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Practices and Challenges of Ethiopian Social Security Agency Pension Funds Investment

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This is to certify that the thesis prepared by Hiwot Amare, entitled: practices and challenges of pension funds investment in social security agency and submitted in partial fulfillment of the requirements for the Degree of Master of Business Administration in Finance complies with the regulations of the university and meets the accepted standards with respect to originality and quality.

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Declaration

I declare that this research project is my own work. It is submitted in partial fulfillment of the requirements of the degree of Masters of Business Administration for the college of Business and economics, Addis Ababa University. It has not been submitted before for any degree or examination in any university.

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Practices and Challenges of pension funds investment in Ethiopian Social Security Agency

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Abstract

This study was undertaken to assess the practices and challenges of pension funds investment in Ethiopian Social Security Agency. The primary data were collected from seven key informants who had specialized knowledge about the pension funds investment of the Agency. This was supplemented by secondary data. The researcher used a mixed approach study where the quantitative data show existing pension funds investment practices of the agency quantitatively and the qualitative data shows the opinion of respondents regarding pension fund investment practices at SSA and related issues. The study result show that the attainment of unsatisfactory return on pension funds investment, concentration of the funds on non- marketable and, short-term assets which yield low return, and lack of standard investment practices like, lack of investment policy, detail and exhaustive investment guideline, unable to measure performance periodically and disclose to the public, and unable to follow the existing guideline in its investment activities. The agency's investment activities has been influencing by implicit and explicit government intervention specially, the invested pension fund in one way or another way has been used as a captive source of finance for government .In addition, underdeveloped financial market, limited expertise in the area, low market return and low understanding about the fund from officials have been challenging the investment of pension funds in SSA.

Key words: pension funds, pension funds investment, Social security Agency

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Acronym

CPPIB	Canadian Pension Plan Investment Board
DB	Defined Benefit
DC	Defined Contribution
ETB	Ethiopian Birr
ILO	International Labor Organization
ISSA	International Social Security Association
MGS	Malaysian Government Securities
MOFED	Ministry of finance and economic development
OECD	Organization for Economic Cooperation and Development
PAYGO	Pay-as-you-go
POESSA	Private Organization Employees Social Security Agency
SSA	Social Security Agency
SSI	Social Security Institutions
SSS	Social Security Systems

CHAPTER ONE

Introduction

1.1. Background of the study

Globally, there are a lot of people who need help to sustain their life and to fulfill their basic necessity. Especially, as they become old in age and their ability to generate income weaken the reliance of citizens on government increases. Government on the other hand should prepare a way to help the citizens. In essence, unless one takes a libertarian view, it is the role of the government to ensure that people do not reach old age being poor (Aaron and Reischauer, 1998; and Diamond 1995).

More often Social Security Systems (SSS) provide a means for citizens to secure their living in their retirement period or while they are active employee. So as to distribute benefit for those who are entitled Social Security institutions (SSI) engaged in collecting fund, administering the fund and distributing benefit. Usually, institutions which are responsible for pooling of the fund also invest the fund in manner that will give return and contribute for the fund. Such systems couldn't be said just only serve as a means of providing income for beneficiaries; of course they are of utmost importance for the elderly, but they have great effect on the functioning of the national economy and everyone's welfare (Gajek and Ostaszewski, 2004) .

A pension plan, which is one part of Social Security, is a program set up by an employer, union or a government that provides regular income payments to retired payments meeting the conditions set forth in the plan (Abebe, 2003).

As to meet the need of beneficiaries at retirement years, pension plans, require a sustainable fund. In any pension plan, pension fund is comprised of the assets accumulated to pay retirement incomes.

In Ethiopia pension plan as part of the nation's Social Security programs give income security in old age, disability or death. The Ethiopian Social Security Agency (SSA), which is responsible for administering the plan, has potential to invest the pension funds due to its surplus funds and the nature of its long horizon liability. In light of the contingent and long-term nature of its financial obligations, SSA is expected to build and manage a portfolio that will generate long-term returns that contribute to the future pensions of today's working members (Gebrehiwot, 2007).

Efficient pension fund investment can have many advantages. More importantly it gives the institutional investor (i.e. SSA) the chance to sustain its fund, thereby enhance the income of pensioners they would receive in their retirement period, Moreover; it can contribute for the development of the financial sector as a whole and for emerging firms in particular. According to Gebrehiwot (2007), the importance of investing pension funds described as;

> *Pension funds can even afford to invest in young companies still developing their product /services (venture capital) and support growing companies throughout economic cycles (expansion/merchant banking capital) and lease companies. They are also better placed to buy the private equity interests of investors forced to sell in a market where ready buyers are scarce as in the case in Ethiopia.*

Unlike the countries with a developed pension system ,it is hard to say that this perception is largely shared among the policy–makers in Ethiopia, since we do not see any policy that support the investment of the funds and their confidence in pension funds as a tool for development of financial sector . Hence the focus of this study is on current practices and challenges of pension fund investment of SSA.

1.2. Statement of the problem

The 2003, International Social Security Association (ISSA) report that covers African countries including Ethiopia points that, the investment of most of SSIs in Africa have registered negative real growth rates. This underperformance is attributed to a number of reasons, including macro-economic factors, unfavorable market conditions, poor portfolio planning, limited expertise and limited investment opportunities.

In Ethiopia, there is a growing realization of the need to address the underlying cause of negative performance and a study is underway to establish criteria for and governance of investment practice (ISSA, 2003).

Despite the growing realization of inefficient investment performance, the agency's investment activities constrained by direct or indirect influence of government that dictate the Agency to invest in low yielding government securities for example ,according to SSA (2003) report SSA has not performed well in its investment activities in all investment periods as compared to its potential especially ,in recent years the agency was unable diversify its portfolio and obligated to invest the reserve left from the pension payment on Treasury bills as it was directed from Ministry Of Finance And

Economic Development (MOFED). The asset portfolio is also dominated by short-dated assets: in 2002/03, for example, Bank deposits (with Development Bank of Ethiopia (DBE) and Construction and Business Bank CBB) and T-bills constituted about 77%, indicating high portfolio concentration in short-term assets (Week.et.al.2004). Underdeveloped financial market of the nation and lack of expertise in the investment area also creates problems on investment of the pension funds investment (Tarekegne 2004). This all problems resulted in Low return on investment usually below inflation rate.

Since the aim of pension funds investment is to sustain the pension funds in addition to the contribution made by beneficiaries and thereby to guarantee the income distribution of beneficiaries, the agency is expected to have efficient investment activities to meet its liabilities without any shortfalls. For instance, if the returns continue to be low and no measures has to be taken; it seems that it couldn't meet the projected cash flow deficits of the agency. According to International Labor Organization (ILO) (2001) actuarial review, the government undertakings' scheme and civil servants' scheme were projected to be able to meet all expenditures until 2003E.C.,getting into cash-flow deficit starting 2004E.C (and depletion of reserves by 2013E.C) if they merged together.

Generally, the investment of pension fund shouldn't be seen as a simple case as it was indicated by Gebrehiwot (2007);

> *the way the funds are invested (i.e. selection of investment and maintenance) should be of concern not only from the point of view of covering current benefit payments but also the need the pension scheme over the long term as well as to*

> *match the anticipated growth in pension liabilities, and the growth of fund as a source of investable resources (contributing to economic growth and job creation).*

Hence, efficient pension funds investment offers a great opportunity for the SSA to improve the status of pension funds and thereby the benefit payment for beneficiaries. It also aids the development of the nation's financial sector. However the needed improvements call for efficient and effective investment of the pension funds. Regular pension contribution is not sufficient to get the SSA pension funds sustainable. According Weeks *et al.* (2004) fund growth depends not only on the balance between pension contributions (premium payments) and payment of benefits (or claims) but also on the returns from investing the reserves.

The pension plan of Ethiopia is part of the Social Insurance system of the nation based on collection of monthly pension contribution processing and payment of claims for: retirement pensions, invalidity pensions, and survivors pensions and lump sum payments. Meeting the lifelong social protection requirement of beneficiaries requires growing amount of fund. While the contribution of employees periodically serving as a main source of the fund, the institution responsible for administrating the funds which is SSA has also been investing.

However, information is lacking on practices of the agency, in investing the funds, managing the investment, and investment linkages with the other issues; among policy makers, and stakeholders. The aim of this study is, therefore to study existing practices and challenges of Ethiopian SSA's pension funds investment.

1.3. Research Question

The study addresses the following research questions:

1. What is the current situation of pension funds investment in SSA?
2. What are the challenges of pension funds investment practices in SSA?
3. How is the pension funds investment administered?
4. What is the effect of investment performance on financial earning of pensioners and SSA's employees?

1.4. Objectives of the study

The main objective of the study was to assess practice and challenges of Ethiopian SSA pension funds investments. To achieve this general objective, the following specific objectives were addressed. These were to;

- Examine the pension funds investment practices of the SSA,
- Identify the challenges faced by SSA in its pension funds investment practices,
- Assess the pension funds investment administration of the agency, and
- Examine how the agency's pension funds portfolios compromised

1.5. Significance of the study

Generally, the purpose of the study is to assess the practices and challenges of SSA pension funds investment. Understanding the investment practices of the agency with all its challenges has academic as well as policy relevance. That is, it likely contributes to the body of knowledge by bringing empirical evidences of the practices and challenges of investing SSA's pension funds and associate with those in the academia.

It has policy relevance in that it helps the policy makers to assess the practices and challenges of pension funds investment and to take corrective measures if it is mandatory. It may also show opportunities that might not have been exploited and areas of policy interventions. Moreover, it initiates the concerned organization to reassess its existing practices regarding pension funds investment with a view to bring changes on how pension funds invested.

Employee associations, active employees who currently contribute for the fund, employers, employer's association and pensioners are also other parties that are benefited from the study. The study assists them in understanding how the fund is invested and how it affects their benefit .As a result, they can develop a potential to argue with the concerned body. Moreover being the first study to analyze the practices and challenges of pension fund investment of SSA , this study contribute a lot for other studies to be conducted in the future. The study has the potential to refine the existing knowledge of the audience with respect to Ethiopian SSA pension funds and its investment practices. Thus, the study is expected to serve as initial reading for those researchers who are interested in undertaking deep investigation in the area.

1.6. Delimitation of the study

This study was delimited to analyze the practices and challenges of pension funds investment at SSA that covers government employees. A Social Security Agency that covers the private employees was not considered as the subject for the purpose of this study.

Since the SSA for private employees is under formation, it doesn't engage in investment practices and, therefore, it was not feasible to consider it as a subject of the study.

1.7. Limitation of the study

The analysis of primary data was based on the interview result from key informants and the responses may be subject to personal biases and subjectivity which may affect the reliability of the study. Moreover, intention of the concerned parties not to make the secondary data revealed results in lack of adequate data and information. Despite aforementioned limitations, a great care was made while interviewing the respondents. Basic issues that deserve focus were taken in to account to obtain data for the study with the limited time and other resources and hence the objective of the study was achieved.

1.8. Organization of the paper

This study attempted to analyze the practices and challenges of pension funds investment of SSA. It was organized in five chapters. The first chapter introduces the background for the study, the rationale behind the study, the objectives, significance and scope of the study. The second chapter addressed the detail review of theoretical and empirical literatures on pension fund investment and related issues including some other countries practices. The third chapter presented the methodology used in the study. The fourth chapter was dedicated to the detail analysis of the data collected for the study. The summary of findings, recommendations and conclusions were included in the fifth chapter.

CHAPTER TWO

Review of Related Literature

2.1. General Concept and Definition

2.1.1. Pension fund and Pension Plan

One may distinguish a pension plan and a pension fund, according to Davis (2002) a pension plan is a contract setting out the rights and obligations of members and sponsor of a pension scheme. A pension fund is comprised of the assets accumulated to pay retirement incomes (either directly as in DB or via purchase of an annuity as in DC).

A pension plan, which is one part of social security, is a program set up by an employer, a labor union, or a government that provides regular income payments to retired payments meeting the conditions set forth in the plan. There are three universally accepted conditions; these are: age, disability and death (Abebe, 2003).

Pension funds are an accumulated assets contributed by sponsors and beneficiaries to provide for the deferred future pension entitlements of beneficiaries (Davis 1995; Bodie and Davis 2000). They are also a type of funds that collect pool and invest contributed by sponsors and beneficiaries to provide for retirement income of beneficiaries (Ibid). According to their definition a pension fund is established by the contribution of both sponsors and beneficiaries in response to the consumption demand of beneficiaries at retirement period. This could not only meet by collected fund, it also demands the investment of the fund.

2.1.2. Types of pension plans

Pension systems broadly can be categorized as defined benefit (DB) and defined contribution (DC) by the benefits they promise and PAYGO and funded based on the way they finance that promise.

