

11 **A SURVEY OF FACTORS INFLUENCING LIQUIDITY OF  
OCCUPATIONAL PENSION FUNDS IN KENYA //**

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**DECLARATION**

I hereby declare that this management research paper is my original work. It has not been presented by any other person from the university or any other institution.

Signature .....

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This project has been submitted for examination with my approval as university supervisor.

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## DEDICATION

This project is dedicated to my husband Michael Kiptepkut for his academic guidance and support. I highly appreciate his encouragement and willingness in seeing me through the completion of the research project.

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## **ABBREVIATIONS**

STBIC	Stanbic Investments Management services Ltd
OM	Old Mutual Asset Managers
GENK	Genesis Kenya Investments Management Ltd
AIG	AIG Global Investments Company
ICEA	ICEA Investments Services Ltd
CO-OP	Co-op Trust Investments Services Ltd
KEN	Kenindia Asset Management Company
CFC	CFC Financial Services Ltd
JFS	Jubilee Financial Services Ltd
MAD	Madison Asset Management Ltd
BARC	Barclays Trust Investments Services

## **ABSTRACT**

The research involves an investigation into the factors that influence liquidity of pension funds in Kenya and challenges faced by fund managers in ensuring liquidity of the pension funds. The information was obtained using a questionnaire administered to investment managers of the fund managers registered with Retirement Benefits Authority (RBA). Most (84%) pension funds managed by fund managers are Defined Contribution (DC) Plans because they are easy to administer and manage as they require less actuarial valuations and risk is borne by members and not the sponsor.

The results identified the factors that influence liquidity of pension funds in Kenya as investment return, regulatory bodies, early retirements, actuarial assumptions among others. The biggest challenge faced by fund managers currently in Kenya was that of retrenchments/redundancies. Other challenges include inflation, unstable stock market and low yielding investments.

# CHAPTER ONE

## 1.0 INTRODUCTION

### 1.1 Background

The investment objective of pension schemes is to obtain a high level of capital appreciation and preservation while maintaining sufficient liquidity to meet the schemes ongoing obligations. Pensions schemes have been established to provide some basic welfare support to members particularly after retirement. However pension in spite of their importance is widely neglected, they are difficult to understand and are regarded by many as remote eventuality. (Fabozzi, 1997). This explains why little has been written on pension fund schemes. Nevertheless changes in pension law and practice have been considerably extensive over the past 2 decades. They have been subjected to increasing strain from the state, legal bodies, members and organized labour unions. (McGill & Grubbs, 1989).

The money contributed to pension schemes represents a form of saving and provides capital for investment. It has been observed that pension schemes have accumulated quite a substantial amount of assets both liquid and immovable assets. In 1997 private and government pension funds in the USA held over \$ 1.35 trillion in financial assets (Gardner, 2000). In Kenya the pension industry had accumulated assets valued at Kshs. 130 billion as at 31<sup>st</sup> December 2002 (RBA, 2002). In Luxemburge, assets under administration totaled some 520 billion US dollars as at December 1999 (ALFI 1999). This makes Luxemburge the leading center for administration in England and third largest in the world. Kevin (1993) notes that even where it is conceded that funding of pensions is the wiser course, there has been growing criticism that the funds do not benefit the states rather the critics maintain that the fund managers have dedicated their responsibility in favour of maximum return for the benefit of members.

Pension schemes are regarded as financial institutions their primary objective being to benefit companies shareholders while at the same time providing timely benefit to a contributor which is indirectly determined by factors that influence investment decisions. Yeager and Seitz (1989) points out that investment decisions in pension funds will basically depend on the current and future liquidity requirements as well as on the structure of the pension funds. Further, investment decisions will be pegged on the legal framework, social objectives, political and economic indicators.

The problem of employment of pension funds capital is indeed a difficult one to ensure liquidity of the fund. Fund or asset managers must therefore come up with an efficient portfolio asset mix, which maximizes returns with the minimal risk while at the same time meeting the funds obligations of being able to pay the contributors on retirement. (McGill & Grubbs, 1989). Pension funds operate by raising funds from various sources. Member's contributions have been a constant source of income and this forms the capital for investment and further investment growth. Member's contributions therefore form an important component of liquidity indication of a pension fund.

According to Gardner and Mills (1991), pension funds unlike some institutions have no liabilities with maturity dates in the traditional sense. They have obligations to covered employees, but most obligations are difficult to qualify and must be estimated by actuaries. Instead of considering pension fund obligations in the traditional balance sheet sense, the ensuing focus is on the sources of funds and cash outflow of pension funds. The author further argues that corporations with employees covered by pension plans provide the majority of funds for investment. In this case employees may/may not contribute. Thus corporate decisions determine whether or not the plan is adequately funded, over or under funded. If a plan is over funded, the value of its assets exceeds that of its estimated obligations and the fund net worth or an excess of assets over obligations. When a fund is under funded it has negative net worth because

assets are less than obligations. Adequately funded plans have no net worth and assets values equals the value of estimated future obligations. The idea of funding therefore is to maintain acceptable liquidity position in order to meet current and future obligations. What factors should a fund manager consider in pursuit of satisfactory liquidity position inspite of unstable financial and monetary situation not withstanding the pressures and tensions that this growing wealth cannot fail to incite?

Costly and far reaching mistakes can and probably will be made unless firms take great care in making their investment decisions. Bad decisions cause major financial loss, which negatively impacts on the liquidity of the fund. Given the crucial importance of firms investment decisions managers need a logical and practical assessment procedure by which to appraise the investment opportunities. This procedure must promote the shareholders wealth, although in the final decision other objectives (especially for a pension fund unique characteristics) must be taken into account. Investment appraisals which include the net present value and pay back period among others give an indication of the liquidity of investments undertaken by a pension fund (Mclaney, 1997)

There are a variety of institutions and each institution has its typical investment objectives and constraints. The investment decision process however is universally the same. As suggested by Rader (1989) the investment processes includes: -

Formulating a policy statement which focuses on the firm's long and short-term requirement, examining the current and projecting the economic, political and social conditions in constructing portfolio (for example, in the case of pension funds an expected retrenchment will affect portfolio composition and thus liquidity) and the construction of the portfolio guided by the risk, return and liquidity elements.

Whereas selecting investment opportunities to pursue is important because, projects involve relatively large irreversible commitments of finance and these commitments are long term, it is also important to consider other factors that will ensure liquidity of the pension funds.

## **1.2 Statement of the Problem**

Pension schemes hold substantial capital. Over the years, pension funds have operated silently with minimal interference from the stakeholders. The pensions industry in Kenya in particular was estimated to hold assets of 130 billion as at December 2002. The managers of pension plans face challenges just like those of other public/private companies such as Banks, Non-Banking Institutions, but the pressure is to ensure that the multifaceted objectives of a pension fund that is, administration and management of assets, are in line with the existing regulations and pensions expectation.

A major reason why policy statements are developed is to determine an overall corporate strategy. Reilly and Brown (1997) argues that although a policy statement does not indicate which specific security to buy, policy statement should provide guidelines as to which assets should be included in each asset class in order to maintain certain level of liquidity in line with the funds obligations. Investing in assets that assures the funds availability of funds to pay the pensioners is a critical issue.

In order to provide timely retirement and disability benefits to members pension funds need to achieve the level of liquidity expected by its contributors. Poor investments, misappropriation of scheme funds, diversion of schemes funds to sponsor businesses are some of the major problems in the Retirement Benefits Industry in Kenya. According to Treynor (1975), investment Management is becoming an important industry in Kenya. The responsibilities of investment managers are enormous and their potential rewards are great. Unfortunately pension funds and other funds such as a mutual funds all share one serious

problem: the return and the desired liquidity achieved in any one period is subject to wide fluctuations and other non-financial factors such as age bracket, aids epidemic and economic indicators which are beyond the control of investment management. Factors that influence the liquidity of pension funds in Kenya are not known. This study therefore sets to explore the factors, which influence pension funds liquidity.

### **1.3 Objectives of the Study**

1. To identify factors that influence liquidity of occupational pension funds in Kenya.
2. To establish challenges faced by fund managers in ensuring liquidity of the occupational pension funds in Kenya.

