IMPACT OF THE DIGITALISATION OF FINANCIAL SERVICES ON SUPERVISORY PRACTICES IN THE PRIVATE PENSION SECTOR

CASE STUDY: KENYA

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INTERNATIONAL ORGANISATION OF PENSION SUPERVISORS

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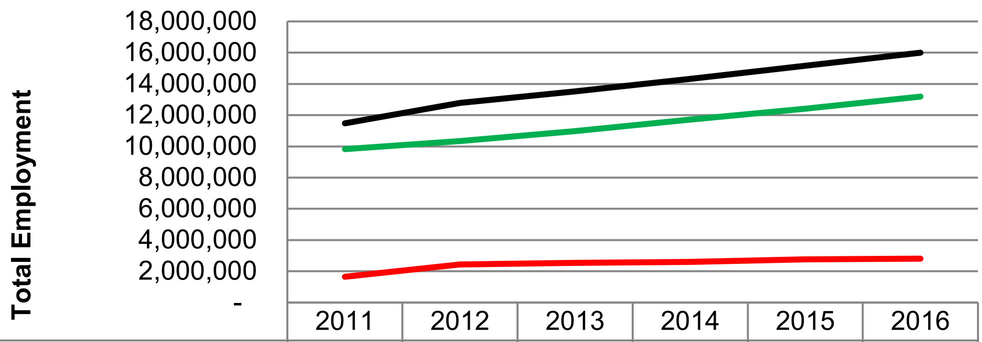
1. Retirement Benefits Sector in Kenya

1. The pension system in Kenya largely covers the working population in the public and the private sector. It favours formal-sector workers who enjoy access to existing formal pension arrangements to the exclusion of the self-employed and the ever-increasing number of informal-sector workers. Three pillars support the system. Pillar Zero, state-funded for citizens beyond age 65, was introduced in 2009 on a pilot basis. The minimum age has been revised upwards to 70 years with a monthly payment of KES 2000, equivalent to about USD 20. Pillar One is contributory and mandatory represented by the National Social Security Fund (NSSF). However, an element of voluntary contribution was introduced through the NSSF Act, 2013. Pillar Two is employer-based and contributory except for the Civil Service Scheme. The latter, however, is undergoing conversion following the enactment of the Public Service Superannuation Act, 2012. Individual Pension Schemes, on the other hand, are established and operated by independent financial institutions.

2. Pension Coverage

2. The graph below shows the extent of pension coverage among Kenya's workforce over a six-year period from 2011-2016. Coverage falls far below total employment, indicating that most of the workforce is not covered. The national pension coverage is about 20% of the labour force (RBA Statistical Digest, 2017). The majority of those in schemes, however, work in the formal sector – public or private. The informal sector, which employs the majority of workers (83.4%), remains generally unreached by pension services. Given the low coverage, impetus to encourage take-up became profound. The Retirement Benefits Authority (RBA), working together with other stakeholders in the industry, has had to come up with initiatives to expand pension coverage, especially to the informal sector where nearly all workers are not covered by any form of pension arrangement.



	2011	2012	2013	2014	2015	2016
Employment	11,475,	12,782,	13,524,	14,316,	15,163,	15,996,
Pension Coverage	1,651,5	2,446,1	2,544,1	2,596,6	2,758,6	2,810,6
Uncovered	9,823,6	10,335,	10,980,	11,720,	12,404,	13,185,

3.

3. Case for Digitalisation in Kenya – Skewed Labour Market

4. Kenya's labour market as observed above is dichotomous and highly skewed towards the informal sector, which accounts for four in every five workers and continues to create most jobs. In 2017 it created 787,800 jobs compared to 110,000 created by the formal sector (Economic Survey 2018). Besides, it is also a significant contributor to GDP at about 23%. The sector, though generally unregulated, is