I. Defined benefit (DB) vs. Defined contribution (DC)

In DB plans pension payments are based on a specific pension-crediting formula and years of service. As described by Modigliani and Muralidhar (2005), the essence of a DB pension plan is that it provides a “defined benefit” a prespecified annuity either in absolute currency or as a fraction of a measure of salary (for example, a defined percentage of the final salary or an average of some past years of salary). In DC plans participants, sponsors, or both make prespecified contributions and Participants invest contributions in assets. The final pension is uncertain (prior to retirement) because it depends entirely on asset performance of the accumulated contributions (Ibid). In DB the plan’s sponsor (government) is responsible for ensuring that the fund assets are sufficient to provide for current and potential liabilities, in contrast, the retirement income of beneficiaries under DC plans determined by investment earning.

II. Pay-as-you-go (PAYGO) vs. Funded

In PAYGO plans, the retirement pensions paid out over a given period are financed from the contributions paid over that same period by those in employment (employees and employers). In funded pension plans, the contributions are paid into a fund from which capital and interest accrued are then used to pay out pensions (Abebe, 2003).

According to Modigliani and Muralidhar (2005), in a pure PAYGO, there is no accumulation of funds because all contributions are disbursed to service pensions. However, funding requires an accumulation of funds before retirement to service future liabilities. Funds are invested in either marketable or nonmarketable assets. Unlike PAYGO plans, funded plans have a potential to accumulate resources that can be invested.

2.2. Review of basic issues concerning Pension fund investment

2.2.1. Guiding principles of social security funds investment

According to ISSA (2005), social security funds are held by social security schemes in order to safeguard the schemes' ability to pay benefits and provide services, to generate investment income that helps to finance benefits and services ,and, in many instances ,to ease transitory demographic pressures. In 2005, ISSA provide social security funds investment guidelines that any social security fund should follow by adopting it with their specific situation. Within the document, guidelines related to governance prerequisites, governance structure, governance mechanisms and largely investment of social security pension funds are outlined.

I. Governance prerequisites

With regard to the governance structure, the minimum governance principles and consideration are: there should be a clear identification and assignment of operational and oversight responsibilities in the governance of a social security scheme. If an entity other than a government ministry is established to administer a social security scheme, the governing body is ultimately responsible for ensuring that the provisions of the legislation establishing the social security scheme are observed and that the interests of scheme members, beneficiaries and other stakeholders are protected.

In accordance with the legislation establishing a social security scheme and/or the decision of a scheme's governing body, there should be an investing institution may be either the entity administering the social security scheme or an entity established expressly for the purpose of investing the scheme's funds. And, the appointment of investment committee responsible for developing the investment policy and investment strategy.

The governing bodies of the social security scheme and of the investing institution should be accountable to the scheme members, beneficiaries, and other stakeholders of the social security scheme. In order to ensure the accountability of the governing bodies, their members should be liable for their actions and for their failure to act. In the same token, the guideline regarding suitability states that, membership of the governing bodies of the social security scheme and of the investing institution (as well as any specific investment committee) should be subject to minimum suitability standards, in order to ensure a high level of integrity and professionalism in the governance and administration of the scheme and of the investing institution.

Where they lack sufficient expertise to make fully informed decisions and fulfill their responsibilities, the governing bodies of the social security scheme and of the investing institution should seek expert advice or appoint professionals to carry out certain functions. And an auditor, independent of the government, the governing body of the social security scheme, the entity administering the social security scheme and the investing institution, should be appointed by the government or the governing body of the social security scheme to carry out annual audits of the social security scheme. The auditor should be free from political interference. The appointment of an actuary by the government or the governing body of the social security scheme to carry out periodic actuarial reviews of the scheme whose is free from political interference and also outlined in the guideline .Custody of the assets of the social security schemes can be carried out by the entity administering the scheme, by the investing institution, by a government entity such as the central bank or treasury, or by an independent custodian.

In addition to a governance structure, ISSA provided that there should also be suitable governance mechanisms; social security schemes should have appropriate control, communication and incentive mechanisms that encourage good decision –making, proper and timely execution, transparency and regular review and assessment. In relation to governance mechanisms, in general ISSA requires appropriate systems of control in place, and internal reporting channels between the entity administering the scheme, the governing body, the investing institution, the government and other persons involved.

In addition to the above principles, the governing bodies of the social security scheme and of the investing institutions should disclose relevant information to all parties. And Scheme members, beneficiers and other stake holders should be granted access to prompt statutory redress mechanisms through a body established for this purpose or through the courts.

II. Investment

Investment of social security funds should be made with the view to achieving a reasonable balance between the twin objectives. They are security (the investment should assist the social security scheme to meet its commitments in a cost-effective way) and profitability (the investment should achieve maximum returns, subject to acceptable risk.)

With regard to integrated approach, the investment of the funds of a social security scheme should take into account the financial system under which the scheme operates, and be consistent with its short–medium and long-term financing objectives. In addition to investment objectives and integrated approach the guideline also outline some points about investment policy and strategy.

The investment policy of a social security scheme should be based on prudent–person principles and appropriate qualitative restriction. It should take into account; risk management, diversification and dispersion, matching assets and liabilities, including considerations of duration and maturity, currency matching, and performance measurement and monitoring. In addition to taking consideration these concepts the investment policy and investment strategy should be consistent with the financing objective of the social security scheme and its cash-flow requirements , the investment policy of a social security scheme should be established taking into consideration the economic policies of national financial authorities such as the ministry of finance and or central bank and ,a statement of the investment policy and strategy should be formally articulated by the governing bodies of the social security scheme and of the investing institution and should be publicly available.

No minimum level of investment should be prescribed for any given category of investment, except on exceptional and temporary basis and for compelling prudential reasons. If prudent–person principles are applies to managing the investment of social security funds; they should be set out, with a minimum body of rules, by the governing body of the social security scheme or by the government. The governing body of the social security scheme or of the investing institution should adopt criteria concerning the expertise that is required of investment managers and other advisors on investment policy and strategy and their implementation. The social security scheme should have an appropriate structure to control decisions taken on the basis of the prudent –person principles.

Assets should be valued in accordance with generally accepted accounting principles. And periodic analysis of each asset class and the portfolio as a whole should be carried out to determine nominal, risk-adjusted, and inflation-adjusted (real) rates of return. The analysis of investments should be publicly disclosed.

2.2.2. Investment considerations for different types of pension plans

Since pension funds provide means for individuals to accumulate saving over their working life so as to finance their consumption needs in retirement, national governments have a particular concern about their investment performance and associated risk. "The issue of how pension funds are invested becomes an important issue. In this regard, authorities have a policy concern about the investment performance of pension fund assets, otherwise shortfalls in required retirement income will have to be met by the nation state" (Clark and Hu, 2005).

If investment provides an insufficient rate of return, it could not give guarantee that it will contribute for benefit payment of retires. Investing in low yielding assets, may bring inadequate rates of return. On the other hand, excessive risks may arise notably if assets are poorly diversified. It is therefore the task of the responsible bodies to define the right investment strategy based on the type of the pension plan, since the investment strategy differs based on the type of the plan. For instance, investment risk treated differently in DB and DC plans. According to (Clark and Hu 2005 and Blake 2007a), One of the key differences between these two types of pension plan is the locus of investment risk.

For DB, pension benefits are defined, in that they are always a certain percentage of the employee's final or average salary, regardless of the fund management's performance. In this context, plan sponsors bear the investment risk. In contrast, for DC plans, the investment risk is transferred to the individual employees. Plan sponsors make payments to DC plan participants' accounts by matching employees' contributions. There are technically no fixed liabilities in DC funds, and focus can justifiably be placed on assets.

2.2.2.1. Investment objective and strategies for the plans

With regard to investment objective ,several studies emphasize that ,DC pension fund should in principle required to maximize expected return for a given risk, so as to attain as high as possible replacement ratio at retirement, since returns to members of pension plans backed by such funds may be purely dependent on the market . However, according to Davis (2002) for both DB and DC funds, the portfolio distribution and the corresponding return and risk on the assets seek to match or preferably exceed the growth of average labour earnings.

This will maximise the replacement ratio (pension as a proportion of final earnings) obtainable by purchase of an annuity at retirement financed via an occupational or personal DC fund, and reduce the cost to a company of providing a given pension in a defined benefit plan.

Davis 2002, argues that appropriate investment strategies will depend on the nature of the liabilities, including whether pensions in payment are indexed and the demographic structure of the workforce. Investment strategies will also be influenced by the minimum-funding rules imposed by the authorities which determine the size of surplus assets, as well as accounting conventions affecting the way shortfalls are presented in annual reports. As to the investment strategies for DB plans, (Blake 2007a; Blake and Inkmann 2004, and Blome et al 2007) suggested that a strategy considering both assets and liabilities is more appropriate.

2.2.2.2. Pension Fund Regulation

Beside the use of alternative strategies so as to manage the investment of pension funds, governments, and authorities may put regulation that dictate the funds' investment. As in most cases the investments of pension funds create concern for government. If retirees cannot receive enough income to live, the government has to incur fiscal costs to meet it, although pensioners might not receive the same amount of income as expected from their funds. In consequence, to mitigate the adverse impacts of excessive risk taken by pension plans, governments typically seek to restrict the investment behavior of pension funds.

Beside the government concern for securing the retirements income by regulating the pension fund sector, according to (Davis 2001), Market failure is another reason why the authorities might seek to regulate the pension fund industry. He also suggested that pension regulation has the broad core objective of aiming to ensure that retirement income security for individuals is ensured. Pension fund investment regulation is very wide ranging. However, regulation on portfolio is common in many countries especially the qualitative asset restriction and prudent person rules bring controversial issue for various literatures.

> *A quantitative portfolio regulation is simply a quantitative limit on holdings of a given asset class. Typically, those instruments whose holding is limited are those with high price volatility and/or low liquidity. Meanwhile, a prudent person rule stipulates that investments should be made in such a way that they are considered to be handled "prudently" (as someone would do in the conduct of his or her own affairs) (Davis and Steil 2001).*

According to Davis (2001) ,quantitative regulation of portfolio distributions entail limits on holdings of assets with relatively volatile nominal returns, low liquidity or high credit risk, such as equities, venture capital/unquoted shares and real estate, as well as foreign assets, even if their mean return is relatively high. The aim is to protect beneficiaries against insolvency of operators and investment risks, by ensuring adequate diversification of assets.

2.3. Practices of pension funds investment in some other countries

This part of the literature review is devoted to assess the practices of pension fund investment in other countries, especially focusing on public pension funds as the case under study focuses on Ethiopian public pension funds investment. To determine the difference on how they are dealing with investment issues of their public pension fund, thereby to broaden our understanding of pension fund investment, this part will include the practices of various countries. The included countries are countries that are found on the category of partially funded DB on the list of Palacios and Pallares (2000). However, some of the countries have reformed their system to fully funded DC like Sweden. The reason to see the practices of only those countries found on the category of partially funded DB is that the Ethiopian SSA pension scheme also funded on the same way as those countries and it appears to the same categorization in the work of (Ibid). Being in the same categorization give these countries the same weight for discussing their investment practices, the assessment of the countries practices includes their governance, explicit and implicit laws apply to the investment, portfolio concentration and investment and return.

I. Governance structure

The governing body may be a government ministry, the board of the social security institution or the board of an entity established expressly for the purpose of investing the scheme's funds. In many countries the responsibility of investment management for pension funds passes to either a separate investment committee or board that oversees the overall investment activities of the fund or the main board of trustees serves as an investment committee .The board or the investment committee may be composed of labor unions, employers and the government. Sometimes pensioners are also represented. This makes them "tripartite" by nature. The head of the board or the committee usually appointed by government .For example Tunisia has a commission on investments presided by the minister of social affairs (ISSA, 2003). Not like most cases, in Morocco the investment committee is not made up of administrators or government representatives, but is presided over by the director general and his financial stuff (Ibid) In Japan the Chairman of the investment committee is appointed by the Ministry of Health, Labor, and Welfare (Iglesias and Palacios,2000).

According to World Bank (2003), public pension funds with sound corporate governance protections, independent boards and sources of financing, along with a clear legal mandate to pursue competitive returns may avoid some of the pitfalls associated with pension fund investing. This is one of the reasons why many guidelines emphasis the importance of proper governance for efficient investment of pension funds.

II. Restriction and Mandates

Legal frame work of and /or set of investment principles that restrict the investment choices of pension governing body or board are common in different countries. However, the restriction doesn't go as it was in the first place, it shows amendments. In Korea for example, a law passed in the late 1980s, automatically channeled two thirds of the National Pension Fund to the Ministry of Finance (MOF) in the form of special loans, Iglesiasa and Palacios, (2000). However ,in 2009 Korea's corporate defined benefit pension allowed to invest 30% of max in only listed equity, on government bonds , retail investment funds (30% on equity fund ,40% on balanced fund and no limit on bond fund,) ,private investment funds(max of 50% on equity and balanced fund and no limit on bond fund),and, no limit on bank deposit. But the fund was not allowed totally to invest on real estate and loans.

