CIVIL-SERVICE PENSION REFORM IN BOTSWANA

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ABSTRACT
The Government of Botswana has recently concluded a reform of its pay as you go civil service pension arrangement to a fully funded defined contribution pension fund. This study traces the policy discussion leading up to the reform decision, and references these against best practice pension reform principles. The study further analyses the steps and effectiveness of the reform implementation. To provide a fuller appreciation of the pension debate, reference is made to other pension arrangements that are available in the Botswana context.

ACKNOWLEDGEMENTS
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LIST OF ACRONYMS
BOB  Bank of Botswana
BOBC  Bank of Botswana Certificate
BPOPF  Botswana Public Officers Pension Fund
BSE  Botswana Stock Exchange
DFA  Division of Financial Affairs
DSS  Department of Social Services
ELT  English Life Table
GDP  Gross Domestic Product
MEFMI  Macroeconomic and Financial Management Institute of Eastern and Southern Africa
OECD  Organisation for Economic Co-operation and Development
CHAPTER 1

1.1 PENSION REFORM OBJECTIVES

The goal of any pension reform should be to ensure that all people regardless of their level or form of economic activity have access to the capacity to remain out of extreme poverty in old age.\(^1\) In a country with scarce resources, it is important to allocate these pension resources in co-ordination and recognition of other social objectives aimed at alleviating poverty not only amongst the elderly, but other vulnerable members of society.

Another key consideration for pension reform is to ensure that the pension systems are financially sustainable as ongoing concern. The majority of pension systems previously defined a benefit due to retirees, and paid these benefits as an when they became due, without any savings component to meet these current and future liabilities. Changing demographics and socio-economic conditions have resulted in increasing pension liabilities, creating financing hardships. To counteract this trend, recent years have witnessed intense pension reform efforts in countries around the globe. Pension reform can take different forms, namely parametric, notional defined contribution and systemic.

Parametric reform encompasses changes to pension benefit rules. To minimize the escalation of pension related costs, parametric changes include lowering benefit rates. Other parametric changes are the tightening pension eligibility conditions by increasing the retirement age, and tightening conditions for early retirement and disability pensions. Enhancing administrative efficiency to reduce operational costs, contribution evasion and fraud are other parametric reform examples. With respect to state pension systems, raising payroll taxes is a form of parametric reform. Parametric reforms are cost focused, ‘they do not address distortions in economic incentives that characterize systems with weak links between contributions and benefits.’\(^2\),


Notional Defined Contribution reform mimic funded schemes by quantifying the liabilities of the pension scheme. To meet these liabilities, contributions (by both the employer and or employee) based on a percentage of individual earnings create ‘notional’ individual account values. These individual accounts are notional as they are assimilated to state funds. The accounts earn a rate of return set by government. The future benefit, as defined by the value of an individual’s notional account at a retirement, is simply a claim on the future public budget.

Systemic reform introduces new pension systems. The new system has elements of pre-funding to meet retirement benefit obligations.

A change to the pension system has an impact on the wider financial system. ‘There is a growing need among policy makers, the regulatory community, as well as among private sector participants, to compare structural changes’ in retirement systems and their impact on the financial system. Through these efforts, issues that deserve further analysis can be synthesized.³

Botswana has recently undertaken civil service and universal pension reform initiatives. This paper aims to review and contrast these reform initiatives against best practice, as well as to assess the effectiveness of the reform, against the stated objectives.

There is need to review the reform strategies of other countries to gain a more comprehensive view of the pension reform process, its associated challenges and outcomes. Direct comparisons are not feasible given the varying demographics, country profiles, and reform strategies. Further, there is a lot of variation with respect to pension data collection and reporting standards. This impacts on the data quality, and further limits the ability to compare international statistics.

The bulk of financial data encompassed in this report is denoted in nominal ‘Pula’ terms. The Pula, is the name of Botswana’s currency. To facilitate international comparisons,

the table below represents the value of the Pula and the US dollar equivalent for the period under review in this study.

Table 1: Pula / US $ Exchange Rate

<table>
<thead>
<tr>
<th>Year</th>
<th>US $ Equivalent</th>
</tr>
</thead>
<tbody>
<tr>
<td>1982</td>
<td>0.9425</td>
</tr>
<tr>
<td>1983</td>
<td>0.8654</td>
</tr>
<tr>
<td>1984</td>
<td>0.641</td>
</tr>
<tr>
<td>1985</td>
<td>0.4769</td>
</tr>
<tr>
<td>1986</td>
<td>0.5442</td>
</tr>
<tr>
<td>1987</td>
<td>0.6387</td>
</tr>
<tr>
<td>1988</td>
<td>0.5166</td>
</tr>
<tr>
<td>1989</td>
<td>0.5341</td>
</tr>
<tr>
<td>1990</td>
<td>0.5344</td>
</tr>
<tr>
<td>1991</td>
<td>0.4825</td>
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<tr>
<td>1992</td>
<td>0.4431</td>
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<tr>
<td>1993</td>
<td>0.3899</td>
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<td>1994</td>
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<td>1995</td>
<td>0.3599</td>
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<td>1996</td>
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<td>1997</td>
<td>0.2625</td>
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<td>1998</td>
<td>0.2243</td>
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<tr>
<td>1999</td>
<td>0.2159</td>
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<tr>
<td>2000</td>
<td>0.1865</td>
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<td>2001</td>
<td>0.1432</td>
</tr>
<tr>
<td>2002</td>
<td>0.1829</td>
</tr>
<tr>
<td>2003</td>
<td>0.2058</td>
</tr>
<tr>
<td>2004</td>
<td>0.2148</td>
</tr>
<tr>
<td>2005</td>
<td>0.1953</td>
</tr>
<tr>
<td>2006</td>
<td>0.1739</td>
</tr>
</tbody>
</table>

Source: Bank of Botswana
The major objectives of the research paper are:

a) To establish the reform pre-conditions and best-practice with respect to pension reform processes;

b) To contrast the reform process undertaken by the Government of Botswana against best practice;

c) To assess the effectiveness of the reform against the reform objectives;

d) To make recommendations on further reform strategies, as determined by the findings of this research paper.

Reform is an ongoing process, determined by policy analysis methods of problem structuring, forecasting, monitoring, evaluation and recommendation.
1.2 THE BOTSWANA CIVIL SERVICE PRE-REFORM PENSION LANDSCAPE

The oldest formal pension system in Botswana focuses mainly on public sector employees, vis-à-vis the Pensions Act Cap 27:01. The Pensions Act Cap 27:01 defines the operational framework of the Botswana civil service pension system. It pre-dates the Republic of Botswana, which came into being on 30\textsuperscript{th} September 1966. The Pensions Act Cap 27:01 is a legacy of British Imperial rule. It defines public service to include ‘service in the public service of the Union of South Africa in respect of any officer transferred from a pensionable office in that service to a pensionable office under service of the Government of Bechuanaland before 1\textsuperscript{st} January, 1960.’ Public Service is further defined to include service to the East African High Commission, the National Health Service of the United Kingdom, to name but a few.

This pension system is not funded. ‘The government simply picks up the bill for civil service pensions. (These systems) are found almost exclusively in former British colonies in the Caribbean, sub-Saharan Africa and South Asia.’ The benefit is a function of salary (inclusive of inducement and personal allowances) at retirement, length of service, and an accrual factor.

The coverage of this retirement savings mechanism is limited to a quarter of the formal working sector. The employment environment in Botswana, like many developing countries, has limited share of its population involved in the formal sector. In Botswana, formal sector employment accounts for 296,387\textsuperscript{5} referenced against a total working population of 0.8 million. Formal sector employment represents only 37\% of the working population, with only 140,000 (17.5\% of the working population) covered by pension arrangements (both private and public). The Government of Botswana being accountable for approximately 45\% of the formal sector, making it the largest single employer.

\textsuperscript{5} Heytens et al. (13-May-05). Botswana Statistical Index. International Monetary Fund. Page 11.
The majority of the working population does not have any pension saving mechanisms in place. Further pension reform initiatives are required to address those not currently covered. ‘The extent of old-age security depends on the viability of informal arrangements, mostly family support. Yet neither this support nor the evolving status of the elderly in Africa has been the subject of much study, and little is known. In some countries, particularly those stricken by the HIV/AIDS epidemic, the problem appears to be more acute.’ The limited studies hamper the possibility of infusing indigenous retirement savings mechanisms toward the pension reform debate.

1.3 A SYNSOPSIS OF INDEGENOUS RETIREMENT SAVINGS MECHANISMS

Traditional ‘retirement’ savings mechanisms applicable in Botswana are based on cattle and small stock farming. During their active work lives, families accumulate cattle and other small stock inclusive of goats and sheep, as a store of wealth. The economic system is better based. Land is considered a national asset. As such it is leased for use by tribesman, rather than assuming direct and permanent ownership.

Those not fortunate enough to have inherited cattle from their forefathers, sell their labour toward livestock rearing activities. Upon a successful tenure, they are remunerated in the form of livestock, allowing them to accumulate their own wealth base. Once past one’s active work life, children assume control of their parents’ assets, which are applied toward maintaining the upkeep of these parents in their old age.

Animal farming is complemented by crop husbandry, to provide sustenance on a ongoing basis. Crop husbandry is a labour intensive undertaking. Children provide an important labour resource for both crop husbandry and cattle farming.

Children are considered an important aspect of retirement planning. They play a role by providing labour toward the accumulation of wealth, and the administration of care to the

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elderly. It is not uncommon for the children (in adulthood) to alternate in providing old age care for their elderly parents. This principle of retirement planning is still relevant in Botswana, although it is fast being replaced by an increasing reliance on monetary based forms of economic activity and the related retirement savings concepts.

In contrast, children are considered a liability in monetary based economies.

### 1.4 OLD AGE PENSION AND WORLD WAR II VETERANS ALLOWANCES

October 1996 saw the introduction of a universal old age scheme, administered by the Department of Social Services, Ministry of Local Government. The Department of Social Services (DSS) is responsible for the development of social welfare policies and the provision of social safety net and social protection programs to the vulnerable members of society. In addition to the civil service pension scheme, Cap 27:01, the universal old age pension is the second government sponsored unfunded pension scheme. It is mainly geared toward destitute senior citizens, allowing them access to a very basic sustenance. The non-means tested benefit, payable to persons 65 years and over, complements the limited coverage of formal sector pension schemes.

Old age pension benefits are payable monthly, in the form of cash, bank credit, or cheque. Proxies may be appointed by those beneficiaries that are not able to access benefits as result of disability. A beneficiary who receives the allowance via bank credit, cheque or proxy, is required to have a life declaration certificate endorsed quarterly by local officials, confirming that they are still alive. Failure to endorse the life declaration certificate results in the suspension of benefit payments. Citizenship is confirmed by national identity cards (O-Mang), issued by the National Registration Office. Not all of the elderly have O-Mang identity cards. Of those that do have identity cards, some do not have date of birth entries to these identity cards as a result of unavailable date of birth records. To overcome these hurdles, Age Assessment Committees exist in each district, to assist the elderly toward meeting the benefit identification criteria.
In April 1998 an additional pension allowance was introduced for Batswana citizens who participated in World War II. With respect to deceased veterans, the pension allowance is payable to the spouses of these veterans, or children under the age of 21 (if spouse is deceased). Benefits were not paid retrospectively. It is expected that the liability associated with this veterans’ benefit will decrease in time, as there are no new entrants to be considered.

The universal old age pension may be augmented by a Destitute Persons Cash Allowance, introduced in April 2003. The Destitute Persons Cash Allowance is payable to any destitute citizen, over the age of 16, registered under the Revised National Policy on Destitute Persons.

Table 2: Eligibility criteria for Department of Social Services

<table>
<thead>
<tr>
<th>Old Age Pension</th>
<th>World War II Veterans Allowance</th>
<th>Destitute Persons Allowance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Registered with DSS Citizen</td>
<td>Registered with DSS Citizen Valid O-Mang Participation in World War II (and or WWI) Spouse or child (under 21) of a deceased veteran</td>
<td>Registered with DSS Citizen Valid O-Mang</td>
</tr>
<tr>
<td>Valid O-Mang Attained Age 65 Not be receiving a pension from another countries' old age pension Benefit payable is P 116 per month (2004/5 rates)</td>
<td>Benefit payable is P 272 per month (2004/5 rates) Approximate number of beneficiaries as at 2004/5 is 4,412</td>
<td>Benefit payable is P 61 per month (2004/5 rates) Approximate number of beneficiaries as at 2004/5 is 40,984</td>
</tr>
<tr>
<td></td>
<td>Approximate number of beneficiaries as at 2004/5 is 87,349</td>
<td>Source: Department of Social Services, Ministry of Local Government</td>
</tr>
</tbody>
</table>
2001 Census data indicates a population of 83,493 above age 65, in line with the Old Age Pension 2004/5 experience of 87,349. The effect of emigration on the 2001 census population data has not been confirmed.

The expenditure trend of the Old Age Pension fund is expected to rise over time as a result of benefit increases and or increase in the number of beneficiaries. Botswana has a relatively young population with over 50% of the population below age 20. The sharp decrease in expenditure in 2005 is the result of administrative processes being strengthened to prevent fraudulent and or false benefit claims.
Chart 3: Population distribution by Age from 2001 census

Source: Department of Social Services, Ministry of Local Government
CHAPTER 2

2.1 CIVIL SERVICE PENSION SCHEME ELIGIBILITY
The Botswana public service makes a distinction between three labour classes. Those eligible for a pension are classified as a ‘permanent and pensionable.’ Those eligible for a severance benefit, are classified as ‘industrial class’ workers, whilst staff employed on fixed-term contracts are eligible for a gratuity benefit. Severance and pension benefits are mutually exclusive, as stipulated by Section 27 of the Employment Act Cap 47:01. The section states, ‘On the termination of .. employment, whether by reasons of the death or retirement of the employee or for any other reason, the employer shall pay to an employee who has been in the continuous employment with him for 60 months or more.. provided that where.. the employee.. is entitled to the payment of a pension or gratuity or both a pension and gratuity.. no severance benefit shall be payable.’

