AGENCY FOR TRANSFORMATION
Re-imagining agricultural and environmental policy

PUBLIC POLICY ISSUE PAPER/02/2014

UGANDA PENSION LIBERALISATION: WILL WORKERS MONEY BE SAFE?

Author: Morrison Rwakakamba[i]

A: A peep into motivation behind putting workers money on open market

Going by both anecdotal and available experiential evidence, the most plausible motive behind the bill to fully liberalize social security in Uganda could be the low hanging fruit that National Social Security Fund (NSSF) is - period! From international investment banking agencies to profiteering private and bureaucratic outfits – the target is most likely, liquid cash stashed at the NSSF. NSSF is Uganda's largest liquidity holder with a current asset base of UG shillings 3.85 trillion and the largest creditor of Government, holding treasury bills and bonds worth approximately 2 trillion shillings representing 40% of total government securities. NSSF currently has 9000 registered employers with 370,000 active members out of 35 million Ugandans. NSSF collects 50 billion UG shillings per month and an average collection of 556 billion UG shillings per annum for the last 3 years. The current annual payout to members is Uganda shillings 11.5 billion. Net earnings for 2012-2013 were Uganda shillings 376 billion. A 2013 Actuarial Valuation by M/s Callund Consulting of UK confirmed that NSSF is fully funded, with sufficient resources to discharge its liabilities to all its members, with zero expense to the tax payer.

The foregoing good financial health of NSSF has been massively dented by corruption and impropriety related scandals over the years. Procedural irregularities related to sale of bonds a few weeks before maturity, purchase of land at Nsimbe and Temangalo without following set procedures and the Uganda Clays Limited loan buyout that went bad – lead to huge and injurious financial losses to workers/savers under the NSSF scheme. At the center of this preceding mess is the problem of poor fund governance. The integrity of this scheme can only be guaranteed with strong governance mechanism with firm regulation and enforcement regime. For example, the standard requirement and procedures for NSSF Board membership should be upgraded. This standard should be stretched to cover the entire social security and wider social protection schemes in Uganda. Why isn't the Country focusing on strengthening innovations at NSSF and tightening its governance to tame past scandals and secure savers money? Why is the Liberalization of Retirement Benefits Sector Bill now before Finance Committee of 9th Parliament seeking to repeal the National Social Security Fund Act?

B: Fault lines in the current liberal regulatory narrative

Uganda Cabinet approved policy interventions for establishment of a pension regulator, which resulted in enactment of the Uganda Retirement Benefits Regulatory Authority Act 2011 (URBRAA) - and Liberalization of Pension of Pension Sector Bill was consequently tabled before 8th Parliament by Hon. Minister of MFPED. The foregoing bill is now being handled by Finance Committee of the 9th Parliament. The bill in parliament will provide expansive legislative cover for URBRA. As we wait for bill to be disposed of by Parliament, the URBRA Act 2011 has glaring fault lines. For example its Board has no representation of workers/Savers or their organizations (Trade unions and employers associations). Section 8 of the URBRA Act authorizes the Minister of Finance to appoint 3 Permanent Secretaries and 4 persons knowledgeable in administration of retirement schemes on the Board (Page.10 URBRA Act 2011). Is it a given that savers/workers interests will be vouched by a Board fully constituted by the Minister without parliamentary approval and any form of inbuilt oversight?

For such a key regulation to be watertight and effective, it must have separate oversight nodes. Board Members of URBRA should be appointed by the Minister and publicly vetted by Parliament before appointment to ensure full public legitimacy for the Board. The Chief Executive Officer of URBRA should be publically interviewed to guarantee integrity and uprightness of the process. Members of URBRA Board should be exempted from Boards of pension schemes to avoid conflict of interest. To have the quality Boards we need to regulate and manage workers money, all candidates for Board positions should be credentialed and in possession of corporate governance certificate or equivalent. This procedure should also be applied to NSSF, through amending of the NSSF Act. If we don't get the regulation right- savers money cannot be safe.

