Financial market development, policy and regulation: the international experience and Ethiopia's need for further reform

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Chapter 4
The Development, Policy and Regulation of Private Pensions

4.1 History and Current State

i. The International History in Brief

Caring for the aged and the destitute existed as family, church or community business before the 19th century.[1814] Mutual self-help schemes were also common among merchants and factory workers in Europe and Northern America until they vanished in the 19th century.[1815] Formal pensions originated in Western Europe in that century to curb the dislocation effects of the industrial revolution.[1816] They expanded in the first half of the 20th century due to the socio-economic contingencies brought about by the Second World War.[1817] The first employment based pension was sponsored by the Bank of France in 1808.[1818] State involvement in pensions started in 1889 in Germany under auspice of Chancellor Bismarck and grew through three eras, namely the Bismarck era (till the First World War), the social security era (1930-1952), and the social protection era (1952 and the following).[1819]

The Bismarck era initiated pension to workers in industries based on contribution by the workers since the government of the time took little responsibility.[1820] It started with paternalistic occupational pensions for the benefit of elite employees.[1821] It expanded the occupational pensions to non-elite employees and led to welfare capitalism towards its end.[1822] It introduced contributory old-age insurance as part of broad program of social insurance for Germany which served as model for Rumania, Sweden and the Netherlands until the First World War (1914-18).[1823] New Zealand also introduced non-contributory pension on ground of residence in the era (i.e. 1898) which served as model for many countries other than Rumania, Sweden and the Netherlands until the First World War.[1824] The War was, then, followed by boom of contributory pensions in the European and non-European countries.[1825] It was followed by workmen's compensation and sickness insurance conventions signed in the 1920's under the auspice of ILO.[1826]

1814 Littlewood, 1998, at p. 6.
1815 Swaan and Linden, (eds.), 2006; and Degefe Duressa Obo, 2009, at pp. 1 & 16-24.
1816 Shalev, 1996, at pp. 331-334; and Enrico and Armin, 2008.
1817 Ibid.
1818 Littlewood, 1998, at pp. 6-7.
1819 Littlewood, 1998, at pp. 6-7; and Enrico and Armin, 2008, at pp. 5-7.
1820 Ibid.
1821 Shalev, 1996, at pp. 331-332.
1822 Ibid.
1823 Littlewood, 1998, at pp. 6-7.
1824 Id., at pp. 6-7.
1825 Littlewood, 1998, at p. 7; and Enrico and Armin, 2008, at pp. 5-7. The occupational pension schemes grew more in USA than in Europe (Shalev, 1996, at pp. 331-332)
1826 See the Unemployment Indemnity (Shipwreck) Convention 8 of 1920; Workmen's Compensation (Agriculture) Convention 12 of 1921; Workmen's Compensation (Accidents) Convention 17 of 1925; Workmen's Compensation (Occupational Diseases) Convention 18 of 1925; Sickness Insurance (Industry) Convention 24 of 1927; Sickness Insurance (Agriculture) Convention 25 of

The social security era (1930–1952) saw increased government involvement in the provision of pension coverage.[1827] Governments started pensions financed through employee, employer and government contributions during the era.[1828] The US introduced its occupational pension in 1935, the UK consolidated its state benefit system for the retired in 1942, and many other countries followed the trend in the era.[1829] The ILO also adopted several workmen insurance and social security conventions during the era.[1830] The International Social Security Association (ISSA) was also established in 1927 to serve as forum for international cooperation in the provision and administration of social security in the era.[1831]

The social protection era (1950's and the following) brought about the idea of providing fully government funded social security to citizens irrespective of employment.[1832] It saw the constitutional recognition of social security as human right to citizens when state welfare programmes flourished across countries following the end of the Second World War in form of state insurance against foreseeable and unforeseeable risks.[1833] The Social Security (Minimum Standards) and other Conventions of the ILO were also adopted to set standards for old age pension benefits, invalidity benefits, survivors' benefits, employment injury benefits, sickness benefits, medical care provisions, unemployment benefits, maternity benefits, and family allowances when members of the international community expanded their pension provisions through forms of universal provision, social insurance, social assistance, employers' liability, provident funds and private insurance schemes in the era.[1834]

1927; and Protection against Accidents (Dockers) Convention 28 of 1929 – all available in the ILO website (ILO, 2007).

1827 Shalev, 1996, at p. 332; and Enrico and Armin, 2008, at pp. 5-7.

1828 Littlewood, 1998, at p. 7.

1829 Ibid.

1830 See the Old-Age Insurance (Industry, etc.) Convention 35, Old-Age Insurance (Agriculture) Convention 36, Invalidity Insurance (Industry, etc.) Convention 37, Invalidity Insurance (Agriculture) Convention 38, Survivors' Insurance (Industry, etc.) Convention 39, and Survivors' Insurance (Agriculture) Convention 40 of 1933; Workmen's Compensation (Occupational Diseases) Convention 42 and Unemployment Provision Convention 44 of 1934; Maintenance of Migrants' Pension Rights Convention 48 of 1935; Ship owners' Liability (Sick and Injured Seamen) Convention 55 and Sickness Insurance (Sea) Convention 56 of 1936; Social Security (Seafarers) Convention 70 of 1946; and Seafarers' Pensions Convention 71 of 1946 – all available in the ILO website (ILO, 2007).

1831 The ISSA exists today as non-profit organization bringing together institutions and administrative bodies involved in the administration and regulation of social protection schemes throughout the world. It deals with all forms of compulsory social protection that, by legislation or national practice, are integral parts of a social security system. (ISSA, 2007)

1832 Shalev, 1996, at p. 332; and Enrico and Armin, 2008, at pp. 5-7.

1833 Shalev, 1996, at p. 332; and Littlewood, 1998, at p. 7.

1834 See the Social Security (Minimum Standards) Convention 102 of 1952; Equality of Treatment (Social Security) Convention 118 of 1962; Employment Injury Benefits Convention 121 of 1964 (Schedule I amended in 1980); Invalidity, Old-Age and Survivors' Benefits Convention 128 of 1967; Medical Care and Sickness Benefits Convention 130 of 1969; Migrant Workers (Supplementary Provisions) Convention 143 of 1975; Occupational Safety and Health Convention 155 of 1981 (with Protocol of 2002 to the Convention); Maintenance of Social Security Rights Convention 157 of 1982; and Social Security (Seafarers) Convention (Revised) 165 of 1987 - all available in the ILO website (ILO, 2007).

The provision of social security has grown in the eras between two extremes, namely the occupational pension (welfare capitalism) of the US and the state social security (welfare state) of the Scandinavian countries.[1835] The countries of Scandinavia and Western Europe have strengthened state social security through unfunded state pensions to meet the demands for social welfare while the US has focused on occupational pension plans in the name of social security.[1836] Japan has resembled the US with public pension coverage through a National Pension Insurance (NPI) system which was combined with a system of occupational pensions in the corporate sector.[1837] It has differed from the US by the Confucian tradition of familial solidarity that surrounded its occupational pension system.[1838] The rest of the world had varied mixture of state social security, occupational pension and private life assurance.[1839] The majority of the countries had unfunded pay-as-you-go schemes by the first half of the 1990s while some had provident funds with lump sum benefits or a blend of the state social security and the pay-as-you-go occupational pensions.[1840] One country, namely Singapore, had funded state provident scheme while another, namely Chile, had compulsory funded pension that offered retirement benefit based on individual accounts (i.e. defined contributions) by 1994.[1841] The use of private insurance annuities for retirement was intensified as of the late 1990s.[1842]

The various systems have, however, converged in the 1990s and thereafter. Many of the countries have acknowledged the possibility of providing pensions through the market as opposed to the state and adopted a public-private welfare nexus in which they run a mixture of first pillar state pensions, second pillar private pensions, and third pillar life annuities in the period.[1843] The Scandinavian and

1835 Shalev, 1996, at pp. 1-21 & 332-334; Enrico and Armin, 2008, at pp. 5-7; and Alan and Ronald, 2009, at pp. 4-11.

1836 Shalev, 1996, at p. 333; Dobbin and Boychuk, 1996, at pp. 104-130; Rein, 1996, at pp. 27-42; Jacoby, 1996, at pp. 44-69; Stevens, 1996, at pp. 73-96; øverbye, 1996; Hughes and Stewart, (eds.), 2004; and Becker, 2007, at pp. 103-105. The social security system in the US has been composed of an Old-Age and Survivors Insurance Programme (introduced in 1935), a Disability Insurance Programme (introduced in 1956), and a Medical (Health Care) Insurance (Medicare) Programme (introduced in 1965) which are occupational. It has been complemented by a funded private pension system introduced and governed by the Employee Retirement Income Security Act (ERISA) of 1974. The 2010 reform has expanded the scope of application of the system to the private and personal sectors. Dobbin and Boychuk, 1996; Becker, 2007, at pp. 101-114; Bloomberg, 2009; BBC, 2009c; and BBC, 2010.

1837 Shalev, 1996, at pp. 333-334; and Harner, 2000, at pp. 94-97.

1838 Toshimistsu Shinkawa and Pempel, 1996, at pp. 280-323.

1839 Dietvorst, 1999, at pp. 15-17, 20-21 & 23-33.

1840 Fox and Palmer, 2001, at pp. 90-113; and Leo Stevens, et al., 1999, at p. 93.

1841 Fox and Palmer, 2001, at pp. 90-113; and Littlewood, 1998, at p. v. Singapore introduced the funded state pension system in the 1950s while Chile introduced the compulsory funded pension in 1981 (OECD, 2006a, at p. 198; and Alberto, et al., 2006).

1842 United Kingdom was the major exception to grow them since the mid-1980s. OECD, 2002, at pp. 79-93; and Richard, et al., 2003.

1843 Tables 8(Chap. 4); 9(Chap. 4); 10(Chap. 4); Davis, 1995, at pp. 4 & 5-6; Shalev, 1996, at pp. 327-330 & 335-337; Holzmann and Stiglitze, 2001, at pp. 1-3; Fox and Palmer, 2001, at pp. 90-113; Dixon and Hyde, 2001, at pp. ix-xiii & 1-213; OECD, 2002, at pp. 79-93; OECD, 2003, at pp. 75-93; Richard, et al., 2003; Barbara and Axel, 2003; Hughes and Stewart, (eds.), 2004; Queisser and Whitehouse, 2006, at pp. 50-55; Broeders, et al., (eds.), 2008; and Banyár and Mészáros, 2009. The World Bank has also published its "Averting the Old Age Crisis' and recommended the making of reforms towards a pension system that includes three pillars (i.e., a first pillar PAYGO system, a

European countries have reformed towards private funded pensions through defined contribution individual accounts while the US has debated on the introduction of a system that can combine defined contribution individual accounts and a government funded defined contribution program.[1844] Japan has removed the management and investment restrictions on its pensions, introduced defined contribution accounts, and encouraged the birth of private pension fund managers and record keeping groups.[1845] Many of these and the other countries have also created reserve funds for the pay-as-you go pensions and encouraged the use of private insurance in the period.[1846]

The rise of private pensions has also got attention of regional institutions, in particular in Europe, in the late 1980s.[1847] It has also resulted in the establishment of the International Organization of Pension Supervisors (IOPS) in July 2004 which has served as world-wide forum for policy dialogue, exchange of information and standard setting on matters of private pension supervision.[1848] The IOPS exists currently as specialized institution for private pension matters along with the International Social Security Association (ISSA) and the International Association of Insurance Supervisors (IAIS) which concentrate on the provision of social security and regulation of commercial insurance, respectively.[1849]

ii. The History in Ethiopia

Caring for the aged, the sick, the widow and the orphan was also customary practice in Ethiopia until the 1920s.[1850] Governmental welfare service started in the country only when:

- a welfare agency was established by Emperor Haile Selassie I (Ras Tafari Mekonnen of the time) at the Dabra Libanos Monastry in June 1921 (30 May 1913 Eth. C.) to assist the destitute;
- a social welfare organization was found under patronage of the late Empress Menen with branches in Harar, Dessie, Gondar and Jimma in 1931 to educate orphans (and children of the poor) and to establish home centres for the aged and the destitute; and

second pillar prefunded scheme and a third pillar voluntary saving scheme) in this period (World Bank, 1994).

1844 Shalev, 1996, at p. 335; Skidmore, 2001, at pp. 187-203; Richard, et al., 2003; Barbara and Axel, 2003; Hughes and Stewart, (eds.), 2004; Becker, 2007, at pp. 104-105; Broeders, et al., (eds.), 2008; and Empel, (ed.), 2008, at pp. 56-62.

1845 Shalev, 1996, at pp. 335-336; OECD, 2006a, at p. 198; Harner, 2000, at pp. 99-110; and Banyár and Mészáros, 2009.

1846 OECD, 2006a, at pp. 190-199 & 210-211; Adrian Blundell-Wignall, et al., 2008; Juan Yermo, 2008; Broeders, et al., (eds.), 2008; and Banyár and Mészáros, 2009. Only the US (as of 1940) and Portugal (as of 1989) had reserve funds for the pay-as-you-go pensions until most countries introduced these funds in the 1990s and thereafter (OECD, 2006a, at pp. 210-211).

1847 Chance, 1993, at pp. 67-68; Leo Stevens, et al., 1999, at pp. 87-145; Kavelaars, 1999, at pp. 43-83; Drabbe, 1999, at pp. 5-14; and Empel, (ed.), 2008, at pp. 56-62.