Gratuity and pension benefits are not mutually exclusive. An employee may be eligible for both a gratuity and pension benefit as is the case with the civil service scheme, Cap 27:01. ‘Permanent and Pensionable’ employees after a service period of 15 years qualify for a gratuity benefit, whilst service of twenty years or more entitles one to both a pension and gratuity benefit.

2.2 CIVIL SERVICE SCHEME REFORM OBJECTIVES
Government, the main employer in Botswana, has the civil service pension scheme for its Permanent and Pensionable employees legislated under the Pension Act Cap 27:01, financed on a pure pay-as-you-go basis. Concerns about the long term cost sustainability of the civil service pension arrangement, was the main trigger for reform.

The objectives of pension reform aim at ensuring the adequacy, affordability, sustainability and robustness of the pension arrangement.

Pension adequacy is determined in terms of the schemes ability to prevent old age poverty regardless of the longevity of pensioners’ lives, and or adverse economic
conditions. The amount of pension earnings is established with reference to social indicators including access to housing, health care, and other basic services. The ‘World Bank experience generally indicates that, for a typical, full career worker, an initial target of net-of-tax income replacement.. is likely to be about 40 percent of real earnings to maintain subsistence levels of income in retirement. This rate varies, with lower-income workers requiring higher replacement rates as compared to higher-income workers. The retirement age is another key factor that impacts on pension adequacy. Younger retirees require a lower replacement rate as they have the capacity to supplement their pension benefit. From a cost perspective, this argument is countered by the fact that younger retirees require pension benefits to be payable for longer periods.

**Pension affordability** refers to the saving capacity of the individual, employer, and or the state (in the case of state sponsored schemes). Sparse budget resources have to be evaluated against competing needs. In the case of limited financial resources, the pension benefit may be reduced, or removed in entirety. ‘Benefit levels tend to reflect the financial condition of each pension fund or, in the case of public-sector workers, the budget situation.’ Other strategies to consider include cost sharing mechanism where the employee, employer and or state share the burden of pension provision.

Participants make payments to the pension scheme via direct contributions or taxes, dependant on the funding mechanism. The ‘World Bank experience indicates that contributions in excess of 20 percent (of income) are likely to be detrimental for middle and high income countries.. for low income countries, the threshold may be as low as 10 percent. ‘It could be argued that an increase in the employee contribution improves both the finances of the scheme and the overall fiscal situation. However, for this to be the case, the net wages would have to be permanently reduced.’

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collection system should minimize the incentive for evading contributions, especially where universal pension benefits are provided.

Adequate funding and affordability depend on the financial soundness of the pension scheme. The financial soundness of the scheme should be maintained now and in the future, for the program to be considered sustainable. The pension scheme ‘should be structured so that the financial situation does not require unannounced future hike in contributions, unannounced future cuts in benefits, or major and unforeseen transfers from the budget.\textsuperscript{11} The temptation, when the scheme experiences shocks, is to cut back on benefits. Borrowing to meet short term needs is permissible, although this should be in a limited capacity. Uncapped borrowing to meet current needs may displace other claims on future resources.

Ideally, the pension scheme should have some surplus resources to act as a buffer against economic and other adverse shocks. \textit{Robustness} refers to the capacity of the scheme to withstand major shocks and to remain viable in the face of unforeseen conditions and circumstances. Main shocks to the scheme may come in the form of economic, demographic, or political risks.\textsuperscript{12} The design of the pension system should therefore be unique to the environment in which it is implemented. Once designed, the system should be stress tested to assess its ability to respond to a full range of likely scenarios in the short, medium and long term.

\subsection*{2.3 REFORM PRE-CONDITIONS}
Before any reform can be undertaken, there is a need to assess the local conditions, to ensure that they are able to support the reform objectives. ‘Too much is at stake for the current and future retirees, and the country as whole, to engage in a reform that is unlikely to attain the country’s social and economic objectives.\textsuperscript{13} The World Bank has suggested four criteria against which the reform process should be evaluated.

\textsuperscript{11} Ibid.
\textsuperscript{12} Ibid.
First, does the reform make sufficient progress toward the goals of a pension system?
The goals of a pension system include protection against old age poverty, the capacity to sustain consumption levels, as well as the ability to offer access to retirees across geographic and economic divides.

Second, is the macro and fiscal environment capable of supporting the reform?
Retirement planning is a long-term commitment. The reform should therefore be sustainable in the long run. It is important for the reform not to pose any systemic risk to the macro-economic fundamentals. Macro-economic stability alone is not enough, ‘pension systems must be fiscally and politically sustainable to achieve their income-support objective.’

Related to the above point, is an assessment of the administrative capacities of our jurisdiction to be able to implement, operate and manage the elements of the pension reform. These include information technology and human resources capacities. Related attributes include the availability of information such as member identification systems to monitor beneficiaries within the reformed system.

Finally, there should be adequate regulatory and supervisory oversight to ensure that the pension system operates in a well governed, accountable and transparent environment. Regulatory oversight requires enabling legislature. However, legislature alone cannot deliver the required governance standards. A robust and determined regulatory agency is the key toward ensuring the success of the reform system.

It is against these criteria, that the pension reform undertaken in Botswana will be evaluated.

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CHAPTER 3

3.1 THE REFORM ARGUMENT

The main issue to contend with in respect of pay-as-you-go civil service schemes is that of sustainability. It is important for a scheme to operate without experiencing sharp operating cost hikes, or benefit decreases, in the face of uncertain future financial conditions. ‘Combined with the greater generosity that characterizes civil-service schemes and the large share of the formal sector working in low-income countries’ public sector, the burden of civil service pension on the budget may be significant.\(^{15}\)

‘Periodic reviews of the long-term financial position of pension schemes – particularly those financed on a pay-as-you-go basis or partially funded basis – are an essential input to the policy making process.\(^{16}\) The reform initiative of the civil service scheme in Botswana commenced in 1985, stimulated by an actuarial study of the civil service scheme conducted as at 1 July 1984.

3.2 ACTUARIAL REVIEW OF THE CIVIL SERVICE SCHEME

The 1984 study quantified the accrued pension liabilities of the civil service scheme, as defined by the Pension Act 27:01. ‘This study recommended that the scheme be funded and estimated the pension liabilities to be around P 136 million.\(^{17}\) (representing 8.6% of GDP\(^{18}\))’ Without pension reform measures, this pension liability was projected to rise over time.

To minimize the cost burden, which would ultimately result in the civil service pension scheme becoming unsustainable, the World Bank recommends a funded approach, even if partially. This will have the effect of reducing future cost implications. ‘The introduction of a mandated funded (civil service) pension fund has given rise to

\(^{15}\) Ibid. Page 22.
\(^{17}\) Hon. P.H.K. Kedikilwe_Minister of Finance & Development Planning Ref: 1/3/41 XXX11(116); 19th May 1999, page 1
considerable debate inside and outside the (World) Bank. The Bank takes the position that not all countries are ready to introduce a funded pillar, and should not do so. At the core of the debate:
(a) can funded pensions be introduced in a rudimentary financial market environment, and if so, what are the minimum conditions?
(b) What are the good or best regulatory practices that typical client countries should follow?
(c) What are the good or best supervisory practices to be applied?
(d) What are the options for countries with small open systems?19,

There is no one size fits all approach, the actual design of the pension system will depend very much on the local conditions and objectives in a given country. These local conditions include not only the economic fundamentals, but the national priorities as well. With respect to the Botswana context, the impact of the HIV scourge on the workforce, and subsequently on the retirement savings strategies, must also be considered.

The diagram below represents the possible sequence of events related to HIV infection and the corresponding employee benefits.

**Figure 1: Employee benefits related to HIV infection**

![Employee benefits related to HIV infection diagram](adapted-from-institute-of-actuaries-working-party-on-hiv-aids-bulletin-5)

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3.3 THE REFORM DECISION

No decision was taken on the issue as it was felt that the (1984) study was not comprehensive. Further, the data needed to conduct the study had not been collected in advance, making it difficult to carry out accurate calculations and cost projections.

A more comprehensive study was undertaken as at 1 July 1994. The study, undertaken by Coopers & Lybrand Actuarial and Benefits Consultancy Services UK (Coopers & Lybrand), was motivated by the Revised Income Policy (as approved by the National Assembly on 13 September 1990) which recommended that ‘Government should conduct a thorough investigation of the advantages and disadvantages of introducing a funded pension scheme to replace its existing unfunded pension arrangement.’

The objectives of this study were outlined as follows:

(a) To estimate the present value of Government’s civil service pension liabilities, taking into account future growth of these liabilities.

(b) To recommend, cost, and compare possible modifications to the civil service pension scheme. Options to be considered include making the scheme contributory, whether pension benefits should be based on defined contributions or defined benefits, whether to defer payments in respect of early retirees until they attain normal retirement age.

(c) To provide the Government of Botswana with an assessment of the pros and cons of introducing a funded scheme. Further, to provide recommendations on how to introduce such a scheme, who should manage it, and the governance structure of such an entity.

The cost basis of the civil service scheme (Cap 27:01) is based on an accrual (savings) factor which determines the generosity of the scheme, the salary at retirement of the

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20 Hon. P.H.K. Kedikilwe_Minister of Finance & Development Planning Ref: 1/3/41 XXX11(116); 19
May 1999, page 2
employees, and their length of service. The returns earned on any accumulated scheme funds, if any, serve to meet the civil service scheme costs.

To overcome the 1984 data availability limitations, a preliminary assessment of the available and requisite data, was conducted. A small reference group, chaired by the Ministry of Finance of Finance and Development, was established to provide guidance to Coopers & Lybrand, assist with data sourcing and compilation, and most importantly to ensure that the recommendations of the actuarial study are promptly considered by Government. It is interesting to note that the Chairman of this Reference Group is the current Chairman of the Board of the Board Trustees of fully-funded reformed Botswana civil service scheme, nominating Mr. Ditlhogo Nelson Mokgethi as a credible civil service scheme reform champion.

3.4 1994 CIVIL SERVICE ACTUARIAL STUDY
The starting point of the study was to confirm the legal ability to make changes to the benefits provided by the public sector pension scheme either for current officers or officers who have yet to be recruited. With reference to Sections 115 and 116 of Constitution of Botswana, the legal opinion confirmed that pension benefits are determined by the law in force when a Public Officer joins the service, and may only be improved thereafter. Benefit changes may however be applied to persons who join the public service after the new legislation comes into force. For current officers, neither vested nor unvested interests can be changed to their disadvantage without their consent. The recommendation was for a totally new scheme to be legislated, applicable to all new civil service entrants, with serving officers being provided an option between the old regime and the new regime.

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22 Public Sector Pension Scheme. Ministry of Finance & Development Planning Ref: 2/9/36 II (40); 24th January 1995.
23 Public Sector Pension Scheme. Ministry of Finance & Development Planning Ref: 2/9/36 II (42); 26th January 1995.
24 Ibid.
The study further included aspects of benefit design, investment mandates, administration and funding. Benefit changes recommended, and the supporting arguments, were as follows:

1. Reduction of length of service required to earn rights to pension benefits (vesting scale) from 20 years to 3 years.
   - The length of the vesting scale (20 years) deters job mobility.
   - It could result in the retention of poorer performers.
   - It is arguably unfair.

2. Remove lump sum benefits, to be replaced by pension benefits with a commutation function. These lump sum payments are payable by the fund if your length of service at retirement (exit) is longer than 15 years, but less than 20 years.
   - Retirees can dissipate benefits without adequate investment of benefits.
   - Lump sum benefits do not take advantage of the pension schemes ability to share longevity risk.

3. Reduce early retirement benefits and, or increase the benefits for normal or late retirees such that they are actuarially equivalent.
   - Long serving civil servants receive less favorable benefits than shorter serving civil servants.
   - This induces early retirement, without taking into account the interests of the civil service and manpower planning considerations.
   - Pension are payable for longer periods increasing the cost of providing the benefits.

4. Define a normal retirement age of age 60.
   - This retirement age is consistent with current life expectancy.

5. Introduce personal tax deductible contributions by civil servants.
   - Provides for cost sharing.
   - Promotes civil servants recognition of the scheme and highlights the importance of pension saving.
   - Consistent with contributory public schemes in the region i.e. Zambia, Zimbabwe and South Africa.
The study, quantified the accrued liabilities due to the civil service under the Pension Act 27:01 to be P 2.2 billion (representing 20% of GDP\textsuperscript{25}). The 1984 actuarial study had estimated the accrued pension liability at 8.6% of GDP.

The report further projected that the current pay-as-you-go scheme would increasingly claim a greater portion of the civil service payroll from 3% in 1995 to 25% in 30 years time, assuming new entrants. This figure would increase to 32% (in 30 years time) if no new entrants were factored in.

A summary of the actuarial valuation study is summarized below.