Mandates and restrictions are not always so explicit; they can also take the form of investment principles or guidelines that steer the portfolio toward social and economic development objectives (Iglesiasa and Palacios, 2000). One of the investment principles of the Ghanaian public pension fund is the need to provide investments, which are development, oriented: ....we live in a developing country and the contributions are the collective savings of the population and these savings should be directed towards improving some basic provision of services that will generate some return as well as benefit the population (Henry DEI, 2001). Loans for students and housing finance are some of common investment examples of social investment.

Although in 1997 Public pension funds in five African countries responded positively when asked if there was a formal link between the government's economic development plan and the use of pension reserves, 2002 ISSA's report that covers eleven French-speaking African countries showed that the relationship between the national development plan and the social security organizations' investment plan is merely incidental.

In addition to the restriction that put asset class restriction explicitly, or direct the investment to social investment, Restrictions and mandates can also be used to force pension funds to lend money to the government. Many countries apply rules that explicitly or implicitly force public pension fund managers to purchase government bonds. In some cases, such as the United States, this is the only investment allowed (Iglesiasa and Palacios, 2000). Before its 2001 reform, the Japanese reserve fund was also largely used to invest and lend money to government agencies for public works in the country.

Impavido (2002) also confirm that governments have often imposed on financial intermediaries explicit social and developmental objectives that undermine their financial viability;

> *When explicit mandates are absent, governments have often relied on their powers of coercion to ensure sufficient demand for their debt to finance public expenditure or demand for other securities to finance well-connected entrepreneurs and public enterprises. Sometimes regulations require commercial banks to meet reserve and liquidity requirements by holding government paper. Other times, and both in developing and in developed countries, commercial banks, insurance companies, pension funds, as well as social security funds are required to invest in government bonds, sometimes in specially issued nonmarketable instruments with substantially below-market yields(* Impavido, 2002).

Unlike many nations, the Canadian legislated requirements draw a sharp distinction between the investment mandate of the Canadian Pension Plan Investment Board (CPPIB) and that of public funds in many other nations (MacNaughton 2001). For example, unlike pension funds in Japan, Korea, and the United States, the CPPIB is only required to make funds available to government if it is decided that a bond portfolio is to be built and the CPPIB has not yet built one. Furthermore, it is not required to make loans to state-owned firms, it is not required to make social investments, and it is not used to implement economic development policy, as occurs in many other nations, including Sweden, Japan, and Iran (Ibid).

Like that of pension funds, public pension fund reserves are also subject for political influence on investment decisions and in particular for investing the fund for macro-stability or developmental goals. As reported by Yermo, J. (2008) for example, in Korea and Japan, the government has in the recent past pressed their respective reserve funds into buying shares to support the stock market at times of financial weakness, such as during the 1997-8 Asian financial crisis.

III. Investment options

Public pension funds that could able to avoid the imposition of government may face underdeveloped financial market to invest the accumulated fund. It seems that this problem is more apparent on countries that do not have well developed capital market and shallow financial sector. As cited by Iglesiasa and Palacios (2000) the countries with the lowest ratios of stock market capitalization and commercial bank credit to Gross Domestic Product (GDP) are found in Sub-Saharan Africa and the poorer parts of the former Soviet Union. The ratio is used to highlight the wide variation in the depth of financial sectors across countries. ISSA in 2002 reported that inadequate outlets for investments, narrow money and /or stock markets, or the paucity of financial instruments were considered as a limitation for investment for French –speaking countries including morocco and Tunisia. However, until recently countries like United States and Canada that their potential of domestic capital markets do provide potential investment outlets for large public pension funds, stick to few assets. Various literatures and theories don't only proof that allowing abroad investment will reduce both systematic and unsystematic risks but provide it as a solution for lack of potential domestic investment outlets.

IV. Asset allocation, and investment performance

Table1and 2, reports broad portfolio allocations for public pension schemes in selected countries. Table 1 shows the portfolio allocation of the funds in 1990s as it is reported in (Iglesiasa and Palacios, 2000).Table 2 shows the some of the same country portfolio allocation after ten years as it is reported in the paper of Blundell-Wignall *et al.* (2008).

By looking the two portfolios, some generalization can be made from the countries practices. As it can be seen from the table 1, some public pension funds hold a conservative portfolio in 1990s invested mainly or solely in fixed income securities or loans to public (Canada, Korea, and Japan), however in recent years the investment policies have rapidly turned towards equities and other asset classes in the higher risk-return spectrum, as it is seen in table 2.Exceptinally, it is the public pension fund of united states that doesn't change its asset allocation. Unlike that of United States public pension fund, after the reforms, which took place in 2001, in Jordan portfolio moved more aggressively into equities, while the share of real estate and of loans and bonds was reduced considerably.

Table 2.1: Publicly-managed pension fund portfolios in 16 countries, 1980s and 1990s

Country	Year	Government bonds	Loans/mortgages/housing bonds	Equities	Real estate /others	Total
Canada	1991	100	0	0	0	100
Japan	1995	63	17	19	0	100
Korea	1997	89	3	3	6	100
Sweden	1996	42	40	0	18	100
USA	1997	100	0	0	0	100
Jordan	1995	52	25	17	6	100
Egypt	1995	100	0	0	0	100
Yemen	1996	100	0	0	0	100
Senegal	1980	93	6	1	0	100
Jamaica	1987	91	9	0	0	100
Costrica	1987	79	15	0	6	100
Morocco	1994	58	32	7	3	100
Philippines	1995	44	38	10	8	100
Tunisia	1990	43	30	0	27	100
Ethiopia	**1996**	**80**	**0**	**0**	**20**	**100**

Source: Palacios and Pallares, 2000

Table 2.2: Publicly-managed pension fund portfolios in 6 countries, 2006/7

Country	Year	Bonds	Equities	Cash	Property	Alternative investment	Other
Canada	2006/7	28.3	57.9	0.1	6.8	6.9	0
Japan	2006/7	62.7	37.3	0.0	-	-	-
Korea	2006/7	83.2	13.7	0.3	-	2.5	0.3
Sweden	2006/7	38.7	53.1	1.1	-	3.8	3.3
USA	2006/7	100.0	-	-	-	-	-
Jordan	2006/7	17.0	63.5	8.1	4.4	2.6	4.3

Source: Blundell-Wignall *et al,* 2008

Regarding pension fund performance, historically, public pension funds were managed poorly in most countries. They were forced to invest in government bonds and housing loans at low nominal interest rates, while investments in foreign assets were prohibited. In countries that suffered from high inflation, real investment returns were negative, while even in countries where nominal interest rates exceeded inflation, the returns on public pension reserves were well below equity market returns and well below the returns achieved by private pension funds (Impavidoa, et al .2008).

For instance in Egypt, the SSIs have accumulated reserves between 30 and 50 percent of GDP over the past two decades. The administered rate of interest was initially fixed at a low level. As a result of high and volatile inflation, the institutions 'earned' a negative real rate of return of minus 11.7 percent between 1981 and 1989 (World Bank1994:128).

During the 1990s, the nominal rate of interest was raised to market levels and, with inflation falling to single digits, the SSIs 'earned' positive annual real rates of return of more than 5 percent (Ibid).

SSI in several Latin American countries in the 1970s and 1980s as well as in sub-Saharan African countries suffered heavy losses in their holdings of government bonds and housing loans, mainly because these instruments paid fixed nominal rates of interest at a time when inflation spiraled out of control and they also suffered from high levels of non-repayment (World Bank 1994, Iglesias and Palacios 2000).

As reported by Impivado *et.al*, (2008) the past record of the investment performance of public sector pension funds ranged from mediocre to disastrous and was far poorer than the record of private pension funds. Public pension funds that achieved a mediocre level of performance included, among others, the ATP (AllmännaTilläggsPensionen) fund in Sweden for the period before the early 1990s, the Social Security Corporation (SSC) of Jordan, and the National Pensions Fund (NPF) of Mauritius .These funds underperformed financial markets because they invested heavily in marketable government bonds and did not benefit from the higher returns that were available on corporate equities and bonds or foreign assets.

In contrast to these some public pension funds especially in developed countries perform well in recent years. For instance, the public pension funds in Canada, Sweden, Korea and Japan achieve annual nominal return of 12.9, 9.8, 5.39 and 14.3 respectively (Mitchell *et al.*, 2008).

2.4. Overview of pension law in Ethiopia

The pervious Social Security Authority, the current Social Security Agency established with the aim of expanding the country's social security system and reach citizens step by step .According to the social security authority establishment proclamation No. 38/1996, the authority was authorized to invest the social security funds in "profitable and reliable investment activities "and to own property . This proclamation was on effect to recent time, even the authority changed to agency.

According to the current FDRE 2011 public servants' pension proclamation No.714/2011, the social security agency is responsible for administering the pension funds. About utilization of pension funds, the proclamation states that;

> *The pension funds shall be utilized only for effecting payments of benefits stipulated in this proclamation, investments in treasury bonds and other reliable and investments to be specified by directive to be issued by the ministry of finance and economic development and covering the operational expenses of the Agency* (FDRE,2011pp 5947).

2.5. Empirical research on pension fund investment

Many studies that have been done on pension fund investment especially on public pension funds try to show the investment activities of the public pension funds from their governance side. Olivia S. Mitchell (2001) finds that political appointees and ex officio board members tend to dominate decision-making, frequently with many public pension directors chosen to represent the interests of plan participants. Perhaps because of this different governance structure, public pension plans often direct their investments toward "in-state" projects, a practice associated with diminished rates of investment return. He confirms that the DB plans created by state and local governments in USA to provide retirement benefits to teachers, uniformed officers, and other civil servants investments are frequently subject to nonfinancial criteria.

A study by Pinheiro (2004), that focuses on pension funds for government workers in Organization for Economic Cooperation and Development (OECD) countries resemble the findings of Mitchell. In particular, the study finds that, Civil servants' pension funds are more vulnerable to investment mismanagement risks. They are often required to, directly or indirectly, finance infrastructure, social projects or allocate resources on investments not necessarily linked to retirement income objectives.

Some empirical evidence for the US shows that public pension funds that had been required to make a certain portion of in-state investments generated lower investment returns compared with other funds these studies demonstrate that pension funds investment are especially public pension funds are not invested in accordance to financial criteria .

To shed some light on this issue, Iglesias and Palacios (2000), found that countries with poor governance experience achieved low return on their investment return. They have used twenty developed and developing countries public pension fund as a sample and for many of these countries, investment returns of public pension funds are often below bank deposit rates and almost always below the growth of per capita income. They also found that publicly-managed funds almost always face serious political obstacles that hamper their ability to invest effectively. Their asset allocation is systematically biased toward targeted investments and lending to government at low yields. As a result, returns are much lower than those found in privately-managed funds and mostly lower than bank deposit rates.

Evidences that attach governance and pension fund investment also found on the works of Ambachtseer (2001), Iglesias and Palacios (2000), Mitchell and Hsin (1997), and Useem and Mitchell (2000), although some of them focuses on private pension funds, for instance Ambachtseer (2001).

Other paper on this area focuses particularly on some countries practices in general with respect to some benchmarks. In his paper Yermo, J. (2008), discuss main aspects of the governance and investment of Public Pension Reserve Funds in Selected OECD Countries, using the OECD and ISSA Guidelines as reference of good practices. And the researcher concludes that the surveyed funds show relatively high levels of governance and Investment management. Although the paper tries to cover the main issues concerning the governance and investment of the funds, it fails to assess the impact of any identified weaknesses on the fund's operation and in particular on its investment performance. And the analysis was limited to only select OECD countries.

Some theoretical, many empirical literatures also try to see the investment of pension fund in light of investment regulation. Some even base their analysis on regulation that limits the investment of pension funds other than government securities. For instance papers done in another countries and on the same cases proof that restriction, especially those restriction that forces the pension fund to be invest on government bonds and other fixed income government securities in large amount doesn't encourage the fund accumulation and lead to low return on investment, but penalize pensioners, because it impede the potential of the fund to diversify.

A study conducted by a Goldman Sachs (1995) for the period 1985 to 1994 to see the impact of over –investment(i.e. about 90% of the total asset) of the Malaysian provident fund on Malaysian Government Securities (MGS) during the 1980s and 1990s showed that if the proportion invested in MGS had been reduced to 75% and that in equities and properties had been raised to 10% and 5%, then the average returns on this more diversified portfolio would have been some 15% higher with a corresponding reduction in risk of about 12%. A more balanced portfolio with 50% in MGS, 25% in equities, 10% in cash and 15% in properties would have increased returns by about 35% and lowered risk by 10%, as compared to the Malaysian provident fund's historical portfolio with 90% invested in MGS and 10% in cash.

Using data on china from1993 to 2004/06, Hu *et al.* (2007) shows that there would be better investment performance if china pension fund with pillar one were allowed to include other assets other than government bonds and deposit loan that constitute 50 -50 % of the total portfolio . They conclude that current Chinese pension fund investment regulations should consider removing lower limits on government bonds and bank deposits ,Allowing investment in more asset classes (e.g. shares and real estate) and Gradually allowing for pension assets to be invested abroad in order to strengthen the system.

