability to invest outside the country. In cases where this is not possible, pension funds with the scale, expertise and governance can invest in illiquid assets such as commercial or domestic real estate which have value that tends to grow with inflation.

As portfolios reduce the focus on growth and increase the focus on producing stable income, currency risk should be considered. Given that retirement spending is presumed to happen predominantly in the home country it may be appropriate to reduce currency risk progressively, a change that must be weighed against the continued value of diversification in non-domestic assets.

VARIABLE ANNUITIES, INVESTMENT AND SELF-ADJUSTING MECHANISMS

Longevity is increasing in almost every country and the cost of retirement increases when longevity increases. As time goes on the age parameters that define a retirement system – normal retirement age, early retirement ages, deferred annuity ages, will need to be increased for a retirement system to be sustainable. Whether the cost is borne by the government, by employers or by members, increasing longevity eventually pushes up costs to a point where changes are required. Because legislative changes to a retirement system can create political challenges, self-adjusting age mechanisms should be considered. Generally, self-adjusting mechanisms will have the objective to be cost neutral (the cost of the system is not changed, when an adjustment to an age parameter is made). However, they may also be designed to gradually increase or decrease costs over time or in tack with GDP or some similar measure that indicates how much retirement income is affordable at a sustainable level.

Benefits can also be adjusted as investment returns materialize. Similar to a variable annuity which adjusts an individual’s benefit up and down with returns, the benefits for a system can be adjusted in a similar fashion. Sweden uses a variable annuity approach to providing retirement income which has several advantages. First of all, it takes advantage of the efficiency of longevity pooling (described above) but does not take on the systematic longevity risk related to the life expectancy of the population living longer than expected. Instead the mortality experience of the population is tracked and benefits are adjusted up or down to keep the system in financial balance. If more retirees than expected survive in a particular year, then benefits will be adjusted down for the entire population that is receiving payments. In this way, changes in life expectancy are gradually recognized in the system, increasing the sustainability of the system without
large adjustments to benefits which could be a hardship and without the need for political decisions which are too easily deferred until the system is in a crisis and significant changes are required. The Swedish approach is able to provide annuity income to retirees without the need for insured annuity products. This means that there is also no need for capital requirements to back the promises – another source of cost efficiency.

Another benefit of the Swedish approach is that the need for accurate mortality data is lower than for pricing a standard annuity where an insurer takes on longevity risk for 40 years or more. Hence it may be more applicable to developing countries where mortality data is less accessible. In Sweden the system is updated periodically as the statistical agency produces updated mortality tables. In a developing country the accuracy of the system could be progressively improved rather than taking a permanent risk with a set of subpar mortality tables. However, as highlighted above, for fairness reasons, it will be important to ensure that the pricing is not regressive and that there is a way in which the higher income, longer-lived population can be segmented from the poorer and likely shorter-lived.

One key idea in this volume is that the same types of differentiation to improve enrolment and participation can be used at retirement to improve retirement income outcomes. Everyone benefits from scalable administration and investments, but the precise terms of the payout arrangement can be varied for different groups.

**RULES OF THUMB, EDUCATION AND COMMUNICATION**

Where retirees have the option to take their savings as a single lump sum amount and must manage asset allocation and spending themselves, education initiatives are often pursued and in theory are valuable. However, evidence suggests that it is challenging to teach people to make good decisions despite many interesting and energetic initiatives. A key issue is that strong financial aptitude is correlated with natural ability at planning and choosing financial products, but evidence that training in financial aptitude increases the likelihood of actively deciding to participate in retirement savings programs or make optimal financial choices at retirement is weak. Whilst many countries believe that this is a particular problem in their country, this issue is significant in every country. Even in highly educated developed countries the benefits of financial education can be limited and transitory.19

On the other hand, communication is clearly important in supporting major policy reforms but may be most effective with very simple messages that link to a clear action. This is highlighted in Chapter 3 on the U.K. auto-enrolment experience where the campaign slogan was ‘I’m In’ – a message focused on getting people to remain in

the system. The intent is not for individuals to learn and retain any particular pension knowledge, but just to be convinced not to opt out.

One approach to changing behaviour is to proactively teach people good rules of thumb. It is well-established that people do use rules-of-thumb – known as ‘heuristics’ in the literature – when making decisions on pensions and savings. This option is not suggested as best practice – that was set out earlier based on a market structure with a group/bulk purchase model and a mix of annuitization and drawdown tailored to the type of provision available from other sources including the state. However, the aim is to communicate rules of thumb that have some degree of rigour underlying them. Similar rules of thumb can be adapted to each country, adjusted for local conditions such as the real rate of return and longevity.

A few concepts that are useful for determining rules of thumb are:

**Simple percentages for spending guidelines are useful.** Typically, percentage guidelines should have some rough and simple relationship to expected real rates of return. A retiree who spends an amount exactly equal to the real rate of return every year will end up with the same amount, adjusted for inflation, in his or her account every year during retirement. Spending guidelines can typically be 1% to 2% greater than the expected rate of return on a conservative portfolio, with 1% being more appropriate in countries with higher life expectancies and 2% potentially being appropriate in a country with lower life expectancy. For example, in a country with life expectancy at age 65 that is less than 80 and with expected returns on a conservative portfolio of 3%, it may be appropriate to communicate a rough guideline of 5% spending per year. That is fairly high, but appropriate for the relatively low life expectancy and reasonably high expected return.

**Safe spending rises with age.** The potential remaining future lifetime decreases as a retiree ages which means that safe spending levels increase with age. A guideline that is a function of age can be appropriate – for example age divided by 15 could be appropriate in a country with an expected real return on assets of 3% on a conservative portfolio. This would suggest spending of 4% at age 60 and 5% at age 75. Many retirees will want to spend more in the early years of retirement than in later years, but safe spending levels do increase with age.

**Asset allocation guidelines can also be based on age.** For example, the idea that the percentage allocation to bonds should be equal to age (60% in bonds at age 60) can be useful. In countries with inflation-indexed bonds, higher allocation of bonds are appropriate. In countries with small or non-existent inflation-indexed bond markets, a greater allocation to equities may be advisable in order to enable retirement income to keep pace with inflation and growth in the economy.

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21 The real rate of return is the rate of return minus inflation.
It is useful to distinguish between payout guidelines which fix a level of spending at retirement – e.g. spend 4% of initial retirement wealth and increase that with inflation in future years\(^{22}\) - and those with a spending level that will adjust up or down as the savings balances increases or decreases. An example of an approach that adjusts spending is one that suggests spending a certain percentage – e.g. 4% - of the current account balance. Fixed approaches provide stable spending but more risk of running out of money, while an approach that adjusts based on the current account balance is more likely to last the entire lifetime. Fixed approaches are more subject to investment risk and an important type of risk that is relevant for pension payouts called sequencing risk. Sequencing risk occurs in any portfolio where there is continual net cash outflow from a portfolio and therefore is highly relevant for retirement payouts.

Table 20.4 shows the significant impact of sequencing risk on pension balances and different approaches to spending. The problem is that large drawdowns in the balance due to poor returns early in the retirement period are much more damaging to long-term security than poor returns later in the retirement period. In the table the fixed approach to spending is labelled “% of balance at retirement”. The adjustable approach is labeled “% of current balance”. Most retirees will not follow a strict formulaic approach to spending and their actual spending pattern is likely to combine elements of both of these approaches.

**Table 20.4**

*The impact of sequencing risk on pension balances in drawdown*

<table>
<thead>
<tr>
<th>Remaining balance after 10 years</th>
<th>% of balance at retirement</th>
<th>% of current balance</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Year of -20% return</strong></td>
<td>3%</td>
<td>5%</td>
</tr>
<tr>
<td>none</td>
<td>88,722</td>
<td>66,603</td>
</tr>
<tr>
<td>1</td>
<td>77,639</td>
<td>53,488</td>
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<tr>
<td>3</td>
<td>79,571</td>
<td>56,709</td>
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<tr>
<td>5</td>
<td>81,359</td>
<td>59,688</td>
</tr>
<tr>
<td>7</td>
<td>83,011</td>
<td>62,411</td>
</tr>
<tr>
<td>9</td>
<td>84,538</td>
<td>64,987</td>
</tr>
<tr>
<td><strong>PV of spending</strong></td>
<td>27,217</td>
<td>45,362</td>
</tr>
</tbody>
</table>

Source: Authors calculations

Assumptions: USD 100,000 savings balance at retirement; results with 2% real returns in top row compared to results which average 2% real geometric returns but with a -20% return included, which means the returns in the other 9 years = 4.03%, in order to average 2%.

\(^{22}\) The so-called “4% rule” which became common in the U.S. in the 1990’s and 2000’s.
The table shows the portfolio balance after 10 years, given that a large downturn in the markets has impacted the portfolio in one year out of the 10. For example, a retiree who spends 5% of their initial savings, increased with inflation every year (column 2) and experiences a -20% return in year 1 of their retirement will find their portfolio depleted to only 53,488 from 100,000 after 10 years. The last row in the table shows that spending is higher (and more predictable) over the 10-year period for the strategies which fix levels of spending based on the initial portfolio value. However, the portfolio value is impacted significantly by downturns and in particular by sequencing risk. A retiree whose portfolio is hit with a large downturn right after retirement is impacted severely – at either level of spending shown, the portfolio after 10 years has only about half of the original value (after inflation). The approach which adjusts spending exactly as the portfolio increases or decreases will find that their portfolio value is impacted only modestly by volatility or large downturns and sequencing risk is not an issue.

While both of these basic approaches can be used by individual retirees to help them manage their retirement funds during the payout period, the table illustrates the challenges and the potential problematic outcomes that may result from retirees managing their own spending. If a retiree is asked to manage their own investments that creates additional risk and burden for a retiree. And these problems are likely to escalate to unmanageable levels as retirees age and lose cognitive ability.

CONCLUSION

This chapter has set out seven areas for consideration in the payout phase of a pension system – in both developed and developing countries. The right approach depends on the country, and should be examined against the long run outcomes that the pension system is seeking to achieve. In general, the objectives of the payout phase will be to pay meaningful income during member’s lifetimes, expand coverage, and deliver it in a sustainable way. The system will want to ensure the security of assets and enable efficient market structures, investment, and administration of payments. In addition, an approach to retirement that encourages increasing participation in the labour market at both young and old ages will be needed to fund ever-longer lives.

Policies on early withdrawal of pension assets should be developed with an understanding of how they may impact the ultimate objective of the system – to pay retirement income. Unless withdrawals are repaid or somehow stimulate additional contributions (for which there is little evidence) then they will ultimately be detrimental.

Rising longevity requires increasing retirement ages and longer labour market attachment in order to the contributions, and, ultimately the income needed to fund a secure old age. Countries sometimes worry that this will negatively impact the employment chances of younger workers, but the available evidence suggests this is not the case. Linking future
retirement ages to (rising) longevity is likely to enhance sustainability as much as any other feature of the system.

This chapter emphasizes that scale, expertise and governance are just as important in the payout phase as in the accumulation phase. Too often even countries with well-designed accumulation phases default to an individual choice option for payouts – a choice for which members are not well-equipped and which adds additional cost. Likewise, innovations in data and ID, and in payments and account management – the same developments used to expand coverage in developing countries - can also make the payout phase far simpler and more efficient.

The chapter reviewed the pros and cons of different products, highlighting the strengths that traditional annuities have but also describing the requirements from the capital market and regulators. Options with variable payouts linked to actual investment returns and developing mortality experience can deliver many of the benefits of guaranteed lifetime income solutions without the costs associated with them. Likewise, systematic withdrawals offer many advantages compared to simple lump sum payouts. However, they do not guarantee lifetime income and sometimes require members to make complex choices and/or manage their own asset allocation which the literature shows is very challenging for ordinary members. One possible improvement in this area is to develop simple rules of thumb of the type many members use anyway, but based on sophisticated underlying modelling performed by the regulator.

There is tremendous opportunity to improve old age income for people in developing countries through the integration of financial technology and inclusion. These developments can be enhanced with best practice on scale, expertise and governance learned from pension markets globally. The opportunity to improve accumulation programs is large but applies just as much, if not more so, to the way retirement income is delivered from the hard won savings of ordinary people everywhere.
REGULATION, SUPERVISION, MARKET STRUCTURE AND MEMBER PROTECTION

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WILLIAM PRICE
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INTRODUCTION

Governments establish policies on a wide range of topics that they consider to be important and use various policy instruments to help achieve their objectives. Pensions are important from many perspectives, both social and economic, to workers and their families, employers, and the economy. Strong pension systems can be rewarding to all stakeholders, but weaknesses can pose risks. This chapter looks at how to make choices in relation to regulation, supervision, market structure and member protection for the pensions sector that will support the achievement of government policy objectives.

Regulation is the framework of rules, principles, and guidelines that set out expectations for the way the pension system will work. Regulation sometimes requires or prohibits actions; for example, restricting the investments of a pension fund. Regulation might also be used to affect behaviour; for example, requiring good governance and risk management. Alternatively, regulation might specify rights or outcomes for entities or individuals; for example, the right of a member to appeal a decision of the plan administrator regarding eligibility for benefits.

Supervision consists of the mechanisms and systems used to monitor the implementation of regulation and to take enforcement action if expectations are not being met. Used together, regulation and supervision reinforce one another; using one without the other is unlikely to be effective. Regulation without supervision provides little assurance that market participants will behave in accordance with expectations. Supervision without regulation provides little guidance to market participants on how they are expected to behave.

The market structure of a pension system can be profoundly important in determining its success. Market structure is affected by and might be considered as an element of the overall regulatory framework. But it is important enough to be considered on its own – indeed Chapter 17 on Governance and Investment and Chapter 18 on Costs show how differences in structure can have profound impacts on results. For many types of markets, governments tend to leave the market structure to evolve in response to market mechanisms. But pension markets have many special features. Achievement of broad coverage might require mandatory or quasi-mandatory approaches, to produce outcomes that are not simply the result of the interplay of supply and demand between providers and consumers, such as seen in a typical consumer goods market. The economies of scale in administration and investment management are such that in small markets pension administration can have a quasi-utility nature. And lifelong portability across time, geography, occupation and formal and informal labour markets argues for co-ordination or interoperability in certain elements of the value chain to cut costs and avoid multiple small accounts. Moreover, pension markets are one of the few where not-for-profit governance structures are very common and have been shown to deliver outcomes as good as, if not better than, for-profit alternatives (see Chapter 18 on Costs and Returns). So, the approach
is not a rarity, as in some markets, but is the governance structure under which most global pension assets\(^1\) are currently being managed.

Market structure is also highly relevant to determining the most effective approach to member protection. Many of the standard elements of the member protection toolkit – disclosure, cooling-off periods, redress mechanisms and financial education – exist in pension markets. But there is not much evidence that they are hugely effective in improving outcomes. Even highly-educated people can find pensions daunting. Simple changes to default rules, such as auto-enrolling people into a pension plan, can very significantly increase participation, as shown in Chapter 3 on the U.K.. In theory, such approaches should not work if members have the right information and are making clear choices. However, it is clear not only that members find it very challenging to understand pensions but also that even high quality (and often relatively expensive) financial education is often unable to bridge the gap. In a normal market this would mean that people simply would not buy the product. However, lack of pension provision can be unacceptable from a public policy perspective because of the consequences for old-age poverty. In this challenging policy context, a critical part of the member protection toolkit can be having institutions with strong governance acting in the members’ best interests. There is a wide range of alternatives for doing this, which might involve “traditional” private sector providers, well-run employer-sponsored pension funds with expert trustee boards, or arm’s length not-for-profit providers set up under statute with a specific mission.

The rest of this chapter begins with a discussion of possible policy objectives and how regulation, supervision, and market structure and member protection strategies can support their achievement. Section 3 highlights the need to have a solid understanding of the current situation before designing the framework of regulation, supervision, market structure and member protection. Section 4 discusses the development of the framework itself. Section 5 highlights the importance of establishing specific goals and indicators that can be used to measure their achievement. Section 6 deals with the identification of risks to the achievement of goals, while section 7 discusses strategies that can be used to deal with the risks. Sections 8, 9, and 10 describe steps that might be taken in the implementation of regulatory, supervisory, and market structure and member protection strategies, respectively.

**ESTABLISH POLICY OBJECTIVES**

Governments can have diverse policy objectives related to the pension system. Some objectives might focus on the outcomes the pension system is expected to achieve, such

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\(^1\) See, for example, the make-up of the world’s 300 largest pension funds in the annual Towers Watson P&I survey of the Global 300 largest pension funds. The point is not to assume that one structure or another is necessarily superior, but to be rigorous in evaluating the most effective value chain for the pension market in a jurisdiction – particularly in relation to whether it is compulsory, quasi-mandatory or voluntary.
as: efficiency, coverage, adequacy, sustainability, and security. Other objectives might be more far-reaching, relating to the economy or social welfare.

The outcomes-based diagnosis and assessment (OBA) framework for private pensions\(^2\) puts the pension outcomes that will improve people’s lives at the heart of an assessment methodology designed to identify how private pensions can contribute to improving those outcomes. The five key outcomes are defined in Box 21.1. Of course, these outcomes overlap. For example, good governance may contribute directly to security and efficiency and indirectly to sustainability. Effective supervision may affect all the outcomes. Furthermore, trade-offs between the outcomes are often important when considering policy objectives.

The pension system can contribute to the achievement of various economic objectives. For example, the pools of capital accumulated in pension funds can be a source of financing that can support economic growth and the development of broader and deeper financial markets. The long-term nature of pension obligations means that the investments of pension funds can contribute to financial stability. A well-designed pension system can also provide incentives for the formalization of the labour market.

A government’s specific social welfare objectives in terms of poverty reduction or enhancing the rights of women and minorities can be set out in terms of objectives for coverage and levels of adequacy. Such outcomes can be expressed not only in aggregate – for example, average pensions to reach 50% of average earnings – but also in relation to achieving a minimum level of income or to ensuring gender equality in adequacy.

Ideally, government’s policy objectives should be clearly identified, realistic, and internally consistent. Sometimes this is done in a comprehensive and formal manner, for example, in a policy paper. But even where this has not been done, it is essential that those responsible for pension regulation and supervision obtain as much clarity as possible regarding policy objectives. This will help them to develop appropriate strategies and weigh the trade-offs that might be involved. It also facilitates rigorous monitoring and evaluation of the policies and approaches that are implemented.

Box 21.1

Key Outcomes for Private Pensions
(definitions taken from Price and others 2016)

**Efficiency:** Maximizing net-of-fee returns by improving investment and cost performance subject to acceptable risks. Efficiency also relates to the efficiency of the labour and capital markets, as each interacts with the pension system through direct contributions to pensions (through longer working lives and contributions, lower costs of capital, or greater financial inclusion) as well as through indirect contributions to...
jobs and investment. For labour markets, this includes removing disincentives for work or formal work caused by excessive contributions or contributing to growth by increasing labour market participation at older ages. For capital markets, it relates to capital market depth through the development of non-bank financial capital to fund productive investment and maximize the benefits of wider capital market reforms – for example, in securities markets and infrastructure financing.

**Sustainability:** Ensuring that the promised retirement income will be delivered for this and future generations without placing burdens on government, employers, or workers for financing that will not be met. Sustainability is inherently improved by a diversified set of pillars or tiers so that one part of the system, public or private, does not have to bear all the weight of long-run demographic trends. Sustainability also relates to political and individual support – with a technically viable reform having sustainability challenges if political consensus is weak, public expectations are not realistic, the system is not equitable, or intergenerational inequity is high.

**Coverage:** Maximizing the proportion of the working-age population that is accumulating retirement income entitlements and the proportion of retirees receiving such financial support in retirement. Coverage encompasses measures to include informal and other difficult-to-reach workers within retirement benefit accumulation. This includes building on innovations in ID and IT and having multiple channels into contributory pensions. It also includes a recognition that expanding targeted non-contributory “social” pensions will be necessary if full coverage of income in old-age is to be achieved – emphasizing there are limits to private pensions and hence the need to build diversified pension systems. The coverage outcome includes the impact of a wide range of policies, including broad eligibility rules, tax relief, educational support, and improved compliance and formality. This is a rapidly developing area in relation to the informal sector. Extensions to the OBA framework will be developed in the future – integrating insights from work developing coverage expansion strategies, pilots and implementation initiatives in a number of jurisdictions.

**Adequacy:** Ensuring people accumulate retirement benefit entitlements that protect them from poverty, allow them to share in increased prosperity, and that people are protected against a severe drop in living standards at retirement, taking account of other sources of financial support. In contributory systems, adequacy involves ensuring sufficient and equitable contributions during retirees’ working careers in order to generate adequate retirement benefits. It can be measured in a range of ways, which include retirement income as a percentage of average wages, poverty levels, and own (career) earnings. It also relates to outcomes immediately after retirement and, as people age, to reflect the impact of inflation on retirement income over time. And it is essential to see who has inadequate pensions – for example, to include the distribution by gender, income, and other characteristics.
Security: Ensuring the security of assets to minimize the risk that funds that have been (or should have been) accumulated to provide retirement benefits are lost or misappropriated before the benefits are delivered. The importance of long-run growth in assets is central to the promise of pensions. But this is of no use if the assets are not there in 50 years when they are needed to generate income. So, security covers a wide range of elements, including basic conditions, such as the enforceability of law; accounting, actuarial, and auditing capacity; data and payment systems; valuations and risk management; and control frameworks. It also covers the processes to ensure the recovery of any permitted shortfalls in assets (for example, in defined-benefit plans). Security relates to the performance of the supervisor as well as compensation mechanisms and protection of assets from government or employer expropriation.

Regulation, supervision, market structure and member protection programs play important roles in the achievement of policy objectives, in a variety of ways. As well as the core elements of regulation in terms of how pensions will be structured and who can provide them, there are a wide range of other interventions to consider, such as whether to provide guarantees of returns or outcomes rather than have a pure defined-benefit or defined-contribution system, and whether to provide incentives for pension participation and, if so, how – for example, through taxation or matching and whether to include limits on the incentives available for a given individual to avoid a pension system becoming regressive.

The OBA framework can be useful in considering what steps might be taken to strengthen the pension system and how various policy instruments, including regulation, supervision, market structure and member protection programs, might be applied in implementing such steps. It identifies key features, which help to drive the various outcomes. The key features were derived from a broad range of sources and were mapped against international principles, standards, and guidelines on pensions.

Many of the key features can be addressed, either in full or in part, through regulation, supervision, or member protection programs. But this cannot be done well without a clear understanding of the current situation in a particular jurisdiction.

UNDERSTAND THE CURRENT SITUATION

Private pensions are not only part of the wider pension system and hence social policy, but also intimately related to the macroeconomic environment, the capital and labour markets, and, through them, the long-run growth prospects for an economy. It is useful to identify those elements that are within the scope of a supervisor and those elements that are
important to outcomes but outside its scope. However, even where areas are outside their scope, supervisors might engage in an active dialogue with a Central Bank, Ministry of Finance, Ministry of Social Affairs, or Ministry of Labour through which to communicate the importance of broader reforms.

Understanding the economic and political environment of a jurisdiction and whether the preconditions for pension regulation and supervision – or reforms to the pension system more generally – exist is an essential element of developing reforms tailored to the needs of a jurisdiction (Holzmann and Hinz 2005; IEG 2006; Rocha and Rudolph 2008; Barr and Diamond 2009). These include economic factors such as the macroeconomic situation as well as the availability of legal, accounting, and actuarial professionals. These preconditions are always important areas to consider, because even if they have previously been met in a jurisdiction the situation can change.

One critical precondition for successful regulation and supervision is the development of a political consensus in support of it. Politics are always challenging, but successful regulators and supervisors need to be aware of the political situation and find ways to build the case for change.\(^3\) The variety of stakeholders involved in the pension sector, often including multiple government bodies, creates a high risk of confusion and conflict regarding objectives and responsibilities, which can compromise the effectiveness of regulation and supervision. The guidance provided by a policy for the pension sector that sets out clear objectives and responsibilities can significantly mitigate that risk.

Regulators and supervisors need to understand the overall framework for pensions in a jurisdiction. This includes the various pillars, such as social protection programs, employment-based social security pensions, private pensions, and other sources of retirement income that are available. How these pillars operate, their contributions to pension coverage and adequacy, and the sustainability of their costs are all relevant. The legal arrangements for pensions, including taxation and other regulatory requirements, set the parameters within which the market must operate.

There is a very wide range of options regarding exactly how a pension system can have its private assets collected, managed, and paid out. Market analysis should identify the entities involved at each stage of the value chain; for example, those playing key roles in promotion and access may not be the same as those doing the administration of accounts or managing the pay-out of the assets. How the different players are governed is important, particularly in the administration, fund management, and pay-out parts of the value chain. Finally, it is important to look at the programs, products and services that are currently available; how they are distributed; and the types of customers who are using them – as well as options for improving on all these elements. A high-level value chain is set out in Figure 21.1.

\(^3\) Action Planning Guide, Toronto Centre, October 2015.
The identification process should extend beyond the offerings of regulated financial institutions to include programs offered by others, which might include government agencies. The market structure and entities involved in private pensions will affect the demand and supply sides of the market and can have a significant impact on pension outcomes, particularly on costs and investment returns (Impavido, Lasagabaster, and García-Huitrón 2010), and can create regulatory challenges. For example, distribution mechanisms for obtaining contributions and converting them into invested assets can be very costly, and the use of sales agents might lead to excessive churning of pension investment portfolios. Regulatory and supervisory actions might be needed to deal with such market problems.

It can be useful to map out the market structure, to provide a visual overview of the programs and entities involved and how they relate to one another; see, for example, Figure 21.2 regarding the work-based pension system in India. It is not always easy to identify who is involved, but discussions with stakeholders such as known market participants, government institutions, and employers about who they deal with can help to provide a more complete picture. Then consider each entity from a functional standpoint and identify what roles it plays in the delivery of pensions. Also, seek to understand the objectives of the market participants and the ways the pension-related functions support their objectives.
The complexity of the pension sector can sometimes extend to the involvement of multiple institutions in regulation and supervision. Some might be financial supervisors, while others might be regulators or supervisors of non-financial activities. Still others might have development responsibilities—for example, for economic or agricultural development—or deal with taxation. Many of the steps discussed in relation to understanding the market apply similarly when dealing with diverse authorities. For example, it is useful to develop an understanding of the objectives of each authority, as well as both the entities and the functions that are within the scope of its responsibility.