1848 IOPS, 2006; IOPS, 2007; IOPS, 2007a; and IOPS, 2007b.

1849 ISSA, 2007; and IAIS, 2007a.

1850 SSA, 1993, at p. 9.

- a Haile Selassie I Welfare Trust Foundation was established to look after the social welfare services of the time.[1851]

The Imperial government strengthened the welfare functions through first and second five years development plans.[1852] It established the Ministry of National Community Development and Social Affairs to follow up the community development matters and the first Ministry of Pensions to follow up the pension and social security matters during the first five years plan period of 1957 to 1961.[1853] It introduced rules for private life insurance and consolidated the rules, principles and regulations on public and private employment by enacting the Civil and Commercial Codes of 1960, the Central Personnel Agency and Public Service Order of 1961 and the Public Employment Administration Order of 1962.[1854] It also enacted labour relations and pension laws and increased the establishment of community development centres during the second five years plan period of 1962 to 1967.[1855]

The labour relations law focused on the industrial peace and welfare of employees of the non-governmental and autonomous governmental institutions.[1856] It recognized the voluntary provision of provident funds and authorized the Ministry of National Community Development to prescribe the general labour conditions and provident fund rules to be respected during and in the absence of collective agreement.[1857] The Commercial Code of 1960 also provided for a system of voluntary private life insurance.[1858] The pension law, however, introduced a compulsory system of retirement pension for the civil and military employees of the government (and their survivors).[1859] It established civil and military funds that could pay three types of benefits: a retirement pension and gratuity, an incapacity pension and gratuity, and a survivor's pension and gratuity.[1860] It made the pension compulsory subject to withholding of contributions from salaries of the employees and the state budget by the Ministry of Finance of the time.[1861]

1851 IGE-MI, 1964, at pp. 373ff; and IGE-MI, 1970, at pp. 99-100.
1852 IGE-MI, 1970, at p. 97.
1853 IGE-MI, 1970, at p. 97; and SSA, 1993, at pp. 9-10.
1854 IGE, 1960; IGE, 1960a; IGE, 1961c; IGE, 1962b; IGE, 1962e; and IGE, 1962f.
1855 IGE-MI, 1970, at pp. 97-99; IGE, 1961b; IGE, 1962a; IGE, 1963h; and IGE, 1963k. The number of community development centres has reached forty five by 1970 (IGE-MI, 1970, at pp. 97-99).
1856 IGE, 1962a, at art. 2(g).
1857 Id, at arts. 3(i), 3(j) & 2(k).
1858 It introduced property, liability, life, accident and illness insurance (in respect of risks on land, rivers and air) into the country along the lines of the French law of 13 July 1930 and the Italian Civil Code of 1942. It left the system of maritime insurance to the 1960 Maritime Code of the country. All the schemes were introduced as insurance businesses to be run by private insurance companies to be licensed and regulated by the Ethiopian government of the time and were open to all residents of the country who could pay for the premiums of the companies. IGE, 1960, at arts. 654-714; and Winship, 1974, at pp. 81-83.
1859 IGE, 1961b. Public servants who rendered service to the government were to be provided with land and/or lump-sum benefits for their service during the period before the introduction of this pension scheme. Id., at art. 44.
1860 IGE, 1961b, at arts. 3-9, 10-14 & 15-25.
1861 Id., at arts. 5-34, 36(a) & 42.

The Haile Selassie I Trust Foundation also coordinated the establishment of community development centres and facilitated the establishment and supervision of the following:

- five hospitals, namely the Haile Selassie I hospital (Addis Ababa), the Saint Paul's Hospital (Addis Ababa), the Gandhi Memorial Hospital (Addis Ababa), the Leul Ras Mekonen Hospital (Harar), and the Saint Mary's Hospital (Axum);
- one clinic specialized in mother and child welfare services, namely the Woizero Beletchachew Abajobir Clinic (Addis Ababa);
- two schools, namely the Haile Selassie I School for the blind (Addis Ababa) and the Abraha Bahta School for the blind (Asmara);
- two homes, namely the Haile Selassie I Children's Home (Addis Ababa) and the Abraha Bahta Home for the Aged (Harar); and
- three aid institutions, namely the Eguale Mawta Kindergarten (Addis Ababa), the Umbrella Factory for the handicapped (Addis Ababa), and the Bete Selihom (Dabra Libanos).[1862]

It conducted family planning education as part of its humanitarian activities and received contributions of money, land, machinery and other properties from national and international sources for its purposes.[1863]

The Ministry of National Community Development and Social Affairs also established a Rehabilitation and Training Centre in 1957 to facilitate the training and employment of the handicapped.[1864] Several other institutions were also established in the 1960s, including the following:

- the Armed Forces Wives' Association (established with branches in Asmara, Gondar, Harar, Dire Dawa, Negele and Guenet to care for the welfare and education of children of those who lost their lives in military service);
- the YMCA and YWCA (established to care for youth welfare);
- the Remand Home (established to care for the rehabilitation of juvenile delinquents); and
- the Red Cross Society (established to care for all welfare and humanitarian works).[1865]

The Christian Missionaries and UN agencies of the time also participated in the implementation of welfare projects while an organization called the Ethiopian Council for Social Welfare coordinated all the voluntary social welfare organizations of the time in cooperation with the Ministry of National Community Development and Social Affairs.[1866] A School of Social Works was

1862 IGE-MI, 1970, at p. 99; and IGE-MI, 1964, at pp. 373ff.

1863 The Emperor and the German Evangelical Church stood as main donors to the Foundation. IGE-MI, 1970, at p. 99.

1864 Id., at p. 100.

1865 Ibid.

1866 Ibid. The Council also engaged in the initiation of research and dissemination of knowledge in the areas of social welfare by organizing seminars and sponsoring publications (ECSW, 1967).

also established in 1959 by the Ministry of Public Health and the University College of Addis Ababa of the time to train social workers who were to assist the social welfare development effort.[1867] An Employment Exchange Office was also established in Addis Ababa under the 1962 labour relations law to facilitate private employment.[1868]

The post-1974 Military Government continued with the pension system created by the Imperial Government with some adjustment on the pension laws and institutions.[1869] It expanded application of the pension scheme to permanent employees of the agricultural, commercial, industrial, transport, banking and insurance undertakings whose ownership was transferred to the government and to permanent employees of the Franco-Ethiopian Railway Company who were Ethiopian nationals (by birth or acquisition) and replaced the provident fund schemes of these institutions by an Undertakings Pension Fund.[1870] It also introduced severance pay and disability benefits to employees of the private sector by a labour law that replaced the Imperial Labour Relations Proclamation of 1963.[1871] It did not establish pension for employees of the private sector assuming that the sector was to be marginal due to the socialist policy of the time and that the voluntary provident fund schemes started during the Imperial time were to continue for the remaining parts of the sector.[1872] It also centralized the commercial insurance scheme introduced by the Imperial Government in the Ethiopian Insurance Corporation.[1873]

The post-1991 Transitional Government has adjusted the occupational benefits and severance pay schemes for employees of the private sector by enacting new labour law.[1874] It has not established pension for them as in the previous regimes.

The Federal Government has promised to enhance the pension scheme into a social security system since 1995.[1875] It has redefined the basic principles of the labour law for the private sector and consolidated the pension laws for the public sector since 2003. [1876] It has:

- re-established the governmental pension funds as i) Civil Service and ii) Military and Police Service Funds;

1867 IGE-MI, 1970, at p. 101. The School lived as department of the Faculty of Arts of the University College of Addis Ababa between 1961 and 1963; became independent unit of the Haile Selassie I University (now the Addis Ababa University) in 1963; and became member of the International Association of Schools of Social Work subsequently (Ibid.).

1868 Ibid.

1869 PMGE, 1974b; PMGE, 1974c; PMGE, 1975h; PMGE, 1975i; and PMGE, 1976j.

1870 PMGE, 1975i.

1871 PMGE, 1975k.

1872 Ibid.

1873 The pension and life annuities businesses of the Corporation were, however, negligible throughout the tenure of the Military Government compared to the general insurance business. Note the annual reports of the Corporation and the Statistical Abstracts of the Central Statistics Agency of the country for the 1970s and 1980s.

1874 TGE, 1993a.

1875 FDRE, 1995, at art. 89(8) & 90; and FDRE, 2002g, at pp. 114-118.

1876 FDRE, 2003e; and FDRE, 2003g.

- re-defined the pension benefits into five, namely: i) retirement pension and gratuity, ii) invalidity pension and gratuity, iii) incapacity pension and gratuity, iv) survivors' pension and gratuity, and v) contribution refund; and
- made the consolidated pension law applicable to permanent employees of all the wholly or partly budgeted government offices, public enterprises, and the enterprises in which the government's capital share is not less than fifty percent.[1877]

It has made the retirement pension available as payment for life to the public servants who:

- complete at least ten years of service and retire upon attainment of a retirement age of sixty (for both sexes) or of a retirement age as may be fixed by the defence and police force laws (for members of the military and police force);
- resign from service after twenty five years of service and attain an age of three years less than the retirement age as may be adjusted (for members of the defence force) or five years less than the retirement age as may be adjusted (for the others);
- separate from service after twenty years of service due to privatization or closure of work and attain the age of forty five;
- separate from service after twenty five years of service due to institutional transformation of the employer institution and attain the age of fifty; and
- resign from service after twenty years of service voluntarily or for causes other than those defined by law and attain the age of sixty.[1878]

It has made the retirement gratuity available as lump sum payment to all public servants who attain the retirement age after having served for less than ten years.[1879] It has made the invalidity pension available as payment for life to public servants who:

- separate from service after ten years of service due to failure to fulfil the medical condition of service;
- resign from service after twenty five years of service and become incapable before attainment of the retirement pension age for this group; and
- resign from service after twenty years of service voluntarily or for causes other than the ones mentioned in the law and become incapable before attainment of the retirement pension age for this group.[1880]

It has made the invalidity gratuity available as lump sum payment to all public servants who retire because of failure to fulfil the medical conditions of service after having served for less than ten years.[1881] It has made the incapacity gratuity

1877 FDRE, 2003e, at arts. 3, 2(1-2), 4, 13-16, 17-20, 21, 29-33 & 34-39; FDRE, 2003g; FDRE, 2004bd; and FDRE, 2009a.

1878 FDRE, 2003e, at arts. 13 & 12; FDRE, 2004bd; and FDRE, 2009a. The law authorizes the Council of Ministers to adjust the retirement ages (FDRE, 2003e, at art. 12(3)).

1879 FDRE, 2003e, at art. 15.

1880 Id., at art. 17(1-2), 13(5) & 18.

1881 Id., at arts. 19-20.

available as lump sum payment to public servants who sustain employment injury of not less than ten percent without losing their capacity to work and the incapacity pension available as payment for life to public servants who sustain employment injury of not less than ten percent and separate from work due to absolute incapacity.[1882] It has made the survivors' gratuity available as lump sum payment to the widow or widower and children of the public servant who died before having completed ten years of service without having been separated from service and the survivors' pension payable for life to the widow or widower, children and parents of the public servant who died:

- after entitlement to retirement, invalidity or incapacity pension;
- after ten years of service without having been separated from service and before attainment of the retirement age;
- after twenty years of service and separation from service by voluntary resignation or a cause not mentioned in law, or
- after twenty five years of service and resignation from service for any cause.[1883]

It has made the refunding of contributions available to the public servants who resign from work after ten years of service and to those who separate from work for any cause at any time after completion of twenty years of service.[1884]

It has also integrated the finance and non-finance functions of the pension in the Social Security Authority and re-established the Authority as Social Security Agency since July 1998 and June 2006, respectively.[1885]

1882 Id., at arts. 22-28 & 30-33.

1883 Id., at arts. 34(1-3), 35-39 & 13(5).

1884 Id., at art. 21.

1885 SSA, 1998, at p. 4; and FDRE, 2006. The functions were assigned to different institutions until 1998. The Imperial Government enforced them through the Ministry of Finance of the time and a Minister of Pensions during the years between 1957 and 1961, through the Ministry of Finance and a Pension Commission accountable to the Ministry of Pensions from November 1961 up to April 1966, and through the Ministry of Finance and the Public Service Pensions Commission after 1966 (IGE, 1962; IGE, 1962b; IGE, 1962d; IGE, 1962e; IGE, 1962f; IGE, 1963a; IGE, 1963j; and SSA, 1993, at pp. 11& 38-52). [The Ministry of Finance collected the contributions to the civil and military funds, paid the benefits from the funds, and managed the balances of the funds while the Ministry of Pensions and the Pension Commission controlled the decisions on the entitlements to pensioners and supervised the overall enforcement of the pension laws]. The Military Government enforced them through a Pension Authority accountable to the Ministry of Labour and Social Affairs and the Ministry of Finance (PMGE, 1975i; and SSA, 1993, at p. 11). [The Pension Authority existed as Public Service Pensions Commission, succeeding the Imperial Pension Commission, until October 15 1975, as Pension Security Organization in the years between October 15 1975 and September 09 1976, as Public Service Pensions Authority in the years between September 09 1976 and 1989, and as Pensions and Social Security Authority since 1989. It followed up the overall enforcement of the pension laws while the Ministry of Finance run the finance functions]. The Military Government also enforced the finance and non-finance functions of the Undertakings Fund (created in 1975) through the Pension Authority and the latter has paid the pension benefits through the Commercial Nominees Private Limited Company (a company owned by the Commercial Bank of Ethiopia and the Construction and Business Bank S.C.) since April 1978 (SSA (PERD), 2003, at p. 29). The post 1991 transitional government has continued with the disintegrated approach by renaming the institutions (FDRE, 1996d).