### **1.4 Importance of the Study**

The fund managers will learn on the factors that affect liquidity of pension schemes. These will enable them focus on the relevant issues to ensure liquidity.

Academic community: - The research will provide a basis for further research on the subject, and also add to the body of knowledge regarding liquidity in pension funds.

Stake holders: - The research will enlighten the stakeholders on the factors that affect liquidity of their pension funds, creating in them awareness and interest of ensuring financial stability of their schemes.

## **Working Definitions**

### *Pension Funds*

The retirement Benefits Authority (RBA) defines a pension fund as “a defined contribution scheme in which members and employers contributions are accumulated in an individual account with investment return and other surplus or deficits as determined by trustees of the scheme”.

### *Liquidity*

According to Gardner and Mills (1991) liquidity is the degree of readiness of an institution to meet all present and future obligations in a timely manner.

### *Portfolio*

Brigham and Gapenski (1994) defines a portfolio as combination of assets. This can be real or financial (securities) assets.

### *Defined Contribution / Defined Benefit*

According to Gardner (2000), Defined Contribution scheme do not specify the benefit or stream of income but a Defined Benefit (DB) promises a specified benefit.

### *Investment*

Reilly and Brown (1997) defines investment as a “current commitment of dollars for a period of time to derive future payments that will compensate the investor for: - the time the funds are committed, expected rate of inflation, and uncertainty of future payments.



### *Security*

Any asset that can be used either as collateral or that which entitles the holder to some income streams. Examples of paper securities include Government Treasury Bills and Bonds, Commercial paper, real estate etc.

## CHAPTER TWO

### 2.0 LITERATURE REVIEW

#### 2:1 Pension Funds

Pensions funds are legally distinct from their associated company. They are managed by a trustee who by agreement must manage the fund for the benefit of the stakeholders. They operate under contractual savings agreements that obligate them to pay retirement benefits to workers. However, Toulson (1982) argues that pension funds may have agency problems, if pension fund managers do not have a strong motivation to create value for the fund. Preda (1991) notes that investment return on average contribute the majority of a pension plans wealth; investment return contribute about 80% to pension wealth and contributions only about 20% for the funds in North America. Investment return therefore determines the wealth available for employees at retirement and contributions that a firm must pay to provide employees with retirement benefits. There are differences that exist between pension schemes and pension provident funds. Angima (1985) provides analysis and argues that a pension scheme is a compulsory insurance scheme under which employees have contributions deducted from their wages, contributions are added by their employer and both contributions pooled in common fund, some times with contributions from government. A provident fund is a compulsory savings scheme, employees and employer contributions are allocated to the credit of each individual account or employee.

On the same note Gardner (2000) confirms that retirement plans offered by pension firms are generally classified as either Defined Benefit (DB) or Defined Contribution (DC). A DB plan promises a specified benefit or income stream during retirement, while a DC plan, in contrast does not specify the benefit or retirement income. Employee's retirement income in a DC plan will depend on investment returns. According to a survey carried out by Gardner (2000) in the

USA, employer retirement plan contributions are currently under DC plans. About 20 years ago most retirement plans were under DB plans. In 1994, 24.6 million participants were active in DB plans compared to 40.3 million active participants in DC plans. The trend worldwide is towards DC plans because it is easy to administer.

## **2.2 Investments and Liquidity**

### **2.2.1. Liquidity**

Gardner and mills (1991) defines liquidity as the ease with which an individual, business or financial institution can obtain cash by selling non-cash assets, in other words the degree of readiness of an institution to meet all present and future financial obligations in a timely manner. It can also be defined as the ease with which financial institutions can obtain cash by borrowing from external sources. Pension funds need not consider explicit reserve requirements but they must have cash for benefit payments. They must be able to pay benefits to retirees when they are due. It is also worth noting that managing liquidity in pension funds is easier than depository institutions such as Commercial Banks. According to Toulson (1982) liquidity needs of depository institutions are not only affected by requirements of regulators but by the expectations of the depositors. Most depository institutions operate under a set of liquidity requirements established by the state through the Central Bank. The author also states that depository institutions generate most of their interest income from loans. To retain the loyalty of customers a lender must be able to provide funds for all loan applications that meet its credit standards. Thus an institution needs to maintain liquidity to support the expected loan demand. In the case of pension funds there is need to maintain an appropriate level of liquidity to be able to pay the contributors on retirement.

### 2.2.2. Elements of Investments Decisions

Reilly and Brown (1997) defines investment as a “current commitment of dollars for a period of time to derive future payments that will compensate the investor for:- the time the funds are committed, expected rate of inflation, and uncertainty of future payments”. Gitman & Joehnk (2001) defines a Portfolio as a combination of various assets such as treasury bills, bonds, cash, immovable assets and stocks among others. Portfolio management on the other hand refers to the analysis and selection of a portfolio. The central task of investment management is to construct a portfolio, which ensures liquidity is maintained as required. Lofthouse (2001) suggests that for all investors, institutional and private, they must consider;

- investment objective,
- assets classes to include in the portfolio,
- weights assigned to various assets classes,
- the selection strategies to use with each asset class and
- evaluation of the above 4 aspects.

The basic question facing all investors is which securities to buy. According to Bruno (2000), the answer to this question depends upon many factors such as: economic forces, financial status of the investor, the industry where investment interest lies etc. Pension funds are known for investing in long-term assets basically due to the nature of their business and their distinct objectives. This will normally determine the asset allocation and consequently the asset weights to be assigned to each asset class. A portfolio mix simply means the approach to diversify ones or to hold various assets at once (Markowitz,1956). The author observes that investors should not only care about the expected returns of their wealth but also about the risk. This led him to seek to find the portfolio with maximum expected return for a given level of risk. The goal is to diversify or invest in various assets in order to avoid total failure. Diversification is better

explained in the saying “ Don’t put all your eggs in one basket”. Diversification existed in the 19<sup>th</sup> century but in a naive way, where one held several assets with no practical reasons to explain the mix. Gitman and Joehnk (2001) argues that the emphasis of the traditional approach was inter-industry diversification. Traditional approach invested in large successful companies because they were liquid and more acceptable by the public. There are various sources of risk, but two main categories of risk identifiable are diversifiable risk (unsystematic risk) and undiversifiable risk (Systematic risk). (Mayo, 1998).

Diversifiable risk represents the portion of an asset risk that is associated with random forces that can be eliminated through diversification. It is attributable to firm's specific events such as strikes, court cases, poor management, e.t.c. According to Clarke (1991) un-diversifiable risk is attributed to market factors that affect all firms. It cannot be eliminated through diversification examples include war, inflation, international events, political events, exchange risk and market risk. Market risk is associated with fluctuation in security prices and in particular securities held in the fund. Clarke (1999) also explains that risk is measured by use of standard deviation, which measures the dispersion around an average value of returns. In Summary therefore, an investment manager should consider the risk factors associated with the assets available. This will assist in weights or value to assign to each asset class.

On the other hand Mayo (1998) defines return as “ the sum of income and capital gains generated by Investment”. Return is also described by Gitman & Joehnk (2001) as the level of profit from an investment. Return according to the author may be in form of dividend interest, appreciation in value or gains from selling assets at profitable prices. Return is important in investment decisions because it allows us to compare the actual gain from investments with the levels of return we need. A basic example is that you would be satisfied with an investment that earns 10%, if you needed it to earn 8%. According to Griffiths (1990) the level of return will depend on internal characteristics such as type of investment, quality

of management and how the investment is financed. It will also depend on external characteristic such as wars, political events, shortages and inflation. Levy and Sernat (1993) argues that a satisfactory return will depend on whether the present value of benefits equals or exceeds the present value of its costs. A high present value of benefits will be acceptable than one with low present value of benefits in comparison with the returns. The best return would thus ensure financial stability ensuring liquidity levels are maintained as required.