**CREATING THE INSTITUTIONAL FRAMEWORK**

If regulation, supervision, and member protection are to be effective, they should take place within a clear, appropriate, and enabling framework. The regulatory perimeter should be clearly defined and an institutional framework established to carry out regulation and supervision. The institutions involved should have the mandates, powers, and resources needed to operate. They should also organize themselves to operate effectively and efficiently.

Government might broadly support the need to regulate and supervise private pensions to achieve its policy objectives. However, this does not necessarily mean that legislation will
clearly set out what parts of the pension system will be subject to regulation and supervision. For example, some pension programs might be operated by a government agency and exempted from supervision. Some financial products used to fund private pensions might be covered by another sector’s regulations, but neither clearly within or outside the scope of pension regulation.

The regulatory perimeter should be clearly defined. All aspects of the market should be considered, including pension programs, pension entities (such as pension plans, pension funds, and pension companies), service providers (such as investment managers, administrators, and advisors), the various products and services that they provide, and the activities that they undertake. In each case, it should be clear whether the matter is subject to regulation. If not, steps should be taken to clarify the regulatory perimeter. This might require consultation among various authorities, as well as with industry, and changes to legislation.

The institutional framework should include a pension regulatory authority, but often includes other institutions as well. For example, many of the entities that provide products and services to the private pension sector might already be regulated and supervised by authorities responsible for other parts of the financial system, such as insurance, banking, or securities. When more than one institution is involved, clarity is important with respect to who does what within the pension regulatory perimeter. The responsibilities of the various authorities with respect to pensions (and more generally, as well) should be delineated as clearly as possible and they should cooperate with one another in carrying out such responsibilities. Policy objectives and instruments should be appropriately matched to the institutions involved, and any regulatory and supervisory gaps and overlaps should be identified and dealt with. For example, it is not uncommon to find an insurance supervisor who thinks the pension supervisor is examining the pension business of insurers, while the pension supervisor assumes the insurance supervisor is doing so.

For example, the following delineation of responsibilities might be appropriate in many jurisdictions:

- **Government ministry**: policy and legislation regarding types of programs, eligibility or requirement to establish or participate in pension plans, and minimum and maximum standards for plan design and funding (benefits and contribution levels) to obtain favourable tax treatment.

- **Pension regulatory and supervisory authority**: regulation and supervision of pension plans and the entities that provide services to them, with respect to their activities in providing such services. Cooperate with primary supervisors of the entities with respect to regulatory requirements, licensing, ongoing supervision, and intervention.

- **Other regulatory and supervisory authorities (insurance, banking, and securities)**: regulation and supervision of the entities that provide financial services to pension plans, as primary supervisor of the entity. Cooperate with the pension authority with respect to regulatory requirements, licensing, ongoing supervision, and intervention, to facilitate that authority’s regulation and supervision of the activities of...
these entities in providing services to pension plans.

The institutional framework often evolves over time and can become quite complex. It will reflect the history, politics, and culture of the jurisdiction. If it is to be effective, it should also be appropriate to the level of economic development of the jurisdiction, the nature and scope of its financial system, and the financial and human resources available to carry out supervision. For example, if there are no publicly traded securities or private sector pension plans in a jurisdiction then it might well be inappropriate to establish separate institutions to regulate and supervise the securities and pensions sectors.4

Variations can occur in the scope of responsibilities assigned to the authorities. For example, authorities might be established that are specialized by sector (such as pensions, insurance, banking, and securities); integrated across sectors; specialized by type of supervision (such as macro-prudential, micro-prudential, market conduct, financial integrity, and competition policy); or specialized by function (such as regulation, supervision, or member protection). Variations can also occur in institutional form: government agency; central bank; autonomous agency; or self-regulatory organization. But there are probably relatively few jurisdictions that adopted any of these variations in a “pure” form. The approaches can be mixed to develop hybrid models that will best respond to the situation in a particular jurisdiction.

There is no dominant structural solution. A careful analysis of arrangements that worked well during the global financial crisis highlighted instead that regulators and supervisors needed to display both the ability and willingness to act. It was not enough to have sufficient powers, because many who had the powers did not act. So, in addition, the institutional culture needs to support effective supervision.5

Figure 21.3

Ability and Willingness to Act Drive Effective Regulation and Supervision

4 Organizational Alternatives for Supervisors, Michael Hafeman, Toronto Centre, January 2016.
Design of the overall institutional framework can be challenging, since each of the many alternatives presents the need to trade-off various advantages and disadvantages. The OECD has developed guidance on this subject, which includes several principles for design: maximize synergies; ensure consistency and coherence in the use of policy instruments; align incentives and minimize potential conflicts; promote accountability; and minimize risks for the taxpayer.

The institutions responsible for regulation and supervision should have clear mandates and responsibilities, with their objectives being set out in legislation. They need operational independence, along with adequate resources and powers, to pursue and achieve their objectives. These fundamental needs are highlighted in the IOPS Principles of Private Pension Supervision, which are set out in Box 21.2.

Several of the IOPS Principles are interrelated and can be particularly difficult for new supervisory authorities in developing markets to achieve. In developed markets, it is often possible for the authorities to obtain adequate resources by imposing fees and levies on the regulated entities. But in developing markets, the size of the pension sector might be insufficient to generate adequate resources without imposing unreasonable costs on the sector. To secure adequate resources, it might therefore be necessary to obtain funding from the government budget. However, this poses a risk to independence. The risk can be mitigated by strong governance mechanisms for the supervisory authority, which impose accountability while preserving independence.

**Box 21.2**

**IOPS Principles of Private Pension Supervision**

**Principle 1:** Objectives – National laws should assign clear and explicit objectives to pension supervisory authorities.

**Principle 2:** Independence – Pension supervisory authorities should have operational independence.

**Principle 3:** Adequate Resources – Pension supervisory authorities require adequate financial, human and other resources.

**Principle 4:** Adequate Powers – Pension supervisory authorities should be endowed with the necessary investigatory and enforcement powers to fulfil their functions and achieve their objectives.

**Principle 5:** Risk-Based Supervision – Pension supervisory authorities should adopt a risk-based approach. Note that this relates to risk-based structures and processes, not how individual risks are to be supervised, which is covered under other features.

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An institution involved in regulation and supervision should organize itself to operate effectively and efficiently. Key aspects of an organization are its structure, culture, business processes, strategy, and human resources. There are two main types of structures used by regulatory and supervisory authorities: functional and divisional. Functional structures are particularly common among institutions that focus on a single sector. For example, the structure might include three main departments: regulation, supervision, and administration. An advantage of a functional structure is that the staff within each department specialize in carrying out a particular function, which can enable them to become efficient at performing certain tasks. A disadvantage of such a structure is that communication is often upward and downward within the organization, which can compromise cooperation among the various departments.8

Divisional structures are organized into self-contained divisions, each of which carries out a full range of functions. For example, an integrated supervisory institution might include divisions such as: pensions, banking, insurance, capital markets, and non-bank financial institutions. Each division would carry out regulation, supervision, and administration functions related to its assigned financial sector. Organizations often develop structures that are hybrids of the functional and divisional models. They do so to try to capture the advantages of each while minimizing the disadvantages.

The organisational structure should seek to avoid internal conflicts that might compromise the independence or effectiveness of the organization in achieving its objectives. For example, regulation and supervision responsibilities might be separated from those related to the development of the pension sector. It should provide clear accountabilities for results, while at the same time including mechanisms to promote internal cooperation and avoid a “silos” mentality.

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8 Organisational Alternatives for Supervisors, Michael Hafeman, Toronto Centre, January 2016.
Regulatory and supervisory responsibilities require the application of a wide range of technical, professional, and managerial skills. Particularly in newer and smaller institutions in developing jurisdictions, some skills gaps might exist. For example, some specialized expertise, such as actuarial, might not exist at all within the organization, while types of expertise might be possessed by just one or a few people. Organizations should undertake a detailed assessment of skills needed – both currently and prospectively – as well as an inventory of skills available, and develop plans to deal with the gaps. This should help to ensure that recruitment and development of staff can be dealt with proactively. Many regulatory and supervisory authorities also make use of outside experts to help them obtain the necessary expertise.9

An institution will also need systems, procedures, and internal controls to facilitate its work. If regulation and supervision of pensions is being carried out by a well-established institution, these things will probably already be in place. If the institution is new, it might be able to leverage the work done by other institutions in the jurisdiction, by adapting their systems and procedures to meet its own needs. Much can also be learned from those in other jurisdictions, either by communicating with them directly or making use of outside experts.

If more than one institution is involved in the regulation and supervision of pensions, it is essential that they cooperate in carrying out their responsibilities. Legislation should permit them to do so and written agreements, such as memoranda of understanding, should be reached to document the way the cooperation will take place. Cooperation should occur at all levels, from the establishment of policy, to the development of regulation, to the implementation of supervision.

ESTABLISH SPECIFIC GOALS AND INDICATORS

Regulation and supervision exist to help achieve various policy objectives. But rather than just saying that “we want things to improve”, it is useful to establish specific goals and develop indicators that can be used to measure progress toward them. Doing so helps those carrying out regulation and supervision to develop strategies. It also enables both them and policy makers to assess the effectiveness of the strategies and their implementation. This contributes to accountability and should prompt a rethinking of strategies that are not having the desired effects. Ideally, goals should be established for each policy objective. But it is particularly important for an institution responsible for regulation and supervision that goals be established for the policy objectives that are most directly related to its mandate.

In practice, it can be easier to set specific goals after considering possible indicators of progress toward desired outcomes and the actual situation in the jurisdiction with respect

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to those indicators. The OBA framework provides a wide range of indicators for each of the five outcomes and identifies the data needed to calculate each indicator. For example, coverage indicators include the current number of contributors and pension recipients and their shares of the relevant segments of the workforce and population. Security indicators cover a wide variety of factors. They include the funding ratios of defined-benefit plans and others that provide guarantees, as well as the extent to which pension assets are held separately from other assets. Data on assets lost to insolvency, fraud, or theft are relevant, as are the potential losses that were avoided through coverage by compensation schemes. The existence of mortality data and the availability of projected improvements support the secure funding of pensions. The existence of large data gaps for any outcome sets a baseline for improvements.

While the full range of indicators could be considered, the focus should be on those most relevant to the pension system in the jurisdiction. Sources of the information needed to calculate these indicators should be identified. In some cases, the information is likely to be readily available. In other cases, it might not exist or might have to be obtained from a variety of sources, such as the government statistical bureau, other financial supervisors, or the labour ministry.

Where possible, historical information should be collected and the indicators calculated. It might be necessary to make estimates or assumptions to deal with shortcomings in the data. For some of the indicators, for example, those related to coverage, it is useful to prepare projections of the data to show how the indicators might be expected to evolve over time.

Goals for the improvement of key indicators should be established. The goals should take account of the historical information, projections (where relevant), and the policy objectives. Goals should be both challenging and realistic, with respect to both the levels of the indicators and the time frames within which they are to be achieved.

**IDENTIFY RISKS TO THE ACHIEVEMENT OF THE GOALS**

One of the most important uses of the OBA framework is as the starting point in the development of risk-based supervision for pensions. The risk-based supervision approach is enhanced by having a clear statement of the outcomes and goals that the supervisor wants to achieve. This enables the supervisor to focus on the risks to the achievement of the desired outcomes and goals. An updated approach to risk-based supervision, known as Outcomes and Risk-based Supervision or the ORBS methodology.  

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10 This section sets out the ORBS approach at a high level. A detailed Handbook has been developed — see Ashcroft, Hafeman and Price (2017).
Risks to the achievement of desired outcomes might include adverse events at various levels within the pension system, such as a program, a pension plan, a product, or a service provider. They might also occur outside the pension system, such as in the capital markets, the economy or because of the actions of Government. The OBA framework has identified key features that support the achievement of desired outcomes. Weaknesses in the key features indicate risks, so the key features can serve as a checklist for identifying risks. For example, each of the IOPS Principles is a key feature under the security outcome, so weaknesses in observance of these principles pose risks to achieving secure pensions.

The current situation can be considered with respect to each key feature and weaknesses identified. Consideration should be given to the level of the system at which each weakness is relevant. For example, would it pose a risk only to the members of a pension plan that suffers from the weakness, or might it affect the outcome for the entire pension system?

The weaknesses identified can be rated in terms of their inherent risks, in other words, the level of risk that they present before considering steps that have been or could be taken to mitigate the risk. Each inherent risk can be rated in terms of both the probability of its occurrence and the impact that it would have on the achievement of the outcomes or goals if it does occur. In some cases, data might be available to support quantification of the probability or impact. However, in most cases, qualitative assessments must be made based on knowledge of the situation and judgement. The results of the risk identification
and rating can be summarized in tabular form or as one or more two-dimensional risk maps. For example, one risk map might capture weaknesses that are relevant for the pension system while another might relate to those at the entity level.\textsuperscript{11}

Then existing mitigants of the risks should be identified. The residual risks, after taking mitigation into account, can also be rated in terms of probability and impact.

For example, consider a key feature for security: investments are sufficiently secure, liquid and diverse. A possible weakness is that pension fund managers might make poor investment selections, which could result in low rates of return and the loss of business to other pension fund managers. The probability of this being a system-wide risk to security was considered low in the jurisdiction, but its impact would be medium if it did occur. The risk is mitigated by investment regulations and disclosures of performance, which are considered to reduce the residual probability and impact to low.

Before developing strategies for dealing with the risks, it is useful to prioritize them. Priorities should be heavily influenced by the risk ratings, but other factors might also have to be considered in assessing the relative importance and urgency of dealing with the various risks. For example, an independent task force might be developing recommendations for changing certain aspects of the pension system, so it might be necessary to defer dealing with related risks until its recommendations have been received. Or there might be too many high- or medium-rated risks to deal with soon given the staff and other resources available. In addition, the interventions should be prioritized in relation to how well their benefits justify their costs.

**DEVELOP STRATEGIES FOR DEALING WITH THE RISKS**

The process for developing risk strategies is integral to risk-based supervision. It provides the bridge between the system-wide risk analysis and the specific supervisory actions taken. It enables priorities to be objectively analysed and set. Monitoring of the implementation of the chosen actions then completes the cycle.

Strategies should be identified for dealing with each of the risks. The identification might be carried out in a workshop, by management and key staff members. It might be supported by using a template, which could document information such as:

- A description of the risk;
- The inherent and residual risk ratings, with reasons;
- The scope for the institution to influence the situation, which when combined with the risk ratings led to the assignment of priority;

\textsuperscript{11} Outcome Based Assessments for Private Pensions: Methodology with a Case Study for Costa Rica, William Price, John Ashcroft, and Evan Inglis, World Bank, June 2016.
• The behaviours that need to be sustained or changed to maintain an acceptable risk rating or reduce the residual risk to a tolerable level;

• Options for sustaining or achieving these behavioural changes;

• An analysis of the expected cost-effectiveness of each option, to enable them to be prioritized; and

• An action plan template to identify the steps involved in implementing the prioritized options.

Various types of strategies might be employed, either alone or in combination with one another, to deal with each of the risks. It is useful to categorize the strategies, because there can be synergies among them. For example, if regulations need to be revised to deal with a high-priority risk then this might provide the opportunity to make revisions at the same time to deal with several other risks. Strategies might be categorized as follows, although some strategies will probably fall into more than one category:

• Regulation;

• Off-site analysis;

• On-site inspection;

• Communication;

• Supervisory intervention;

• Staff training;

• Data collection and IT; and

• Member protection initiatives.

The process should be integrated with the institution’s planning process. This will facilitate prioritization of the strategies, scheduling of the action plans, and monitoring of progress. The risk analysis, identification of strategies, and prioritization should be repeated periodically to keep them up to date as conditions change. Doing so enables staff to see that decisions are revisited in the light of experience and that there will be further opportunities to revisit assumptions and update the approaches to regulation and supervision.

**IMPLEMENT**

**REGULATORY STRATEGIES**

As noted above, regulation is the framework of rules, principles, and guidelines that set out expectations for the way the pension system will work. Regulatory strategies can be much more diverse than simply enacting laws or enforceable regulations, and sometimes a less formal approach can be more effective. Alternatives approaches that might be used to set expectations include:
• Primary legislation – although this is in the hands of lawmakers, institutions involved in regulation and supervision often provide the impetus for pension legislation and should provide considerable input;
• Regulations – legally enforceable, and often within the control of the institution or the ministry to which it is accountable;
• Guidelines – support operationalization of the primary legislation and regulations, and typically issued by the institution on its own authority;
• Communication with key stakeholder groups; and
• Communication with individual key stakeholders.

There are two main approaches to regulation: principles-based and rules-based. In the principles-based approach, regulation sets out objectives and general principles and industry participants determine how they will satisfy them. In the rules-based approach, regulation sets out detailed and uniform requirements. Each of these approaches has some key objectives, but also comes with potential disadvantages, as summarized in Table 21.1.

Table 21.1  
Approaches to Regulations

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<tr>
<th></th>
<th>Key Objectives</th>
<th>Potential Disadvantages</th>
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<tr>
<td><strong>Principles-based</strong></td>
<td>• Focus on outcomes</td>
<td>• Expectations can be unclear, so guidance is needed to operationalize the principles</td>
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<tr>
<td></td>
<td>• Respond to a wide range of business situations</td>
<td>• Legal uncertainty for industry</td>
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<td></td>
<td>• Promote dialogue on expectations</td>
<td>• Enforcement can be difficult</td>
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<td></td>
<td>• Provide flexibility for innovation</td>
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<td></td>
<td>• Suitable even in changing market conditions</td>
<td></td>
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<tr>
<td><strong>Rules-based</strong></td>
<td>• Provide clarity and certainty regarding expectations</td>
<td>• Focus on details and compliance, not the spirit of the requirements</td>
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<tr>
<td></td>
<td>• Provide transparency and fairness</td>
<td>• Can stifle innovation</td>
</tr>
<tr>
<td></td>
<td>• Support enforceability</td>
<td>• Difficult to write rules to deal with all situations, especially as innovation occurs</td>
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<td></td>
<td></td>
<td>• Compliance with the rules does not guarantee that objectives will be achieved</td>
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</tbody>
</table>
In practice, jurisdictions often use a blend of these “pure” approaches. Several factors might influence the approach used by a jurisdiction. One is the legal system, with civil code jurisdictions tending to be more rules-based than common law jurisdictions. This is sometimes erroneously thought to indicate that civil code countries cannot adopt risk-based supervision. They may have to be more specific in their regulatory requirements, but civil code jurisdictions such as Chile and Canada (in the province of Quebec) have successfully implemented risk-based supervision. Another is the culture regarding compliance in the jurisdiction, where a weak culture of compliance might require enforceable rules. Finally, if the industry is not well-developed then its interpretation of the principles might not be in line with good practices.

Regulations can cover deal with many aspects of a pension system, as indicated by the scope of the OECD Core Principles of Private Pension Regulation; see Box 21.3. Private pensions are typically also subject to other regulations, such as those dealing with taxation and employment standards.

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**Box 21.3**

**OECD Core Principles of Private Pension Regulation**

**Part I – General Principles**

- Core Principle 1. Conditions for effective regulation
- Core Principle 2. Establishment of pension plans, pension funds, and pension entities
- Core Principle 3. Governance
- Core Principle 4. Investment and risk management
- Core Principle 5. Plan design, pension benefits, disclosure, and redress
- Core Principle 6. Supervision

**Part II – Principles Specific to Occupational Plans**

- Core Principle 7. Occupational pension plan liabilities, funding rules, winding up, and insurance
- Core Principle 8. Access, vesting, and portability of occupational pension plans

**Part III – Principles Specific to Personal Pension Plans**

- Core Principle 9. Funding of personal pension plans, wind-up and insolvency
- Core Principle 10. Equal treatment, business conduct, competition and portability of personal pension plans

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When developing regulatory strategies and materials, considerable resource materials are available as references. They include the OECD Principles, OECD and IOPS papers, regulations of other jurisdictions, and case studies, such as those included in this book. Although there is much that can be learned from others, caution should be exercised to ensure that any regulation used as a model is carefully adapted to the local situation and needs. In any case, the process of implementing regulatory strategies should include consultation with key stakeholders, as highlighted by IOPS Principle 7 on cooperation and consultation.

**IMPLEMENT SUPERVISORY STRATEGIES**

As with regulation, there are two main approaches to supervision: risk-based and compliance-based. In the risk-based approach, the supervisor assesses the risks assumed by industry participants and how effectively they are managing the risks. In the compliance-based approach, the supervisor assesses compliance with regulatory requirements. Under either approach, the supervisor intervenes based on its assessments. Each of these approaches has some key objectives, but also comes with potential disadvantages, as summarized in Table 21.2.

**Table 21.2 Approaches to Supervision**

<table>
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<th>Key Objectives</th>
<th>Potential Disadvantages</th>
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<tbody>
<tr>
<td><strong>Risk-based</strong></td>
<td>• Identify risks and respond proactively</td>
<td>• Requires highly-skilled supervisory staff</td>
</tr>
<tr>
<td></td>
<td>• Focus resources on the most significant risks</td>
<td>• Enforcement can be difficult</td>
</tr>
<tr>
<td></td>
<td>• Promote good governance and effective risk management</td>
<td>• Customers of smaller entities might receive less protection</td>
</tr>
<tr>
<td><strong>Compliance-based</strong></td>
<td>• Supervisory assessment is straightforward</td>
<td>• Supervisory focus on the details, rather than the bigger picture</td>
</tr>
<tr>
<td></td>
<td>• Enforcement is facilitated</td>
<td>• Difficult to deal with significant risks, unless there has been non-compliance</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Difficult to form an overall view on an entity, group, or sector</td>
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In practice, jurisdictions often use a blend of these “pure” approaches. Several factors might influence the approach used by a jurisdiction. One is the level of supervisory experience and expertise, since effectively performing risk-based supervision requires a highly-skilled supervisory staff. Another is the level of industry development, because if the industry is not well-developed it might be less able to manage its risks effectively, but might nevertheless be expected to comply with regulatory requirements. The culture regarding compliance in the jurisdiction is important, because supervisory intervention under a risk-based approach is often based on judgements regarding the quality of risk management rather than objective evidence of non-compliance with legislation. Finally, the legal system can be a factor, although even civil code jurisdictions have successfully implemented risk-based supervision.

One critical misunderstanding to be avoided is that adopting risk-based supervision increases risk. In fact, the opposite is true – the risk-based approach directs scarce supervisory resources to the areas of greatest risk. In a compliance-based system, some important risks might be missed because they are in areas that are not currently subject to detailed checks. Sometimes, a risk-based approach operates in tandem with a principles-based approach to regulation, for example, allowing well-governed organizations greater flexibility in investment strategies. But even this does not necessarily mean more risk. Enabling those who can manage it effectively to take on more investment risk helps to mitigate the risk of lower pensions or higher required contributions, which can be consequences of the lower returns achievable with restrictive investment requirements.

The risk-based approach is prescribed by IOPS Principle 7, so many supervisors who do not currently use this approach are working toward implementing it. IOPS has developed a comprehensive Toolkit, which explains many aspects of risk-based supervision and provides numerous examples of the models used by various jurisdictions and the challenges they faced in implementing them.¹³

The implementation of risk-based supervision is not a quick or easy process. Typically, it takes at least two years — and often longer, depending on the starting point. Box 21.4 illustrates some of the key action steps that are typically required. It follows on from Figure 21.4, which set out the high-level steps of the Outcome and Risk-based Supervision approach, and takes these down to the next level in terms of how to implement entity-level supervision.

Outcome and Risk-based Supervision approach, and takes these down to the next level in terms of how to implement entity-level supervision.

Box 21.4
Illustrative Action Steps for Implementing Risk-based Supervision at an Entity Level

1. Decide which types of entities will be assessed.
2. Identify the significant activities performed and risk management functions used by each type of entity.
3. Determine the categories of inherent risks to be used and which ones are relevant for each significant activity.
4. Determine how inherent risks, quality of risk management, and net risk will be rated and how the relative importance of each significant activity will be reflected in the overall net risk rating.
5. Decide which types of financial assessment will be performed for each type of entity.
6. Determine how the composite risk rating will be assigned.
7. Develop a guide to intervention.
8. Document the risk-based supervision framework for communication with industry and other key stakeholders.
9. Review existing regulations, guidelines, and assessment tools and map them to the various cells in the entity risk matrix. Identify gaps.
10. Review existing supervisory activities and map them to the various cells in the entity risk matrix. Identify gaps and activities that might be discontinued or reduced.
11. Identify information needs and sources. Review existing information requirements imposed on supervised entities. Identify gaps.
12. Communicate with industry and other stakeholders about the risk-based supervision implementation project.
13. Identify skills needed by supervisors. Develop training and recruitment plans to deal with any gaps.
14. Develop and consult with industry on draft guidelines.
15. Develop tools and design supervisory processes for risk assessment.
16. Train some staff and perform pilot assessments of a few entities.
17. Modify assessment tools and supervisory processes, as necessary.
18. Finalize guidelines and communicate with industry about the assessment framework, in more detail.
19. Train (all) staff to perform assessments.
20. Begin performing assessments of all entities.
IMPLEMENT MARKET STRUCTURE AND MEMBER PROTECTION STRATEGIES

As highlighted in the introduction, traditional member protection strategies can and should be put in place in a pension market. But policymakers should be cautious about expecting too much in terms of their contribution to the long-run outcomes of a pension system. Instead, greater attention should be placed on the market structure of a pension system and what exactly will be delivered to the average member, particularly in a mandatory pension plan, who may have little interest in or understanding about pensions but needs one and has been mandated to have one.