Table 3: Civil Service Actuarial Valuation Summary

<table>
<thead>
<tr>
<th>Actuarial Valuation Date</th>
<th>1-Jul-84</th>
<th>1-Apr-94</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Active Members</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number</td>
<td>50,823</td>
<td></td>
</tr>
<tr>
<td>Average Age</td>
<td>35</td>
<td></td>
</tr>
<tr>
<td>Average Past Service</td>
<td>8</td>
<td></td>
</tr>
<tr>
<td>Pensionable Emoluments (p.a) Total</td>
<td>802,390,000</td>
<td></td>
</tr>
<tr>
<td>Pensionable Emoluments (p.a)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Average</td>
<td>15,788</td>
<td></td>
</tr>
<tr>
<td>Past Service Liability</td>
<td>2,166,453,000</td>
<td></td>
</tr>
</tbody>
</table>

| **Pensioners**           |          |          |
| Number Pensioners        | 2,112    |          |
| Pensionable Emoluments (p.a) Total | 14,107,000 |          |
| Pensionable Emoluments (p.a) |          |          |
| Average                  | 6,679    |          |
| Past Service Liability Pensioners | 38,089,000 |          |

| **Total Past Service Liability** | 136,000,000 | 2,204,542,000 |

| **Gross Domestic Product** | 1,581,395,349 | 10,000,000,000 |

Source: Public Sector Scheme. Ministry of Finance & Development Planning Ref: 2 / 9 / 36 II

\textsuperscript{25} GDP data derived from \textit{Economic Review 1996}. Bank of Botswana. Page S1
The second part of the report focused on additional projections to assess the cost sustainability of the contributory defined benefit fund, as recommended by the actuary. ‘He was of the firm view that the defined benefit approach be retained mainly because of:

a) Unfavourable experience of defined contribution in other countries with embryonic, sub-scale debt and equity markets;

b) The need to give predictability of pension to the lower paid, in particular.\textsuperscript{26}

With reference to the above arguments, the actuary suggested that Government introducing an index-linked bond. The gilt, in addition to improving the investment options available to scheme, would further provide useful inflation proofing.

The recommended contributory defined benefit scheme assumed a 5% and 10% contribution rate for employees and the employer respectively. To bring the fund to a fully funded position, an additional 10% special contribution by the employer was recommended for a 25 year period. The mortality assumptions were based on English Mortality table ELT 14, with a two year loading. Other actuarial valuation assumptions are summarized as follows:

\textsuperscript{26} Public Sector Pension Scheme. Ministry of Finance & Development Planning Ref: 2/9/36 II (113); 13\textsuperscript{th} February 1997.
The cost projections of the recommended contributory defined benefit fund, indicated that the civil service scheme costs would rise at a slower rate than the Gross Domestic Product (GDP), attaining the desired sustainability outcome.
Additional scenarios were simulated, with varying assumptions, to test the robustness of the recommended scheme design. The chart below indicates the cost implications, as a result of varying these assumptions. Scenario A represents the default (assumptions) scenario.
Chart 5: Stress test to assess the robustness of 1994 Actuarial Cost Projections

Source: Public Sector Scheme. Ministry of Finance & Development Planning Ref: 2 / 9 / 36 II

Other assumptions changes included an increase of the mortality loading by an additional three years, in a bid to assess the impact of the HIV/AIDS on the civil service scheme cost projections. ‘The main concern of many actuaries (is) to advise the trustees of pension schemes, and employers sponsoring such schemes, on the implications of HIV infection and AIDS for the financing of the schemes. Assessing the overall impact may be difficult because of the many factors involved… Other difficulties involved in predicting future AIDS cases include adjustments for reporting delay, under-reporting and changes to AIDS definition. ‘

The most rapid cost increase was exhibited by Scenario H, which included Age dependant WITHDRAWAL, RETIREMENT, and PROMOTIONAL SALARY assumptions; in addition to the existing actuarial assumptions (a more realistic scenario).

The least rapid increase was exhibited by Scenario J. In addition to the age dependant WITHDRAWAL, RETIREMENT, and PROMOTIONAL SALARY assumptions, a +1% investment return differential, and +3 year mortality loading (AIDS loading) were included. The effect of the Age dependant WITHDRAWAL, RETIREMENT, and PROMOTIONAL SALARY assumptions creates the greatest cost volatility, highlighting the importance of accurate data toward these cost projections.

All scenarios tested of the defined benefit contributory scheme, exhibited cost projections increases below the rate of projected GDP growth rate, confirming robustness.

3.5 1994 CIVIL SERVICE SCHEME REFORM DECISION

The 1994 study recounted some of the advantages and disadvantages of funding the scheme, and recommended that, on balance, it would be best to keep the scheme unfunded.\(^{28}\) The reasons for this recommendation, as proffered by the Government of Botswana, were as follows:

1. The domestic financial market in Botswana at this point were considered rudimentary, and thus lacked the capacity to absorb the substantial funds to be advanced by government to fund the past service liability. The Actuarial Report concluded, ‘Whilst we understand the reasons advanced for suggesting that pension funds are much more realistic if they are invested.. the local market could not handle such amounts of money, we wish to also warn that taking such amounts of money from the local economy may have adverse effects on the economy.’\(^{29}\)

2. Further, due to exchange controls in place, funds invested abroad would possibly incur withholding tax penalties on dividend pay-outs. Bank of Botswana investments of government reserves, which in essence served as a funding instrument under the pay-as-you-go arrangement, therefore offered an advantage as they were not liable for tax.

\(^{28}\) Hon. P.H.K. Kedikilwe Minister of Finance & Development Planning Ref: 1/3/41 XXX11(116); 19th May 1999, page 2

\(^{29}\) Public Sector Pension Scheme. Ministry of Finance & Development Planning Ref: 2/9/36 II (80); 19th September 1995.
3. Further, there was limited regulatory capacity and supervision of the financial sector, more specifically the pension and provident funds industry.

The recommendation adopted, therefore, was for government reserves, as managed by the Bank of Botswana, to be notionally earmarked to match the accrued pension liability thus creating a pseudo funding arrangement. ‘To a certain extent, whether or not pension spending is financed through contributions, as opposed to direct budget support is immaterial. On the other hand, the lack of an earmarked contribution reduces transparency and can make certain reforms more difficult.\(^{30}\)

The notional funding approach was not implemented. ‘In any case,(without explicit operational rules) it would not have been a satisfactory arrangement since there would be no guarantee that Government would not dip into the earmarked reserves during hard times.\(^{31}\)


\(^{31}\) Hon. P.H.K. Kedikilwe_Minister of Finance & Development Planning Ref: 1/3/41 XXX11(116); 19\(^{th}\) May 1999, page 2
CHAPTER 4

4.1 THE DECISION TO FUND THE CIVIL SERVICE SCHEME

The decision to create a fully-funded civil service scheme was crystallized by the realization that a pay-as-you-go scheme provides few incentives to maintain a disciplined pension regime in respect of awarding pension increases. Referenced against the provisions of Section 116 and 117 of the Constitution, this guaranteed that any benefit adjustments would be upward.

A case in point was the upward adjustment of the accrual factor from to 1/450th in 1998. Further benefit changes were the removal of the two thirds of pre-retirement salary cap on maximum pension benefits payable, and a general salary increase of 25% to civil servants (and pensioners). This resulted in a considerably higher pay-as-you-go expenditure experience, inconsistent with the cost projections of the 1994 study, which assumed civil servant salary and pension increases of 15% per annum.

Table 5: Actual vs. Project Pension and Salary Increases

<table>
<thead>
<tr>
<th>Year</th>
<th>Actual Increase</th>
<th>Projected Increases</th>
</tr>
</thead>
<tbody>
<tr>
<td>1995</td>
<td>8.00%</td>
<td>15%</td>
</tr>
<tr>
<td>1996</td>
<td>5.00%</td>
<td>13%</td>
</tr>
<tr>
<td>1997</td>
<td>9.50%</td>
<td>11%</td>
</tr>
<tr>
<td>1998</td>
<td>25.00%</td>
<td>0%</td>
</tr>
<tr>
<td>1999</td>
<td>0%</td>
<td>9%</td>
</tr>
<tr>
<td>2000</td>
<td>6.00%</td>
<td>5%</td>
</tr>
<tr>
<td>2001</td>
<td>9.00%</td>
<td>5%</td>
</tr>
<tr>
<td>2006</td>
<td>8.00%</td>
<td>5%</td>
</tr>
</tbody>
</table>

Source: 1994 and 2001 Actuarial Reports

The cumulative effect of these changes translated into an immediate doubling of the cost implication of the civil service scheme, which had remained non-contributory. With
inflation adjustments, the total pension liability rose to 33% of GDP\textsuperscript{32}, matching the 25 year cost increase projections of 1994 under a contributory defined benefit scheme. Concerns of long term scheme sustainability and affordability had once again resurfaced.

An increase of the pay-as-you-go pension liability creates a fiscal pressure if no new revenue sources are identified to meet the increased cost. ‘Combined with the greater generosity that characterizes civil-service schemes and the large share of the formal sector working.. in (the) public sector, the burden of civil service pension on the budget may be significant.’\textsuperscript{33} It can be argued therefore, that the 1999 pension reform decision was largely motivated by fiscal pressures, the basic framework of which had already been defined in the 1994 actuarial study.

Botswana is not the only country to experience this rise in civil service pension liabilities, it is a global phenomenon. The question remains, was there enough fiscal pressure on the Government of Botswana to warrant the pension transition?

More importantly, does the reformed civil service scheme achieve the objectives of pension adequacy, affordability, sustainability and robustness?

The debate can be extended to policy implementation. Was the implementation of the funded pillar to the civil service scheme accorded the appropriate sequencing, technical expertise, stakeholders, and communication strategy?

The answer to these questions will be offered by the evaluation of transition steps undertaken by the Government, referenced against pension reform best practice principles; to confirm or explode the myth that ‘there is no ‘intelligent design, merely ex-post rationalization.’\textsuperscript{34},

\textsuperscript{34} Ibid. Page 55.
4.2 1999 – WHY NOW?

‘There have been encouraging developments in the financial services industry since 1994, which indicate that funding the scheme can now be a viable option.’

The late 1980’s in Botswana saw the enactment of multiple financial sector legislation. This legislation related specifically to the Financial Institutions Act 1986, the Pension & Provident Funds Act 1987, and the Insurance Industry Act 1988 (amendment of 1979 Act). These Acts were promulgated following an interest from government and industry alike, to establish a transparent and enabling financial sector environment.

Pension funds are a powerful actor in financial markets. Undertaking such a reform in an environment with a limited financial sector creates both opportunities and challenges. The challenges, as summarized in the 1994 actuarial review included:

- Rudimentary domestic financial markets.
- Exchange controls to restrict / penalize offshore investments
- Limited regulatory and supervisory oversight of the financial sector.

To counter these challenges, the ‘encouraging’ financial sector developments as summarized in the Ministry of Finance and Development Planning’s 1999 recommendation to Cabinet included:

4.2.1 ADEQUATE REGULATORY AND SUPERVISORY OVERSIGHT


The investment of pension assets would therefore be overseen by the Collective Investments Under takings Act. Additional financial sector oversight would be provided

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by the Ministry of Finance and Development Planning, via the Division of Financial Affairs. The enactment of the Pension & Provident Funds Act Cap 27:03 in 1987 formalized the workings of the private pension industry, as well as providing for a regulatory oversight to be administered by the Registrar of Pension and Provident Funds. The Office of the Registrar of Pension and Provident Funds is housed within the Division of Financial Affairs (DFA). The DFA provides financial sector regulation with respect to the insurance and pension industries. The Botswana Stock Exchange is a self regulating entity, with the DFA providing the umbrella oversight.

The government pay-as-you-go civil service scheme, as defined by the Pensions Act Cap 27:01 is exempt from the provisions of Cap 27:03.

The (World) Bank strongly suggests initially applying strict regulations and relaxing them gradually as sound financial markets develop. ‘The regulations (that) should be applied to... funded schemes from the very beginning. include (a) appropriate licensing and capital requirements for service providers; (b) full segregation of assets, sponsors, management firm, and the use of external custodian banks; (c) asset diversification and the rules of asset management (the qualification of and licensing of internal or external managers); (d) asset valuation rules (mark to market) and rate-of-return calculations (the mutual fund instead of the savings account model); (e) periodic actuarial reviews and financial audits; (f) transparency and information disclosure; and (g) effective supervision and consistent application of sanctions.

The Regulations for which there remains uncertainty regarding whether and when they should be applied include (a) controls on market structure and choice; (b) funding, investment, and portability rules; (c) legal investment limits versus the prudent-man principle; (d) limits on commission and switching; and (e) profitability rules and guarantees. 37,

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4.2.2 MACRO AND FISCAL ENVIRONMENT CAPACITY TO SUPPORT THE REFORM

“Corporations had also started issuing bonds on the Botswana Stock Exchange, signaling evolution of the financial sector. The Botswana Stock Exchange in 1997 offered a market capitalization of US $ 614 million (P 2,336 million)\textsuperscript{38}.”

Industry innovation contributed to the continued enactment of more financial related legislation continued through the decade of the 1990’s. Acts which were promulgated included the Botswana Stock Exchange Act 1994, Banking Act 1995, Bank of Botswana Act 1996, Capital Transfer Tax (revised 1996 and 1997), and the Collective Investments Undertakings Act (revised 1999). This legislation did have a positive effect on the development of financial landscape, witnessed by the enhancement in the complexity and participation in the collective investments, pension, insurance, stock exchange activities.

Further, exchange controls had been liberalized. Pension funds were now able to invest assets offshore providing diversification opportunities. The 1987 Pension & Provident Funds Act had nurtured a small but growing pension fund industry, with total assets of P 3 billion (in 1999), regulated by the Registrar of Pension & Provident Funds. A directive was issued by the Registrar in 2001, prescribing a 70% offshore investment limit for pension funds.

Botswana’s foreign exchange control regulations were abolished effective 1\textsuperscript{st} April 1999. In response to the liberalization of Botswana’s exchange controls, the Registrar of Pension and Provident Funds issued a directive in 2001 allowing registered pension funds permission to invest offshore, subject to a limit of 70% off total assets. The result for the pension industry was the ability to invest more funds abroad to take advantage of the diversification principles. This offshore investment limit has remained unchanged to-date.