Two hundred non-governmental organizations (ninety of which are located in Addis Ababa) are also created in the country to deal with issues of the aged, the disabled and the people with difficult circumstances.[1886] The Ministry of Labour and Social Affairs and the Regional Labour and Social Affairs Bureaus of the country are also working on the issues of these people and coordinating the non-governmental organizations.[1887] The country does not, however, have private pension system yet and the aforementioned pension law developments have only consolidated the retirement pension system for government employees.

4.2 The Functions of Pensions

i. The International Experience

Pensions can have financial and non-financial functions. The OECD countries have used them both to ensure retirement income security and achieve labour, investment, financial market, corporate governance and other objectives.[1888] They have used the first pillar pensions to:

- substitute the traditional extended family means of caring for the aged;
- help individuals to save for retirement by providing them with the base level of benefits they need;
- overcome the problems of individuals to cater for their own retirement due to myopia;
- overcome the free-riding problems of those who do not want to save unless society forces them;
- overcome the adverse selection problems and transaction costs in private annuity markets;
- correct the market failures in private insurance including the risks of longevity, inflation and investment;
- overcome the risks of inflation and variable return across generations;
- enhance the stability of income, demand and consumption through the life cycle of the human being,
- cater for the lifetime poor (i.e. for the one who can not save not because of myopia but owing to lack of income during work age);
- redistribute income, alleviate poverty, and promote social welfare and stability; and
- encourage investment.[1889]

They have used the second pillar private pensions to:

1886 MoLSA, 2008.
1887 Ibid.
1888 Davis, 1995, at pp. 27-28 & 53-75; øverbye, 1996, at pp. 159-181; Dietvorst, 1999, at pp. 20 & 23-41; Fox and Palmer, 2001, pp. 93; Leo Stevens, et al., 1999, at pp. 92-98, 100 & 126-130; Iglesias and Palacios, 2001, at p. 216; OECD, 2005a, at p. 216; OECD, 2006, at pp. 208 & 226; OECD, 2006a, at pp. 190-191, 193 & 199; Queisser and Whitehouse, 2006, at pp. 56-59 & 61-63; Becker, 2007, at pp. 103-104; and Turner, 2007, at pp. 84-86.
1889 Davis, 1995, at pp. 29-31; and Alan and Ronald, 2009.

- pool and share risk between employers and employees;
- protect employees from social security cuts, inadequate replacement rates, and political and inflation risks of the first pillar pension;
- overcome the fallings of the life-cycle hypothesis and alleviate retirement poverty[1890];
- enhance private saving, investment, capital market development, and corporate finance;
- provide employers with long term fund;
- enhance information about current and future earnings of employees;
- create common interest between employers and employees; and
- establish reputation of employers in labour markets.[1891]

The private pensions have also contributed to qualitative developments in the financial markets of the countries, including the following:

- increment of demand for financial instruments;
- reduction of transaction costs;
- introduction of new financial instruments;
- innovation of markets;
- development and restructuring of the infrastructure, regulation and corporate-financial relationships in the financial markets;
- motivation of corporate takeovers; and
- internationalization of the financial markets.[1892]

The old public pensions in the transition and emerging market countries have existed as 'mandatory retirement saving schemes' in an intermediary form between social security and pension funds (i.e. as compulsory pension schemes that bear rights that can be transferred between jobs like social security and as pension schemes that are based on individualized actuarial accounts that avoid redistribution of resources between ages but force the young people to shift consumption to their old ages like funded pensions).[1893] They have, however, failed to offer sustainable retirement income security due to several reasons, including the evasion of wage taxes, centralization to serve government objectives, weakness of investment returns, de-capitalization of reserves, introduction of unrealistic replacement ratios, rise of inflation, lack of indexation, lack of annuities, rise of lump-sum withdrawals, lack of sufficient saving, rise of political risks, and high demographic problem due to rapid ageing, early retirement and

1890 The life-cycle hypothesis assumes that individuals plan to derive utility from smooth pattern of consumption over both working and non-working ages and that they accumulate resources during their working ages to consume during retirement. It assumes that individuals are far-sighted enough and have the ability to plan for their retirement and hence that discretionary saving will work. It suffers from the shortcoming that individuals may not plan their futures because of myopia or poverty. Davis, 1995, at pp. 11-15.

1891 Davis, 1995, at pp. 8-26, 77-90 & 158-258; Shah and Fernandes, 2001, at pp. 336-354 & 360-362; and Queisser and Whitehouse, 2006, at pp. 63-70.

1892 Davis, 1995, at pp. 25, 158-183 & 203-228.

1893 Davis, 1995, at pp. 25, 245-258; and Alberto, et al., 2006.

other causes.[1894] The private pensions in the countries are, accordingly, used to supplement the old pension systems as social security safety-net.[1895]

The private pensions in the transition and emerging market countries have also contributed to the development of securities markets when rules and understandings relaxed in favour of portfolio investment.[1896] They are used to spread risk, increase asset return and saving, raise the supply of long-term finance, spur financial innovation, facilitate privatization, stimulate the improvement of accounting, auditing, information disclosure and other infrastructure, and encourage labour productivity by increasing labour mobility from the informal sectors.[1897] The successful development and use of the funded pensions in the countries has, however, also been a function of the following:

- the prior level of development of the financial markets (in particular the capital markets);
- the reasonable absence of political interference in economic activities (i.e. the level of free market orientation);
- the degree of efficiency in administration and regulation;
- the availability of skilled personnel;
- the protection to rights of the pension shareholders and members;
- the presence of flexible regime for investment of the pensions (such as the prudent-man rule as opposed to heavy portfolio regulation);
- the indexation of the pension benefits;
- the adoption of sound macroeconomic and regulatory framework; and
- the fiscal treatment of the pensions.[1898]

The pensions in both the OECD and the non-OECD countries are also used to serve the following additional functions:

- strengthen the revenue positions of governments;
- increase national saving;
- broaden household choice for investment (in the capital markets);
- encourage cross boarder investment;

1894 Ibid.

1895 Davis, 1995, at pp. 25 & 245-257; and Alberto, et al., 2006. Many of the countries have introduced reforms that favoured the development of private pension funds with individualized accounts that can be invested. A number of them including Chile, Singapore, Malaysia, Korea, Cyprus, Fiji, Brazil, Indonesia, the Philippines, Jordan, India, Turkey, Egypt, Zimbabwe and Botswana have set up the funds with different sources of funding. Egypt, the Philippines, Jordan and Turkey have required their partial funding by the social security while Cyprus, Indonesia and Brazil have required their financing by company pension funds; Fiji and Malaysia by their national provident funds; Zimbabwe, Botswana and India by a combination of their provident funds and company schemes; Korea by life insurance companies; Chile by the defined-contributions of employees to be administered by private pension fund investment management companies; and Singapore by defined contributions of the employees to be administered by a government investment agency. Alberto, et al., 2006.

1896 Rossotto, 2003, at pp. 119-151.

1897 Ibid.

1898 Rossotto, 2003, at pp. 119-151; Davis, 1995, at pp. 174-176 & 245-258; and Shah and Fernandes, 2001, at pp. 355-360 & 362.

- encourage the formalization of informal sectors and work relations; and
- enhance competition, efficiency and economic growth.[1899]

ii. The Case of Ethiopia

Ethiopia does not currently have comprehensive social security. It has only occupational pension for government employees, some provident fund scheme for private sector employees, and some social assistance for the old, the destitute and the needy.[1900]

The governmental pension is compulsory pay-as-you-go scheme where:

- the government and its employees pay contributions defined as percentages of the monthly salaries of the employees, and
- only retired government employees (and their dependents) get payments from current contributions based on their average salaries and years of services.[1901]

It does not serve as universal basic system that assures minimum standard of living for citizens since it provides only subsistent income to very small population of the country.[1902] It does not also serve the functions of facilitating saving, employment, investment, corporate finance and capital market development since its benefit payments are small and its resources are hardly invested.[1903] The private sector provident funds and social assistances do not also serve these functions since they are informal and voluntary payments.[1904]

4.3 The Rationale and Direction of Reform

i. The International Experience

The OECD countries have reformed their pensions due to:

- increase of demographic and labour difficulties (including aging, fertility decline and early work exit),
- non-accumulation of the funding in the old PAYG system,
- decline of the scope for government funding of social security,
- rise of efficiency concern, and

1899 Fox and Palmer, 2001, at pp. 91-130; and Holzmann, Packard and Cuesta, 2001, at pp. 452-453, 455 & 457-479.

1900 Note the discussion under the 'history and current state' subtitle above.

1901 FDRE, 2003e; FDRE, 2004bd; FDRE, 2009a; and note the discussion under the preceding subtitle.

1902 Tables 1(Chap. 4); 1(Chap. 4) - Continued ((1 of 1); 2(Chap. 4); 3(Chap. 4); & 6(Chap. 4).

1903 Tables 5(Chap. 4); and 6(Chap. 4).

1904 Data is not available on the size and coverage of the provident funds except for the funds administered by the Commercial Nominees Private Limited Company (Table 7(Chap. 4)). It is, however, common knowledge that the funds are kept in bank accounts for payment to employees upon termination of contract of employment. Most of the social assistance is also conducted informally although some two hundred non-governmental organizations are known to the Ministry of Labour and Social Affairs of the country (Note the discussion under the 'history and current state' subtitle above).

- advent of the neo-liberal ideology.[1905]

Most of them have reduced their PAYG pension liabilities by changing their benefit formula, increasing the pensionable age, and tightening the link between contributions, life time earnings, and pension benefits.[1906] Three countries, namely UK, Australia and Sweden have increased the funding of their systems by introducing individual account systems.[1907] Some like Italy and Sweden have gone to a middle road between the traditional PAYG defined benefit system and the fully funded defined contribution financial account system by introducing a nominally defined contribution (NDC) PAYG system that has required:

- payment of contributions on earnings at fixed rates during work life,
- crediting of the contributions to individual notional accounts of the workers, and
- annual indexation of the capitals (and benefits) to the contribution base and the changes in the life expectancies of the workers.[1908]

The Netherlands has also followed middle road by developing second pillar pensions as stand-alone - capital funded - collective pensions that are between the public PAYGO system and the defined contribution individual account scheme that has replaced the defined benefit plans in the other countries.[1909] Japan has diversified the public and private pension schemes, introduced defined contribution individual accounts, and allowed the rise of private pension fund managers, investment advisors and fund record keepers.[1910] The US has debated

1905 Davis, 1995, at pp. 3 & 40-52; Rietbergen, 1999, at pp. 13 & 17; Dietvorst, 1999, at pp. 20-21; Fox and Palmer, 2001, at pp. 90-100; Dixon and Hyde, 2001, at pp. ix-xiii & 1-213; Richard, et al., 2003; Barbara and Axel, 2003; Hughes and Stewart, (eds.), 2004; OECD, 2006, at p. 208; OECD, 2006a, at pp. 190-193; and Banyár and Mészáros, 2009. The neo-liberal ideology of privatisation was implicit in the multipillar pension reform advocated by the World Bank in 1994 (World Bank, 1994; Holzmann and Stiglitze, 2001, at pp. 1-3; Fox and Palmer, 2001, at pp. 90-113; and Dixon and Hyde, 2001, at pp. ix-xiii & 1-213).

1906 Fox and Palmer, 2001, at pp. 97-98.

1907 Ibid.

1908 Id., at pp. 98-100.

1909 The pensions are called collective since they have allowed individuals to pull and delegate their savings and investment decisions to professionals who have then linked the affairs of the individuals to the strategies of the financial markets. They have created risk sharing contracts between generations that are not traded in the financial markets. They are called stand alone since they do not have risk absorbing sponsors in form of government or corporation, but make their members owners of the assets and bearers of their risks (so that they will either share the risks among themselves or shift them to others by trading financial instruments on the capital markets through their professionals). Bovenberg, 2008.