## **2.3 Factors that Influence Liquidity of Pension Funds**

### **2.3.1. Risk, Return and Diversification**

According to McGill and Grubbs (1989) pension funds investment policy must address rate of return objectives, acceptable risk, liquidity requirements and diversification requirements

Dietz (1976) defines expected return on a benefit fund portfolio as the expected average return on invested assets over any specified period of years, liquidity in an investment portfolio as the degree to which cash can be generated without investment losses and risk as the degree of probability of realizing the expected return. McGill and Grubbs (1989) observes that the rate of return objective in general terms without qualification is to maximize the return consistent with preservation of principal and need for liquidity. Both systematic and non-systematic risk must be taken into consideration.

Liquidity is paramount in pension funds when it comes to paying members when they retire. However a typical well-managed pension plan has minimal liquidity needs, (holding other external factors constant), which can be met by the plans cash management program. Diversification is one method of achieving portfolio management, which could be through assets and sector among others.

Dietz (1976) goes a head to outline the relationships between risk, return and liquidity. In the first instance the author states that liquidity is purchased as sacrifice for return. Thus the most liquid assets have low or no return. High expected returns such as mortgages are associated with low liquidity. Return and risk are related in that the higher the risk, the higher the return and vice versa. Liquidity and risk are related in the sense that low liquidity portfolios are associated with high risk and vice versa. An example is the government bills, which are readily convertible, that is high liquidity verses low return. Dietz (1976) concludes that investment strategy with which a portfolio manager must deal involves finding the right mixture of the three elements. The rest of this chapter will discuss other factors that influence liquidity in pensions industry.

### **2.3.2 Predictability of Cash Outflow**

A pensions fund objective is to pay workers a lump-sum payment or an income stream after retirement. Therefore estimating liquidity of pensions funds according to Reilly & Brown (1997) depends on whether the plan is defined benefit plan or defined contribution plan. A defined benefit pension plan pays retirees a specific income stream after time of service plus contributions from the company. Under a defined benefit plan, the company is fully responsible for payment of benefits under any future circumstances. This therefore means that a younger employee base means less liquidity requirements. An older employee base means more liquidity is needed to pay off the retiring employees. The older employee base will require the pension fund to hold more cash or cash equivalent. Defined contribution pension plans on the other hand do not set a specific rate or benefits payable to a retiree. Employees contribute to one account and the members make investment decisions themselves. The risk is thus borne by the members and not the firm. Studies carried out have shown that such plans are conservative in investments. They are too cautious and tend to avoid risks. A study carried out by Federal Reserve System in USA confirmed that such pension funds invested heavily on common stock to a tune of 45% of total assets. Smaller holdings included deposits (9%), and mortgages (0.5%), in

such cases the fund managers are cautious and invest where they can influence management of the corporate firms.

Mennis and Valentine (1981) holds the same views that liquidity estimations of pension funds are greatly affected by the way future benefits are planned. He argues that a defined benefit plan pays employees a defined income after retirement. This means that the payment will be determined by the workers salary and seniority. In this particular scenario contributions are capitalized and by use of the actuarial rate should be equal to the future benefit. The firm carries the risk on the pension plan. Defined benefit will therefore lead to conservative investment policies. They hence invest in bonds to reduce risk. In a defined contribution fund, rates paid by workers and employees are set but the benefits are not fixed and depend on the return of the period. Defined contribution plans can therefore afford to take more risks and choose a portfolio that will yield high long-term return. Traditionally, contributions of a pension fund were pooled and managed collectively. But the recent trend is to have all stakeholders including employees decide on investment strategies.

Hill and Harrison (2002) holds the same view that the factors affecting predictability of cash outflow are primarily plan characteristics and influence of the "escalator effect". Certain types of plans influence the liquidity needs of the fund. According to the authors, a non-contributory plan has no possibilities of cash outflow because of employee's withdrawal from the plan. On the other hand where plans are contributory, often employees may withdraw the amounts of their own contribution upon separation from the plan. These varying liquidity needs restricts or relaxes investment policies. If one has a contributory plan, the best option is to go for short-term investment to allow for immediate payments. Dietz (1976) suggests that another plan feature, which should be considered is the death benefit provision. He argues that liquidity needs are greater for plans making lump sum death payments than for those in which there are no death



benefits. Any plan which has features allowing lumpsum withdrawals needs more liquidity than similar plans where lumpsum is prohibited.

### **2.3.3 Reliability of Cash Inflow**

Pilch and wood (1982) found out that pension schemes have certain indicators, which should predict their liquidity levels. One is that well managed funds in a performing economy and stable employer will always have continuous flow of new money available for investment and making retirement benefits. The certainty of future inflow makes adjustments in investments and required liquidity levels relatively easier. Pilch & Wood (1982) gives an example of the fund expected to change the proportion of its portfolio with the guaranteed income, it is easier to use the new money instead of having to sell existing investment. This makes investment decisions a little bit broader and easier. The second characteristic according to Pilch and Wood (1982) is that, liabilities of pensions schemes tend to be linked to inflation or cost of living. When pensions are due they are cleared towards final salary, which may have been growing. There is a clean incentive therefore to buy investment, which is expected to increase in value in the same way thus improving future liquidity of the fund. Such include property and equities.

According to Black and Dewhurst (1981), the importance of cash inflow is obvious because pension funds benefits can be paid out from the money received by the trustee from the company, employee contributions and investment income. Black and Dewhurst (1981) argue that if where a trustee is for example, 99% sure that contribution and income will exceed benefit payments in each of the next 20 years, there is no need to worry of safety of principal fan liquidity of the funds assets in the short run. However in situations where there is a probability of say 0.5 that benefits will exceed contributions and income in the next 20 years; a more conservative investment in the sense that, less risky assets will be acquired and liquidity will not be compromised. Cash inflow to the fund according to Dietz (1976) depends on 3 major factors; (a) company's

earnings (b) internal cash generation and (c) work force characteristics. Thus for example earnings are much stable in non-cyclical than cyclical industries. A strong successful company can plan its competitive position to meet cash needs than a weak company. Therefore the trustees of Nation Newspapers Ltd, Coca Cola or Standard Bank would have more assurance of receiving sufficient payment than the trustees of Kenya Times. According to Dietz (1976), workforce characteristics have an important bearing on cash flow. A company characterized by a young, growing work force can expect to make growing contribution each year. Pay out will be small, hence more cash for investment primarily for the long term. An opposite situation occurs where a company has a mature work force contributions of benefits payments are largely offsetting especially where the size of the work force is declining. Investments strategies here will be restricted to less risky short-term investments.

#### **2.3.4. State Participation**

In practice the policy relating to the employment of social security funds may differ widely among countries and develop unevenly with time (Mouton, 1975). A major factor to developing African Social Security Schemes or pensions schemes is the high handiness of the state. There is an increasing strong trend towards loans to the state especially in the English speaking countries. In most cases, these are never paid back to the pension schemes adversely affecting the financial position of the funds.

This trend is due to political rather than technical reasons. In Nigeria, Ghana and Tanzania for example loans to state from provident funds represent 80-99.3% of all investments. In Gunea, the resources of National Security fund are at present fused with those of public treasury, (Pierre 1975). The Kenyan Scenario is no much different. It is claimed that the NSSF has lost substantial amounts through political deals. The recent being the 256 million which was stashed into a collapsing bank for what is believed to be political gains. Such large sums being siphoned out without a single return affects the liquidity of the funds.

### **2.3.5 Regulatory Pressure**

Closely related to political pressure are the regulatory pressures on the administrators of the retirement funds. In Kenya, for example the Retirement Benefits Authority (RBA) was constituted in 1997 to regularize the pensions sector. RBA's role is to protect the interest of members and sponsors of the retirement schemes so as to ensure members received a reasonable retirement income. The key concern is to safeguard the retirement savings from misappropriations, poor investments, poor administration and record keeping. Control of these factors guarantees liquidity hence reasonable income. The other objective of RBA was to spur economic growth through enhancing the mobilization of domestic savings and capital formation. The RBA is also mandated to oversee the enforcement of the law. In respect to investment, the RBA established a guideline on the percentages required for each category of assets (see appendix IV). Lacaille & Sauter (2002), have a different view that the influence of the regulatory commission on pension investment policy will depend on whether the commission is conservative or cost conscious. The conservative commission may consider equality investment as speculative. A different commission might recognize the importance of return thus becoming more aggressive in their investment policy and improving their financial status, hence improving liquidity.