Finally, Botswana is the only A rated company in Africa, a testament to the strong macro-economic principles underlying its economy. Funding requirements would be financed from Botswana’s contingency reserve, valued at US $ 6.229 billion as at December 1999\(^\text{39}\), under the management of Bank of Botswana. The Botswana Government had built up this contingency reserve fund with savings, and interest earnings, accumulated from previous surplus budgets.

‘Countries with incomplete but sound financial systems that have relatively high per capita income, credible macroeconomic policies, and free capital movements offer the best case for funded pension and annuity systems.’\(^ {40}\) Botswana is a textbook example such a country, as such the argument for introducing a funded pillar, without question.

### 4.2.3 ADMINISTRATIVE CAPACITY TO IMPLEMENT, OPERATE AND MANAGE ELEMENTS OF THE PENSION REFORM

The administrative capacity is a key component for ensuring that information is correctly captured, and managed. This is especially key, where the reform involves conversion to a defined contribution arrangement, where there is need to create individual member accounts. These individual member accounts need unique identifying features, and as well as systems to credit contributions, and interest earnings, as well as to debit benefit payouts. ‘Administrative efforts of any reform should start with a careful assessment of the quality of current systems of account numbering and information transfer.’\(^ {41}\) The most challenging aspect of the administrative effort is at inception, where data is often not available in electronic format and therefore, needs to be captured manually. The 1994 actuarial study had provided a vital assessment of the administrative capacity of the civil service scheme with respect to information availability.


Some of the pension reforms undertaken in Latin America to introduce fully funded national schemes, integrated with defined contribution civil service schemes, were delayed to allow the development of adequate capacity. ‘A main lesson for (World) Bank staff advice to client countries,. implement the reform only when the administrative preparations is sufficiently advanced and problems are expected to be manageable.’

Further, the fund management / administrative capacity of the private pension industry had increased as such the funded civil scheme could consider outsourcing some of its processes. The companies able to offer these administrative and asset management services included Old Mutual Financial Service, Botswana Insurance Fund Management, Botswana Life Insurance Limited, Metropolitan Life, Ngamiland (Fleming) Asset Management, Time Management (Alexander Forbes Financial Services), and Investec Asset Management, to name but a few.

4.2.4 DOES THE REFORM MAKE SUFFICIENT PROGRESS TOWARD THE REFORM OBJECTIVES

The Ministry of Finance and Development Planning’s 1999 recommendation to Cabinet called for the introduction of a defined contribution civil service scheme. ‘It reduces the cost of pension provision’ was the bold argument advanced by the Ministry of Finance & Development Planning. The main concern with respect of the defined benefit civil scheme as defined by Cap 27:01 was the escalating future liability. The interest of Botswana Government was to arrest this liability.

The introduction of defined contribution civil service scheme would be more able to contain scheme costs, as the liability of the employer (government) is limited to the prescribed contribution rate. A defined benefit scheme, even if funded, has an open ended future liability to be borne by the employer, dependant on future experience.

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42 Ibid. Page 181.
43 Hon. P.H.K. Kedikilwe_Minister of Finance & Development Planning Ref: 1/3/41 XXX11(116); 19th May 1999, page 5
4.2.5 SECONDARY REFORM OBJECTIVES

‘The secondary goal of .. pension reform is to create developmental effects, either by minimizing negative impacts, such as the effects on labour markets or macroeconomic (in)stability created by imbalanced systems, or by leveraging positive impacts, especially by increasing national saving and by promoting financial market development. These development effects are determined by and large by the design and implementation of the pension system. ‘There is rising empirical evidence that the system’s characteristics – most important being design, financing mechanisms, and administrative implementation of benefits – have an important bearing on developmental effects.44,

There is strong empirical evidence of a link between pension reform and financial market development. Funding the civil service pension liability would give the employees ownership of the single most important national asset, from which the development of financial markets could be geared. ‘The fund will be a source of long-term capital to the economy, which will be an aid to the.. development of capital markets.45,

4.3 1999 CIVIL SERVICE SCHEME REFORM DECISION

A Presidential Directive Cab 27/99, issued on 1st December 1999, called for the establishment of a funded defined contribution civil service scheme. The directive, as issued by His Excellency the President, is summarized as follows:

a) A contributory funded pension scheme for the Public Service of Botswana be established.

b) The new scheme shall be a defined contribution scheme.

c) Future employees and those who opt to join the scheme should contribute to the scheme at a rate of 5% of their pensionable emoluments, with a facility for additional voluntary contributions for those who want to top up their benefits.

d) Government should contribute to the scheme at a rate of 15% of the employees’ pensionable emoluments.

e) The scheme shall be a separate legal entity from Government.

f) A Board of Trustees shall be established to run the scheme.

g) Current employees (including current pensioners) shall be given a two-year period in which to opt to joining the scheme.

h) Portability of pensions between the civil service and private sector should be accommodated in the new pension scheme.

i) Employees participating in the new scheme should have a right to a (full) benefit after 5 years. The benefit should be in the form of a deferred pension with a provision for a 25% cash withdrawal, should the employee leave government service before attaining normal retirement age.

j) Employees should be allowed to commute (cash) up to one-third of their accumulated pension benefit at the time of retirement.

k) The early retirement age for the new pension scheme will be 50 years.

An Interim Board, with representatives from various government arms (inclusive of the Directorate on Public Services Management, the human resources arm of government), civil service staff associations, civil service pensioners, was formed to spearhead the establishment of the defined civil service scheme. This Interim Board was again chaired by the Ministry of Finance & Development Planning, this time by the Permanent Secretary.
CHAPTER 5

5.1 THE REFORM PROCESS

The Interim Board deliberated on the rules, management and governance of the proposed defined contribution civil service scheme. The Board made the following proposals to, and subsequently approved by, Cabinet via Presidential Directive Cab 38/2000.

a) The scheme will be established as a separate and private entity from Government, under the Pension and Provident Funds Act, 1987. The scheme shall be called the Botswana Public Officers Pension Fund (BPOPF). The Fund will be established with effect from 1st April 2001.

b) The BPOPF will be managed by a Board of Trustees comprised of four Trustees appointed by Government, five Trustees appointed by employees and one Trustee elected by pensioners.

The Board of Trustees will appoint (external) administration and investment managers of the Fund. The Fund will also appoint its own auditors and actuaries. All expenses relating to the running of the Fund will be met by the Fund.

c) The normal retirement age is 60 years (or any other age according to the conditions of service applicable to the specific public service cadre). The early retirement age is 50 years, or any other age if the employee is in ill-health. The late retirement age is 70 years.

d) Pension benefits will be based on the member’s equitable share, defined as the accumulation of the Government’s (15%) and the employee’s (5%) contribution, plus the investment income.

e) Employees will be allowed to commute up to one-third of their equitable share at retirement. The balance will be applied to provide a monthly pension (annuity) from the fund, or registered insurer.

f) The annuity options include:

   a. 5 and 10 year guarantee options.
   b. Single or joint life annuities.
   c. Flat, 5% escalation, or with-profit pension increases.
g) If an employee dies in service, a lump sum equal to the greater of one year’s pensionable salary or the equitable share will be paid to the dependants or estate of the employee.

h) Withdrawing employees will be allowed a withdrawal cash benefit of 25% of their benefit entitlement.
   a. If an employee leaves service after serving less than 5 years, the benefit entitlement will be his own accumulated contributions and the interest thereof.
   b. If an employee leaves after serving 5 or more years, the benefit entitlement will be his equitable share.

i) Benefits provided under the Fund shall not be reduced, attached, ceded, pledged or hypothecated, or subject to any form of execution under a judgment of court or court order.

j) A deduction of benefits, by the Trustees, will only be with the approval of the Registrar of Pension and Provident Funds for housing loans granted in terms of Section 18 of the Pension and Provident Funds Act Cap 27:03.

k) Employees withdrawing from service will be allowed to transfer their benefits to other approved pension arrangements. Employees joining Government will be allowed to transfer their accrued pension benefits into this Fund.

l) Any disputes in respect of the operation of the fund, which cannot be resolved, will be referred to arbitration in accordance with the Arbitration Act.

m) The Trustees and or Government may dissolve the fund, subject to the approval of the Registrar of Pension and Provident Funds.

5.2 THE LEGAL PROCESS

‘The passage of law begins the most critical phase: reform implementation.’ To set the reform process in motion, the Pension Act Cap 27:01 was amended in 2001 to insert the following chapter 8, entitled ‘Botswana Public Officers’ Pension Fund:

(1) Any person who, before 1st April 2001 –
   (a) is a pensioner or receives any gratuity or other allowance under this Act; or

46 Ibid. Page 180.
(b) holds a pensionable office and is eligible for a pension, gratuity or other allowance under this Act, may if he so wishes, transfer his benefits under the present non-contributory pension scheme to the contributory Botswana Public Officers Pension fund established under the Pension and Provident Funds Act.

(2) A pensioner or other person who opts to transfer his benefits under subsection (1) shall do so within 24 months of the commencement of operations of the Botswana Public Officers’ Pension Fund.

(3) Every person who is employed in a pensionable office on or after the 1st of April, 2001 shall join and draw his benefits from the Botswana Public Officers’ Pension Fund.

The enactment of this legislation created two parallel civil service schemes, one contributory (defined contribution), and the other non-contributory (defined benefit pay as you go). Other Acts that were similarly amended were specific to special services, i.e. the Botswana Defense Force Act, the Police Act, and the Prisons Act. These Acts contained pension clauses applicable to this special cadre of the public service. Amendments were necessary to require facilitate their participation in the BPOPF, albeit under the special circumstances previously prescribed under these respective acts.

Unlike its predecessor, the Botswana Public Officers’ Pension Fund (BPOPF) was under the supervisory oversight of the Registrar of Pension and Provident Funds, and the regulatory framework prescribed by the Pension and Provident Funds Act Cap 27:03.

The transfer of funds from Government to the BPOPF was facilitated, and given the force of law, by the creation of Pension Liability Service Fund Order, Statutory Instrument No. 56 of 2001, under section 25 of the Finance and Audit Act Cap 54:01.

Section 25 of the Finance and Audit Act empowers the Minister of Finance and Development Planning to establish Special Funds, the purpose, revenue and administration of which is authorized in the manner provided by the written law establishing the fund. The purpose of the fund, as defined in Statutory Instrument No. 56 is to (a) service the pension liabilities of public officers who opt to join the Fund; and (b) hold monies appropriated by Parliament for the purpose stated under paragraph (a). The
revenue into the fund is appropriated by Parliament, and the administration of the fund
the responsibility of the Permanent Secretary of the Ministry of Finance and
Development Planning.

This strict adherence to procedure and letter of a law is a testament to the prudent
management of affairs by the Botswana Government. This principle further enabled the
completion of the conversion exercise, without which the political will may have
dissipated given the increasing cost implications associated with the creation of the
BPOPF.

5.3 THE IMPLEMENTATION PROCESS
The Interim Board was dissolved as at 25th November 2000. In its stead was established a
permanent Board of Trustees comprised of senior government officials from the various
government Ministries and Departments, representing the employer. The employee
representation was sourced from the various employee associations namely the Teachers
Association, the Botswana Civil Service Association, and the Botswana Local
Government Service Association. The interest of existing civil service pensioners was
additionally by served by having a representative to the Board.

Before the Interim Board was dissolved, it mapped a clear path on the way forward. The
initiatives included the outsourcing of the management of the fund, inclusive of auditing,
actuarial, administrative, and custodial functions. The publicity campaign to educate civil
servants on the functioning of the BPOPF, and the options available to them was to be
similarly outsourced. It was expected that the fund would overtime undertake the
management functions once it developed the necessary capacity and expertise.

The appointment of the fund actuary was finalized as at 4th December 2000. The
objectives of the valuation exercise were to determine the accrued liability values in
respect of civil servants, inclusive of pensioners. The function of the auditor was a
requirement to perform annual audits in line with the statutory requirements of the
Pension and Provident Funds Act Cap 27:03. Pricewaterhousecoopers was selected to fulfill this role.