Various studies show that setting a quantitative restriction whether on international diversification or domestic diversification doesn't bring the desired optimal risk/return trade –off. Therefore, going to more liberized form of investment regulation should result in higher portfolio return. The studies proof that moving to less restricting rules reduce the risk of portfolio by leading to optimal risk –return trade off. Hu, *et al.* (2007) look how keeping a large amount fund on government securities increase risk, basing their empirical analysis on Pillar one B that is only allowed to be invested in Bank deposits and Government bonds that is a state pensions and with the aim of providing pensioners with the basic needs.

Most of the literature on restriction of pension fund investment focuses on a one type of qualitative restriction that is international investment restriction. This kind of argument found on the studies of Davis (1995, 2001, 2002b, 2002c), Hu (2008), and Oxera (2007).

On the role of financial structure in influencing the investment of pension funds there are also some country specific evidences. For instance, Studart (2000) present the case for brazil, he found that, at least five aspects of the Brazilian macro economy and the functioning of its financial markets has to do with a minor role played by pension funds as providers of long-term funds to productive investors and directing most of their resources to the financing of public debt and the acquisition of real assets, such as real state. They are:

- High inflation and macroeconomic instability, which led to highly uncertain financial environment and to short-termist behavior of most financially surplus units in the country;

- High levels of public debt financed by issuance of highly remunerated government bonds;
- The existence of relatively easy access (for large companies) to long-term, subsidized credit from public institutions;
- Too much volatility of asset prices both in the short and medium run, which makes institutional investors reluctant to invest, and
- The lack of appropriate regulatory arrangements and institutions to stimulate the direct acquisition of corporate securities by pension funds, or to channel their savings towards the financing of productive investment.

According to Thillainathan (2000), the investment performance of the Malaysia's Employees Provident Fund (EPF) is seriously constrained by financial markets that are under-developed in addition to the nature of the provident fund scheme, and the regulations imposed upon it. One of their key conclusions is that pension reform *perse* can drive capital market development only up to a point. Pension reform also requires a reform of capital markets.

On their paper Barbone and Sanchez B (1999), presets that the problems with the management of pension reserve funds in sub-Saharan Africa do not arise exclusively from bad governance. It has also been the case that over the last decades investment opportunities have been very limited. It appears, in fact, that investment returns in the sub-continent have been low if not negative over the last decades. The profitability crisis and the crisis of the financial sector have not been any less dramatic than the social security crisis. The result has been a loss of credibility in both the public and private sectors.

In order to see the asset allocation of pension funds, various empirical studies have been formulated, however many surveys on the pension fund asset allocation have been carried out in the developed counties, especially in USA and UK markets (Blake et al. 1998).

Blake et al. (1998) report asset allocation and performance of more than 300 UK pension funds. They find that the allocation practices of funds have remained rather steady from 1986 to 1994.Notable observation is the high allocation to equities (78 percent) with only 14 percent in fixed income. Since, the study focuses on the performance rather than asset allocation; it is difficult to state why U.K. pension funds prefer to invest more in equities than us pension funds. Looking for the U.K financial sector in general and the equity market in particular at the same period may give answer for this question.

For both U.S. private defined benefit and defined contribution plans Bodie, (1988), reports some data on the asset allocations. The main findings for the defined benefits plans are that larger single employer plans hold about 60 percent in fixed income securities and 20 percent in equities; and smaller single employers invest 50 percent and 20 percent, respectively. However, the study fails to address public pension plans.

Although the above studies present the asset allocation of some UK and USA pension funds, they do not provide the factors that affect the strategic asset allocation of the pension funds.

Alestalo and Puttonen (2005) , conducted their study using data on the Finnish B-pension funds (both corporate and industry-wide). Thus, the focus is on the pension funds of the income-related defined benefit scheme. They found that the liability structure of a pension fund, and the nature of the Finnish pension system, which is a mix of pay-as-you-go and pre-funded systems affects its asset allocation. However, the result doesn't show clearly which allocation is explain by the factors, since the allocations of Finnish pension funds are highly dispersed. One fund holds its entire portfolio in fixed income securities whereas other funds have none, or only a minute portion of fixed income holdings. Also equity investments vary a lot, ranging from 0 percent to over 70 percent of the asset allocation.

Outside developed countries, Fahd (2010) conducted a study on asset allocation for government pension funds in Pakistan. By using a Mean variance model, the study shows that the portfolio is balanced with stocks' share of 51% and aggregate bonds and bills' share of 47%. In addition he argues that pension fund assets should neither be invested to retire the government debts of provincial governments nor to bolster the stock exchanges in times of economic crises.

2.6. Studies on pension fund investment in Ethiopia

So far, in Ethiopia, much attention has not been diverted in investigating the practices and challenges of pension funds investment. Although, unpublished Gebrehiwot (2003), conducted a study on investment outlets for SSA pension funds. In the same paper he raised a concern on the low return of the assets after calculating the real return of portfolio for the period 1991E.C.-1998E.C.He has argued that the averaged -1.41% real return was mainly due to the very low returns on the Treasury bills and Government bonds that constitute two third of the portfolio. Despite his effort to present the absence of securities markets, particularly the absence of a wide range of alternative financial assets of long maturity to invest as the reason for the limiting of SSA pension fund to low return funds, the researcher doesn't go deeply in investigating the other underlying justification. On the same paper the researcher provides possible domestic alternative investment assets including stocks as investment outlets for SSA pension fund.

A study conducted by Tarekegne (2004) in Social Security Authority (SSA) on managing pension funds revealed that the scheme had been investing only on government securities and banks (government banks) which are less risky and have low return. However, he noted that the investment of the authority limited to governmental tools because of the absences of pension fund investment policy designed by SSA and results in inefficient fund management. His study also revealed that it is the government appointee in the board that decides on investment issue of the authority.

Mulualem (2002) studied the accounting and management of pension funds of Social Security Authority .In his finding he discovered that although the authority established as an autonomous public office allowed by proclamation 38/1996 to invest its resources in profitable and reliable investment activities, he found that the authority have been investing its resources in relatively less risky investment namely Government bonds and Treasury bills as well as Fixed time deposit hence earning low return.

CHAPTER THREE

Research Methodology

This chapter addresses the research design, data collection methods, and methods of data analysis.

3.1. Research methods, materials and procedures

3.1.1. Research design

A descriptive research design was used to portray the existing practices and eventually determine the challenges that constraint the investment of pension funds in SSA. This in turn helped to come out with the prevailing facts. Mixed approach (qualitative and quantitative) was used in data analysis. Collection of data at a single point in time necessitated the study to take cross sectional research design, as it was not essential to see any significant change in a data by differing the time of data collection.

3.1.2. Procedures

After the problem defined, initial facts and data on prevailing practices were collected to show the extent of the problem. Important data were collected using interview questions and secondary documents that are related to SSA pension funds investment. All facts, opinions and evidences that were collected, analyzed after they organized to come out with relevant information.

3.2. Types and Method of data collection

To enhance the quality of data multiple data sources were employed for the study: primary and secondary data. Both qualitative and quantitative data were used in the study. The qualitative and quantitative data were collected through interview and from secondary data sources respectively.

3.2.1. Primary data

Since the study focuses on assessing the practices and challenges of pension funds investment of SSA, and the target population which directly related to the subject under study are small in numbers and hence do not satisfy the statistical sampling procedure, it is hardly possible to select sample population that pertains to the issue. Therefore the study aimed at focusing on the key informants who have been in a direct contact with a pension fund investment activities at SSA formerly and currently; more specifically the Investment and Fund management directorate employees at SSA and the directorate director. Thus, the interviewees were selected intentionally by the researcher considering their relation to the subject under study. The interviewees include those who had served or being giving services as director, vice-director, chief accountant, senior project analysts, and team leader in SSA investment and fund management department.

Structure of the interview

In this study, key informant interview was used to collect the primary data as a result of the nature of the study and the number of the study population. To analyze the practices and challenges of pension fund, an interview was found to be the best method to collect the needed data for the study. In addition, the numbers of sample population were seven; as a result, interviewing them was preferable. A semi-structured interview was conducted with each of the key informants to acquire the necessary information for the study. A semi-structured interview is an interview in which the orders of various topics are dealt with and the wordings of the questions are left to the interviewer's discretion (Corbetta, 2003). This enables the researcher to have control over the topics and the format of the interview also to pose necessary questions to garner the necessary information.

3.2.2. Secondary data

Mainly agency's report on pension fund investment activities and stastical abstracts were used as a secondary data and analyzed accordingly

3.3. Data analysis

For the study, quantitative and qualitative methods of data analysis were used. After the data collected, it was coded and entered in to Statistical Package for Social Science version 19 (SPSS) for analysis. Percentages, frequencies and mean were used to summarize and categorize the collected data. In addition, questions such as 'yes' or 'no', which contain fact information, were analyzed qualitatively in a way that answers the research question.

CHAPTER FOUR

Data Analysis and Presentation

In this part of the study, respondent's characteristics, pension as part of social security in Ethiopia, SSA's general principles on pension fund investment, sources of finance, trends of pension contribution, benefit payments, and growth prospect of the SSA discussed accordingly.

4.1. Characteristics of the respondents

A total of seven key informants were personally contacted and interviewed by the researcher. All of the interviewees have been /is working on positions related to pension funds investment of the agency and have the relevant information.Table4.1, presents the characteristics of these interviewees in terms of their sex, education qualifications, position and years of service in the SSA.

Table4.1: The Characteristics of Respondents

Variables	Frequency	Percentage
Sex (%)		
Female	2	28.60
Male	5	71.40
Total	**7**	**100**
Education Qualification (%)		
Ph.D.	-	-
MA/MSc	2	28.60
BA/BSc	5	71.40
Diploma	-	-
Total	**7**	**100**

Former /Current /Position (%)		
Director	3	42.90
Senior project analysis /senior lecturer	1	14.30
Senior accountant	2	28.50
Team leader /Head of department	1	14.30
Total	7	**100**
Years of Service		
< 10 years	-	-
10-20 years	3	42.90
20-30 years	2	28.60
> 30years	2	28.60
Total	7	**100**

Source: Own Survey data, 2012.

About 28.6 % of the respondents were women and the rest 71.4% of them are male (Table 4.1). It is apparent from table 4.1.that the majorities of the respondents 5(71.43%) hold a BA/BSc degree, the remaining 2(28.57%) respondents were found to be on MA/MSc level of education. The same table shows that three out of the total interviewees 3(42.9%) is currently a director, whose one of them is now an investment and fund management directorate director at SSA, the rest two had been an investment and planning head and vice president at SSA sometimes before and now directorate director and vice director at investment and fund management position of Private Organization Employees Social Security Agency (POESSA). One (14.3%) had been a pension fund investment office head and senior project analysis at SSA some years back and currently senior lecturer and head of Economics department at Unity University, another two (28.5) currently a senior accountant of fund management team at SSA, and one (14.3%) had been a team leader of SSA investment committee sometimes before and now head of the department at POESSA .With regard to years of services more of the respondents (42.9%) served between ten and twenty years, followed by 2(28.6 %) respondents that served between twenty and thirty years and (28.6%) of them also serve more than thirty years. This indicates that almost all interviewees in one way or another have connection with pension funds investment of the Agency. Thus, were important agent in the operations (the investment of SSA pension funds); and hence are expected to be dependable informants by virtue of their roles and ample years of work experience in their respective responsibility area.

4.2. Pension system as part of social security in Ethiopia

For the last fifty years, pension is the existing social security benefit for the public servants in Ethiopia. And more or less the Ethiopian SSA pension plan categorized on PAYGO pension plans as the retirement pensions paid out over a given period are financed from the contributions paid over that same period by those in employment (employees and employers).Based on the benefit the SSA pension plan promises to beneficiaries it is categorized as a defined benefit plan .The Ethiopian pension system is a defined–benefit type where the pension formula is defined in advance (Gebrehiwot, 2007).The contingencies covered are old age, invalidity, survivors (death) and employment injury. Benefits are paid in the form of pension benefit for life, gratuity and reimbursement of pension contribution. The Establishment proclamation No. 495/2006 has given the necessary powers and duties to the SSA to administer the pension schemes, including the collection of contribution and the payments of benefits.

Since July 1998 E.C, the SSA has engaged in managing the collection of contributions and the payment of benefits of all the schemes.

4.2.1. Social Security Agency

Currently, the SSA is accountable to the Ministry of Labour and Social Affairs. SSA administers both Military and Police Service and Civil service Pension Funds and it provides entitled beneficiaries with an age, invalid, and survivor's pension and lump sum payments. The agency is also responsible for investing the pension funds that are remaining from benefit payments.