### **2.3.6. Social Concern**

This is a recent development and a non-financial factor. US Department Research Report No. 27 describes this as a need to have funds invested in worker housing projects. This is aimed at benefiting certain groups. It is clear that investments made on such non-financial basis will have to be judged on the same basis. A Kenyan example is that NSSF where a lot of money was invested in housing projects which were initially aimed at benefiting the middle and upper class members of the society but later turned out to be unprofitable. This for some time negatively affected the cash flow and payments of retirements

benefits. Gardner and Mills (1991) argue that if social responsibility is "interference", the most efficient portfolio for the pension fund may be unobtainable. Decisions must clearly be in the best interest of the covered employees to ultimately pay them their dues when they retire.

### **2.3.7 Population Trends**

Any shift in the center of demographic gravity changes society, its mood, values as well as its institutions issues. Drucker (1976) asserts that the demographic gravity lies in that age group of adult or adolescent which represents both the largest single age group and the fastest growing one. In 1959 the center of demographic gravity in USA was age 39. This was seen as the oldest in America's history. 5 years later the center of demographic gravity had swung to 17. In the next 12 years there was a baby boom. 30 years down the lane the babies of the baby boom entered the labour force. This created demographic center of gravity. Gardner & Mills (2000) notes that the US social security systems runs a surplus but the balance is projected to turn to a deficit in the next century as the nations largest demographic group, baby boomers, begin and continue to retire. Population trends therefore assists in establishing liquidity levels for a given period of time.

Drucker (1976) goes further to argue that demographic changes will precipitate economic changes. There will be need for greater productivity of all wealth producing resources. These in effect means that the investment strategies or options should incorporate the expected demographic changes such that if a scheme is expecting a certain percentage of the members to retire due to age, during a certain period, then their strategies should be geared towards making the scheme liquid during that period.

Still on demography or age groups of the members of a pension scheme, Pilch and Hood (1975) made the following assumptions in determining the cost of fund and consequent liquidity requirements as: number of members who will die

before retire i.e. mortality rate, length of life of those who survive to draw a pension i.e. life span, turnover of employees and early retirements. Population trends and population changes will thus for many years have a major impact on society, policies and politics especially in the pension industry where age is a factor considered in retirement programs.

### **2.3.8 Attitude of Corporate Sponsor**

In a company-controlled fund, the Board of Directors is the fund authority and they should be seen to be participating in investment decisions. According to Dietz (1976) if these bodies do not set the necessary policies, then the board will end up accepting the attitude of the trustees. This attitude may be conservative or aggressive and the financial standing and performance should be evaluated in its light. One of the unusual aspects of pension fund management is the potential division of control among several parties. The funds administrators may make investment decisions themselves, or entrust responsibility of investing all or part of the fund assets to portfolio managers. The sponsoring firm, the administrators and managers may at times have conflicting interests. This affects the operations of pension funds resulting in poor performance of the funds.

### **2.3.9 Actuarial Assumptions**

The impact on pension plans of changing even one actuarial assumption has been the subject of research. The assumptions affect new funds that the employee contributes and thus funds available for investment each year as well as the plans with regulatory authorities. Gardner and Mills (1991) argue that because each pension plan operates under its own set of actuarial assumptions, it is impossible to assess the funding adequacy of the pension system as a whole. The author confirms that when pension fund managers notify the corporate sponsor that a plan is over funded, contributions may decrease, directly affecting the liquidity position hence impacting on the management of the pension fund. In the USA for example the stock market surge and falling interest

rates between 1982 and 1986 increased the value of pension fund assets. Actuarial assumptions in some plans were changed, increasing the expected rate of return on assets in future. Because this rate is used to discount future obligations, estimates of present value of obligations decreased and some corporations reduced contributions.

### **2.3.10 Early Retirement/Redundancies**

Employees leaving service earlier than planned have continued to affect the management of pension funds. Mass retrenchments due to poor economies have no doubt affected the financial position of pension funds. The actuarial assumptions may not hold in such circumstances resulting in instability of the pension plans. Such cases can seriously constrain a scheme if sudden large payouts are required. Paying out unexpected lumpsums will affect the liquidity of the funds. The Aids epidemic will have similar effects on the liquidity of the pension funds.

### **2.3.11 Investment Manager's Performance**

The role of investment manager is to advise the trustees on available investment vehicles and expected risk and returns for each vehicle, undertake research at company, sector, and country levels and above all manage the portfolio so as to ensure liquidity is available to meet the schemes obligations. This calls for professionalism and the ability to manage the funds business under unfavorable conditions. The objective of the fund is to pay retirees when they are due, and the managers must thus ensure liquidity at all times. Performance measures will provide checks and balances which ensure efficiency of the funds. Portfolio performance measures will analyze both past performance and future returns. However according to Ngene (2002), the use of portfolio performance measures in Kenya is wanting.

Management style is another key factor in determining the performance of a pension fund. Some funds have used an active management strategy also

known as tactical assets allocation. In this scenario managers try to make timely movements among stocks, bonds and cash. These techniques were successful in shielding some funds from the 1987 crash. Passive management implies a well-diversified portfolio with infrequent trading and market level risk and return expectation. Passive management will concentrate on less risky assets. Sharpe (1999) holds the same views that management styles influences portfolio selection. Passive management tends to hold securities with small and infrequent changes unlike active management where any risky opportunity will be utilized to increase returns. A passive manager according to the author would go for treasury bills and any other security acceptable to the stakeholders. Therefore portfolio structure will depend on client's preferences or change in risk profile.

#### **2.4 Challenges Faced by Fund Managers in Ensuring Liquidity of Pension Funds**

Pension schemes face challenges in their management of liquidity just like any other financial institution. Pension fund managers must therefore identify these challenges and work towards harmonization in the process of achieving funds objectives. Kenyan pension funds have faced various challenges ranging from social issues to fluctuation of stock prices.

The Aids scourge for example, has reduced the projected cash inflow compelling pension funds to invest in the short term to be able to pay the recurring survivor benefits. The established assumptions about the mortality rate have thus been affected. The assumptions affect the estimates of future cash flows and accurate determination of future liabilities of the fund. Share prices in the recent past have tended to fluctuate because of the unperforming economy and political changes. A share at Kenya power and Lighting company for example was 250/= in 1999 and in 2003 it had fallen to 42/= per share. In this case, the unpredictable stock prices will hinder projection of returns, hence inhibiting the projection of the required liquidity levels. The early retirement wave of the early to late nineties in Kenya destabilized pension schemes investment processes. This was more

prevalent in the public sector where retirement benefits are paid out of normal recurrent cash flows. In the long run, this early retirements place extreme pressure on a firm's financial position and its investment decision and eventually it may be unable to meet its obligations. Kenya Railway, former Kenya Posts & Telecommunication Corporation and the Civil services pension scheme among others were affected by civil service reform programs during this period.

Current fund managers must work out ways of getting out of the past poor investments performance. These were situations where schemes collect contributions from workers and channel them to non-performing items resulting in liquidity problems. Such practices had long-term effects on pension funds. Fund administration has traditionally been regarded as a bank back office activity. The result is markedly administrative culture on transaction processing. According to Cidrac and Hoeltge (1999), the most successfully funds are looking to transform this administrative culture into a service. This will mean greater integration of client needs and preferences at all levels of the decision – making process. A dynamic client – responsive management style and working practices should be introduced. The challenge to the investment manager is whether they are able to incorporate client's preference in their decision making. In some cases, the market value of the assets is substantially less than what the scheme paid for them, such that when they are liquidated, members benefits are eroded. Inflation is of course the problem that makes development of a sound benefit formula so difficult. According to Yeager and Seitz (1989), it is very difficult for pension plan to provide inflation protection. Two obvious effects of inflation on pension plans as outlined by Gardner & Mills (1991) are the effect on retiree benefits and effect on investment income. If a final average plan formula is used, then inflation will strongly affect pensions obligations unlike the career average plan. The lack of sound actuarial basis for determining the amount of expected inflation to use in controlling benefits and present fund contributions is a big challenge to investment managers.



## **CHAPTER THREE**

### **3.0 RESEARCH METHODOLOGY**

#### **3.1 Research Design**

A survey was conducted through administration of a questionnaire.

