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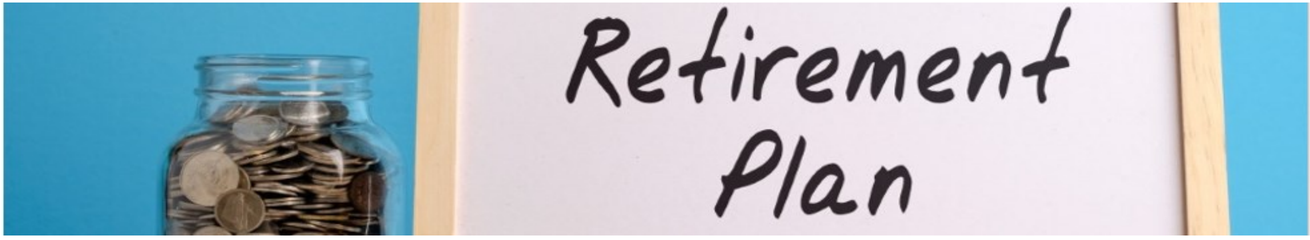

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The Proposed Amendments to the Regulations for Occupational Retirement Benefits Schemes and Umbrella Retirement Benefits Schemes

Introduction

The Cabinet Secretary for the National Treasury and Planning has issued, for public participation and consultation, draft Retirement Benefits (Occupational Retirement Benefits Schemes) (Amendment) Regulations, 2020 (the "Draft ORBS Regulations") and draft Retirement Benefits (Umbrella Retirement Benefits Schemes) (Amendment) Regulations, 2020 (the "Draft URBS Regulations").The regulations seek to amend provisions of the Retirement Benefits (Occupational Retirement Benefits Schemes) Regulations, 2000 and the Retirement Benefits (Umbrella Retirement Benefits Schemes) Regulations, 2017. The changes the Draft Regulations seek to introduce were previously made in 2017 ("the 2017 Amendment Regulations"). However, because of lack of public participation, the High Court declared the 2017 Amendment Regulations unlawful, prompting the legislative process to start afresh.

Definitions

An Occupational Retirement Benefits Scheme ("ORBS") is a scheme provided by an employer, exclusively, to its employees, An Umbrella Retirement Benefits Scheme ("URBS"), on the other hand, caters for multiple unrelated employers. The URBS structure reduces the cost of setting up and maintaining an ORBS for employers while also increasing the overall returns and benefits due to the advantage of pooling of funds. Members of an ORBS or URBS , who leave the sponsoring employer, may withdraw up to 100% of their contributions and 50% of the employer's , defer their benefits, or transfer them to an Individual Pension Plan Scheme ("IPPS") or a scheme sponsored by their new employer. These schemes are in addition to the state pension scheme in Kenya, the National Social Security Fund, whose contributions are required by law.

The proposed changes are analysed based on their impact on members' benefits, governance, and scheme administration.

Members' Benefits

1. Reserve Funds

The Draft ORBS Regulations propose to:

- Limit the size of a reserve fund created by any ORBS to not more than 5% of its total value. This is line with already existing rules relating to IPPS. A reserve fund is made up of investment return made by a Retirement Benefits Scheme ("RBS") that has not been distributed to member accounts. Reserve Funds are used to smooth out the scheme's rate of return, and in Defined Benefits Schemes to secure the guaranteed benefit. This limitation, however, is not proposed to apply to URBS for unclear reasons.
- Empower the Retirements Benefits Authority ("RBA") to require scheme trustees to adjust the levels of a reserve fund. This is also in line with the existing IPPS Rules. The Draft ORBS Regulations do not propose criteria for this or if RBA may require the scheme trustees to adjust the level of a reserve fund to below 5%. We anticipate that RBA will provide reasons for a required adjustment.
- Require an ORBS which maintains a reserve fund to provide for distribution of the reserve fund to exiting members, in its scheme rules. This ensures members get a share of these funds which are derived from investments made from their contributions. The Rules do not propose a formula for this distribution, but we anticipate the formula to be adopted by each ORBS and set out in its rules will balance the interests of remaining members with those of exiting members. In an URBS, the scheme's actuary reviews and certifies the basis of paying the transfer value where the scheme has a reserve fund.

April 06, 2021

2. Access to retirement benefits on early retirement

The Draft ORBS Regulations seek to prevent an exiting employee from accessing any contributions made on their behalf by their employer. Currently, an exiting employee can access 100% of their contribution and up to 50% of their employer's contribution. This change is informed by public policy interest in ensuring that in a country with a low savings rate, employees are not left destitute on retirement.

The Draft URBS Regulations also propose to allow a withdrawing member to either defer their benefits or transfer them to another scheme including an ORBS and IPPS. This change will allow transfers similar to an ORBS.

3. Pay out of retirement benefits

The Draft ORBS Regulations propose to make it compulsory for an ORBS to give retiring beneficiaries the option to receive their benefits by income draw down ("IDD"). Currently, an ORBS may but is not required to provide IDD, as an alternative to the purchase of an annuity. This change only applies to ORBS and it is unclear why the change is not proposed to apply to URBS and IPPS for consistency on pay out options for members on retirement. This change, if passed, is certain to be well received by members of ORBS, who will have more options for accessing their retirement funds.