It could be argued that some other financial products are compulsory—such as motor third-party liability insurance in many countries, so why are pensions so different? Compared to most compulsory products, pension products extend over a much longer period, pose a more complex combination of investment and other risks, and have much less sense of immediacy—unlike the need to purchase motor insurance before driving a car. But perhaps the most important difference is the benchmarking evidence on the performance of alternative pension delivery approaches. It shows that structures that make use of a single administrator, or an arms-length not-for-profit governance body determining a default investment strategy, often perform very strongly. This is not universally the case, so each jurisdiction should determine whether the potential market structure benefits seen in countries as varied as Sweden, Kosovo, Malaysia, and India can be replicated there. Wholly-private systems may be more appropriate if there are concerns about expertise, capacity, or political interference, as outlined in Chapter 17 on governance and investment. The key point is that if there is a robust market structure for getting people into pensions that are run effectively and in their long-term interest, then the traditional consumer protection toolkit may not be needed as much. Or in other words, good structural solutions are likely to deliver much more value added than the standard consumer protection toolkit.

That said, it is worthwhile to have in place a standard set of consumer protection features as a necessary but not sufficient part of the overall framework. These would include financial literacy and member awareness programs, information hotlines and websites, dispute resolution mechanisms, and safety-net schemes.

**Financial literacy and member awareness programs:** There is not a great deal of evidence for the benefits of trying to teach people to understand the difference between stock and bonds, and to be active choosers of their investment strategies. Many people do not feel comfortable with making such choices, even where support is provided. For example, over 99% of the members of NEST in the U.K. use the default fund. The figure for the default fund in Sweden’s defined contribution pillar is over 90% and these kinds of numbers would also be seen in many company-sponsored plans that provide a default. This is an entirely rational response from consumers, who (often rightly) assume that the selection
of the default fund will have received very significant attention and there will be a faithful attempt to ensure it provides a good option for the “average” member.

However, this is not to say that no financial education is worthwhile. Simple, well-run, campaigns that focus on critical decisions such as joining or not opting-out of a system, or of delaying retirement, can be very important. As Chapter 3 on the U.K. highlights, the levels of opt-out were far below expectations. One part of the explanation is the effective campaign around the concept of “I’m In” – using extensive advertising and communication – in simple terms and with high profile figures – around a single, simple decision or non-decision. Although less impactful in terms of total numbers, there is also evidence that such campaigns can be cost effective for other pension plans.\(^\text{14}\) The campaigns tend to be relatively inexpensive, so if they have even a small impact they can be cost effective. But they are not likely to be the tool that will achieve high levels of coverage or adequacy.

**Information hotlines and websites:** Although many members may never seek information, it is important to have easily-accessible information for those who do. Moreover, even members who are happy to take the line of least resistance during the accumulation phase are likely to seek information as they approach retirement. There will also be those who suffer from adverse life events, from disability to bereavement, who will need support at critical but infrequent stages.

Having a simple and easily usable website is a standard requirement for a modern pension plan. Being able to access human operators is also standard and important – but the costs need to be very closely monitored. As Chapter 18 on Costs shows, member service is an important element of overall performance, but it can be expensive. Many of the world’s leading pension plans spend quite a large amount on such services – but can do so because their vast scale means that this is still a very small percentage of assets under management and hence has only a small drag on net-of-fee returns. For smaller or newer pension plans, designing simple, low-cost and automatic pathways – as part of a strong, member-focussed governance – can help to keep costs low by reducing the need for members to make choices.

This is an area however, where information and communications technology innovations, including social media, are developing rapidly. As Chapter 9 on Mexico and Chapter 22 on Financial Inclusion show, there are a growing number of innovative ways to engage consumers that are eminently scalable and may bridge the gap between truly bespoke advice and interaction and generic information. This is an interesting area, which policy makers, governing bodies of pension plans, and supervisors should keep under review.

**Dispute resolution mechanisms:** Even if overall governance and expertise are very high and the whole pension value chain is well-run, there will always be a need for some form of dispute resolution. Mistakes happen, systems fail, and differences of opinion occur. Some jurisdictions require pension plans and service providers to establish mechanisms

\(^{14}\) Madrian (2014) Presentation at the World Bank’s 6th Global Pension and Saving Conference.
for resolving complaints, and to communicate their existence and relevant procedures to the members. Many jurisdictions provide regulatory redress mechanisms that come into play once a member has approached the relevant pension plan or service provider and given them a chance to make good on the situation.

**Safety-net schemes:** The inability of a pension plan to meet its financial obligations can impose significant hardship on members and beneficiaries. Some jurisdictions have created safety-net schemes (or pension guarantee funds) to help mitigate the potential losses to members and beneficiaries, for example, the Pension Benefit Guarantee Fund (PBGF) in the US and the Pension Protection Fund (PPF) in the U.K.. Safety-net schemes typically guarantee the benefits promised by a defined-benefit pension plan in the event of the bankruptcy of the sponsoring employer, if the assets in the pension fund are insufficient to meet the plan’s liabilities. The guarantees are generally subject to limitations, such as a cap on the amount of an individual’s monthly pension that will covered. Setting up, operating, and financing a safety-net scheme is not simple. Also, the existence of such a scheme creates potential moral hazard risk. For example, decision makers might adopt riskier investment strategies and weaker funding approaches if they know that the members have some protection in the event of failure. Strong regulation and supervision are needed to reduce the risk that the guarantees provided by a safety-net scheme will be needed – and to keep the safety-net scheme itself financially sustainable.

These are all important elements, but the aim should be to try to reduce the need for member protection mechanisms, as they inevitably add time and cost to a system. Prevention is better than a cure!

**CONCLUSIONS**

At the heart of any pension system should be the achievement of good outcomes that will benefit citizens of the jurisdiction in old age. The pension system needs to have broad coverage and be politically and financially sustainable, while delivering adequate pensions that help to alleviate poverty and to avoid steep drops in income as people retire. Ideally, this should all happen efficiently and securely, so that money contributed now will be well invested and reliably available when it is needed – often many years later. Good regulation and supervision are essential to achieving these goals. Regulation, in broad terms, can also help to create an effective market structure, since mass-market pension products with very high coverage are seldom, if ever, the result of organic market forces alone. This chapter has set out a high-level framework that helps to deal with the challenges – and emphasizes that a rigorous process – from identifying long-run outcomes to implementing entity-level supervision is the most important part of the story. There is no ideal, standardized solution that will work well in all jurisdictions. But it is possible to develop robust, jurisdiction-specific solutions, if attention and resources are devoted to analysing the jurisdiction- and entity-specific risks and opportunities and developing the most effective regulatory, supervisory, market structure and member protection approaches to tackling these risks.
FINANCIAL INCLUSION AND PENSION INCLUSION LESSONS LEARNED ON ACCESS, USAGE AND FINANCIAL CAPABILITY

SUSY CHESTON
CHESTON & ASSOCIATES,
SENIOR ADVISER PINBOX SOLUTIONS

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THE FINANCIALLY EXCLUDED AND THEIR PENSION NEEDS

The vast majority of the world’s people who work outside formal, salaried employment have no pension. They expect to survive in their old age by working, using their own savings and assets, or through support from their children. These sources will not always supply a decent standard of living, and many elderly will spend their last years in penury.

In the past few decades, through the financial inclusion movement, great progress has been made – and is continuing – to connect the financially excluded to modern financial systems. The financial inclusion and microfinance sectors focus on basic financial products: savings, credit, payments and, to some extent, insurance. They have found cost-effective ways to serve lower income populations, and in so doing, have created institutions, infrastructure, and applied technologies that could now be brought to bear to bring pension products to this vast segment.

To be accurate, in some countries non-contributory pension systems have existed for over 100 years, with governments going to extreme lengths to deliver payments across difficult terrains and geographies. But the issues are multiple. In many countries, the poor lack these government-provided pensions, which often supply only a small portion of those who need such pensions. Even fewer have the chance to pay in to contributory systems. And where coverage exists, the costs and difficulties of delivering the pensions and ensuring that they reach the right people can be very significant.

This chapter explores how the learning and innovation taking place in financial inclusion can address and potentially alleviate barriers to pension inclusion. It will review the characteristics of the financially excluded market segment in developing countries, discuss the specific challenges they pose for financial service providers generally and pension providers in particular, and point to promising solutions, using examples from financial inclusion and from innovators in behavioural economics and financial capability. Moreover, the insights from other chapters on how to deliver pensions with the market structure, governance and investment working in the interests of members can be combined to positive effect with the insights coming from financial inclusion. The authors are convinced that the relevant ingredients are available to enable great progress over the next few years, and because the well-being of so many people will depend on it, this situation has to be addressed with a sense of urgency.

The first half of this chapter provides a broad portrait of the financially excluded. Section 1A focuses on the central challenge: incomes that are informal, irregular, and small. It identifies some segments where financial exclusion is particularly deep. Section 1B briefly reviews the approaches of the financially excluded to their old age support, emphasizing that adequate support will almost certainly involve a portfolio of strategies. Part 2 of the chapter
turns to the challenges of providing pensions to the financially excluded (or newly/barely included). Section 2A looks at the practicalities of collecting small, irregular inbound pension contributions in light of new technologies such as mobile money that offer the promise of reducing collection costs. Section 2B examines the behavioural challenges of working with previously excluded people who know little about (and may trust less) formal financial services. Section 2C discusses the need for consumer protection, with reflections on how this issue is playing out in financial inclusion. A brief concluding note ends the chapter.

1A. PROFILE OF THE FINANCIALLY EXCLUDED

According to the Global Findex, the World Bank’s demand-side survey on financial inclusion, 2 billion people around the globe do not have a bank account, with the greatest numbers of unbanked in East and South Asia (including India, China, and the Pacific). Despite significant increases over the past several years, only 54% of adults in developing economies have a bank account, in great contrast to high-income economies, where bank account ownership is almost universal at 94%. While the number of bank accounts has grown in many developing countries, many of these accounts are not in active use, in contrast with the active usage patterns seen in high income countries. For example, in high income countries, most account holders (about 60%) make three or more withdrawals per month, but in low and middle income countries, fewer than 10% do so. Taken together, the estimates are that about 3 billion people are either unbanked or underbanked. (To oversimplify, the unbanked face an access gap while the underbanked face a usage gap.)

These are the people to whom the financial inclusion sector reaches out. Their characteristics pose specific challenges for traditional financial service providers, and these challenges are only magnified when considering pension products. However, expansion and innovation in services to these populations is occurring at a rapid, possibly even revolutionary, pace, providing greater access and addressing usage gaps with more relevant products, as we will discuss.

In seeking to understand the special challenges posed by this segment, the first characteristic to consider is income – its size, source, and irregularity. Most of the financially excluded work in the informal sector – as farmers, microenterprise proprietors, or day labourers – or they cycle in and out of formal employment. Their incomes range both above and below national poverty lines, with many, especially in rural areas, having very low incomes. The small size of their incomes means that they have only small surpluses to set aside for long term savings.

The incomes of the financially excluded are also irregular, volatile, and often seasonal. In Portfolios of the Poor, one of the cornerstone studies for financial inclusion, the authors note that the difficulty poor people face is not just with living on USD 2 or less per day, but that the USD 2 does not come in every day, appearing instead in varied amounts and at different times. This irregularity makes it difficult for informally-employed people to follow a scheme

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1 Sonja Kelly and Elisabeth Rhyne, “By the Numbers: Benchmarking Progress Toward Financial Inclusion” (Center for Financial Inclusion at Accion, June 2015), p. 19.
that requires regular payments. While many people are willing and able to make savings contributions for their later years, few will be able to sustain sufficient, regular contributions across multiple decades in order to yield a meaningful retirement income. Indeed, this is why a basic pension pillar that delivers a poverty-alleviating income floor in old-age is recommended. Nevertheless, for the financially excluded, contributions could become a significant element of old age security. We argue that a desirable pension system is one that mixes public and private provision, with contributory and non-contributory elements. Our focus in this chapter is on harnessing the contributory potential of the unbanked and underbanked population.

A related problem is that the sources of income for most people in this segment are informal. Without a link to a large institution, there is no ready way to capture and set aside a portion of the income as it is generated. While many of the pension-excluded may have formal employment at various times in their lives, they are likely to move in and out of formal employment, and they may migrate from one location to another.

Another salient characteristic of the financially excluded is their vulnerability to shocks. They are exposed to illness, theft, economic downturns, extreme weather, and more – and they tend to lack sufficient safety nets to recover. As a result, such shocks often force them to draw down any accumulated savings.

The financially excluded tend to have relatively low socio-economic status, as reflected in low scores on variables including literacy, education, access to technology (though this is changing), and connection to formal institutions of all kinds. Despite their lower status and because of their vulnerability, it has been thoroughly demonstrated that the people in these groups often have complex financial lives. However, most of their financial transactions are informal – involving friends, family, employers, and customers rather than formal financial institutions. As a result, many of the excluded lack familiarity with the concepts of formal financial products, such as insurance and pensions. In order to connect successfully with this client segment, providers must reach across these literacy and educational barriers and, if the product is to succeed, customers must develop trust in the provider and confidence in their own ability to use the product.

Within the broad range of the financially excluded, there are population segments where exclusion is more severe. According to the Findex, across the globe, women are 9% less likely than men to have an account; the gap is much larger in regions such as South Asia and the Middle East. And since women live longer on average than men, their challenges in managing their finances in old age can be more significant. More extreme exclusion is
also associated with low formal education, lower income, and rural locations. As one might expect, people with disabilities, refugees, and members of disadvantaged ethnic groups are more severely excluded. And social exclusion begets financial exclusion. Those who have no cultural or social support for using formal financial services are more excluded, in some cases because of self-exclusion. Those at the upper end of this spectrum, such as small business owners and urbanites with some education who are near the poverty line, also struggle to get access to the financial services they need.

At the same time, the need for pension support among the financially excluded is rising because lives are lengthening and traditional support mechanisms may be declining. Even the financially excluded are benefitting from advances in nutrition and health care: like their better-off counterparts, they are living longer. They are having fewer children, and their children more often move away, undermining traditional patterns of elder care. As a result, they may need old age support longer than they expect, while being less able to call on their children to provide it. Older people also have less access to financial services. Many lenders and insurers have age caps that exclude older people from formal credit and insurance. Age caps can be as low as 55, so a micro-entrepreneur may live for 20 or 30 more years after she no longer has access to credit.\(^5\)

The characteristics we have just reviewed have direct implications for the design of financial services and help explain the absence of pension coverage for most of the financially excluded. In sum, the picture we have drawn shows both daunting barriers to providing pension services and great need.

This picture is, however, a snapshot. Reality is more dynamic, and provides avenues for experimentation and progress. Excluded populations are rapidly gaining access to basic formal financial services. In the three years from 2011 to 2014, over 700 million people gained access to basic accounts, and since then, in India alone, 250 million new accounts have been opened in the past two years.\(^6\) These changes result from decades of learning about how to serve the poor, and they are now accelerating due to technologies that make it cost-effective for the first time ever to serve people in less accessible areas whose transactions are small. Microfinance has shown that low income people are reliable borrowers, and mobile money has shown that they are willing to use technology to carry out transactions. Research demonstrates that low income people are often skilful financial managers, maximizing the use of their scarce resources. And thanks to the increased availability of data on low-income people and how they manage their finances, providers are innovating in the design of new and sometimes hybrid products, creating a portfolio approach that both meets customer needs and also strengthens the business model for the provider.

\(^5\) See “Aging & Financial Inclusion” by the Center for Financial Inclusion at Accion and HelpAge International (February 2015).
\(^6\) Global Findex 2014. The Global Findex is the world’s most comprehensive database on financial inclusion, based on interviews with about 150,000 adults in over 140 countries, designed by the World Bank, collected in partnership with the Gallup World Poll, and funded by the Bill & Melinda Gates Foundation.
For example, the increase in savings is promising, as seen in Figure 22.1. According to the 2014 Global Findex, 54% of people in low and middle income economies saved money in the previous year, up from the 31% reported in the 2011 Findex. As the Center for Financial Inclusion’s ‘By the Numbers’ report notes, however, there is a gap between those who report saving at all and those who report saving in a financial institution – which is likely an indicator of informal saving through cash or assets such as livestock and property. (See also Chapter 11 on the Pacific Island Countries for evidence on the differential coverage of formal and informal saving.) Saving in financial institutions tends to be higher where there is greater trust in banks, a higher level of convenience, and low-fee savings products.

Figure 22.1

Saving Activity (Developing Economies)


According to the Global Findex, people who live in countries with higher savings rates are much more likely to save for old age. Despite continued informal savings, the increase in accounts also bodes well, as “Adults who have an account at a financial institution or a mobile money account are about 53%-64% more likely to save for old age than adults who lack an account.” Other factors correlate highly with saving for old age, such as having an outstanding mortgage or a job. According to the Global Findex, “In every region, employed adults are far more likely to save for old age than unemployed adults, with the only exception of South Asia.”

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7 Leora Klapper and Karina Broens Nielsen, “10 Insights on Financial Inclusion from the 2014 Global Findex,” (CGAP Blog, 6th May 2015). Klapper and Broens Nielsen report that “In developing economies, most people who save money don’t use an account to do so. In high-income OECD countries, about 70% of savers keep their savings at a bank or another financial institution, compared to about only 40% of savers in developing economies. A common alternative in developing economies is to save using a person outside the family or a semiformal savings club, including rotating savings and credit associations (ROSCAs).

8 Kelly and Rhyne, “By the Numbers,” p. 21.

On the strength of these insights, a financial sector infrastructure is being constructed in countries all over the world to enable the excluded to access and use financial services. Pension providers may well be able to ride on this infrastructure to begin offering pensions to those whose profiles previously put them beyond limits. But as highlighted in Chapter 18 on costs, and Chapter 17 on governance and investment, if the most is to be made of these new opportunities, it will be essential to match the new infrastructure with a clear understanding of what drives value in the interest of members and their retirement income.

1B. HOW THE FINANCIALLY EXCLUDED PLAN FOR THEIR OLD AGE TODAY

Around the world, people have unrealistic ideas about how they will manage their finances in old age. The 2014 Global Findex found that only about a quarter of adults save for old age. The rate is higher (above 35%) in high-income economies and East Asia, than in developing countries. Women are less likely to save than men.

The 2007 Invest India Income and Savings Survey (IIISS) by the pinBox founding team showed that 46% of Indians surveyed were not at all concerned about their ability to meet their financial needs when they grow old. Among workers not covered by a pension plan, fewer than one in fourteen were consciously saving for retirement, and the accumulated lifetime savings, in most cases, were inadequate, representing on average between one and one and a half times average annual earnings.

In “The Future of Retirement,” by HSBC, 39% of retired respondents in the U.K. said that they had not prepared adequately for a comfortable retirement, and “almost three-quarters (73%) of retirees have been unable to realise at least one of their hopes and aspirations since retiring.”

On average, health declines and physical limitations increase with age, yet most people expect to enter retirement in good health and retirement plans are often based on such rosy expectations. The subtitle of a report by Morneau Shepell focused on Canada says it all: “Forgotten decisions: The disconnect between the plan and reality of Canadians regarding health and finances in retirement.” Despite the expectation of good health by the survey respondents, 61% of them have one or more chronic health conditions. The result is under-planning for health costs and, therefore, over-spending of their savings.

According to the 2011 WHO report on Global Health and Aging, the number of disabled people in most developing countries seems certain to increase as the number of older

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people continues to rise.\(^\text{13}\) Likewise, the 2015 HSBC Future of Retirement report found that the majority of people surveyed in 17 countries and territories were unable to predict how much they will spend on healthcare in retirement. They worry about their mobility, their ability to care for themselves, and the impact of caring for family members who have health issues.\(^\text{14}\)

So what actually happens? How do people cover their expenses when they grow old? Data from Colombia reveals a major gap between what people expect and what actually happens. The World Bank and Government of Colombia carried out a nationally representative study in 2013 that asked people under 60 what they expected their income sources would be in old age, and asked people over 60 what their actual circumstances were. As seen in Figure 22.2, those under 60 expected that their top income sources in old age would be their own savings and assets and their work. Yet those over 60 found that government pensions and family and friends were by far their most important sources of income.

Figure 22.2

**Strategies to Cover Old-Age Expenses, Colombia (2013)**


Colombia is not the only country where people are not able to work as much in old age to cover their needs. Research undertaken in 2016 for the Center for Financial Inclusion at Accion in the Dominican Republic, Ecuador, and Peru unearthed a common refrain among micro-entrepreneurs: exhaustion, coupled with doubt about the possibility of ever taking a rest. A market vendor in Lima, Peru said “Since I’m already 57, I don’t want any harder [work].” And a bakery owner in Guayaquil, Ecuador said “I have so many plans, but I already feel tired.” After investing long hours over many years building their businesses, these entrepreneurs wanted to slow down. Many of the microenterprise clients interviewed for this study bought or built rental properties as an income strategy for old age. They built apartments above their own homes, or rented former homes and business sites. As Christy Stickney reports in *Emerging SMEs: Secrets to Growing from Micro to Small Enterprise,* “rental income has become the de-facto pension for much of this population.”

The study underlines two important points: first, that even the hardest-working, most motivated people do not want to continue at a gruelling pace forever, so their income from work will likely diminish; and, second, that most people will need multiple income sources to meet their needs in old age. This echoes a key point highlighted in the overview chapter, that the most effective pension system is one that is a diversified mix of public and private pillars, including family, work, housing, rental income and insurance. The family and other means will remain very much part of the overall mix.

**MEETING THE CHALLENGES OF PENSION PROVISION FOR THE FINANCIALLY LESS INCLUDED**

Pensions have distinct features that make it difficult for financial services providers simply to add them to an existing suite of product offerings. The time horizon over which contributions are made is very long, requiring a stable relationship with the pension provider over decades. To secure the future, contributions must be safeguarded over this long period. These considerations, together with the characteristics of the pension-excluded, give rise to questions that must be answered if pensions are to be developed for these segments.

The first question is whether the pension-excluded (or sub-segments of the excluded) have enough income to make saving for a pension worthwhile. If the amounts that can be set aside after immediate consumption are too small, the accumulated value in a pension fund will yield insignificant payouts in later years or be absorbed in administrative costs. Contributory pension inclusion may not be feasible for all of the currently excluded, and that is why a basic poverty alleviating floor – or ‘zero pillar’ in World Bank terminology – is advocated as part of the pension system. However, it is likely that a significant and growing portion of the financially excluded have sufficient income to be effectively served – and in any event, people who receive a basic zero pillar pension will still need additional

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sources of income to achieve a decent living standard. A more detailed discussion of this question would require actuarial, income, and transaction cost data that are beyond the scope of this chapter.

Nevertheless, it is clear that a stand-alone system devoted to the low income segment will have high management costs as a percentage of funds under management. Thus, a first conclusion about pensions for the poor is that fund management and oversight must involve pooling with other funds management, such as with the pensions of higher income savers. For more details on the most effective strategies in terms of the overall pension value chain see Chapter 18 on costs and Chapter 17 on governance and investments. With the need for a low cost/high governance outcome for fund management as a foundational premise, we can set aside fund management for the purpose of this chapter and turn to three questions:

**How can small and irregular pension contributions be captured?** Given the size of contributions by the poor, it must be inexpensive for providers to receive payments and convenient for contributors to make them. In the absence of employer-based aggregation, collection systems must work for individuals and very small businesses. The financial infrastructure has to be smart enough to harvest contributions to pensions at times when cash is on hand and to connect these smaller and often idiosyncratic contributions into a meaningful pot of money. Insights from financial inclusion may help in the design of cost-effective value chains that deliver quality and security at very low cost. Automatic or default-based contribution mechanisms may be essential, although finding such mechanisms that work for the poor is not easy.

**How can the willingness or discipline of the consumer to contribute be built and maintained?** Low-income people may be unfamiliar with pensions and unwilling to participate in a scheme unless they are fully comfortable with its dimensions, including the process of enrolling and contributing, the safety of their money, and the returns relative to competing uses. Financial capability interventions are needed to both inform prospective participants and turn new knowledge into behaviour.

**How can safety and consumer protection be ensured?** Trust is essential for convincing people to put their precious resources into a financial institution. Unfortunately, the pension-excluded are often subjected to frauds and scams. Therefore, consumer protections must be robust and easy to understand. Not only must funds be safeguarded, but also errors must be easily corrected and questions answered.

The remainder of this chapter considers how these three questions might be answered, drawing on lessons from the financial inclusion movement.

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16 Price (2014)
Sidebar 1
An Alternative to Pensions: Rental Income for Microentrepreneurs

Consuelo has been selling fruit in markets around Quito [Ecuador] for the past 36 years. Consuelo’s husband, Diego, provides transportation services, working as an independent truck owner and operator.... Now in their late-50s, Consuelo and Diego have raised four children, financed the construction of their home, and are preparing to build additional rental apartments to generate future income. Last year, Consuelo borrowed USD 13,000 to purchase land and build a fence around the property where they plan to build four new rental apartments. When asked about her future plans, Consuelo speaks of the new rental apartments she is preparing to build. She plans to work as long as she can, and eventually live from her rental income.

“Emerging SMEs: Secrets to growth from micro to small enterprise” by Christy Stickney, Center for Financial Inclusion at Accion, October 2016.

2A. THE CHALLENGE OF COST-EFFECTIVELY COLLECTING SMALL, IRREGULAR CONTRIBUTIONS

The costs of collecting individual, small, and often irregular inbound payments have until now prohibited the offer of pensions to lower income people operating in the informal sector. A benchmark for costs in pension delivery of, say, 0.5% of assets under management is very challenging when set against the need for many small contributions that are collected individually. If costs are much higher, they will absorb too much of the funds saved and it will not be worthwhile for people to contribute.

The cornerstone of many successful mainstream pension plans has been connection to large employers that provide a link to many contributors at once (scale), some administrative support (customer interface), and an inexpensive, automatic means of collecting payments. Large employers have the staff capacity, financial resources, and longevity to interface with a pension provider or even in some cases to provide pensions directly. Smaller employers do not have this capacity and should be considered much the same as individuals when thinking about pension engagement. But as the U.K. experience highlighted in Chapter 3 shows, employers may still be a useful channel to get their employees into the pension system even in cases where they have only a handful of employees – but only if the products and mechanisms are simple and require no oversight by the employer.