4.3. SSA's General Principles on Pension Fund Investment

Internationally, there are standard investment principles that are expected to be followed by SSI in investing the fund. Safety, yield, liquidity, nation's interest, diversification, and capital preservation are some of the most applied principles. Accordingly, the SSA outlined four general investment principles for its investment purpose. While dealing with investment issue of the agency; the pension fund investment manager is expected to apply/consider the four principles *(1)* ***Safety***- invests with minimum or no risk investment portfolio. The safety principle is lies on the fact that the pension fund is a trust fund and they need to be invested in care and diligence. However, the value interpretation given by agency for safety principles doesn't meet the finance theories that detect there is no risk free investment portfolio. Even risk free assets may not be risk free as long as inflation rate is there, *(2)* ***yield***- allocates the investment in the area where the investment return is maximum.

This principles go with the allocation of the pension fund on investment area that give maximum yield, this in turn demand the involvement of some risk, *(3) **Liquidity***- allocate investment in the area where some of the investment can be converted into cash. Nor does the pension fund require safety concern in its investment, it also require liquidity as soon as it is needed. Pension funds require liquid assets, since they have the liability that is due every time, and *(4) **Harmony with the public interest***- Allocate investment for the best economic and social interest of the public. The investment practices of SSA revealed that investments are made taking aforementioned principles underlining investment of pension funds. However, it was found to give more weight to safety among the others.

4.4. Source of finances, trends of pension contribution and benefit payments, and growth prospect

In SSA the two sources of funds for pension schemes are the regular contribution of employees and employers and the return from investing the excess of cash from pension contributions over benefit payments. Currently, the rate of regular contribution is 18% of the civil servants' pension fund and 25% in the Military and Police Service Pension Fund. The employee's share in both case is 5%, for the first year and then increasing to 6% for the second year, 7% for third year and above while the rest 7% for the first year, 8% in the second year, 9% in third year and 11% for the fourth and above years contributed by the public office in the case of civil service pension fund. The public office in the case of military and police service pension fund contribute 18% for the first year, 20% for the second year, 22%for the third year and 25% for the year four and above .The annual pension contribution, payment, growth of contribution, growth of payout and payment as percentage of contribution of the SSA from the year 1991E.C-2002 E.C is indicated in table 4.2.

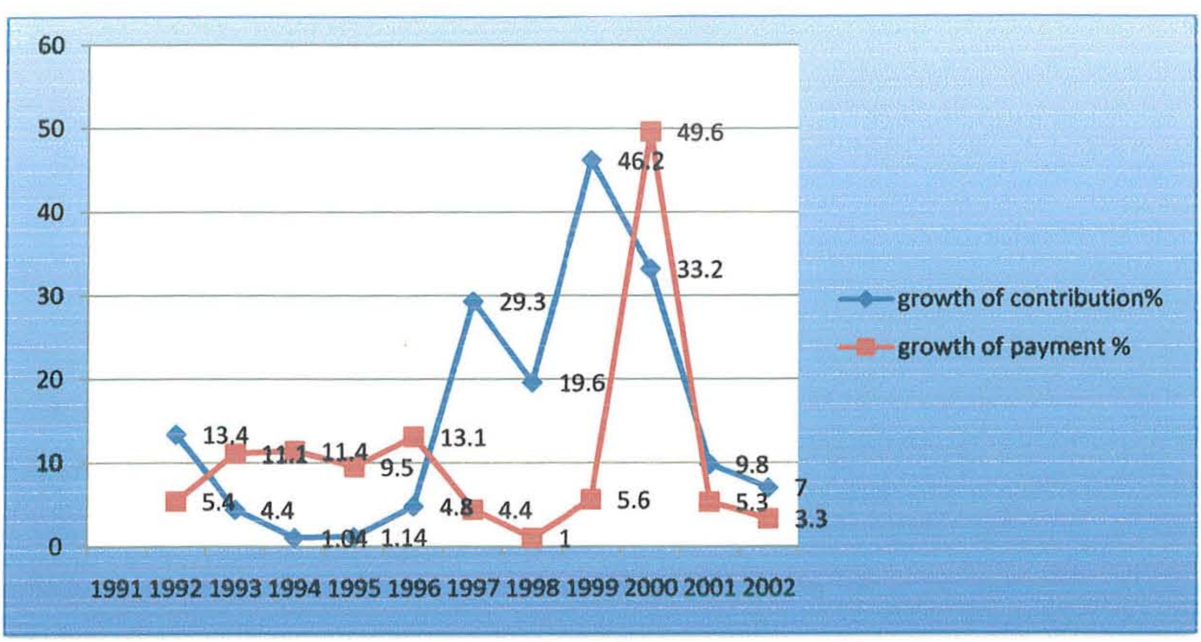
Table4.2: Annual pension contribution and payment trends,1991-2002E.C in million

Year	Contribution (Birr)	Payment (Birr)	Growth of contribution %	Growth of payment %	Payments as % of contribution
1991	458.5	373.6	-	-	81.5
1992	520.1	393.9	13.4	5.4	75.7
1993	544.3	437.5	4.4	11.1	80.4
1994	549.9	488.4	1.04	11.4	88.8
1995	556.3	532.9	1.14	9.5	96.1
1996	583.1	602.9	4.8	13.1	100.9
1997	754.5	630.6	29.3	4.4	94.0
1998	902.7	637.1	19.6	1.0	70.6
1999	1320.2	673	46.2	5.6	51
2000	1759	1007	33.2	49.6	57.2
2001	1932	1061	9.8	5.3	55
2002	2068	1096.9	7.0	3.3	53.04

Source: SSA, 2012.

Based on the data revealed in table 4.2, the contribution and pay out number almost in all years are approximate and even in 1996E.C the payout amount exceed the contribution amount. This kind of coincidence, however, leaves the agency with cash deficit. Even though annual pension contribution growth is increasing, pension payments are also growing much faster such that they are rapidly caching up. In the year 1995E.C, the SSA had an accumulated fund of 556.3 million, which increased to 2.1 billion by the end of 2002 (SSA, 2003). Income shows a 15.4% increase by average, on the other hand, pension payment on average increases by 10.8%. As can be seen from the table 4.2, in all year's payment as a percentage of contribution is more than 50%, which is a real danger which influences sustainability of the accumulated fund. As of 2003 the SSA has 5.5 billion ETB in reserve and investment (Ibid).

Figure 1: growth of payment (%) and growth of contribution (%)



Source: Owen Computation based on SSA Data (2012)

4.5. Analysis and Findings of the Study

The instrument questions prepared by the researcher for the interviewees and their responses are categorized below. Some of the findings and questions which are not convenient to compile in tables could be analyzed without tables. The analysis comprises both the opinion of interviewees and document review. I tried to tabulate the analysis in accordance with the basic questions.

4.5.1. The Current pension fund investment practices of SSA

In this part the amount of fund yearly invested and the types of assets were analyzed as hereunder.

4.5.1.1. The amount of pension fund invested

As the data obtained from the agency shows that, in thirteen years SSA invest a total of 33,583,717,141 ETB, the average pension fund invested from 1991- 2003 E.C is 2,847,116,703.00 ETB per year; with maximum investment of ETB 6,085,335,006.76 in 2000 and a minimum investment of 1,050,000,000.00 in 1991 E.C.

Table.4.3: The amount of pension fund invested (on yearly basis)

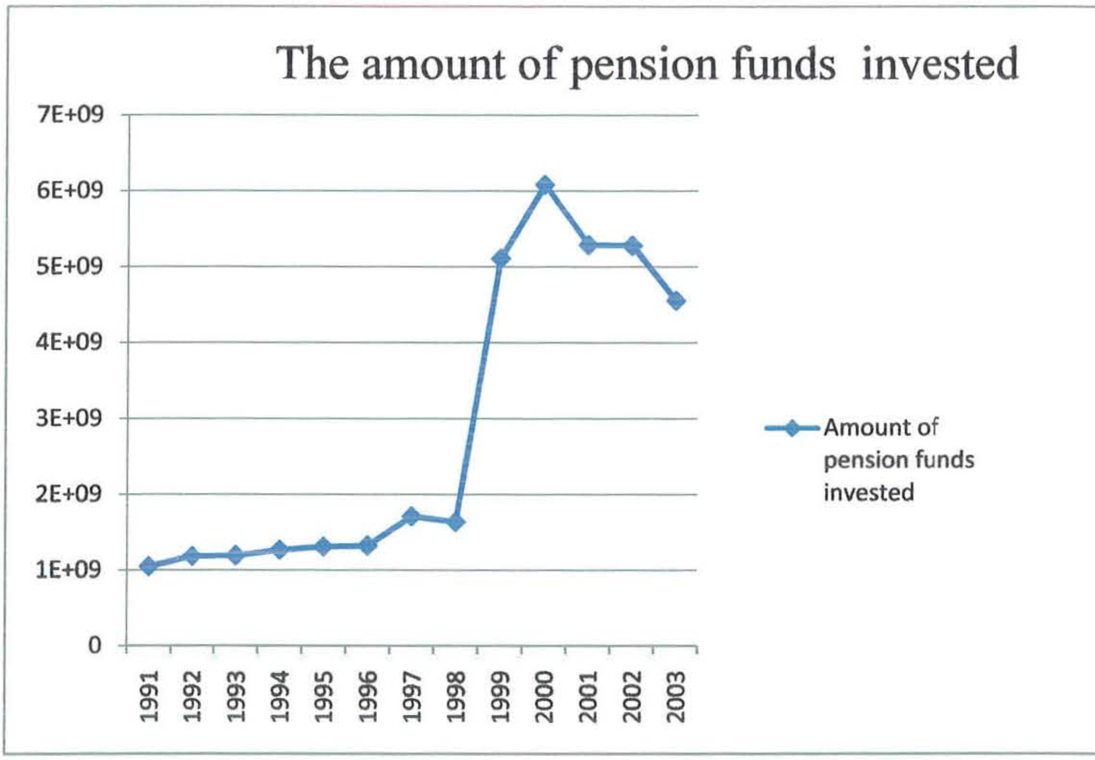
Year	Amount of pension funds invested in ETB
1991	1,050,000,000.00
1992	1,183,800,000.00
1993	1,195,000,000.00
1994	1,267,441,860.00

1995	1,310,763,889.00
1996	1,325,993,298.00
1997	1,711,409,396.00
1998	1,636,690,647.00
1999	5,112,567,943.00
2000	6,085,335,006.76
2001	5,292,068,071.00
2002	5,282,237,993.15
2003	4,559,209,037.00
Total	**33,583,717,141.00**
Mean	**2,847,116,703.00**
Minimum	**1,050,000,000.00**
Max	**6,085,335,007.00**

Source: own calculation from SSA reports

As can be seen from the table 4.3 the agency increased the amount of fund invested every year starting by 1 billion ETB in 1991 reached about 5 billion in 2003, even the agency have invested 6 billion in 2000E.C.

Figure 2: Amount of pension fund invested



Source: Owen Computation based on SSA reports (2012).

As can be observed from both table 4.3 and figure 2, the amount of pension fund investment shows a steady growth for about eight years starting in 1991E.C. Without exceeding two billion ETB, however a tremendous increasing trend is witnessed after 1999 which is a good sign of investment practice.

4.5.1.2. Types of assets in SSA portfolios

Table 4.4, shows all types of financial assets that have been included in SSA's portfolios from the year 1991-2003 E.C. including their percentage share in each year SSA portfolios.