1910 Harner, 2000, at pp. 94-110. The current Japanese public pension scheme comprises a National Pension Insurance (NPI) for all residents aged 20 to 60, an Employee Welfare Pension Insurance (EWPI) for salaried employees of corporations, and a Mutual Aid Association Plans (MAA) for public sector employees. Its private pension scheme comprises Corporate Pensions (consisting of Employee Benefit Pension Plans, Tax-Qualified Pension Plans and Non-Tax-Qualified Company Retirement Allowances), a National Annuity Fund, and Private Pensions (of the US 401(K) type individual contribution plans). The NPI stands as the core of the Japanese pension system being supplemented by the other funds. The governance structure for the public funds is transferred from the Trust Fund Bureau of the Ministry of Finance and its delegate (the Pension and Welfare Service Corporation under the Ministry of Health and Welfare) to the Pension Bureau of the Ministry of Health, Labour and Welfare (for the pensions) and the Social Insurance Agency and Regional Social on the introduction of private individual accounts in the occupational pension system and succeeded to expand the scope of application of the occupational pension system to the private and personal sector in 2010.[1911]

The Latin American countries have implemented their reforms due to fiscal deficit, poor functioning of the old PAYG system, and appreciation of the Chilean private pension model as success.[1912] Chile has developed an individual account second pillar pension system to offer its workers with retirement benefit in form of annuity while Argentina, Uruguay, Peru and Columbia have adopted mixed approaches by combining their first pillar PAYG pensions with a modest second pillar (Argentina and Uruguay) or offering a system that allows the making of choice between the first and the second pillars (Peru and Columbia).[1913] The other countries of the region, namely Mexico, Bolivia and El Salvador, have undergone reforms towards the second-pillar funded schemes.[1914] The concern with the Latin American reformers has also been on how to design and regulate the new systems in order to maximize individual equity (i.e. assure that pensioners will get benefits that are commensurate with their contributions).[1915] Hence, some like Argentina have focused on the making of reform largely within the existing system of PAYG by re-regulating it (such as by relating the benefits to contributions (as opposed to wages), reducing the future benefits, and financing the pensions through tax) while others like Bolivia have gone to a second pillar pension system with new regulation for all participants.[1916]

The Eastern European and Central and Eastern Asian countries have made their reforms due to the change of economic policy to free market and the rise of concern on how to enhance the coverage and financing of the existing pensions.[1917] They have faced the problems of high pension debt, weak pension administration, low pension contribution, low retirement age and strong legacy of special privileges to selected groups.[1918] The initial phases of their pension reforms were reactive concentrating on trimming of benefit payments to meet the financial resource limitations of the pension systems while the subsequent reforms in the 1990s were proactive including steps to phase out the existing privileges to social

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Insurance Bureaus (for pension and health insurance matters) while the management and investment of the private pensions is largely under authorized pension fund managers and advisors. Ibid; and MHLW Japan, 2007-10.

1911 Dobbin and Boychuk, 1996; Skidmore, 2001, at pp. 187-203; Becker, 2007, at pp. 104-105; AP, 2009e; Bloomberg, 2009; BBC, 2009c; and BBC, 2010.

1912 Iglesias and Palacios, 2001, at p. 216; Fox and Palmer, 2001, at pp. 93 & 104; Madrid, 2003; Gill, et al., (eds.), 2004; Carlos Ochando Claramunt, 2004, at pp. 25-46; OECD, 2005a, at p. 216; OECD, 2006, at p. 226; and OECD, 2006a, at p. 199.

1913 Fox and Palmer, 2001, at pp. 104-105; Carlos Ochando Claramunt, 2004, at p. 25; and Alberto, et al., 2006.

1914 Ibid.

1915 Fox and Palmer, 2001, at pp. 105-106; Carlos Ochando Claramunt, 2004, at p. 41; and Alberto, et al., 2006.

1916 Fox and Palmer, 2001, at p. 106.

1917 Lindeman, et al., 2000, at pp. 1-46; Fox and Palmer, 2001, at pp. 93 & 100-101; Castel and Louise Fox, 2001, at pp. 424-430; Iglesias and Palacios, 2001, at p. 216; Elaine Fultz, 2004, at pp. 3-24; OECD, 2005a, at p. 216; OECD, 2006, at p. 226; OECD, 2006a, at p. 199; and Banyár and Mészáros, 2009.

1918 Ibid.

groups and steps to make systemic changes towards pillar two (individual account) pensions.[1919] The steps taken to phase out the old privileges have included the discontinuation and conversion of rights, the transfer of acquired rights to newly created occupational pensions, and the increment of the retirement age.[1920] The steps taken to introduce systemic change have included the complete phasing out of the old PAYG system in favour of pillar two pension (Kazakhstan); the introduction of mixed system of nominal defined contribution (NDC) in pillar one and compulsory individual account in pillar two (Hungary, Poland, Croatia, Latvia, Estonia and Bulgaria); and the reduction of early exit and tightening of the benefit formula in pillar one and encouragement of the development of voluntary supplementary private pension in pillar two (the rest).[1921] Many of the South East Asian countries have also introduced defined benefit (or nominal account) systems as first pillar pensions, provident funds as second pillar pensions, and a blend of these two as mixed systems since they have faced weak unfunded occupational pensions for the civil service, fragmented schemes for the private sector employees, and low coverage, weak asset management systems and strong fiscal pressures.[1922]

The Middle East and African countries have hardly engaged in pension reforms until the 21st century.[1923] They have run defined benefit unfunded public pensions for the government employees and nominally defined contribution based provident fund schemes for some of the employees of the private sector.[1924] They have faced little demographic pressure of ageing compared to the high and middle income countries of the other continents and depended on informal community caring systems.[1925] They have started to debate on the privatisation of their pensions by end of the 20th century when they learned from the reforms in the other regions.[1926] They have increased the momentum of their reforms in the 21st century due to calls i) for expansion of the coverage and benefit in their pensions, ii) for improvement of the utilization and investment of their pensions, iii) for betterment of the administrative techniques and performance of their pensions, and iv) for privatisation of their pensions.[1927] The idea of privatising pensions was pursued partly due to the social and economic developments in the regions and partly due to the growing international recognition that the private sector can play important roles in the provision of social protection and mobilization of domestic savings if it is given the responsibility to run pensions.[1928] The organization of

1919 Fox and Palmer, 2001, at pp. 101-111; Elaine Fultz, 2004, at pp. 3-24; Lindeman, et al., 2000, at pp. 1-46; and Banyár and Mészáros, 2009.

1920 Ibid.

1921 Ibid.

1922 Ibid.

1923 Fox and Palmer, 2001, at pp. 111-112; Von Braun, 1991, at pp. 395-412; Morgan, 1991, at pp. 415-463; Ahmad and Hussain, 1991, at pp. 247-301; Osmani, 1991, at pp. 305-349; and Carmelo Mesa-Lago, 1991, at pp. 356-392.

1924 Fox and Palmer, 2001, at pp. 93 & 111-112; and Iglesias and Palacios, 2001, at p. 216.

1925 Fox and Palmer, 2001, at pp. 93 & 111-112; and Von Braun, 1991, at pp. 395-412.

1926 Ibid.

1927 Fox and Palmer, 2001, at pp. 93 & 111-112; Iglesias and Palacios, 2001, at p. 216; OECD, 2005a, at p. 216; OECD, 2006, at p. 226; OECD, 2006a, at p. 199; ISSA, 1998; ISSA, 2000; ISSA, 2000a; ISSA, 2003; ISSA, 2003a; and ISSA, 2005.

1928 Fox and Palmer, 2001, at pp. 111-112; ISSA, 1998; ISSA, 2000; and ISSA, 2000a.

sustainable pensions is, however, still challenging for the regions due to resource constraint.[1929] The governments of most of the countries of the regions are also reluctant to address the matters of pension reform as the pension reforms are also part of the public sector employment and pay issue.[1930]

The pension reforms around the globe have, accordingly, been on three matters:

- reforming the pension system towards private defined contribution funded schemes in individual accounts and putting the first, second and third pillar pensions together (whether that is by blending the pillars or by keeping them separately);
- lowering the administrative costs of the individual account systems (such as by centralizing the functions of collecting contributions, paying annuities, keeping accounts and clearing transactions); and
- making the remaining first pillar pension better than it was before.[1931]

Hence, many of the countries have shifted:

- from collective provision of pensions by the state to private provision of same through the market, hence from a welfare state or welfare capitalism model in the provision of pensions to a public-private welfare nexus through multipillar pensions;
- from basic-income pension (where the state pays same flat rate to the retiree or differentiates between amounts based on the number of years of work without considering earning) to means-tested schemes (where the pension benefits are tested by the value of the pension income to the retiree or the level of the non-pension incomes and assets available to the retiree); and
- from defined benefit pensions (where the state or the sponsor undertakes to bear the risks with the pension funds and to pay the members a predetermined percentage of their average or final salaries) to defined contribution schemes (where the pension members make earnings-related contributions to commercially managed individual accounts, get benefits that vary with the market returns of the accounts and, hence, bear the risks in the pensions).[1932]

Many of them have also required the mandatory provision of the second pillar pensions, encouraged the voluntary provision of private insurance annuities as supplementary third pillars, and created reserves that support the remaining first pillar pensions.[1933] They have also raised the retirement age, linked the benefit formula to long periods of average earnings and life expectancy, increased the

1929 ISSA, 2005; and Banyár and Mészáros, 2009.
1930 Fox and Palmer, 2001, at pp. 111-112.
1931 Fox and Palmer, 2001, at pp. 113-121; James, Smalhout and Vittas, 2001, at pp. 254-303; Holzmann, Packard and Cuesta, 2001, at pp. 452-479; Shalev, 1996, at pp. 335-337; OECD, 2003, at pp. 75-93; Hughes and Stewart, (eds.), 2004; Queisser and Whitehouse, 2006, at pp. 49-77; OECD, 2006a, at pp. 190-198; and Banyár and Mészáros, 2009.
1932 Ibid.
1933 Rocha, Hinz and Gutierrez, 2001, at p. 171; Fox and Palmer, 2001, at pp. 91-130; Hughes and Stewart, (eds.), 2004; OECD, 2006a, at pp. 190 & 210-211; and Becker, 2007, at pp. 101-114.

pension contributions and their fiscal incentives, reduced the number of defined benefit pension plans, increased the number of the defined contribution and fully funded personal savings accounts, and reduced the operating costs of the pensions by increasing the flexibility and competition in the provision and management of the pension funds.[1934] The number and size of the funded pensions with defined contributions and the reserves for the first pillar pensions have, accordingly, grown in many of the countries after the mid 1990s.[1935]

The recent concern in most of the high income OECD countries is on further development of sustainable and equity market based pension system with appropriate regulatory and fiscal environment.[1936] The concern in the middle income Eastern European, Asian and Latin American countries is on expansion of system coverage, reduction of risk and uncertainty, sustenance of finance and investment, enhancement of efficiency and equity, enhancement of saving, diversification of the financial markets, enhancement of the market oriented reforms, enhancement of regulatory capacity, and reduction of poverty.[1937] The poor countries are also advised to consider the development of formal private pensions as one among the many reforms that should be implemented to reduce deprivation and vulnerability.[1938]

The enhancement of private funded pensions is also recommended in the aftermath of the 2008 financial and economic crisis in order to have balanced and secure pension system.[1939] The World Bank also recommends adoption of a five pillar pension system by adding 'zero pillar' (which should be non-contributory and universal) and fifth pillar (which should include not direct monetary benefits but the provision of non-monetary benefits such as housing and health care for the retired poor) to the three pillars that exist already (i.e. the first pillar PAYGO system, the second pillar funded scheme and the third pillar insurance related voluntary saving scheme).[1940]

1934 OECD, 2006a, at pp. 196-199.

1935 Fox and Palmer, 2001, at p. 93; Leo Stevens, et al., 1999, at p. 93; Iglesias and Palacios, 2001, at p. 216; OECD, 2004, at pp. 231-233 & 237-238; OECD, 2005, at p. 193; OECD, 2005a, at pp. 213-221; OECD, 2006, at p. 226; and OECD, 2006a, at pp. 190-198 & 210-211.

1936 Some, like France, are also struggling to ensure the sustainability of their pensions by increasing the retirement and pension ages. The Netherlands is doing it both by increasing the retirement/pension age and cutting pension benefits. Fox and Palmer, 2001, at pp. 121-125; Rocha, Hinz and Gutierrez, 2001, at pp. 171-208; Arlman, 2003, at p. 240; Hughes and Stewart, (eds.), 2004; Brown, 2007; Kay and Sinha, (eds.), 2008; Bode, 2008; Broeders, et al., (eds.), 2008; Banyár and Mészáros, 2009; and EC, 2009a.

1937 Lindeman, et al., 2000, at pp. 1-46; Fox and Palmer, 2001, at pp. 107-112; Holzmann, Packard and Cuesta, 2001, at pp. 452-479; ISSA, 2002a; ISSA, 2003a; Madrid, 2003; Gill, et al., (eds.), 2004; Elaine Fultz, 2004, at pp. 3-24; Carlos Ochando Claramunt, 2004, at pp. 27-42; ISSA, 2005; ISSA, 2006; Johnson and Williamson, 2006, at pp. 47-65; Brown, 2007; Kay and Sinha, (eds.), 2008; and Banyár and Mészáros, 2009.

1938 Ahmad, et al., 1991; Jean Drèze and Amartya Sen, 1991, at pp. 28-32; Platteau, 1991, at pp. 112-163; Atkison and Hills, 1991, at pp. 83-108; Burgess and Stern, 1991, at pp. 43-74; Holzmann, Packard and Cuesta, 2001, at p. 479; Johnson and Williamson, 2006, at pp. 47-65; Willmore, 2006, at pp. 67-89; and Holzmann, et al., (eds.), 2009.

