REGULATION OF PENSION SCHEMES IN KENYA:

A CASE FOR A PENSIONS GUARANTEE FUND

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G62/88259/2016

A THESIS SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF MASTER OF LAWS (LL.M) OF THE UNIVERSITY OF NAIROBI

2018

SCHOOL OF LAW

THE UNIVERSITY OF NAIROBI
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DECLARATION

I JACKLINE WAKUTHII WARUI, declare that this thesis is my own original work and that it has not been submitted for examination for the award of a degree at any other university. All sources of information have been acknowledged.

SIGNED:

JACKLINE WAKUTHII WARUI …………………………

DATE: …………………………

This thesis has been submitted for examination with my approval as the University Supervisor.

SIGNED:

DR. NJARAMBA GICHUKI …………………………

DATE: …………………………

ACKNOWLEDGEMENT

My deepest gratitude goes to my supervisor, Dr. Njaramba Gichuki, for his profound support, ideas and invaluable guidance during the writing of this thesis. His guidance has made me a better thinker, writer and researcher. I would also like to thank him for affording time for me despite his busy schedule.

I would like to express my utmost gratitude and special thanks to my dear husband Peter Kibe and to my beloved son, Ephraim Kibe, who endured my limited family time and for their encouragement all through the journey of my studies. To my parents and friends for offering prayers and motivation through my LL.M studies which has made completion of my studies possible, may God bless you all.

Above all I give glory to God for granting me sufficient grace to start and complete this thesis. His name be Praised!

DEDICATION

I dedicate this thesis to all state officers, public officers and the legal practitioners and businesses doing work related to pensions and pension schemes in Kenya. I trust that they can use this research to develop ideas on the establishment of a pensions guarantee fund in Kenya in order to promote social security.

LIST OF INTERNATIONAL INSTRUMENTS AND STATUTES

International Conventions

International Labour Organization Convention
Universal Declaration on Human Rights.
The International Labour Organization Social Security (Minimum Standards) Convention
The International Convention on the Elimination of All Forms of Racial Discrimination, Convention on the Rights of the Child,
The Refugee Convention and International Covenant on Economic, Social and Cultural Rights.

National Laws and Regulations

Capital Markets Authority Act
Compensation Rules and Procedures for Investor Compensation Fund
Insolvency Act, 2015
Insurance (Policyholders Compensation Fund) Regulations, 2010
Kenya Deposit Insurance Act
National Social Security Fund Act
Pensions Act, 1950
Retirements Benefits Act, 1997
Retirement Benefits (Deputy president and Designated State Officers) Act
The Constitution of Kenya, 2010
Salaries and Remuneration Commission, Wage Bill Quarterly Bulletin, Volume 1, 2017

Cross-border laws

Employee Retirement Income Security Act, 1971, USA
Law on Improvement of Occupational Pensions, 1974, Germany
Pensions Benefit Act, Ontario
Pensions Act, 2004, UK

LIST OF CASES

Grenville Holden Hampshire v. The Board of the Pension Protection Fund [2016] EWCA Civ 786.

Kenya Plantation and Agricultural Workers' Union v. The Board of Trustees, National Social Security Fund and the Hon. Attorney General, Petition No. 11 of 2014.

LIST OF ABBREVIATIONS

CAJ	Commission on Administrative Justice
CJEU	Court of Justice for European Union
DIF	Deposit Insurance Fund
ICF	Insurance Compensation Fund
KDIC	Kenya Deposit Insurance Corporation
OECD	Organization for Economic Community Development
NSSF	National Social Security Fund
PPF	Pension Protection Fund
RBA	Retirement Benefits Authority

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ABSTRACT

The right to social security is provided for under Article 43 (1) (e) of the Kenyan Constitution. Kenya also has an obligation to ensure enjoyment of this right under the international conventions that it has ratified which now form part of our laws as per article 1 (5) and (6) of the Constitution. The right to social security refers to protection measures or programs which are meant to promote the welfare of the population and protect them against economic and social distress. Among such measures is the protection of pension schemes benefits. Pension schemes benefits assist individuals to continue with their usual life upon death of the breadwinner, incapacitation, loss of employment or after retirement. For this reason, they should be safeguarded against loss in any possible way. Pension schemes face many challenges among them poor administration and investments of pension funds, lack of transparency and accountability, misappropriation of scheme assets by the trustees and loss of scheme funds through negligence of trustees and insolvency. There is thus need to protect them against such risks in order to realize the right to social security. One of the ways in which pension scheme benefits can be protected is by establishing a pensions guarantee fund in Kenya.

This study thus seeks to make a case for establishment of a pensions guarantee fund in Kenya while making proposals on how such a fund can be effectively managed. This study is informed by the life hypothesis cycle which propounds that people plan their spending based on their current income and expected future income. Since they may not have the strength to work more when old, they save up during their youthful days via pension schemes. If these savings are not protected, then the whole purpose of pension schemes will be defeated.

CHAPTER 1

INTRODUCTION

1.1. BACKGROUND

Social security refers to protection measures or programs which are meant to promote the welfare of the population and protect them against economic and social distress. Social security is defined by the International Labour Organization as "the protection provided to individuals as well as households by the society in ensuring health care access and guaranteeing income security especially during old age, times of sickness, work injury, unemployment, loss of bread winner or maternity, and invalidity."[1] Additionally, the right to social security as defined by the UN Human rights of the High Commission, is the right of accessing and maintaining benefits, either in cash or in kind without being subjected to discrimination so as to be protected, *inter alia,* from lack of work-related earnings due to maternity, work-injury, sickness, unemployment, disability, inadequate family support especially for the elderly and children, unaffordable health care, and demise of a family member. " [2]

The right to social security is recognized internationally as a human right. Its origins dates back to the adoption of the Universal Declaration on Human Rights. The Declaration provided that "everyone, as a member of society, has the right to social security and is entitled to realization,

[1] International Labour Organization, 'Facts on Social Security in Africa' <https://www.ilo.org/public/english/protection/socsec/pol/campagne/files/africafactsheet.pdf> accessed 21st July 2018.

[2] UN Human Rights Office of the High Commissioner, 'Toolkit for Social Security' the Economic, Social and Cultural Rights, General Comment 19 < https://www.ohchr.org/EN/Issues/RightSocialSecurity/Pages/SocialSecurity.aspx> accessed 21st July 2018.

through both the nationwide effort and global cooperation and at the same time in line with the resources and organization of every country, of the cultural, social, as well as economic rights that are undeniable for the individual's dignity as well as the free development of the person's personality."[3] Although the Declaration had no force of law, it was and is still given the force of general rules of international law.

The International Labour Organization Social Security (Minimum Standards) Convention recognizes the nine branches of social security: medical care, unemployment benefits, old age benefits, work injury, maternity benefits and survivor's benefits among others. The right to social security is equally recognized by the Convention on the Rights of the Child, The International Convention on the Elimination of all Forms of Racial Discrimination, The Refugee Convention and International Covenant on Economic, Social and Cultural Rights.

In order for social security to have its meaningful impact, it must have the following elements:[4]

i) The social security system should cover individuals for unexpected eventualities and situations in life that impede the earning ability of an individual and ability of that person to maintain a comfortable living standard.
ii) The benefits must be beneficial and accessible to everyone in need of social security without any discriminative practice based on race, immigration or any other thing. Access includes physical access, affordability, right to information and participation.
iii) The various schemes that provide different benefits should ensure adequacy and appropriateness.

[3] UN Declaration on Human Rights, Article 22.
[4] Deogratius Odokel Opolot, 'The Right to Social Security in International Law: A Critical Analysis of Uganda's Compliance with her Obligations' (Master Thesis, Lund University 2007) pp 14-15. http://lup.lub.lu.se/luur/download?func=downloadFile&recordOId=1555219&fileOId=1563586.

iv) Discriminatory practices based on sex, race, sexual status, political views, religion, social or national origin, and birth or socio economic status should not be the determinants of social security programs.

v) The Social security administration must have governing rules and procedures for eligibility to benefit and benefits termination. Further, the rules and procedures should be fair and reasonable with legal remedies available in case the rights are breached.

The International Covenant on Economic, Social and Cultural Rights provides that state parties recognize the right to social security.[5] The UN also acknowledges four key elements to social security: availability of schemes, accessibility, affordability of the contributions and adequacy of the benefits.[6] These echo the points elucidated above as follows:

i) Availability – this right requires that the system of implementation is available and operational to ensure that risks and contingencies are taken care of.

ii) Accessibility – the right must be reachable physically and otherwise to all persons especially the disadvantaged and marginalised groups without discrimination.

iii) Affordability – the contributions required should be stipulated in advance and the costs associated with the programs should be reasonable for everyone.

iv) Adequacy – the benefits must be sufficient in amount and duration to enable everyone realize his or her rights to family protection and assistance, an adequate standard of living and adequate access to health care.

The UN Committee on Economic, Social, and Cultural Rights (CESCR) further provided guidance to states on what the right to social security entails. The right includes the following interrelated and essential features: availability, adequacy, accessibility and coverage for social

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[5] Article 9.

[6] United Nations Human Rights Office of the High Commissioner, 'Tool Kit on the Right to Social Security' <http://www.ohchr.org/EN/Issues/RightSocialSecurity/Pages/SocialSecurity.aspx> accessed 10th June 2018.

risks and contingencies especially the nine branches of social security.[7] These branches include: sickness, old age, health care, unemployment, employment injury, family and child support, maternity, disability and death.

In Kenya, the right to social security is specifically recognized by the Constitution of Kenya, 2010, as a socio-economic right under Article 43 (1) (e). In the same breath, the general rules of international law and any treaty or convention ratified by Kenya on social security automatically forms part of the laws of Kenya in terms of Article 2 (5) and (6) of the Constitution. Kenya having ratified the International Convention on the Elimination of all Forms of Racial Discrimination, The International Labour Organization Social Security (Minimum Standards) Convention and the International Covenant on Economic, Social and Cultural Rights, among others, has an international obligation to ensure the right to social security is enjoyed by its citizens.

In Kenya, the social security is provided in form of schemes i.e. the National Social Security Fund (NSSF) and a health insurance scheme which is the National Hospital Insurance Fund (NHIF). These schemes are organized and managed by the Government of Kenya. The Government has made the two schemes mandatory for all employers and employees. Self-employed individuals may also subscribe to these schemes. Under the schemes, members are able to access retirement or old age benefits, withdrawal benefits, survivor's benefits, incapacity benefits, funeral grants and health care. This research focuses on pensionable benefits.

[7] The UN Economic and Social Council, Committee on Economic Social and Cultural Rights, General Comment 19, 39th Session, 2007 pp 5-7 available at https://tbinternet.ohchr.org/_layouts/treatybodyexternal/Download.aspx?symbolno=E%2fC.12%2fGC%2f19&Lang=en accessed 13th November 2018.

There are also other schemes offered and managed by private entities such as insurance companies and cooperatives. The overall objective of such schemes remains making benefits available to any member who belongs to a scheme, after their retirement or at a future date.

Social security in Kenya is a matter of government concern hence the law supports establishment of pension schemes and regulates their operations. A pension scheme is an arrangement through which an employee and/or an employer contributes money into a fund over time which money is invested and paid back to the employee at a later date, usually after retirement. Such schemes have now been expanded to cover individuals who are self-employed or in informal employment.

It is paramount that social security is guaranteed as a right. As seen above the essential elements of the right must be present: availability, access, affordability and adequacy. Kenya has passed this test by establishing the NSSF and NHIF funds and making their contributions very reasonable hence affordable to all. Membership to these funds is also open to all and the benefits are adequate. Further, other private schemes are also regulated by the Government to enable them pass the test. Pension schemes operate to enable individuals to save up money for their future use. The schemes therefore invest these savings and pay the individual upon retirement, incapacity or death of the scheme member. The concern of a scheme member at all times is to receive their ultimate benefit under the scheme. Schemes may be prone to challenges such as loss of scheme funds, misappropriation of funds, insolvency and inefficiency. Scheme funds therefore need to be protected from such eventualities to ensure the right to social security is achieved. There is thus need for a mechanism to guarantee this ultimate benefit to a member. One of these mechanisms is the establishment of a pensions guarantee fund in Kenya.