Table 4.4: Composition of Assets in the Portfolio (1991E.C- 2003E.C)

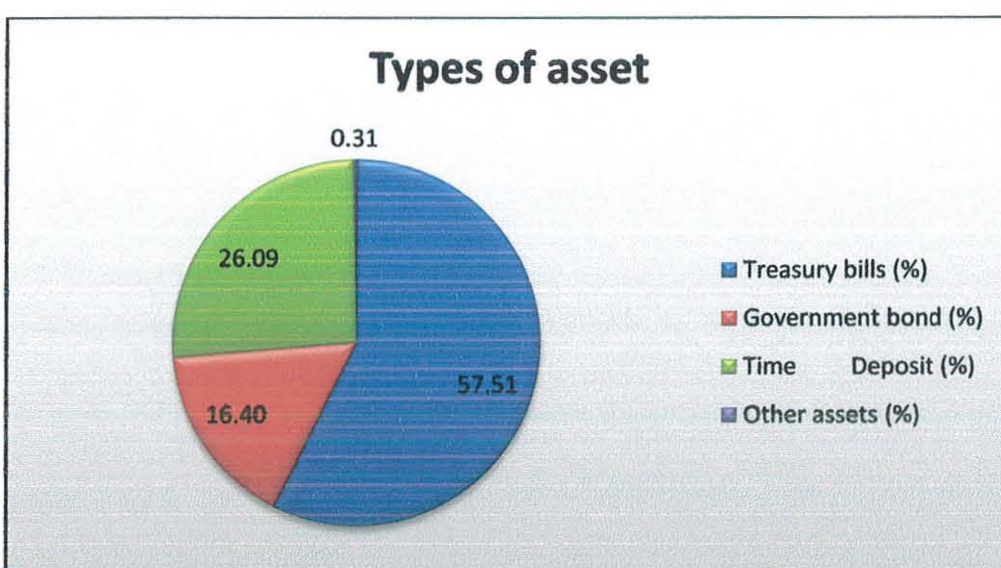
	Types of asset				
Year	Treasury bills (%)	Government bond (%)	Time Deposit (%)	Other assets (%)	Total
1991	19.70	36.40	43.90	0.39	**100**
1992	31.60	31.90	36.50	0.35	**100**
1993	33.40	29.90	36.70	0.34	**100**
1994	35.40	25.80	38.80	0.32	**100**
1995	41.94	23.04	35.02	-	**100**
1996	43.36	20.89	35.75	0.16	**100**
1997	59.00	14.60	26.40	-	**100**
1998	58.50	13.70	27.80	-	**100**
1999	84.00	4.02	11.98	-	**100**
2000	84.93	4.89	10.18		**100**
2001	83.85	2.87	13.28	-	**100**
2002	85.00	3.00	12.00	-	**100**
2003	87.00	2.20	10.80	-	**100**
Average	**57.51**	**16.40**	**26.09**	**0.31**	**100**

Source: Gebrehiwot , 2007.(From 1991-1998)

SSA, 2012. (From 1999-2003)

As can be seen from table 4.4, Treasury bill, Government bond and Time deposit are the major types of investment assets. Although, there were some attempt to invest on Shares and Loans, they account only a small percentage and it doesn't show continues trend. The investment on Treasury bills shows an increasing trend, currently, the agency's investment portfolio is basically composed of only three types of financial assets, namely Government bonds, Treasury bills and Time deposits ,all of which are non- marketable and short – dated assets .More recently agency completely diverted to Treasury bills: In 2003 E.C., for example Treasury bills account for 87% of the total portfolio shares which is a huge percentage .This has an implication that safety is given more concern than the rest of the pension fund investment principle yet undermine the possible income that the same will have had it been putted in other possible mixes of assets. The following figure shows the average percentage of each asset in total investment portfolio of SSA from the year 1991E.C. to 2003E.C.

Figure-3: Average percentage of assets mix in total investment portfolio 1991-2003



Source: Owen Computation based on Gebrehiwot (2007) and SSA, (2012) Data

The pie-chart clearly shows that the majority in the asset mix are Treasury bills. On average Treasury bills constitute about 57% of share on thirteen years portfolios, which is more than half of the share next to Treasury bills, Time deposit accounts for 26 percent, followed by government bond (i.e. 16 percent) and other assets account only 0.31 percent. It is clear that in thirteen years of investment period the portfolios of SSA are dominated by Treasury bills, despite its poor return.

4.5.2. The governance of pension fund investment in SSA

Table 4.5, revealed that the majority of the interviewees six (85.7 %) agree with the necessity of setting a tripartite representation on the agency's board of management regarding the pension fund investment, while only one (14.3%) indicated that they had no opinion concerning the necessity of tripartite representation in the board of management of pension fund investment. This shows that a more than half of the key informants think that it is necessary to apply a tripartite representation on the agency's board of management regarding the pension fund investment. The majority of the interviewees who agree with the statement support their position in that investment decisions ,policies and strategies that are only in line with the government interests and that ignore the benefit of pensioners and contributors have been passed for years because the all the members of the board of management are usually government appointee officials .The interviewees additionally argued that had there been a government, workers, and employer if possible pensioners representation in the board, it would have been a chance to confront and to decrease a certain percent of influence. In addition, other stakeholders other than government could have a chance to know how the funds invested and its impact over their benefit. In a number of countries, it is now standard practice to have the law provide for tripartite representation on the board of management. Even where this is not a legal requirement, the practice nonetheless favors tribalism. The case in point is that of SSA where neither the law require a tripartite board nor is in practice the case.

Table 4.5: The necessity of tripartite representation and investment committee

Item	Interviewees		Remark
	No.	%	
a) It is necessary to have a tripartite representation in the board of management of SSA regarding pension funds investment.			
Agree	6	85.70	
Disagree	-	-	
No opinion	1	14.30	
Total	7	**100**	
b) It is necessary to have a separate investment committee in SSA regarding pension funds investment.			
Agree	6	85.70	
Disagree	-	-	
No opinion	1	14.30	
Total	7	**100.00**	

Source: own survey, 2012.

In item' b' of table 4.5, it is shown that 6(85.7) of the interviewees agree with necessity of investment committee. The majority of the interviewees were aware of the fact that the agency need a separate investment committee that charged exclusively with the responsibility of pension funds investment and related decisions, since currently the agency has no investment committee. Beside overseeing the investment of pension funds investment ,the main board of management serves as an investment committee and the agency's Investment and Fund management division follow up everyday's investment activities like taking part on Treasury bills. The majority of individuals who declared the necessity of a separate investment committee justified their position in that there should be an investment committee exclusively responsible for developing investment policy and investment strategy.

4.5.3. Investment policy and guidelines

As per the data that gathered from the interview question revealed there is an investment guidelines that give description/guide on the way how the fund should be invested, however the agency has no investment policy. The current directorate director of Investment and Fund management also firmly confirmed that is an investment guideline that was approved by the board of management in 2000 E.C, but no investment policy.

Table 4.6: Investment policy, and guideline

Item	Interviewees		Remark
	No	%	
a) The existing policy, guidelines policies) about pension fund investment are detailed and exhaustive.			
Agree	-	-	
Disagree	5	71.40	
No opinion	2	28.60	
Total	7	**100**	
b) The investment of the fund is according to the existing guidelines /policies.			
Agree	-	-	
Disagree	6	85.70	
No opinion	1	14.30	
Total	7	**100**	

Source: own survey, 2012.

The majority of the respondents (71.4%) disagreed that the existing guidelines about pension fund investment are detailed and exhaustive while only two (28.6%) of the respondents denied their opinion on the issue. The majority of the respondents who claimed that the existing investment guideline are not detailed and exhaustive argue that the investment guideline could not go beyond generally expressing the asset allocation strategy of the agency and some general principles about investment .They also argue that although the guideline outline asset allocation strategy/portfolio mix that would be followed by SSA in its investment and specify the investment principles that are required to be followed by the agency, it does not consider other investment issues like governance structure ,governance mechanisms , investment management ,performance measurement ,benchmarks and others.

In item 'b' of the same table large percent of the respondents (85.7%) confirmed that the fund is not invested in accordance to the investment guideline. While only one (14.3%) of respondent has no opinion on the issue. A large percent of respondents who claimed that the pension fund is not invested according to the existing investment guideline asserted that as soon as the first approval of the guideline by the board of management, there were some attempt by the agency to invest the funds in areas that were identified by the guideline, for instance in real estate and shares however all the attempt couldn't go far away as the activities soon stopped because of the imposition from MOFED as to divert the fund into purchasing Treasury bill. The respondents even added that currently the agency doesn't consider the established guideline for its investment activities rather guided by the recent proclamation and invest almost all amount of the fund in Treasury bills. The same things is identified when secondary data was reviewed, although the agency established an asset allocation strategy on its investment guideline (see the table below), currently the agency is not investing accordingly even a more apparent example how the guideline is not followed by the agency is the percentage of Treasury bills account in effect greater by a 67.47% of the amount specified on the guideline, no investment so far undertaken on Demand deposit and Saving deposit. The investment made on Government Bond, Corporate bond & shares and Real Estate is also insignificant as compared to the percentage given in the guideline.

Table 4.7: Investment Portfolio Mix/Asset Allocation by SSA as it was outlined on guideline and current allocation

Type of Investment	Percentage asset allocation strategy provided on the guideline	Percentage of current asset allocation
Short term		
Demand Deposit	2.00	-
Saving Deposit	8.00	-
Fixed time Deposit	35.00	14.50
Treasury Bill	15.00	82.47
Sub total	**60**	**96.97**
long term		
Government Bond	5.00	2.80
Corporate bond & shares	25,00	0.20
Real Estate	10.00	0.03
Sub-total	**40**	**3.03**
Total	**100**	**100**

Source: SSA, 2003.

4.5.4. Investment considerations

During the interviews, respondents were asked if the agency consider risk return trade off analysis in its investment decisions. 5(71.4%) of the interviewees replied that the agency doesn't consider risk-return trade off analysis in its investment decision while 2 (28.6%) of the interviewees give their response by saying yes for the statement.

The latter group starts its argument by referring to the period where the agency used to evaluate the loan request proposed by different organization. Specifically the loan request made to the agency from different organizations evaluated as to see whether they are beneficial or not. On the other hand the majority of interviewees who declared that the agency doesn't consider risk return trade –off analysis argue that since the agency's investment outlets are known and repeated beside utilizing much of its investment fund on Treasury bills does not leave the agency with a chance to consider risk return trade off analysis in its investment decision. In addition, as this group argues, in addition to the huge amount of the fund investment on Treasury bills, most of the time the time deposit investment is also on secured government banks which leaves it with no alternatives to evaluate other banks offers, and the remaining investment assets is government bond which is not subject to analysis like that of Treasury bills.

Table 4.8: Risks return trade off analysis

Item	Interviewees		Remark
	No	%	
a) SSA consider risk return trade off analysis in its investment decisions			
Yes	2	28.60	
No	5	71.40	
Not sure	-	-	
Total	7	**100**	

Source: own survey, 2012.

As per item 'a" of table 4.9, an overwhelming majority, that is 5 of the interviewees agree with the necessity of including the principle of diversification as one of the agency's investment principles, whereas the remaining two (28.6%) of them had no opinion. The majority of the interviewees support their opinion in that diversification would give the agency a chance to consider various investment alternatives and this in turn help the agency to realize a sufficient return. From the literature review regarding the practices of other countries, the status of the majority of the interviewees could be supported in that the public pension funds of different countries start to diversify their conservative portfolios that had been holding mainly fixed income securities in their portfolios. The majority's status could also be supported by the empirical literatures that show domestic diversification as a general and international diversification brought significance change on risk –return of pension funds.

Table 4.9: Diversification as a general principle

Item	Interviewees		Remark
	No	%	
a) The inclusion of diversification as one of SSA's general principle of investment and its consideration for investment decision is necessary.			
Agree	5	71.4	
Disagree	-	-	
No opinion	2	28.6	
Total	7	**100**	

Source: Own survey, 2012.

4.5.5. Investment return and overall performance

Good enough, all the interviewees have declared that the SSA does not measures performance of its investment activities periodically and disclose to the public. As per respondents, since the agency's investment funds are in assets that are regarded as in risk free government securities, it does not attempt to evaluate each asset class and the portfolio as a whole periodically or to disclose publicly.

ISSA (2003) report also agrees with the majority's interviewee's idea and it reported that the agency doesn't measure the investment operation as all funds are in risk free government securities.

Beside the ISSA social security pension fund investment guidelines that demanded performance analysis of each asset class and the portfolio as a whole should be carried out to determine nominal ,risk adjusted ,and inflation –adjusted (real) rates of return and the analysis of investments should be publicly disclosed, ,the agency fail to evaluate the performance of its investment operation .

Table 4.10: Investment performance

	Interviewees		**Remark**
	No	**%**	
a) SSA earn sufficient yield on invested pension fund			
Agree	2	28.60	
Disagree	5	71.40	
No opinion	-	-	
Total	**7**	**100.00**	
b) The investment of pension funds so far matches the investment objectives of the agency.			
Agree	-	-	
Disagree	5	71.40	
No opinion	2	28.60	
Total	7	**100**	

Source: Own survey, 2012

As item 'a' of table 4.10 shows, 2(28.6%) of the interviewees agree that the invested pension fund so far give sufficient yield while a large amount of the interviewees i.e., 5(71.4%) argued for insufficient yield on investment .Since the question asks reasons for those of the respondents who disagreed, they had given the reasons that they thought had lead to insufficient yield. About 4 (80%) of the respondents from those who disagreed explain that high portfolios concentration in short term assets which yield low returns is the reason for insufficient yield. And only one (20%) argued that the agency's tendency for prioritizing safety rather than profitability left the agency with insufficient investment yield

Table 4.11: Respondent's reasons for insufficient yield

Reasons	High portfolios concentration in short term assets which yield low returns	agency's tendency for prioritizing safety rather than profitability
No	4	1
%	80.00	20.00

Source: own survey, 2012.

Referring a computed secondary data regarding the performance of SSA portfolios from the year 1991-2003(see table 4.12), the status of the majority of the interviewees could be supported in that the average nominal portfolio return was low even the real return for most of the years were negative.