Under URBRA Act 2011, license for custodianship of pension scheme or fund management scheme will only be issued if the applicant is a financial institution licensed under the Financial Institutions Act, 2004. The preceding Act provides for regulation of commercial and retail banks and not investment banking and prospecting by fund management firms that will be propped by liberalization of pension sector. Investment banking is a new frontier. Investment banking deals mainly with corporate customers and specializes in securities markets activities including underwriting, trading, asset management, advisory activities and corporate restructuring such as mergers and acquisitions – Whereas, commercial banking relates to deposit-taking and lending whereas investment banking is predominantly a securities business (See- Financial Times Lexicon 2009). For workers money to be safe, new and hybrid laws are necessary to regulate this form of savvy banking. Our monetary regime is crafted for commercial banks and not investment banks. The Financial Institutions Act, 2004 and Bank of Uganda Act (Ch.51) of

2000 should be urgently amended to cater for investment banking – if a consensus is secured that that's where we want to go.

C: Understanding the on surface liberal argument

At the center of ensuing pieces of legislation is opening of workers savings to market forces. The Proposed liberalization of workers savings is on surface expected to give workers higher returns on their savings – because theoretically it will open up the pension sector, break the alleged monopoly of National Social Security Fund (NSSF) over mandatory social security contributions and provide for entry of savvy investment and hedge fund managers (they are already here) from across the globe to provide creamy options and high return products for savers. Ugandan workers will choose who to save with depending on the rate of return given by competing private fund managers. But these Fund Managers do tactical investment and trading on stock exchange. Remember, stock markets are like nest eggs that can disappear in an instant. This is risky for workers who have worked for years to save for the future. The foregoing liberal outlook looks sexy, savvy, agile and nimble and is being marketed aggressively by different groups with entrenched self-interests. But there are serious ideological, moral, contextual and practical flaws with this open market trading and vending of workers savings in Uganda. Ugandans, especially savers and officialdom, should before making critical legislative decisions and actions fully securitize the risks and dangers associated with this liberal model as elucidated in section **E** of this Public Policy Issues Paper.

D: Social Security is about people and a business of Government

What we must understand as a Country is that Social Security is about people and not about profits. Under Social Security, people earn the right to participate by working and contributing. Social security is never intended to be an investment program. With absence of firm legislation, the argument for pension liberalization relegates the fundamental aspect of social protection. Retirement benefits are the most important part of social protection catering for old age replacement income. The guarantor for such benefits can only be government because social security for all citizens is the business of government and not private sector. The most important motivation of private sector is profits. Private sector and individuals can't guarantee social and public good. Private individuals don't build roads and railways. Government does. In year 2000, Dr. Ezra Suruma (Former Minister of Finance Planning and Economic Development - Uganda) argued correctly that Social security encompasses the moral, ethical, political and sociological views of society about itself. The liberalization of social security will mean hands off ideology with respect to social responsibility that government needs to bear to its citizens.

In fact, the move to fully liberalize social security contravenes Uganda's international commitments. For example, Government of Uganda signed the International Covenant on

Economic, Social and Cultural Rights (ICESCR) on 21st January 1987, by which it undertook to recognize the right to social insurance by creating an enabling and economic and legal environment. Article 10(1)(f) of the Protocol for Establishment of the East African Community entitles workers to enjoy the rights and benefits of social security as accorded to workers of host partner state. Article 12 of the protocol obligates Uganda to review and harmonize its national social security policies, laws and systems to provide for social security for all public workers and self-employed persons who are citizens of partner states. Indeed- Kenya, Tanzania and Rwanda have preserved their NSSF institutions as mandatory schemes. By seeking to repeal NSSF act as proposed in the bill before parliament, Uganda will be a lone ranger in the East African Community green fairway for harmonization of pension and social benefits for citizens.

E: Dangers that come with private pension schemes and fund managers

National Sovereignty: All Fund Management Companies that have been licensed by URBRAA are foreign owned and controlled. Surrendering national savings to them undermines Uganda's capacity to utilize domestically generated savings for development and perpetuates dependence on foreign aid- that comes with conditionalities that undermine technology transfer and development of local content. Indeed, the tragedy of absence of focus on local content is captured in definition of "Actuary" in the URBRA Act 2011- "***Actuary" means a person recognized as such by the Institute of Actuaries in England, the Faculty of Actuaries in Scotland, the Canadian Institute of Actuaries, the Society of Actuaries of the United States of America, the Institute of the Actuaries of Australia or a person holding such equivalent qualification"*** *(Page: 5 URBRA Act 2011)*- there is absolutely no mention of qualifications obtained in Uganda, when Makerere University is offering degrees in Actuarial sciences.