1939 Kay and Sinha, (eds.), 2008; Pablo Antolin and Fiona Stewart, 2009; Banyár and Mészáros, 2009; and EC, 2009a.

1940 Kay and Sinha, (eds.), 2008, at p. 8.

ii. The Case of Ethiopia

Ethiopia recognizes the provision of pension annuities by the long-term insurers and the payment of occupational benefits, severance pays and provident fund benefits by the private sector employers.[1941] It has studied the ways for expanding pension coverage to the private sector in cooperation with the ILO, UNDP and the French government since 1993.[1942] The studies have recommended the creation of private pension which may be managed by the Social Security Agency or separate pensions.[1943] The government has not, however, implemented the recommendations for fear that the reform may create burden on the treasury.[1944]

The occupational benefits and severance pays in the private sector are, however, piecemeal and negligible while the provident funds are informal.[1945] The provision (and consumption) of life insurance and pension annuities is also very negligible.[1946] The coverage and management of the governmental pension system is also very weak.[1947] Most of both the employed and unemployed population of the country are, therefore, living without formal pension and life annuity coverage. The old are also suffering from retirement poverty. The country needs to improve on these.

The country also needs to focus on two functions which are important for the development of the financial market: i) forcing saving and ii) mobilizing the saving for investment. The Ethiopian households and individuals are reported to have very limited saving due to both their expenditure habits and the low levels of their

1941 The occupational benefits and severance pays are compulsory schemes under the labour law of the country while the pension annuities and provident funds are voluntary schemes recognized by the insurance supervision and tax laws (TGE, 1993a; TGE, 1994b, at art. 2(16); FDRE, 2002e, at arts. 13(b) & 21(1); FDRE, 2002f, at arts. 3-4; and FDRE, 2003g). The country has also introduced some micro health insurance schemes in collaboration with the cooperative societies, savings and credit unions, and women's associations of the regions and allowed the provision of micro insurance and fund management services by the microfinance institutions (FDRE(MOI), 2004/2005, at p. 505; and FDRE, 2009, at art. 3).

1942 Note annual report of the Social Security Agency for the years between 1994 and 2004; the study reports archived in the Agency; SSA (PID), 1999; SSA (PID), 2004, at pp. 40-41; and FDRE(MOI), 2004/2005, at p. 505.

1943 Ibid.

1944 The fear of the government was not published officially. It was, however, common knowledge among officials of the Social Security Agency.

1945 Data is not available on the exact size of both. The Commercial Nominees Private Limited Company manages some of the provident funds (Table 7(Chap. 4)).

1946 The total long term insurance is less than 6% of the total insurance business in the country. It is also only the Ethiopian Insurance Corporation which has attempted at running pension business as part of its long term insurance business. The pension business of the corporation is, however, also negligible. Tables 7(Chap. 2); 8(Chap. 2); and annual reports of the Corporation.

1947 The coverage of the system is less than 1% of the total population (which is less than 2% of the total employed or less than 69% of the total permanently employed population of the country) (Table 1(Chap. 4) - continued (1 of 1)). The contribution collection, benefit payment and investment functions of the system were also disintegrated until they were assigned to the Social Security Agency in June 1998 (FDRE, 1996d; SSA, 1998, at p. 4; and FDRE, 2006). The pension resources are also hardly invested to earn good return (Tables 4(Chap. 4) & 5(Chap. 4) with the notes to them). A new pension investment office is established under the Social Security Agency only recently to curb the situation.

incomes.[1948] The direct mobilization of saved resources from the households and non-households to investment is also weak due to absence of formal institutional savers and the market mechanism for direct resource mobilization.[1949] The development of private pensions is necessary for these reasons along with the improvement of the governmental pension system, the encouragement of private insurance, the creation of securities market, and the taking of other developmental measures.

Hence, the country needs to implement five sets of measures in order to enable the creation of formal private pensions.

First, it needs to make the pension reform part of its poverty reduction strategy.[1950] It needs to have clear vision on the reform measures to be taken to materialize the poverty reduction goal in respect of both the formal and the informal sectors of the urban and rural societies and consider the introduction of private occupational pensions as appropriate measure for the formal sector. The private pensions can serve as tools for the general poverty reduction goal of the country since the extended family system is still strong.[1951]

Secondly, it needs to make the pension reform part of its saving and investment promotion and financial market development policy. The private pensions can serve as means to promote the objectives of saving and investment which are included in the country's investment laws.[1952] The presence of institutional savers in form of pensions will also contribute to the development of the securities market which the country needs to have.[1953]

Thirdly, it needs to compel the employers and the employees in the formal private sector to participate in the private pension system as this has been done for the governmental pension. The private sector has not developed sustainable provident fund schemes under the voluntary approach let alone a private pension system and it is important that the government takes the initiative to compel participation of the employers and the employees in the private pension system.[1954] This needs to begin by institutionalising the existing provident fund schemes into private pension. The schemes have the immediate potential to grow into private pension if the government requires the development of retirement funds by the private sector as opposed to the provision of temporary saving schemes.

1948 Tables 15(Chap. 3) up to 19(Chap. 3); CSA, 1998; CSA, 2001; and CSA, 2007.

1949 Note the discussion under the securities market chapter above.

1950 The development and poverty reduction plans of the country (known as Sustainable Development and Poverty Reduction Program (SDPRP) 2002-2005 and Plan for Accelerated and Sustained Development to End Poverty (PASDEP) 2006-2010) have not considered the development of private pension as instrument of poverty reduction despite the promises of the government to widen the scope of the country's pension system. FDRE, 2002g, at pp. 114-118; Ethiopia, 2002; Ethiopia, 2004; Ethiopia, 2006; FDRE (MoFED), 2006; FDRE (MoFED), 2006a; FDRE (MoFED), 2007; and FDRE (MoFED), 2007a.

1951 CSA, 1998; CSA, 2001; and CSA, 2007.

1952 FDRE, 1996c; FDRE, 1998a; FDRE, 1999; FDRE, 2002c; and FDRE, 2003ej.

1953 Note the discussion under the 'potential functions and need for development of the market' subtitle of the securities market chapter above.

1954 Note the discussion in the preceding paragraphs.

Fourthly, it needs to enact a retirement law for the private sector. It does not currently have retirement law for the sector since the labour laws focus on regulation of the occupational (illness and injury) benefits and severance payments to employees.[1955] The post-retirement employment of the old can, of course, serve as safety net against retirement poverty (and the enactment of a retirement law for the private sector may be taken as bar to this). The use of post-retirement employment as safety net for retirement poverty is, however, unsustainable approach partly because the retiree will become old soon and partly because the usefulness of the safety net depends on accessibility of the employment opportunity in the private sector to the retiree. The best approach is to expand the pension coverage for the benefit of the retired and reserve the employment opportunity for the young population.

Fifthly, it needs to promote the pension annuity businesses of the insurance companies through interventions on both the supply and the demand sides. It, on the supply side, needs to encourage the insurance companies to engage in the provision of long term insurance with significant pension annuity services through the tax incentives. Its current tax regime makes the pension payments and investment profits of the existing Pension Funds and the employers' contributions to the existing pension, provident and similar retirement funds (that are made up to fifteen percent of the employees' monthly salaries) free from taxation.[1956] It also makes the employers' contributions to the pension, provident and similar retirement funds (that are made up to the fifteen percent limit) deductible from the taxable business incomes of the employers.[1957] It has done these to encourage the development of its current pension system and the same measures need to be extended to the pension annuity businesses of the insurance companies and the future private pensions. It, on the demand side, needs to stimulate the employers, employees and households to consume the products of the insurers by giving them tax incentives as well as raising their awareness about the usefulness of life insurance and pension annuities.

The country also needs to take the following two measures which will contribute to the aforementioned:

1. The saving institutions of society (such as the *Edir* and *Equb*) and the saving and credit cooperatives in the labour market of the country have remained to be informal and piecemeal.[1958] Developing these institutions and transforming them into formal companies will contribute to the aforementioned functions of enhancing and mobilizing private saving since these are the closest institutions

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1955 PMGE, 1975k; TGE, 1993a; and FDRE, 2003g.

1956 FDRE, 2002e, at arts. 13(b), 21(1)(c) & 30(1)(c); FDRE, 2002f, at arts. 3-4; and FDRE, 2003e, at art. 51. The exemptions do not include life insurance annuities and provident fund payments.

1957 FDRE, 2002e, at arts. 20 & 21(1)(c).

1958 Table 18(Chap. 3); Degefe Duressa Obo, 2009, at pp. 77-83; CSA, 1998; CSA, 2000; CSA, 2001; CSA, 2006; CSA, 2007; FDRE(MOI), 2004/2005, at pp. 171 & 173-181; and FDRE(MOI), 2005/2006, at pp. 83, 349, 373, 395-396, 431-432, 472, 509, 521-523, 553, 571, 587 & 598. Note also the discussions under the 'potential functions and need for development of the market' and 'constraints and measures to develop the market' subtitles of the securities market chapter above.

to households and individuals. The country needs to enact a law that will require the formal incorporation of the institutions as mutual companies and give them tax incentives.[1959] This will also mean revolutionizing a sector which has lived for long as informal and unknown.

2. Both the private sector employers and the government enjoy full discretion in determining salary in the absence of minimum wage law. This has led to many cases of low payment to the detriment of the saving potentials of employees.[1960] The country needs to enact minimum wage law in order to cure this and enhance the saving potentials of employees.

These two measures need not, however, be considered as pre-conditions for creation of the private pensions. They are peripheral measures that can contribute to the enhancement and mobilization of saving and, hence, the creation and development of the private pensions.

4.4 Modelling the Pension Structure and Its Regulation

4.4.1 Modelling the Pension Structure

i. The International Experience

a. The Rise of Pensions as Competing Market Institutions

The pensions in many countries have exited in the past as unfunded monopolies sponsored by employers and governments, hence eliminating the role of competition.[1961] The post 1990 reforms have, however, resulted in the decentralization of pensions, the rise of multipillar pensions (in which funded private pensions have become dominant), the increment of individual responsibilities in the funding (and control) of pensions, and the rise of flexibility in the management of pensions.[1962] The role of competition in the pension sector to ensure good pension provision is also increasingly recognized as the pension systems are privatised and made flexible.[1963] Hence, both the funded and unfunded pensions have become market institutions subject to competition along with the other financial institutions.[1964]

b. Organization of the Pensions

The first pillar pensions in the countries have existed in one of three forms:

1959 The country does not currently have rules for the mutual company form of organization. It only has laws for cooperatives and non-mutual business organizations which are not used well for organizing the saving institutions of society and the labour market (IGE, 1960; FDRE, 1998f; FDRE, 2004ab; FDRE, 2004ac; and FDRE, 2010a). Enacting a law that will require and encourage the formation of these saving institutions as mutual companies is necessary to cure the problem.

1960 Note Table 15(Chap. 3). Most of the private sector employers do not also have collective agreements under the labour law which can check this (FDRE, 2003g).

1961 Note the discussion under the 'history and current state' subtitle above.

1962 Note the discussion under the 'rationale and direction of reform' subtitle above.

1963 Drabbe, 1999, at pp. 5-14; Littlewood, 1998; OECD, 2006, at p. 207; and OECD, 2006a, at pp. 207-209.

1964 Ibid.

- as universal basic system which offers flat-rate pension financed by general taxes on PAYG basis,
- as insurance based funded system which offers earnings-related defined benefit pension financed by earnings-based contributions, or
- as hybrid system involving the PAYG basic system and the insurance based funded system.[1965]

The second pillar pensions have grown as financial intermediaries which collect and invest funds on pooled basis for eventual payment as pensions.[1966] They have existed as funds backed by assets accumulated by or on behalf of the plan members to pay for their own pensions without implying intergenerational transfer of resources unlike the first pillar PAYG social security pensions where current contributions of the employed population are paid directly to the pensioners.[1967] Hence, they have existed as funded occupational or personal pensions that complement the first pillar social security.[1968] They have existed as defined benefit or defined contribution funds with the difference between the two being on assignment of the investment risk to members and sponsors of the funds.[1969] They have exited as legally separate pools of assets without legal personality or as incorporated entities with legal personality, in one of the following four broad types:

- as accounts held in banks or insurance companies without legal personality,
- as participation endowment insurance funds without legal personality,
- as mutual pension funds run by management companies without legal personality, or
- as foundations, trusts or mutual companies with legal personality. [1970]

The first three types have existed as funds managed by the financial or management companies that sponsor them because of their non-personality.[1971]

1965 Table 11(Chap. 4); Davis, 1995, at pp. 28, 40, 43, 59 & 60-76; øverbye, 1996, at pp. 159-181; Dietvorst, 1999, at pp. 36-38 & 16-33; Leo Stevens, et al., 1999, at pp. 92-98; Queisser and Whitehouse, 2006, at pp. 56-59 & 61-63; Becker, 2007, at pp. 103-104; and Turner, 2007, at pp. 84-86.

1966 Tables 8(Chap. 4); 9(Chap. 4); 10(Chap. 4); 12(Chap. 4); and Davis, 1995, at pp. 5, 53-75 & 124.

1967 Tables 9(Chap. 4); 10(Chap. 4); 12(Chap. 4); Davis, 1995, at pp. 7, 28 & 53-76; Dietvorst, 1999, at pp. 16-33 & 39-41; Leo Stevens et. al., 1999, at pp. 92-98 & 126; Becker, 2007, at pp. 103-104; Queisser and Whitehouse, 2006, at pp. 56-63.

1968 Ibid.

1969 The sponsors of a defined-benefit pension fund often undertake to bear the investment risks and to pay the members with pension amount related to career earning as a predetermined percentage of final or average salary subject to years of service or a flat benefit as per years of service. The sponsors of a defined-contribution pension undertake to pay benefits to the members according to market return and subject to payment of fixed contributions by them, hence making the members bear the investment risk. Ibid.