#### **3.2 Population and Sample Study**

The population of the study constituted pension fund managers registered under the Retirement Benefits Authority (RBA). The respondents were the registered investment managers of the registered fund managers. There were 11 fund managers registered with RBA . (See Appendix III). As at 31<sup>st</sup> August 2003 the fund Managers were managing about 695 funds out of the 1430 schemes registered by RBA.

#### **3.3. Data Collection Procedure**

A structured questionnaire (See appendix II) was used to collect the data. The respondents were the investment managers of fund management firms registered with the RBA. A structured questionnaire was used because of ease of analysis and administration.

#### **3.4. Data Analysis and Presentation**

Data was analyzed using both inferential and descriptive statistics including the mean, mode and frequency distribution. These measures provide ways of describing collections of statistical observations and reducing information to understandable form. Inferential statistics made it possible to identify and interpret data patterns to enable drawing conclusions on population characteristic on the basis of the sample statistics. Ranking as a method of identifying the most important factors was used. Data was presented using frequency tables, and graphs. Comparative analysis on factors considered by DB and DC was performed to identify any differences.

## CHAPTER FOUR

### 4.0 DATA ANALYSIS AND INTERPRETATIONS

The study was aimed at identifying the factors that influence liquidity of pension funds in Kenya and challenges fund manager's face in ensuring liquidity. The population comprised of pension fund managers registered under RBA. The results analyzed relates to eight respondents out of the possible 11 respondents.

#### 4.1 Number of Pension Funds Managed by Each of the Registered Fund Manager and Their Response Rate

**Table 4.1.0 Response Rate**

	<b>Number of fund managers</b>	<b>%</b>
<b>Responded</b>	8	73
<b>Did not respond</b>	3	27
<b>Total</b>	11	100

Source: Research data

Table 4.1.0 shows that 73% of the targeted population responded. This proportion manages about 80% of all schemes managed by registered fund managers. This is a reasonable response for analysis of this study. 27% did not respond.

**Table 4.1.1 Number of Pension Funds Managed by Registered Fund Managers who Responded**

<b>Fund Manager</b>	<b>No. of Pension funds</b>
STANBIC INVESTMENTS	40
OLD MUTUAL ASSET MANAGERS	140
GENESIS KENYA	45
AIG GLOBAL	98
ICEA INVESTMENTS	16
CO-OP TRUST INVESTMENTS	74
KENINDIA COMPANY	110
CFC FINANCIAL SERVICES	30
<b>Total</b>	<b><u>553</u></b>

The eight respondents manage about 553 out of a total of 695 pension schemes managed by registered pension fund managers. Old mutual asset managers has the highest number of schemes under their management. This is followed by Kenindia asset Management Company with a total of 110. The least is ICEA with 16 pension schemes.

**Table 4.1.2 Number of Pension Funds Managed by Registered Fund Managers who did not Respond.**

<b>Fund Manager</b>	<b>Number of Pension Funds</b>
JUBILEE FINANCIAL SERVICES	62
MADISON ASSET MANAGEMENT	80
BARCLAYS TRUST	—
<b>Total</b>	<b><u>142</u></b>

Barclay Trust has since transferred the schemes that were under their management to stanbic and old mutual asset managers. Jubilee financial services Ltd and Madison Asset Management Ltd did not give any response. The number of pensions they manage constitute about 20% of total schemes managed by registered pension fund managers. The number of pensions they manage were obtained from quarterly Newsletter of the RBA, Vol 2 No. 3 March 2003.

#### 4.2 Number of Investments Constituting a Portfolio

**Table 4.2.0 Number of Investments in a Portfolio**

Average No. of Investments	No. of Managers	%
1- 10	5	62.5
10- 20	1	12.5
Over 20	2	25
<b>Total</b>	<b>8</b>	<b>100</b>

Source: Research data

Table 4.2.0 gives an indication of the level of diversification. Many investments with risk and return elements taken into consideration would mean a well-diversified portfolio.

The table above shows that 62.5% of the respondents hold portfolios of investments between 1-10. These were mainly equity and Government paper. 12.5% hold portfolios of 10-20 investments, while 25% hold portfolios consisting of over 20 investments. The other categories include commercial paper and real estate.

### 4.3 Types of Pension Plans

There are basically two types of plans managed by pension fund managers, the defined contribution and defined benefit plans. Plans identified from the study are indicated in Table 4.3.0 below.

**Table 4.3.0: Type of Plan (%)**

	STBIC	OM	GENK	AIG	ICEA	COOP	KEN	CFC
<b>Type of plan</b>	%	%	%	%	%	%	%	%
Defined Benefit	20	20	54	20	0	10	0	0
Defined Contribution	80	80	46	80	100	90	100	100
<b>Total</b>	100	100	100	100	100	100	100	100

Source: Research data

Table 4.3.0 shows that majority of the schemes fall under defined contribution plan. ICEA, Kenindia and CFC do not have any plan under defined benefit category. GENK is the only respondent with a higher proportion of schemes under the defined benefit plan than in the defined contribution plan.

**Table 4.3.1 Number of Schemes Under Each Plan**

<b>Fund Plan</b>	<b>STBIC</b>	<b>OM</b>	<b>GENK</b>	<b>AIG</b>	<b>ICEA</b>	<b>COOP</b>	<b>KEN</b>	<b>CFC</b>	<b>Total</b>	<b>%</b>
Defined Benefit	8	28	24	20	0	7	0	0	87	16
Defined Contribution	32	112	21	78	16	67	110	30	466	84
<b>No.of schemes</b>	<b>40</b>	<b>140</b>	<b>45</b>	<b>98</b>	<b>16</b>	<b>74</b>	<b>110</b>	<b>30</b>	<b>553</b>	<b>100</b>

Source: Research data

The number of schemes is given by: Proportion (%) (Table 4.3.0) X No. of schemes managed by the pension fund manager.

Table 4.3.0 and Table 4.3.1 clearly indicate that most schemes fall under defined contribution plan. Old mutual and Kenindia asset managers have the highest number of schemes under defined contribution plan, 112 and 110 respectively. ICEA Kenindia and CFC do not have any scheme under defined benefit plan. The reason being that DB plans are difficult to manage as they need frequent actuarial valuations unlike the DC plans. 84% of all the pension schemes are under DC plans. This was attributed to the fact that DC plans are easy to administer and manage. They also require less actuarial valuations and that the risk is borne by the members and not the sponsors. Only 16% of the total schemes fall under defined contribution plan. The trend world wide, according to the managers is towards the defined contribution plans.

#### 4.4 The Categories of Schemes Managed by Fund Managers

This analysis focuses on the categories of schemes managed by fund managers. The categories analyzed include the Church, Government, NGO, Private Firms and "others".

**Table 4.4.0 Categories of Schemes Managed by Fund Managers (%)**

	STBIC	OM	GENK	AIG	ICEA	COOP	KEN	CFC
Category	%	%	%	%	%	%	%	%
Government	40	30	51	-	12	67.5	1	-
Church	-	10	7	-	-	1	1	-
NGO	15	10	-	-	-	2	1	5
Private companies	45	50	35	100	88	5	97	80
Others	-	-	7		-	24.5	-	15
<b>Total</b>	100	100	100	100	100	100	100	100

Source: Research data

Table 4.4.0 above indicate the majority (67.5%) of the Government schemes are managed by cooperative bank. Stanbic bank, Old Mutual, AIG Global, ICEA, Kenindia and CFC mainly manage private company schemes with proportions of 45%, 50%, 100%, 88%, 97% and 80% respectively. In particular AIG global only manages pension schemes for private companies. Genesis Kenya and the cooperative bank mainly manage government schemes with proportions of 51% and 67.5% respectively. The findings reveal that church and NGO pension schemes are not very popular among the fund managers.