How can these essential functions be performed in the absence of major employers?

Connecting to large numbers of contributors at once. While low income people in developing countries have few institutional connections, they are not entirely devoid of such connections, and the financial inclusion movement is creating new ones every day.
As early as the 1980s, microfinance began to be built on the principle of organizing (mostly) women into savings and lending groups and either supporting the groups to manage their own funds or offering loans and savings at a group level. This aggregation saved costs for service providers while also building a culture of effective use of financial services. The experience of microfinance demonstrates that groups can effectively reduce the costs of serving customers with low incomes. It also demonstrates that low income people can maintain financial discipline if the amounts are appropriate and motivation is strong. Importantly, the network of microfinance institutions and savings group promoters operating around the world today maintains infrastructure and connections to hundreds of millions of customers: they provide the customer relationships on which pension provision could be built. As shown in Chapter 1 on India, the role of such institutions in enrolment, collections, and payouts can be valuable, while the investment, oversight, and governance of the assets is probably better left to larger, highly supervised, and long-lived institutions.

In addition to saving groups and microfinance institutions, lower income people link to: credit unions, agricultural cooperatives, distributors, commercial banks that offer accounts to low income people, government benefit and subsidy schemes, and mobile money services. Non-financial institutions may also be relevant, such as schools, churches, trade or merchant associations, and social clubs. Any of these organizations could provide a vehicle to connect with groups of lower income people for purposes of enrolment, and the financial institutions can also facilitate collection and payout of contributions.

Managing customer interfaces. One of the main challenges for working with such institutions is equipping their staff. The front line staff or agents who are in a position to encourage pension sign-up, such as microfinance loan officers and banking agents, often don’t understand the products themselves. This has been a finding for banking and insurance inclusion efforts: front-line staff are often ill-equipped to provide guidance on the services available. McKinsey & Co. reported in 2012 that it takes 10 to 15 minutes of in-person engagement with an agent for a customer to feel comfortable using mobile financial services. Agents must be trained to help people over such participation barriers, and the training and time required to effectively promote pension enrolment may be significantly greater than that needed to familiarize a person with an electronic account. One solution suggested by Dr Kavim Bhatnagar recognizes that buyers make the most effective sellers. When field agents are provided pensions for themselves, they are motivated to understand them for their own use, and that translates into more effective promotion of the products to others. Microfinance Opportunities, an NGO that develops techniques to build the capability of financial inclusion clients, creates flip books with simple scripts and pictures that enable banking agents to explain products clearly and consistently to customers.

Reducing and automating the cost of inbound contributions. The good news is that in the financial system at large, technology is dramatically reducing the cost of payments.

18 Author interview with Kavim Bhatnagar, 16th November 2016.
transactions and making it feasible to consider collecting small individual pension contributions that were previously out of bounds. Technology also offers ways to automate contributions, relieving customers of the need to remember to contribute regularly.

Agent banking is one such innovation. This refers to the use of small retail shops as outlets for banking transactions – which is spreading rapidly. The cost to providers of transactions that take place at agents’ locations, assisted by debit and credit cards and point of sale devices, is far lower than the cost of a bank teller transaction. More promising but not yet as widespread, online and mobile phone transactions cost even less. As seen in Figure 22.3, according to CGAP, the marginal cost to set up a low-overhead bank branch (such as a branch in a retail store) is about USD 60,000, far less than the cost of a traditional stand-alone branch. An ATM costs roughly USD 20,000 to set up, a banking agent with a point of sale device costs about USD 650, and setting up a mobile account costs nothing at all. Numbers like these are behind the sea change moving the banking sector to digitize payment transactions everywhere.

There are about as many mobile phones in operation around the world today as there are people, and they are increasingly available to adults of every income level. Many important financial transactions can be done on a basic or feature phone which does not require Internet access. Financial inclusion moves faster with the spread of these phones.

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Particularly in Africa, mobile money accounts are growing fast, and in five countries – Côte d’Ivoire, Somalia, Tanzania, Uganda, and Zimbabwe – more adults have a mobile money account than an account at a financial institution.20

In a few years, most of those accounts will operate through smart phones with internet access and an array of apps, which will allow more complex customer interfaces. Global smartphone penetration is expected to exceed half of the global population in 2017, according to Forrester, a technology and market research company, and every geographic region will see a significant rise by 2020 (see Figure 22.4). And prices are coming down, already reaching as low as USD 30 for some models, though not without substantial sacrifices in quality.

Figure 22.4
Projected Global Smartphone Adoption, 2020

![Projected Global Smartphone Adoption, 2020](image)

Source: Center for Financial Inclusion at Accion based on data from the GSMA Mobile Economy Series 2016.

Current payment systems are hybrids of digital and cash systems, and thus, although they are far cheaper and more available than traditional bank branch systems, the extremely low costs mobile money could ultimately produce are not yet available. Most systems rely today on banking or phone company agents to accept and disburse cash. With most mobile money and digital banking systems, lower income customers put value into the mobile “wallet” by handing cash to an agent. An example of such a system is the Saldazo bank account provided by Banamex, the Citibank affiliate in Mexico, in collaboration with Oxxo, a convenience store chain whose employees/franchisees serve as banking agents. The Saldazo account has become the most popular bank account in the country in a very short time.21 Customers deposit cash into the account at their local Oxxo stores and then use

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either a debit card or mobile phone to make purchases or send money. In such a system, each party—i.e., Banamex, Oxxo, and the phone company—charges a small fraction of the payment value. For more details on innovations in Mexico, see Chapter 9.

An agent-based system like Saldazo works for people who receive their income in cash, as most of the financially excluded do. However, the worldwide movement to shift away from cash and into digital income disbursement is on the move, opening the way for further cost reductions by eventually lessening the need for a relatively expensive agent network.

Governments are kick-starting the less-cash transition by making government-to-people (G2P) payments for social transfers, payroll, agricultural subsidies, government-subsidized loans, procurement, and unemployment benefits—and, of course, pensions—in digital form. The Better Than Cash Alliance, a U.N.-based project, works with governments around the world to assist them to migrate welfare payments from cash to digital.

Payments are provided on a prepaid card, into a bank account, or in a few cases into a mobile wallet. The customer can then use electronic means to pay for purchases without handling cash (although at present most recipients still choose to cash out their entire payment at once). While the emphasis on digital G2P focuses on outbound transactions, once established, the channel could flow inbound, too.

Other efforts to digitize transactions are often linked to large distributors of fast-moving consumer goods, agricultural marketing chains, or, especially in China, e-commerce. And in 2016 India’s “demonetization” made an enormous (though painful) push toward a less-cash society by declaring ordinary currency notes invalid, sending merchants of all sizes rushing to set themselves up to accept electronic payments. The array of cash-free payment services becoming available is dizzying—e-commerce, merchant payments, bill payments, cell phone re-charge, school fees, entertainment tickets and transportation. At least some of these services are already available to many lower income customers around the world.

As transactions become digital, they become more convenient and cheaper for customers, too. The spread of banking agents has brought banking services physically closer to customers, and eventually, when transactions are entirely phone-based, they will be available 24/7, wherever a person may be, reducing the customer’s transport and time-lost costs to nil.

This is important because low-income people have serious time and travel constraints. Digital channels provide more and more convenient customer service points, and if well

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21 Gabriela Zapata Alvarez and Martha Casanova, “How a Retail Chain Became Mexico’s No. 1 Bank Account Supplier” CGAP blog, 30th November 2016.
23 Klapper and Broens Nielsen, “10 Insights on Financial Inclusion from the 2014 Global Findex,” report that “Hundreds of millions of people could join the formal financial system if governments and businesses made payments into accounts instead of in cash. The Global Findex data point to several big opportunities to help the unbanked get access to financial services. Globally, shifting government wages and transfer payments from cash into accounts could increase the number of adults with an account by up to 160 million; doing the same for private-sector wages could increase the number by up to 280 million.”
designed, they involve customer interfaces that are very easy to use. User-friendly, friction-free phone features include fingerprint authentication, one-click payments, and set-it-and-forget-it features found in apps such as Uber and Lyft, which make the act of payment essentially disappear.24

The spread of digital payments is hastened by modernization of the domestic payments infrastructure.25 For example, digital IDs are essential to enable remote account opening, which commercial banks believe is key to unlocking the market at the base of the pyramid. (See Chapter 14 for more on Digital IDs.) And providers are increasingly exploring ways to serve the previously excluded, and in the process learning more about how to create cost-effective and customer-friendly channels, backed by efficient operations and scrupulous monitoring.26 The financial inclusion ecosystem features an increasing variety of partnerships among governments, retailers, banks and microfinance institutions, payment companies, insurance companies, financial technology companies, data analytics companies, financial capability providers, and more. The need to ensure that new customer segments yield a positive business case may make financial institutions more receptive to connecting with pension providers than ever before.

The key message here is that in the next few years many more people will have financial accounts and use digital payment systems, creating the conditions to enable digital or mobile collection of inbound pension contributions, by enabling scale at manageable cost. The story of financial inclusion in low income countries is a digital story, as developing countries leapfrog developed countries in innovative use of technologies, without the impediment of legacy systems and infrastructure.

Pension inclusion systems that work in developing countries will not simply be adaptations of designs originating in developed countries. Inbound pension contributions could ride on the new digital rails, if fee sharing can be negotiated for all parties. A pension provider could negotiate very low charges to piggy-back on channels primarily dedicated to other transaction types. How would this work? Any time money is coming in, there is potential for some of it to be set aside for pensions, particularly if the set-aside can be automated. Set-asides may even be possible for some occasions when money is going out.

To find the best entry point, the first line of investigation is to identify regular payments that previously excluded people receive or make. Some lower income people receive regular salaries from small businesses or domestic employment, and others receive government benefit or subsidy payments, as noted. The “Gift a Pension” (www.giftapension.org) initiative by Micro Pension Foundation and pinBox Solutions is an example from India that works with individuals who employ domestic help. Employers pay in to pension accounts for their employees as a regular part of salaries. Payments into social security accounts are already required in higher income countries, such as the

U.S., and Gift a Pension builds on their example, demonstrating that small employers, potentially including small businesses, can help collect pension contributions.

It has been shown that if motivated, low income people can make regular payments even if they do not receive income regularly. Millions of people pay weekly into savings groups or make regular loan repayments to microfinance institutions. Any of these transactions could be tapped as opportunities for small sums to be set aside as pension contributions. In fact, many microfinance customers already pay a small loan insurance premium with every repayment. The challenge for linking a pension contribution to loan repayments is that loans last typically no more than a year or two, so the decision to pay in to a pension would need to be re-affirmed or negotiated repeatedly. Given that many customers switch lenders frequently, a micro-lender might view its ability to offer a connection to a pension scheme as a means to build long term customer loyalty.

But many people have no regular payments of any kind, which increases the challenge significantly. Nevertheless, it may still be possible to connect with some forms of irregular payments. As an example that taps into the inter-generational aspect of pensions, remittance senders often wish to direct their contributions to be used in ways they approve of, and so may be willing for a portion of their contributions to be set aside in pensions for their relatives. Agricultural marketing boards that purchase crops at harvest could also be tapped to set aside a portion of their payments to small farmers.

Bank accounts and purchase transactions can also be tapped if the payment mechanism is simple enough. The Mexican government’s pension administrator allows pension payments to be made through 7-Eleven convenience stores and other outlets. Not only is such a system useful for informal sector workers, it is also potentially important for the many people who signed up with a pension scheme through formal employers but whose employment has ended. And there are round-up schemes in many places that round purchase amounts up to the next whole number and move the few cents difference into savings accounts. For people of moderate income, this could be a useful mechanism.

### 2B. THE CHALLENGE OF CONSUMER BEHAVIOUR

It will be highly challenging for low income people operating largely informally to maintain regular pension contributions over decades sufficient to amass useful amounts. Very creative design will be needed to connect products to life patterns, informed by a deep understanding of behavioural motivations.

In order for a pension scheme to successfully enrol people who have limited experience with formal financial services, it must convince them to participate, a challenge that will be more difficult because of the lack of a large employer to manage this process and provide motivation. Gaining customer acceptance entails the following challenges: providing knowledge about pensions and the particular scheme; overcoming the rational concerns people have about safety and returns; overcoming the intrinsic behavioural biases that

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27 Sonja Kelly, “Would you like a pension with that?” Center for Financial Inclusion blog, 27th May 2015.)
cause people to behave in less than rationally optimal ways; and providing a convenient transaction mechanism (as discussed above).

**Providing information to support enrolment.** Lack of knowledge is an important barrier for financial inclusion. The 2014 Standard & Poor’s Global Financial Literacy survey found that only 33% of the world’s adults were financially literate.\(^{28}\) Low financial literacy is an even greater barrier for pension coverage—even for higher income customers in developed countries. Analyses of financial knowledge compared with investor performance show that less knowledgeable people invest in assets that generate lower returns on retirement saving along with lower non-systematic risk.\(^{29}\) It is challenging to calculate an optimal savings rate, whether to join a savings plan, how much to contribute, and how to invest. Defined contributions plans put the burden on the consumer to calculate and invest wisely. Sendhil Mullainathan wrote in the New York Times about his paralysis when making investment decisions for his retirement; he was confused by the jargon and unable to judge whether he had made good decisions. What makes his ‘confession’ noteworthy is that Mullainathan is a professor of economics at Harvard University, and a recipient of a MacArthur Foundation ‘genius grant’.\(^{30}\)

If someone with Mullainathan’s credentials can’t sort it out, what does that mean for the rest of us, and especially low income people in developing countries?

Given the likely technology-based future of contributions, customers will also need to know how to use digital channels, making digital literacy essential. Digital literacy is a particular challenge for rural residents, women, and other groups with lower exposure to digital channels and access to mobile phones and banking agents due to cultural, mobility, and other barriers. GSMA’s 2013 study on women and mobile financial services reported on the many women who were aware of mobile money services but had never tried them. Those who had tried them tended to adopt them for regular use.\(^{31}\) An analysis of the 2014 Global Findex data by GSMA’s Connected Women program points out that “women in low- and middle-income countries are 36 % less likely than men to access and use mobile money, which translates to 1.9 billion women worldwide.” In some places the gender gap in mobile money ownership is much higher. In South Asia, for instance, women are 67% less likely than men to have a mobile money account.\(^{32}\)

One frequent response to these challenges is the offer of financial education to inform people about how they should behave to achieve their lifetime financial goals. Yet most

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traditional financial education and financial literacy programs are costly and ineffective. Bernartzi and Thaler reviewed attempts employers had made to educate their employees and supply tools to help them make better decisions about pensions. In one case, a large employer found that the average score on a financial literacy test changed from 54 out of 100 to 55 out of 100 after employees participated in a free financial education program. While we don’t know the cost of that program, surely it was too high to warrant a one-point improvement on the test. Even where financial education programs have increased knowledge, they often fail to change behaviour. Despite high costs, they have not successfully closed the gap between knowing and action. As Bernartzi and Thaler note, “Employees often leave educational seminars excited about saving more, but then fail to follow through.”

For people with little formal schooling and no supportive employer to encourage their attendance, traditional education is an even less effective means to prompt pension sign-up and subsequent regular contributions. This finding emphasizes the urgency to focus on making enrolment and contributions as automatic as possible, building them into daily routines, and related methods.

In marketing pensions for people new to financial services, information provision will be necessary and will probably require a more intensive effort than for mainstream pensions. We will discuss the ways to make this process more behaviourally savvy, but first need to address the very rational concerns about returns that may keep people from being enthusiastic about pensions.

**Addressing concerns about returns and meshing with existing financial lives.** The financially excluded have vibrant financial lives that take place beyond the borders of the formal financial system. In order for a pension product to be attractive, it must essentially out-perform the available informal alternatives. People in the informal sector want their scarce resources to work hard for them. They are often reluctant to save in financial form because they see money in a bank as passive, while money deployed to buy livestock, inventory, or even lent to a neighbour is actively working to meet needs and provide a return. While people do recognize their need for an old-age income strategy, they care that money set aside will at least maintain its value if not provide a good return. A history of high inflation instils a preference for in-kind saving and has undoubtedly contributed to the relative lack of interest in savings shown by low income Latin Americans. The Global Findex finds increased rates of savings for old age in countries that have deposit insurance, indicating “evidence in favour of institutional arrangements enabling greater trust in the financial system.”

Many people strive to acquire assets – notably real estate – that can provide income in old age. Building a rental flat on top of a person’s dwelling may appear to be a better bet for old age income than entrusting funds to a pension, and historically in some countries, building a flat was indeed a much better investment. However, in countries with stable inflation and deposit insurance, putting money into a long term pension can also be a

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34. Demirgüç-Kunt, Klapper and Panos, “Saving for Old Age,” p. 3.
good investment and viewed by consumers as part of a portfolio of income strategies for their later years.

Since low-income people are particularly vulnerable to shocks, they have a greater need for liquidity than higher-income people. Hybrid products that allow for some withdrawal in the event of an emergency can help alleviate that concern, as can access to health insurance. Financial inclusion offers examples of hybrid risk management products designed to take into account the needs of low-income customers, such as combining savings to pay for less expensive events such as outpatient care, with insurance to cover expensive events such as inpatient care. Some innovative examples of bundling products are shown in Chapter 19 on inclusive insurance. As the chapter highlights, there have been a number of carefully designed approaches—but they have often been unable to overcome profound difficulties in the ‘last mile’ aspects in relation to costs and the impact of sales agent delivery models. This is why the financial inclusion solutions to these issues are so important.

**From knowledge to behaviour.** Knowledge and a rational consideration of returns are not the only relevant barriers. Knowledge does not guarantee that behaviour will follow. There is often an enormous gap between what people know and what they do. Life circumstances and human nature get in the way.

The gap is evident, for example, when people sign up for financial services that they subsequently fail to use. According to the Global Findex, about 20% of adults in the developing world who have an account—and 40% in South Asia—have left it unused for at least a year.³⁵

Behavioural insights, as recently promoted by the field of behavioural economics, catalogue the biases to which we humans are inherently susceptible, such as inertia and avoidance. For example, in a U.K. study of enrolment in defined benefit pension plans, only half of eligible employees signed up—even when the plan was fully paid for by the employer and required no employee contribution.³⁶ Anxiety about aging, disability, and death can lead to wishful thinking, lack of action, and paralysis. Too often, social and cultural norms exacerbate these fears—or, at least, do not support saving for old age.

Behavioural economics have also demonstrated the tendency to place a greater value on the present than on the future—a phenomenon known as “temporal discounting.” The easiest course is to put off decisions that have a long time horizon. Low-income customers who manage pressing needs with scarce resources often hold liquidity to be a high priority in light of frequent emergencies, or they may prefer competing uses for money that provide greater near-term return, such as investment in a microenterprise.

Even when customers make a decision to enrol in a pension scheme, their intent to maintain contributions may be derailed due to forgetfulness, lack of a specific plan, small


hassles like paperwork that create a deterrent, or lack of self-control. The Center for Financial Inclusion at Accion uses the term financial capability to refer to interventions informed by behavioural economics that focus on behaviour change in addition to knowledge or skills. CFI’s 2016 report identified seven promising behaviourally informed practices (see sidebar). Chapter 3 on the U.K. experience shows the importance of re-enrolment on a regular basis. In the first wave of automatic enrolment only about 10% of workers opted out. Interestingly as these 10% are being re-enrolled, their opt-out rate is only around 5%. That is to say the first decision to opt out is almost never repeated.

Of the seven practices, nudges, reminders and defaults are of paramount importance for pensions. In standard pension schemes, behavioural obstacles to enrolment and subsequent contributions are overcome through the use of default options that are operative unless a person explicitly decides otherwise.

Defaults overcome inertia and minimize the hassles that prevent participation. Under automatic enrolment, employees are enrolled by default and can choose to opt out, which has been shown to increase uptake significantly above processes in which employees must opt in. In one US study of 401(k) plans, employees that were automatically enrolled in a retirement savings plan overwhelmingly accepted the plan, while employees without automatic enrolment typically took over a year to join. Conversely, when a new pension scheme was launched in Rajasthan, India in 2007, estimates by Invest India Micro Pension Services (IIMPS) showed that 80 million workers were capable of saving for retirement, yet in the absence of a default set for enrolment, barely 5% of them were doing so. Default options overcome barriers to both enrolment and contributions by making the process as automatic as possible. They reduce the anxiety that results from having an overwhelming set of options.

The efficacy of reminders and nudges has been shown for other financial products. In randomized field tests, Karlan et al. (2010) found that simple text message reminders to save increased savings account balances by 6%. Juntos is a financial technology company that contracts with financial service providers to send text reminders and nudges that are personalized based on customers’ reactions. Its platform enables automated two-way conversations with customers that are informed by behavioural insights, such as reducing friction for the customer, building customer trust and confidence, and rewarding desired behaviours such as increases in savings. For instance, Juntos sends messages complimenting customers for depositing money. In the first three months of Juntos’ first pilot in Colombia, active new accounts increased by 33%, and average account balances grew by 50% compared to a control group.

Default options are essential for the pension-excluded, but they are difficult to establish. Two examples show how this could become quite sophisticated, though both are now available only in the US. ‘Digit’ is a free, automatic savings tool that uses a sophisticated algorithm to analyse income and spending habits, and then, based on the analysis, makes regular transfers into a customer’s savings account. Similarly, ‘Even’ is an app that helps hourly workers transform irregular pay checks into steady salaries. After analysing their bank accounts, the app informs customers of the smoothed ‘Even pay’ (salary equivalent) they will receive from now on. When users out-earn their ‘Even’ salary, the company banks the surplus into a separate, Even-managed savings account (the ‘Even cushion’). It taps that account to top up the salary during low-earning periods.

Tencent’s WeChat in China provides an extraordinary example of seamless transactions that are enabled by linking a mobile app to a bank account or credit card. The social network has well over 800 million active users, and they “can use the app to manage a credit card statement, pay utility bills, hail a taxi, order a food delivery, buy movie tickets, send money to friends, get a banking statement, book a doctor appointment, find geotargeted coupons, and more.” This is on top of nonfinancial transactions such as playing games, tracking fitness data, meeting strangers nearby, or recognizing music. Having a single, integrated app for all of these functions opens up the potential for new ways not only to make payments into a pension account but also to develop new saving habits—in other words, combining a new infrastructure with behavioural practices.

However, defaults are not the only relevant behaviourally-informed strategy for overcoming biases, as the following examples show. An abundance of apps created by financial technology start-ups apply the behavioural practice ‘customize it’ to personal financial management tools that help improve financial decision-making. SmartyPig, for example, is an online and mobile-enabled tool designed to help users save for specific goals. The tool helps users create a goal and then automatically debits from a checking or savings account an amount determined by the user.

Simplified products decrease the cognitive burden and fatigue of decision-making, as well as the need for extensive financial education and marketing. Even simplifying the enrolment process can make a difference. Participation rates increase when employees are offered a chance to accept a pre-selected saving rate and asset allocation, rather than choosing from a range of options, and when an enrolment form is partially filled out in advance.

Another behavioural barrier that can be removed through use of technology is the embarrassment of not understanding a product. Customers can be too ashamed to ask questions of a bank representative face-to-face. Juntos has found that some customers

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are more willing to express their concerns or ask for information through an anonymous communication channel such as an SMS. Juntos has also found that small things, like being able to check an account balance on the phone – and actually practicing doing it – build customer confidence to try different types of transactions. Likewise, Fundación Capital in Colombia set out to encourage women in a conditional cash transfer program to receive their payments from an ATM. Women were provided tablets that addressed a range of financial capability needs, including simulating using an ATM so women could practice “using” the ATM at home rather than in a public setting where they might feel uncomfortable.

Sidebar 2
An Alternative to Pensions: Rental Income for Microentrepreneurs

The Center for Financial Inclusion at Accion identified seven behaviourally-informed practices that support positive customer behaviours, especially at critical decision-making moments, such as when signing up for and using financial products. In an interview in November 2016, Dr Kavim Bhatnagar provided examples of applications of each practice to pension inclusion in India.

Teachable moments. Reach customers when they are making financial decisions.
“Why do you want to withdraw the full amount when you don’t need all the money today?” That’s the question business correspondents (banking agents) in Madhya Pradesh were trained to ask workers when they came to withdraw their wages. The workers were paid USD 40 every 20 days for manual labour under a government program. The payment was credited into the workers’ bank accounts, but nearly everyone withdrew all USD 40 at once. The banking correspondents, trained in financial literacy, helped the workers think through how much they actually needed. The next question was “Do you think you will need money in your old age as well?” With these prompts, delivered at the teachable moment when they were able to take immediate action, many workers began to make payments of USD 2 or USD 5 per paycheck into a pension account.46

Learning by doing. Let consumers practice using products.
Invest India Micro Pension Services (IIMPS) found that staff who are training customers in pension literacy aren’t very effective when they don’t have pensions themselves. But once staff are given pensions and incentivized with contributions by their employers, they learn the ins and outs of the product and are motivated and equipped to sell it to others.

Nudges, reminders and defaults. Timely reminders and default options support good habits.
Sending reminders to customers to make payments helps build a healthy habit——

such as through text or audio messages. And matched savings can provide a powerful nudge to participate, as the Rajasthan government did by adding a matching contribution to the member’s saving up to a maximum of INR 1,000 per year per worker.47

Rules of Thumb (Heuristics). Mental shortcuts help turn learning into habit.
Rules of thumb have been used to show the power of compounding. The IIMPS Pension Calculator shows that your saving can grow 20-fold if you start when you are 20. Rules of thumb help break down pension contributions to a less daunting amount. IIMPS asked construction workers how many cups of tea they drank each day—the average was seven—and how many cigarettes they smoked—usually about half a pack. The workers were challenged to cut down by one cup of tea plus two cigarettes per day. The savings of 6 rupees per day resulted in about USD 30 per year—an amount that would make a good start on a pension.

Make it Fun. Games and humour aid learning and retention.
Accion India worked with IIMPS to make learning about pensions fun, through client education that incorporates movies, games, stories and magic shows. A video series introduces pensions along with other financial services, with each video building interest in the next. The key lessons are reinforced by peer educators through familiar games such as Monopoly, Tick-Tack, and Unseen and Foreseen. Accion India has also developed magic shows that deliver messages on savings, borrowing, financial planning, over-indebtedness, etc.