Table 4.12: Real and nominal portfolio return of SSA 1991E.C-2003E.C

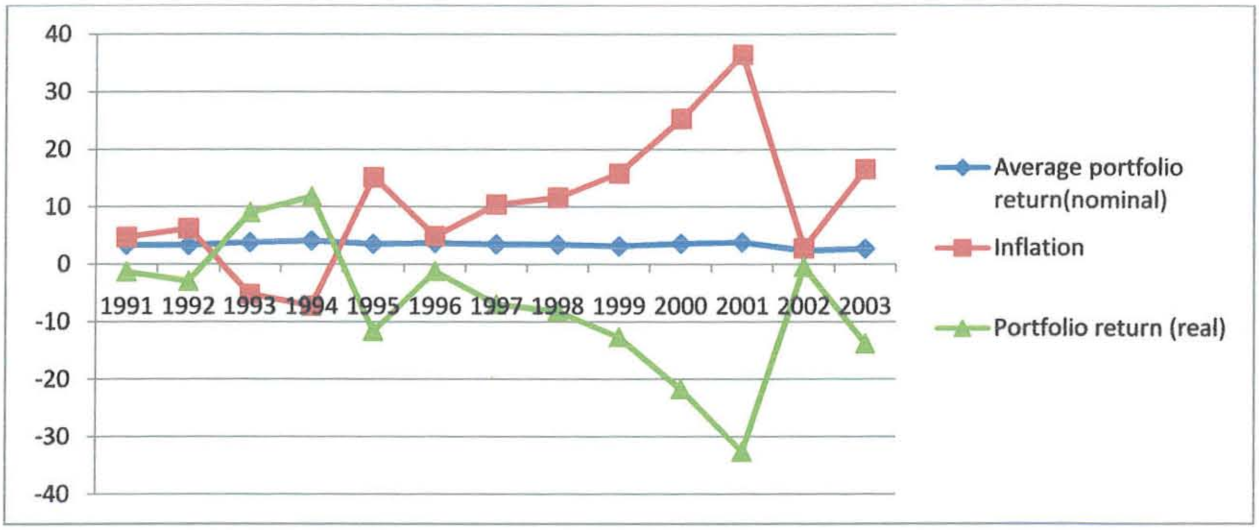
Year	Average portfolio return(nominal)	Inflation	Portfolio return (real)
1991	3.4	4.7	-1.3
1992	3.3	6.2	-2.9
1993	3.8	-5.2	9.0
1994	4.1	-7.2	11.8
1995	3.53	15.1	-11.6
1996	3.71	4.9	-1.2
1997	3.48	10.4	-6.92
1998	3.43	11.6	-8.17
1999	3.16	15.8	-12.64
2000	3.6	25.3	-21.7
2001	3.83	36.4	-32.57
2002	2.37	2.8	-0.43
2003	2.7	16.5	-13.8

Source: 1991-1998, Gebrehiwot, 2007.

1999-2003, own computation based on SSA, 2012 data

Table 4.12 and figure 4 shows that the average nominal portfolios return in thirteen years could not exceed 5%; even the return shows a decreasing trend in the recent years. Regarding the real portfolio return, as shown in the same table and figure, it was almost relatively volatile (due to fluctuating inflation) and was all negative except the year 1993 and 94 E.C which is positive as inflation goes negative in the same year.

Figure 4: Real and nominal portfolio return of SSA 1991E.C-2003E.C



Source: own computation based on Gebrehiwot (2007) and SSA, (2012) Data

The document review and facts also supports the reasons that are given by the respondents for insufficient yield .As can be seen from table 11 the portfolio of SSA is completely dominated by short term assets that yield low return. In thirteen years for example ,Treasury bill on average constitute about 57% of the agency's investment portfolios ,indicating high fund concentration in short term assets which, though liquid ,also yield low returns . And this in turn contributes for overall low return of the agency's investment.

In part 'b' of table 4.10, 5(71.4%) of the interviewees denied that the investment of the fund so far match the investment objectives of the agency, the rest 2 (28.6%) had no opinion on the issue. Those who disagreed with the statement gave their explanation by referring the agency's investment objective. Although the objective of the agency is to sustain the pension fund and to create economic and social capital in order benefit the society ,neither of these objectives are in line of achievement.

They also argue that ,the yearly pension fund investment return in birr is not as such significant in sustaining the funds ,as the investment earning doesn't show a continues and sustainable increasing trend .In meeting the other objective ,which is creating economic and social capital in order to benefit the society ,the strongly argue the current investment status of the agency couldn't reach in creating economic and social capital as it hinders by low coverage of work force in the nation that contribute for low mobilization of fund by the scheme and thereby contribute for low investable funds. They added that, so far the agency hasn't engaged in investment areas that directly create economic and social capital for the society rather stay as captive source of finance for government .

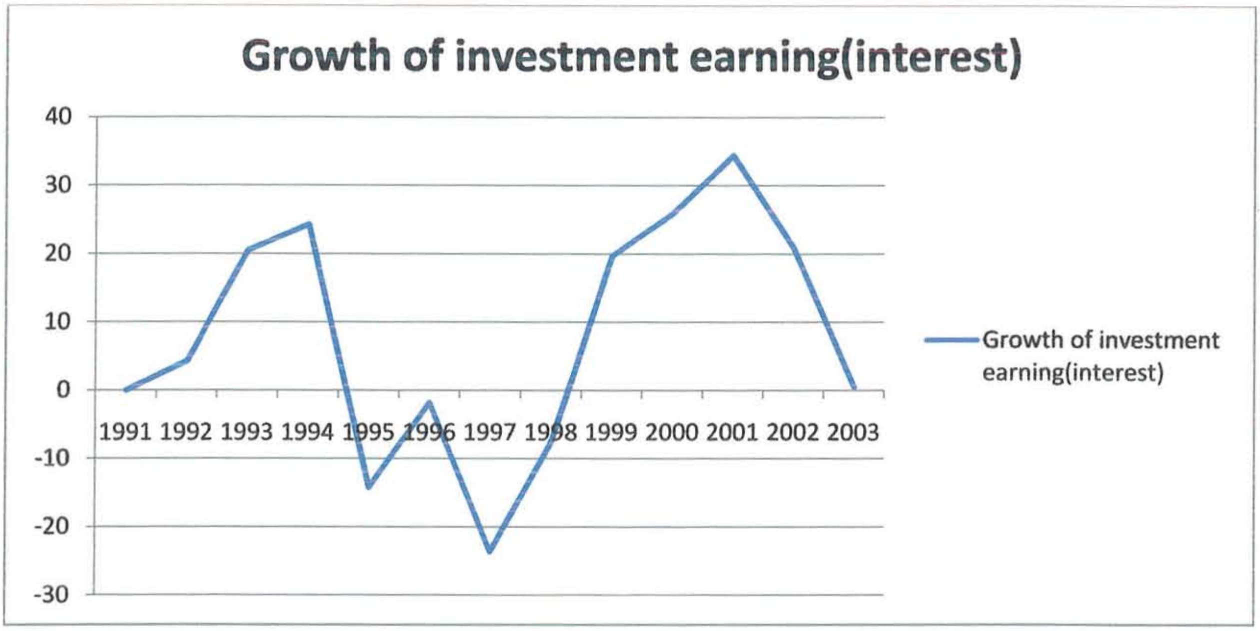
The secondary data review also supports the idea of the majority of the interviewees. As is shown in table 4.13, it can also be observed both from the table and the graph that the interest gained in those thirteen years shows increasing trend for the first four years (1991E.C-1994E.C), then it decreased dramatically until1999 E.C. The investment income shows a trend of increase in the last three years .In the same token, the percentage growth of investment earning shows unstable trends. Such a trend cannot be said optimum for the pension fund investment as per the principle of SSA pension fund investment (refer section 4.3) and thereby to meet objectives of sustaining the fund. Thus, the agency is expected to take measure to foster the proper growth of earning from the pension fund investments.

Table 4.13: Investment earning in ETB and growth of investment earning

Year	Amount of pension funds invested	Investment earning	Growth of investment earning(interest)
1991	1,050.000,000	37,353,262	-
1992	1,183.800.000	38,968,987	4.3
1993	1,195.000.000	46,976,351	20.5
1994	1,267,441,860	58,392,562	24.3
1995	1,310,763,889	50,100,000	-14.2
1996	1,325,993,298	49,201,000	-1.8
1997	1,711,409,396	37,549,000	-23.62
1998	1,636,690,647	34,634,659	-7.7
1999	5,112,567,943	41,156,100	19.7
2000	6,085,335,006.76	52,170,000	25.9
2001	5,292,068,071	70,000,000	34.4
2002	5,282,237,993.15	84,936,088	20.9
2003	4,559,209,037	85,374,750.61	0.51
Total	33,583,717,141		

Source: SSA, 2012.

Figure 5: Growth of investment earning



Source: Own computation based on SSA data (2012)

4.5.6. Financial market and investment outlets

Respondents were asked whether the agency have mandate consider risky assets. From the total of 7 respondents, the majority of the interviewees 6(85.7%) knew that the agency have no mandate to consider risky assets as an investment alternative. Only one (14.3%) of the interviewees was not sure of the issue. Referring to the proclamations and agency's previous practices the opinions of the interviewees who declared that the agency has no mandate to consider risky assets found to be true. Proclamation No. 714/2011, detect the agency to consider only Treasury bills, this in turn shut the chance of the agency to consider risky assets. However, in the previous proclamation that only specify the investment of the fund on reliable and profitable assets. Although ,it is not clear which assets are reliable and profitable ,the agency was also limited to risk free government securities .Even when the mandate to consider risky assets does not clearly restricted in legislation , the agency seems couldn't resist the pressure of MOFED that give guideline to concentrate on risk free assets .One good and apparent example is the agency's investment activities in the year 2000E.C. and 2001E.C.,on these years the agency try to diversify its portfolio by including some assets that are considered as risky like real estate and shares . After project analysis and initial investment on real-estate lands, the agency had to drop real-estate and share investment from its portfolio and stick to treasury bills because of MOFED's pressure on the agency. This shows that currently the agency has no mandate to consider risky assets as it is detected to invest in other areas by the proclamation and other pressures.

Table 4.14: Financial market and investment outlets

Item	**Interviewees**		**Remark**
	No	%	
a) SSA has mandate to consider risky assets as investment alternative			
Yes	6	85.70	
No	-	-	
Not sure	1	14.30	
Total	7	**100.00**	
b) The current financial market development of the nation constraint the diversification potential of the agency.			

Agree	4	57.20	
Disagree	2	28.50	
Not sure	1	14.30	
Total	7	**100**	

Source: own survey, 2012.

As it is shown on table 13, four (57.2%) of the interviewees believed that the current financial market development of the nation constraint the diversification potential of the agency, while two (28.6%) of the interviewees disagree and only one (14.3%) is not sure about the statement. The first group, argue that if there were a more organized financial market specifically securities market, it would be easy for the agency to participate and diversify its portfolio. They added that the agency would not concentrate on short term assets that yield low return, if there were various investment outlets. The other group, on the other hand starts its arguments by mentioning the contribution provided by the financial sector of the nation. As this group argues, the current financial development of the nation has the potential to meet the investment capacity of the agency. They also added that ,the financial sector has the potential for providing assets like time, demand deposits and ,shares ,therefore it's agency's investment strategies and ,government intervention that constraint the diversification potential of the agency's.

Referring to literature review and other countries practices review especially African countries, one notes that a good majority of the interviewees had interesting argument on this issue. It is apparent that many African countries pension funds face shallow financial market and limited investment outlets which pose a real problem of investment. In Ethiopia, shallow financial market and limited investment outlets can be also be the case.

4.5.7. The effect of Investment performance on financial earning of pensioners and employees.

The SSA invests the pension funds aiming to sustain the fund and benefit the society. Behind these determined objectives and the whole idea of investing the fund, there is the interest and benefit of pensioners, contributors, employers and government. To know the effect of investment on financial earning of pensioners and employees, interviewees were asked how the profitability of the agency's investment affects the financial earning on employees of the agency.

Table 4.15: The effect of investment performance on financial earning of employee

	No	%
There is no direct linkage between the investment profitability and financial earning of employees	7	100
There is a direct linkage between the investment profitability and financial earning of employees	-	-
Total	**7**	**100**

Source: own survey, 2012.

According to table4.15, all of the respondents said that the profitability of the agency's investment has no effect on the financial earning of agency's employees. They assure that there is no linkage at all between the employees and investment performance, since the payment of employees is covered by the government budget.

Table 4.16: The effect of investment performance on financial earning of pensioners

	No	%
There is a direct linkage between the investment profitability and financial earning of pensioners	7	100
There is no direct linkage between the investment profitability and financial earning of pensioners	-	-
Total	7	**100**

Source: own survey, 2012.

With regard to the performance of the agency's investment effect on financial earning of pensioners, all of 7(100%) respondents said there is a direct linkage between the investment profitability and financial earning of pensioners .Especially this effect is apparent whenever there is an attempt to amend the benefit payments of pensioners .As the interviewees explained ,like that of inflation ,the living condition of beneficiaries ,reserve amount ,and other factors ,the investment performance and its effect on fund accumulation also reviewed for the purpose of taking decision on pensioners income change. They also added that, although the investment performance considered on decisions that determine the financial earning of the pensioners, there is no written rules that dictate the investment earning increment lead to benefit payment increment.