**Table 4.4.1 Total Number of Pension Schemes Managed by Fund Managers**

	STBIC	OM	GENK	AIG	ICEA	CO-OP	KEN	CFC	TOTAL	%
<b>Category</b>										
Government	16	42	23	-	2	49	1	-	133	24
Church	-	14	3	-	-	1	1	-	19	3
NGO	6	14	-	-	-	2	1	1	24	4
Private companies	18	70	19	98	14	4	107	24	354	65
Others	-	-	-	-	-	18		5	23	4
<b>No. Of schemes</b>	40	140	45	98	16	74	110	30	553	100

Source: Research data

The total number of pension schemes managed by fund managers is given by:  
 $\text{Proportion (\%)} = (\text{Table 4.4.0}) \times \text{No. of schemes managed by the pension fund manager.}$

The table shows that 65% of pension schemes managed by fund managers are from privately owned firms. This includes the Bank, manufacturing and service industries. 24% of the schemes are from the Government mainly the parastatals. The mainstream government runs their own pension scheme. Church and NGO based pensions schemes constitute 4% and 3% respectively of the schemes managed. "Others" under investor categories include savings and credit cooperative ( Sacco) societies.



#### 4.6 The Asset Class Preferred by Each Investor Category

This analysis seeks to establish the most preferred asset class by each of the investor categories. These categories are classified as the Church, NGO, Government, Private firms and "others".

**Table 4.5.0 Preferred Asset Class by Investor Categories**

Asset category	Number of respondents by investor category						
	Gov't	Church	Private firms	NGOS	Others	Total	(%)
Equities	-	-	3	-	-	3	8
Cash	-	-	1	-	-	1	3
Deposits	-	-	-	-	-	0	0
Government paper	6	5	6	4	4	25	70
Property	1	-	1	-	-	2	5
Off-shore investments	-	-	1	-	-	1	3
Corporate bonds/ commercial paper	1	1	1	1	-	4	11

Source: Research data

The table above shows that 70% of responses indicate Government paper to be the most preferred asset class. This was followed by corporate bonds (11%) and equities (8%). Property (5%), off shore investment (3%) and cash (3%) were relatively less popular investments. None apparently kept funds as deposits, the reason being that bank deposits do not give an attractive return in terms of interest earned. The popularity of Government paper stems from its certainty and predictability of cash flows on due dates.

#### 4.6 Factors Influencing Liquidity

This analysis is premised in finding out the factors influencing liquidity of pension funds in Kenya. All the fund managers consented to the fact that there are many factors that influence the liquidity levels of pension funds. For ease of analysis such factors have been classified into 3 categories, Financial, Non- financial and Institutional factors.

The analysis also involves determining which factors influence liquidity most by ranking them in order of preference. For the purposes of this study, the ranking was: 1 for very important, 2 for important, 3 for fairly important, 4 for unimportant and 5 for irrelevant.

Average ranking is defined as the rank multiplied by the number of (No) respondents divided by the total number of respondents.

**Table 4.6.0 Financial Factors Influencing Liquidity of Pension Funds**

Ranking	Risk		Return		Diversificati on requirement		Reliability of cash inflow		Predictability of cash out flow	
	No.	%	No	%	No	%	No.	%	No	%
1	3	37.5	2	25	1	12.5	3	37.5	4	50
2	1	12.5	2	25	3	37.5	4	50	1	12.5
3	4	50	2	25	3	37.5	1	12.5	-	-
4	-	-	2	25	-	-	-	-	1	12.5
5	-	-	-	-	1	12.5	-	-	2	25
<b>Total respondents</b>	8	100	8	100	8	100	8	100	8	100
<b>Average ranking</b>	2.10		2.50		2.60		1.75		2.50	

Source: Research data

The table above shows that reliability of cash inflow is the most important financial factor considered by pension fund managers in ensuring liquidity. The average ranking was 1.75. This was attributed to the fact that pensions schemes main objective is to pay benefits when due. This means that at any one time the fund must be liquid to meet its obligations. The elements / pointers that determine reliability of cash inflow are thus given priority by pension fund managers while ensuring liquidity. Risk, return and predictability of cash out flow were also ranked important with an average ranking of 2.1, 2.5, and 2.5 respectively. The least important factor was diversification requirement with an average of 2.6.

**Table 4.6.1 Non financial Factors Influencing Liquidity of Pension Funds**

Ranking as No	Performance of fund managers		Actuarial assumptions		Population trends		Early retirements		Aids Epidemic	
	NO	%	NO	%	NO	%	NO	%	NO	%
1	2	25	3	37.5	2	25	6	75	2	25
2	3	37.5	3	37.5	-		1	12.5	1	12.5
3	2	25	1	12.5	1	12.5	1	12.5	1	12.5
4	-	-	1	12.5	3	37.5	-	-	1	12.5
5	1	12.5	-	-	2	25	-	-	3	37.5
<b>Total respondents</b>	8	100	8	100	8	100	8	100	8	100
<b>Average Ranking</b>	2.4		2.0		3.4		1.4		3.2	

Source: Research data

The table indicates that 75% of the managers considered early retirement as the most important factor that influences liquidity of pension funds. Managers stated that retrenchments have forced fund managers to put funds on short-term

investments. It was ranked 1.4. The second most important factor in ensuring liquidity was the actuarial assumptions. According to the managers the inclusion of the age profile of the contributors influenced level of the liquidity requirements. The least important factor in this category was population trends. This was ranked 3.4. 63% of the fund managers considered population trends as unimportant because Kenya has not experienced any drastic change of population of its working force.

**Table 4.6.2: Institutional Factors Influencing Liquidity of Pension Funds**

Ranking as No.	Social concern		State interference		Attitude of corporate sponsor		Regulatory bodies	
	No	%	No	%	No	%	No	%
1	-	-	2	25	1	12.5	4	50
2	1	12.5	1	12.5	3	37.5	2	25
3	1	12.5	-	-	4	50	1	12.5
4	2	25	1	12.5	-	-	-	-
5	4	50	4	50	-	-	1	12.5
<b>Total Respondents</b>	8	100	8	100	8	100	8	100
<b>Average ranking</b>	4.1		3.5		2.4		1.9	

Source: Research data

The table above shows that regulatory bodies in this case, the Retirement Benefits Authority (RBA) was the most important factor influencing liquidity. The average ranking was 1.9. Managers said that limits on individual asset classes restricted them from maximizing return when opportunities arise. For example limiting investments in higher yielding treasury bonds / Government securities to 70% whereas some trustees would find it risky to invest in the stock market leaves them with limited investment vehicles. According to one respondent the limit on offshore investment barred them from fully utilizing investments abroad.

The second most important factor was the attitude of the corporate sponsor, which was ranked 2.4. Social concern and state interference were least important with rankings of 4.1 and 3.5 respectively. The respondents attributed this to the fact that institutional framework has been adequately outlined by Capital Markets Authority (CMA) and Retirement Benefits Authority (RBA) statutes. These have then minimized the need for state or social concern. Secondly considerations on managing private firms pension schemes are purely on law.

In summary therefore the factors influencing liquidity can be categorized as important, fairly important and irrelevant. Among the important factors are return, risk, diversification requirement, reliability of cash inflow, predictability of cash outflow, performance of fund managers, actuarial assumptions, early retirements, regulatory bodies and attitude of corporate sponsor.

Risk, return and diversification requirement are regarded as important because they are the basic elements an investment manager should consider while constructing a portfolio to ensure liquidity of the pension scheme. Predictability of cash outflow mainly depends on the type of plan of the pension scheme. The type of plan plays a role in determining the investment profile. Predictability of cash outflow therefore is ranked important because it indirectly affects investment return. The financial position of pension funds is normally affected by mass unforeseen retrenchments, resulting in huge payouts. This is a relatively new issue, which the pension industry is encountering and has been considered important in ensuring liquidity of pension scheme. The influence of RBA on the investment policy of Pensions industry became important since its enactment in 1997. From the study its average rank is 1.9.

The fairly important factors were state interference, population trends and Aids epidemic. 65% of the pensions schemes are from the private sector. State

interference is thus limited. Pensions industry has also not recorded any effects of population trends on pension schemes financial position.

The least important factor was social concern. This is a recent development and a non-financial factor. Most of the respondents did not see it as a factor that influences liquidity.