There are several classes of retirement benefit schemes in Kenya as highlighted below:

1.1.1. Statutory/public schemes

There are schemes established by statute. The main scheme is the National Social Security Fund (NSSF). This is a mandatory scheme for all employees in Kenya. It is also open for voluntary membership for people who are self - employed or who may not qualify for membership as employees e.g. have reached the retirement age.[8]

1.1.2. Defined contribution and Defined benefit schemes

A Defined Contribution Scheme applies where there are fixed contributions from both the employee and the employer based on a percentage or a fixed amount where the benefits of a member equals the contributions made less any costs incurred such as insurance against death. The benefit is only determined at the time of payment and is not known in advance.[9]

A Defined Benefit Scheme on the other hand refers to a contribution arrangement where member's benefits, which are often based on the existing scheme rules, are defined before joining the scheme. Mostly, benefits are based on the last salary and/ or the number of years the employee worked.[10]

[8] NSSF Act 2012, s 18.
[9] Retirement Benefits Authority website available at http://www.rba.go.ke/index.php/en/retirement-benefits-schemes accessed 5th May 2018.
[10] ibid.

1.1.3. Provident Fund and Pension Fund

A provident fund is one where payment is done in lump sums together with other benefits to workers upon leaving an organization or to their dependants in the case of the employee's death. On the other hand, a pension fund is one paid upon retirement where a member is paid part of his contributions as a lump sum and the remainder is paid out in periodical payments.[11]

1.1.4. Occupational scheme and individual scheme

The Occupational schemes on the other hand are private sector firms which run pension schemes. With an aim of collecting retirement benefits for employees, employers may establish such a scheme where they ran it for their employees only or join an already established scheme.[12] The Individual Retirement Schemes are mostly run by financial organizations. In Kenya, insurance firms mostly operate these schemes where they serve as a saving path to individuals. The main difference is that in individual schemes, it is the individual who initiates to make contributions on his/her own behalf towards saving for retirement, while an occupational scheme is set up by an employer who makes contributions on behalf of their employees for the provision of retirement benefits. Both the employer and the employee make the contributions.[13]

This paper looks at the regulation of retirement schemes in Kenya in a bid to ensure that pensioners have a secure income upon their retirement. It proposes the establishment of a pensions guarantee fund. This will be achieved by critically evaluating how the legal framework

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[11] Ibid.

[12] Ibid.

[13] Adil Suleiman, ' A look at various pension schemes on offer in Kenya' *Business Daily* (Nairobi, 29th January 2018) <www.businessdailyafrica.com/lifestyle/pfinance/A-look-at-various-pension-schemes-on-offer-in-Kenya/4258410-4283542-1gkxmqz/index.html> accessed 5th May 2018.

regulating pension schemes in Kenya and the protection they provide for pensioners savings. The paper will go further to consider the case for or against a pensions guarantee fund to compensate pensioners in cases where schemes collapse. The paper will also examine the existing guarantee funds in the financial sector in Kenya while analytically comparing that with what other jurisdictions have. It will conclude and make recommendations on why we need the pensions guarantee fund in Kenya and make proposals of how such a fund can be managed or administered.

It is against this background that this study highlights the challenges that pension schemes face in payment of retirement benefits and proposes a solution that would guarantee pensioners of their money in specific cases where such schemes collapse with no salvage to pay such pensioners.

1.2. STATEMENT OF THE PROBLEM

The operation of most pension funds and schemes in Kenya has been the subject of various debates in contemporary Kenya due to the failure to compensate pensioners when they retire or are incapacitated.[14] This problem has been highlighted by various writers on the subject as set out in the literature review. Such challenges include: poor administration and investments of pension funds, lack of transparency and accountability,[15] non-remittance of monthly contributions by employers, misappropriation of scheme assets by the trustees, loss of scheme funds through negligence of trustees and poor investment of the scheme assets.[16] Other

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[14] Isaiah Opiyo, 'Why Kenya Urgently needs the National Credit Act' *Business Daily*, (Nairobi, 5th August 2012.

[15] Sundeep K Raichura, 'An analytical review of the Pension System in Kenya' 2008 pp 17 https://www.oecd.org/finance/private-pensions/41564693.pdf accessed 28th July 2018.

[16] Christine Gatwiri Kimathi, 'A critical analysis on the role of the Retirement Benefit Act and Regulations in the prevention of loss of Retirement Benefits in the Occupational Pension Schemes' (Master of Laws Thesis, The University of Nairobi 2013).

complaints relate to unresponsiveness, discourtesy, inefficiency, delay, refusal to pay, discrimination and abuse of power in the processing of retirement benefits.[17]

In some instances, pension schemes have collapsed due to maladministration, poor investment decisions, insolvency, and this has had the effect of denying members their retirement benefits hence not securing their social security which is the very basis of the establishment and operation of pension schemes in Kenya. These problems are facilitated by the fact that the law governing administration of such pension schemes does not provide recourse to members/beneficiaries of the schemes in so far as compensation is concerned. Whereas the RBA creates offences relating to scheme operations, the penalties provided are very lenient to deter their commission.[18] Recovery of lost funds can also be done via asset recovery process or liquidation. However, these processes take a long time and the delay will jeopardize the petitioner in need of their benefits. Further, there is no guarantee that the pensioner will receive the benefits at the very end.

The main object of establishing the pension system is to ensure the intended beneficiaries can benefit from their hard work and life savings in future. If there is no money is available to pay or compensate beneficiaries, the very purpose of a pension fund will be defeated. Whereas some of the problems can be solved by improving efficiency, the law does not provide a clear remedy in cases of insolvency. The law thus needs to provide for recourse to contributors and beneficiaries of pension funds by guaranteeing the receipt of their life savings where pension schemes

[17] Commission on Administrative Justice, 'Sentenced to Poverty at Sunset: An Investigation Report on Systemic Issues inherent in the Payment of Payment of Pensions, Gratuity and other benefits' 2016 www.ombudsman.go.ke/index.php/resource-center/investigation-reports/category/48-investigation-reports-2016 accessed 28th July 2018.

[18] Retirement Benefit Act s 39 provides for to a fine not exceeding five hundred thousand shillings, or to imprisonment for a term not exceeding two years, or to both.

collapse. This gap in the law is what this study seeks to address by the establishment of a pensions guarantee fund.

1.3. JUSTIFICATION FOR THE STUDY

As highlighted in the statement of the problem, there needs to be a recourse or fall back mechanism for contributors who sacrifice to save for their future and the pension schemes they use to do so suffer loss of funds or maladministration or become insolvent.

The Retirements Benefits Act in regulating the administration of pension schemes makes provisions for governance and protection of scheme funds for the benefit of the contributors. For instance, there is a mandatory requirement for registration of every pension scheme and any fund custodian or manager or administrator and trustees as well as the criteria of determining suitability of persons who can act in those capacities.[19] Whereas the RBA also provides for restrictions on what can/cannot be done with scheme funds, it also provides for deregistration a fund and any of its officials for irregularities and punishment of such officers for criminal culpability.[20] However, where penalties are provided, they are very lenient to deter maladministration and mismanagement of funds considering the huge loss that can be occasioned by poor scheme administration.[21] Whereas the officers involved may be prosecuted for their misgivings, the interest of pensioners is their money. Prosecution of cases in Kenya takes a long period of time and where such officers are found culpable and ought to refund lost money, asset recovery may take time in which case the pensioner banking on their pension for their daily life

[19] Retirement Benefits Act 1997, s 22, 22A

[20] ibid, s 32-40.

[21] ibid s 39 provides for to a fine not exceeding five hundred thousand shillings, or to imprisonment for a term not exceeding two years, or to both.

will be at a loss. A liquidator may also be appointed for recovery of assets and funds but this involves another court process. Since compensation is paid once liquidation is finalized, the delay will jeopardize pensioners' lives. The law however does not provide recourse in cases where scheme funds become insolvent as a result of poor administration or mismanagement of schemes.

In Kenya, there has been reported incidences where pension schemes have been threatened to collapse and pensioners risk losing out on their retirement benefits. A few of these are highlighted below:

a) The Kenya Railways Staff Retirement Benefits Scheme

In 2012, the RBA audit report reported that the Kenya Railways Staff Retirement Benefits Scheme Board of Trustees was accused of gross misconduct, conflict of interest and irregularly dealing with the scheme's property. Some of these irregularities included transfer of property to board trustees for their personal use and failing to follow the required procedure in disposing off the schemes assets. The Daily Nation reported that the massive irregularities were likely to sink the scheme thus halting the monthly payments for beneficiaries.[22]

b) The Technical University of Kenya Scheme

In November 2016, the RBA announced its intentions of dissolving the Technical University of Kenya (Former Kenya Polytechnic) Scheme on grounds of insolvency with unremitted contributions exceeding Sh 800 million. This was as a result of failure by the University to remit employees contributions for months. RBA reported that the scheme was in an unsound financial

[22] Sunday Nation Team, 'KR pension scheme on brink of collapse over irregularities' *Saturday Nation* (Nairobi, 18th February 2012) www.nation.co.ke/business/KR-pension-scheme-on-brink-of-collapse-/996-1330404-rc2a2oz/index.html accessed 5th May 2018.

state with funding that is lower than the minimum level as recommended under the Retirement Benefits Act and there were no measures put to improve the same.[23] The liquidator would attach the University property and attempt recovery of the employee's remittances. This left the beneficiaries at risk of loss and some of the beneficiaries had died before receiving their funds.[24]

c) Counties Pensions Fund

A report by the Counties Pensions Fund CEO in October 2017 informed that the County Governments have not remitted Sh. 30 billion to employees' pension and provident funds (LapFund and LapTrust). The CEO however downplayed any risks of loss of contributors money in the two funds.[25] In as much as there may not have been any risks then, risks build over time. Such non-remittances of funds would likely lead to expending the funds to other uses and when they are required for beneficiaries, the funds may not be available.

d) NSSF

In 2016, it was reported that NSSF had spent approximately 52.51% of the collections on administration for the year ending June 2015. NSSF spent Sh. 105 in managing every Sh 200 contributed in a month. This amounts to 3.73 of the overall assents revealing that the organization breached the ceiling of 2 per cent. This led to a reduction of the amount available

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[23] The Retirements Benefit Act (Minimum Funding Level and Winding Up of Schemes) Regulations, 2000, Regulation 4 provides that the funding of a scheme is below the minimum funding if the assets are less that 100% of the liabilities or if it cannot meet its liabilities as and when they fall due.
[24] Edwin Okoth, 'Shs. 800m debt sinks Technical University's pension scheme' *Business Daily* (Nairobi 15th November 2016) www.businessdailyafrica.com/corporate/Sh800m-debt-sinks-Technical-University-s-pension-scheme/539550-3452630-t7oy2b/index.html accessed 5th May 2018.
[25] Lee Mwiti, 'Concern over County governments failure to remit employee pension' *Standard Media* (Nairobi, 27th October 2017) www.standardmedia.co.ke/business/article/2001258530/counties-on-the-spot-over-sh30bilion-pension-cash accessed 5th May 2018.

for investments, which consequently squeezed the returns of retirees.[26] The fund's expenses were Sh 6.1 billion during the same period, against collections that amounted to Sh11.7 billion in the period under review. However, the acting Managing Trustee at the time did not answer questions on the measures that had been employed to reverse the issue.

In July 2017, the CEO of RBA cautioned pension scheme administrators of poor governance. He urged trustees to commit themselves to take responsibility where fund managers interfere with pension funds prior to demanding stable remuneration. The CEO highlighted poor governance of pension funds and poor investment decisions as a failure of pension schemes. An example is where fund managers put contributors' money into Imperial Bank a few months before its collapse as a result of poor decision making.[27]

The foregoing thus reinforces the introduction of a pensions guarantee fund to cushion the contributors or would be beneficiaries of pension schemes in case such schemes collapse. The Fund operates in such a way that members of collapsed retirement benefits schemes should still be compensated from the fund especially after proof their membership and contributions to the collapsed pension scheme.[28] This requires clear rules of what amount is guaranteed and what needs to be proved as well the procedure for making such claims.

This is specifically important when one considers the fact that in Kenya, private entities, insurance companies and cooperative societies and other investment institutions are having arrangements similar to the definition of an investment scheme which needs regulation and

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[26] David Herbling, 'NSSF spends half of employees' contributions on administration' *Business Daily* (Nairobi, 1st November 2016) www.businessdailyafrica.com/NSSF-spends-half-of-employees--contributions-on-administration/539552-3437832-k5w14d/ accessed 15th April 2018

[27] Lee Mwiti, ' Show commitment in your work, Kenya's RBA tells pension scheme fund trustees' *Standard Digital News* (Nairobi, 9th March 2017) www.standardmedia.co.ke/business/article/2001232051/show-commitment-in-your-work-rba-tells-pension-scheme-fund-trustees accessed 15th April 2018.

[28] Jeffrey L. Murrell, 'Alternative to Bankruptcy: Chapter 128 Proceedings-Webcast Replay' (Wisconsin Seminar, 19th November 2012).

assurance by Government of its safety. Given the fact that most of these companies and entities may have gone under receivership with no recourse to the members, it is important to introduce a fund that would cover the unfortunate occurrences of collapse of pension schemes.