1970 Rocha, Hinz and Gutierrez, 2001, at pp. 177-182; OECD, 2006a, at p. 189; OECD, 2007a; and Hans Blommestein, et al., 2009.

1971 Their governance has, for instance, been delegated to banks and insurance companies in Japan; to life insurance companies or pension fund managers in Portugal and Spain; to pension and portfolio management companies in Turkey; and to pension fund management companies in Czech Republic, Poland and many Latin American countries. OECD, 2006a, at p. 189; and Rocha, Hinz and Gutierrez, 2001, at pp. 177-178.

The first types have exited in many of the OECD countries as defined contribution individual accounts managed by the financial companies without representation of the plan members.[1972] They have existed under the regulatory frameworks for the banks and insurers that run them.[1973] The second types have exited in some of the OECD countries as separate joint stocks with participation of the plan members and their shareholders in their governance.[1974] They have existed under the regulatory frameworks for joint stock companies.[1975] The third types have exited in the Latin American and some of the East European countries as defined contribution funds without boards and voting rights to the plan members.[1976] They have existed under the regulatory frameworks for the management companies.[1977]

The foundations and trusts (in the fourth type) have existed in Europe as defined contribution or defined benefit occupational pensions with varied management and governance structures (that are largely subject to the regulatory frameworks meant for occupational pensions).[1978] The defined contribution pensions have existed as institutions that shift risk to employees and have been subjected to split representations to limit the principal-agent problem they face while the defined benefit pensions have existed as institutions that shift risk to the employer or the sponsor and have often been required to contribute to a guarantee fund.[1979] The mutual companies have exited in some of the European countries as non-profit making or employer-based funds whose board members are in principle to be selected from the pension members.[1980]

The third pillar schemes have existed as private life insurance savings.[1981] The size of these and the second pillar pensions has generally been influenced by the value attached to them, the size of the first pillar pension and the level of development of the commercial insurance sector in the countries.[1982]

ii. The Case of Ethiopia

Ethiopia needs to consider the following market and governance related issues in developing the private pensions:

- the issue of separating the pensions from the existing governmental pension system and the financial institutions;

1972 Rocha, Hinz and Gutierrez, 2001, at pp. 177-178; OECD, 2007a; and Hans Blommestein, et al., 2009.
1973 Ibid.
1974 Rocha, Hinz and Gutierrez, 2001, at p. 178.
1975 Ibid.
1976 Ibid.
1977 Ibid.
1978 Rocha, Hinz and Gutierrez, 2001, at p. 179; OECD, 2007a; and Hans Blommestein, et al., 2009.
1979 Ibid.
1980 This has been the case, for instance, in Hungary. Rocha, Hinz and Gutierrez, 2001, at pp. 181-182.
1981 Davis, 1995, at pp. 28 & 53-76; Dietvorst, 1999, at pp. 16-33 & 39-41; Leo Stevens et. al., 1999, at pp. 92-98 & 126; Becker, 2007, at pp. 103-104; and Queisser and Whitehouse, 2006, at pp. 56-63.
1982 Ibid.

- the issue of organising the pensions as consolidated or set of independent funds;
- the issue of organising the pensions as incorporated or unincorporated institutions;
- the issue of organizing the pensions as funded or unfunded institutions;
- the issue of organising the pensions as defined benefit or defined contribution schemes; and
- the issue of organising the pensions as competing or public good institutions.

The separation of the private pensions from the existing governmental pension system has already become issue when the study group of the Social Security Agency of the country tried to consult members of the private sector on the modalities of introducing pension for the employees of the sector.[1983] Members of the private sector have reacted against expansion of the governmental pension system to the private sector despite their wishes for development of private pension system.[1984] The answer to the issue also needs to be a matter of efficiency consideration. The existing governmental pension system has not been efficient in the tasks of collecting contribution, generating income and paying benefits. The tasks were disintegrated across the pension and other institutions of the country for many years while the income generation has been limited to collection of interest from bank accounts and few government securities.[1985] The Social Security Agency is also working currently as a hardly experienced pension fund manager.[1986] The country needs to separate the existence and management of the private pensions from the existing governmental pension system for this reason.

The business of pension need not also be unified with the insurance and microfinance businesses in the country since the existing insurers and microfinance institutions are not engaged in pension business despite their authorization to do so by the insurance and microfinance supervision laws.[1987] The experience in many of the other countries has also shown that pension is not insurance although insurers can engage in it.[1988] It has also shown that the existence of pensions as individual accounts held in banks (or insurance companies) (as this was practiced in the developed and some of the transition and emerging market countries) has the disadvantage of putting the funds in the hands of the existing banks (and insurers) to the detriment of competition although it can be useful to diversify the risks in pensions through the businesses of the banks

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1983 Note the study mentioned in the 'rationale and direction of reform' subtitle above and the reports archived in the Agency.

1984 Some have even withdrawn their provident funds from their accounts in the banks and the Commercial Nominees Private Limited Company for fear that the government will force them to join the existing governmental pension system. Note unpublished reports of the banks and the Commercial Nominees Private Limited Company.

1985 Tables 4(Chap. 4); and 5(Chap. 4) with the notes to them. Note also the discussion under the 'rationale and direction of reform' subtitle above.

1986 Ibid.

1987 Note the discussion under the 'rationale and direction of reform' subtitle above.

1988 Both history and the current practice in the countries has shown the separate existence of the state social security, private pension and insurance annuity schemes as first, second and third pillar pensions despite consideration of the three as complementary schemes (Note the discussions under the 'history and current state', 'functions of pensions' and 'direction of reform' subtitles above).

and the insurers.[1989] It is also found that the separation of pensions from the other financial institutions is useful to diversify the channels for resource mobilization, encourage saving and investment, and trigger innovation.[1990]

Organisation of the private pensions as unincorporated funds to be managed by each employer (or sponsor) can trigger competition (hence, better management) and the competition (and better management) so triggered can have positive effect on the development of the pensions and the financial and labour markets of the country. The employers and the financial institutions of the country do not, however, have experience as pension fund managers. The employers have not been better than the Social Security Agency in their management of the provident funds since they have kept the provident funds in ordinary savings accounts.[1991] The banks, insurers and microfinance institutions do not also have the experience of running pension funds. Only the Commercial Nominees Private Limited Company (owned by the Commercial Bank of Ethiopia and the Construction and Business Bank of the country) has tried to act as (pension and provident fund) manager. The company has, however, also acted as watchdog of the saving accounts of the provident funds and simple facilitator of the pension payments of the Social Security Agency in practice.[1992]

Hence, the best approach for the country is to require institutionalisation of the pensions as incorporated companies with their own governance. Requiring the share company form is also appropriate since this form is the commonest and preferred structure for organization of the financial institutions in the country.[1993] The share company form has also the advantage of combining capital, reserve, limited liability, professional management, shareholder participation (in governance), accounting, external auditing (and control), and information disclosure.[1994] This will also allow the pensions to live with and manage their own assets and liabilities as corporate entities instead of as pool of assets that are prone to external management and abuse.

The share company is, however, also a demutualized profit making commercial business organization.[1995] It may be considered as inappropriate to the nature of pensions since pensions are not necessarily (and need not necessarily) be profit

1989 Rocha, Hinz and Gutierrez, 2001, at pp. 177-178.
1990 Ibid.
1991 Note the discussions under the 'functions of pensions' and 'rationale of reform' subtitles above.
1992 The provident funds administered by the company were never invested (Table 7(Chap. 4)). The company's pension payment services were also limited to execution of the decisions of the Social Security Agency.
1993 TGE, 1994a, at art. 4(2); FDRE, 2008b, at art. 9; TGE, 1994b, at arts. 2(3) & 4(1)(a); FDRE, 1996g, at arts. 2(2) & 4(1)(b); FDRE, 2009, at arts. 2(3) & 5(1)(c); and note the discussion under the banking, insurance and microfinance chapter above.
1994 It is an organization form under the commercial code and commercial registration laws of the country that can maintain capital, absorb risk, sustain funds, limit liability, protect members and allow participatory governance all of which are important for a private pension fund. IGE, 1960, at arts. 306, 325-428 & 445-509; and FDRE, 2010a.
1995 IGE, 1960, at art. 10.

motivated institutions as the international experience has shown.[1996] Pensions need also to have the non-business goals of social protection, resource redistribution, and poverty reduction even if they have to exit as market institutions (and their resources need to be invested to earn returns).[1997] The non-profit mutual company forms may, therefore, be most appropriate for the future pensions in the country. The decision should, however, be made as a matter of response to demand. The country has not seen formal movement to creation of non-profit mutual companies in any of its sectors so far.[1998] There is also no government policy for creation of mutual companies in any of the sectors. The business organization and commercial registration laws of the country do not also have specific rules for the mutual company form.[1999] Whether the employees in the formal sector will prefer to have the demutualized or mutual company form of incorporation for the private pensions is also matter to wait and see. Hence, the country needs to start with the demutualized share company form and consider the mutual company form of incorporation when it becomes necessary.[2000]

The choice of organising the pensions as funded or unfunded and as defined benefit or defined contribution schemes has to be made by taking into account the advantage of each option over the other. The funded defined contribution scheme excels the unfunded (pay-as-you-go) defined benefit scheme by its ability to accumulate assets before maturity of the obligation to pay benefits. It has also the advantage of shifting risk from the pension funds to the individual pension members and hence of sustaining the pensions. The recent international experience is also towards this.[2001] These justify that Ethiopia needs to follow the funded defined contribution approach. The country should, however, also take care of the danger of risk shifting to the individual pension members. This can make the pension members losers particularly when fund management experience is low, the market for pension fund investment and return is weak, and the choice and consciousness of the pension members are limited all of which are and will be the case in Ethiopia for some time. These justify that the country needs to go for the unfunded defined benefit approach since this approach can avoid the problem by placing the risk in the pension funds. The protection of pension members in this way is, however, also unsustainable as the international experience has shown.[2002] The best choice for the country is to follow the funded defined

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1996 Rocha, Hinz and Gutierrez, 2001, at pp. 177-182; and Platteau, 1991, at pp. 155-163. Note also the discussion under the 'functions of pensions' subtitle above.

1997 Jean Drèze and Amartya Sen, 1991, at pp. 30-32; and Atkison and Hills, 1991, at pp. 83-103. Note also the discussion under the 'functions of pensions' subtitle above.

1998 There are only *Edirs* and *Iquibs* in the informal social sector and saving and credit cooperatives in the formal labour market which can grow into the mutual company form. Table 18(Chap. 3); Degefe Duressa Obo, 2009, at pp. 77-83; CSA, 1998; CSA, 2000; CSA, 2001; CSA, 2006; CSA, 2007; FDRE(MOI), 2004/2005, at pp. 171 & 173-181; and FDRE(MOI), 2005/2006, at pp. 83, 349, 373, 395-396, 431-432, 472, 509, 521-523, 553, 571, 587 & 598. Note also the discussions under the 'rationale and direction of reform' subtitle and the securities market chapter above.

1999 IGE, 1960; and FDRE, 2010a. Note also the discussion under the 'rationale and direction of reform' subtitle above.

2000 The mutual company can then be formed as share company having the pension plan members as its shareholders under the future pension regulation.

2001 Note the discussion under the 'rationale and direction of reform' subtitle above.

2002 Note the discussion under the 'rationale and direction of reform' subtitle above.

contribution approach and to adopt mechanisms through which it will protect the individual pension members. The mechanisms may include minimum pay, industry fund guarantee and similar regulatory requirements.

The decision on organising the pensions as competing or public good institutions should also be made based on the advantage of each approach over the other. The competition approach has the advantages of:

- maximizing individual want (i.e. enabling the pension members to act according to their own preferences);
- increasing the incentives for pension members to seek information about the performance of their pensions;
- encouraging the pension members to participate in the management of their pensions;
- enhancing the quality of management and investment of the pensions; and
- improving efficiency in the allocation of resources.[2003]

It is also argued that the old pension system as protected monopoly has led to more distortions than benefits and hence that countries need to develop voluntary private saving schemes that operate under the free market principle.[2004]

It is, however, also argued that the increment of flexibility and competition in pensions has the following disadvantages:

- increasing the financial cost of information (since widening choice and increasing competition will increase the need for information on pension and investment options);
- increasing the time cost of decision making (since widening choice and competition will increase the need to spend time to make decisions);
- decreasing the optimality of pension decisions (since the aforementioned costs can make people go for low cost and inappropriate pension and investment alternatives); and
- undermining the making of effective decision by pension members (since pension flexibility and competition can lead to choice overload that may be unmanageable by consumers).[2005]

The applicability of competition policies and laws on pensions is also debated since pensions have existed in the past as public goods exempted from competition.[2006]

The international trend has, however, been towards eliminating the idea of running pensions as protected monopolies. Many countries have decided to run their pensions as competing market institutions with flexible governance,

2003 OECD, 2006, at p. 207.
2004 Littlewood, 1998.
2005 OECD, 2006, at p. 207.
2006 Drabbe, 1999, at pp. 8-14.

investment choice, and control of too much risk taking because of the aforementioned advantages of competition.[2007] Ethiopia needs to learn from this and organize the private pensions as competing institutions with the necessary regulation.