#### **4.7 Measurability of the Factors Influencing Liquidity of Pension Funds in Kenya.**

This study seeks to establish the difficulty in measurability of factors influencing liquidity and their incorporation into the process of decision-making. The factors being analyzed include the financial, non-financial and institutional factors. The ranking will be 1 for very difficult, 2 for difficult, 3 for least difficult, 4 for not difficult and 5 for "not considered at all". The analysis is tabulated as below: -

**Table 4.7.0 Measurability of Factors Influencing Liquidity**

Factor	Rank	1	2	3	4	5	6	Total respondents	Average Ranking
	No	-	3	3	1	1	-		
%	-	37.5	37.5	12.5	12.5	-	100		
	No	Risk	2	1	2	2	-	8	2.00
	%		25	12.5	25	25	-	100	
Actuarial assumptions	No	Ret urn	2	3	2	1	-	8	3.25
	%		25	37.5	25	12.5	-	100	
Diversification requirement	No	1	1	1	2	2	1	8	2.75
	%	12.5	12.5	12.5	25	25	12.5	100	
Reliability of cash inflow	No	1	2	-	2	3	-	8	3.50
	%	12.5	25	-	25	37.5	-	100	
Predictability of cash outflows	No	1	3	2	1	1	-	8	2.75
	%	12.5	37.5	25	12.5	12.5	-	100	
Social interference	No	1	1	1	-	2	3	8	4.25
	%	12.5	12.5	12.5	-	25	37.5	100	
State interference	No	-	1	-	1	2	4	8	5.00
	%	-	12.5	-	12.5	25	50	100	
Legal requirement	No	1	-	-	3	3	1	8	4.25
	%	12.5	-	-	37.5	37.5	12.5	100	
Corporate sponsor	No	-	1	1	2	3	1	8	4.25
	%	-	12.5	12.5	25	37.5	12.5	100	
Inflation	No	2	1	2	1	2	-	8	3.00
	%	25	12.5	25	12.5	25	-	100	
Management style	No	-	1	3	1	2	1	8	3.90
	%	-	12.5	37.5	12.5	25	12.5	100	
Early retirement	No	-	4	1	1	2	-	8	3.10
	%	-	50	12.5	12.5	25	-	100	
Aids	No	-	2	2	1	-	3	8	4.00
	%	-	25	25	12.5	-	37.5	100	

Source: Research data

Table 4.7.0 indicates that investments return, diversification requirement and predictability of cash outflow were the most difficult factors to measure and incorporate into the decision making process. The average ranking was 2.0, 2.75 and 2.75 respectively. The managers attributed this to the fluctuation of stock

prices, interest rates and inflation. Investment risk and inflation had an average ranking of 3.

According to the managers the least difficult factors to incorporate into decision-making were social concern, state interference, legal requirements, corporate sponsor and Aids Epidemic. These factors ranked 4.25, 5, 4.25, 4.25 and 4 respectively. The reason given by managers was that the institutional framework already has guidelines and procedure and what is left is the implementation of the same by the fund managers.

#### **4.8 Challenges Faced by Fund Managers in Ensuring Liquidity**

This shows the analysis of challenges faced by fund managers in ensuring liquidity of pension schemes. The issues being ranked as challenging included retrenchments, Aids epidemic, unstable stock market, low yielding investments due to poor investments of the past, improving service quality, inclusion of clients preference in decision making, corporate governance considerations, political risk, inflation and others. The challenges are ranked on a scale of 1 to 6 with most challenging ranked one and irrelevant ranked six. The table below shows the results of the analysis.



**Table 4.8.0 Challenges Faced by Fund Managers in Ensuring Liquidity.**

Rank Factor		1	2	3	4	5	6	Total respon dents	Average Ranking
Aids epidemic	No	-	2	4	-	1	1	8	3.40
	%	-	25	50	-	12.5	12.5	100	
Retrenchment	No	2	6	-	-	-	-	8	1.75
	%	25	75	-	-	-	-	100	
Unstable Stock Markets	No	1	5	-	2	-	-	8	2.40
	%	12.5	62.5	-	25	-	-	100	
Low Yielding Investments	No	1	5	-	2	-	-	8	2.40
	%	12.5	62.5	-	25	-	-	100	
Improving Service Quality	No	1	2	1	2	2	-	8	3.25
	%	12.5	25	12.5	25	25	-	100	
Inclusion Of Clients Preference	No	1	4	1	1	1	-	8	2.60
	%	12.5	50	12.5	12.5	12.5	-	100	
Corporate Governance Consideration s	No	-	1	4	-	2	1	8	3.75
	%	-	12.5	50	-	25	12.5	100	
Political Risk	No	2	2	1	1	1	1	8	3.00
	%	25	25	12.5	12.5	12.5	12.5	100	
Inflation	No	1	3	2	1	-	1	8	2.90
	%	12.5	37.5	25	12.5	-	12.5	100	

Source: Research data

Table 4.8.0 shows that retrenchments is the biggest challenging factor facing fund managers in ensuring liquidity. The average ranking was 1.75. According to the managers retrenchments affected liquidity of pensions funds as they are

seldom planned. The second most challenging issues were unstable stock market and low yielding investments due to poor investments of the past. They were ranked as 2.4. The least challenging issue was corporate governance considerations with an average ranking of 3.75. This was attributed to the fact that the sponsors (parent companies) are cooperative and were always consulted and are part of the decision making process.

The second least challenging factor was the Aids epidemic with an average ranking of 3.4. This was due to the fact that the objective of a fund manager is to manage the portfolio to ensure that the required liquidity level is maintained. In this regard the manager is required to make tactical asset allocation decisions based on the strategic allocation contained in the investments policy. The Aids epidemic therefore does not feature at this point. It is absorbed in the actuarial assumptions, which reflects the mortality rates.

## **CHAPTER 5**

### **5.0 SUMMARY AND CONCLUSIONS, LIMITATIONS, RECOMMENDATIONS AND SUGGESTIONS FOR FURTHER RESEARCH**

#### **5.1 Summary of Findings and Conclusions.**

##### **5.1.1 Summary of Findings**

The data analysis was based on eight respondents managing 553 pension funds. The eleven possible respondents (population) manage approximately 695 pension funds. The eight respondents registered under RBA therefore manage about 80% of pension funds under the management of fund managers.

The most common type of plan managed by pension fund managers is the defined contribution plan which is easy to administer and manage. 84% of the pension schemes fall under the defined contribution plans. 62.5% of the respondents manage portfolios of securities between 1 and 10. 65% of the pension schemes managed by registered pension fund managers are from the private sector.

The most preferred asset class by corporate bodies (sponsors) was the government paper. This was preferred because of its certainty and predictability of cash flows on due dates. None of the respondents preferred deposits. The most important factors that influence liquidity within the financial, non-financial and institutional categories were reliability of cash flows, early retirements, and regulatory bodies respectfully.

There seems to be a general consensus that since 65% of the schemes are from the private sector, state interference and social concern are not part of the considerations in running the schemes funds.

Only two out of eight respondents gathered information on whether there is a difference between the factors considered by DC and DB plans. This may be attributed to the fact that 84% of the schemes under fund managers are defined contribution plans. Two respondents consented to the fact that one needs frequent actuarial valuations in a defined benefit plan than in a defined contribution plan.

There seems to be a high inclination on financial factors being considered difficult in measuring and their incorporation into the decision making process, as opposed to the institutional and non-financial factors. The most challenging issue in ensuring liquidity of pension funds was retrenchments/redundancies. Unstable stock market and low yielding investments due to poor investments of the past were also considered challenging.

### **5.1.2. Conclusions**

The investment limits on individual asset class by the Retirement Benefits Authority has influenced the investment style. According to one respondent, small firms have found it difficult to maximize returns if they stick to the guidelines. Another felt that they need to invest more on off shore assets. The RBA therefore should come up with commonly agreed guidelines on investment limits.

The corporate sponsors seem to have been inclined to investing in government paper only. There is need to develop an efficient capital market to encourage them diversify effectively.

There are varied issues that affect liquidity of pension funds. There is need for fund managers to clearly identify the factors that are within their control and work towards developing measures to deal with them. Those that are not within their realm should be understood to facilitate proper assimilation into their working

frameworks. Sharp decline in interest rate on government paper is posing a major challenge to pension fund managers considering that the equities market has not effectively picked up.