Customize It. Tailor advice to an individual’s specific financial situation.
The IIMPS “Pension Calculator” is a tool for customization, showing the impact of different contribution amounts in a way that is clear and easy to understand at a glance.

Make it Social. Leverage the influence of peers and culture.
Introducing the pension concept may not succeed on a one-to-one basis, but when 20 women answer in chorus and discuss their options, peer pressure kicks in, and a pension culture begins to form.

2C. BUILDING TRUST THROUGH CONSUMER PROTECTION

Goats, gold, real estate, and cash under the mattress may all seem safer to a financially excluded person than trusting hard-earned and scarce income with a financial institution. This may be in part due to lack of familiarity, but it is also exacerbated by recurrent scams in the market. A pension has advantages relative to, say, goats, if regulation and good design mean that it offers basic protections for consumers and can deliver fungible assets that have accumulated over decades. Healthy consumer protection depends on governments doing their part while also counting on providers to integrate consumer

47 Zarabi, “Rajasthan’s pension scheme for unorganised sector draws praise”
protection into their operations. In addition to ensuring fund safety through deposit insurance or other forms of guarantee, pensions should embody the seven Client Protection Principles promoted by the Smart Campaign and widely accepted throughout the microfinance sector. Six of the seven are readily applicable or adaptable for pensions (The principle on preventing over-indebtedness applies only to loans):

- **Appropriate products and delivery systems**, which encompasses sales techniques. Examples abound of mis-selling products that are not actually likely to benefit customers, especially when commissioned sales agents are used. This has been a particular issue for insurance, and pensions are vulnerable for some of the same reasons.48

- **Transparent pricing, terms and conditions.** Special efforts are needed to create products that are extremely simple and easy to understand, even if that may come at a cost to flexibility. Check-box agreement to terms and conditions is not acceptable. Providers must take care that customers understand what they are signing.

- **Fair pricing.** This principle may be difficult to assess without a market, but excessive fees are an example of a frequent problem. Care must be taken that a financial institution handling pension transactions charges a fair price. There are numerous examples of lenders charging excessive fees for credit insurance.

- **Fair and respectful treatment.** In addition to treating customers politely and humanely, this principle includes non-discrimination on the basis of gender, religion, age, etc.

- **Privacy of customer data.** Pension systems must handle customer information securely and avoid selling or providing it to third parties without consent (again, not just check-box consent). This is a rapidly changing area, as data is increasingly plentiful and valued as a commodity.

- **Mechanisms for resolving complaints.** Grievance systems are a fundamental tenet of consumer protection. It should always be easy for a customer to know how to resolve a problem.

These principles are relevant during all phases of pensions, but it is good to call out particularly the need for good practice during the distribution phase, as older people have been shown to be more susceptible to mistakes and abuse in financial services.

The Better Than Cash Alliance has created a similar set of principles for G2P payments, and GSMA has done the same for mobile money, in both cases working from the template set by the Smart Campaign. Likewise, the key features of good private pensions have been set out in ‘Outcome Based Assessments for Pensions: A Handbook’ and also in work by the Organisation for Economic Co-operation and Development (OECD) and International Organization of Pension Supervisors (IOPS). However, principles are insufficient. They should be backed by clear operational standards. The

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Smart Campaign has developed a certification program to recognize financial institutions that fully implement the Client Protection Principles, and this kind of certification is especially important in countries where consumer protection regulation is weak. A form of certification could make sense for pension providers as well.

**CONCLUSION**

**WHAT CAN BE DONE NOW?**

With technology changing rapidly to make it extremely easy for people to make digital payments and to reduce the cost of those payments, pension designers face a future that will enable access to large numbers of previously excluded people made possible through means such as inexpensive collection of inbound contributions. However, the full conditions for such systems are still under construction. Those conditions include ubiquitous smart phones with mobile money, a shift away from cash and agents and onto purely digital transactions, and the achievement of universal access to financial accounts. Given the fast pace of movement toward such a future, it would behove pension planners to begin building their systems in a way that anticipates such change, with a testing and learning approach to design. In addition to resolving the mechanics and governance of pension systems that can reach the pension-excluded, now is an important moment for learning more about how to build in features to attract customers, to be understandable to poorly educated people, to out-perform informal alternatives, and to overcome behavioural biases. Financial inclusion has so much momentum that it makes sense to plan based on a vision for a few years hence, with a view toward a quantum leap in what pensions can provide to the currently uncovered billions.

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DELIVERING THE REFORMS: THE CENTRAL ROLE FOR A MISSION OFFICE

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INTRODUCTION

This chapter looks at the experience of three countries in developing and delivering ground breaking pension reforms. Two of the countries, India and the U.K., have individual country chapters in this volume. Whereas, experience gained in New Zealand, the third country, was critical to the success of the U.K. reforms. As with the other chapters in this volume a key message is that reformers must think of a wider range of issues if they want to gain the maximum advantage in expanding pension coverage and financial inclusion. The focus on the Mission or Program Office is not an incidental part of successful reforms, in fact, it can be fundamental, and the approaches compared and contrasted below all have a common core that can greatly assist reformers to achieve the goals to which they aspire.

Around the world pension supervisory authorities, tax authorities, and other government agencies play an important role in facilitating the change from concepts, theories, and legislation to operational capabilities in the endeavour to reach the policy aims. Increasingly, these days, in order to realize the policy objectives, these authorities resort to complete the task in a Mission or Program mode with increased attention, energy, and resources for a defined time frame.¹

The appointed Mission Office plays a central role in turning policy in to success. As the name itself suggests, the Mission Office has a specific Mission that is to be achieved in a clear time frame. It is different from the traditional government offices in terms of the execution of the task assigned.

A Mission Office resembles a project organisational structure starting at the senior level with an Executive sponsor (Mission Head), through to team members. They all play key roles in the success of a project and, therefore, it is important their roles are well defined. However, the Mission is much more than a project. A Mission is undertaken as a national priority--there is an emotion attached to it. Thus, while the principles of project management are employed in the running of a Mission Office, the office provides the backbone for executing an important national task. These Mission Offices can look different, for instance, in New Zealand, with the introduction of KiwiSaver in 2007, it saw the Inland Revenue (Tax Authority) design and implemented a central administration model, which undertook processes, such as member enrolment, opt outs, payment transfer to schemes, to enforcement for non compliance. The U.K. has implemented a model under the overall program leadership from the Department of Work and Pensions (DWP) where the Pensions Regulator has more of a supervisory role, educating employers on what to do and enabling them via engagement with market suppliers, such as payroll software companies or scheme providers to undertaking compliance enforcement should employers choose not to comply. In India, in order to implement the largest

¹ In Outcomes Based Assessments for Pensions: A Handbook the authors for perhaps the first time integrate key implementation factors as part of the assessment framework. See Price, Ashcroft and Hafeman (2016).
Delivering the Reforms: The Central Role for a Mission Office

Financial Inclusion drive in the world, the Mission Office played a crucial role. It helped in integrating the efforts of banks and insurance companies in one place, guiding them towards implementation, aggregating their own Management Information Systems (MIS) to share the overall results with all stakeholders, and mitigating customer problems wherever banks and insurance companies were found wanting.

While in U.K. and New Zealand, the Mission Offices have successfully introduced pension reforms resulting in increased levels of retirement savings, in India the Mission Office was instrumental in bringing more than 120 million people into the formal banking system within a small time frame of less than five months.

The rest of this chapter is structured as follows: We first look at the setting up of the Mission Office including roles of the various teams followed by the expected outcomes from the Mission Office like data and results within the tightly defined timelines. Before concluding we summarise the overall challenges and risks.

**OWNERSHIP**

WHERE SHOULD THE MISSION OFFICE RESIDE?

The answer to which government department or organisation should take on this central role is not an easy one. In short, it depends on a number of factors that need to be considered when choosing the right department to take the lead such as:

**Reputation:** It is important to consider the existing reputation and ‘brand’ that the selected organisation has. If it is strong it will give external parties confidence and the design and deployment will be well considered and undertaken. Questions to consider while assessing organisations are for example:

- Does the organisation have a reputation for delivering ‘big’ projects?
- What are the internal capabilities, from staff to systems?
- Do they have the capacity to take on additional responsibilities, or are they stretched already?
- Do they have a good relationship with government, ministers, and stakeholders?

**Existing remit:** It is also important to consider the existing remit of each organisation. If the customer base is similar to the new customer base, then a level of relationship will easily be formed. There will also be other benefits, such as existing customer data/information (contact details) for engagement. Questions to consider while assessing the division of responsibilities are for example:

- Who is their ‘sponsoring’ minister-- Minister of Finance (FM)? Minister of Business Development?
• What is the engagement base at present, does it match the new one?
• What data do they hold?
• What would have to be obtained, and from where?
• Does it align to the organisation’s main objectives?

Finally, the key decision on the ownership of the Mission Office rests on the strategic objectives that are to be achieved. These need to be in tune with the reputation as well as remit of the organisation that will own the Mission Office.

It is important that the right organisation is selected to undertake the Mission Office. The closer this organisation is to the customer base, stakeholders, and government, the easier it will be to build confidence and participation in delivering the reforms.

In New Zealand, for instance, Inland Revenue already interacted with employers, individuals, payroll software companies, accountants, and other stakeholders. The FM was the overall sponsor for ensuring that KiwiSaver reforms would progress and be funded to do so. Inland Revenue has a high reputation for delivering major projects successfully, such as child maintenance, student loans, therefore the government and stakeholders were confident with Inland Revenue’s ability to deliver. Similarly in India, the responsibilities were given to the Ministry of Finance, as they had been the champions of an earlier financial inclusion programme.

MISSION OFFICE SETUP

The degree of the setup phase will depend on whether the mission Office is a new start up organisation or if it is to be integrated within an existing one. The task, however, will still be complex and challenging, some of the main areas in the setup phase that will need to be undertaken are:

• Programme/Project setup
• Organisational structure and role definition
• Recruitment
• Infrastructure setup
• Governance model

PROGRAMME/PROJECT SETUP

The initial phase will be the establishment of a project. PRINCE2, which is the de facto project management methodology in use in the U.K. government and other countries, defines a project as:

\[ A \text{ temporary organisation that is created for the purpose of delivering one or more business products according to an agreed business case. } \]
It further identifies common reasons for the project to fail:

- Lack of clear business case
- Lack of ownership at the executive
- Lack of support from the top of the organisation
- Results to be produced not defined sufficiently or unequivocally
- Lack of acceptance criteria and quality criteria
- Lack of clarity of roles, responsibilities and authority
- Lack of structure and specific checkpoints
- Change of specification or lack of a working change control
- Lack of commitment from the users from the start of the project

**BUSINESS CASE**

Having a well defined business case is important from the outset. A business case will typically cover:

- Reasons – why the project is necessary and how it will contribute to the corporate/programme strategies and objectives.
- Business options – in terms of ‘what are we going to deliver’ not the how. Generally business options are compared to the ‘do nothing’ or zero option.
- Expected benefits – benefits should, where ever possible, be identified for both financial and non-financial, and the benefits should be linked to the overall project objectives and results expected to be delivered.
- Expected disbenefits – the disbenefits also need to be specified. So this maybe something that will be disadvantaged or lost as a result of the option taken.
- Time scales – this will cover the time the investment will be made for and the time in which benefits will be achieved.
- Costs – the costs of producing the deliverables.
- Investment appraisal – assessment of the development cost versus the maintenance and usage costs during the lifespan of the project. It will identify a break even or payback period.
- Major Risks – identify what the most important risks are.

In India, for the financial inclusion drive in August 2014, the business case was well encapsulated by the Mission Office team in the form of a Mission document that would act as a guiding star in times to come. The Mission document clearly outlined: why the financial inclusion drive was necessary; how it was different from the previous efforts made in this direction; what will be the key strategic drivers to achieve the objectives; the risks involved; and the expectations from the different players.

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2 Project management based on PRINCE2 2009 edition
3 https://www.pmjay.gov.in/files/E-Documents/PMUDY_BROCHURE_ENG.pdf
MISSION OFFICE ROLES AND RESPONSIBILITIES

Typical roles of a Mission Team include:

1. **Mission Head** – this role will be given to a senior member of the organisation with a relevant area of responsibility that the change will affect. He or she will be the project ‘champion’ and will commission others to deliver the required stages. It is important the person is involved from the start and play an important role in defining the project. This person will play a leading role in navigating the project through tricky diplomatic areas.

   Some of his or her key responsibilities are:
   - The delivery of planned benefits associated with the project.
   - Ensures resolution of issues escalated by the project manager or the project board.
   - Sponsors the communications programme; communicates the programme’s goals for the organization as a whole.
   - Makes key organisation/commercial decisions for the project.
   - Assures availability of essential project resources.
   - Approves the budget and decides tolerances, on areas such as budget, timeframes, scope, and risk
   - Leads the project board.
   - Has ultimate authority and responsibility for the project.
   - Provides clear direction for the project and how it links with the organisation’s overall strategy
   - Ensures the project is on time, on budget and on scope

2. **Project Board** – The broad remit of the project board is to support the executive sponsor in providing overall direction and management for the project and to make key decisions including commitment of resources. The board will generally include management grade personnel. It will have board members that can represent the interests of users, both internal and external, as well as suppliers to ensure resources are available, as well as to challenge feasibility of plans and ideas.

   Some of their key responsibilities are:
   - Championing the project and raising awareness at senior level.
   - Approving strategies, implementation plans, project scope, and milestones.
   - Resolving strategic and policy issues.
   - Driving and managing change through the organisation.
   - Prioritising project goals with other ongoing projects.
   - Communicating with other key organisational representatives.
   - Holding the project accountable to its projected scope and time.

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4 Project management based on PRINCE2 2009 edition
In India, the project board was called the Steering Committee and besides the FM who was the Mission Head, it had members of the Central Bank and other stakeholders who were crucial for the delivery of the project.

3. **Mission Director** – The Mission Director’s role is the overall responsibility for the successful planning, execution, monitoring, control, and closure of a project.

This person is responsible for developing, in conjunction with the Mission Head, a clear definition and deliverables of the Mission. They will then ensure that the Mission is accomplished on time, to budget and to the required quality standard (within agreed specifications). The Mission Director is also responsible for managing the work of consultants, allocating, and utilising resources in an efficient manner and maintaining a co-operative, motivated, and successful team.

Some of their key responsibilities are:

- Managing and leading the Mission team.
- Recruiting Mission Office staff and consultants.
- Managing co-ordination of the partners and working groups engaged in Mission work.
- Detailed planning and control including: project plans, managing deliverables, risks and issue management. Resolving cross-functional issues at project level.
- Managing project scope and reordering control and escalating issues where necessary.
- Monitoring project progress and performance.
- Providing status reports to the project sponsor.
- Managing project training within the defined budget.
- Liases with, and updates progress to, project board/senior management.
- Managing project evaluation and dissemination activities.
- Managing consultancy input within the defined budget.
- Final approval of the design specification.
- Working closely with users to ensure the project meets business needs.
- Definition and management of the User Acceptance Testing programme.
- Identifying user-training needs and devising and managing user-training programmes.

**MISSION OFFICE TEAMS**

Depending on the scale of the project, the project will usually be made up of a number of teams consisting of a range of skills and capabilities. These teams will have a mixture of consultants, contractors, business representative, business analysts, IT developers, system testers, and media/communications experts.
The Pensions Regulator was accountable for the design and implementation of the new automatic enrolment workplace pension reforms, Figure 23.1 is an illustration of the various business areas and teams set up to undertake this task. Chapter 3 on the overall reforms provides additional information on the overall pension reform agenda in the U.K. and the roles of some of the other key players, such as the (DWP. In this chapter the focus is on the lead implementation agency which was the Pension Regulator.

Starting with business support, a wide range of business teams were required to provide support and input to the design. Ultimately, these business teams would have a variety of ongoing responsibilities they would have to implement.

For instance: the finance team to assist with business case financial analysis and bids; human resources to assist with defining roles and recruitment; and IT, not only involved in systems design, but also required to provide tools and access to systems.

The regulator then formed a programme of work establishing a number of project teams. The creation of these teams required drawing on a variety of resources across the regulator’s business. The teams formed within the programme were:

Figure 23.1
**Overall Business and Systems Architecture**

<table>
<thead>
<tr>
<th>STRATEGY AND GOVERNANCE</th>
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<tbody>
<tr>
<td>Business Support</td>
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<td>Finance</td>
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<td>Policy</td>
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<td>Service Design</td>
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<td>Communications</td>
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<td>Human Resource</td>
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<td>IT</td>
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<td>Procurement Contract</td>
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<td>Services</td>
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<td>Customer Services</td>
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<td>Compliance &amp; Enforcement</td>
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<td>Service design and</td>
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<td>integration</td>
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<td>Campaign services</td>
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<td>Communication services</td>
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<td>research services</td>
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<td>Analytics services</td>
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<td>Risk evaluation services</td>
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<td>Data management services</td>
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<tr>
<td>Service design and</td>
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<tr>
<td>integration</td>
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</table>

**DESIGN TEAM**

The design team will work through a series of stages starting with a comprehensive design that will set out the overall business and systems architecture (see Figure 23.2. They
will then move to the next phase of defining in more detail the requirements at systems, policy and procedural, and organisational structural level. Once resources and funding are secured they will then move on to the development and testing phase. For the IT team this could be done through the use of off the shelf software solutions or more bespoke solutions depending on the organisation’s existing systems. The final stage will then see the implementation, which will start with areas such as staff recruitment and training, and commencement of communications campaigns through the deployment of the systems and procedures.

**Figure 23.2**

**End to End Design Phases**

- **High level Design**
  - Setting out business and systems architecture
  - A high level design document will usually include a high level architecture diagram depicting the components, interfaces and networks that need to be further specified or developed. The document may also depict or otherwise refer to work flows and data flows.

- **Detailed Design**
  - During the detailed design stage various design elements of the final solution are defined and documented which will enable the solution to be built, tested, delivered and run as BAU.
  - Here the high level architecture will be defined in more details to assist developers and other team members have a clear understanding requirements.

- **Develop and Test**
  - Build the IT solutions required to support the business requirements
  - Document procedures and policies to support staff
  - Design the communication campaigns

- **Implement**
  - Develop deployment plan covering areas such as recruitment, campaigns, training, IT systems, policies and procedures

**REFLECTIONS ON SETTING UP A MISSION OFFICE**

According to one of the participants in the Indian experience, “The choice of the Mission office coordinator which was so critical was left to me. In fact, the designation of the Mission office coordinator came much later. Initially it was just the Control room in charge. The person whom we chose was Mr LPR to head the control room which was meant to coordinate various activities required for the inauguration function by the Hon’ble Prime Minister.

LPR was a retired officer of the country’s largest bank-State Bank of India. However his youthful looks defied those of somebody close to retirement. He had a good understanding of the Financial Inclusion Eco-system in the country, was energetic and
had fire in the belly to contribute. Luckily for us, he was a good leader too and was articulate enough to convey his point of view in an alien territory. I just rang up LPR and asked him to come over to head the control room initially. Since, there was hardly any time, I had kept my seniors informed, and we had decided that approvals from the Mission Head as well as the necessary paper work could be taken up later, after the Mission gets formally launched by the Prime Minister.

Banks and insurance companies slowly sent us the rest of the team members. I made it a point to interview each one of them, despite the constraints of time, knowing fully well that these team members were going to be the backbone of the Mission office structure that we had in mind. The interview was also to gauge their willingness to work on something so big. Some of them agreed to work only till the launch of Pradhan Mantri Jan Dhan Yojana (PMJDY). That was fine with us. We did not want unwilling team members because we thought that we needed tremendous energy to carry forward the task at hand. Most of the team members were however, a fine blend of energy and expertise to take on the challenge. We formed two teams - the first used to work from 8 in the morning till about 4 in the evening, the second team used to arrive by 2 pm and work till 10 pm. For about a month in the Mission office, we just forgot about Saturdays and Sundays. We of course, took care to substitute one for the other if someone reported sick or had a family emergency. Otherwise, it was all work for us. Data collection from the banks and coordination with the 676 districts in the country was our prime job. The Prime Minister had asked all his colleagues including Ministers and Members of Parliament (MPs) to reach out to people in the 676 districts and get their bank accounts opened. So the Mission office, in its initial days, used to get a number of requests asking for data in the respective constituencies of the MPs. It was only after three months that we could design a portal where everyone could view the data district wise. ”

In India, the Prime Minister reached out to all bankers by email soliciting their support in ensuring the success of the Mission (Modi, 2014).

INDIRECT COMMUNICATION

National and regional indirect communications campaigns are essential to ensure a wider coverage of citizens. These are in the form of advertising through TV, radio, bulletin boards, newspaper, web, and social media.

The U.K. used extensive messaging to gain high levels of awareness of the reforms. It is important that campaigns are simple, clear, and targeted at the right level for the audience. In the U.K. the first employers to undertake the new duties were large employers
so campaigns were designed using high profile large business entrepreneurs. They popularized the message that said, ‘I’m in’ – this acknowledged they will be undertaking the duties and will be ‘in’ the new pension system. The campaign then changed as the duties rolled out to small and micro employers, changing to introducing employers, such as nannies and motor mechanics.

New Zealand smartly used the term KiwiSaver, which resonates very well for citizens as they are proud of the Kiwi brand. They also ran a campaign across a wide range of channels from radio, television to direct mailing, developing a strong logo brand.

In India too, the Financial Inclusion Mission, needed to reach out to the most deprived sections of society. Hence, communicating with the security guards, maids, drivers, vegetable vendors, and many others in a language that they could understand became very important. Since there are 22 recognized languages in India, all communications in the media were translated into regional languages to reach the target audience.

An important factor to be kept in mind is the cost benefit analysis. While mainstream media in the Television and print is often needed to ensure that there is a sufficient degree of awareness, it is often very costly. In the Indian context, the Financial Inclusion Mission

Figure 23.3
U.K. Marketing Campaigns, source the pensions regulator

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An important factor to be kept in mind is the cost benefit analysis. While mainstream media in the Television and print is often needed to ensure that there is a sufficient degree of awareness, it is often very costly. In the Indian context, the Financial Inclusion Mission
had to reach out to the masses, particularly in the villages. While the Prime Minister's appeal, made a lot of difference, local level politicians too played a very constructive role in reaching out. Besides these, wall paintings, street plays, advertising in the inter-state buses, and such other initiatives at the local level, ensured that the message reached the people at affordable costs.

Marketing campaigns are usually conducted by specialized agencies and, therefore, the selection of the agency becomes very important. The agency to be selected should not only have experience in the specific field but they should also be willing to commit resources considering the timelines of the Mission.

Figure 23.4
India New Account advertising Flyer

INR 1 Lakh is INR 100,000 or USD (1,500).
REFLECTIONS ON MARKETING AND LAST MINUTE ADJUSTMENTS

According to one of the participants in the Indian experience, “The entire marketing campaign needed to use the name, logo and tagline of the Mission. However, although the campaign was to start on the 25th of August, the logo and tagline was yet to be decided with just ten days to go. This was because a decision was taken that the name, logo and tagline was to be selected by crowd sourcing. A competition was launched across the country for a period of two weeks with prizes to be won. The designs were to be submitted on a portal.

The strategy behind this decision was not only to involve the people in the design but also to create the pre marketing buzz around the soon to be launched Mission. The competition evoked great response. We received more than 6,500 entries from across the country. There was a high level committee which had to make about 10 recommendations for the final selection. We decided to first shortlist about 500 entries from the 6,500 received based on pre-announced parameters. This itself was a task. Besides the Mission office team of 20 members, we involved additional 30 officers from 6 pm to 12 midnight to complete the shortlisting. Next day the high powered Committee recommended the 10 designs to the Prime Minister’s office and within the next few days we were able to finalise the name, logo and tagline.

Once this was done, it had to be communicated to rest of the country for the printing of banners and posters for the launch. Fortunately for us, technology helped and while the Mission office uploaded the heavy design files, they could be downloaded flawlessly even in the remotest corners of the country. On the day of the launch of the scheme, the Prime Minister himself gave away awards to the winners of the design contest”.

CUSTOMER SUPPORT

Often organisations fail to recognise the need to set up customer support operations early on. Although at times the changes may not be fully designed or implemented, citizens will try to understand what is happening and when. The establishment of a customer contact centre as early as possible is important. Additionally, the early introduction of webpages to reiterate the message will also help provide some level of awareness for people. The U.K. and NZ both had some level of web services and a customer contact centre in place at least six months prior to the ‘go live’ implementation of the reforms.

In India, two national level toll free numbers were set up to answer queries and also redress the grievances of the people. In addition 25 toll free numbers were set up, one in each state capital to do the same job in regional languages.

TARGETING AND MONITORING

At the outset of the Mission it is important to do thorough research to gain an understanding of what people know already, along with what are their attitudes to saving
and change. This research will help to gauge the levels of marketing required, whether it be direct or indirect.

However, sometimes, the start of the Mission itself is a political decision and, therefore, there might not be enough time for pre-Mission research. In India, for instance, the target was to provide at least one bank account per household. However, there was no data on the exact number of households, which had/did not have a bank account. Hence, this data collection was done concurrently. The entire country was divided into wards in urban areas and into sub-service areas in rural regions. The responsibility of ascertaining the exact number of households without bank accounts was given to one bank while a bank account could be opened in a bank of the customer’s choice. Therefore, while one bank was responsible for one duty the other banks shared the other.

New Zealand and the United Kingdom both gauged the awareness and understanding the citizen had around the reform changes. They also tracked the level of public acceptance. This research and tracking is important and helps the Mission Office design what level of education will be required across the nations. They also set a target of gaining around 85% awareness and understanding levels.

COMPLIANCE

The establishment of a compliance team will also be essential as inevitably there will be some who choose not undertake their duties. The U.K. Pensions Regulator set out clearly the compliance strategy that it would adopt, which is to educate, enable, and enforce.