1.4. LITERATURE REVIEW

The topic on pension funds/schemes in Kenya has been of interest to quite a number of writers. This study highlights a few of those relevant studies.

In 2008, Mr. Sundeep Raichura[29] reviewed Kenya's pension system while highlighting the various types of pension schemes. He highlighted the motivation behind Retirement Benefits Act enactment in 1999 and the establishment of the Retirement Benefits Authority in 2000. The purpose involved protection of members' benefits and an improvement of governance schemes.[30] The law required compulsory registration of pension schemes with viability checks and floor capped funding requirements of defined benefit schemes and restrictions on any antagonistic alterations to the benefits of members. Moreover, the schemes were intended to appoint external investment managers and custodians registered under RBA with clear investment policies equally in place to limit on investments in asset categories in order to reduce risks concentration and ensure asset diversification.[31]

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[29] Sundeep K Raichura, 'An analytical review of the Pension System in Kenya' 2008 https://www.oecd.org/finance/private-pensions/41564693.pdf accessed 28th July 2018.
[30] ibid pp 17.
[31] ibid pp 18.

On governance, the law provided for certain measures such as disclosure requirements, annual audits and periodic reviews. Yearly benefit statements together with annual general meetings for scheme members were also introduced. Specifically, the regulations require provision of a number of reports and documentations to the RBA which comprise of trust deeds, annual audits, statements of investment policy, agreements and custody reports from service providers, contribution records on a quarterly basis. Scrutiny of documents and submission timelines serves the purpose of aiding the RBA to evaluate compliance level of the scheme based on exposure to risk and existing legislation.

Mr. Raichura further highlighted the challenges the sector was facing. "There was bad investment as well as administration of scheme funds with specific focus on concentrations of investment, especially in property. In most cases it had happened unintentionally, but lack of effective supervision and controls was a recipe of mismanagement as well as outright misappropriation. Additionally, NSSF lacked disclosure and accountability while at the same time the organization suffered from governance issues and issues relating to its investments as well as payment of benefits."[32]

He further made a case for further reforms on the law. Such include to strengthen the pension system's institutional structures, expanding the scope through appropriate policy measures and increasing the adequacy of benefits through a phased increase in mandatory contributions, which have since been implemented.[33] This study remains relevant in providing a background of the pension schemes in Kenya and how the reforms have come about over the years. It is however different from the current study because whereas it provided a review of the pension system in Kenya, with possible future reforms, the current study focuses on the need for a guarantee fund

[32] ibid pp 17.
[33] ibid pp 27.

to compensate contributors in cases where such schemes with all the legal and policy framework collapse.

Mr. Amos Njuguna investigated the strategies for improving efficiency of pension funds in Kenya. [34] The main objective of this research was to explore ways to enhance pension fund efficiency by establishing determinants of efficiency. The study also looked at effect of other factors such as organizational culture, regulations, risks, ethics and age of contributors on efficiency of pension funds. The writer looks at investment strategies, pension fund size, pension fund governance, ethics and risks as the main determinants of efficiency and investigates the relation between the above factors and efficiency.

The study confirmed that the size of the fund was a key determinant of pension funds financial efficiency. The smaller the fund, the more efficient it was. The view that the age of members has an impact on the operational efficiency of pension funds was confirmed. This study's empirical findings sup ort this notion, as it revealed how the membership category of 31 through 40 years influenced governing of pension funds. However, the findings revealed that age of members failed to have an impact on the pension funds financial efficiency. However, fund leadership and governance are critical in the success of any pension fund.[35]

This study is also relevant to the current study in that while acknowledging that pension schemes suffer inefficiencies, it provides a background on causes of inefficiency which will assist in analysing the need for guarantee pension fund and its efficiency.

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[34] Amos Njuguna, 'Strategies to Improve efficiency of Pension Funds in Kenya' (Doctorate Degree, Nelson Mandela Metropolitan University 2010).

[35] ibid pp 227.

Ms. Christine Kimathi**,** did a critical analysis on the role of Retirement Benefits Act and Regulations in the prevention of loss of retirement benefits for occupational pension schemes. In her study, she highlighted the problems experienced by pension schemes with a particular focus on the occupational pension schemes. Some of these challenges include: non-remittance of monthly contributions by employers, misappropriation of scheme assets by the trustees, loss of scheme funds through negligence of trustees and poor investment of the scheme assets.[36] The purpose of her study was to identify why the above problems continue to persist and also identify the weaknesses in the law and the regulations. The findings of the study revealed that the laws on retirement benefits are not sufficiently prepared to avoid risks that lead to loss of retirement benefits and that the role of Retirement Benefits Authority fell short in averting these challenges.

Ms. Kimathi proposed some solutions to address the problem. She proposed for the law to secure pension contribution arrears with a charge over the assets of the employer in both insolvencies and receivership cases. She also proposed the need to criminalize the non-payment of contributions so as to expose employers to prosecution by the state. The regulation of trustees as far as their selection process and remuneration is concerned as well as the establishment of pensions guarantee fund were among the proposed solutions. The first and the second proposals are yet to be implemented while the third one has been provided for in the law. Her fourth proposal is the subject of this study i.e. the establishment of a pensions guarantee fund.

Whereas Ms. Kimathi's study is remains relevant in highlighting the gaps in the then law, it gives us a starting point that the pensions guarantee fund is necessary to establish. The current

[36] Christine Gatwiri Kimathi, 'A critical analysis on the role of the Retirement Benefit Act and Regulations in the Prevention of Loss of Retirement Benefits in the Occupational Pension Schemes' (Master of Laws Thesis, The University of Nairobi 2013).

study thus seeks to provide what would be a long term solution for contributors of pension funds who suffer the above highlighted challenges and to build up on specifically the pensions guarantee fund as proposed.

Ms. Olivia Okeyo focused her survey on the investment portfolio of pension funds in Kenya.[37] She focused on the RBA Guidelines and investment portfolios in order to provide a solution to the existing problem where there was over investment/over-reliance on one portfolio of investment. The researcher aimed at determining the factors that influence the choice of pension funds investment portfolio and at the same time to understand factors that funds take into consideration while choosing fund managers. She also sought to determine the relationship between the RBA guidelines and other investment variables and how pension fund asset base influence choice of portfolio investment. This study is relevant although different from the current study. Whereas it focused on investments portfolios for pension funds and how they can be diversified to gain more value for beneficiaries, it has a relationship with the current study in that, it is as a result of poor investments decisions that pension schemes fail. Therefore, there is need for a guarantee pension fund in case such failures happen.

Mr. David Nyakundi[38] analysed the problems facing Kenya's pension system with a view to propose legal reforms. Some of the highlighted problems include: fragmented laws and lack of a harmonized policy, limited scope, unfunded obligations, indiscreet asset management, delayed payment (or non-payment) of pensions and poor application of pension law. His study however

[37] Olivia Adhiambo Okeyo, 'A Survey of the Investment Portfolio of Pension Funds in Kenya' (Master Thesis, The University of Nairobi 2016).
[38] David B Nyakundi, 'Problems facing Kenya's pension system: A case for reforms of laws relating to pensions' (Master Thesis, the University of Nairobi 2006).

focused on limited coverage, low pension scheme funding, indiscreet management of assets and a poor enforcement approach to pension law.

Mr. Nyakundi proposed reforms which would enhance the pension system and guarantee old age income security to avert old age poverty. Some of the proposed reforms included: to subject NSSF to a competition so as to boost its governance, submitting contributions together with pay-as-you-earn taxes under Income Tax Act (which was implemented for occupation schemes). The funding in Private Occupational Schemes to be enhanced by creating criminal culpability to employers who do not remit employees' contributions to the schemes (already implemented under the RBA Act) and the law to provide for adequate procedures on funding levels of pension schemes.

He also suggested the need to amend the National Social Security Act in order to enhance transparency in management and investment of assets. Regarding private occupational pension schemes, it was prudent to prohibit fund managers from making policies on investment due to conflict of interests. The Retirement Benefits Act needed to differentiate the functions of fund managers and investment advisors in various schemes. In the wake of the highlighted problems, this study seeks to provide a way to guarantee pensioners of their money where even the proposed measures do not work.

Mr. Nzomo Mutuku made a case for the viability of protection of pension schemes in Kenya.[39] His study concluded that in the same way there are protection funds for the financial services sector such as the insurance industry, the capital markets and deposit protection fund in the

[39] Nzomo Mutuku, 'Need and viability of a benefit protection fund for retirement benefits schemes in Kenya' (RBA Research Paper, 2011). <www. rba.go.ke/.../22-research-reports-2010-2011?...viability...protection-fund-for-retiremement benefits schemes in Kenya>.

banking sector, there is need to have a protection fund for pension schemes in order to mitigate risks such as market failure, insolvency, systemic and actuarial risks. Whereas Mr. Mutuku's study is very closely related to the current study as it already gives a starting point on the finding that it is indeed necessary to have a protection scheme for pension schemes in Kenya, it becomes reliable because the findings were established through an empirical research. However, Mr. Mutuku's study does not tell us how such a fund should be established and administered to curb the challenges that similar schemes in Kenya and in other jurisdiction face. This study therefore seeks to fill in the gap by giving insights on what can be done to ensure the fund is efficient.

The Commission on Administrative Justice in 2016 further investigated the systemic issues which are inherent in payment of pensions and gratuity among other benefits.[40] This was prompted by the numerous complaints received by the Commission regarding payment of benefits to retired public officers. Such complaints related to unresponsiveness, discourtesy, inefficiency, delay, refusal to pay, discrimination and abuse of power in the processing of retirement benefits. The systemic investigation looked into the processes, administrative procedures and legal framework operational in the payment of retirement benefits. Specifically, the study looked at the factors causing delay in processing and payment of retirement benefits, reasons for non-payment of retirement benefits, level of awareness on requirements for processing retirement benefits and the level of decentralization of services by the respective departments as well as poor records management. The respondents of the study also cited dissatisfaction on the services offered as a result of delays in processing retirement benefits, inefficient officers and lack of transparency in the process.

[40] Commission on Administrative Justice, An investigation Report on Systemic Issues inherent in the payment of pensions, gratuity and other benefits, 2016 www.ombudsman.go.ke/index.php/resource-center/investigation-reports/category/48-investigation-reports-2016 accessed 21st July 2018.

The CAJ made several recommendations on what can be done to deal with such systemic issues. Among them, they recommended that the National Treasury should set aside sufficient funds for payment of pension to retirees, review of laws on pensions, elimination of the issues by having officers do their job right, devolution of pensions department and establishment of a complaints department. Whereas, systemic issues can be addressed, this study does not tell us how to ensure pensioners still receive their benefits where the pension scheme has suffered loss or is at risk of collapsing for mismanagement or other maladministration or insolvency. This is the gap that the current study seeks to fill.

Ms. Fiona Stewart[41] analysed the issue of pension benefit security among OECD countries. She outlines the risk experienced by beneficiaries of defined benefit or defined contributory occupational pension schemes, where the corporate plan sponsor falls bankrupt while the company pension plan is inadequately funded. She further makes the case for and against the establishment of pension guarantee funds. Whereas the need for a fall back mechanism for pensioners, the lack of effective alternatives, problem of diversification and market failure justify the existence of such funds, the question of moral hazard, cost of running such a fund and the expected challenges may discourage the same. However, Ms. Stewart notes that pension guarantee funds do not come without difficulties but measures can be put into place to address the challenges. Good funding rules accompanied by other measures like asset immunization and giving scheme benefits priority in bankruptcy make the fund more effective. The fund must

[41] Fiona Stewart, 'Benefit Security Pension Fund Guarantee Schemes' OECD Working Papers on Insurance and Private Pensions, No. 5, OECD (2007).

however be carefully designed to avoid the inherent weaknesses. Ms. Stewart also does a comparative study of 8 OECD countries that have established pension guarantee funds.

This article is very relevant to the research. It will inform on the case for and against the establishment of pension guarantee fund while highlighting the measures that can be put in place to ensure their effectiveness. It will also inform the comparative study in Chapter 4.

The above literature remains relevant in providing a pool of knowledge and enabling the reader to understand the evolution that the pension schemes sector has undergone over the years. They provide a background for this research by outlining the journey that the pension scheme sector has walked through, the reforms that have taken place and the existing or would be challenges. However, these studies do not tell us how to ensure that the ultimate benefit of an individual investing through a pension scheme is protected. They focus on improving efficiency and governance of pension schemes. The link to achieving the right to social security through protection of pension benefits is missing. They do not address the ultimate goal of establishing pension schemes which is to ensure the pensioner or contributor to a pension scheme revived their benefit. Whereas Ms. Gatwiri proposes the establishment of a pensions guarantee fund, Mr. Mutuku goes further to make a case for a pensions guarantee fund via an empirical research. They however do not address the issue of how such a fund would operate in Kenya, its legal or institutional framework, its funding and how it can overt the challenges that other guarantee funds face. This is the gap that the current study seeks to fill.