Locally generated and consolidated savings have potential to transform Uganda. In fact, instead of borrowing in foreign currency to finance projects like dams, roads and railways, Government of Uganda should use NSSF shillings at negotiated moderate interest rates that are eventually recouped to savers in Uganda. This brings in double benefits – public benefits for entire citizenry and benefits for private savers/workers. The typical argument advanced against domestic debt is the cheaper concessional rates from multilateral agencies like World Bank and bilateral debt from China. However, unlike debt service which involves net capital flight, the cost of servicing domestic debt is ploughed back to Ugandan savers. To service external debt, government buys dollars on the open market at today's forex rates much higher than the rates when dollar debt was incurred 20 or so years ago. The resultant debt service costs are thousands of times than the interest rate indicated in loan agreements. This is because external loans are in dollars and our tax revenue used to service them is in shillings. The concessional interest rates charged by World Bank and other donors do not factor the hidden cost of foreign exchange caused by a depreciating shilling over the long-term. The table below illustrates the unsustainability of our development financing model for a US$1million taken in 1987:

Table 1: Forex Risk Cost of US$ 1 Million of External debt

	1987 (UGX)	2013 (UGX)	Cost %
Cost of Loan at disbursement	60,000,000	2,600,000,000	4333
Exchange Rate	60	2,600	4333

An argument could be made that the repayment using a depreciated shilling is equal to the real value of dollars disbursed when discounted for inflation. However, cumulative inflation since 1987 cannot be as high as 4333%.

It should be noted that NSSF portfolio of 3.8 trillion, is not enough to finance long term infrastructure ambitions for Uganda. But with streamlining of pension sector to get millions of citizens in informal sector (Savings and Credit groups in the informal sector, farmers and cooperative groups etc.) should be targeted and recruited into mandatory social security savings. This will hugely expand NSSF portfolio. But we can start with the little to build critical infrastructures. Tanzania borrowed NSSF money to build the University of Dodoma, to construct the 100km Dar es Salaam – Chalinze dual carriage way, and the building of 150 MW Mkuranga power plant. This example shows that NSSF money can help reduce Uganda Government external borrowing. The danger of crowding out private sector in the domestic credit market will also be resolved when government borrows from NSSF and not commercial banks. This will release pressure on domestic money in commercial banks and in turn push interest rates down for private borrowers.

Value for Money: Pension Funds worldwide are predominantly invested in fixed income (treasury bills, bonds and fixed deposits). In fact, NSSF's 82% of investment portfolio is in fixed income. These assets involve minimal expertise and risk. As such, they are typically transacted by a few staff on fixed payroll expense irrespective of portfolio size. Private Fund management funds on the other hand charge a percentage of asset value as fees irrespective of return, a cost borne by the worker for no value. This is in addition to fees for administrators, custodians and auctioneers. The only expertise of Fund Managers could be equities on stock exchange. However, the Uganda Securities Exchange (USE) is small, undeveloped and can barely absorb 5% of pension funds. Forcing money on tiny exchange will disrupt market fundamentals of demand and supply critical for success of any capital market. Fund managers, if allowed in our system will be forced to invest workers money in foreign capital markets outside the jurisdiction of Uganda Government for firm and effective regulation.

Market Risk: Driven by profit motive and maximum return rather than safety motive of workers money, Private pension schemes and Fund Managers will inevitably divert workers savings into complex but risky investments like derivatives, futures, hedge funds etc. These fancy investments literally collapsed the United States and European Economies in 2009, requiring Government bail outs of their leading banks using taxpayer's money. The US and EU were unable to protect savers from systematic failures of their sophisticated securities markets that sought to make higher returns without creating value until the bubble burst. The biggest losers were pension funds that held the biggest investments on those markets. As a Country, Uganda should draw lessons from those market failures in US and EU and build a double decker regulations and guarantees capable of protecting savers money.

Bureaucratic safeguards: Fund managers have capacity to exploit lucrative offers on market by taking quick decisions that sometimes end up in high returns. However, NSSF is inhibited to engage in tactical trading on the stock exchange by bureaucratic procedures that entail no objection from the Minister of Finance, Solicitor General, PPDA, approvals from contracts committee, Chief government valuer etc. These layers have to some extent offered meaningful protection to savers money. Full blast and unfettered liberalization will remove them and keep workers money at the mercy of market waves.