4.4.2 Modelling the Regulation

4.4.2.1 The Reasons and Objectives of Regulation

i. The International Experience

The regulation of pensions is justified by reasons within and outside finance and the risks involved in pensions.
The reasons that justify pension regulation within the domain of finance are the problems of market failure and the need for resource redistribution.[2008] The former includes the problems of:

- information asymmetry (to the users of pension funds),
- negative externality (to the state - as leader of the pension fund development or guarantor of the pension fund liabilities in times of failure), and
- monopoly (that may result in large discretion to fund managers and lead to the risk of fund bankruptcy).

The latter includes the issue of fairness of the resource distribution between generations (i.e. between those who pay to the pensions and those who receive the benefits as retiree currently).

The reasons that justify pension regulation outside the domain of finance are the need to control tax misuse (when tax benefits are recognized for the pension funds); the need to enhance the coverage, adequacy and security of the retirement income; and the need to enhance competition, labour mobility and efficiency in the economy.[2009]

The risks involved in pension that justify regulation include investment, agency, and systemic risks.[2010] The investment risks include risks that arise due to market fluctuation and non-diversification of assets. The agency risks include risks that arise due to non-alignment of the interests of pension managers and pension members given the long-term horizons of pensions, the informational asymmetries between fund managers and members, the low level of legal and financial sophistication of fund members, and the room for fraud, malfeasance and theft of assets. The systemic risks include risks that arise due to connection of the pension industry with the other segments of the financial market and the economy. Pensions are, of course, little prone to the liquidity risk of the type

2007 OECD, 2006; Littlewood, 1998; Drabbe, 1999; and note the discussion under the 'rise of pensions as competing market institutions' subtitle above.
2008 Davis, 1995, at pp. 91-93.
2009 Ibid.
2010 Rocha, Hinz and Gutierrez, 2001, at pp. 182-183.

banks face. They are, however, prone to the risks of collapse in asset price, capital erosion, and spill-over effects that may result from banking crisis, insurance failure and general economic downturn.[2011]

The design and regulation of private pensions is, therefore, mostly aimed at meeting the following objectives:

- enhancing the coverage, adequacy and sustainability of the pensions;
- assuring the prudence (i.e. health, stability and efficiency) of the pensions;
- promoting and maintaining competition;
- protecting the pension consumers from the dangers of information asymmetry, pension failure and abuse;
- protecting the state and society against the burden and side effects of pension (such as the burden of fund guarantee on the state and the moral hazard problem of protection on society); and
- achieving the social policy objectives of poverty reduction and redistributive equity.[2012]

The prioritisation of these objectives, however, differs from country to country since the countries differ in their domestic contexts and the values they attach to the objectives.[2013]

ii. The Case of Ethiopia

Ethiopia does not have private pension regulation currently. It needs to develop it from the scratch as it allows the birth of private pensions. In doing so, it needs to define and prioritise the objectives of the pension regulation according to its immediate and long term needs.

The immediate needs are expanding coverage, reducing retirement poverty, enhancing saving, and making the pension contributory to the development of the financial market since the majority of the population are living without retirement pension and there is no enough long term saving to finance investment.[2014] The pension regulation needs to give priority to these as it starts.

The long term needs are:

- enhancing adequacy, sustainability, competitiveness and prudence of the pensions;

2011 Ibid. The 2008 financial and economic crisis has also shown the likelihood of these effects although the pension funds around the world are not hit by the crisis as much as the banks and the insurers (Adrian Blundell-Wignall, et al., 2008; Broeders, et al., (eds.), 2008; Alan and Ronald, 2009; Alan, et al., 2009; Banyár and Mészáros, 2009; EC, 2009; and EC, 2009a).

2012 Most of the pension regulators include these in their regulatory objectives. See websites of the pension regulators listed in Table 1(Chap. 5).

2013 Ibid.

2014 Note the discussions under the ‘rational and direction of reform’ subtitle and the securities market chapter above.

- assuring the protection of consumers; and
- eliminating the information asymmetry and moral hazard problems that may exist behind the pensions.

The pension regulation needs to give attention to these as the private pensions grow.

4.4.2.2 The Instruments, Contents and Approaches of Regulation

i. The International Experience

a. The Types of Instruments

The regulation of pension funds has three building blocks like the regulation of banking and insurance markets, namely i) the licensing (ex-ante control) block, ii) the ongoing monitoring block, and iii) the ex-post supervision (problem resolution) block.[2015] The pension funds are, accordingly, subject to licensing, asset segregation, capital, reserve, governance, investment, asset custodian, external audit, actuarial valuation, reporting, public disclosure and fund guarantee requirements that are implemented through prior approval, off-site surveillance, on-site inspection and punitive or remedial measures by the regulators.[2016]

The adoption and specific content of the instruments of regulation is subject to several factors, including the historical evolution and particular legal structure of the pensions, the political and cultural environment for the pensions, the institutional and regulatory development for capital markets, and the level of economic development of the countries,.[2017] Hence, the countries that have funds operated by management companies have often focused on capital and professional credentials of the management companies in setting their licensing requirements while the countries that have followed the trust and foundation approaches have focused on trust law based liability rules and rules for board composition, responsibilities and voting.[2018] The countries that have pension plans operated by banks and insurers have relied on the banking and insurance prudential rules to protect the assets of the pension members.[2019]

Many of the countries also have capital, reserving, and external custodian rules to limit the agency risks in fund management and to help the overall enforcement of prudential regulations.[2020] They also require the valuation of assets and disclosure

2015 Rocha, Hinz and Gutierrez, 2001, at pp. 191-194; Queisser and Whitehouse, 2006, at pp. 56-59 & 61-63; Becker, 2007, at pp. 103-104; Turner, 2007, at pp. 84-86; OECD, 2005a, at p. 216; OECD, 2006, at p. 226; OECD, 2006a, at p. 199; Dietvorst, 1999, at pp. 36-38 & 16-33; øverbye, 1996, at pp. 159-181; and Davis, 1995, at pp. 43, 59 & 60-76.

2016 Ibid.

2017 Rocha, Hinz and Gutierrez, 2001, at p. 183.

2018 Id., at p. 184. UK has followed the trust law approach while many of the other European countries have relied on the system of split representation in boards. Ibid.

2019 Id., at p. 185.

2020 Ibid. Hungary also imposes these requirements on its mutual companies while the Latin American countries impose them in respect of their fund management companies. Id., at pp. 190-191.

of information (including on capitals, reserves, costs and returns) to the fund members and the general public.[2021] They also impose external audit and actuarial requirements to control abuse and make the funds sustainable.[2022] They also impose investment regulations to diversify and minimize the agency, portfolio and systemic risks in pensions.[2023] The investment regulations often exit as Prudent Person Rule in the Netherlands and the Anglo-Saxon countries and as investment ceilings in most of the other OECD countries.[2024]

Many of the Latin American and Central and Eastern European countries also impose guarantee requirements to ensure minimum returns to the pension funds.[2025] The Latin American countries require the constitution of central guarantee funds to guarantee the agency as opposed to the market risks in pensions while the Central and Eastern European countries require this as means to guarantee the agency and market risks.[2026]

b. The Contents of Regulation

Given the varieties of instruments indicated in the preceding subtitle, the pension regulations of the countries are related to three content areas:

- the assets of the pensions,
- the liabilities of the pensions, and
- the organization of the pensions.[2027]

The asset related regulations focus on the distribution of portfolios, the funding of benefits, and the ownership of surpluses of the pensions.[2028] The liability related regulations focus on the compulsion of employers and employees to membership, the insurance of benefits, the relationship between the pension funds and the general social security, the choice between annuities and lump sum withdrawals, the indexation of benefits, the vesting and portability of benefits, the equality of treatment between pensioners, and the treatment of dependents.[2029] The organization related regulations focus on the protection of pensioners against fraud, the supply of information to fund members, the representation of employees in management of the funds, and the general organization of the management and regulations of the funds.[2030]

2021 Id., at pp. 185-186.
2022 Id., at p. 186.
2023 Id., at pp. 186-187.
2024 Id., at pp. 187-188.
2025 Id., at pp. 188-190.
2026 Ibid.
2027 Table 13(Chap. 4); Queisser and Whitehouse, 2006, at pp. 56-59 & 61-63; Becker, 2007, at pp. 103-104; Turner, 2007, at pp. 84-86; OECD, 2005a, at p. 216; OECD, 2006, at p. 226; OECD, 2006a, at p. 199; Dietvorst, 1999, at pp. 36-38 & 16-33; øverbye, 1996, at pp. 159-181; and Davis, 1995, at pp. 60-76.
2028 Ibid.
2029 Ibid.
2030 Ibid.

The portfolio regulations exist as quantitative limits on asset holding and investment.[2031] They exist in the continental European countries and rarely in the Anglo-Saxon countries.[2032] They are often used to avoid concentration of risk and thereby to protect the pension fund beneficiaries from the risks of fund failure.[2033] They are sometimes used to ensure the existence of demand for government bonds.[2034] The Anglo-Saxon countries regulate the portfolio discretion of managers by a 'prudent person rule' which requires the pension fund managers to diversify the pension fund investments and to be prudent, diligent and loyal (to the funds and the fund members).[2035] The recent trend in many of the countries is, however, also towards liberalizing the quantitative regulations in favour of the Anglo-Saxon 'prudent person rule'.[2036]

The funding regulations exist since private pensions based on pay-as-you go are less credible because of the risks of failure inherent in the life cycle of a private firm.[2037] Many of the countries have, accordingly, considered the desirability of:

- forbidding unfunded pensions;
- imposing minimum standard of vesting;
- requiring funding up to defined levels (such as ABO (defined accumulated obligation), PBO (projected benefit obligation based on indexation up to retirement), and IBO (indexed benefit based on indexation after retirement));
- imposing ceilings on under-funding (to avoid inadequacy of the funds) and over-funding (to avoid abuse of tax privileges);
- introducing guarantee schemes (to be funded by contributions from the pension plans (usually for defined-benefit schemes)); and
- setting the asset return, interest and discount rates the pension funds have to assume in the calculation of their funding levels.[2038]

The trend and advice has also been towards risk based regulation of the funding of private pensions.[2039]

The regulation of ownership of surpluses exists to control abuse of tax privileges and maximize the surplus funds as back-up to the benefit promises of the pensions.[2040] Hence, many of the countries have regulations that:

2031 Queisser and Whitehouse, 2006, at pp. 56-59 & 61-63; Becker, 2007, at pp. 103-104; Turner, 2007, at pp. 84-86; OECD, 2005a, at p. 216; OECD, 2006, at p. 226; OECD, 2006a, at p. 199; Dietvorst, 1999, at pp. 36-38 & 16-33; øverbye, 1996, at pp. 159-181; and Davis, 1995, at pp. 93-96.

2032 Davis, 1995, at pp. 96-98; and OECD, 2002a, at pp. 41-68.

2033 Davis, 1995, at pp. 96-98.

2034 Davis, 1995, at pp. 96-98.

2035 OECD, 2002a, at pp. 41-68.

2036 Davis, 1995, at pp. 97 & 262-265; OECD, 2002a, at pp. 41-68; and OECD, 2006a, at pp. 207-208.

2037 Davis, 1995, at pp. 98-99.

2038 Davis, 1995, at pp. 99-104; øverbye, 1996, at pp. 159-181; Dietvorst, 1999, at pp. 36-38 & 16-33; OECD, 2005a, at p. 216; OECD, 2006, at p. 226; OECD, 2006a, at p. 199; Queisser and Whitehouse, 2006, at pp. 56-59 & 61-63; Becker, 2007, at pp. 103-104; and Turner, 2007, at pp. 84-86. The countries, however, differ in their specific funding structures due to historical, economic and political differences (Enrico and Armin, 2008).