1.5. THEORETICAL FRAMEWORK

This research will rely on the four theories: the economic analysis of law theory, public interest theory, the agency theory and the life cycle hypothesis theory. These are highlighted below.

1.5.1. Economic analysis of law

This theory applies the macroeconomic analysis to rules of law. It looks at analysis of law or legal systems from an economic point of view. Economic analysis of law looks at the scheme of incentives and disincentives available while making any legal decision. The theory holds several assumptions such as: people make rational decisions, resources are scarce therefore people seek to maximize utility.

The main proponent of this theory was Richard Posner. In propounding his theory, Posner was influenced by the Utilitarianism theory which emphasize on the greatest good for the greatest number of people. Within this theory, the preferences of all individuals to see which approach maximizes their achievement, identifies their common good. This common good becomes the greatest amount of individuals' satisfaction. In the same light, have to make decisions rationally on where to invest their money for future benefits. Since money is usually a scarce resource, they have to consider a scheme which will give them maximum and assured benefit. Further, the theory applies to administration of pensions schemes in that administrators and managers of pension schemes are expected to make rational investment decisions which will attract good returns thus maximize the benefits for the contributors as maximum benefit is the business of every contributor.

1.5.2. Public interest theory

This theory was propounded by Pigou who held that regulation of the economy was as a result of demand by public for the rectification of failure in market practices. The government intervention is assumed to be for the benefit of the society at large and the regulating body to be acting on the society's behalf. [42] Public interest thus is the public expectation to be served reasonably and moderately and laws are presumably enacted to serve public interests. This theory explains that market failure to self-regulate forces government intervention in the market.

This theory provides a justification for the establishment of the Retirements Benefits Authority, the main body that regulates and supervises the establishment and management of retirement benefits schemes.[43] Regulation of pension schemes by RBA is thus to be done for protection of the public who put money in such schemes and to correct any inefficiencies in the market such as by prohibiting what can be done or not done with scheme funds.

1.5.3. Agency theory

Agency theory seeks to understand relationships that exist among agents and principals. Agent is this case might represent a principal in a business, he or she is expected to act in the principal's best interest without any regard for self-interests. Difference in interests amongst the agents and principals is a major source of conflict, since some of the agents might not act perfectly in the best interests of the principal. The effect of miscommunication and disagreement might bring about problems in firms. Incompatible desires might lead a wedge amongst stakeholders and

[42] A.C. Pigou, *The Economics of Welfare,* (Macmillan and Company, London 1932).
[43] Retirement Benefits Act, s 5.

result into inefficiencies as well as financial losses. This leads to the principal-agent problems. The relationship should thus be guarded to remain solid and serve the intended interests.

This theory is relevant to this study in that contributors to pension schemes entrust their money to the trustees/administrators of these schemes to hold and invest it for their benefit in future. The contributor is thus the principal and the trustee/administrator the agent. The agent should strive to serve the interests of the contributor/principal. Self interests result into mismanagement, maladministration, conversion of funds etc which are not in the interests of the principal. This also creates the need for the law to regulate this relationship and more so the agents such as fund managers and trustees. On this note, the agent should be given incentives to be able to act so. This justifies the Enwealth Consultancy Report which recommended trustees to be compensated for their oversight role.

1.5.4. Lifecycle Hypothesis Theory

This is one of the economic theories about spending and saving behaviour among people. It was postulated in the works of Fraco Modigliani and Richard Brumberg (student).[44] The theory presumes that people have a spending plan based on their future incomes. It is thus likely to take on debt when one is young, on the presumption that in future income they will pay the debt off. Individuals spending habits are based on their present income and the expected forthcoming earnings. Thus they create a cycle of expenditure based on their expected earnings over their life

[44] Albert Ando and Franco Modigliani, ‘The "Life Cycle" Hypothesis of Saving: Aggregate Implications and Tests’ (1963) 53 (1) The American Economic Review.

time. The life cycle hypothesis considers dependence in consumption and saving behaviours of an individual in a life cycle.

This theory thus gives a justification for establishment of pension schemes through which individuals can make savings for their future. Since the cycle is that when one grows older or after retirement they may not save as much, pension then provides social security to individuals. It is in this spirit that the same should be guarded to ensure contributors benefit from their lifetime savings.

This theoretical framework backs-up the background of the study and justifies the study itself by showing that whereas the pensions guarantee fund is necessary, it has to be effectively implemented for individuals to enjoy the very purpose of pension schemes i.e. in order to achieve the right to social security. According to the economic analysis of law theory, the main proposition for pension schemes is to achieve maximum benefit for the contributors who make decisions rationally to save through pension schemes while considering their expected future benefits. Since the life-cycle hypothesis theory shows individuals save less when they are old, they should thus derive benefits from their life savings when they grow older as well. This makes a case for protection of pension benefits via a guarantee fund. In light of the challenges that such a fund is likely to face, regulation of the fund is necessary to ensure that it serves public interests as opposed to private interests. Further, regulation works to govern the principal - agent relationship between pensioner/contributors of pension schemes and the fund managers, custodians and trustees. Securing public interest in the running of such schemes while avoiding the agency problems should be the main goal.

1.6. OBJECTIVES OF THE STUDY

The overall objective of this research is to make a case for a pensions guarantee fund for compensating contributors in case a pension scheme collapses or in cases of maladministration leading to loss of scheme funds.

In order to achieve this main objective, other sub-objectives to be achieved include:

i) To analyse and critique the legal framework governing pension schemes in Kenya;

ii) To make a comparative analysis of pensions guarantee fund from other jurisdictions and management of the same;

1.7. RESEARCH QUESTIONS

i) Is there need for a pensions guarantee fund for compensating contributors in case a pension scheme collapses or in cases of maladministration leading to loss of scheme funds?

ii) What is legal framework governing pension schemes in Kenya?

iii) What other jurisdictions have a pensions guarantee fund and how is it managed?

1.8. HYPOTHESIS

The study proceeds on the assumption that there is no assured means of compensating contributors of pension schemes in Kenya where schemes collapse as a result of maladministration or insolvency.

1.9. RESEARCH METHODOLOGY

This is a legal study which is qualitative in nature. The study uses both primary and secondary sources of data. The primary data sources include legislations and case law while the secondary sources include books, articles, journals and web sources on the subject in question. The study is also a comparative research as it encompasses a comparative analysis of four states that have a pensions guarantee fund similar to the one the current study seeks to establish.

1.10. LIMITATIONS

There are few countries with guarantee funds similar to what this study proposes thus the scope within which to benchmark is limited. Further, there is only one pension guarantee fund among African countries and the literature on pension guarantee funds is also very limited.

1.11. CHAPTER BREAKDOWN

Chapter One is the introductory Chapter. It includes the background information for the research and the objectives of the study. It also demystifies the problem statement and the justification for the study, the literature review, theoretical framework, research questions, hypothesis, and the methodology to be used in carrying out the study. Chapter two contains the legal framework of pension schemes in Kenya. it analyses this framework and critique the extent to which the law protects pensioners' benefits as well as the gaps therein.

Chapter three discusses the viability of a pensions guarantee fund in Kenya. This Chapter addresses the case for and against establishment of a pensions guarantee fund in Kenya. In supporting the case for establishing such a fund in Kenya while highlighting how the case

against can be overcome, it will also benchmark with the existing guarantee funds in the Kenyan financial sector.

Chapter four is a comparative analysis of pensions guarantee fund in other jurisdictions. The jurisdictions to bench mark against include: The United States of America, Canada, the United Kingdom and Germany. These jurisdictions have guarantee funds which cover defined benefits in cases where the employer suffers insolvency. The comparison will be based on the cover provided by each fund, source of funds, how the fund operates and the challenges they face. These jurisdictions have among the most elaborate and successful guarantee funds despite the challenges they face. Further, their way of operations, they are designed to cover contributors of pension funds where pension schemes fall insolvent which is the objective this research seeks to achieve. They will thus provide very useful insights in to this research.

Chapter five covers the conclusions and recommendations of the research. It draws from the findings of the study and make recommendations on how the fund can be implemented in Kenya.

CHAPTER 2

THE LEGAL FRAMEWORK OF PENSION SCHEMES IN KENYA

This Chapter looks at the legal framework governing pension schemes. It highlights the measures that the law puts in place to protect contributors of pension schemes in so far as social security is concerned as well as the existing weaknesses in the law. There is an elaborate legal framework on pensions schemes in Kenya.

The Government has established two bodies to handle the operation of pension schemes in Kenya.[45] The first body is the National Social Security Fund which receives contribution from members and saves it for the contributors' future use in the event of retirement or incapacitation or as the case may be. The NSSF Act[46] makes provisions for the various contributions that may be made under the scheme and further introduces contributions from voluntary members who are not in salaried employment but would wish to join the scheme and secure their future.

The second body is the Retirement Benefits Authority that is established under the Retirement Benefits Act, 1997. The objective of the Act is to establish the Retirement Benefits Authority so as to supervise, regulate and support retirement benefit schemes, develop the sector of the retirement benefits, and for connected roles.[47] The body is mandated to intervene on matters of social security and ensure that members are promptly compensated. Other players in the sector

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[45] Lemma W. Senbet and James K. Seward, 'Financial Distress, Bankruptcy and Reorganization' (1995) University of Maryland Law Journal, USA.
[46] No. 45 of 2013.
[47] Retirements Benefits Act 1997, long title.

include insurance companies and cooperative societies under which retirement benefits may also be advanced to retiring members.[48] These are also subject to regulation by the RBA.

This part discusses the five of the laws relating to regulation of pensions in Kenya. The Pensions Act that provides for the grant as well as regulation of gratuities, pensions together with other allowances belonging to the public service officers employed by the Government of Kenya. The Presidential Retirement Benefits Act provides for retirement benefits for persons occupying office of the Presidency. Moreover, the Retirement Benefits (Deputy President and Designated State Officers) provides for retirement benefits for Deputy or Vice Presidents and designated State Officers such as Speaker of National Assembly or the Senate, Chief Justice and Deputy Chief Justice and Prime Minister and the Provident Fund which establishes a Provident Fund for specific Government employees and at the same time provide the contributions by those Government employees to the Fund.

2.1. THE RETIREMENT BENEFITS ACT

The Retirement Benefits Act, 1998 provides for the regulation of retirement benefit schemes in Kenya. This is the umbrella law on pension schemes in Kenya. The main object of the Act is to establish a Retirement Benefits Authority for the regulation, supervision and promotion of retirement benefits schemes and for the development of the retirement benefits sector.[49] The object and functions of the Retirement Benefits Authority (the Authority) are clearly spelt out under Section 5 of the RBA.

[48] Schleifer, A. and R. Vishny, 'Liquidation Values and Debt Capacity: A Market Equilibrium Approach' (1992) Journal of Finance 47(4), 1343-1356.
[49] Retirement Benefits Act, Cap 197 Laws of Kenya, the Long Title

A retirement benefit scheme is an arrangement (other than a contract for life assurance) in which people get an entitlement for benefits through payments, based on their age, experience, level of earnings that is payable upon retirement or death or when an event takes place as specified in the contract. In this case, an arrangement by an insurance company for a life cover does not count as a retirement benefit.