It is important the government does put in place punitive powers for use as a first resort. These powers may ultimately be needed to encourage compliance. They may range from issuing financial penalties to undertaking criminal charges through the courts. The Pensions Regulator in the U.K. introduced three stages to the compliance journey for the employer. The majority of employers who had not complied on time have resolved this position shortly after the receipt of a compliance notice. The issuing of a financial penalty is a last resort.

In India, the compliance was enforced in a unique way. The Mission team would have a weekly Video Conference (VC) with the participating banks and insurance companies. The agenda papers including the weekly progress made by the banks would be collated by the Mission Office and shared with all at least a day in advance. The VC participants were also informed in advance about their strong and weak points and during the VC they were asked to explain the remedial action taken by them. Initially some of the participants used to come ill-prepared at the VCs. However, gradually they realized that the VCs were data driven and they could not escape the tight scrutiny. So Wednesdays, 11 am -1 pm became the appointed time during which no other tasks were scheduled from both sides and the progress made in the Mission was in large part due to this commitment shown.

Inevitably the design and implementation of any reforms will be cross-governmental adding a level of complexity.

While a range of governance models, structures in resources material, such as PRINCE2 or MSP Managing successful projects is available, the important point is to have good governance in place.

For example, the U.K. programme oversight was through the DWP. A programme board was formed, chaired by the senior responsible officer (SRO) accountable for the overall delivery of the programme. Membership was formed with the Pensions Regulator, responsible for implementing the duties across employers and industry supplies, such as scheme providers, payroll professionals, and National Employment Savings Trust (NEST), which was the scheme provider set up by the U.K. government with a public service obligation of accepting all employers.

The setup of a mission Office requires a high level of taxpayer funding, therefore, it is important a good governance framework is in place monitoring the programme of work is being done to scope, budget, and time.

Figure 23.5
Oversight of the programme

**Arrows indicate workforce unless otherwise stated**

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In the Indian context, the Union Finance Minister (FM) was the Mission Head overseeing the entire Mission's progress. Although the day to day progress was monitored by the Mission Office team, it was important to have the FM as the Mission head to ensure full cooperation from all stakeholders. The Mission in India needed convergence with the Ministry of Rural Development and the Ministry of Communications in particular. Given that the bureaucracy can sometime find ways to go slow, it was important that the FM headed the High level monitoring committee, which also included the ministers of the two ministries. In addition, the role of the Central Bank as the independent regulator of the banks was very important. Therefore, the Governor of the Reserve Bank of India (RBI) was also a member of this committee.

Besides this high level governance structure, it was ensured that the Mission succeed at the grassroots level. India has 676 districts. A district is a basic governance unit, almost equivalent to a small town comprising several hundred villages. Bigger cities can have several districts. The district is headed by a District Collector (also known as District Magistrate) for the purposes of governance. In order to ensure the success of the PMJDY Mission, district level committees were formed in each of the 676 districts, which comprised representatives of banks, insurance companies, and those of the local bodies. These committees were reviewed by the state level committees on a regular basis.

**INTERNAL AND EXTERNAL REVIEWS**

During the life cycle of the setup phase of the mission office, it will be necessary to undertake a series of internal and external reviews. Reviews will ensure a level of transparency and accountability.

Project reviews will look at areas such as:
- Business case -- valid, viable, worthwhile
- Project planning -- critical path, completeness, suitability
- Change management -- adherence of control, timeliness
- Risk and issue management -- depth, coverage, resolution
- Project costs -- actual vs. budget
- Sign-off and criteria for stage gates
- Approach to vendor management -- contracting, dependencies
- Business readiness -- pre-‘go-live’
- Project communications -- accuracy, detail, honesty

They will provide a level of assurance that the project is on track to scope, time, cost, and within the quality agreements.

**MANAGING STAKEHOLDERS**

Stakeholder engagement is the process by which an organisation involves people or key people with other organisations who may be affected by the decisions it makes or can
influence the implementation of its decisions. Stakeholders may support or oppose the change being undertaken. They may play a very important influential role within the organization or within the community, therefore, it is important that key stakeholders are identified and a strategy to manage them implemented.

The Mission Office will play a major role engaging with key stakeholder groups. There are a number of models to assist with the identification of stakeholders, (see Table 23.1)\(^8\). There is a standard model Deloitte sets out that assess the degree of impact on the stakeholder. In Table 23.1 on the left hand side is the influence of the organisation on the stakeholder. If the stakeholders have high impact and high influence, the greater the stakeholder engagement you will need to manage.

Table 23.1
Stakeholder Priority Setting Matrix

<table>
<thead>
<tr>
<th>Stakeholder influence on organisations</th>
<th>No Influence</th>
<th>Low Influence</th>
<th>Some influence</th>
<th>Formal power/high influence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stakeholder’s support for the business has little or no impact its success</td>
<td>Stakeholder’s support for the business can highly impact the business’ success</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Organisation impact on stakeholder</td>
<td>Stakeholder is highly dependent on organisation — no choice</td>
<td>Treat fairly — honour commitments to these stakeholders in line with policy, regulations and industry norms. Otherwise endeavour to keep stakeholders satisfied insofar as balance of cost and benefits allowed</td>
<td>Strategic threat or opportunity — invest in engagement process to understand concerns and develop solutions</td>
<td></td>
</tr>
<tr>
<td>No direct impacts — stakeholders have broad range of choice</td>
<td>Low priority — provide access to general channels of information and feedback</td>
<td>Keep involved and informed, but ensure balance between concerns or high influence stakeholders and those people actually impacted by decisions</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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\(^8\) [https://www2.deloitte.com/content/dam/Deloitte/za/Documents/governance-risk-compliance/ZA_StakeholderEngagement_04042014.pdf](https://www2.deloitte.com/content/dam/Deloitte/za/Documents/governance-risk-compliance/ZA_StakeholderEngagement_04042014.pdf)
For key stakeholders, for the introduction of pension reforms, you will need to consider what your engagement strategy will be.

**Government:** Various members of parliament will play an influential role in the success of the project delivery. This will be through their constituency representation or portfolio, e.g. minister for finance, minister of business, etc. This will be dependent on government office roles. If cross-party support exists for the reforms, this will play a large factor in the successful introduction. However, typically this will not exist unilaterally. But it is a worthwhile aim given that pension reforms will require multiple electoral periods to be delivered, run, and finally lead to future pension payout.

**Industry Suppliers:** There will be a number of areas in the supply chain that will require engagements. These stakeholders are very important to the success of the mission’s implementation and ongoing achievement of overall policy objectives.

For instance, depending on the model design, software developers engaged for the mission play a role in enabling employers to have automated systems to accurately meet the legislative requirements such as, in the case of the U.K., assessing workers eligibility to be enrolled, as there are age and income criteria conditions; calculate the contribution rates to be deducted from a workers’ wages; and distribute memberships and payment schedules to scheme provider/s. It is important technology is developed to support the legislation, this will limit the risk of employers’ unintentional non compliance.

Engagement with professional bodies is also an important area to plan for and undertake. These groups will often play the role of ‘watchdogs’ on a number of government reforms and activities, so working closely with these groups will help mitigate adverse public commentary and garner greater support. There will be opportunities through the design and roll out phases to work with these groups through areas such as member group sessions to test design concepts till the final products, through shared communication to members.

A number of main stakeholders that should be engaged:

- Scheme providers
- Banks
- Insurance companies
- Payroll software developers and payroll bureaus
- Middleware software developer
- Business advisors
- Individual financial advisors

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Middleware is computer software that provides services to software applications beyond those available from the operating system. It is software that enables communication and management of data in a distributed manner, to one or more different systems.
There are also other professional bodies that should be engaged, such as:

- Federation of small business
- Institute of chartered accountants
- Bookkeepers society
- Home carer groups
- Unions

Initial and ongoing engagement with these groups is crucial not only to assist with the design and implementation, but also to gain acceptance, support, and enable public support. This in turn will assist the overall implementation. It is important to note that some of these may be very non-traditional when the aim is to expand pension coverage to groups not usually covered. It is important to go beyond those normally associated with the pension debate.

**DATA**

Data will play an important role through the design, implementation, and ongoing operational stages.

At the design stage the collection of data through research will be important to gauge insights from the audience with whom you are, or will soon be, engaging. For instance, in New Zealand they undertook employer and market research to gauge an understanding of employer or industry attitudes and support for the introduction of the KiwiSaver policy, and gauged the levels of current awareness and understanding that employers have of requirements of them once implemented.

Data on individuals and employers will also be gathered and maintained in a central database for communication and ongoing customer service. Usually customer data is held in a central customer relationship management system (CRM). Data sources could be varied. In the U.K., employer information, such as name, address, and number of employees is regularly fed to the Pensions Regulator electronically from Her Majesty’s Revenue and Customs (HMRC). Companies’ House provides company registration numbers. In India, the source of the data were the Core Banking systems of the banks involved in the Financial Inclusion Mission. However, as mentioned earlier, the data was needed district-wise since a district is a basic administrative unit in India. Since there are several banks in a district, the Mission Office used to collect the district-wise data from all banks, pool it, and then get the complete picture of the district.

It is important to establish the equilibrium between customer privacy issues and the data needed in the Mission office. Other than customer grievances, the data needed by the Mission Office is mostly on an aggregate basis to ascertain the progress made. However, it is still vital to understand the individual customer journeys to optimize design and implementation.
RESULTS

To assist with the successful delivery of the reforms it is advisable to ensure that there are robust monitoring and tracking mechanisms in place. This may be through the use of clear Critical Success Factors (CSFs), as in the case of the U.K..

CSFs are the essential areas of activity that must be performed well to achieve the mission. By identifying CSFs, one can create a common point of reference to help direct and measure the success of the Mission.

As a common point of reference, CSFs help everyone in the team to know exactly what’s most important. And this helps people perform their own work in the right context and so pull together towards the same overall aims.

As mentioned above, in the Indian context, the CSFs were the district-wise households where at least one member had a bank account.

Some other examples of CSFs are:

- The Mission Office is able to commence its duties on time within budget.
- Delivery of the communications strategy within budget and planned timeframes.
- Prior to the duties coming into effect, employers are aware of them and how to discharge them.
- Providers and advisers have sufficient knowledge to provide products and services that are fit for purpose to enable employers to comply with their duties.
- X% of employers comply with their duties on time.
- By the end of the implementation stage the increase in the number of savers is in line with programme projections.
- A majority of savers are saving persistently.
- Opt out rates are in line with programme assumptions.

To illustrate this, Figure 23.6 highlights some of the areas the automatic enrolment programme monitored to see if it the programme was successfully achieving the success criteria. For instance, the levels of awareness and understanding were originally set at 95% and 80%, which through the delivery phase reached achievement rates of 96-99% and 87-89%. Similarly, opt out rates were much lower that originally assumed.

One of the areas New Zealand monitored success through was also the take up of enrollments, which continues to show a steady increase in membership overtime, with now over 2.5 million members enrolled against a total country population of 4.7 million.11
Figure 23.6
Selected performance assumptions

<table>
<thead>
<tr>
<th>Assumption</th>
<th>Original estimate</th>
<th>Out turn (revised estimate)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of employers to declare compliance</td>
<td>1.3 million</td>
<td>1.8 million</td>
</tr>
<tr>
<td>Proportion of employers with eligible workers</td>
<td>Not measured</td>
<td>65%</td>
</tr>
<tr>
<td><strong>Employer knowledge:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Awareness</td>
<td>95%</td>
<td>96%-99%</td>
</tr>
<tr>
<td>Understanding</td>
<td>80%</td>
<td>87%-89%</td>
</tr>
<tr>
<td>Opt-out rates</td>
<td>28%</td>
<td>8%-14%</td>
</tr>
<tr>
<td>Persistency of saving (3 out of 4 consecutive years)</td>
<td>&gt; 50%</td>
<td>78% (2014)</td>
</tr>
</tbody>
</table>

While critical success factors help track the short to medium term success, one should consider the value of a programme of research and evaluations throughout the lifecycle of the initial setup phase.

Undertaking evaluations are important to ensure the legislative objectives are being met. In New Zealand the KiwiSaver programme undertook a series of research activities during the implementation phases along with annual evaluations over an eight year period.

The primary legislative objectives of KiwiSaver are to:

- encourage a long-term savings habit and asset accumulation by individuals who are not in a position to enjoy standards of retirement similar to those in pre-retirement
- increase individuals’ wellbeing and financial independence, particularly in retirement, and to provide retirement benefits.

New Zealand also looked at compliance costs borne by employers, as this was an area for which the government was criticized. With the changes from one system to another placed a high administration cost and burden on employers. Research undertaken showed that while administering KiwiSaver, any advisory assistance and time taken to learn about KiwiSaver reduced the employer’s compliance cost; from NZD 770 annual average cost in 2009 to NZD 661 in 2013.

The U.K. also undertook a series of surveys across employers and intermediaries. This research programme assessed areas such as levels of awareness and understanding of the policy requirements. As illustrated below, awareness of the reforms grew overtime for micro employers from 61% in spring 2013 to 79% in spring 2016. This research helped to gauge the success levels of the campaigns and direct mailing on increasing awareness. A survey was undertaken with employers to ascertain the ongoing duties costs they incur. Among those using external advisers/providers, the median monthly cost reported ranged from GBP 42 for micro employers to GBP 100 for small employers and GBP 175 for medium employers.

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Figure 23.7

Number of active/provisional KiwiSaver members, by enrolment method

<table>
<thead>
<tr>
<th>Month</th>
<th>Opt in Via Provider</th>
<th>Automatically Enrolled</th>
<th>Opt in Via Employer</th>
</tr>
</thead>
<tbody>
<tr>
<td>June 2008</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>June 2009</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
</tr>
<tr>
<td>June 2010</td>
<td>0.5</td>
<td>0.5</td>
<td>0.5</td>
</tr>
<tr>
<td>June 2011</td>
<td>0.8</td>
<td>0.8</td>
<td>0.8</td>
</tr>
<tr>
<td>June 2012</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
</tr>
<tr>
<td>June 2013</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
</tr>
<tr>
<td>June 2014</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
</tr>
<tr>
<td>June 2015</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
</tr>
<tr>
<td>June 2016</td>
<td>1.3</td>
<td>1.3</td>
<td>1.3</td>
</tr>
</tbody>
</table>

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12 Research papers can be found - http://www.thepensionsregulator.gov.uk/doc-library/research-analysis
Table 23.2

<table>
<thead>
<tr>
<th>Research Reports</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Early retirement withdrawal research with providers</td>
<td>The purpose of this research is to find out how KiwiSaver providers are communicating with their members eligible or becoming eligible to withdraw their KiwiSaver savings for retirement purposes. The research also looks into the options, information, and advice KiwiSaver providers are giving their members.</td>
</tr>
<tr>
<td>Provider feedback</td>
<td>Documents findings from research with KiwiSaver scheme providers. The research looks at the effectiveness of the engagement between Inland Revenue and providers during the roll-out of KiwiSaver.</td>
</tr>
<tr>
<td>Employer survey</td>
<td>Examines awareness, understanding, and reactions to KiwiSaver amongst employers, and assesses whether they felt informed about their obligations under KiwiSaver.</td>
</tr>
<tr>
<td>Individual survey</td>
<td>Documents findings from research with members of the public. The research looks at the awareness and understanding of KiwiSaver amongst the general public and the extent to which KiwiSaver communications activities have assisted individuals to make informed decisions about membership.</td>
</tr>
<tr>
<td>Who is enrolling in KiwiSaver?</td>
<td>Summarises the key trends and demographic profiles from the analysis findings of the SoFIE (Survey of Family, Income and Employment) and Inland Revenue KiwiSaver administrative linked data set.</td>
</tr>
<tr>
<td>Phase 2 employer panel</td>
<td>Presents findings from the second phase of research with a panel of employers. The purpose of the panel research is to understand how employers are implementing KiwiSaver in the workplace.</td>
</tr>
<tr>
<td>Phase 1 employer panel</td>
<td>Presents findings from the first phase of research with a panel of employers. The purpose of the panel research is to understand how employers are implementing KiwiSaver in the workplace.</td>
</tr>
<tr>
<td>Auto-enrolment report</td>
<td>Documents the findings from qualitative research with employers and employees about the KiwiSaver auto-enrolment process.</td>
</tr>
<tr>
<td>Qualitative research</td>
<td>This research provides insights from KiwiSaver members and non-members regarding their attitudes and behaviours towards savings. It also helps give an understanding of the positive and negative implications of KiwiSaver for employers and individuals.</td>
</tr>
<tr>
<td>Additionality and substitution</td>
<td>This study gauges KiwiSaver members’ perceptions about the amount of new savings they have made as a result of KiwiSaver. The study also quantifies KiwiSaver members’ perception of how much of their savings has been diverted to Kiwisaver from other forms of saving.</td>
</tr>
<tr>
<td>Early retirement withdrawal survey</td>
<td>On 1st July 2012, the first KiwiSaver members who were 65 years of age and had been in the scheme for five years became eligible to withdraw their savings. This report describes the savings-related characteristics, experience, intentions, and drivers of those KiwiSaver members eligible to withdraw their savings.</td>
</tr>
</tbody>
</table>

14 http://www.ird.govt.nz/aboutir/reports/research/previous-research-evaluation-reports.html
<table>
<thead>
<tr>
<th>Evaluations</th>
<th></th>
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</thead>
<tbody>
<tr>
<td>Government retirement savings incentives in New Zealand: do they provide</td>
<td>This Value for Money analysis reviews the KiwiSaver programme from its inception</td>
</tr>
<tr>
<td>value for money?</td>
<td>to the last available full year’s data (2012-13). It looks at value for money</td>
</tr>
<tr>
<td></td>
<td>from both an annual and cumulative basis over that time. The focus of this</td>
</tr>
<tr>
<td></td>
<td>analysis is upon the direct fiscal cost and the direct savings effect.</td>
</tr>
<tr>
<td>KiwiSaver evaluation: Survey of Individuals</td>
<td>A technical report that presents data and analyses from a survey of KiwiSaver</td>
</tr>
<tr>
<td></td>
<td>members and non-members.</td>
</tr>
<tr>
<td>KiwiSaver evaluation: Survey of Individuals (summary report)</td>
<td>Synthesises data from the technical survey report and discusses the implications</td>
</tr>
<tr>
<td></td>
<td>of the survey findings.</td>
</tr>
<tr>
<td>SME tax compliance costs 2009: KiwiSaver compliance costs evaluation</td>
<td>This report looks at small and medium enterprises (SMEs) self-reported KiwiSaver</td>
</tr>
<tr>
<td>report 3</td>
<td>compliance costs provided as part of a 2009 survey measuring 1,728 SMEs tax</td>
</tr>
<tr>
<td></td>
<td>compliance costs across a range of tax types.</td>
</tr>
<tr>
<td>KiwiSaver evaluation: Follow-up survey of SME employers</td>
<td>This report provides findings of follow-up research to the 2009 SME tax compliance</td>
</tr>
<tr>
<td></td>
<td>costs survey (above). This research asked SME employers to report on a range of</td>
</tr>
<tr>
<td></td>
<td>other costs (including making changes to remuneration approaches and other</td>
</tr>
<tr>
<td></td>
<td>workplace-based superannuation schemes) associated with meeting their KiwiSaver</td>
</tr>
<tr>
<td></td>
<td>obligations.</td>
</tr>
<tr>
<td>KiwiSaver evaluation: Opting-out and taking contributions holidays report</td>
<td>Presents the key trends and characteristics of those people who have opted-out</td>
</tr>
<tr>
<td></td>
<td>of KiwiSaver or taken a contributions holiday over a four-year period since the</td>
</tr>
<tr>
<td></td>
<td>scheme inception to 30th June 2011.</td>
</tr>
</tbody>
</table>

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**Figure 23.8**

**Awareness of automatic enrolment by size, over time**

- **Significantly higher**
- **Micro 1-4 staff**
- **Small 5-49 staff (profile n previous waves)**
- **Small 5-29 staff**

<table>
<thead>
<tr>
<th></th>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Micro 1-4 staff</td>
<td>61%</td>
<td>70%</td>
<td>70%</td>
<td>65%</td>
<td>77%</td>
<td>78%</td>
<td>79%</td>
</tr>
<tr>
<td>Small 5-49 staff</td>
<td>74%</td>
<td>82%</td>
<td>85%</td>
<td>86%</td>
<td>88%</td>
<td></td>
<td>90%</td>
</tr>
<tr>
<td>Small 5-29 staff</td>
<td>86%</td>
<td></td>
<td>90%</td>
<td></td>
<td></td>
<td></td>
<td>95%</td>
</tr>
</tbody>
</table>
In India, because of the tight timelines, the evaluations were carried out by external agencies in close coordination with the Ministry of Finance. The evaluations were very useful in course correction and devising better strategies for more effective implementation.

**TIMELINE**

The setup and implementation timelines will depend on a number of factors such as:

- **Overall remit** or scope the Mission Office has been given

- **Scale**: The targeted population size, for instance, New Zealand overall employer population is around 170,000, while the United Kingdom has approximately 1.5 million employers. In India the estimated target was 75 million bank accounts that was later revised to 100 million. Given the scale was not excessive in New Zealand they opted for a ‘big bang’ approach and implemented a ‘go live’ for all employers on 1st July 2007. The U.K. opted for a staging profile that brought employers into the system month by month over a 56 month period starting with the largest employers working through to the small and micro size employers (with one to four employees).

- **Delivery target date**: This will play a huge factor in the speed at which a mission office will need to work through each stage. Often governments set unrealistic timeframes for when the legislative change or reform will take effect. From the drafting and enactment of the KiwiSaver legislation, New Zealand had less than two years to design, build, and implement all factors of the programme from mission office set up, procurement of resources and tools, IT systems development, and recruitment of staff. In India, too, the timelines were very stiff. The Mission started on 28th August, 2014 and was given a completion deadline of 26th January 2015 -- a time span of less than five months.

- **Procurement**: Countries will vary in their procurement approach, however, there will be requirements to publically seek tenders for areas such as IT systems, offices, tools, and media campaigns. Procurement can be simple and quick. However, for high cost tenders, you will typically see a period of two to six months for the process of: request for tender; evaluation of the tenders; and any due diligence that may be required.

- **High level and detailed design requirements**: The Mission Office will work through a series of design workshops to set out the requirements from systems, procedures, operating models, and educational material. It is becoming more common now to build and deploy operations in an agile project management approach. This method of building and deploying in stages is important to address the needs of the operations at that time. For instance, educational campaigns, material, website services, and contact centre support will be required early before a ‘go live’ date. Whereas, full IT systems and client relationship management capability may not be required until closer to when any reform or requirements are placed on citizens or employers. These stages can range for anywhere between six to nine months.
Typically from the establishment of a mission office to design, building, and implement change, one will need a minimum of nine to 18 months, although this is dependent on the scale of the change. Once deployed, the Mission Office, depending on the setup, will hand over the operations and material and integrate the operating model to the core organisational structure. This would be managed by a scaled down Mission Office team over a three to four month window to ensure a smooth transition.

**OVERALL CHALLENGES AND RISKS**

Working through the various stages, the mission office will face a number of challenges and risks. These will be in areas such as:

- **People capability** - It will be critical to recruit the right people with the right expertise for a variety of roles. A mix of international and domestic personnel may be required. A good lesson is to identify and source experienced people who have undertaken similar duties in other jurisdictions. This will assist with making sure lessons they learned are applied to the present mission and the same mistakes are not repeated. Sometimes, there might be situations when one can’t wait for the perfect team member to turn up. So, one might have to do a little trade-off between waiting and getting the tasks at hand executed. One can think of outsourcing in such cases. For instance in the Indian context, there was a need for generating quick MIS and the Mission office staff in the initial days were not equipped to provide this. Therefore, one of the prestigious consultancies was hired for three months to execute the task on an immediate basis.

- **Staff retention** - It is important to maintain stability of personnel from setup to deployment. This will ensure that productivity is not lost through having an ongoing training requirement, reviewing of past decisions, and design approach and, thus, to allow teams to remain focussed on timelines and delivery.

- **Political consensus** - If there is cross-party support this will mitigate the need for an ongoing defensive approach. If there is not, there may be ongoing public debates, discussions, and challenges at every stage of the Mission Office’s programme. There is a risk that governments will make changes throughout the build and deploy stages which will make the delivery more challenging. If political parties undertake public support messaging this will go a long way to making the delivery phase a ‘softer’ landing for citizens and employers. In the Indian example, the new government in power improved in scale and delivery what the previous government had tried to do, with limited success. This led to the opposition claiming all along that the Mission was “old wine in new bottle”. However, with the right kind of information dissemination programs, gradually a broad consensus was built that the Mission was finally for the benefit of the underprivileged.

- **Funding** - It is important to secure the right level of funding for the Mission office. It is also important through the funding bid stage to build in contingencies and post
deployment funding for remedial work. Typically, timeframes will be challenging. Therefore it is important for funding to be set aside to enhance systems, fix systems defects with which the programme goes live, and to change materials through ongoing learning.

- **Balancing the old world order with the new** - managing the stakeholders: As has been mentioned earlier, Mission offices bring about disruptive changes in the execution of tasks assigned to them. This may bring anxieties for the traditional systems, stakeholders, and teams who were used to working in a particular fashion till now. It is the job of the Mission Director to balance the change from the old to the new. The Mission Directors should be encouraged to be placed in the hierarchy of the traditional teams also so that they can fulfil this role of transition.

## CONCLUSION

Mission or Program offices should be set up when the Political Executive has clarity on the goals to be achieved in a specified time frame and is ready to commit the monetary and other resources for the Mission Office. This chapter has attempted to highlight some of the steps that might be helpful in the Mission Offices’ journey in the accomplishment of the public policy goals. Mission Offices act as nerve centres with increased attention, focus, and clarity and are, therefore, essential when old policy objectives which couldn’t get renewed attention. As with other chapters in this volume the focus on the Mission Office is important because getting the implementation right is not incidental, but fundamental to success. However, in almost all texts on pension reform and policy these issues are overlooked. It is hoped that the reformers of the future will find this chapter useful so that they know what they will need to have in place, and also understand the broader range of staff and capabilities for the reform process.