The BPOPF also appointed an administration function, using the Government of Botswana’s tendering processes. The administration services that were to be provided included the following:

- Ensure that contributions are paid timely into the fund
- Provide quarterly administration reports to the Trustees
- In conjunction with the Principal Officer and Fund auditors, ensure that statutory returns are submitted to the Registrar of Pension and Provident Funds
- Maintain membership records
- Opening bank accounts on behalf of the fund
- Produce periodic benefit statements for the fund membership
- Process and pay fund benefits as and when due
- Arrange group life insurance as and when necessary (the fund death benefits provide for the payment of death benefit amounting to the greater of the member’s annual benefit or the fund credit
- Provide secretarial services to the Board of Trustees
- Provide Trustee training.
- Conduct Public education campaign

Table 6: Administrator Fee Structure

<table>
<thead>
<tr>
<th>Number of Active Members</th>
<th>Fee per member p.a.</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 to 5000</td>
<td>P144</td>
</tr>
<tr>
<td>Next 5000 to 10000</td>
<td>P120</td>
</tr>
<tr>
<td>Next 5000 to 15000</td>
<td>P108</td>
</tr>
<tr>
<td>Next 5000 to 20000</td>
<td>P96</td>
</tr>
<tr>
<td>Next 5000 to 25000</td>
<td>P84</td>
</tr>
<tr>
<td>Next 5000 to 30000</td>
<td>P72</td>
</tr>
<tr>
<td>Next 5000 to 35000</td>
<td>P60</td>
</tr>
<tr>
<td>Next 5000 to 40000</td>
<td>P60</td>
</tr>
<tr>
<td>Next 5000 to 45000</td>
<td>P48</td>
</tr>
<tr>
<td>Next 5000 to 50000</td>
<td>P48</td>
</tr>
<tr>
<td>Greater than 50000</td>
<td>P36</td>
</tr>
<tr>
<td>Number of Deferred Members</td>
<td>Fee per member p.a.</td>
</tr>
<tr>
<td>----------------------------</td>
<td>---------------------</td>
</tr>
<tr>
<td>0 to 500</td>
<td>P144</td>
</tr>
<tr>
<td>Next 5000 to 1000</td>
<td>P120</td>
</tr>
<tr>
<td>Next 5000 to 15000</td>
<td>P108</td>
</tr>
<tr>
<td>Next 5000 to 20000</td>
<td>P96</td>
</tr>
<tr>
<td>Next 5000 to 25000</td>
<td>P84</td>
</tr>
<tr>
<td>Next 5000 to 30000</td>
<td>P72</td>
</tr>
<tr>
<td>Next 5000 to 35000</td>
<td>P60</td>
</tr>
<tr>
<td>Next 5000 to 40000</td>
<td>P60</td>
</tr>
<tr>
<td>Next 5000 to 45000</td>
<td>P48</td>
</tr>
<tr>
<td>Next 5000 to 50000</td>
<td>P48</td>
</tr>
<tr>
<td>Greater than 50000</td>
<td>P36</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Number of Pensioners</th>
<th>Fee per member p.a.</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 to 500</td>
<td>P216</td>
</tr>
<tr>
<td>Next 500 to 1000</td>
<td>P120</td>
</tr>
<tr>
<td>Next 1000 to 1500</td>
<td>P108</td>
</tr>
<tr>
<td>Next 1500 to 2000</td>
<td>P96</td>
</tr>
<tr>
<td>Next 2000 to 2500</td>
<td>P84</td>
</tr>
</tbody>
</table>

Source: Civil Service Pension Scheme. Ministry of Finance & Development Planning Ref: 2 / 9 / 36 V

With the establishment of a funded contributory pension scheme, it was of fundamental importance that public officers were informed of the benefits and provisions of the new pension dispensation vis-à-vis the Cap 27:01 unfunded scheme. The education campaign sought to enable serving officers to opt accordingly. One of the initial key functions of the fund administrator was to conduct a public education exercise informing civil servants of the pros and cons of the BPOPF versus the Civil Service Pension Fund Cap 27:01. Extensive use of the existing government information channels was made in this respect. The campaign included literature to be used in the communication exercise, as well the conducting staff meetings in various centers across the country, and the use of medium such as newspaper, radio and television.

Other external service providers appointed to the BPOPF were the roles of Asset Manager and that of Fund Auditor.

The duties of the asset manager are summarized as follows:

- Invest surplus funds as directed and agreed with the Trustees
- Provide quarterly investment report to the Trustees
• Arrange for custodian services

Due to the size of the fund, multiple asset managers were appointed to the fund, namely African Alliance Asset Managers, Botswana Insurance Fund Management, and Fleming Asset Management Botswana. Private service providers were sourced to improve transparency and professionalism of the BPOPF operations. ‘The experience of Argentina indicates that simply placing assets in private control cannot guarantee their full protection.’ 47

Table 7: Asset Management Fee Structure

<table>
<thead>
<tr>
<th>Firm</th>
<th>Fee schedule</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Fleming Asset Management</strong></td>
<td>Local Assets - Segregated Fund Management</td>
</tr>
<tr>
<td></td>
<td>First P200m @ 0.325% p.a</td>
</tr>
<tr>
<td></td>
<td>Thereafter @ 0.300% p.a</td>
</tr>
<tr>
<td></td>
<td>Offshore Assets - Segregated Fund Management</td>
</tr>
<tr>
<td></td>
<td>Active Managed Assets</td>
</tr>
<tr>
<td></td>
<td>First USD 10m @ 1.25% wrap fee</td>
</tr>
<tr>
<td></td>
<td>Thereafter @ 0.85%</td>
</tr>
<tr>
<td></td>
<td>Offshore Assets - Segregated Fund Management</td>
</tr>
<tr>
<td></td>
<td>Passively Managed Assets</td>
</tr>
<tr>
<td></td>
<td>First USD 10m @ 0.25%</td>
</tr>
<tr>
<td></td>
<td>Thereafter negotiable</td>
</tr>
<tr>
<td><strong>Botswana Insurance Fund Management</strong></td>
<td>0.40% p.a for Direct Investments</td>
</tr>
<tr>
<td></td>
<td>Local Equity - 1.50% p.a</td>
</tr>
<tr>
<td></td>
<td>Local Property - 1.50% p.a</td>
</tr>
<tr>
<td></td>
<td>Local Bonds - 0.50% p.a</td>
</tr>
<tr>
<td></td>
<td>Fixed Interest - 0.50% p.a</td>
</tr>
<tr>
<td></td>
<td>Offshore Equity - 0.50% p.a</td>
</tr>
<tr>
<td></td>
<td>Offshore Bonds - 0.50% p.a</td>
</tr>
<tr>
<td></td>
<td>Plus a 1% allocation fee on new contributions</td>
</tr>
<tr>
<td><strong>African Alliance</strong></td>
<td>Local Assets - Segregated Fund Management</td>
</tr>
<tr>
<td></td>
<td>First P100m @ 0.60% p.a</td>
</tr>
<tr>
<td></td>
<td>Thereafter @ 0.500% p.a</td>
</tr>
<tr>
<td></td>
<td>Offshore Assets - Segregated Fund Management</td>
</tr>
<tr>
<td></td>
<td>Active Managed Assets</td>
</tr>
<tr>
<td></td>
<td>P 50m @ 1.00%</td>
</tr>
<tr>
<td></td>
<td>Subject to a minimum annual fee of P 250,000</td>
</tr>
</tbody>
</table>

Source: Civil Service Pension Scheme. Ministry of Finance & Development Planning Ref: 2 / 9 / 36 V

Another consideration with respect to sourcing private service providers is that of cost. ‘Administrative costs are higher in Africa than in any other region.’ High costs have the long term effect of reducing the income replacement ratio at retirement.

Of concern during this transition phase, was the limited pension knowledge and experience of the BPOPF Trustees. The Board of Trustees ability to provide effective oversight of the activities of the fund service providers was therefore limited.

5.4 2001 CIVIL SERVICE SCHEME ACTUARIAL VALUATION

An actuarial valuation of the pay as you go civil service scheme Cap 27:01 was undertaken as at 31\textsuperscript{st} March 2001. The actuarial valuation sought to quantify the actuarial liability of this scheme as well as to quantify the accrued benefits (past service liability) in respect of each officer, who had joined the civil service before April 2001. The accrued benefit is based on the officer’s length of service, salary experience, and the accrual factor of the non-contributory scheme Cap 27:01. Those serving officers who opted to join the contributory BPOPF scheme would have their accrued benefits values, under Cap 27:01, transferred to the BPOPF to serve as the opening balance in their individual member accounts.

The Actuarial Valuation experienced some of the information hiccups that were experienced by the 1994 exercise. Information related to actuarial valuation exercise is maintained by various, and often unrelated government agencies. This makes the consolidation of information particularly cumbersome. In some cases the required data was not available in the time nor the format required, requiring some data assumptions to be made. These estimates included dates of birth, salary experience over the service period and additional pensionable emoluments. Other errors experienced included non-pensionable officers being included to the exercise, whilst some eligible officers were left out. Pensioners were similarly afforded the option to join the BPOPF. Pensioners had

their transfer benefits calculated in the same manner as active members of staff, without recognizing the fact that they were already in retirement.

Serving public-officers were supplied with option forms indicating their prospective transfer benefits, should they opt to join the new fund. This exercise provided an opportunity for officers to confirm the actuarial valuation data entries related to their birth dates, service period, and current salary experience. The sourcing of completed forms comprised another challenge given the nationwide spread of civil servants. Useful toward the collection and compilation of these forms was the recently appointed BPOPF administrator. The actuarial valuation exercise was undertaken by Actuarial Solutions (Pty) Ltd in partnership with Hymans Robertson & Company Actuaries and Consultants (Pty) Ltd.

Table 8: Summary of Civil Service Actuarial Valuations Cap 27:01

<table>
<thead>
<tr>
<th>Actuarial Valuation Date</th>
<th>1-Apr-94 49</th>
<th>31-Mar-01</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Active Members</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number</td>
<td>50,823</td>
<td>69,930</td>
<td>38%</td>
</tr>
<tr>
<td>Average Age</td>
<td>35</td>
<td>36</td>
<td>3%</td>
</tr>
<tr>
<td>Average Past Service</td>
<td>8</td>
<td>10</td>
<td>26%</td>
</tr>
<tr>
<td>Pensionable Emoluments (p.a) Total</td>
<td>802,390,000</td>
<td>2,183,805,000</td>
<td>172%</td>
</tr>
<tr>
<td>Average</td>
<td>15,788</td>
<td>31,228</td>
<td>98%</td>
</tr>
<tr>
<td>Past Service Liability</td>
<td>2,166,453,000</td>
<td>8,778,063,000</td>
<td>305%</td>
</tr>
<tr>
<td><strong>Pensioners</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number Pensioners</td>
<td>2,112</td>
<td>3,275</td>
<td>55%</td>
</tr>
<tr>
<td>Pensionable Emoluments (p.a) Total</td>
<td>14,107,000</td>
<td>53,364,000</td>
<td>278%</td>
</tr>
<tr>
<td>Pensionable Emoluments (p.a)</td>
<td>6,679</td>
<td>16,294</td>
<td>144%</td>
</tr>
<tr>
<td>Average</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Past Service Liability Pensioners</td>
<td>38,089,000</td>
<td>773,845,000</td>
<td>1932%</td>
</tr>
</tbody>
</table>

| Total Past Service Liability | 2,204,542,000 | 9,551,908,000 | 333% |

| GDP                       | 11,115,000,000 | 16,905,800,000 | 52% |

| Total Service Liability / GDP | 0.198339361 | 0.565007749 | 185% |

| Future Service Contribution Rate | 24% | 33.3% | 39% |

Source: 31-Mar-01 Actuarial Valuation Report of the Botswana Civil Service Scheme

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49 Due to delays in sourcing and compiling data, the actuarial report was as at 1-Jan-95, although the report data was dated 1-Apr-94.
It should be noted that in determining the required future service contribution of the civil service scheme Cap 27:01 as at 1-Apr-94 and 31-Mar-01, the Projected Unit method and the Attained Age method of valuation were used respectively. The use of different methodologies stemmed from the fact that the civil service Cap 27:01 was closed to new entrants as at 31-Mar-01. Projected Unit methodology is utilized to determine liabilities where the fund is an ongoing concern, taking into account projected future liability changes. The Attained Age method is applied to closed funds, quantifying the past service liabilities accrued at the valuation date. Direct comparison of these actuarial valuation results is therefore limited.

The other aspect of this actuarial valuation exercise were assumptions related to numbers and profile of existing officers who would opt to join the BPOP from the Cap 27:01 civil service scheme. ‘The likelihood of the conversion depends on a variety of issues, such as the age of the member, the attractiveness of the transfer benefit, the current / future health of the member and the likelihood that the member will withdraw in the future.’ With reference to the improved mobility offered by the BPOP, the expectation was that younger serving officers were more likely to covert to the new funded arrangements. The age profile of the Cap 27:01 as at 31-Mar-01 was as follows:

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With reference to the expected conversion experience, the exercise further recommended an investment strategy to be adopted by the BPOPF. To determine this investment strategy, reference is made to the nature, term, and currency of the BPOPF liabilities. The idea is to select asset classes which match the scheme’s liabilities in terms of nature, term and currency.

With respect to the currency considerations, almost all of the assets would have to be held in Botswana Pula to minimize foreign exchange risk. The invest term is dependant on how far the aggregate fund membership is from retirement, whilst the nature of assets reflects the character of schemes pension liabilities.

In contrast to the Ministry of Finance and Development Planning’s 1999 recommendations to Cabinet, the conclusion of the actuary was that the local financial market did not have the asset array to meet the BPOPF asset requirements. To enhance
the available assets in the local financial market, the option of a bond / gilt issue by Government of Botswana again resurfaced.

For effective income replacement at retirement, the pension benefits need resistance to inflation erosion during the build-up and post-retirement phase. In the defined contribution context offered by BPOPF, the return on assets has to match or exceed the inflation experience. Index-linked gilts offer an ideal prospect for assets to be protected against inflation. Nonetheless, conventional gilts are an acceptable substitute as inflation expectations are factored into the pricing.

In the absence of ideal assets in the local financial market, the actuary recommended an investment mix consisting of Bank of Botswana Certificates, equities, and related short term securities. ‘Such an asset allocation is geared towards a high-risk strategy of growth.’

CHAPTER 6

6.1 THE BPOPFL TRANSITION PHASE

The government, to encourage an earlier option decision by serving civil servants, offered an additional 2.5% to the 15% already pledged in the BPOPFL rules, payable until March 2003. Employees during this period would be liable for a reduced to 2.5% contribution rate. The step contribution experience would phase in the pension contribution experience, and encourage those interested in opting in, to do so at the earliest opportunity.

The response to the call to join the BPOPFL was slow, prompted by the slow roll out of the member education campaign. An initial disbursement of P 150,000,000 was made by Government to meet the initial fund liabilities. As members opted to join the BPOPFL, the actuaries determined their transfer values, and funds were made payable to the fund. The effect of these payments on government coffers resulted in some liquidity constraints. As a result of these constraints, the prospect of notional accounting with respect to the BPOPFL, was resuscitated by the Accountant General. The suggestion did not cede any funding strategy changes given the advanced implementation stage of the BPOPFL. The Botswana Public Officers Pension Fund, was at this stage independent and legally entitled to demand due payments from government.