The main objective of the Authority is regulating and supervising the establishment and management of retirement benefits schemes.[50] The Act further obliges the Authority to protect the interests of members and sponsors of the retirement benefits sector. A key example is insurance companies which offer health and life insurance cover to members of retirement benefit schemes. The Authority also ensures the growth of retirement benefits sector and provides guidance on national policy and implementation of the same.[51]

The Act regulates the administration of schemes and makes provisions for to safeguard retirements benefits. Some include:

i) The establishment of the Retirement Benefit Authority (Authority)

The Authority as the regulator of the retirement benefits sector requires to be properly structured and operated to enable it perform its regulatory role effectively. The Authority is established as a body corporate with all powers and status of such a body. This gives the Authority independence and a going concern status. It is managed by a Board of Directors who are the decision makers in

[50] ibid, s 5
[51] ibid

so far as the affairs of the Authority[52] are concerned and are protected from personal liability incurred while discharging their role.[53] This gives directors the assurance to carry out their duties without fear. The Authority is also required to keep proper books and accounts every financial year and to submit the statement of income and expenditure and the statement of assets and liabilities to the Auditor General (for Corporations) for audit.[54]

The above provisions ensure that the BRA is properly managed and operated with accountability checks in order to enable its role as a regulator. If the regulator has gaps in their management, structures etc, the rest of the industry will be at stake.

ii) Power to investigate offences

The Authority has power to investigate any offence allegedly committed, to investigate a manager, a custodian, an administrator that might have been involved in embezzlement, fraud, misfeasance or any other misconduct that may arise in relation to its regulated activities. It can also investigate how the regulated activity is carried out and whether there are interests of the individual clients or in the public interest.[55] This is to safeguard public interest in the schemes.

iii) Registration of schemes requirement

The mandatory requirement for registration of a retirement benefit scheme before it can be commenced. This enables the Authority to determine if it qualifies to be established and for compliance thereafter.[56]

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[52] ibid s 6.
[53] ibid s 14.
[54] ibid s 21.
[55] ibid s 5B
[56] ibid s 22(2)

iv) Registration of custodians, managers, administrators and trustees

A custodian is a company responsible for the safe custody of moneys, financial instruments, and title documents for assets of scheme funds. A manager is a company that manages the scheme monies or assets for purposes of investments. An administrator is in charge of a scheme and a trustee is a person who holds the assets invested in the scheme for the benefit of contributors.[57] In some cases, these roles can fall on one person especially in schemes with a reverse system where scheme funds count as part of employer's assets. This however should be discouraged because of the high risk posed to contributors' money. There should be efforts to separate the said roles as much as they may in some ways overlap.

The Act provides for mandatory registration of any person to act as a custodian or manager or administrator and trustees as well as the criteria of suitability of persons who can act in those capacities.[58] Such criteria revolves around the financial status/solvency of the person, the education background and experience to enable them understand the nature of their functions, the integrity, character and the ability to carry out their function competently, fairly and honestly. This is to ensure funds are well managed/administrated for the benefit of pensioners or intended beneficiaries.

v) Scheme deregistration

There are requirements for deregistration of scheme or registered fund manager, custodian, administrator for any irregularities. A fund may be deregistered if it is discovered that

[57]ibid s 2.
[58] ibid, s 22, 22A.

information provided during its establishment was materially false or untrue, if it is declared insolvent or does not comply with the law governing it.

vi) Scheme funds

It is a requirement for all schemes to have a fund where all contributions, investment earnings, income and all other moneys payable can be paid. These monies are to be maintained separately from the funds which may be in the control of trustees or managers.[59] This enables centralisation of funds and proper management of cash flows.

vii) Annual reports and accounts

The trustees of every scheme are required to keep proper books and records of accounts of income, expenditure and assets/liabilities of the fund. The accounts of the scheme shall be audited by an auditor appointed by the trustees with approval of the RBA Board. The audited accounts should be submitted to the RBA CEO within three months after the end of each financial year. These provisions are to promote accountability if the usage and investment of the scheme funds.[60]

viii) Protection for member contributions

The Act protects member's contributions in two ways. Members funds are protected from any execution or attachment process of any nature. Further, in the event of bankruptcy, such contributions should not form part of the assets of the member or of his employer to be available

[59] ibid s 31.
[60] ibid s 34.

for creditors.[61] Second, upon the death, the benefits under a scheme devolve to the estate of the member for administration as per the scheme rules.[62]

ix) Investment of scheme funds

The Act requires every scheme to have a comprehensive investment policy for investment of the scheme funds. This helps to maintain the capital funds of the scheme and to secure market rates of return on such investment. This ensures that scheme funds are invested in ways that will be beneficial or increase contributor's benefits.[63]

x) Restrictions on use of scheme funds

The Act also puts restrictions on what can/cannot be done with such funds e.g. they cannot give direct or indirect loans to any person or be used as security for loans. Further, any monies which comprises of statutory contributions cannot be placed in any other investments other than government securities or infrastructure bonds issued by public institutions.[64]

xi) Offences

The Act creates offences for officers involved in unsafe and sound practices or who act contrary to the law in the administration of pension schemes.[65] The CEO of the Authority also has power to direct such officers to refrain from such conduct. The failure to submit audited accounts in respect of a scheme is also an offence under the Act[66] and punishable by a fine not or imprisonment. The establishment of a scheme without proper registration or contrary to the

[61] ibid s 36.
[62] ibid s 36A.
[63] ibid s 37.
[64] ibid s 38.
[65] ibid s 40.
[66] ibid s 34 (4A).

provisions of the Act also amounts to an offence. In all the above cases, the Act provides for fine of a maximum amount of five hundred thousand shillings, or to imprisonment for a maximum term of two years, or to both where one is found culpable.

The Retirement Benefits Act designed several ways of ensuring to safeguard contributors of pension schemes money for their future benefit. The Act provides for safeguards that are useful when the schemes are in normal operations, solvent, and funds are available to pay contributors. When a scheme becomes insolvent, normal insolvency law applies if it is a body corporate. A liquidator may be appointed for recovery of assets and funds. However this is a process involving the courts which may take a long time to be resolved. Even so, the contributor of pension funds may not be guaranteed to receive their money in spite of the delays in the process.

The Act only provides that trustees and managers should ensure that contributions into scheme should be remitted into the scheme fund as reasonably as possible. If the contributions remain due for more than 30 days, the trustees/managers should report to RBA CEO.[67] The law does not provide for recourse in this regard. After reporting, it does not provide for the role of BRA in ensuring the contributions are remitted to the relevant scheme fund. This creates problems on payment of such unremitted contributions. As Kimathi[68] notes in her article, trustees and managers are required to give a remedial plan of how the unremitted contributions will be paid to the scheme. However, the trustees and managers being employees, it is difficult for them enforce the remedial plan to the employer for fear of losing their jobs. In the event of the employer becoming insolvent therefore, such unremitted contributions will rank as third priority claims i.e.

[67] ibid s 40(d).

[68] Christine Gatwiri Kimathi, 'A critical analysis on the role of the Retirement Benefit Act and Regulations in the Prevention of Loss of Retirement Benefits in the Occupational Pension Schemes' (Master Thesis, The University of Nairobi 2013) pp 49.

amounts deducted by the bankrupt company from the salaries of employees in order to satisfy their obligations to other persons.[69] There is no special treatment of such unremitted contributions.

Further, where penalties are provided for offences committed in contravention of the RBA, the penalties are very lenient to curb maladministration and mismanagement of funds considering the loss that can be occasioned by poor scheme administration i.e. to a fine up to five hundred thousand shillings, or to imprisonment for a maximum term of two years, or to both.[70] The culpable officers may be prosecuted for their misgivings and end up being convicted thus learning their lessons as well as deterring others in similar positions. However, the main interest of contributor of a pension scheme is their money. The question thus remains how to ensure that the contributor of a pension scheme will be guaranteed to receive their life savings in such incidences. The recourse is establishing a pensions guarantee fund to save the days.

2.2. THE NATIONAL SOCIAL SECURITY FUND (NSSF) ACT

The National Social Security Fund (NSSF) is a fund established and governed by the NSSF Act, 2013. The Fund mainly aspires to provide basic social security for its members and their dependants. It also seeks to increase membership coverage for the scheme, to increase benefits paid by the Fund as well as allow self-employed persons access of social security for themselves and their dependants.[71] The focus of this write up is on guarantee of social security which ties

[69] Insolvency Act, Second Schedule, Paragraph 3
[70] ibid s 39.

[71] NSSF Act s 4.

with the first of the objects of the NSSF Fund i.e. provide basic social security for its members and their dependants in cases of contingencies as the NSSF Act may provide.

The NSSF Fund is thus a retirement benefit scheme as defined under section 2 of the Retirement Benefits Act. As such the NSSF is subject to the RBA in so far as regulation of retirement benefits schemes are concerned. We will thus look at how the NSSF Act guarantees or safeguards the social security of its members.

i) Compulsory registration of employers and employees under a contract of service

The NSSF Act promotes social security by requiring compulsory registration of employers and employees under a contract of service.[72] An employer who fails to register under the Act commits an offence and is liable to a fine of fifty thousand (Ksh. 50,000/-) shillings.[73] The Act also provides that 6% of each employee's monthly pensionable earnings shall be paid into the Fund by the employer and each employee.[74] This is for all employees where there is a contract of service with that employer. However, this provision was suspended by the High court decision in ***Kenya Plantation and Agricultural Workers' Union v. The Board of Trustees, National Social Security Fund and the Hon. Attorney General***[75] to allow employers and employees time to understand the law so as to enable smooth implementation. Thus contributions are made at the old rates provided for in the Repealed NSSF Act i.e. Ksh. 200 by employer and Ksh. 200 by the employee. The NSSF Act further provides that the employees contribution should be deducted

[72] ibid s 19.
[73] ibid s 19 (6).
[74] ibid s 20.
[75] Petition No. 11 of 2014.

from their earnings but the employer's contribution must not be paid from employees earnings but from other employer resources.[76]

The Act acknowledges that employers and employees may be registered under other pension schemes. It thus allows such employers to opt- out of NSSF. However, this applied to employees with Tier II contributions. Tier II contributions are those above the average statutory minimum monthly basic wage determined from time to time by the Cabinet Secretary responsible for social security matters. However, there is an applicable procedure before an employer can opt out of the Fund. The employer is required to make a written request to RBA at least 60 days before opting out and the RBA will assess if the contracted out scheme meets the reference scheme test before giving approval for opting out.[77] This ensures that an employer would not just put the employees money in any scheme without the RBA assessing the risks, financial stability and safety of contributor's money.

ii) Voluntary membership

The NSSF Act also provides that self- employed persons may register for NSSF as its scope was expanded to cover voluntary memberships.[78] Voluntary members are required to pay a minimum of two hundred shillings per month or four thousand eight hundred shillings per annum to a provident fund[79] and an individual provident fund account opened for each voluntary member.

[76] ibid s 22.
[77] ibid s 21.
[78] ibid s 4.
[79] ibid s 23.

iii) Benefits not assignable or transferrable

Section 30 of the NSSF Act protects any a member's benefits from any set off or attachment against any debt of any legal process or order of a court of law. This resonates with the object of the Act to promote social security for future contingencies or old age. If the Act allows such money to be otherwise utilized, it will defeat the very purpose of the Fund.

iv) Proper keeping of books and accounts

The NSSF is also required to be keep proper books and accounts and prepare statements of income and expenditure and statements of assets and liabilities as well as a statement showing the segregation of pension fund assets and provident fund assets and submit them for audit to the auditor general. The NSSF Board is mandated to ensure that the audited accounts of the Fund are published in at least two daily newspapers of wide circulation throughout Kenya within 3 months after audit is complete.[80] Accountability is key for every organization especially where it involves members of the public. Audit of accounts and records thus enables the NSSF achieve accountability.

v) Offences

The Act creates offences for failure to register with the Fund for employers and employees as well as evading contributions or other amount due to the Fund.[81] Other offences relate to failure to disclose material information or misrepresenting any information for one's benefit or benefit of a person known to them. The penalties range from imprisonment for a maximum term of three

[80] ibid s 51.
[81] ibid s 55(a).

years or fine of up to five hundred thousand shillings.[82] In some cases, an employer may be required to pay an amount equal to that owed to the Fund e.g. if they have not been remitting the contributions required to the Fund.

vi) Priority for payment of contributions

The NSSF Act gives priority to contributions due to the Fund over other debts. Where property is attached in a legal process to satisfy debts and it is sold, the proceeds of the sale should not be distributed to any person unless the court makes provision for the payment of any amount due by the employer to the NSSF.[83] The Act further protects contributions to the Fund by providing that they shall not be assets for the benefit of creditors in the event of the bankruptcy or insolvency of the contributor.[84]

vii) Exemption from stamp duty and income tax

The NSSF Act exempts any contract, instrument or documents executed by or on behalf of the Fund and for the benefit of the Fund from stamp duty which would otherwise be payable.[85] Further, the Act exempts from taxation any income of the Fund as well as benefits paid out of the fund.[86] The benefits are not available for attachment for debt or under any legal process. This protection promotes a guarantee of social security.

Whereas the NSSF Act safeguards members' contributions for their future benefit as highlighted above, it has a few shortfalls. The Act discriminates the members of the scheme in voluntary

[82] ibid s 55 (i) to (v).
[83] ibid s 59.
[84] Ibid.
[85] ibid s 65.
[86] ibid s 66.

membership (Provident Fund) compared to those in compulsory membership i.e. by virtue of employment (Pension Fund) in so far as the benefits are concerned. Contributions for voluntary membership are two hundred shillings whereas the Act required an employer and employee to contribute 6% of the employee's pensionable earnings.[87] This provision was suspended and contributions now stand at two hundred shillings for both employer and employee. On the benefits, there are several benefits such as retirement benefit (upon retirement), invalidity benefit (in case of physical or mental incapacitation), survivors benefit (in case of death), funeral grant for funeral expenses and emigration benefit for those who move out of the country with no intention to return and live in Kenya.

