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NBFIRA
Non-Bank Financial
Institutions Regulatory
Authority

NBFIRA PRESENTATION TO THE BOTSWANA PENSIONS SOCIETY CONFERENCE, 29 FEBRUARY 2016

The Chairman of the Botswana Pensions Society, Chairpersons and Trustees of various pension funds, principal officers, esteemed guests, industry players, ladies and gentlemen, good morning.

I am delighted at the invitation extended to NBFIRA to make a presentation at this esteemed Pensions Conference.

The theme of the Conference "Retirement Funds and the Economic Development of Botswana" could not be more pertinent.

The central role and importance of retirement funds as a vehicle for the mobilization of long term domestic savings is acknowledged all over the world.

The sustainable growth and development of our Nation is primarily based on the provision and maintenance of supporting infrastructure such as roads, dams, power utilities, housing etc. The Government of Botswana remains the primary financier of infrastructure projects, including responsibilities for project implementation, execution and maintenance.

Pension funds play a critical role in mobilizing domestic savings and due to their long term investment horizon, are a significant sector in partnering governments in infrastructure development the world over.

As at 30 June 2015, Retirement Funds in Botswana had a total asset base of P69.9 billion Pula. As at this date, 63% of such fund assets were invested offshore and 37% invested locally. Whilst indeed Retirement Funds are allowed to invest up to 70% of their assets offshore, it is expected that Asset Managers take more proactive steps in identifying opportunities locally and

significantly increase the proportion of pension fund assets invested locally.

NBFIRA would wish to challenge Fund Managers in particular by being more proactive in identifying more investment opportunities locally.

1. HISTORICAL PERSPECTIVE OF THE INDUSTRY

Allow me Mr Chair to give a historical perspective of the industry and why this particular theme of this Conference becomes much more pertinent.

Over the past fifteen years, the role of pension funds in the capital markets in Botswana has assumed much greater significance. Perhaps the most important development in the retirement sector, was the policy pronouncement by the Government of Botswana to establish a fully funded pension fund for civil service employees in 2001; from the previously unfunded defined benefit arrangement.

This civil service pension reform in 2001 rapidly increased the size of retirement fund assets, from about P1.9 billion in 2000 to approximately P69 billion Pula today.

The multiplier effect was a rapid growth and development in the non-bank financial services industry, primarily the asset management industry and related service providers.

It is of concern that the size of the retirement fund industry has not translated into greater economic activity in addressing both the pre-retirement and post-retirement needs of your members who effectively are the owners of the funds that you manage. In this discourse, retirement funds are not expected to depart from their core mandate which is post retirement financial security for your members.

2. REGULATORY CHANGES

I would also take this opportunity to provide some perspective and background on the regulatory and legislative changes.

In light of the growth of this industry, the Government of Botswana recognized the need for a more robust supervisory and

regulatory reform policy framework for not only retirement funds, but the entirety of the non – bank financial services sector.

The Non-Bank Financial Institutions Regulatory Authority Act, 2006 was promulgated which formally established the Non-Bank Financial Institutions Regulatory Authority ("NBFIRA"), as a separate legal body charged with the primary mandate of regulating and safeguarding the non-banking financial services sector.

You will recall that prior to the formation of NBFIRA, the Registrar of Pensions was a Department within the Ministry of Finance and Development Planning.

In addition to the NBFIRA Act, various financial services laws, have been promulgated which include a new Retirement Funds Act, the Securities Act, and more recently the Insurance Act. Other bills are also in the pipeline including the CIU Bill and a revised NBFIRA Bill.

NBFIRA is happy with, and indeed encourages consultation with, and taking into consideration the views of the industry as we shape the regulatory framework for the betterment of the industry, being mindful of the members that you represent.

All these changes place much greater demands on boards of trustees to keep you up-to date with the regulatory framework.

During the past two decades, occupational pension plans not only in Botswana but worldwide have observed a significant shift towards DC systems, where the role of DB schemes has progressively declined

DC funds by their very nature, perhaps place added demands on trustees to take extra care in safeguarding member funds, who ultimately bear the investment risk.

A related problem is that our annuities market in Botswana is neither deep enough nor competitive enough and has failed to grow at the same pace as the retirement funds sector. The Regulatory Authority is examining the annuities sector closely and will be engaging with both existing and potential annuities providers on potential solutions to this problem.

In some DC pension funds, members are required to make complex decisions with regards to the investment strategy of their portfolios. This creates a challenge for trustees of how to effectively communicate to members the concept of the investment risk inherent within each portfolio, as well as the default portfolios.

In general terms members tend to understand absolute measures such as the projected final value of their pension accounts. The challenge therefore is for Trustees to provide your members with sufficient information, timely for them to make sound decisions

In summary therefore, the management of DC schemes places a heavy burden on trustee boards.