Table 9: BPOPFL Year One Age Transfer Schedule as at 31-Mar-02

<table>
<thead>
<tr>
<th>Age Band</th>
<th>Proportion in Band</th>
<th>Average Service (yrs)</th>
<th>Average Pensionable Salary (P)</th>
</tr>
</thead>
<tbody>
<tr>
<td>16 – 20</td>
<td>0.00%</td>
<td>0.8</td>
<td>14,520</td>
</tr>
<tr>
<td>21 – 25</td>
<td>4.20%</td>
<td>1.8</td>
<td>16,056</td>
</tr>
<tr>
<td>26 – 30</td>
<td>23.10%</td>
<td>4.4</td>
<td>22,116</td>
</tr>
<tr>
<td>31 – 35</td>
<td>25.90%</td>
<td>8.1</td>
<td>26,376</td>
</tr>
<tr>
<td>36 – 40</td>
<td>17.70%</td>
<td>12.1</td>
<td>33,432</td>
</tr>
<tr>
<td>41 – 45</td>
<td>12.90%</td>
<td>16</td>
<td>39,684</td>
</tr>
<tr>
<td>46 - 50</td>
<td>8.30%</td>
<td>18.1</td>
<td>45,456</td>
</tr>
<tr>
<td>51 - 55</td>
<td>4.20%</td>
<td>18.4</td>
<td>47,424</td>
</tr>
<tr>
<td>56 - 60</td>
<td>2.20%</td>
<td>19.7</td>
<td>50,868</td>
</tr>
<tr>
<td>61 - 65</td>
<td>1.50%</td>
<td>15.9</td>
<td>45,360</td>
</tr>
<tr>
<td>&gt; 65</td>
<td>0.10%</td>
<td>17.2</td>
<td>50,784</td>
</tr>
</tbody>
</table>

Source: Actuarial Solutions. BPOPFL Insurance Options Report. 31-May-02.
As anticipated, the highest transfer rate experience was in the lower age bands, stimulated by the improved pension mobility offered by the BPOPF. During this option window, scheduled to close as at 31\textsuperscript{st} March 2003, the fund had some operational issues to consider, namely:

- Should the BPOPF insure the minimum one time annual salary death benefit?

The BPOPF rules have a provision which provides for an in service lump sum death benefit equal to the greater of one year’s pensionable salary or the equitable share, payable to the dependants or estate of the deceased employee. Due to the high uncertainty relating to the profile of new entrants and incoming transferees, and the AIDS mortality experience, the fund was exposed to mortality risk in respect of the guaranteed one year’s pensionable salary, should this benefit be greater than the fund credit. The recommendation of the actuary was for the fund to insure this risk with a life office. The fund, based on its size and the minimal sum assured at risk, opted to self-insure this risk. To meet any adverse claim experiences, the fund in terms of its rules, established a Reserve Account. The Reserve Account is funded by residual interest considerations, should the declared interest be less than the actual interest experience earned by the fund. Other credits to the Reserve Account are sourced from residual monies where the employee withdraws from the fund during the vesting period (before being entitled to their full fund credit).

- The pros and cons of the BPOPF paying pensions for future retirees; and

The value of a retirement benefit payable from a defined contribution fund is determined by the amount of contributions paid into the fund, the interest gained on these contributions, and the cost of the annuity purchased at retirement. The Pension and Provident Funds Act Cap 27:03 permits pensions to be paid by the pension fund or an insurance company registered under the Insurance Industry Act Cap 46:01. The decision for the BPOPF to pay pensions was assessed against the ability of the fund to find assets to match the pension liabilities of future retirees. The lack of suitable investments (gilts) meant that the fund would have a mis-match risk. This concern was further compounded by the fact that no formal study had ever been conducted on pensioner mortality in
Botswana. ‘The extent to which pensioners live longer than that assumed by the actuaries in the factors provided, would result in a “loss” to the fund.’ In response to these concerns the BPOPF availed a dual option for future retirees to source a pension from either the fund or a registered insurer.

- The implications of allowing existing Government Pension Fund pensioners to transfer to the BPOPF.

The pension offered by the Civil Service Pension Scheme Cap 27:01 had historically risen with civil service salaries, a discretionary dispensation. The option to transfer to the BPOPF was also extended to existing civil service pensioners (Cap 27:01). Transfer to the BPOPF would allow pensioners to opt for a pension that rises by a pre-determined amount, or in line with investment returns attained by the fund. Existing civil service pensioners were offered a transfer benefit equal to the present value of future pensions. The lack of assets to match liabilities meant that government would incur a higher transfer cost as conservative factors would be utilized.

---

Table 10: Annuity rates applied to pensioner transfer calculations [payment of 0.08333 per month, in advance]

Mortality Assumptions:

<table>
<thead>
<tr>
<th>Mortality Table:</th>
<th>Financial Assumptions:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age Adjustment:</td>
<td>Interest rate: 10.00%</td>
</tr>
<tr>
<td>% of a(55):</td>
<td>Expenses: 2.50%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Guarantee</th>
<th>Male</th>
<th>Female</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 years</td>
<td>100%</td>
<td>100%</td>
</tr>
<tr>
<td>5 years</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>esc</th>
<th>0% p.a</th>
<th>5% p.a</th>
<th>10% p.a</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>10</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>0</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>10</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table: Annuity rates applied to pensioner transfer calculations [payment of 0.08333 per month, in advance]

- The establishment of a process whereby the Government of Botswana could recover debts from civil servants before they exit service.

Another operational issue to contend with was a mechanism for government to recover any debts the retiring or withdrawing employee may have in favour of government, at the time of exit. This feature whilst built into the Civil Service Pension Scheme Cap 27:01 (Cap 27:01 Section 7(a) – A pension, gratuity or other allowance granted under this Act shall not be assignable or transferable except for the purpose of satisfying a debt due to the Government of Botswana); was not provided for by the Pension and Provident Funds.

Source: Actuarial Solutions. BPOPF Insurance Options Report. 31-May-02.
Act Cap 27:03. Cap 27:03 specifically provides for the protection of pension assets against any form of indebtedness or attachment (Cap 27:03 Regulation 32(a) – No right to a benefit payable from a fund shall be capable of being ceded, pledged or hypothecated or be liable to be attached or be subject to any form of execution under a judgement or order of a court). Despite this protection, the government introduced Government of Botswana Form - T160, to be signed by exiting members, empowering the administrator to recover any debts due to government from the cash benefit payable at withdrawal or retirement. Debts to government are primarily incurred via the motor vehicle and residential advance scheme availed to civil servants. Other debits are a result of government accounting and recovery procedures operations. Other deductions are levied as a result of outstanding tax facilitated by the Income Tax Cap 52:01. These deductions with respect to withdrawing serving civil servants, may exceed the twenty-five percent cash benefit available at withdrawal. It remains to be seen whether BPOPF members may challenge government on this potentially ‘illegal’ recovery procedure.

6.2 THE BPOPF TRANSFER PROCESS

As serving civil servants made their option known to the BPOPF, the fund via their administrators would make an affirmative option known to the fund actuary. The actuary then re-calculates the transfer option based on the current salary experience, and other data as re-confirmed by the individual. Given the possible interim salary increases (the period between the 2001 actuarial valuation and the selection of transfer option), the experience generally resulted in an increase of the actual transfer amount. This experience was especially valid with respect to the Botswana Defense Force, which underwent a salary structure rationalization exercise as at 1-Apr-02. The result was that members of the Botswana Defense Force that made their transfer option post the salary structure adjustment, received a considerably higher transfer benefit as opposed to those that transferred before the salary ratification exercise.

As the fund grew, additional cost increase demands were received from the fund administrators. The fund administrators argued that the multiple payment sources into the fund (currently at 39 with respect to the Botswana Government agencies nationwide), and
the requisite manual data cross-checks, necessitated a 28% administration fee hike. The BPOPF trustees were able to negotiate a 17% increase in this respect. Further, the actuarial fees, which were initially borne by government to determine its liability in respect of the reform process, were also shifted to the fund as the transition phase neared completion.

To ensure accurate determination of transfer benefits, the fund actuaries (Actuarial Solutions; and Hymans Robertsons & Co. Actuaries and Consultants), performed two independent and parallel transfer benefit calculations, and the results cross-checked to identify any deviations. Despite these checks, an erroneous transfer benefit calculation as at August 2002 with respect to 368 members, resulted in an overpayment of P 98,774,213.10. The error was triggered by unformatted salary identification codes in respect of the members. The integrity of the transfer calculation methodology was thrown into question. This overpayment was netted of against future transfer liabilities due to government. This error served to frustrate the motion by the BPOPF Board of Trustees to hold government liable for interest payments due on outstanding transfer payments due the fund. The Botswana Government argued that the transfer process was dependant on interaction between government and BPOPF agents.

Once an individual’s transfer benefit is determined, the transfer benefits are compiled by the fund actuaries and a transfer schedule compiled for action by the BPOPF administrator. The administrator then notifies the Accountant General to mobilize the requisite transfer capital. Given the significant amounts involved, notice is given to Bank of Botswana to liquidate investment reserves to credit government coffers. The transfer amounts are then credited to the fund via a cheque payment to the BPOPF. The BPOPF account, maintained by the fund administrator, then forwards these funds to the investment managers for appropriate investment placements. Delays in effecting placement by these service providers, which did occur in some cases, would similarly rob the fund membership of potential interest earnings.
<table>
<thead>
<tr>
<th>Transfer Date</th>
<th>No. of Officers</th>
<th>Transfer Value</th>
<th>Amount Paid by Government</th>
<th>Date Paid by Government</th>
<th>Outstanding Pension Liability</th>
</tr>
</thead>
<tbody>
<tr>
<td>30-Apr-01</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>31-May-01</td>
<td>0</td>
<td>0</td>
<td>2,000,000.00</td>
<td>19-May-01</td>
<td>(2,000,000.00)</td>
</tr>
<tr>
<td>30-Jun-01</td>
<td>0</td>
<td>0</td>
<td>148,000,000.00</td>
<td>4-Jun-01</td>
<td>(150,000,000.00)</td>
</tr>
<tr>
<td>30-Sep-01</td>
<td>455</td>
<td>136,713,536.17</td>
<td></td>
<td></td>
<td>(13,286,463.83)</td>
</tr>
<tr>
<td>31-Oct-01</td>
<td>4,474</td>
<td>1,013,389,170.98</td>
<td></td>
<td></td>
<td>1,000,102,707.15</td>
</tr>
<tr>
<td>30-Nov-01</td>
<td>1,551</td>
<td>303,428,404.17</td>
<td>350,000,000.00</td>
<td>8-Nov-01</td>
<td>953,531,111.32</td>
</tr>
<tr>
<td>31-Dec-01</td>
<td>2,173</td>
<td>486,515,117.23</td>
<td>877,880,501.00</td>
<td>14-Dec-01</td>
<td>562,165,727.55</td>
</tr>
<tr>
<td>31-Jan-02</td>
<td>98</td>
<td>18,999,479.17</td>
<td>456,940,050.70</td>
<td>18-Feb-02</td>
<td>124,225,156.02</td>
</tr>
<tr>
<td>28-Feb-02</td>
<td>1,028</td>
<td>207,270,274.96</td>
<td></td>
<td></td>
<td>331,495,430.98</td>
</tr>
<tr>
<td>31-Mar-02</td>
<td>500</td>
<td>108,032,397.05</td>
<td></td>
<td></td>
<td>439,527,828.03</td>
</tr>
<tr>
<td>30-Apr-02</td>
<td>1,596</td>
<td>333,221,636.07</td>
<td>669,742,586.30</td>
<td>3-Jun-02</td>
<td>73,006,877.80</td>
</tr>
<tr>
<td>31-May-02</td>
<td>873</td>
<td>195,620,138.59</td>
<td>195,620,138.60</td>
<td>19-Jun-02</td>
<td>73,006,877.79</td>
</tr>
<tr>
<td>30-Jun-02</td>
<td>1307</td>
<td>280,933,668.94</td>
<td>280,933,668.95</td>
<td>8-Jul-02</td>
<td>73,006,877.78</td>
</tr>
<tr>
<td>31-Jul-02</td>
<td>2417</td>
<td>469,620,586.64</td>
<td>469,620,586.65</td>
<td>13-Aug-02</td>
<td>73,006,877.77</td>
</tr>
<tr>
<td>31-Aug-02</td>
<td>4194</td>
<td>1,251,070,853.81</td>
<td>1,251,070,853.80</td>
<td>19-Sep-02</td>
<td>73,006,877.79</td>
</tr>
<tr>
<td>30-Sep-02</td>
<td>2780</td>
<td>586,659,868.28</td>
<td>586,659,868.30</td>
<td>7-Oct-02</td>
<td>73,006,877.75</td>
</tr>
<tr>
<td>31-Oct-02</td>
<td>2600</td>
<td>589,739,990.38</td>
<td>589,738,990.40</td>
<td>7-Nov-02</td>
<td>73,006,877.75</td>
</tr>
<tr>
<td>30-Nov-02</td>
<td>1701</td>
<td>265,438,972.20</td>
<td>265,438,972.20</td>
<td>3-Dec-02</td>
<td>73,006,877.77</td>
</tr>
<tr>
<td>31-Dec-02</td>
<td>1510</td>
<td>358,831,204.33</td>
<td>358,831,204.30</td>
<td>14-Jan-03</td>
<td>73,006,877.80</td>
</tr>
<tr>
<td>31-Jan-03</td>
<td>1083</td>
<td>114,141,150.56</td>
<td>114,141,150.56</td>
<td>12-Feb-03</td>
<td>73,006,877.79</td>
</tr>
<tr>
<td>28-Feb-03</td>
<td>2491</td>
<td>517,097,255.91</td>
<td>517,098,252.85</td>
<td>10-Mar-03</td>
<td>73,005,880.85</td>
</tr>
<tr>
<td>31-Mar-03</td>
<td>5806</td>
<td>1,121,852,273.80</td>
<td>1,121,852,273.80</td>
<td>23-Apr-03</td>
<td>73,006,877.79</td>
</tr>
<tr>
<td>30-Jun-03</td>
<td>8879</td>
<td>1,673,523,323.85</td>
<td>1,673,523,323.85</td>
<td>13-Jul-03</td>
<td>73,006,877.75</td>
</tr>
<tr>
<td>31-Jul-03</td>
<td>2386</td>
<td>409,605,690.49</td>
<td>409,605,690.49</td>
<td>18-Aug-03</td>
<td>73,006,877.75</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>38,637</strong></td>
<td><strong>8,358,575,979.24</strong></td>
<td><strong>7,163,716,824.61</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Civil Service Pension Scheme. Ministry of Finance & Development Planning Ref: 2 / 9 / 36 V

The transfer experience into the BPOPF was more favorable than the initial actuarial projections. Younger civil servants were attracted, as anticipated, by the reduced vesting scale (from 15 to 5 years) and the portability of their pension savings. Of interest was the similarly high enrollment by longer serving (older) civil servants. Amongst the reasons for the high option rate amongst this group (longer serving civil servants), was the improved security of pension benefits, as opposed to a pay-as-you-go arrangement with no pre-funding element. Other civil servants opted to join the BPOPF on the mistaken premise that they would be entitled to en-cash their full fund benefit at retirement.