The Act provides that for member of Pension Fund, there is a funeral grant of Ksh. 10,000 available to the next of kin which is not available in cases of members of the Provident fund. Further, for Survivor's pension and Invalidity pension, there is a distinction between Tier 1 and Tier 11 contributors. Tier 1 being those whose monthly wage is below the minimum wage for certain cities, their beneficiaries are entitled to the late member's contributions and an extra benefit[88] For Voluntary membership, the nominated beneficiary is only entitled to one's contributions as at the date of death or becoming incapacitated. The discrimination on basis of social status arises in that there could be voluntary members who make less or money equivalent to employees in the Tier 1 class yet they miss out on the extra benefit provided for the pension fund. Social security as a concept is should be available to all persons irrespective of social status.

[87] ibid s 20.
[88] ibid s 55(2).

The NSSF, 2013 Act does not provide for the rate of return to be paid to contributors. In the past, the rate of return has been argued to be proportionate to the rate of earnings on fund assets. since 2003, the rate of interest was a minimum of 2.5% per annum which as Raichura[89] argues is very minimal and has been a subject of debate for increment over the years. the rate of interest ought to match the return on fund earnings over a given period of time. The rate of interest has also been below the return rate allocated by other retirement benefit schemes in Kenya. This inconsistency creates lack of support, disincentive to participate and encourages non-compliance among the Fund members.[90]

There is also a concern on the expenditure of NSSF which is said to be very high compared to contributions made. In 2016, it was reported that NSSF had spent approximately 52.51 percent of the collections on administration for the year ending June 2015. NSSF was in breach of the set 2% maximum expenditure by spending Sh105 to manage each Sh 200 monthly contribution. This amounted to 3.73 per cent of total assets. The effect was to lower money available for investments and retirees' yields.[91] The Fund's expenses stood at Sh 6.1 billion in the year, against collections amounting to Sh11.7 billion in 2016. While the goal of NSSF is to provide social security to its members, this can well be achieved by keeping expenses on the low in order to maximize investments and ultimate benefits to the contributors.

The Auditor General's report for the year ended June 2016 also highlighted that NSSF had unremitted employees contribution of about Ksh. 755 million for the 20 employers whose files were sampled. Further, the suspense account had about 764 million of contributions not allocated

[89] Sundeep K Raichura, 'An analytical review of the Pension System in Kenya' 2008 pp 9 https://www.oecd.org/finance/private-pensions/41564693.pdf accessed 28th July 2018.
[90] ibid.
[91] David Herbling, 'NSSF spends half of employees' contributions on administration' Business Daily (Nairobi, 1st November 2016) www.businessdailyafrica.com/NSSF-spends-half-of-employees--contributions-on-administration/539552-3437832-k5w14d/ accessed on 15th April 2018.

to specific contributors. Mismanagement, lack of transparency and accountability of income from properties in Mombasa, Kisumu and Nairobi was also evident in lack of due diligence and documentation on transactions relating to properties.[92] This indicates to the inefficiencies surrounding NSSF operations as highlighted by several writings.

The NSSF Act also does not give recourse to a contributor in cases where the Fund itself becomes insolvent or falls victim of maladministration or mismanagement of funds. The Act provides security in cases where employers fall insolvent or are liable to debt where its property or money becomes subject of attachment. The contributions or any money due to the NSSF has priority over other debts. Further, the benefits payable to contributors upon retirement or to their beneficiaries cannot be attached to settle debts in a legal process.[93]

In cases where it is the Fund itself liable for debt or is insolvent, how are the contributions protected? It is worthy noting that the NSSF is the only body receiving all contributions from employees, employers and voluntary members, yet the Act does not give recourse for them in case the fund becomes insolvent. As Kimathi noted in her research on the role of RBA in protection of retirement benefits, the Insolvency Act did not provide for preferential treatment for retirement benefits for unremitted pension contributions.[94] She proposed an amendment to the Insolvency laws to allow for this. The Insolvency Act, 2015 made an attempt to cover this. The Second Schedule[95] provides that third priority claims include amounts deducted by the bankrupt or company from the wages or salaries of employees in order to satisfy their obligations

[92] Auditor General, 'Financial Statement of NSSF for the Year ended 30th June 2016'.
[93] ibid s 30, s 59.
[94] Christine Gatwiri Kimathi, 'A critical analysis on the role of the Retirement Benefit Act and Regulations in the Prevention of Loss of Retirement Benefits in the Occupational Pension Schemes' (Master of Law Thesis, The University of Nairobi 2013) pp 49.
[95] Insolvency Act, Second Schedule, Paragraph 3.

to other persons. Arguably, deducted pension contributions fall under this class. However, this would only apply to unremitted contributions. In cases of contributions already remitted, the law does not provide for a remedy to contributors. This then justifies establishment of the pensions guarantee fund which would come in to pay contributors whose benefits are due as the Fund reorganizes or solves its liquidity or other problems.

2.3. PENSIONS ACT

The Pensions Act, Cap 189 Laws of Kenya was enacted to allow for the provision and regulating of pensions, gratuities and other allowances for the public service officers in Kenya. The Act applies as a charge on the Consolidated Fund[96] and very officer has a right to pension or gratuity which excludes the compensation for past services.[97]

Under section 13, pensions payable under the Act cannot be assigned or transferred unless it is in payment of a debt due to the Government or for payment of maintenance of a wife or a child of the public officer to whom pension or gratuity has been paid.[98] In some cases, if an officer becomes bankrupt or is convicted and sentenced to imprisonment before or after retirement, pension or gratuity payable may be stopped.[99] However, pension and/gratuity is payable to dependants where an officer dies during service or after retirement.[100]

[96] Pensions Act, 1950 s 4.
[97] ibid s 5.
[98] ibid s 6.
[99] ibid s 14 and 15.
[100] ibid s 18 and 19.

The Pensions Act does not provide if the employees in the public service make individual contributions to the Fund since their payments are made from the Consolidated Fund. In case the Consolidated Fund does not have funds to pay a beneficiary at any one time, what is the recourse of such a person?

2.4. RETIREMENT BENEFITS (DEPUTY PRESIDENT AND DESIGNATED STATE OFFICERS) ACT

This Act provides for retirement benefits for Deputy or Vice Presidents and designated State Officers such as Speaker of National Assembly or the Senate, Chief Justice and Deputy Chief Justice and Prime Minister upon their retirement.[101] The Act further provides for the retirement benefits which include a monthly pension equal to 8% of the last monthly salary when the officer was in office, a lump sum pension equal to one year's salary for each term the officer was in service, one or two saloon cars of capacity not exceeding 2000 cc and one four wheel car of capacity not exceeding 3000 cc, fuel allowance of 15% of the last monthly salary, a medical fund and hospital cover for local and international hospitals and other additional benefits like drivers and support staff.[102]

Upon death of an entitled officer, the benefits are paid to their spouse and/or children.[103] The Act also provides for the accounts relating to expenditure to be audited and reported by the Auditor General.[104]

[101] Retirement Benefits (Deputy president and Designated State Officers) Act s 3.
[102] ibid s 5-7.
[103] ibid s 9 and 10.
[104] ibid s 14.

2.5. PRESIDENTIAL RETIREMENT BENEFITS ACT

This Act is more similar to the one governing retirement of Deputy President and designated state officers but with a few additions.

A retired president is entitle to *inter alia*: a monthly pension equal to 8% of the last monthly salary, a lump sum pension equal to one year's salary for each term the President was in service, two new cars of his choice of capacity not exceeding 3000 cc and two four wheel car of capacity not exceeding 3400 cc, house allowance at 23% of the monthly salary, fuel and entertainment allowance of 15% of the last monthly salary, water, electricity and telephone allowance at 23% of last month's salary and a medical fund and hospital cover for local and international hospitals and other additional benefits like drivers and support staff.[105]

Upon death of an entitled officer, the benefits are paid to their spouse and/or children.[106] The benefits paid are tax free[107] and the Act also provides for the accounts relating to expenditure to be audited and reported by the Auditor General.[108]

The Pensions Act, the Retirement Benefits (Deputy President and Designated State Officers) Act and Presidential Retirement Benefits Act form part of legislations that provide for retirement benefits in Kenya. These are governed by the Retirement Benefits Act in so far as retirement benefits are concerned. These three are relevant as they promote social security of public and state officers.

[105] ibid s 5.
[106] ibid s 7-7A.
[107] ibid s 10.
[108] ibid s 11.

2.6. CONCLUSION

The legal framework on pensions and retirement benefits in Kenya is quite elaborate as highlighted above. The main law is the Retirement Benefit Authority Act which establishes the Retirement Benefit Authority. The Authority regulates the administration and supervises the establishment and management of all other schemes which fall under the definition of a "scheme" under the RBA Act. This regulation is one of the ways of protecting pension scheme benefits.

The protection of pension benefits from taxation or attachment or sequestration in cases of debt recovery provides a relief to a pensioner that their right to social security is secured. The laws also creates offences through which persons contravening the law as far as governance of pension schemes is concerned can be charged and prosecuted. The requirements for keeping of proper books and accounts as well as audit also enhance the protections available to pensioners. However, where penalties are provided, they are very lenient to deter maladministration and mismanagement of funds considering the huge loss that can be occasioned by poor scheme administration.[109] Whereas the officers involved may be prosecuted for their misgivings, the interest of pensioners is their money. Prosecution of cases in Kenya takes a long period of time and where such officers are found culpable and ought to refund lost money, asset recovery may take time in which case the pensioner banking on their pension for their daily life will be at a loss. A liquidator may also be appointed for recovery of assets and funds but this involves another court process. Since compensation is paid once liquidation is finalized, the delay will impact on a pensioner's life negatively.

[109] ibid s 39 provides for to a fine not exceeding five hundred thousand shillings, or to imprisonment for a term not exceeding two years, or to both.

Whereas the Retirement Benefit Authority regulates all schemes and puts in place measures to secure pensioners money, the above laws do not provide a cover in cases where such funds collapse or suffer insolvency. The measures put in place, as highlighted above, provide protection as long as the schemes are a going concern and operating smoothly. Whenever there are issues such as mismanagement of the scheme, loss of funds or when the scheme is insolvent arise, the law does not provide recourse to the contributor of such a scheme. This in effect creates the need for another institution (the pensions guarantee fund) to safeguard pensioners' savings in cases where schemes collapse or become insolvent.

CHAPTER 3

THE VIABILITY OF A PENSIONS GUARANTEE FUND IN KENYA

The purpose of establishing pensions schemes is to encourage pensioners to save money for future use/need. According to the life-cycle hypothesis theory, people plan their spending based on their current and expected future income. Since the cycle is that when one grows older or after retirement they may not save as much, pension thus provides social security to individuals. This future income/benefit from schemes therefore needs to be protected otherwise the very purpose of pension schemes will be defeated.

The ultimate risk faced by beneficiaries of pension schemes being the loss of retirement income where the schemes are underfunded and suffer insolvency.[110] This section examines the arguments for and against the benefit/pensions guarantee schemes as highlighted below.

3.1. CASE FOR PENSION GUARANTEE FUND

3.1.1. Need for a fall back mechanism for pensioners

The previous chapters have highlighted the challenges that pensions schemes face some of which go to the very basis of establishing such schemes. These include: poor administration and

[110] Fiona Stewart, 'Benefit Security Pension Fund Guarantee Schemes' OECD Working Papers on Insurance and Private Pensions, No. 5, OECD (2007) pp 5.

investments of pension funds, lack of transparency and accountability,[111]non-remittance of monthly contributions by employers, misappropriation of scheme assets by the trustees, loss of scheme funds through negligence of trustees and poor investment of the scheme assets,[112]unresponsiveness, discourtesy, inefficiency, delay, refusal to pay, discrimination and abuse of power in the processing of retirement benefits.[113] Most of these challenges sum up to maladministration which coupled with poor investment decisions may lead to collapse of such schemes and ultimately to insolvency of the scheme. When a scheme collapses, what happens to a pensioner who was waiting on the scheme benefits for their future life? This shows there is need for a recourse mechanism to ensure the pensioner ultimately gets their benefits.