competitive and key to economic development. Nevertheless, it is quite weak on pension coverage, which needs to be developed. One of the mandates of the Retirement Benefits Authority (RBA) is to promote the development of the pension sector. Its pension coverage development, nonetheless, cannot be adequately enhanced by the existing system because of the unique attributes of its workers. They earn generally low, irregular incomes. Further, workers change job and type of activity frequently, thereby experiencing high labour mobility. These attributes, amongst others, dissuade participation in existing saving schemes. These serve workers in the formal sector earning regular and stable incomes, who can therefore afford to make predetermined monthly contributions towards their retirement. Because of low and irregular earnings and high labour mobility, innovation was paramount in designing new plans to help the informal sector save in a similar fashion. RBA and the National Federation of “Jua Kali”[1] Associations[2], therefore, entered into a collaboration to establish a suitable retirement savings plan that would cater for the bigger sector’s workers.

4. Birth of Digital Mbao Pension Plan

5. Mbao[3] Pension Plan was set up as an independent pension plan in 2011 to specifically target workers in the informal sector, the majority of whom are self-employed and run micro, small and medium enterprises (MSMEs), commonly referred to as “jua kali” in Kenya. Mbao Pension Plan is a voluntary, defined contribution provident fund. It began as a successful Corporate Social Investment (CSI) initiative. The Authority collaborated with Ear, Nose and Throat specialists under the Operation Ear Drop Kenya initiative to undertake a Hearing Conservation Program (Kwena and Turner, 2013). It was designed to provide free ear check-ups for artisans, particularly targeting welders and tinsmiths at a Nairobi estate called Kamukunji. During the event, RBA conducted pension education and awareness campaigns for the artisans, stressing the importance of saving for retirement. Subsequent meetings held with their representatives discussed ways of forming a vehicle to enable them save for retirement. The scheme began operations in Nairobi and today has spread to all 47 counties in the country.

6. Mbao Pension Plan requires members to make a daily minimum KES 20 contribution using their mobile phones. They use the mobile money transfer services offered by the two leading networks in Kenya, Safaricom and Airtel. This means payments can be made through M-PESA and Airtel Money transfer services in real time 24 hours a day from anywhere within the mobile phone network coverage. They can do this from the comfort of their homes or businesses without the need to visit a financial institution. The contributions are reflected instantly on the members’ phones as receipted by the Administrator of the scheme. They can also check their contribution balances online. The transaction fee charged by the service providers was initially subsidised. This helped address low incomes and made it affordable to most workers to also send the largely affordable contribution rate of KES 20 a day. When the daily contribution is too much to make due to seasonality of incomes in the sector, the obligation can be summed up and sent in weekly, monthly or annually as is suitable. Thus, in accordance with income flows, contributions can always be sent in to cover arrears or paid in advance to cover for leaner periods ahead. This flexibility addressed many concerns of the sector’s workers occasioned by their unique attributes.

7. The ubiquity of mobile phones and experience of most Kenyans with mobile money services, which commenced with money transfers in March 2007 when M-PESA was introduced, greatly aided the quick uptake of the Mbao product. The plan is fulfilling its objectives of extending pension coverage to the

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1 Jua Kali is a Kenyan terminology for economic activities undertaken under the open sky and subject to the hot sun. Although some artisans now operate under sheds, the term still applies to these as well.

2 An umbrella body for workers in the informal sector.

3 Mbao is a Kenyan colloquial word for KES 20, which was the equivalent of one Sterling Pound (locally pronounced Mbao) just at independence in 1963. Today it is the equivalent of USD 0.2.

informal sector by enabling workers to enrol and save for their retirement in order to live dignified lives in old age.

5. Mbao Pension Plan Performance

8. The Plan has provided an opportunity for workers in the informal sector to save for their retirement. A number of formal-sector workers, even those who belong to other pension savings arrangements, have also been attracted to the scheme to boost their retirement incomes. In 2017, membership had risen to about 100,000 with a fund value of nearly KES 130 mln. However, over the period annual enrolment numbers have been declining, going by the number of active membership (See table below). Both active membership and amounts contributed in 2016 dropped by more than 50% from the peak in 2014.