## **5.2 Limitations of the Study**

Some of the respondents took a long time with the questionnaires. This forced the researcher to work long hours within the short time available to ensure the quality of the analysis was not comprised.

Some of the respondents did not have all the required data. Two of them did not respond.

Some respondents considered the information requested to be confidential for the researcher had to meet and assure their senior managers of their confidentiality with which the information will be handled. This was a hard exercise considering their tight work schedules.

## **5.3 Recommendations to Policy Makers**

The RBA should consider revising the investment limits to take cognizance of the flexibility required by the managers. Most fund managers find the current limits too restrictive.

There is need to have some form of off site or onsite surveillance to ensure the contributors actually get paid on retirement. The RBA Act seems to concentrate more on investments and safety of the funds.

#### **5.4 Suggestions for Further Research**

This research lays foundations for other areas of study. A research on whether institutional framework governing the management of pension funds is appropriate in the young pension sector in Kenya is necessary.

A study to identify the factors that influence investment decisions of pension fund managers in Kenya should be explored.

A further study may focus on establishing the factors that influence liquidity of other asset management firms other than those registered under RBA.

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## APPENDIX 1

### LETTER OF INTRODUCTION

Joanne C. Rotich  
University of Nairobi  
Faculty of Commerce,  
P.O. Box 30197,  
**NAIROBI**

Dear Sir/Madam,

I'm a master's degree student in faculty of Commerce, University of Nairobi. In partial fulfilment of the MBA degree, I am conducting a study on "Factors that influence liquidity of pension funds in Kenya and the challenges fund managers face in ensuring liquidity".

You have been selected to form part of this study. To this end, I kindly request for your assistance in completing the questionnaire.

The information and data required is needed for academic purposes only and will be treated in strict confidence. A copy of the research project will be made available to your firm on request.

Thank you.

Yours sincerely,

**JOANNE C. ROTICH**

**APPENDIX II**

Questionnaire for Respondents

Name of the firm: \_\_\_\_\_

Rank/Title of respondent: \_\_\_\_\_

1. How many pension funds do you manage?

\_\_\_\_\_

2. Indicate the proportion of the type of funds you manage.

%

Defined Benefit (BD)      \_\_\_\_\_

Defined Contribution (DC)      \_\_\_\_\_

3. Please provide the reasons for the above proportions.

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

4. What proportions of the schemes under your management belong to the following sub- categories?

%

Government      \_\_\_\_\_

Church      \_\_\_\_\_

Non Governmental Organizations      \_\_\_\_\_

Private companies      \_\_\_\_\_

Others      \_\_\_\_\_

5. Which is the most preferred asset class by each of the above categories? (Tick as appropriate.)

Category	Asset Class						
	A	B	C	D	E	F	G
Government (Quassi Govt.)							
Church							
Private firms							
NGOs							
Others							

**KEY**

- A - Equities
- B - Cash
- C - Deposits
- D - Government Paper
- E - Property
- F - Offshore Investment
- G - Corporate bonds/Commercial paper.

6. On average how many investments does each investment portfolio of a pension scheme contain? (Tick us appropriate)

- 1 – 10
- 11 – 20
- Above 20

7. Are there any factors that influence the liquidity of the pension funds?  
(Tick as appropriate)

- Yes
- No

8. If your answer in question 7 is yes, which factors among the ones listed below do you consider in your investment policy for the purpose of ensuring liquidity of the pension funds? Please rank them in order of importance.

Key

1. Very important
2. Important
3. Fairly important
4. Unimportant
5. Irrelevant

<u>Factor</u>	<u>Rank</u>				
	1	2	3	4	5
Investment Risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Investment Return	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Diversification Requirement	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Reliability of cash inflow	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Predictability of cash outflow	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Others (Please Specify)

(a) _____	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
(b) _____	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
(c) _____	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
(d) _____	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

What is your reason for different rating of the above factors? Explain

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9. Which of the following institutional factors have influenced liquidity levels of the funds under your management? Please rank them in order of importance.

Key

1. Very important
2. Important
3. Fairly important

- 4. Unimportant
- 5. Irrelevant

<u>Factor</u>	<u>Rank</u>				
	1	2	3	4	5
Social concern	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
State/political interference	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Attitude of Corporate investor	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Regulatory Bodies	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Others (specify)

(a) _____	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
(b) _____	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
(c) _____	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
(d) _____	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

What is your reason for different rating of the above factors? Explain

---



---

10. Which among the non-financial factors listed below have influenced liquidity levels of the funds under your management? Please rank them in order of importance for the purposes of ensuring liquidity.

Key

- 1. Very important
- 2. Important
- 3. Fairly important
- 4. Unimportant
- 5. Irrelevant

<u>Factor</u>	<u>Rank</u>				
	1	2	3	4	5
Performance of fund managers	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Actuarial assumptions	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Population Trends

Early retirements

Aids epidemic

Others (Please specify)

(a) \_\_\_\_\_

(b) \_\_\_\_\_

(c) \_\_\_\_\_

(d) \_\_\_\_\_

What is your reason for different rating of the above factors? Explain

---

---

11. Is there a difference between the factors considered by DB plans and DC plans?

YES

NO

12. If your answer to Q11 is Yes, List the key factors considered by the two plans in ensuring liquidity in the format provided below.

(I) Factors considered by DB plans

(a) \_\_\_\_\_

(b) \_\_\_\_\_

(c) \_\_\_\_\_

(d) \_\_\_\_\_

(e) \_\_\_\_\_

(II) Factors considered by DC plans

(a) \_\_\_\_\_

(b) \_\_\_\_\_

(c) \_\_\_\_\_

(d) \_\_\_\_\_

(e) \_\_\_\_\_

13. Has the retirement Benefit Authority (RBA) affected/Limited your investments freedom?

- Yes   
 No

Explain.

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14. Factors influencing liquidity are varied and sometimes difficult to measure and incorporate into the process of decision making. State the degree of difficulty in the measurement of each of the factors influencing liquidity.

Key

1. Very Difficult
2. Difficult
3. Somewhat difficult
4. Least difficult
5. Not difficult
6. Not considered at all

<u>Factor</u>	<u>Rank</u>					
	1	2	3	4	5	6
Investment Risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Investment Return	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Actuarial assumption	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Diversification Requirement	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Reliability of cash Inflow	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Predictability of Cash Outflow	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Social Concern	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
State interference	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Legal requirements	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>



Corporate Investor	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Inflation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Management Style	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Early retirement	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Aids epidemic	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

15. The following are challenges and problems faced by fund managers. State the extent to which they pose a challenge in ensuring liquidity.

Key

1. Most Challenging
2. Challenging
3. Fairly challenging
4. Least challenging
5. Not challenging
6. Irrelevant

<u>Factor</u>	<u>Rank</u>					
	1	2	3	4	5	6
1. Aids Epidemic	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. Retrenchment/Redundancies	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. Unstable Stock Market	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4. Low Yielding Investment due to poor investments of the past	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5. Improving service quality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
6. Inclusion of clients preferences in decision making	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
7. Corporate governance considerations	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
8. Political Risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
9. Inflation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
10. Others (Specify)						
(a) _____	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
(b) _____	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
(c) _____	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
(d) _____	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

### **APPENDIX III**

#### **PENSION FUND MANAGERS IN KENYA**

- 1) Madison Asset management Services Limited
- 2) Global Investment Company
- 3) Barclays Trust Investment Services
- 4) CFC Financial Services Limited
- 5) Co-operative Bank Trust Investment Services Limited
- 6) Genesis Kenya Investment Management
- 7) ICEA Investment Services
- 8) Kenindia Asset management
- 9) Old Mutual Asset Managers Kenya Limited
- 10) Stanbic Investment Managements Services Limited
- 11) Jubilee Financial Services Limited

## APPENDIX IV

<u>Assets Category</u>	<u>RBA Maximum</u>
1. Equities	70%
2. Cash	5%
3. Deposits	30%
4. Government paper	70%
5. Property	30%
6. Offshore Investment	15%
7. Corporate Bonds/Commercial paper	15%
8. Unquoted shares	5%

Source: RBA, Act, Subsidiary Legislation, 2000