F: Public service pension scheme and the danger of a bloating implicit pension liability

The unfunded pension liability of government of Uganda for its existing civil servants is bloating. The implicit pension liability (accrued to date liabilities if the scheme were to be wound up) is currently estimated at US$4.1 billion representing 25% of Uganda's GDP (World Bank Technical note options for the reform of Public Pension Fund in Uganda, June 2011). If unchecked, this pension liability will continue to stretch the country's debt burden. It also has implications for Uganda's debt rating. Government should move quickly to incrementally put aside this money and adopt a running recurrent system of monthly pension charge on the consolidated fund for all pensionable workers in the public service.

G: Learning from the World and the Region

Of the ten largest pension funds on earth, nine are government sponsored and set up under Act of Parliament, typically collecting mandatory contributions. They are in Japan, Norway, Netherlands, South Korea, Singapore, Canada and Malaysia – and these are open market economies that have private sector led growth and divesture but made a conscious choice to exclude social security for its citizens from fangs of unfettered open trading and tactical investing. In Kenya the National Social Security Fund Bill 2013 transformed NSSF into a public and mandatory defined contribution scheme for all formal employees. The New Kenya social security scheme will also work as a national social insurance scheme to which all workers must contribute 6% of gross earnings with a matching 6% contribution from their employers. Kenya pioneered liberalization of pension sector in 2003. After experiencing the peril of pension fund competition in private sector with no guarantees for workers, the Jubilee government reversed that policy.

In Tanzania NSSF was established by Act. No. 28 of 1998 to replace defunct National Provident Fund. In Tanzania, NSSF is mandatory scheme covering companies, Non- Governmental Organizations, Embassies employing Tanzanians, International Organizations, organized groups in the informal sector, government ministries, parastatals, self-employed and any other category as declared by Ministry of Labour. In Rwanda, the Rwanda Social Security Board (RSSB) established by Law. No. 45 of 2010 merged RSSB with Rwanda medical insurance scheme with a vision of a comprehensive social security system that addresses social security needs of all Rwandans. The scheme is and provides pension, medical insurance and occupational risk cover for all salaried workers including political leaders who make mandatory contribution equivalent of 7.5% matched by their employers. From the foregoing, the key lesson is that Government of Uganda should remain the key guarantor of Social Security and keep NSSF as a default fund and provide expansive reforms to link social security to health insurance for savers/workers. Other schemes can operate but not until a strong and water tight regulatory environment is in place.

H: What to do Monday Morning

1. **Cover informal Sector**: Less than one million Ugandans are covered by existing social security pension schemes. Yet many more millions are earning income in the informal sector. Government should move quickly to create enabling regulation and incentives to have millions in informality covered.
2. **Strengthen Governance and Oversight of Pension Funds**: URBRA Act 2011 should be amended to have workers and employers represented on the board. Board Members of URBRA should be appointed by the Minister and publicly vetted by Parliament. The Chief Executive Officer of URBRA should be publically interviewed. Members of URBRA Board should be exempted from Boards of pension schemes to avoid conflict of interest. To have the quality Boards we need to regulate and manage workers money, all candidates for Board positions should be credentialed and in possession of corporate governance certificate or equivalent. This procedure should also be applied to NSSF, through amending of the NSSF Act. For emphasis, the Executive Director and Deputy Executive Director should be publicly interviewed. If we don't get the regulation right- savers money cannot be safe.
3. **Provide tight regulation for Investment Banking**- Investment banking is a new frontier. For workers money to be safe, new and hybrid laws are necessary to regulate this form

of savvy banking. Our monetary regime is crafted for commercial banks and not investment banks. The Financial Institutions Act, 2004 and Bank of Uganda Act (Ch.51) of 2000 should be urgently amended to cater for investment banking – if a consensus on nature of pension liberalization is achieved.

4. Transform Social Security into a Social Protection Scheme that takes care of pension, welfare and medical insurance
5. Go slow on International Fund managers until a water tight regulatory framework and institutions are in place to protect savers/ workers money.
6. **Reign in Implicit pension liability**: Government should move quickly to incrementally put aside this money and adopt a running recurrent system of monthly pension charge on the consolidated fund for all pensionable workers in the public service.

---

[i] Morrison Rwakakamba is Chief Executive officer, Agency for Transformation, an independent think and do tank based in Kampala- Uganda. www.agencyft.org