An IDD allows for regular payments to a beneficiary from their retirement benefits pot which remains invested and may grow or decline depending on the performance of the scheme. Unlike an IDD, an annuity is an insurance contract purchased with the retirement benefits pot, which guarantees the beneficiary regular payments either immediately or at some future time.

Under the Draft URBS Regulations, an URBS which provides for payment of retirement benefits by way of an annuity or IDD will be required to allow its members to select the annuity or IDD provider. However, there is no proposal to make provision of IDD mandatory for an URBS.

4. Special Provisions for URBS

The URBS Regulations also provide for:

- Partial Liquidation where a participating employer ceases to remit members' contributions or commits an act contrary to the scheme rules and the Retirement Benefits Act. Partial liquidation is the transfer of all assets and liabilities of the withdrawing employer to another registered scheme, but without affecting operation of the RBS for continuing members.
- The surplus of an URBS will not be refunded to the sponsor of the URBS but instead:
  - it may be applied as a contribution holiday for the participating employers and members as determined by an actuary, if it is above 10% of the liabilities of the URBS;
  - it may be allocated equally between the members and the employer, if liabilities of the scheme are being transferred to another RBS;
  - a portion proportional to the value of the liability, may be transferred to the transferee scheme in the case of partial transfer of the accrued liabilities of the scheme.
- RBA approval will be necessary to amalgamate URBS. The RBA will be empowered to make such approval conditional. This ensures members' interests are protected by RBA in its supervisory role on behalf of the scheme members.

April 06, 2021

Governance

1. Appointment of administrators

The Draft ORBS Regulations propose to bar a trust corporation from appointing an administrator related to it by way of ownership, employment or directorship. This change is specific to ORBS and aims at increasing accountability in the administration of ORBS. However, we note that the Draft ORBS Regulations do not provide a transitional period for implementation, which if not addressed will be a significant oversight. One of the key concerns raised in the High Court case that annulled the 2017 Amendment Regulations was the disruption this change would bring to existing business models in the pension industry.

This is because there are few, if any, stand-alone corporate trustees offering trustee services for ORBS. This is likely to increase the costs of providing an ORBS to employees, as it eliminates the cost efficiencies of having related entities provide both corporate trustee services and administration services. This change may therefore be difficult to implement in the short term and, will require a sufficient transitional period.

2. Constitution of URBS sponsor

The sponsor of an URBS will be required to have in its board of directors and top management at least four persons with academic or professional qualifications in administration of schemes, law, finance, actuarial science, economics, and a person with at least 5 years' experience in the administration of RBS. This provision is unclear and may lead to misinterpretation because it is not clear whether it applies to the board of directors and the top management individually or collectively. Clarity is also needed on whether the person possessing at least 5 years' experience in administration of RBS may be part of or must be independent to the other four persons proposed.

3. Management Committees and Trustees

For URBS, each participating employer and its employees will be required to nominate a maximum of three members to form a management committee. The management committee will inform the corresponding participating employer and its employees of matters affecting the scheme. This may amount to duplication of the role of trustees in keeping members of an URBS informed of the scheme's activities and investments.

The sponsor of an URBS, opting not to appoint a trust corporation, will be required to appoint nine trustees of the scheme. Five of the trustees are to be nominated by participating employers from amongst the members of the management committees. The remaining four to be nominated by the sponsor should have good professional standing, be approved by RBA, as well as not be related to the sponsor by way of employment, directorship or have a business relationship with it.

This change is likely to be difficult to implement because of the sheer numbers involved. The size of the trustee board should be commensurate with the size or number of the participating employees in an URBS. To address these concerns, the regulations should instead provide a workforce-size based threshold for setting up management committees. In that regard, the size and other matters in relation to the Management Committees will be best addressed if set out in the Special Rules applicable to an employer.

April 06, 2021

Scheme Administration

1. Suitability of the scheme

The Draft URBS Regulations introduce factors that employers need to consider before joining an URBS. These include, among others, whether the scheme has the right professional and technical capacity. These may have better been addressed through a guidance note.

2. Reporting Responsibilities

To promote better governance of URBS, the Draft URBS Regulations propose to empower the auditor of a scheme to audit the controls in place for monitoring receipt of contributions and reporting of late payments in addition to the scheme auditor giving its opinion on the adequacy of those controls in determining unremitted contributions.

Conclusion

The proposed changes are essentially the same as those contained in the 2017 Amendment Regulations. Schemes will have ninety (90) days to comply with the changes, if they are passed in present form. There is some inconsistency as to why some changes that ideally would apply to all form of schemes i.e. IPPS, ORBS and URBS only apply to certain types of schemes. Proper alignment may be necessary to avoid the need to continuously amend the regulations. We will keep you updated on any developments regarding their coming into force and implementation.