2039 OECD, 2008a; OECD, 2008b; and Broeders, et al., (eds.), 2008, at pp. 165-217.

2040 Davis, 1995, at p. 104.

- assign ownership of the surpluses to the body that bears the responsibility to run the pension fund,
- entitle the beneficiaries with the pension benefits as opposed to the surpluses and other means to finance the pension fund, and
- limit the uses that can be made from the surpluses by the body that bears the responsibility to run the pension fund.[2041]

The compulsion of membership in the private funds is justified by the advantages it offers, namely the potential relief to the first pillar social security, the coverage of low-income workers who would be uncovered if membership were voluntary, the enhancement of labour mobility and efficiency, the fair distribution of tax advantages, and the overcoming of market failures that are common in annuities markets.[2042] Only few countries, namely Australia, Switzerland and France have, however, recognized these justifications and imposed statutory compulsions for membership in practice.[2043] Most of the other countries do not force membership by law as they recognise compulsion only at the company or occupation level by collective agreement.[2044]

Many of the countries require insurance in the defined-benefit pension schemes.[2045] The insurance of pensions is, however, also prone to the moral hazard problem which is common to deposit insurance and fund guarantee schemes. Hence, many of the countries also impose rules that:

- regulate the market valuation and auditing of assets of the pensions;
- restrict the asset choices of the pensions; and
- require the setting up of risk-based premiums by the insurers.[2046]

The recommendation in the aftermath of the 2008 financial and economic crisis has also been towards development of appropriate pension fund guarantee schemes along with capital adequacy requirements and international risk sharing mechanisms.[2047]

The integration of pension funds and social security is made to ensure the adequacy and equitability of the pension services to the pension members and to realize the savings necessary for social security.[2048] Some of the OECD countries

2041 Queisser and Whitehouse, 2006, at pp. 56-59 & 61-63; Leo Stevens, et al., 1999, at p. 93; and Davis, 1995, at pp. 94-107.
2042 Davis, 1995, at pp. 105 & 108.
2043 Queisser and Whitehouse, 2006, at pp. 56-59 & 61-63; Becker, 2007, at pp. 103-104; Turner, 2007, at pp. 84-86; OECD, 2005a, at p. 216; OECD, 2006, at p. 226; OECD, 2006a, at p. 199; Leo Stevens, et al., 1999, at p. 93; Dietvorst, 1999, at pp. 36-38 & 16-33; øverbye, 1996, at pp. 159-181; and Davis, 1995, at pp. 43, 59 & 60-76.
2044 Some of the countries (like the Netherlands and Sweden) have also attained a high level of coverage without compulsion, hence making the compulsion of membership less determinant of coverage. Ibid.
2045 Queisser and Whitehouse, 2006, at pp. 56-59 & 61-63; Leo Stevens, et al., 1999, at p. 93; and Davis, 1995, at pp. 108-112.
2046 Davis, 1995, at pp. 109-112.
2047 Broeders, et al., (eds.), 2008, at pp. 243-257.
2048 Davis, 1995, at p. 112.

have, accordingly, adopted substitution rules and formula that integrate the private pensions and the first pillar social security benefits.[2049]

The choice between annuities and lump-sum payments has been a function of the merits of the approaches in practice. The use of lump-sum payments has been blamed for failing to address the myopia problems of individuals, requiring the presence of more liquid short term assets, undercutting the protection to pensioners, and making the private pensions less preferable.[2050] Hence, some of the OECD countries have either restricted the use of lump sum payments or encouraged the pension annuities by imposing taxes on the lump sum payments.[2051]

The indexation of pensions has been used to manage inflation.[2052] Many of the countries have, however, avoided it because of its technicality and tended to protect the pensions against inflation by imposing final-salary-based defined-benefit schemes as opposed to career averages and requiring the real returns on the pension assets to exceed the growth rates of the real earnings.[2053] The transition and emerging market countries do not also impose it since it requires the existence of securities markets with high indexation and electronic trades and manpower with sufficient skill in modern financial economics.[2054]

The regulation of vesting and portability of pension rights is done to manage labour mobility and equity.[2055] The countries, however, differ on their requirements. Some of them like France and Sweden allow immediate acquisition of rights while others like USA impose vesting for fifteen years.[2056] Many of them allow the portability of pension rights when workers change employers provided that some actuarial requirements are met.[2057] Some of them also make the portability of rights easy by using transfer circuits and arrangements while others make it easy by the national nature of their pension systems.[2058]

The equal treatment issue is related to the transfer of benefits between early leavers and others, between managers and workers, between high-income and

2049 Queisser and Whitehouse, 2006, at pp. 56-59 & 61-63; Becker, 2007, at pp. 103-104; Turner, 2007, at pp. 84-86; OECD, 2005a, at p. 216; OECD, 2006, at p. 226; OECD, 2006a, at p. 199; Leo Stevens, et al., 1999, at p. 93; Dietvorst, 1999, at pp. 36-38 & 16-33; øverbye, 1996, at pp. 159-181; and Davis, 1995, at pp. 112-113.

2050 Davis, 1995, at p. 113.

2051 Id., at pp. 113-114.

2052 Davis, 1995, at pp. 114 & 174-176.

2053 Only few including UK, Canada, Germany and Sweden have continued with the indexation requirement. Queisser and Whitehouse, 2006, at pp. 56-59 & 61-63; Leo Stevens, et al., 1999, at p. 93; and Davis, 1995, at pp. 114-115.

2054 Shah and Fernandes, 2001, at pp. 355-360 & 362.

2055 Davis, 1995, at p. 115.

2056 Queisser and Whitehouse, 2006, at pp. 56-59 & 61-63; Leo Stevens, et al., 1999, at p. 93; and Davis, 1995, at pp. 116-117.

2057 Davis, 1995, at pp. 117-118.

2058 The Netherlands, Japan and USA do the former. The ATP in Sweden is example for the latter. Queisser and Whitehouse, 2006, at pp. 56-59 & 61-63; Leo Stevens, et al., 1999, at p. 93; and Davis, 1995, at pp. 117-118.

low-income earners, between permanent workers and part-timers, between women and men, and regarding the protection of dependents (survivors).[2059] Many of the countries prohibit the discriminatory treatment of these groups and almost all of them (with the exception of Japan) know dependents' pensions.[2060] The transition countries also give due attention to the equality issue.[2061]

The protection of pensions against managerial and investment fraud is often assured through use of independent custodians and actuaries, reduction of the powers of fund trustees, use of employee trustees, limitation of the making of investment, imposition of large minimum funding requirements, undertaking of insurance against fraud, recognition of employee participation in the boards of the pensions, and conduct of private suits under trust or similar law.[2062]

The participation of employees in pension fund management is useful to disseminate information about the pension funds.[2063] It is appropriate when the pension system is defined-contribution as the employees in this system are bearers of the risks and the highest stakeholders in the funds.[2064] The countries do, however, differ on their recognition of the participation. The Netherlands and Australia, for instance, require equal representation of the employers and employees in the boards of the pension funds while Denmark requires the participation of more employees than the employers.[2065] Others like Germany and UK do not impose particular statutory requirement for employee representation in the pensions but achieve it through bodies such as Works' Councils in Germany and Members Trustees in UK.[2066] The latest recommendation is towards inclusion of employees and other stakeholders in corporate governance in general.[2067]

The supply of information to pension fund members is useful to make them:

- know the worth of the total remuneration of their employment,
- judge the adequacy of their contributions to the pension funds and the risks in the investment of the pension funds, and
- understand the nature of and situation with their pension rights.[2068]

The countries, however, also differ on their information disclosure requirements. Some like USA, UK, Australia and Switzerland require the supply of annual financial reports and plans and individual benefit statements to members of the funds while others like the Netherlands require the supply of annual actuarial

2059 Castel and Louise Fox, 2001; and Davis, 1995, at pp. 118-119.
2060 Davis, 1995, at pp. 119-120.
2061 Castel and Louise Fox, 2001.
2062 UK and USA, for instance, rely on private suits under trust law while Denmark relies on a number of the other methods. Davis, 1995, at pp. 120-121.
2063 Davis, 1995, at p. 122.
2064 Ibid.
2065 Ibid.
2066 Ibid.
2067 Broeders, et al., (eds.), 2008, at pp. 218-242.
2068 Davis, 1995, at p. 121.

reports that detail the states of the funds to the fund members.[2069] Germany requires the provision of information on vesting and accrual of the pension rights to the members when they leave work while Japan recognizes the making of only occasional reports by circulars.[2070]

c. The Approaches of Regulation

The countries also implement the pension regulations through two approaches:

- a proactive approach (which emphasizes on ex-ante licensing and ongoing monitoring instruments); and
- a reactive approach (which relies on ex-post problem resolution instruments).[2071]

The adoption of the approaches has often been a function of the basic organization of the pension industry and the level of development of the country (including the level of development of the capital market, the legal system and the economy).[2072] Hence, the countries which have well-established institutions and legal system have followed the proactive approach while the others have tried to mix between the two approaches.[2073]

d. The Limitations

The regulation of pensions as market institutions is recent phenomenon. The instruments and approaches are not standardized yet. Hence, the experience of countries ranges from compulsion to voluntary membership, from requirement of funding to use of unfunded schemes, from direct regulation to use of trustee responsibilities, from strong substantive regulation to regulation by information disclosure, from use of prudent-man rule to portfolio restriction, from rapid vesting to assumption of 'lifetime employment', from direct control of fraud to use of stakeholders, from requirement of fund guarantee to self protection, and from indexation to use of actuarial valuations and other techniques.[2074] The choice of instrument is also a matter of trade-off between the goals of allowing flexibility to the pensions and assuring the presence of adequate retirement income to the pensioners.[2075] The use of competition laws is also limited since pensions were considered as public good and the private pensions are late comers to most competition legislation.[2076]

2069 Id., at pp. 121-122.
2070 Id., at p. 122.
2071 Id., at pp. 191-194.
2072 Id., at p. 192.
2073 Ibid.
2074 Tables 10(Chap. 4); 13(Chap. 4); Davis, 1995, at pp. 122-126; and Banyár and Mészáros, 2009, at pp. 154-164.
2075 Ibid.
2076 Drabbe, 1999, at pp. 8-14 & 207-209.

The pension funds in many of the countries also suffer from weak governance, transparency and investment diversification, low investment return, high capital market volatility and strong government interference although the private pensions are better than the government managed pensions in these regards.[2077]

Hence, countries are advised to further improve on the regulatory and governance frameworks for pensions, the mechanisms for smoothing the fluctuation on pension asset returns, and the size of exposure of the pensions to market and non-market risks. They are advised to improve on the regulatory framework by adopting less restrictive rules, refining valuation and auditing requirements, using proactive instruments, assuring independence of regulators, enhancing international cooperation, and building regulatory capacities.[2078] They are advised to improve on the governance framework by adopting internal and external controlling mechanisms and tripartite representations of the government, the employers and the employees (i.e. the pension members) in the management of the pensions.[2079] They are advised to smooth the fluctuations on asset returns by imposing asset diversification requirements and increasing the use of asset management techniques, derivative instruments and the financial markets to facilitate the financing and allocation of the assets of the pension funds.[2080] They are advised to limit the exposure to market and non-market risks by allowing investment flexibility, introducing fund guarantee schemes, permitting the deferral of pension benefits, and requiring the phased withdrawals of annuities.[2081] They are also advised to reduce the direct involvement of government in the management and investment of pensions, to pursue the privatization of pensions, and to enhance competition.[2082]

The development of private pensions and capital markets is also considered as interactive process.[2083] Hence, the transition and emerging market countries are also advised to:

- pursue the development of their pensions along with the development of active securities markets,
- guide the investment of their pensions in equities of modest liquidity, and
- enhance the fund management skills of their managers.[2084]

2077 Tables 14(Chap. 4); 15(Chap. 4); 16(Chap. 4); Iglesias and Palacios, 2001, at pp. 229 & 225-244; Leo Stevens, et al., 1999, at pp. 100-101 & 129-130; OECD, 2004, at pp. 232-233 & 239; OECD, 2005, at p. 194; OECD, 2005a, at pp. 222-226; OECD, 2006, at pp. 213-228; OECD, 2006a, at pp. 100 & 199-212; Adrian Blundell-Wignall, et al., 2008; and Juan Yermo, 2008.

2078 Rocha, Hinz and Gutierrez, 2001, at pp. 203-206; Iglesias and Palacios, 2001, at pp. 243-244; OECD, 2008d; OECD, 2008f; Juan Yermo, 2008; Pablo Antolin and Fiona Stewart, 2009; and Banyár and Mészáros, 2009, at pp. 154-164.

2079 Ibid; and Broeders, et al., (eds.), 2008, at pp. 218-242.

2080 Iglesias and Palacios, 2001, at p. 197; OECD, 2008d; OECD, 2008e; OECD, 2008f; Pablo Antolin and Fiona Stewart, 2009; and Alan, et al., 2009.

2081 Iglesias and Palacios, 2001, at pp. 198-202; OECD, 2008d; OECD, 2008f; and Pablo Antolin and Fiona Stewart, 2009.

2082 Iglesias and Palacios, 2001, at pp. 243-244; OECD, 2006, at p. 207; OECD, 2006a, at pp. 207 & 208; Adrian Blundell-Wignall, et al., 2008; Juan Yermo, 2008; Pablo Antolin and Fiona Stewart, 2009; and Banyár and Mészáros, 2009, at pp. 154-164.

2083 Rossotto, 2003, at pp. 119-151.

2084 Shah and Fernandes, 2001, at pp. 359-360 & 362.

The 2008 financial and economic crisis has also shown the need for increasing the good governance, financial sustainability and regulatory treatment of the pensions.[2085]

ii. The Case of Ethiopia

Ethiopia does not currently have regulation for private pensions since it does not have the market for them. It needs to develop regulation from the scratch by taking into account the international experience. It needs to address the assets, liabilities and governance matters of the pensions, and regulate the funding, portfolio composition, surplus ownership, insurance, vesting, and portability of the pensions by adopting licensing, ongoing monitoring, and ex-post supervision rules in order to assure the prudence and sustainability of the pensions and protect the pension members as in the other countries. It needs to require the pensions to adhere to qualification, legal form, capital, reserve, minimum guarantee, insurance, asset segregation, investment, asset custodian, actuarial valuation, external audit, risk prevention, reporting, public disclosure, and related governance requirements and put them in competition in order to enhance their health and ensure quality. It needs to learn from the governance shortcomings of the existing governmental pension system and design the future pension regulation in a way that will enhance investment and health of the pensions.[2086] It also needs to restructure the governmental pension agency and subject it to the future pension regulation in order to enhance competition and performance.

2085 OECD, 2008a; OECD, 2008b; OECD, 2008d; OECD, 2008e; OECD, 2008f; Ignazio Visco, 2009; Pablo Antolin, 2009; Pablo Antolin and Fiona Stewart, 2009; and Alan, et al., 2009.

2086 Note the discussions under the 'rationale and direction of reform' and 'modelling the pension structure' subtitles above.