## USEFUL LINKS


[www.sorted.org.nz](http://www.sorted.org.nz)

[www.ccfc.org.nz](http://www.ccfc.org.nz)

[www.pensionsadvisoryservice.org.uk](http://www.pensionsadvisoryservice.org.uk)

## REFERENCES

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DR ALFRED OUMA SHEM is the Chief Manager and Head of the Research and Strategy Department at Retirement Benefits Authority (RBA), Kenya since April, 2014. He was previously the Manager, Financial Inclusion Section of the Financial Inclusion and Stability Division in the Research and Policy Analysis Department of the Central Bank of Kenya (CBK) where he worked for six years from 2009. He worked as a Policy Analyst at the Kenya Institute for Public Policy Research and Analysis (KIPPRA) in the Macroeconomics Division. He has been a Senior Lecturer of Economics at Moi University, Kenya; a Lecturer of Economics at Egerton University, Kenya; and a Research Fellow at the Institute for Development Studies of the University of Nairobi, Kenya. He studied for his Ph.D in Economics at the University of Cologne, Germany after his Masters in Economics and Bachelors degree in Economics and Business Studies at Kenyatta University, Kenya. He has researched widely on issues of financial economics particularly on financial inclusion and microfinance, which drives his main research interests. He is now focused on growing pension coverage in the country, a financial service whose access is still quite low in Kenya. Besides his publications on financial inclusion issues he has also published in other areas of economics such as monetary policy, social policy and financial stability among others.

DR ALOK PANDE is presently working as Deputy Director General in the Department of Posts (in the rank and pay of a Joint Secretary to the Government of India). He is heading the IT Modernisation plan of India Post. Prior to this, he was a Director in the Department of Financial Services, Ministry of Finance. He was also the Additional Mission Director of the Pradhan Mantri Jan Dhan Yojana (PMJDY) which is a flagship scheme of the Government of India. The PMJDY has been hailed as one of the big successes of the Government. Dr Pande has more than 21 years of experience in the
Government of India where he has worked in different capacities. His area of interest as well as experience has been that of ensuring financial inclusion. He did his graduation in Mechanical Engineering from National Institute of Technology, Allahabad in 1992. Dr Pande joined the Civil Services in 1994. He completed his Doctorate from IIM Bangalore in the area of Corporate Finance in the year 2009. His Ph.D thesis was selected for NSE Award for the best thesis in financial economics for the year 2013, the topic being “Book built initial public offering in India: Determinants of pricing, subscription patterns of investors and impact of regulation” Dr Pande has several publications to his credit including two in the prestigious Journal of Corporate Finance and Journal of Financial Markets.

ASTRIT HADO is the Director General of the Social Insurance Institute (SII) of Albania. He is charged with the responsibility of administering the public Social Security System. Prior to this he worked as Deputy Director General for more than 9 years and Director of Integration, Reforms, Agreements and Social Research Department at the same time. He co-authored Albania’s pension reform design which was implemented since January 01, 2015. He has been charged with the responsibility of coordinating the design and instrumentalisation of various reform initiatives and informatization process. He has also been the negotiator for bilateral agreements on social security for the last six years. He holds the MPA degree (Tirana University and Nebraska University) and he is following a Ph.D in Tirana University. He has been a member of the Board of the Albanian Financial Supervisory Authority (AFSA) for 3 years and has been part of establishing and implementing the rules and regulations of voluntary private pension funds. He has been overall project coordinator of the Social Service Delivery Project financed by The World Bank for modernization of social insurance in Albania. He has participated in several conferences on pension issues, in which he shared the experience of the Albanian pension reform with other participants. He is an author and co-author of publications in the field of pensions.

AUDIA BACCHAS is an Associate Consultant on Pensions with Morneau Shepell where she has garnered knowledge on varying aspects of the Canadian pension landscape and conducts various assignments for Caribbean Regulators (both offsite and onsite). She is a contributing author to the Morneau Shepell Handbook of Canadian Pension and Benefit Plans. Audia was formerly employed at the Financial Services Commission (FSC) in Jamaica for eight years. She was involved in numerous initiatives at the FSC in the early stages of operations, such as reviewing industry comments on the draft pension legislation and reviewing Trust Deed and Rules for technical issues. She has extensive experience in offsite (risk based assessments) and onsite examinations and plan wind ups while at the FSC. She holds a master's degree in Business Administration from the Manchester Business School (UK), a Bachelor of Science in Business Administration (Accounting) from the University of Technology (Jamaica) and a Retirement Plan Associates designation (Canada).
CARMEN HOYO is the head of Pensions and Remunerations at Banco de México. From 2011 to 2015 she worked for BBVA Research as Senior Economist in Financial Inclusion and Pensions. She also worked for the National Commission of Retirement Saving System (CONSAR) and for the National Commission of Insurance and Sureties in Mexico. Carmen Hoyo is an Actuary and holds a Masters Degree in Finance from the National University of Mexico. Her research, mainly focused in pension systems and financial inclusion, has been published in specialized journals.

CHARLES COUNSELL is Chief Executive of the Money Advice Service (MAS) in the UK. MAS was set up by the UK Government to help people manage their money. Charles spent six years prior to this as Executive Director of Automatic Enrolment at the Pensions Regulator (TPR) where he was responsible for the successful UK roll-out of this programme, working alongside the Department for Work and Pensions (DWP). In his time at TPR, the automatic enrolment programme led to more than 7.5 million workers newly saving into a workplace pension from over 500,000 employers. Charles was awarded an OBE in 2017 for services to workplace pension reform. He has spent much of his career setting up and leading major change programmes in both the private and public sectors in the UK and overseas.

CHARLOTTE CLARK is the Director for Private Pensions at the Department for Work and Pensions in the UK Government. She is responsible for the Automatic Enrolment Programme, working with colleagues from the Pensions Regulator and NEST. Automatic enrolment has seen participation in pensions rise so that 66% of all employees are active members of a pension scheme, compared with just 47% in 2012 before the roll out started. Over 6.5m workers are now saving into a pension who were not saving for their retirement before. Charlotte is a civil servant by background. Aside from her work on pension reform she has also been head of the Child Poverty Unit and worked on major reforms for labour market and disability. Prior to her current role she was head of Pension and Savings at HM Treasury.

CHINELO ANOHU-AMAZU is Director General and CEO of Nigeria’s National Pension Commission, (PenCom). A government agency, PenCom is statutorily charged with the responsibility of regulating, supervising and ensuring the effective administration of the pension industry in Africa’s largest economy. With a contributor network of over seven million individuals enrolled under the Contributory Pension Scheme and pension funds assets in excess of USD 25 billion, the Commission ensures that assets are invested efficiently and transparently. A highly accomplished public servant and administrator, Chinelo had a sterling multi-jurisdictional career in the private sector and commenced her public service career in the year 2000 as an Adviser at the Bureau of Public Enterprises (BPE). She served as a member of the Pension Reform Committee that introduced the Contributory Pension Scheme through the Pension Reform Act (PRA) 2004 and received a Presidential Commendation for work done. She was subsequently appointed as the pioneer Commission Secretary/Legal Adviser of the National Pension Commission and
spearheaded a major review of the PRA 2004 which culminated in the enactment of the PRA 2014. Chinelo holds a Masters Degree in Telecommunication and Information Technology Law from the London School of Economics, a Bachelor of Laws Degree (LL.B) from the University of Nigeria and earned a B.L from the Nigerian Law School. She has also attended several Executive Education Programs at the Harvard University Kennedy School of Government, the London Business School, the Columbia University Graduate School of Business and the Wharton University Business School.

CRAIG CHURCHILL has more than two decades of finance experience in both developed and developing countries. In his current position as the Chief of the ILO’s Social Finance Programme, he focuses on the potential of financial services and policies to achieve social objectives. Craig has authored and edited over 40 articles, papers, monographs and training manuals on various topics including microinsurance, customer loyalty, organizational development, governance, lending methodologies, regulation and supervision, and financial services for the poorest of the poor. He is the founding chair of the Microinsurance Network and on the governing board of the Access to Insurance Initiative. Craig has a BA from Williams College and an MA from Clark University, both in Massachusetts.

DARREN RYDER has 28 years experience working in the public sector, across a wide range of tax and social policy areas. These include child support, business and individual tax, and retirement savings/pensions. Darren has also worked on major reforms across New Zealand and the UK, along with sharing his expertise of these models with the World Bank and countries they partner with. Darren has been working for the Pensions regulator for the last 6 years and is currently the Director of Automatic Enrolment at the Pensions Regulator in the UK. He has been instrumental in the design and highly successful implementation of automatic enrolment and workplace pensions reforms. This has already seen over 8 million new pensions savers enter the market. Darren’s design and operational expertise is invaluable in assisting with transforming policy to effective business operations. Darren also has a range of experience working across government, managing national audit office and programme reviews. Darren has a wealth of experience managing stakeholders as well as the critical management of risk, and working with outsourcing partners. Prior to the Pensions Regulator Darren gained hands on experience as a senior manager with the KiwiSaver programme - New Zealand Retirement savings, through the business case, procurement, design, implementation and operational phases. Darren managed the implementation of KiwiSaver, a highly successful large scale reform project, that has seen over half of the New Zealand population enrolled into a retirement scheme, with now over $33b NZD in assets already accumulated. Darren has extensive operational, leadership and organisational management capability, undertaking the KiwiSaver National Manager role. Darren was also responsible for the programme management of a large scale national restructure of the New Zealand Tax Office service operations in parallel with running a number of compliance and enforcement teams across tax and social policies.
DR DAVID TUESTA works in the Financial Regulatory Unit of BBVA Research. He is Lead Economist of the Financial Inclusion Unit, responsible for conducting research and to introduce recommendations for Emerging Economies in financial regulation, banking, insurance, pension reform and long-term financing issues for infrastructure projects. Previously, Dr Tuesta was a Member of the Regulatory Board of Energy and Mining - Osinergmin in Lima, Director of the Economic Studies Department at the Ministry of Economy and Finance of Peru – National Tax Office in Lima, Consultant of the Inter-American Development Bank in Asuncion-Paraguay and Economist of Apoyo Consulting in Lima. He participates on a regular basis in joint research projects with the Inter-American Development Bank, the World Bank and the Organization for Economic Cooperation and Development. He is author, editor and contributor to books published by international publishing houses and has several articles in scientific indexed journals. He is a member of the Econolatin Network at the prestigious Klein Institute of Universidad Autonoma de Madrid in Spain. Dr Tuesta has delivered lectures at University Autonoma de Madrid in Spain, at the Economics School of Universidad Católica del Peru and at the Graduate School of Universidad de Lima. He has been speaker in different conferences organized by governments, international financial institutions, central banks and other relevant fora. He obtained his MA in Public Affairs and Economics at the University of Minnesota in the United States and his Ph.D and BA in Economics at Universidad Catolica del Peru.

DENTON RARAWA has been Governor of the Central Bank of Solomon Islands since 2008. Before that he was Deputy Governor of the Bank for ten years. Governor Rarawa is also the Chair of the Solomon Islands Financial Inclusion Taskforce, the Controller of Insurance and the Registrar of Credit Unions in Solomon Islands. He is the current Chair of the Alliance for Financial Inclusion [AFI] Pacific Islands Regional Initiative (PIRI). He holds a Master of Science Degree from the Cardiff Business School, University of Wales, United Kingdom.

DR DOROTHEE FRANZEN is Managing Director Germany at Avida International where she advises institutional investors on organisational performance and governance. Previously, Dorothee was head of pensions research at Allianz Global Investors. She managed a broad research programme and helped to develop the company’s strategic pension policy. Prior to joining Allianz Group, Dorothee held senior roles at HypoVereinsbank in economic research and strategic planning. Dorothee has been in economics and pensions research for three decades. Her work is focused on pension regulation and governance as well as pension investment and risk management. Dorothee worked with the OECD on an international project on the impact of ‘regulation on pension funds’ investment strategies. She also helped MetallRente, Germany’s largest pension scheme, to better understand the savings behaviour of their members and improve their governance. She is Director of the ‘Allianz-Oxford Pensions Conference’, an international pensions conference which held annually at the University of Oxford.
Dorothee has published various papers and articles on pension issues. Dorothee holds a ‘Diplom’ in economics from the University of Munich. She received her DPhil in economic geography from the University of Oxford. She is Visiting Research Associate at the Smith School of Enterprise and the Environment, University of Oxford.

**DR EDWARD ODUNDO** is the Director, School of Pension and Retirement Studies (SPRS), Chairman of the Public Service Superannuation Scheme, Kenya (PSSS), a lecturer at the University of Nairobi, School of Business and a consultant in pensions, tax, corporate governance and financial services. He recently retired as the CEO of the Kenya Retirement Benefits Authority (RBA) – a position that he held since 2001 and was honoured by the former President, His Excellency, Hon. Mwai Kibaki, with The Moran of the Order of The Burning Spear (MBS). He has served as director on the boards of the Nairobi Securities Exchange (NSE), the Kenya Insurance Regulatory Authority (IRA) and Policy Holders Compensation Fund (PHCF). He is currently a Board member of the Insurance Training and Educational Trust (ITET), a Trustee of the Association for the Physically Disabled of Kenya (APDK), Advisory Board member of Africa Investor and the Outgoing President of the International Organisation of Pension Supervisors (IOPS). He has also published a book titled “The Doctrine of Strategic Planning”. Dr. Odundo has held various high level responsibilities including as the Commissioner of Value Added Tax at Kenya Revenue Authority and Founder and First Chairman of the Forum of VAT Commissioners in Africa with its headquarters in Accra, Ghana; First Financial Controller at the Kenya Revenue Authority (KRA), General Manager, East Africa Reinsurance Company Limited and Finance Manager at Kenya Reinsurance Corporation. Dr. Odundo holds a PhD in Business Administration (Strategic Management) from The University of Nairobi, an MBA in Strategic Management and Marketing and a BSc. Degree in Finance and Accounting. He is also an alumni of Harvard University, John F. Kennedy School of Government (HSB), London School of Economics (LSE), and holds membership of several leading professional bodies.

**DR ELISABETH RHYNE** is managing director of the Center for Financial Inclusion at Accion, a research and action center for collaboration on challenges confronting the microfinance and financial inclusion sectors. At the Center, she co-founded the Smart Campaign, a global effort to embed client protection principles and practices throughout the microfinance industry. As senior vice president of Accion from 2000-2008, Ms. Rhyne led Accion’s initial entry into Africa and India. Dr Rhyne has published numerous articles and books on microfinance, including Microfinance for Bankers and Investors, Mainstreaming Microfinance, and The New World of Microenterprise Finance (co-editor). She was director of the Office of Microenterprise Development at the U.S. Agency for International Development from 1994 to 1998. She holds a master's and Ph.D. in public policy from Harvard University and a bachelor's degree in history and humanities from Stanford University.
ERIC RWIGAMBA is the Director General of the Financial Sector Development for the Rwanda Ministry of Finance and Economic Planning. In this capacity, he oversees all financial sector (Banks, MFI, SACCOs, insurance, pension and capital markets) policies, reforms, strategies and legislative framework. Before joining the Ministry, he was the Technical Manager for Access to Finance Rwanda (DfID, WB, KFW funded program). He also served as the General Manager for GroFIN Rwanda (SME fund); the Country Head for Audit and Compliance at Ecobank Rwanda and as Audit Senior at Ernst Young, Uganda. Eric has diversified 14 years expertise in the development and implementation of Financial Sector policies, Strategies, Legislations and corporate Business planning. He is well vast with Finance and accounting, Budgeting and control, SMEs investment, and Auditing, investigation as well as Due diligence. He is a Board member of the Development Bank of Rwanda (BRD), a Board member and vice chair of Capital Market Authority (CMAC), and Advisory Board member of the Financial Intelligence Unit. He holds an MBA in Finance, Bachelor of commerce and is also an ACCA finalist.

ERNESTO BRODERSOHN OSTROVICH has over 20 years of international experience, working in the US and Mexico as a regulator, supervisor and as a consultant. He is currently leading a pinBox international consulting team to review the Kenya Mbao Pension Scheme. He is also a consultant on a World Bank sponsored study for extending pension coverage to the informal sector in Benin. He is simultaneously engaged in various projects internationally including with the pension fund management industry in Mexico. From 2003 through 2016 Ernesto worked at CONSAR, the pension’s supervisory and regulatory authority of Mexico, where held the position of General Director of Regulation and Financial Inclusion. As the DG at CONSAR, he was directly responsible for designing systems and regulations that would help expand voluntary pension coverage among informal sector Mexicans, through the use of technological innovation and regulatory tools. During his time at CONSAR, Ernesto played a key role in major financial sector reforms, such as the design and implementation of regulatory reforms focused on increasing savings, including demand-side (behavioral changes) and supply-side (channels) regulation, unemployment benefit reform, and the civil servants’ pension reform in 2007. He was in charge of regulatory changes and implementation to incorporate biometrics in the pension system focused on reducing overall long term financial sector expenses while facilitating payment processes, as well as coordinating the pension system participant’s various interactions among the different Social Security Institutes in Mexico. Before CONSAR, Ernesto was a consultant for nearly a decade managing and developing leading technology solutions for the financial, telecommunications and entertainment industries in the United States. Ernesto holds a Masters degree from the University of Southern California (USC), and a Bachelors degree with honors from the Instituto Tecnológico Autónomo de México (ITAM). He has post graduate studies specializing in project management and expert systems from the Instituto Tecnológico Autónomo de México (ITAM).
Evan Inglis is an actuary and thought leader on financial issues for retirement and pension plans. He is a Senior Vice President working in the Institutional Solutions Group of Nuveen Asset Management where he advises on strategies for investing pension and individual retirement fund assets. He has over 30 years of experience working with employee benefit plan financial matters and is a frequent speaker and writer on a wide variety of pension issues and ideas. Prior to his time at Nuveen, Evan served as the chief actuary at Vanguard where he advised pension clients on liability-driven investment strategies and served as a resource for institutional clients on pension and related issues. Evan spent the first part of his career with Watson Wyatt (now Willis Towers Watson) where he served in various capacities including as lead actuary for the General Motors pension account, Global Director of Quality and as a senior consultant in the Oslo, Norway and Stockholm, Sweden offices. Evan has served in significant leadership roles within the U.S. actuarial profession. He was on the Society of Actuaries Board of Directors from 2012 – 2014 and is currently a member of the American Academy of Actuaries Public Interest Committee. Previously, he chaired the Pension Finance Task Force, jointly sponsored by the Society and the Academy. He served on the Pension Practice Council of the Academy and the Pension Section Council of the Society, and has contributed to numerous other research and advocacy efforts within the profession. Evan is a Fellow of the Society of Actuaries and a CFA Charterholder. Evan is a thought leader in the pension, investment and retirement industry, writing and speaking frequently on various topics.

Gautam Bhardwaj is an Ashoka Fellow and a social entrepreneur. He is a co-promoter and director of pinBox Solutions, the Singapore-based enterprise committed to supporting digital pension inclusion in developing countries. He has over two decades of experience working extensively with governments, regulators, mainstream financial institutions and multilateral aid agencies across several developing countries in Africa and Asia on pension policy formulation, system design and implementation of inclusive pension programs targeting low income, non-salaried workers. Gautam pioneered the concept of “micro-pensions” in 2005 and established IIMPS – a unique social enterprise focused exclusively on assisting financially excluded and unbanked individuals accumulate micro-savings for their old age. IIMPS had achieved over 1.5 million voluntary micro-pension subscribers across 100-odd districts of 14 Indian States by 2015 when Gautam divested his stake in IIMPS to co-promote pinBox. He has led many World Bank, ADB and UN projects related to pension inclusion and has served on several government of India committees on postal, pension, tax and financial sector reforms. Gautam leads the digital pension solutions vertical at pinBox that provides governments, pension regulators and administrators a ready-to-deploy micro-pension administration IT platform for individual accounts-based voluntary DC pension schemes targeting non-salaried individuals.
DR GONZALO REYES is a Senior Economist for the Global Practice of Social Protection and Labor at the World Bank, where he has advised the governments of Colombia, Ecuador, Jamaica, Trinidad and Tobago and Turkey among others and carried out analytical work on pensions and social insurance. He holds a Ph.D in Economics from Harvard University and an undergraduate degree on Economics and Business from Pontificia Universidad Catolica de Chile. Prior to joining the World Bank he was Head of the Research Division at the Pensions Supervisory Authority of Chile (Superintendencia de Pensiones). During that period he lead a team in charge of supporting the analytical work and development of policy proposals in the Pension Reform Process of 2008 and the legal amendments to the Unemployment Insurance system implemented in 2009. He has also published research articles and written book chapters on pensions systems, unemployment insurance and social protection systems and participated in international seminars on these topics.

DR JAVIER BRONFMAN holds a Ph.D in Public Administration and Policy from American University, Washington D.C., United States of America. He received his Master of Public Administration from Wagner Graduate School of Public service New York University in 2007. His research and teaching includes public policy analysis, microeconomic development, poverty, inequality and social policy. He has worked as an economist at the World Bank and as a consultant for the Inter-American Development Bank and the United Nations Development Programa. He has also advise several governments in different areas related to social policies. His work as an international consultant ranges from pension reform in Trinidad and Tobago to poverty measurement and social program targeting in Indonesia. He teaches poverty and public policy, economic development and microeconomics. Since January 2016 he is Director of the Master Program in Economics and Public Policy at Universidad Adolfo Ibáñez in Santiago, Chile.

JOHN ASHCROFT was a senior manager at the UK Pensions Regulator from 2003-2008 and for most of that time inaugural president of the International Organisation of Pension Supervisors (IOPS). He is now an independent consultant specialising in the regulation and supervision of private pensions worldwide. He also serves on the pensions and insurance advisory panel of the Toronto Centre. His assignments have included: for the IOPS and OECD authoring or joint-authoring several working papers on pension supervision; leading on the risk based pension supervision component of technical assistance projects in Albania, Brazil and Costa Rica, Macedonia and Turkey, for the World Bank or European Commission, helping to draft a new Pensions Act for Guyana. He is also co-author of the World Bank’s Outcome Based Assessment Framework for pensions and several of its publications on implementing risk-based supervision. He has been helping to lead numerous courses on pensions supervision located over five continents.

DR KAMER KARAKURUM-OZDEMIR is a Senior Economist in the World Bank’s Middle East and North Africa Department. Prior to her latest position she was based in the
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**DR KAVIM V BHATNAGAR** has an in depth knowledge and broad based experience in designing, developing and articulating inclusive pension systems in developing countries like India, Nepal, Bangladesh (Ongoing), Rwanda, Cambodia etc. and has vast experience of implementing inclusive contributory and co contributory pensions for the poor in India. A specialist in development economics, social protection, social security and inclusive growth, he brings to the table a unique combination of an ex Indian civil servant (voluntarily retired in 2012) with a broad canvas on strengthening public financial management in social protection policy and strategy; a researcher and a writer, a consultant on PFM pension reforms and social protection and implemeneter of inclusive pension reforms –formal and informal sector. His achievements include Micro Pension Innovation in India including designing, innovating, testing, rolling out and implementing individual account based co/contributory micro pensions for the working poor and labour classes. An MBA and a Ph.D in Management (Pension Economics) he is well accomplished with vast research, consulting and implementation experience and has written extensively on inclusive finance, pension and development sector in refereed journals; presented several research papers at national and international conferences and has made substantial impact on Public Policy Domain and Governance. He is also a visiting faculty at the South Africa based Economic Policy and Research Institute (EPRI), National Academy for Training and Research in Social Security, Ministry of Labour, Government of India; Indian Institute of Management, Ahmedabad (IIMA) Bangalore (IIMB), Indore (IIMI), Institute of Chartered Accountants of India (ICAI) and has rendered consultancy on projects to the ADB, DFID, KfW, UNDP, World Bank, etc.

**KRISHNAN NARASIMHAN** has over two decades of core life insurance domain experience having served in responsible Managerial positions with Life Insurance Corporation of India (LIC) in India and other countries including as Country Head of LICI in Fiji. He was instrumental in launching the first ever microinsurance product in the Pacific in 2011. His engagement with financial inclusion began in Fiji where he served as one of the founding members of the National Financial Inclusion Task Force in 2010 and also chaired the Financial Literacy working group from 2010 to 2012. He is currently the Deputy Programme Manager for the Pacific Financial Inclusion Programme, a joint UNDP/UNCDF initiative. Based in Suva, Fiji PFIP operates in six Pacific countries (Fiji, Papua New Guinea, Samoa, Solomon Islands, Tonga and Vanuatu). Prior to the current assignment, Krishnan was the Financial Inclusion Specialist with the United Nations Pacific Financial Inclusion Programme (PFIP) based in the Solomon Islands. Krishnan
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MICHAE LA HAFEMAN is an actuary and independent international consultant. He provides policy and implementation assistance to national, regional, and international organizations on a variety of issues related to the insurance and pensions sectors. He builds capacity on financial regulation and supervision and contributes to the sound development and operation of financial services by advising governments on a range of other issues. Mr. Hafeman is a director of the Toronto Centre and chairs its Insurance and Pensions Advisory Board. He also serves as a member of the International Relations Council of the Canadian Institute of Actuaries. Mr. Hafeman previously worked in the Canadian and U.S. financial sectors, including serving as Assistant Superintendent at the Office of the Superintendent of Financial Institutions Canada, managing partner of the Toronto pension practice of a major consulting firm, and president of a life insurance company. He has also served as a member of the Public Interest Oversight Board, which oversees the public interest activities of the International Federation of Accountants, and Canada’s Auditing and Assurance Standards Oversight Council. Mr. Hafeman received a B.A. in Mathematics and Economics from the University of Minnesota – Duluth in 1974 and became a Fellow of the Society of Actuaries in 1977, a Member of the American Academy of Actuaries in 1979, and a Fellow of the Canadian Institute of Actuaries in 1990. He was recognized as a Distinguished Fellow by the International Association of Insurance Supervisors in 2007 and as a member of the Swenson Academy of Science and Engineering by the University of Minnesota – Duluth in 2009.