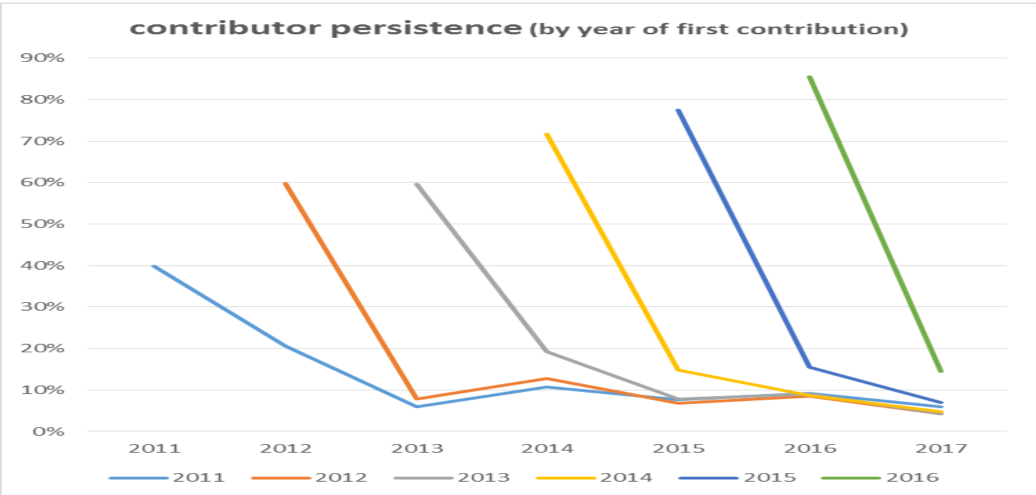
Active membership by contributions

Year	No. of active* members	No. of Contributions	Total amount (KES)
2010	164	477	117738
2011	5233	17732	2829297
2012	23949	122451	22614201
2013	18123	148053	28929914
2014	24550	203818	32520793
2015	17685	117938	24762972
2016	11684	73733	17965648
Total		**684202**	**129740563**

Source: Contribution Database, Eagle Africa 2017.

*Active member means the member made at least one contribution in the year

9. Only a few contributors do so persistently over time as shown in the chart below. For example, of nearly 40% of members who joined in 2011, just about 6% were persistent contributors and the story is consistent over the years. This kind of performance can be attributed to a number of challenges the scheme faces, most of which are operational.



Source: Computations from contribution database, Eagle Africa 2017.

10. One such challenge stems from the current institutional arrangement, which relies heavily on voluntarism and its continued treatment as a corporate social responsibility (CSR). Thus, despite the existence of a team of individuals who are committed to the success of the scheme, CSR should not be the

only driver for its sustainability. It now needs a team with clear roles and responsibilities that is effective and efficient to run the promotion and administration of the scheme.

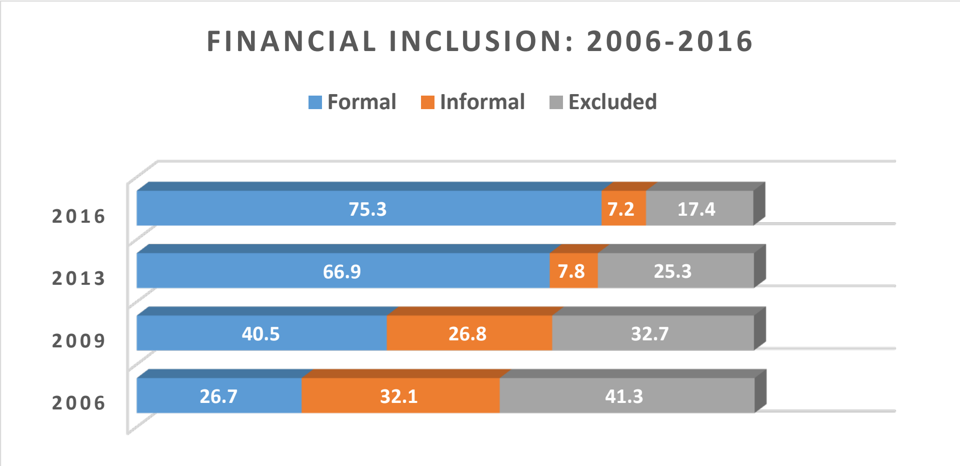
11. Secondly, the platform on which the Plan runs is prone to frequent down-time challenges and in certain cases fails to update member contributions and balances in real time. This, however, is due for overhaul to facilitate smooth and seamless information provision. It is important to have an efficient system running treasury and financial planning of the scheme and better information exchange with the Administrator.