The Pension & Provident Funds Act Cap 27:03, read with the Income Tax (Superannuation Fund Regulations), provides for a 25% cash benefit at pre-retirement.
withdrawal. The balance is deferred until retirement. A cash commutation benefit of 33% is payable at retirement, with the balance being applied to purchase an annuity from the fund, or insurer registered under the Insurance Industry Act Cap 46:01. This experience of misinformation became apparent amongst the early retirees who raised queries with the Registrar of Pension and Provident Funds, when they were not able to encash their fund credit at retirement.

A significant number of pensioners in the civil service scheme Cap 27:01 also opted to join the BPOPF. This was despite the fact that the pension experience of the BPOPF transferred the interest rate (inflation) risk to pensioners. One of the reasons for opting to join the BPOPF was the fact that the existing civil service pension fund Cap 27:01 did not explicitly provide for a pension increase formula. Government had previously awarded discretionary pension increases in line with the salary adjustment experience of active staff. The BPOPF on the other hand offered explicit pension increase options from the retirement annuity menu. Amongst the available options were retirement annuities offering fixed annual or variable with profit adjustments.

The interrogation of pensioner data, to determine the associated transfer costs revealed a shortcoming in the processes of the civil service scheme Cap 27:01. Pensioners to this scheme were not required to complete any proof of existence documentation, as such some payments were made erroneously to deceased pensioners. In this respect, some future cost savings were realized. An amendment to the Pensions Act Cap 27:01 was subsequently introduced requiring pensioners to submit proof of existence documentation.
CHAPTER 7

7.1 CORPORATE GOVERNANCE OF THE BPOPF

The fund was officially launched as 28-November-2002 by His Excellency Festus Mogae, President of the Republic of Botswana. With the full establishment of the BPOPF, the fortunes of the civil service participants was now squarely in the hands of the management oversight of the BPOPF Board of Trustees. A vigorous trustee education exercise was undertaken using both internal and external service providers, resulting in increased competence and a heightened awareness of the fiduciary responsibilities resting with the Board.

The Board of Trustees established multiple sub-committees to oversee the investments and death benefit appropriation. The BPOPF did not initially prescribe an explicit investment mandate to the asset managers, despite the formulation of such by the fund actuary. In the absence of a viable local bond market, and limited capacity of the Botswana Stock Exchange, the investment mandate prescribed by the actuary was as follows:

Table 12: BPOPF Recommended Asset Allocation Strategy

<table>
<thead>
<tr>
<th>ASSET ALLOCATION STRATEGY</th>
<th>Recommended Holding</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Local Asset Allocation</strong></td>
<td></td>
</tr>
<tr>
<td>Equities</td>
<td>20%</td>
</tr>
<tr>
<td>Properties</td>
<td>5%</td>
</tr>
<tr>
<td>Local Bonds / Fixed Interest Securities</td>
<td>n/a</td>
</tr>
<tr>
<td>Cash, fixed deposits, BOB Certificates</td>
<td>5%</td>
</tr>
<tr>
<td><strong>Sub-total: Local Investments</strong></td>
<td>30%</td>
</tr>
<tr>
<td><strong>Offshore Asset Allocation</strong></td>
<td></td>
</tr>
<tr>
<td>Equities</td>
<td>60%</td>
</tr>
<tr>
<td>Properties</td>
<td>0%</td>
</tr>
<tr>
<td>Index linked Bonds</td>
<td>5%</td>
</tr>
<tr>
<td>Cash, treasury bills &amp; short term bonds</td>
<td>5%</td>
</tr>
<tr>
<td><strong>Sub-total: Offshore Investments</strong></td>
<td>70%</td>
</tr>
</tbody>
</table>

Source: Actuarial Solutions. 2001 Civil Service Scheme Valuation Report.
Further, the Pension and Provident Funds Act Cap 27:03, whilst providing for a regulatory oversight of pension fund operations, did not explicitly facilitate for the vetting, registration and interrogation of pension fund service providers, including administrators and asset managers. To protect fund interests, the trustees introduced a requirement for these service providers to put in place fidelity guarantee cover limits related to the size of fund assets under management. The formula applied to determine the minimum fidelity guarantee cover limits was, the sum of two percent of assets under management and two percent of annual contributions. A professional indemnity cover was also put in place to cover the activities of the Board of Trustees.

To further diversify the fund assets which were now growing to be quite considerable, a fourth asset manager, Investec Asset Management was appointed in 2003.

Table 13: Investec Asset Management – Fee Schedule

<table>
<thead>
<tr>
<th>Investec</th>
<th>Local Assets - Segregated Fund Management</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>First P500m @ 0.55% p.a (excluding brokerage, custodial, handling fees)</td>
</tr>
<tr>
<td></td>
<td>P500m - P1b @ 0.45% p.a (excluding brokerage, custodial, handling fees)</td>
</tr>
<tr>
<td></td>
<td>Thereafter @ 0.400% p.a (excluding brokerage, custodial, handling fees)</td>
</tr>
<tr>
<td></td>
<td>Offshore Assets - Segregated Fund Management</td>
</tr>
<tr>
<td></td>
<td>P 500m @ 0.80% p.a. (excluding brokerage, custodial, handling fees)</td>
</tr>
<tr>
<td></td>
<td>P500m - P1b @ 0.9% p.a (excluding brokerage, custodial, handling fees)</td>
</tr>
<tr>
<td></td>
<td>Thereafter @ 0.700% p.a (excluding brokerage, custodial, handling fees)</td>
</tr>
</tbody>
</table>

Source: Civil Service Pension Scheme. Ministry of Finance & Development Planning Ref: 2 / 9 / 36 VIII

A limitation that was exposed in the appointment procedure of both employee and employer trustees, was that appointments were post specific. As a Board Members assumed different post due to promotions, transfers, and or retirement, their appointment to the BPOPF Board was subsequently terminated. The BPOPF Board composition therefore experienced a high turnover, limiting the benefits of the trustee education campaign. An initiative to prescribe a minimum term of office is currently under consideration.
The BPOPFl Trustees, with recognition of the fund size, has appointed a full time fund secretariat, to oversee the operations of the service providers. It is anticipated that as the experience and technical skill set of the BPOPFl secretariat improves, some of the services currently outsourced, will be undertaken by the fund. The long term vision of the BPOPFl, given its size, is to undertake its own administration and asset management function. This process will result in less cost outlays for these processes, as well as minimize the conflict of interest considerations inherent in external relationships.

7.2 BPOPFl INVESTMENT EXPERIENCE

The BPOPFl investment experience was a baptism of fire. The establishment of the BPOPFl coincided with a downturn in global markets resulting in an almost immediate loss to the transfer benefits afforded by government. The Board of Trustees had to undertake further member education initiatives, highlighting the long term investment outlook applicable to pension fund investments. Those members that retired during this period found little comfort in the long term investment outlook.

Table 14: BPOPFl Membership Experience

<table>
<thead>
<tr>
<th>Membership Changes</th>
<th>31/3/02</th>
<th>31/3/03</th>
<th>31/3/04</th>
<th>31/3/05</th>
<th>31/3/06</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opening Balance</td>
<td>0</td>
<td>19,202</td>
<td>56,362</td>
<td>69,778</td>
<td>73,295</td>
</tr>
<tr>
<td><strong>Plus:</strong> New Entrants</td>
<td>22,061</td>
<td>37,830</td>
<td>14,918</td>
<td>5,724</td>
<td>9,121</td>
</tr>
<tr>
<td><strong>Less:</strong> Withdrawals</td>
<td>53</td>
<td>272</td>
<td>566</td>
<td>1,077</td>
<td>1,225</td>
</tr>
<tr>
<td>Redundancies</td>
<td>0</td>
<td>1</td>
<td>-</td>
<td>1</td>
<td>-</td>
</tr>
<tr>
<td>Dismissals</td>
<td>9</td>
<td>23</td>
<td>45</td>
<td>57</td>
<td>90</td>
</tr>
<tr>
<td>Deaths</td>
<td>17</td>
<td>172</td>
<td>314</td>
<td>270</td>
<td>297</td>
</tr>
<tr>
<td>Retirements</td>
<td>33</td>
<td>202</td>
<td>577</td>
<td>802</td>
<td>853</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>21,949</strong></td>
<td><strong>56,362</strong></td>
<td><strong>69,778</strong></td>
<td><strong>73,295</strong></td>
<td><strong>79,951</strong></td>
</tr>
</tbody>
</table>


With the stabilization of financial markets, and investment returns, was a renewed confidence in the BPOPFl to deliver the pension promise. Similarly the investment mandate prescribed by the fund actuaries was formally adopted by the asset managers. Despite the long term investment horizon of pension investments, asset managers who
have their performance reviewed periodically, have pressure to show short-term performance.

Table 15: BPOPF Asset Allocation and Interest Experience

<table>
<thead>
<tr>
<th>BPOPF ASSET ALLOCATION</th>
<th>31/3/02</th>
<th>31/3/03</th>
<th>31/3/04</th>
<th>31/3/05</th>
<th>31/3/06</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Local Asset Allocation</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equities</td>
<td>378,872,020</td>
<td>1,863,507,492</td>
<td>1,326,315,966</td>
<td>3,035,632,583</td>
<td>3,279,729,417</td>
</tr>
<tr>
<td>Properties</td>
<td>-</td>
<td>8,906,600</td>
<td>12,487,100</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Local Bonds / Fixed Interest Securities</td>
<td>583,709,084</td>
<td>1,860,748,381</td>
<td>4,353,668,387</td>
<td>4,664,134,106</td>
<td>1,759,792,686</td>
</tr>
<tr>
<td>Cash and equivalents</td>
<td>26,525,834</td>
<td>43,883,963</td>
<td>95,372,080</td>
<td>43,779,262</td>
<td>1,116,474,400</td>
</tr>
<tr>
<td>Sub-total: Local Investments</td>
<td>989,106,938</td>
<td>3,768,139,836</td>
<td>5,775,356,433</td>
<td>7,752,452,551</td>
<td>6,168,483,603</td>
</tr>
<tr>
<td><strong>Offshore Asset Allocation</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equities</td>
<td>651,741,207</td>
<td>1,405,911,383</td>
<td>4,033,171,660</td>
<td>6,411,011,649</td>
<td>10,819,066,960</td>
</tr>
<tr>
<td>Properties</td>
<td>-</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bonds</td>
<td>293,751,134</td>
<td>1,528,687,078</td>
<td>2,094,771,739</td>
<td>1,112,305,272</td>
<td>1,145,364,326</td>
</tr>
<tr>
<td>Cash</td>
<td></td>
<td>498,322,606</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sub-total: Offshore Investments</td>
<td>945,492,341</td>
<td>2,934,598,461</td>
<td>6,127,943,399</td>
<td>7,523,316,921</td>
<td>12,462,753,892</td>
</tr>
<tr>
<td>Net Current Assets</td>
<td>364,024,174</td>
<td>1,054,857,132</td>
<td>17,216,105</td>
<td>238,261,122</td>
<td>510,793,000</td>
</tr>
<tr>
<td><strong>Total Fund Assets</strong></td>
<td>2,298,623,453</td>
<td>7,757,595,429</td>
<td>11,920,515,937</td>
<td>15,514,030,594</td>
<td>19,142,030,495</td>
</tr>
</tbody>
</table>

| Year-end Interest Return Declared | 7.50% | -14.75% | 17.10% | 13.30% | 29.60% |


7.3 PENSION REFORM AND CAPITAL MARKET DEVELOPMENT

Another recent World Bank research project points to a strong link between contractual savings and equity market development (measured either by the value of trading or by market capitalization). The linkage between pension reform and capital market development in Botswana is explicit.