3.1.2. Market failure

Market failure occurs as a result of inefficient allocation of resources in a free market which in turn distorts the market. In a perfectly competitive market, there is free flow of information across the market. However, the perfect market is not likely to exist in a realistic world. The pensions sector is thus characterized by information asymmetry between the sponsors of pension funds and the contributors.[114] As such, contributors may not have all information they require to make a decision where to invest their money but operate based on perception of which scheme appears more viable or secure. As such, the contributors remain more exposed to risks of

[111] Sundeep K Raichura, 'An analytical review of the Pension System in Kenya' 2008 pp 17 https://www.oecd.org/finance/private-pensions/41564693.pdf accessed 28th July 2018.

[112]Christine Gatwiri Kimathi, 'A critical analysis on the role of the Retirement Benefit Act and Regulations in the prevention of loss of Retirement Benefits in the Occupational Pension Schemes' (Master of Laws Thesis, The University of Nairobi 2013).

[113] Commission on Administrative Justice, 'Sentenced to Poverty at Sunset: An Investigation Report on Systemic Issues inherent in the Payment of Payment of Pensions, Gratuity and other benefits' 2016 www.ombudsman.go.ke/index.php/resource-center/investigation-reports/category/48-investigation-reports-2016 accessed 28th July 2018.

[114] Supra n111 pp 6.

insolvency hence the need for the guarantee fund to cushion them against such risks. This creates the need for regulation of the market by government.

3.1.3. Diversification

Most employees depend on their employment income to sustain their current needs and also make savings for their future. Even if there was free flow of information to make a well informed decision of where to put ones money or pension investment, the problem of diversification still remains. This is because most employees have a single source of income for their future and current life. The reserve system used by employers to fund schemes also creates a problem of diversification as funds are not secured by an external pool of assets. The funds thus form part of the employer's assets reflected in the statement of financial position and remain at risk in the event the company becomes insolvent.[115] For such reasons, pensions guarantee funds should be mandatory.

3.1.4. Systematic risks

Risks are said to be systematic when they affect the entire market or market segment. These compared to unsystematic risks cannot be diversified and they are also referred to as undiversifiable risks. They include inflation, recession and wars. Insurance can thus not cover systematic risks considering that the probability of the event happening would affect the entire market.[116] Therefore, such risks require a cover that would ensure pensioners do not lose their money absolutely. The systematic risks which would not be covered by insurance thus makes a case for establishment of a pensions guarantee fund.

[115] ibid.
[116] ibid.

3.1.5. Political reasons

Many pension guarantee funds are set up are set up as a result of political pressures. For example, the PBGC was set up in the USA to support the economy via industrial sectors while in the UK, it followed from political pressure to cover the many losses that arose from bankruptcy of over 65,000 pension schemes. The justification is that benefit guarantee funds are set up more for political reasons than economic efficiency.[117] In Kenya, similar events take place whereby the public outcry necessitates certain actions to be taken by the Government. In the wake of the rampant corruption, mismanagement of funds, threat of collapse of pension schemes being reported, the question arises whether political reasons are sufficient justification for the establishment of a pension guarantee fund.

As highlighted before in Chapter 1, there are laws to provide for recourse in case of corrupt officers, mismanaged funds can be recovered through asset recovery and collapsed schemes may be saved through appointment of a liquidator. However, the recovery in these processes may take such a long time yet the pensioner/contributor of pension funds is not guaranteed recovery of their money. The heart of pension guarantee funds is to cover pensioners in the event that they are not paid their money. Therefore, whether such guarantee funds are set up for political reasons or otherwise, they remain justified. Their operations can be improved to promote economic efficiency.

[117] ibid pp 8.

3.1.6. Lack of available effective alternatives

This study acknowledges that pensions guarantee funds are necessary but payments from the fund should be employed as a matter of last resort. If it becomes a common pool from which all pensioners are paid from, it will become too expensive to run and almost unsustainable. It this has to be employed where all other alternatives fail. It can be argued that some of the other challenges affecting pension funds payments can be controlled. For instance, market can be overcome by providing employees with requisite information so they can make their pension trade off decisions wisely although this would be highly unlikely in practical terms. Alternatively, asset allocation rules could be applied so as to immunize liabilities fully as well as match them with appropriate assets. Giving pension claims high priority in bankruptcy or treating them as secured creditor rights would provide a better alternative too.[118] If such alternatives work, pensions guarantee funds would be of little use.

Guarantee can be provided through strict funding rules which ensure pension schemes are well funded.[119] It is however difficult to ensure that the scheme are always funded 100% in light of fluctuating market returns or when full immunization of assets is not available. The lack of effective alternatives thus makes the pension guarantee fund necessary so it can step in when other options fail.

[118] ibid pp 9.
[119] ibid pp 9.

3.1.7. Other existing guarantee funds

The financial sector in Kenya comprises of the banking sector, insurance sector, capital markets and pensions sector. The first three sectors all have protection funds namely, the Deposit Insurance Fund, Policyholder's Compensation Fund and CMA Investor Compensation Fund respectively. The arguments for such protection funds is the same as that of pensions guarantee fund i.e. to secure the ultimate benefit to the intended beneficiary. This provides some confidence to the investor or contributor that they will recover their money albeit not fully. This provides a justification for the pensions sector which is part of the financial sector to have a similar protection for its beneficiaries. The focus should thus be to ensure it can overcome the challenges that other protection funds in the financial sector are facing.

3.2. CASE AGAINST PENSION GUARANTEE FUNDS

The case for establishment of a pensions guarantee fund can only be considered amidst the arguments against its establishment in order to make a sound judgment. Some of the arguments against its establishment include:

3.2.1. Wage bill

Government expenditure on wages has been growing over the years and has become a concern. It was reported at 464.9 billion in 2012/2013, 521.6 billion in 2013/2014, 568 billion in 2014/2015, 627 billion in 2015/2016 and 675.8 billion in 2016/2017.[120] Whereas the pensions guarantee fund may be established as a stand alone institution or under the Retirements Benefits Authority,

[120] Salaries and Remuneration Commission, Wage Bill Quarterly Bulletin, Volume 1, 2017.

it will still require funds to run its operations e.g. pay wages to its staff, compensation to Board members besides other administrative costs. The net effect is to raise the wage bill which is already a concern in our country. It is possible to have the fund funded by contributions from sponsors of contribution schemes, government intervention will still be required as the fund has to be run and regulated as a government agency rather than a private one. The question of increased wage bill can thus discourage establishment of such a fund. However, this has to be weighted against the benefit derived from the guarantee fund which is a viable fall back measure for a pensioner.

3.2.2. The moral hazard

The question of moral hazard arises from how human beings are oriented. Humans respond to the environment around them. It would be expected that when scheme sponsors are aware that they can back out on their promise and their liabilities will be taken care of, even where assets are insufficient, the motivation to be responsible may be lost. Such behaviour may include raising benefits to unsupportable levels, cutting their own contribution rates, or pursuing a risky investment strategy.[121]

However, this negative influence can be avoided by limiting claims from the pensions guarantee fund by making them very specific and setting them out without ambiguity. Other measures that can be taken include adopting strict funding rules to reduce the size of possible claims, increasing premiums payable as the scheme becomes more underfunded or adopting risk averse investment strategies.[122]

[121] Supra n 105 pp 7.
[122] ibid.

3.2.3. Expected challenges

These are the would be challenges when dealing with guarantee funds. This is based on the experience of the other protection/guarantee funds in the financial sector in Kenya. Funding is a challenge that arises out of the many claims arising resulting to liquidity issues. Most of these funds are not funded by the government hence their funds are self-raised from contributions, penalties or income from investments. For instance, in June 2010, the Investor Compensation Fund paid Ksh. 281 million to 90% of the claimants of Nyaga Stock Brokers and was left with only 193 million which was expected to settle the remaining 10% claimants as well as claimants from Discount Securities Limited which was under statutory management.[123]

Further, in most cases, compensation is usually paid after the liquidation process is complete. Liquidation usually involves a court process, and due to delays in court cases, liquidation takes a long time to finalize. For instance, the Policyholders Compensation Fund as at 2010 was reported to not have paid anyone from the fund despite so many insurance companies becoming insolvent.[124]

The biggest challenge is the amount of compensation paid by these Protection Funds. The payments are so minimal such that it almost does not warrant to be termed a compensation. In some cases, it may not even be a quarter of one's savings or investments. For example, the Capital Markets Act Compensation Rules and Procedures provides for payment of Ksh. 50,000 per claimant while the Kenya Deposit Insurance Act provides for Ksh. 100,000 per depositor where a bank becomes insolvent, even if one holds more than one bank account. The insurance

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[123] Nzomo Mutuku, 'Need and viability of a benefit protection fund for retirement benefits schemes in Kenya' (RBA Research Paper, 2011) pp 5.
[124] ibid pp 7.

sector is no better as a policy holder also gets compensation of a maximum of Ksh. 100,000 where the insurer falls insolvent.

Since the pension schemes falls within the financial sector, it is worth exploring in more detail the guarantee/protection funds within this sector in Kenya. This will aid in getting a background of their operations, coverage, funding and challenges they experience with a goal to determine whether another guarantee fund for pension schemes is worth establishing or otherwise.

3.3. THE GUARANTEE FUNDS IN THE FINANCIAL SERVICES SECTOR IN KENYA

The financial services comprise of the range of activities provided by the finance industry. Kenya's finance industry comprise of services provided by the banking, insurance, pensions and capital markets sectors. This part looks at the existing guarantee funds in the financial services sector. It outlines the operations, coverage, funding and the challenges that they face. This will assist to build the case for a pensions guarantee fund while providing lessons on the challenges in order to avoid some of the inherent challenges that the pensions guarantee fund is likely to face.

3.3.1. Policyholders Compensation Fund (PCF)

This Fund is established under the Insurance Act[125] and is governed by the Insurance (Policyholders Compensation Fund) Regulations, 2010 under the Act. It was established in 2004 via Legal Notice Number 105 of 2004. This was as a result of the insolvencies that were taking

[125] s 179.

place in the insurance industry. The objective of the fund is to provide compensation for policyholders in the event that the insurance company is becomes insolvent.[126]

The Fund is managed by a Board of Trustees whose functions include compensating policyholders of an insolvent insurer, participating in statutory management of an insurer placed under statutory management and liquidating an insurer among other functions.[127]

The Fund is only invoked when the insurer is declared insolvent and a policyholder lodges a claim. Paragraph 11 of the Regulations provide for when an insurer should be considered insolvent. This includes when declared so by a court of law, when so dissolved under the Insurance Act, subject to voluntary winding up meeting of creditors or where it is wound up by a court at the instance of the Commissioner of Insurance.

The Fund is also limited to Kenyan Policies and an insured will not be compensated where the liability of the insured is covered by another insurance company which is not insolvent.[128]

The Fund is funded by monies appropriated by Parliament for that purpose, contributions of authorized contributions from insurance companies and policy holders, penalties payable and any other monies borrowed or otherwise reimbursed into the Fund.[129] every insurer and policy holder should contribute 0.25% of the premium payable and the insurer should remit the same to the Fund. This should be remitted within 30 days of issue of the policy or renewal of the same.[130]

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[126] ibid s 179(1).
[127] ibid s 179 (2A).
[128] Insurance (Policyholders Compensation Fund) Regulations, 2010, Paragraph 17.
[129] ibid paragraph 3(2).
[130] ibid paragraph 9.

As highlighted by Mr. Nzomo[131], the major concern relates to the amount of compensation paid. Whereas the Regulations in paragraph 12 provide that the Board shall determine from time to time the compensation payable under different classes of insurance and gazette the same, the practice has been that Ksh. 100,000 is payable as maximum compensation. This is such a small amount considering that a policy holder may have paid premiums in excess of the same. The reason for the insurer investing in such a policy is watered down because the social security they seek to achieve is not achieved.

There are also other limitations and conditions applicable in regard to compensation. The Regulations provide that a claim for compensation has to be made within 2 years from the time the insurer becomes insolvent.[132] The rights of any policyholder are also subject to any conditions[133] which may be imposed by the Board such as the rights relating to premiums or any rights accruing to any other person.[134] Moreover, the rights are limited where the liability would arise in regard to another insurer, then this other insurer will be left to settle the claim and the insolvent insurer will not be required to compensate the policyholder.[135] The principle of contribution applies. Whereas the idea behind the principle of contribution may be noble to prevent unjust enrichment, the policyholder may be left at a loss if the second insurer suffers insolvency in future and is unable to compensate him/her.

Further, the Compensation Fund is housed by the Insurance Regulatory Authority which regulates the insurance business in Kenya. This may reduce its operational independence in its affairs. Further, since compensation is only paid once an insurance company is declared

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[131] Nzomo Mutuku, 'Need and viability of a benefit protection fund for retirement benefits schemes in Kenya' (RBA Research Paper, 2011) pp 9

[132] Insurance (Policyholders Compensation Fund) Regulations, 2010, Paragraph 15.