12. Although the scheme has not drawn in the numbers of membership initially thought, stakeholder consultations tend to agree that the scheme has drawn membership from different trades in the informal sector. The scheme treats all informal-sector workers in the same manner and does not address their peculiar needs. For example, motorcycle taxis, fishermen, tailors and roadside vendors do not always have similar interests. The creation of a number of Mbao schemes segmented by different economic activities may be useful in boosting enrolment.

13. In addition, observations over time indicate that workers will not join the scheme unless they are confident about it. Unless they fully and correctly understand the concepts, its features, processes including complaints handling and their own rights and responsibilities, they will not join. This requires an education toolkit and an effective segmented delivery of the same to establish uniform knowledge and understanding of the scheme across persons with different demographics (age, gender, occupations) and different locations (rural, urban). Mbao has demonstrated that voluntary schemes based on mobile phone technology can be an important instrument to promote savings among workers in the informal sector. However, it needs to have the right institutional arrangements and a very responsive platform in place.

6. Advent of Digital Financial Services

14. The Mbao Pension Plan, which runs on a digitised mobile-phone-based platform, is a latecomer to the digitised financial services space. This commenced with the launch of M-PESA money transfer service in March 2007. Over the past 11 years M-PESA has contributed to the evolution of mobile money services to include payments systems and currently the provision of inclusive formal financial services such as credit, savings, insurance, investment and pensions. Its effect has been great, dissolving distances between services providers and their customers – all you need is your mobile money wallet in your mobile phone. There has been a significant reduction to transitions costs and rapidly expanded financial access for the majority of consumers who before had no access at all (Shem, et al., 2012). Before the launch of M-PESA formal financial inclusion was only 26.7%, rising steadily to 40.5% in 2009, 66.9% in 2013 and 75.3% in 2016, according to financial access surveys conducted over the years. It also led to a reduction in informal financial access and those totally excluded from formal and informal financial services (See chart below).



Source: Financial Access Surveys – Various Issues.

Digitisation of financial services

Use Case	Examples
Money Transfer	M-PESA, airtel money, PesaLink
Retail Payments	LIPA NA M-PESA, M-PESA Paybill service
Credit	M-Shwari, M-KOPA
Services	M-AKIBA
Government	eCitizen, m-tiba
Pensions	Mbao Pension Plan

15. Today many financial services are offered digitally. They include those listed in the chart above: Money Transfer Services (M-PESA, Airtel Money, PesaLink, etc.); Retail Payments Services (Lipan na M-PESA, M-PESA Playbill, Airtel Playbill, etc.); Credit (Mshwari, Mkopa, etc.); Services (eCitizen); Government (M-Akiba, Treasury Mobile Direct (TMD), M-tiba, etc.); Pensions (Mbao Pension Plan), etc.

7. Regulatory and Supervisory framework

16. The regulation and supervisory framework for digitised financial services was not envisaged. The existing structures were therefore not suitable for them. Nevertheless, this is understandable since regulators are naturally laggards. The markets have to innovate and regulation then follows to ensure fair play amongst market players and the protection of consumer interests. Nonetheless, if the regulators are not flexible enough to provide for innovation and apply their frameworks as is, then innovations will be stifled. To ensure new products and services and systems of operation are realised, they are required to be innovative as well in terms of how they regulate and supervise. The experience with M-PESA showed that this is the process that enabled its creation. It emerged as a product of technology and the primary regulator was the Communications Authority of Kenya (CA). However, it was used to deliver a financial service, which should be regulated and supervised by a financial sector regulator, in the case the Central Bank of Kenya (CBK).