Some of the key issues that trustees need to specifically address include the formulation of an investment policy that achieves the expected level of return over the long term, a much better governance framework, a robust risk management framework, firmer monitoring and control of service providers, and cost containment.

3. THE KEY ASPECTS OF THE RETIREMENT FUNDS ACT

In light of the growth of the industry and the general shift to DC arrangements, the existing Pension and Provident Funds Act, which was promulgated in 1987 is outdated and has failed to keep pace with the developments on the ground.

The Retirement Funds Act was promulgated in August 2014 and is awaiting the Commencement Order.

Once this Act becomes operational, the existing Pension and Provident Funds Act will be repealed. There is a transitional period for funds to comply with the new Act.

The new Act focuses on greater legislative provisions taking account of the prevailing DC systems, it removes loopholes and ambiguities within the existing Act, and takes account of legislative trends worldwide with the primary objective of

protecting the member. Some of the key aspects of the new Act are -:

1. **Fund Governance**

   The Act provides much more robust governance legislative requirements on both stand -alone and multi-employer funds, or umbrella funds. The concept of independent trustees, defined as independent specialist within the new Act is a generally accepted world-wide practice in various jurisdictions.

   The Act seeks to address potential governance failures through a more balanced representation of stakeholders in trustee boards, and achieve higher levels of expertise, which may be achieved by the use of independent trustees.

   The governance requirements are quite exhaustive and include the requirements for a code of conduct by trustee boards, formulation and adoption of various policies including an investment policy, a communications policy and a risk management policy.

   Further requirements include the need to appoint a fund administrator, a custodian (where the fund is not in a pooled investment structure), the requirement for limited terms of office for service providers and the monitoring of the performance of such service providers.

2. **Fund Management Expenses**

   Fund expenses directly erode member's retirement savings. Trustees should always take active steps to ensure that these are under firm control. NBFIRA is concerned with some funds whose expense ratios are unsustainable and are significantly depleting members' benefits.

3. **Member Communication**

   Each fund needs to develop a communications policy to ensure that it is communicating with its members in a manner that the typical member will understand. Timely communication to members on their pension accumulations and projected benefits

will greatly assist members in estimating their expected outcomes and plan accordingly.

4. THE REVISED RETIREMENT FUNDS REGULATIONS

Supporting Regulations to the new Retirement Funds Act have been drafted and are also expected to be gazetted in due course. The Regulations will also spell out licensing requirements for fund administrators, who are classified as regulated entities in terms of the NBFIRA Act, but have not yet been licensed in the absence of the regulatory framework.

NBFIRA will expect those retirement funds whose business models include the in-house administration of pension funds to similarly apply for licencing as fund administrators.

5. PFR 2

I am happy that after various robust consultations with the industry through a Working Group, made up of representatives from various boards of trustees, asset managers and fund administrators, the PFR 2 has now been finalized.

The revised PFR 2 takes account of the inputs of the industry, without departing from its core objective of reducing concentration risk and achieving diversification within retirement funds through setting quantitative limits per asset class. The Prudential Rule has now been issued and provides a transitional period of six months within which trustees should re-balance their portfolios.

The revised PFR 2 started to be effective on the 1 November 2015 and pension funds have a transitional period of six months to re-balance your portfolios with the expectation that full compliance should be achieved by 30 April 2016.

6. Submission of the Various Statutory Returns

The Regulatory Authority remains concerned that a number of retirement funds are still not submitting audited financial statements as well as other policies on time.

This renders the work of the Regulatory Authority quite difficult as we cannot assess the stability of the non – bank financial system timeously.

4. IMPLEMENTATION OF THE RISK BASED SUPERVISION MODEL

NBFIRA has taken a strategic approach to implement the Risk Based Supervision Model in line with international best practice on supervisory and regulatory practices.

In support of this strategic thrust, a Risk Based Supervisory I.T System has been procured and rolled out to the industry. The Risk Based Supervisory I.T System is expected to improve the flow of information with regulated entities and also allows us to better monitor areas of risk within the non – bank financial system. I urge the industry to make use of the RBSS portal in making the various applications, submissions and returns to the Authority.

During the third quarter of 2015, the NBFIRA teams of people have been going around training entities on this I.T system. I urge the industry to embrace this initiative as it should no doubt create much greater efficiencies in the exchange of information with NBFIRA.

5. CONCLUDING REMARKS

The Regulatory Authority looks forward to a continuous engagement with the industry to ensure we work together in creating a safer and more stable industry which must deliver reasonable and meaningful pension outcomes to the members that we all serve.

In these circumstances, the Regulatory Authority will not hesitate to take necessary steps to ensure there is sound governance, financial discipline, and risk management within the retirement fund sector.

I would also wish to urge service providers to handle member funds entrusted to them with the expected level of skill, prudence, due care, and integrity.

In closing, I would like to applaud you as Trustees, and service providers in investing your time towards this Conference as you share experiences in managing pension funds.

I wish you the best in your deliberations.

I thank you.