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Chart 7: Botswana Stock Exchange Market Capitalization

Source: Botswana Stock Exchange
Other development effects to the financial markets were witnessed by an increase in equity listings, bond, and venture capital listings. Primary amongst the bond issues was the issuance of three bonds by the Botswana Government, namely BW001, BW002, and BW003, in 2003. The issuance by Government was stimulated, not by a genuine need for capital, but rather to aid in the development of capital markets, vis-à-vis the development of a risk free yield curve. This risk free yield curve served as a benchmark for future private sector and parastatal bond issues. ‘Government bonds also add to the choice of financial instruments available to meet the needs of longer-term investors, such as
pension funds and insurance companies, helping them to better manage the various financial risks they face, such as matching their assets and liabilities. The issuance of the government bonds did stimulate corporations to follow suit, witnessed by 20 bond issues in 2004, as compared to 6 the year before. The market has lobbied government to issue additional longer dated gilts. The Government of Botswana has to-date not responded.

Table 16: Government of Botswana Bond Issues

<table>
<thead>
<tr>
<th>Government Bond Issues</th>
<th>Term (yrs)</th>
<th>Coupon</th>
<th>Maturity Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>BW001</td>
<td>2</td>
<td>10.75%</td>
<td>1-Jun-05</td>
</tr>
<tr>
<td>BW002</td>
<td>5</td>
<td>10.25%</td>
<td>1-Mar-08</td>
</tr>
<tr>
<td>BW003</td>
<td>12</td>
<td>10.25%</td>
<td>31-Oct-15</td>
</tr>
</tbody>
</table>

Source: Bank of Botswana

Table 17: Botswana Stock Exchange Listing

<table>
<thead>
<tr>
<th>Year</th>
<th>31-Dec-01</th>
<th>31-Dec-02</th>
<th>31-Dec-03</th>
<th>31-Dec-04</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of Domestic Companies</td>
<td>Domestic Board</td>
<td>16</td>
<td>17</td>
<td>17</td>
<td>16</td>
</tr>
<tr>
<td></td>
<td>Venture Board</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Number of Foreign Companies</td>
<td>Dual Board</td>
<td>6</td>
<td>5</td>
<td>5</td>
<td>4</td>
</tr>
<tr>
<td></td>
<td>Venture Board</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>Number of Bonds Listed</td>
<td>4</td>
<td>5</td>
<td>6</td>
<td>20</td>
<td>233%</td>
</tr>
<tr>
<td>Commercial Paper Listed</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>0</td>
<td>-100%</td>
</tr>
<tr>
<td>Total Number of Securities Listed</td>
<td>30</td>
<td>31</td>
<td>32</td>
<td>45</td>
<td>41%</td>
</tr>
</tbody>
</table>

Source: Botswana Stock Exchange

Despite the increased activity on the Botswana Stock Exchange, the market has not experienced the expected liquidity improvements. This is the result of the buy-and-hold mentality of institutional and private investors alike, spurred by the ‘shortage’ of investment securities. The concerns that the impressive returns experienced by the Botswana Stock Exchange may be caused by inflationary pressures, as opposed to genuine improvements in the value of the underlying securities.

---

Table 18: Botswana Stock Exchange Indices

<table>
<thead>
<tr>
<th>Indices</th>
<th>31-Dec-01</th>
<th>31-Dec-02</th>
<th>31-Dec-03</th>
<th>31-Dec-04</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Domestic Company Index</td>
<td>2455.38</td>
<td>2493.03</td>
<td>2498.71</td>
<td>2888.68</td>
<td>16%</td>
</tr>
<tr>
<td>Foreign Companies Index</td>
<td>648.72</td>
<td>492.12</td>
<td>567.34</td>
<td>643.71</td>
<td>12%</td>
</tr>
<tr>
<td>All Company Index</td>
<td>701.59</td>
<td>541.28</td>
<td>618.40</td>
<td>693.63</td>
<td>12%</td>
</tr>
</tbody>
</table>

| Market Capitalization (Pula Million) | Domestic  | 8909.22    | 9388.77    | 9586.66    | 10876.41 | 13%      |
|-------------------------------------|------------|------------|------------|------------|----------|
|                                     | Foreign    | 173217.38  | 126407.30  | 142484.92  | 162088.00 | 14%      |
| All Company                         | 182126.60  | 135796.06  | 151922.57  | 172964.40  | 14%      |

<table>
<thead>
<tr>
<th>Closing p/e</th>
<th>Domestic</th>
<th>13.46</th>
<th>11.05</th>
<th>10.25</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>All Companies</td>
<td>11.94</td>
<td>17.68</td>
<td>15.84</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Closing Dividend Yield</th>
<th>Domestic</th>
<th>4.93</th>
<th>6.79</th>
<th>7.66</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>All Companies</td>
<td>10.28</td>
<td>3.32</td>
<td>3.03</td>
<td></td>
</tr>
</tbody>
</table>

| Liquidity                          | Domestic   | 9.30%      | 4.10%      | 3.32%      |          |

Source: Botswana Stock Exchange

The limited ability of the stock exchange to absorb investment capital has prompted some investment managers to invest in unlisted equities. In the absence of effective asset management regulatory oversight, and BPOPF unlisted securities procedures, this outlay may be prone to abuse.

Another alternate investment strategy used by asset managers is to invest pension fund assets in the high yielding Bank of Botswana Certificates. Bank of Botswana Certificates (BOBC) comprises of short term paper intended to control money supply in the economy. Without any entry restrictions to the BOBC auction market, asset managers parked a significant amount of BPOPF assets in this securities class. To simulate longer dated paper, the BOBCs investments are merely rolled over at maturity. Whilst the returns were handsome, the irony of it was that the government was paying interest on the very capital it had made available for private sector investments. Recent Bank of Botswana policy changes have restricted access to BOBC auction markets to only commercial banks. The policy, instead of reducing the amount of pension assets invested in BOBC, has seen these funds re-directed onto commercial bank books, to access the BOBC securities, albeit at a cost. ‘Pension funds have effectively been forced to give away some of their yield. Not surprisingly, almost all the banks which have reported.. have seen a
substantial rise in the size of their balance sheets and profits as a result of this change in BOBC regulation.

Other financial market stimulated by the BPOPF, included venture capital funds applying directly to the Registrar of Pension and Provident Funds to receive a local asset status designation. This designation identifies investments into these venture capital funds as local investments, consistent with the minimum 30% local investment guideline.

The investment mandate of the BPOPF has received pressure to include socially beneficial projects to its portfolio. The BPOPF to date has been successful in resisting such pressure, maintaining an investment mandate in line the asset-liability matching requirements. The onset of public-private-partnerships offers an exciting era for the BPOPF to invest in socially beneficial projects, whilst maintaining an appropriate asset-liability mix.

7.4 ASSESSING THE EFFECTIVENESS OF REFORM

In assessing the effectiveness of reform, it is important to not to confuse the flaws in reform implementation with flaws in the reform. Further, in assessing the effectiveness of pension reform, the reform outcomes should necessarily be referenced against the reform objectives.

The objectives of pension reform aim at ensuring the adequacy, affordability, sustainability and robustness of the pension arrangement.

7.4.1 PENSION ADEQUACY

The adequacy of a pension benefit at retirement, in BPOPF defined contribution context, is determined by the following:

- initial transfer amounts (with respect to civil servants who were in service before the civil service pension reform)
- ongoing contributions (15% employer, 5% employee (with a facility for additional voluntary contributions),

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- interest earned; and
- the cost of annuities available at retirement.

In comparison to other funds in Botswana, the BPOPF pension contribution rate of 15% is generous. With a favourable interest experience, the anticipated returns for future retirees are optimistic. The acid test with respect to the adequacy of post retirement income is the cost of annuity provision. The life insurance sector has experienced significant growth since the privatization of the BPOPF.

Chart 9: Insurance Industry Premium Income Experience

![Insurance Industry Premium Income Experience Chart]

Source: Ministry of Finance and Development Planning – Registrar of Insurance

Outside any formal studies of the competitiveness of annuity factors utilized by the Botswana registered insurers, the limited number of annuity providers and the legislated requirement to purchase annuities at retirement may dilute the competitiveness thereof. Further, the regulatory oversight does not, at present, include any prudential prescriptions with respect to the costing mechanism of insurance products. The ability of the BPOPF to
offer pensions to retirees will serve as an important tool to promote competition in the annuity market.

7.4.2 AFFORDABILITY

Having incurred substantial costs in the roll out phase of the BPOPF, the Government of Botswana of Botswana, as an ongoing concern is only liable for the 15% employer contribution. The risk of liability growth which was embedded in the previous pay as you go arrangement has to a large extent been extinguished due to the large percentage of existing civil servants and pensioners (96% and 60% respectively\(^{56}\)) who have opted to join the BPOPF. As a closed scheme, the civil service scheme Cap 27:01 will experience diminishing membership and associated liabilities.

Chart 10: Cost of Civil Service Scheme Cap 27:01

Source: Ministry of Finance and Development Planning. Accountant General - Pensions

\(^{56}\) Source: Botswana Public Officers Pension Fund Secretariat
Should the adequacy of pensions offered by the BPOPF fall below the expectations of members, the government may be encouraged by political considerations to augment benefits with additional monetary inputs. In this respect, the future government obligations are variable. Nonetheless, this is a far cry from the projected liability increases which would increasingly claim a larger share of GDP, to the detriment of other national development expenditures.

7.4.3 SUSTAINABILITY

The issue of sustainability is associated with the above discussion on affordability. Against the backdrop of the fiscal position of the Government of Botswana, a default on its obligations to contribute the required 15% of pensionable to the BPOPF appears unlikely. In this context the sustainability of the BPOPF has been attained. The rules of the BPOPF do however contain a clause allowing for the termination of the fund. ‘The Trustees may terminate the Fund at any time subject to the approval of the Principal Employer and subject to a unanimous decision to that effect by all participating Employers, Members and Pensioners.57

7.4.4 ROBUSTNESS

The main risks facing the fund, is the investment risk borne by fund members, as well as risks related to corporate governance. The Fund has relied extensively on actuarial input to formulate an investment strategy which is conducive with the liabilities borne by the fund. To enhance corporate governance, the Fund has appointed external service providers to lend to the fund the required technical expertise. This approach has not been without its pitfalls with respect to cost and conflict of interest considerations. The BPOPF in its relative size to the Botswana economy, is a mammoth which by all indication is robust enough to withstand short term shocks. Similar to the Titanic, the concept of too big to fail is a myth which has been disproved many a times, especial in the dynamic financial market realm.

57 Botswana Public Officers Pension Fund Rules. Section 10.1
7.5 CONCLUSION

The truth of the matter is that it is really too early to effectively assess the effectiveness of the civil service scheme reform. The Botswana Public Officers Pension Fund, having been established in 2001, is only in its fifth year of operation, and is still developing the required operational capacity. Despite implementation challenges, ‘the BPOPF has created a substantial savings nest for its membership, indicative of prudential foresight by the Government of Botswana. This is an asset which must be protected jealously.\(^{58}\)

The challenges of the BPOPF are no longer consistent with those of civil service pension funds, but rather reflect those of private pension funds, consistent with its structure. The challenges include the desire by employers to dominate the management of pension funds that they sponsor. ‘In view of that the respective board of trustees must be allowed to freely exercise their fiduciary responsibilities independently without undue interference from employer organizations, as that will promote and enhance the up holding of principles of good corporate governance. Similarly, the respective trustees of these pension funds must take it upon themselves to appreciate and understand the onerous responsibility that has been bestowed upon them by being appointed to this board.\(^{59}\)’

Similarly, the financial sector regulatory oversight has responded to financial market developments by enhancing its own operational effectiveness. To this end the Non-Banking Financial Institutions Regulatory Authority Act (NBFIRA), 2006 was enacted as in January 2007, paving way for the establishment of an autonomous regulatory authority, consistent with international best practice. The mandate of the NBFIRA will include explicit oversight of asset managers and pension fund administrators, previously not covered.

The BPOPF experience has resuscitated and highlighted the importance of pension savings. To this end, some members of the National Assemblies, have recently tabled motions for the discussion on the merits and de-merits of the introducing compulsory

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\(^{58}\) Ditlhogo Nelson Mokgethi. Chairman, Botswana Public Officers Pension Fund.

\(^{59}\) Dichopase Ephraim Letebele. CEO / Principal Officer, Botswana Public Officers Pension Fund.
pension provision amongst formal sector employees. This promises to be an interesting debate, against the backdrop of the short-term severance pay benefits paid out every five years by formal sector employers. The future of the pension debate lies in striking a balance between short and long term interest of employees. The Government of Botswana will be included to this debate as its industrial class cadre, currently numbering over 50,000 employees. Approximately 150,000 people are covered under formal pension arrangements, issues of pension coverage, and the funding thereof, are still to be fully addressed under the Universal Pension umbrella.

Table 19: Trends in total labour force 1991 - 2001

<table>
<thead>
<tr>
<th>Year</th>
<th>Unemployed</th>
<th>Employed</th>
<th>Labour Force</th>
<th>Unemployment Rate (%)</th>
</tr>
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<tbody>
<tr>
<td>1991</td>
<td>61,625</td>
<td>379,938</td>
<td>441,293</td>
<td>13.9</td>
</tr>
<tr>
<td>1993/94</td>
<td>107,723</td>
<td>391,804</td>
<td>499,527</td>
<td>21.6</td>
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<tr>
<td>1995/96</td>
<td>94,528</td>
<td>345,405</td>
<td>439,033</td>
<td>21.5</td>
</tr>
<tr>
<td>1998</td>
<td>115,703</td>
<td>441,187</td>
<td>556,890</td>
<td>20.8</td>
</tr>
<tr>
<td>2000</td>
<td>90,729</td>
<td>483,432</td>
<td>574,161</td>
<td>15.8</td>
</tr>
<tr>
<td>2001</td>
<td>109,518</td>
<td>449,235</td>
<td>558,753</td>
<td>19.6</td>
</tr>
</tbody>
</table>


The pension reform debate is by no means over in Botswana. The BPOPF experience will serve as a vital benchmark against which future reform initiatives will be referenced.
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