17. Realising this development, the two regulators engaged in dialogue to find out how best to proceed with responsibility. Led by CBK, they adopted a wait-and-observe approach. It served the innovation well for within a short span of time, it brought forth more benefits than threats. Studying the threats on the other hand enabled the regulators to come up with the regulations to supervise its operations effectively. Such regulations included limitations on sums that can be sent and received by phone, which still applies, although the limits have gone up; and how much to keep in the phone; setting up of Trust bank accounts with major banks; and a host of requirements to deal with the massive network of Telco agents in terms of licensing their operations.

18. This worked and it has been akin to the sandbox approach, which allows businesses to test innovative products, services, business models and delivery mechanisms in the real market, with real consumers. This is done under rules that allow innovations to develop in a controlled environment where some regulations and supervisory measures are relaxed in order to understand them well and develop regulations that are suitable for them. Where innovations cross the boundaries of different regulators, supervisory co-operation is desirable, as was the case between CA and CBK.

19. The digitised financial services have introduced greater access to users by dissolving geographical distances, lowering transactions costs and offering continuous availability. These are all positive, but they have also come with various risks that must be addressed. These include how to deal with the myriad of many small depositors and borrowers. When it comes to transactions, technology again comes in handy because all deals can be made, monitored and corrective actions taken online. Service providers have to submit transactions records, statutory returns and levies electronically. The submissions can be analysed at regular intervals, depending on regulators' capacity. Indeed, some regulators like the CBK do this for some transactions on a real-time basis. RBA is building capacity towards real-time operations and monitoring of the digitised pension service, Mbao, but currently carries out oversight on a weekly, monthly and quarterly basis.

20. In addition, domestic financial sector regulators have, since the Global Financial Crisis of 2008, developed a framework of collaboration. The framework allows them to share information and undertake financial stability and literacy programmes jointly, among other activities. The collaboration has allowed them to operate SupTech, which helps them digitise data, operational procedures, and automate their regulatory processes. This enables the proactive monitoring of financial transactions and clients' data

across the board to prevent non-compliance and respond to any violations in the shortest time possible, if not real time.

21. For example, the RBA returns portal, launched in June 2016, allows supervised entities to submit contribution returns, audited accounts, investment returns, actuarial and custodian reports online. RBA, therefore, proactively supervises. In addition, RBA has a separate channel targeting scheme members, which allows them to file complaints and whistleblow online, facilitating prompt redress.

22. Going forward, regulatory technology (RegTech), innovative software to help businesses comply with regulatory challenges efficiently and inexpensively, is starting to show up. RegTech companies work collaboratively with regulatory bodies by utilising Cloud computing and Big Data to share information. This is a low-cost technology with the ability to share data in real-time securely with various entities. The technology is demand-driven and has emerged to solve challenges arising from a technology-driven economy and the introduction of digital products. These have increased incidences of data breach, cyber hacks, money laundering and other fraudulent activities. RegTech tools monitor online transactions in real time in order to identify irregularities in the digital payment sphere that are quickly relayed to concerned financial institutions for analysis and the determination of fraudulent activities.

23. RegTechs are emerging as the police in the digitised financial services sphere. Examples of such RegTechs commencing operations in Kenya include:-

- **Direct Pay Online** - provides a real time, Cloud-based processing platform which supports multiple transaction types including mobile money, all cards, all currencies, mobile apps and card readers;

- **Lipisha** - offers mobile payment solutions with features including enhanced security, integrated payment networks, payment alerts;

- **Esacco** - a local product designed to manage needs of saving and credit co-operative organisations (SACCOs), Matatu SACCOs, welfare groups, pension schemes, housing co-operatives and other microfinance organisations: prompting accountability, transparency and thus enhancing efficiency. Esacco adheres to the SASRA SACCO Information Management guidelines. The company enables production and hosting of in-depth reports and financial statements from anywhere in the world.

24. The future of regulation and supervision globally will emerge in this arena. How best this is exploited will depend on the speed of innovation by FinTech and collaboration between Regulators and the RegTech companies.

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