MIKE HEALE is responsible for global business development and client service for CEM's investment and administration benchmarking clients. Prior to joining CEM in 1999, Mike had 12 years of pension and life insurance marketing experience. He started his career in education as a basketball coach and lecturer at Laurentian University. Mike has an undergraduate degree in Physical and Health Education from Laurentian and a Master of Business Administration degree from the Richard Ivey School of Business, University of Western Ontario. CEM Benchmarking is an independent provider of objective cost and performance benchmarking information and best practice insights for pension and sovereign wealth funds worldwide. We firmly believe 'what gets measured gets managed'. CEM helps over 150 of the world’s top 300 pension schemes understand and manage their costs and performance. CEM is also a leading data source provider to international academics and furthers research in the investment industry. Further information about CEM's benchmarking services, databases, and research is available at www.cembenchmarking.com
MOHAMMAD MUSLIM CHOWDHURY has more than 30 years of experience as a civil servant and consultant in different areas of Public Financial Management and is the Additional Secretary at the Finance Division of Ministry of Finance of Government of Bangladesh. He has lead the initiatives in the Public Sector Financial Reform and holds in depth understanding of government systems, budgeting, accounting and auditing process and is currently actively engaged in a supervisory role in IFMIS (iBAS++) implementation. He was also actively involved in initial formulation and implementation of PPP Framework in Bangladesh and drafted the PPP Strategy and Policy 2010, issued by the Government of Bangladesh. A Postgraduate in Accounting from University of Chittagong and an MSc in Finance with Distinction from University of Birmingham, UK, he has worked as PFM reform Consultant with World Bank and DFID financed projects of Ministry of Finance and Ministry of Road Transport and Bridges. Mr. Chowdhury has served as Director in the Board of Directors of Bangladesh Krishi Bank, Sonali Bank Ltd (acting Chairman), Titas Gas Transmission and Distribution Company Ltd. Eastern refinery Ltd and Dhaka BRT Company Ltd as Government nominated Director. He was also a Council Member of ICMAB and National Heart Foundation. He was the first MD and CEO of Government owned Infrastructure Financing Company BIFFL. He was a Director in the Board of Directors of SAARC Development Fund (SDF), Bhutan.

NICOLETTE JENEZ was appointed as Deputy Executive Director of the Financial Services Commission of Jamaica effective July 17, 2017. In this role, she works with the Executive Director to lead an effective and consistent regulatory programme that provides adequate safeguards for insurance policyholders, members of private pension plans and the investing public. Ms. Jenez joined the FSC as Senior Director, Pensions in April 2005. Her professional experience in the financial services sector spans several years in the banking industry, which includes her tenure at the Bank of Jamaica and later serving in middle management at Citibank and senior management at Pan Caribbean Merchant Bank. She also worked in management consultancy and auditing while employed to audit firm Deloitte and Touche and served as Vice President of Pension Administration and Pension Marketing with First Life Insurance Company Limited and Life of Jamaica (now Sagicor Life Jamaica Limited) respectively. Ms. Jenez is currently serving her third term as President of the Caribbean Association of Pension Supervisors (CAPS), a regional body comprising pension regulators from 20 Caribbean nations. She holds a Bachelor’s Degree in Management Studies and a Master’s Degree in Accounting. She also holds professional designations as a Chartered Accountant in Jamaica and as a Certified Public Accountant in the United States of America. Ms. Jenez recently completed the International Diploma in Governance, Risk and Compliance from the International Compliance Association.

PARUL SETH KHANNA is co-founder and director of pinBox Solutions, a Singapore-based fintech enterprise committed to supporting digital pension inclusion in developing countries. She also heads the microPension Foundation, an India-based non-profit R&D hub. Over the years, Parul has led the development and implementation of digital outreach and distribution platforms for micro-pension and micro-insurance targeting low income
women in developing countries. This includes "gift-a-pension" -- the first global P2P ePension platform for pension and insurance inclusion of home help (maids, drivers, guards, cooks) and blue-collar workers in export factories in India. Parul has worked extensively in several countries in South Asia and East Africa and assisted governments and pension regulators with designing retirement literacy tools and strategies for expanding voluntary pension coverage among low income, non-salaried informal sector workers. Parul also leads global partnerships and the communities vertical at pinBox that is focused on fostering a constructive dialogue and cooperative action on pension inclusion and coverage expansion between the financial and pension inclusion policy, regulatory, research and business communities. She co-edited the book “Saving the Next Billion from Old Age Poverty: Global Lessons for Local Action” with William Price and Gautam Bhardwaj published in October 2017. In a previous life, Parul was a journalist in the electronic media and has worked at BBC, CNBC and NDTV.

PAUL MARTINIELLO is a Director at CEM Benchmarking and oversees the business development and management of CEM’s Latin American clients as well as for a select group of North American pension investment and administration benchmarking clients. Paul has over 20 years of experience working within the Pension and Investment industry both in Canada and Latin America. He has held various roles providing him a broad experience in operations, risk management, M&A, financial advice & planning and asset management. Paul holds a Bachelor of Commerce in Finance from Ryerson University, is a Chartered Investment Manager (CIM), and is a graduate of the Schulich School of Business International MBA program where he specialized in Finance with a regional focus on Latin America.

RAGHU MALHOTRA is president, Middle East and Africa for Mastercard, and sits on the company’s Global Management Committee. Based in Dubai, Mr. Malhotra is responsible for driving the evolution of the company's technologies and delivering increased value to Mastercard stakeholders across 69 markets. Mr. Malhotra joined Mastercard in 2000 and has held a variety of leadership roles, spanning General Management, Marketing, Business and Product development across multiple geographies in Asia, Middle East and Africa. He was most recently the Division President, Middle East & North Africa. Prior to joining Mastercard, Mr. Malhotra worked for Citicorp Credit, American Express and ANZ Grindlays Bank in a variety of leadership roles across the Consumer Franchise and Financial Services businesses. Mr. Malhotra holds a variety of board and advisory positions across international markets. He is a member of the board of directors of INJAZ Al-Arab (JA Worldwide) Middle East and North Africa, an organization focused on building youth entrepreneurial skills in the region, and also has an advisory role in the Rwandan Ministry of Finance and Economic Planning's Informal Sector Pensions Project. Forbes ranked Mr. Malhotra as one of the top Indian leaders in the region in 2014, 2015 and 2016. He graduated with an honors degree in Commerce from the University of Delhi and earned an MBA from the Melbourne Business School, University of Melbourne. He also has management training from IMD, Lausanne.
ROBERT PALACIOS is Global Lead for the Pensions and Social Insurance Group in the Social Protection and Labor Practice of the World Bank. Between 1992-1994, he was a member of the research department team that produced the World Bank’s influential volume on international pension systems, “Averting the Old Age Crisis: Policies to Protect the Old and Promote Growth”. Since 1995, he has divided his time between operational work and research with work in more than two dozen countries in every region of the world. His publications include articles and books on old age poverty, health insurance and a wide range of pension policy issues. Recently, he was part of the team that produced the flagship report on Aging in East Asia entitled “Live Long and Prosper”.

SEKAYI CAMPBELL was appointed as Chief Actuary of the Financial Services Commission, Jamaica, in November 2014. At the FSC, she manages the division responsible for providing advice and guidance on all actuarial matters concerning registered and licensed entities. Ms. Campbell holds a Bachelor of Science degree in Actuarial Sciences from the University of the West Indies and a Master of Mathematics degree from the University of Waterloo. She qualified as a Fellow of the Society of Actuaries and, after gaining experience in Canadian actuarial practice, went on to qualify as a Fellow of the Canadian Institute of Actuaries. She is also a certified Professional Risk Manager. Ms. Campbell is the Vice Chair of the IAIS’ Financial Inclusion Working Group. Her research interests include economic security issues, particularly for the most vulnerable citizens of our society.

DR SHASHANK SAKSENA is an Indian Economic Service officer from 1987 batch and has degrees of Master of Arts in Economics and LL.B. from University of Allahabad, “M.Sc. in Macro Economic Policy and Planning for Developing Countries” from the University of Bradford, United Kingdom and Ph.D. in “Agricultural Economics” from Dr B. R. Ambedkar University, Uttar Pradesh. Currently, Dr Saksena is an Adviser in the Department of Economic Affairs, Ministry of Finance and is involved with formulation of financial sector policy and legislative reforms. He has also worked in the areas of formulation of reforms in the areas of agricultural price policy, capital markets, external commercial borrowings, banking, pension reforms and State finances in various Central Government Ministries.

STEVEN TANNER is the Chairman of the Council of the Society of Actuaries of Indonesia (2015-2017), member of the Supervisory Board and Chairman of the Certification Committee of the Financial Institution Pension Funds in Indonesia. He is a member of international and Indonesia MENSA. He holds a Bachelor of Applied Science degree in Mathematics and Computing from Curtin University, Western Australia (1986) and is a Fellow of the Society of Actuaries of Indonesia (1992). With more than 30 years’ experience in pension and insurance consulting, he is frequently invited as speaker at pension, employee benefits and insurance conferences, workshops and training program. Steven is actuary and principal of PT Dayamandiri Dharmakonsilindo, an actuarial consulting firm based in Jakarta, Indonesia.
SUSY CHESTON is an innovative leader with over 25 years of international experience providing a range of financial services to underserved populations. She is currently consulting with the Center for Financial Inclusion at Accion (CFI) on a project that she conceived and launched in partnership with the Institute of International Finance to promote the leadership of commercial banks in financial inclusion. "The Business of Financial Inclusion: Insights from Banks in Emerging Markets," for which she served as lead author, highlights the work of 24 emerging market banks. As head of the Financial Inclusion 2020 (FI2020) initiative housed at CFI, Susy engaged 200 organizations in a global consultative process to articulate a roadmap to financial inclusion which was endorsed by 350 senior public and private sector leaders at a widely acclaimed Global Forum supported by 18 leading organizations, including Citi, MasterCard, the Gates Foundation, Visa, and MetLife Foundation. She has also promoted effective approaches to financial capability, and recently managed the project "A Change in Behavior: Innovations in Financial Capability." She has also engaged in advocacy with policy-makers as co-chair of an industry-wide microfinance coalition and overseen organizational development, product development, policy and research as senior vice president at Opportunity International. As founding executive director of the Women’s Opportunity Fund, Susy launched a model to provide microfinance services to women. She oversaw the program's global roll-out at Opportunity International, which currently has 4 million active loan clients.

ULUC UCOZ joined the Turkish Treasury in 1997, where he currently is the head of private pensions. He worked as part of the insurance supervision unit from 1997 to 2001, where his area of responsibility was mostly life insurance supervision with some work concerning non-life insurance. He joined the private pensions team in 2003, where he led several key projects including the recent reforms concerning transition to the state matching contribution system (2013) and the auto-enrollment reform. (2016). Uluc has several national and international roles in addition to his role as the head of private pensions. He is a member of the board of directors of the Pension Monitoring Center, a member of the Bureau of the OECD Working Party on Private Pensions, and member of the executive committee of the IOPS. He holds a B.S. Degree in Business Administration from Hacettepe University as well as an M.S. Degree in Risk Management & Insurance from Georgia State University where he was granted the 2003 Graduate Student of the Year Award. His academic work includes papers presented in National and International Statistics Congresses concerning insurance derivatives, motor-insurance reserving models, and insolvency put options.

VARSHA MARATHE DAYAL is Senior Financial Specialist, South Asia Finance and Private Sector Unit at The World Bank’s New Delhi Office. Since joining the World Bank in April 2003, she has worked on capital market development issues including corporate debt markets, corporate governance, financial regulation, pension reforms and private sector development at the state-level in India. She has also worked on capital market issues in Pakistan, Bangladesh, Sri Lanka and Nepal. Ms. Marathe Dayal has previously worked with the capital markets regulator Securities and Exchange Board of India in Mumbai.
and Delhi where she focused on policy issues related to the secondary capital market development, primary markets and corporate governance. She holds an MBA in Finance and a Bachelors degree in Commerce.

**WILLIAM PRICE** works for the World Bank on pension regulation and supervision, market structure and investment strategy. His work includes country engagement in all regions and research and development on global best practice. He designed the new Outcomes Based Diagnosis and Assessments for private pension (OBA) and Outcomes and Risk Based Supervision (ORBS) models and has published widely on a wide range of pension issues as well as developing the World Bank's 6th and 7th Global Pension and Saving Conferences. He is a Program Leader and on the Advisory Board of the Toronto Centre for Global Leadership in Financial Supervision and on the Advisory Board of the World Bank’s 401(k) Pension Plan. An economist by training, his career included three Budgets as Private Secretary to Gordon Brown and leading the Assets, Savings and Wealth team at the UK Treasury. Will's financial policy expertise combines with past roles on development, macroeconomics and growth including a spell in the IMF/World Bank policy division in the Department for International Development. He was previously Head of Policy at the UK's Pensions Regulator, worked with the OECD and IOPS where he was vice-chair of the Technical Committee and was the UK Regulator's representative on the Board for Actuarial Standards. He received his first degree from Oxford University and has a Masters in Economics from University College London. He is a member of the Royal Economic Society and Chartered Institute of Insurance. He co-edited the book “Saving the Next Billion from Old Age Poverty: Global Lessons for Local Action” with Parul Seth Khanna and Gautam Bhardwaj published in October 2017.

**YVES GUÉRARD** has been President of the Sobeco Group and Executive Partner of Ernst & Young (Canada). He was elected as Secretary General of the International Actuarial Association from 1997 to 2010. He is currently a member of the CIA Climate Change and Sustainability Committee and of the Joint Work Group for the Actuarial Climate Indices in North America. From 1996 to 2001, he was Director for a Canadian Technical Assistance Project in Indonesia to strengthen the non-bank financial sector. In 2006 he was appointed as expert for a World Bank project on the reform of Civil Service pension in Indonesia and in 2013 for the implementation of Universal Health Coverage (UHC) in the United Arab Emirates. From 2013 to 2015 he was retained by ADB as Senior Actuary Specialist to assist the Ministry of Finance and the Planning Agency in the implementation of Social Security Reform in Indonesia. More recently he was appointed as consultant for READI, a project financed by Canada to support capacity development for the actuarial profession in Indonesia. In 1993, he has been conferred the Commemorative medal for the 125th anniversary of the Confederation by the Governor General of Canada. In 1997, he was chosen one of top 20 most influential pension professionals in Canada by Benefits Canada magazine. In 2002, he received the President Award from the Canadian Institute of Actuaries and the Society of Actuaries Presidential Award. In 2010, he became an IAA Medalist.
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<td>AES</td>
<td>Approved Existing Schemes</td>
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<tr>
<td>AFI</td>
<td>Alliance for Financial Inclusion</td>
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<tr>
<td>AFIS</td>
<td>Automatic Fingerprint Identification System</td>
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<tr>
<td>AFP</td>
<td>Administradora de Fondo de Pensiones (Pension Fund Administrator)</td>
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<td>Afores</td>
<td>Retirement Funds Administrators</td>
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<td>AFSA</td>
<td>Albanian Financial Supervisory Authority</td>
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<td>AIC</td>
<td>Alternative Insurance Company</td>
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<td>AIOS</td>
<td>International Association of Pension Funds Supervision</td>
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<td>AKI</td>
<td>Association of Kenya Insurers</td>
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<td>ALM</td>
<td>Asset Liability Management</td>
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<td>AMC</td>
<td>Asset Management Company</td>
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<td>AML</td>
<td>Anti-money laundering</td>
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<td>APA</td>
<td>Africa Pension Awards</td>
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<td>API</td>
<td>Application Program Interface</td>
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<td>APRA</td>
<td>Australian Prudential Regulation Authority</td>
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<td>APS</td>
<td>Aporte Previsional Solidario (Solidarity Subsidy)</td>
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<td>APY</td>
<td>Atal Pension Yojana</td>
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<td>APJII</td>
<td>Internet Service Provider Association</td>
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<td>ARBS</td>
<td>Association of Retirement Benefits Scheme</td>
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<tr>
<td>ASEAN</td>
<td>Association of Southeast Asian Nations</td>
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<tr>
<td>A2F</td>
<td>Access to Finance</td>
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<td>AUM</td>
<td>Assets Under Management</td>
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<td>BBS</td>
<td>Bangladesh Bureau of Statistics</td>
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<td>BCs</td>
<td>Bank Correspondents</td>
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<td>BDT</td>
<td>Bangladesh Taka Currency</td>
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<td>BEFTN</td>
<td>Bangladesh Electronic Fund Transfer Network</td>
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<td>BES</td>
<td>Individual Pension Scheme</td>
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<td>BIMS</td>
<td>Biometric Identification Management System</td>
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<td>BOJ</td>
<td>Bank of Jamaica</td>
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<td>BOT</td>
<td>Boards of Trustees</td>
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<td>BPE</td>
<td>Bureau for Public Enterprises</td>
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<tr>
<td>BPJS</td>
<td>Badan Pelenggara Jaminan Sosial (Administrative Body)</td>
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<tr>
<td>BRAC</td>
<td>Building Resources Across Communities</td>
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<tr>
<td>CARE</td>
<td>Cooperative for Assistance and Relief Everywhere</td>
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<tr>
<td>CARTAC</td>
<td>Caribbean Regional Technical Assistance Centre</td>
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<tr>
<td>CASEN</td>
<td>National Socio-Economic Characterization Survey</td>
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<td>CBK</td>
<td>Central Bank of Kenya</td>
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<td>CBM</td>
<td>Confidence Building Measures</td>
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<td>CBN</td>
<td>Cost of Basic Needs</td>
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<td>CBS</td>
<td>Core Banking System</td>
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<td>CCS</td>
<td>Conditional Cash Transfers</td>
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<td>CEDLAS</td>
<td>Center for Distributive, Labor and Social Studies</td>
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<td>CGA</td>
<td>Controller General of Accounts</td>
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<td>CGAP</td>
<td>Consultative Group to Assist the Poor</td>
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<td>CIC</td>
<td>Cooperative Insurance Company</td>
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<td>CIPR</td>
<td>Comprehensive Income Product for Retirement</td>
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<td>CMA</td>
<td>Capital Market Authority</td>
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<td>CONEVAL</td>
<td>National Council for the Evaluation of Social Development Policy</td>
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<td>CONSAR</td>
<td>Pension System Regulator</td>
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<td>CPFA</td>
<td>Closed Pension Fund Administrators</td>
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<td>CPI</td>
<td>Consumer Price Index</td>
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<td>CPS</td>
<td>Contributory Pension Scheme</td>
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<td>CRM</td>
<td>Customer Relationship Management System</td>
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<td>CSFs</td>
<td>Critical Success Factors</td>
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<td>CSI</td>
<td>Cooperate Social Investment</td>
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<td>CSP</td>
<td>Civil Service Pension</td>
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<td>CUs</td>
<td>Polish Credit Unions</td>
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<td>CURP</td>
<td>Clave Unica de Registro de Poblacion (Unique Identity Code)</td>
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<tr>
<td>CT-OVC</td>
<td>Cash Transfer for Orphans and Vulnerable Children</td>
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<td>DB</td>
<td>Defined Benefit</td>
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<tr>
<td>DC</td>
<td>Defined Contribution</td>
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<tr>
<td>DDO</td>
<td>Drawing Disbursing Officer</td>
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<td>D Half</td>
<td>Disburser</td>
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<td>DWP</td>
<td>Department for Work and Pensions</td>
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<td>EAC</td>
<td>East African Countries</td>
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<tr>
<td>EAP</td>
<td>Economically Active Population</td>
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<td>ECCB</td>
<td>Eastern Caribbean Central Bank</td>
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<td>EDPRS 2</td>
<td>Development and Poverty Reduction Strategy</td>
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<td>EICV</td>
<td>Integrated Household Living Conditions Survey</td>
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<td>ENIGH</td>
<td>Survey of Household Income and Expenditure</td>
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<td>ENOE</td>
<td>National Employment and Occupation Survey</td>
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<td>EPF</td>
<td>Employees’ Provident Fund</td>
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<tr>
<td>EPFO</td>
<td>Employees’ Provident Fund Organisation</td>
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<td>EPS</td>
<td>Encuesta de Proteccion Social (Social Protection Survey)</td>
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<td>EPS</td>
<td>Employees’ Pension Scheme</td>
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<td>ERISA</td>
<td>Employee Retirement Income Security Act</td>
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<td>ESG</td>
<td>Environmental, Social, and Governance</td>
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<td>FAC</td>
<td>Fola Adeola Pension Reform Committee</td>
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<tr>
<td>Acronym</td>
<td>Full Form</td>
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<tr>
<td>FAQ</td>
<td>Frequently Asked Questions</td>
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<td>FEMM</td>
<td>Forum Economic Ministers Meeting</td>
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<td>FGDs</td>
<td>Focused Group Discussions</td>
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<td>FGN</td>
<td>Federal Government of Nigeria</td>
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<td>FINSAIC</td>
<td>Financial Sector Adjustment Company Limited</td>
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<td>FJD</td>
<td>Fiji Dollar</td>
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<tr>
<td>FMCG</td>
<td>Fast-Moving Consumer Goods</td>
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<td>FMF</td>
<td>Fund Management Fee</td>
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<td>FNPF</td>
<td>Fiji National Provident Fund</td>
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<tr>
<td>FSC</td>
<td>Financial Services Commission</td>
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<tr>
<td>FTE</td>
<td>Full-time-equivalent Staff</td>
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<td>GBP</td>
<td>Great Britain Pound Currency</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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<tr>
<td>GINI</td>
<td>Measure of Income Inequality</td>
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<td>GLI</td>
<td>Group Life Insurance</td>
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<td>GOB</td>
<td>Government of Bangladesh</td>
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<td>GOI</td>
<td>Government of India</td>
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<tr>
<td>GRC</td>
<td>Governance, Risk, and Compliance</td>
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<td>GSIA</td>
<td>Global Strategic Investment Alliance</td>
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<td>GSMA</td>
<td>Global System for Mobile Communications Association</td>
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<td>G2P</td>
<td>Government-to-people</td>
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<td>HDDWWA</td>
<td>Husband Deserted Destitute Women and Widow Allowance</td>
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<td>Household Income and Expenditure Surveys</td>
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<td>Her Majesty's Revenue and Customs</td>
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<td>HSNP</td>
<td>Hunger Safety Net Program</td>
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<td>International Association of Actuaries</td>
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<td>IBD</td>
<td>Investment Benchmarking Database</td>
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<td>ICA</td>
<td>Indexed Career Average</td>
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<td>ICC</td>
<td>Integrated Circuit Card</td>
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<td>ICT</td>
<td>Information, Communication and Technology</td>
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<td>Inter-American Development Bank</td>
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<td>IDR</td>
<td>Indonesian Rupiah</td>
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<td>Insurance Development and Regulatory Authority</td>
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<td>Indonesian Stock Exchange</td>
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<td>Institute of Fiscal Studies</td>
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<td>Invest India Income and Savings Survey</td>
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<td>Invest India Micro Pension Services</td>
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<td>ILO</td>
<td>International Labour Organization</td>
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<td>International Monetary Fund</td>
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<td>Mexican Social Security Institute</td>
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<td>INEGI</td>
<td>Institute of Statistics and Geography</td>
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<td>INFONAVIT</td>
<td>Mexican Federal Institute for Worker's Housing</td>
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<td>Indian Rupee Currency</td>
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<td>INSTAT</td>
<td>Albanian Institute of Statistics</td>
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<td>IOPS</td>
<td>International Organization of Pension Supervisors</td>
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<td>Implicit Pension Debt</td>
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<td>Individual Pension System</td>
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<td>Insurance Regulatory Authority</td>
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<td>IRDAI</td>
<td>Insurance Regulatory and Development Authority of India</td>
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<td>Social Security Institute for Public Sector Workers</td>
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<td>IYAK</td>
<td>Labor Solidarity Institution</td>
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<td>Joint Tax Board</td>
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<td>KCB</td>
<td>Kenya Commercial Bank</td>
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<td>KMK</td>
<td>Keputusan Menteri Keuangan (Decree from Minister of Finance)</td>
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<td>Kenya Post Office</td>
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<td>KYC</td>
<td>Know Your Customer</td>
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<td>LDCs</td>
<td>Least Developed Countries</td>
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<td>Insurance Institution</td>
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<td>Long Term Savings Scheme</td>
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<td>M&amp;E</td>
<td>Monitoring and Evaluation</td>
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<td>Mbao</td>
<td>Kenya Pension Plan</td>
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<td>Micro-Finance Institutions</td>
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<td>Mahatma Gandhi National Rural Employment Guarantee Act</td>
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<td>Monthly Income Scheme</td>
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<td>Ministry of Labour and Social Security</td>
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<td>Management Information System</td>
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<tr>
<td>MSMEs</td>
<td>Micro, Small, and Medium Enterprises</td>
</tr>
<tr>
<td>NASCU</td>
<td>National Association of Cooperative Savings and Credit Unions</td>
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<tr>
<td>NAICOM</td>
<td>National Insurance Commission</td>
</tr>
<tr>
<td>NASFUND</td>
<td>National Superannuation Fund</td>
</tr>
<tr>
<td>NAV</td>
<td>Net Asset Value</td>
</tr>
<tr>
<td>NBER</td>
<td>National Bureau of Economic Research</td>
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</table>
Over 1.2 billion informal sector workers in developing countries are excluded from formal pension arrangements and face the grim prospect of living in poverty for over two decades after they are too old to work.

Without an urgent and effective response to pension exclusion, poverty among the future elderly in developing countries will emerge as the dominant cause of increased global poverty. On the other hand, nations that succeed in achieving comprehensive coverage of public and contributions-based pension and insurance programs, will benefit from a surge in stable, long-term savings that can fuel economic growth, employment and infrastructure development.

The book presents a number of new ideas on how countries can combine existing digital financial inclusion infrastructure, with well-designed pension systems to provide secure, simple and universal access to affordable pensions. It brings together a unique collection of country-level case-studies and thematic chapters by policy makers, market practitioners and academics working at the forefront of expanding digital pension inclusion. It will be an indispensable guide to anyone who wants to understand how to combine advances in ID, IT, digital payments and financial inclusion with best practice solutions in mainstream finance to design well-governed pension markets that work in the best interests of members.