4.5.8. Challenges faced by the SSA in its pension fund investment activities

As it was revealed from the interview and other sources, there are some challenges that faced SSA in its pension fund investment activities.

Table 4.17: Challenges of pension funds investment

Challenges	No	%
Government intervention	3	42.80
Low market return on assets	1	14.30
Limited investment outlets	1	14.30
Limited expertise	1	14.30
Low understanding about the funds from officials	1	14.30
Total	**7**	**100**

Source: own survey, 2012.

As per table 4.17, 3 (42.8%) of the respondents provide government intervention as a challenge of the agency's investment activities, they argue that government intervention expressed explicitly by the government representatives that dominates the management board, and More specifically the pressure always comes from the MOFED. Its pressure becomes explicit whenever the minster dictates the agency to shape its investment strategy in accordance to the MOFED programs. Especially the intervention is becoming more demanding in a recent time as the Ethiopian inflation become high, MOFED pressure the agency to channel its large amount of fund to purchasing treasury bills.

Another one (14.3%) of the respondents present Low market return from the assets as another challenge for the agency; the agency is currently receiving while only One (14.3%) of the respondent present Limited outlets as another challenge. This respondent argue that since there is no organized financial market and, stock market specifically in Ethiopia, it constraint the potential of the agency in considering assets other than available government securities.

The other one respondent said that Limited expertise in the area poses a problem on the investment activities of the agency.

Low understanding about the fund by officials also present as a challenges by only one of the respondent from the total of 7 respondents.

CHAPTER FIVE

Summary, Conclusion and Recommendations

This chapter devoted to the highlights of the study and conclusion derived from the findings. The chapter ends with recommendations that were made on the basis of the findings.

5.1. Summary

This study was undertaken to assess the practices and challenges of pension funds investment in Ethiopian SSA. In order to answer the research questions both quantitative and qualitative method were applied. Primary and secondary data sources were used to gather the necessary information. The primary data was collected from 7 respondents that have direct contact with pension fund investment activities of the agency. This was supplemented by information from secondary sources like reports. Basic concepts and definition about pension and plans funds, classification of pension plans, and investment consideration for different types of pension plans were stated in the review of the related literature. Practices of pension fund investment in some other countries were briefly discussed in chapter two.

In connection to this attempt were made to assess opinions of those seven respondents whom most of them were part of the agency's pension funds investment decisions. The opinions of these respondents towards the pension fund investment practices and challenges were collected and documents that were related to the issue were also reviewed. As previously reported in the study seven respondents were purposely selected for interview. The gathered data were presented, analyzed and then the following findings were obtained.

As seen in the findings the agency assigns some amount of fund each year for investment purpose. Although the amount of fund shows an increasing trend in recent years after a steady growth for some years, there was no specific formula or way of assigning the fund.

In addition to this, the study findings indicated that the agency had been investing only in Treasury bills, Government bonds and Time deposit. Other assets like shares, real estate and loan had insignificant share in all the investing period of the agency .Treasury bill account for the highest percentage of share on the agency's portfolio followed by Time deposit and Government bond. Currently even Treasury bills account about 87% of the agency's portfolio.

The finding showed the necessity of a tripartite representation on the board of management regarding pension funds investment. It also showed the necessity of a separate investment committee charged exclusively with the responsibility of administering the investment activities.

As seen in the finding, though it is found to be undetail and non exhaustive, it showed the existence of investment guideline that direct how the funds should be invested. Moreover, the investment activities of the agency were not found to be in accordance to the existing guideline, it was also found that there is no investment policy.

The agency doesn't consider risk return trade off analysis in its investment decisions, since most of the agency's investments are predetermined and in repeated area that doesn't require an analysis.

It was found that the agency doesn't measure investment performance and disclose to the public. This practice was found to stand against the ISSA social security fund investment guideline that detect performance analysis of each asset class and the portfolio as a whole should be carried out to determine nominal ,risk adjusted ,and inflation –adjusted (real) rates of return and the analysis of investments should be publicly disclosed.

The finding indicated that the yield on pension fund investment was not sufficient .The figures also revealed that the overall nominal returns and real returns are very low. The finding also showed that a high concentration of the fund on Treasury bill, low market rate of return and agency's prioritization of safety more than profitability are the reasons for insufficient yield on pension funds investment. In addition, the investment of the fund so far doesn't match the investment objectives of the agency.

It was found that the agency has no mandate to consider risky assets as an alternative investment .Explicit and implicit laws and pressure hinder the agency from considering assets with high risk return spectrum like shares and real estate.

The study finding also showed that the current financial market development of the nation constraints the diversification potential of the agency.

Moreover, the study showed that the profitability of the agency's investment has no effect on the financial earning of agency's employees. It assures that there is no linkage at all between the employees and investment performance however has a direct effect on pensioner's financial earning.

5.2. Conclusion

The respondents were assumed to be knowledgeable of the practices and challenges of pension funds investment by SSA .In areas that uses other documents and references; in most cases it revealed the same information with the explanation of the interviewees.

Hence, a major critique of this study is seen in the attainment of unsatisfactory return on pension funds investment because of less diversification and inefficient investment practices due to this confidence cannot be maintained on it in sustaining the fund, and meeting the investment objectives. From this point of view, it would appear that the fund is not utilized as its potential and it would appear less useful for agency, nation and beneficiaries unless and until measures are taken for better investment of the funds.

The literature review on asset allocation reveals that some public pension funds hold a conservative portfolio in 1990s including Ethiopian SSA pension funds invested mainly or solely in fixed income securities or loans to public (Canada, Korea, and Japan). However in recent years the investment policies have rapidly turned towards equities and other asset classes in the higher risk-return spectrum. On the contrary, in the case of Ethiopian SSA the type of assets remained more or less the same and even increase being conservative in its portfolios by concentrating on treasury bills.
Some other countries practices and international guidelines suggest for the representation of stakeholders other than government representatives in the board of management and a separate investment committee .On the contrary ,in Ethiopia, the board of management is

completely dominated by the government representative that are officials and have influence on investment matter of the agency . And there is no investment committee which is exclusively responsible for pension funds investment issues of the Agency.

The Agency has no investment policy, rather developed an investment guideline, however it seems that no care is taken to make guideline more exhaustive and detail. The current investment activities of the agency are not according to the formulated investment guideline, even, since the first setting up of the guideline, it could not possible to say the investment activities performed by the agency approached the investment guideline.

Various studies in the reviewed literatures show that setting a quantitative restriction whether on international diversification or domestic diversification doesn't bring the desired optimal risk/return trade–off. They show also at least taking domestic diversification would shift the risk return efficient frontier. The findings also reveal the necessity of considering diversification as one of the general principles that guide the investment decisions of the agency as diversification helps the agency to consider assets that are long term in nature and generate real returns that are positive and stable over time.

The review of the related literature pointed out that there is a specific guideline set up by ISSA which detect the measurement of performance and disclosure to the public .However SSA doesn't measure performance and disclose the information. In this case, beneficiaries or other stakeholders have no information on pension issues related to pension fund investment.

The literature review prevails that public pension funds in many countries obligated to invest in accordance to non - financial objectives , almost always face serious political obstacles that hamper their ability to invest effectively and their asset allocation is systematically biased toward targeted investments and lending to government at low yields it also specifically pointed out that public pension funds are also subject for political influence on investment decisions and in particular for investing the fund for macro-stability or developmental goals. And because of these and other governance problems many public pension funds record poor performance even in countries that suffered from high inflation, real investment returns were negative. Like that of many public pension funds ,Ethiopian SSA pension funds investment decisions are influenced by government intervention and even the intervention goes back to pressuring the agency to invest the large amount of fund on assets that are aimed for macro-stability like Treasury bills .It can be concluded that the funds remain captive sources of finance for government .As a result the agency have been gaining insufficient yield ,even negative real return where the inflation exceed the nominal return. Low return on government securities exactly contribute for poor performance of the funds.

The SSA have been engaged in investing the funds as to meet its predetermined objectives of sustaining the fund and creating social and economic benefit for the society but the return so far the agency have been gaining is found to be insufficient and the contribution towards meeting the long –term financial obligations of the SSA and society at large remained weak.

In addition various literatures argue that public pension fund face underdeveloped financial market to invest the accumulated fund. And, specifically they stated that the problem is more apparent on countries that do not have well developed capital market and shallow financial sector. Especially, ISSA 2002 also reported that many social security institutions in Africa face inadequate outlets for investments, narrow money and /or stock markets, or the paucity of financial instruments; in this regard the case of Ethiopian SSA of Ethiopia is not a surprise that its investment activities are challenged by limited outlet.

It is noted that the investment profitability of the agency has no direct linkage with the financial earning of the employees but has direct linkage with pensioners, since the financial earning of the employees are dependent on the budget of the nation like most of the nation's civil servant .However, the profitability of the agency's investment has linkage as it is considered in determining the financial earning of pensioners.

5.3. Recommendation

In light of the study findings and the conclusions, the following recommendations are forwarded.

The concentration of short-dated assets in the portfolios of the SSA may largely reflect the absence of a wide set of alternative financial assets of long maturity to invest in. However ,the agency even with existing situation ,may consider investing in private equities ,real assets such as real estate /mortgages ,bonds and equities of a cross-section of business sectors (e.g. financial-bank ,insurance ,Micro Finance Institutions(MFI)-

sector bonds and equities ,etc.),establishment of equipment leasing companies ,and buying sits in Ethiopian commodity exchange .

The agency might consider inclusion of representatives on the board of management regarding pension funds investment other than government representatives especially representatives from workers and employers, if possible pensioners. Having a tripartite representation would help the agency to make its investment decisions fair.

It is forwarded that there should be either an investment policy or the existing investment guideline should be exhaustive and detail so that there would be a clear and directional way of directing the pension fund investment activities.

The SSA as a responsible administrator of the pension funds should consider diversification as one of its general principles to invest the funds as it gives the agency the chance to consider assets with high risk return spectrum.

The SSA should invest according to the existing investment guideline.

It is felt that the responsible party should review the performance of the agency's investment so that it would stand to take measures to increase the current pension fund investment returns.

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Appendix

Interview Questions

Addis Ababa University

School of Business and Public Administration

MBA in Finance Program

This is part of an academic research undertaking that predicts collection of data regarding pension fund investment of Ethiopian social security agency. In order to fulfill the university's (Addis Ababa University) requirement set for awarding of Masters of Degree in Business Administration.

Hence, I am kindly asking you respondents to give me your candid information for these responses will have eminent influence on the output of the research .your responses will only be used for academic purpose and your identity will not be disclosed to anyone anywhere.

Thank you in advance for your cooperation!

Hiwot Amare

INTERVIWE QUESTIONS

1. **General Information**

1.1. sex

- female
- male

1.2. Educational Qualification:

- Ph.D.
- MA/MSc
- BA/BSc
- Diploma

1.3. Former /current status/position

____

1.4. Years of service:

- Less than 10 years
- 10-20 years
- 20-30 years
- Above 30 years

2. Pension fund investment

2.1. A tripartite representation in the board of management of SSA regarding pension funds investment is necessary.

A. Agree B. Disagree C. No opinion

2.2. In SSA pension fund investment, a separate investment committee is necessary.

A. Agree B. Disagree C. Not sure

2.3. Is there any investment guideline that gives guide how the fund should be invested?

A. Yes B. No C. Not sure

2.4. Is there any investment policy?

A. Yes B. No C. Not sure

2.5. The existing policy, guidelines / policies) about pension fund investment are detailed and exhaustive.

A. Agree B. Disagree C. No opinion

2.6. The investment of the fund is according to the existing guidelines /policies.

A. agree B. disagree C. no opinion

2.7. Does the agency consider risk–return trade off analysis in its investment decisions? if no why?____

____

A. Yes B. No C. Not sure

2.8. The inclusion of diversification as one of a general principle of investment and its consideration for investment decision is necessary. If you agree or disagree why?

A. Agree B. Disagree C. No opinion

2.9. Does the agency measure the performance of its investment activities periodically and disclose to the public?

A. yes B. No C. Not sure

2.10. Does the invested fund so far earn a sufficient yield? if you disagree what is the reason?____

A. Agree B. Disagree C. No opinion

2.11. Whether the investment of pension fund so far match the investment objectives of the agency.

A. Agree B. Disagree C. No opinion

2.12. Does the agency have mandate to consider risky assets as an investment alternative?

A. Yes B. No C. Not sure

2.13. The current financial market development of the nation constraint the diversification potential of the agency.

A. Agree B. Disagree C. Not sure

2.14. How does profitability of the Agency's investment affect financial earnings of employees of this agency? What about pensioners?

2.15. What are the challenges that face the agency in its investing activities?