[133] ibid.

[134] ibid paragraph 16.

[135] ibid paragraph 17.

insolvent or liquidated, the process may take a long time thus defeating the very purpose of making such an investment. By 2010, it was reported that, the Compensation Fund had never compensated anyone since its inception.[136]

3.3.2. Investor Compensation Fund (ICF)

The Investor Compensation Fund is established under Section 18(1) of the Capital Markets Act, Cap 485A, Laws of Kenya. The ICF is administered by a Board whose purpose is to determine and make compensations arising from the Fund. Initially when the Capital Markets Act was enacted, the ICF was administered by the Capital Markets Authority until the Act was amended in 2007 to establish the ICF Board. However, this Board has not since been operationalised. No officers have been appointed to assume the role of the Board.

The primary objective of the ICF is to grant compensation to investors who suffer financial loss resulting from the failure of a licensed stockbroker or dealer to meet his contractual obligations. It is also mandated to pay beneficiaries from unclaimed dividends when claims arise.[137]

The Compensation Rules and Procedures for Investor Compensation Fund, the amount paid as compensation in respect of claims arising from a particular event or set of related events are: Kshs 50,000 per claimant, Kshs 2,000,000 per Participant and Kshs 4,000,000 in the aggregate (i.e. if more than one Participant is involved).[138] The sum of Ksh. 50,000 per claimant or 2 million per Participant is not sufficient in most cases where investors invest millions in the

[136] Nzomo Mutuku, 'Need and viability of a benefit protection fund for retirement benefits schemes in Kenya' (RBA Research Paper, 2011) pp 9.
[137] Capital Markets Authority Act s 18(1).
[138] Compensation Rules and Procedures for Investor Compensation Fund, Rule 6.4.

capital markets. The investors may even get less than Ksh. 50,000 depending on the number where the limit is Ksh. 2 million per Participant.

The fund comprises of monies paid into the Compensation Fund by licensed persons, fines or penalties collected, interest and profits received from investments made and any moneys recovered from insolvent entities and monies received from any other source approved by the Cabinet.

The fund has been reported to suffer from insufficient funds for compensation of investors who have suffered losses consequent to the failure of the stockbrokerage firms to meet their contractual obligations. This has caused delayed compensation of investors as the Authority seeks alternative sources of funds hence further eroding the investor confidence in capital markets. For Instance, In June 2010, the Investor Compensation Fund paid Ksh. 281 Million to claimants via Nyaga Stock Brokers and was left with only 193 million which was expected to settle the remaining 10% claimants and claimants from Discount Securities Limited which was under statutory management.[139]

The East African Financial Journal reported that in March 2009, Discount Securities Limited collapsed with estimated claims of over Kshs. 1.4 billion.[140] However, the Annual Report and Financial Statement for the financial year 2008/2009 indicated that the Fund had then accumulated a total of about Kshs. 425 million, an amount which was far much below the investors' compensation claims.[141]

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[139] Nzomo Mutuku, 'Need and viability of a benefit protection fund for retirement benefits schemes in Kenya' (RBA Research Paper, 2011) pp 5.
[140] Lucy Nyambura Kimani, 'Investor Compensation Funding as a Determinant of Investor Confidence in the Capital Markets in Kenya' (Master Thesis, The University of Nairobi 2010) pp 7.
[141] CMA Annual Report and Financial Statements for the Year ended 30th June 2009 pp 38 www.cma.or.ke/index.php?option=com_phocadownload&view=category&id=13&Itemid=212.

In March 2007, the collapse of Francis Thuo and Partners Ltd came at a time when the Capital Markets Authority's financial statements indicated an accumulated total assets of about Kshs. 125 million as at June 30, 2006[142] against an estimated total claims of Kshs. 150 million according to the East African Financial Journal[143]. Consequently, Francis Thuo and Partners Ltd saw the sale of the firm's seat at the Nairobi Stock Exchange in order to avail funds to fully compensate its investors.

Whereas the compensations by the ICF may promote investor confidence in the stock markets, the payments deplete the reserves which makes ICF have insufficient funds to take care of other claims that may arise. This was the case after compensation of claims under Nyaga Stock Brokers and Deposit Securities. This in another form affects the public confidence in the ICF. Whereas the problem would be curbed by increasing the contributions paid by investors, this is likely to erode their interest which is not good for growth of business.[144]

Further, the ICF Board's operations are yet to be operationalised. The Board after its establishment in 2007 was to be operationalised so as to take over the administration of the ICF from the Capital Markets Authority. This is yet to be done, which leaves the question whether there was a purpose of establishing the Board which has now been un-operational for over 10 years unanswered.

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[142] CMA Annual Report and Financial Statements for the Year ended 30th June 2006 pp 33 www.cma.or.ke/index.php?option=com_phocadownload&view=category&id=13&Itemid=212.

[143] James Anyanzwa, "CMA to Cede Management of Compensation Fund' *East African Standard* (Nairobi, September 29, 2009) p. FJ 19 Cited in Lucy Nyambura Kimani, 'Investor Compensation Funding as a Determinant of Investor Confidence in the Capital Markets in Kenya' (Master Thesis, The University of Nairobi 2010) pp 7.

[144] David Mugwe, 'Investors paid Sh. 281m for losses at Nyaga Stockbrokers' *Business Daily* (Nairobi, 14th June 2011) https://www.businessdailyafrica.com/markets/539552-1180342-kjxbuiz/index.html accessed on 21st September 2018.

3.3.3. Deposit Insurance Fund (DIF)

This Fund was established in 2012 to replace the Deposit Protection Fund. DIF was established via the Kenya Deposit Insurance Act in 2012. This Act also established the Kenya Deposit Insurance Corporation (KDIC), a state corporation providing deposit insurance to depositors in Kenyan banks and deposit-taking microfinance institutions.

The Fund vests in the Corporation and is administered by the KDIC Board.[145] KDIC is mandated to levy contributions for the Fund (from member institutions), to hold, manage and apply the Fund. It also administers the deposit insurance scheme set up under the Act. It is also mandated to receive, liquidate, and wind up institutions for which it is the designated receiver or liquidator, a function previously overseen by the Central Bank of Kenya.[146]

Each deposit placed with an institution is insured by the Corporation. However, this is done only to a maximum amount. The maximum amount payable to a customer is one hundred thousand shillings or a higher amount as may be set from time to time. Where one customer maintains more than one deposit account in one institution, the insured amount remains Ksh. 100,000/-.[147] Where the Corporation is appointed as a liquidator of the institution in question, it has obligations to pay the insured deposits.

The first source of funds to the DIF was monies that existed in the Deposit Protection Fund which had been established under the Banking Act. The DIF is also funded through monies contributed by member institutions, any interests or penalties levied in respect of such

[145] Kenya Deposit Insurance Act s 20(2).
[146] ibid, s 5.
[147] ibid s 28.

contributions, any borrowed money, income that may accrue from investments made by the Fund, any grants or donations or monies otherwise received into the Fund. Parliament does not make any fund allocations for DIF but in cases of urgency, it may appropriate funds for purposes of the DIF.

Members are required to contribute a certain amount into the fund i.e. not be less than three hundred thousand shillings (Ksh. 300,000); not more than 0.4% of the average of the institution's total deposit liabilities. These liabilities are based on the period of twelve months prior or prorated for the number of months an institution has been a member, in cases where they are less than 12 months old in the membership.[148] A penalty interest charge of 1.5% of the unpaid amount accrues every month the contribution remains unpaid by any institution to the Fund.[149]

The main challenge with the DIF is funding and the deposit insured. As highlighted, the DIF is not funded by Parliament unless in very extreme cases. Institutions governed by the Kenya Deposit Insurance Act contribute 0.4% of the average deposits or Ksh. 300,000 per annum whichever is higher. Considering that such monies are used to pay deposits insured, any borrowings made and to pay administrative and other liabilities of the Corporation, moneys available to pay for insured deposits may not be sufficient. Further, requiring all banks to pay premiums at a flat rate is not a good practise. Such premiums should be based on the bank's risk profile as well as the amount of their deposits. This way the contributions paid will increase significantly thus protected amounts can also be increased.

The other problem arises in the maximum payment that can be made to an account holder in an institution. The Act stipulates that a maximum of Ksh. 100,000 is payable even where one has

[148] ibid s 27(3).
[149] ibid s 27(5).

more than one deposit accounts in one institution. Even in the case of joint account holders, their accounts are consolidated with the existing accounts and the compensation remains the Ksh. 100,000 to one depositor. The insurance provided is not sufficient to cover account holders some of which may be holding more monies in the bank accounts. It is also a disincentive to hold moneys in a bank account with such a small protection if the bank becomes insolvent. KDIC should work to increase the contributions levied from institutions so as to provide better insurance to depositors. This will help boost stability and public confidence in KDIC.

3.3.4. Conclusion

The case for the establishment of a pensions guarantee fund in Kenya has been made. As with the existence of the protection funds in the financial services sector, pension schemes and benefits require protection. The ultimate goal is to secure the right to social security for the citizens and the establishment of a pensions guarantee fund is one of the ways to secure this right.

The case for and against establishment of pension guarantee fund have to be weighed against each other to measure the good and the negative aspects of the Pensions Guarantee Fund. The need for a fall back mechanism through which pensioners can benefit in cases where schemes collapse is the overriding objective. As highlighted above, some of the justifications of establishing the fund such as market failure, problem of diversification, systematic risks can be somehow dealt with and pension guarantee funds would not be necessary. However, where the alternatives fail, the fund becomes necessary as a measure of last resort to give aid when there are no other options. It is evident that the claimants who have been compensated in the financial

sector are happy to recover part of their money rather than have no cushion at all e.g. the case of Nyaga Stock Brokers and Thuo and Partners highlighted above.

On the other hand, the issue of increased wage bill, the moral hazard and the expected challenges may discourage the establishment of such a fund. The only concern is that the compensation is too small and in most cases it is not proportionate to one's savings or investments. The moral hazard can be taken care of by reputational loss and loss of future business to prevent firms from poor investment decisions or mismanagement of pension scheme funds. Other preventive and remedial measures can also be employed.

There are 3 key issues cutting across the protection funds in Kenya:

i) Funding – funding for the Funds is not sufficient to cover contingencies when they arise
ii) Delays in payments of payment of compensation due to time taken in liquidation processes
iii) Amount of compensation paid is minimal- compensation paid is not commensurate to one's savings or investments.
iv) Independence in administration of the funds- Board in charge of administration being housed by the regulator e.g. Policyholders Compensation Fund is housed by the Insurance Regulatory Authority which regulates the insurance business in Kenya.

It remains viable that such a pensions guarantee fund is necessary in Kenya. The focus should be to overcome possible challenges to ensure efficiency of the fund. Further, good funding rules can achieve almost all of what a guarantee scheme strives for. These combined with other measures such as immunization of liability or priority bankruptcy rights offer a high level of protection. The guarantee fund would successfully perform its task as a 'last resort' benefit protection measure.

CHAPTER 4

A COMPARATIVE ANALYSIS OF PENSION GUARANTEE FUNDS

This Chapter does an analytical comparison with jurisdictions that have pension guarantee funds. This comparison gives guidance how some of the successful funds are administered while highlighting the challenges they face. These lessons combined what has been highlighted in Chapter 3 on the Kenyan financial sector guarantee funds will advise on best practices for effective administration of the proposed guarantee fund.

There are a number of jurisdictions with a pensions guarantee fund including USA, the United Kingdom, Canada, Germany, Chile, Sweden, Switzerland and Japan among others. This study will focus on 4 jurisdictions only: USA, the United Kingdom, Canada and Germany, These four jurisdictions have guarantee funds which cover defined benefits in cases where the employer suffers insolvency. The comparison will be based on the cover provided by each fund, source of funds, how the fund operates and the challenges they face. These jurisdictions have among the most elaborate and successful guarantee funds despite the challenges they face. Further, their way of operations, they are designed to cover contributors of pension funds where pension schemes fall insolvent which is the objective this research seeks to achieve.

Chile's pensions guarantee fund covers a minimum period of 20 years. Chile will not be a case to benchmark against because this study seeks to provide a solution to pensioners in cases where

the pension scheme becomes insolvent. Insolvency may come at any time thus a caveat on the period is not in the best interests of the pensioners.

On the other hand, Sweden operates guarantee of pension on contractual basis with most employees being covered under collective agreements between employers and employees confederations.[150] It is thus the trade unions that require pensions to be guaranteed and not the government. This system is different from the one anticipated by this study in that the pensions guarantee fund in this study is designed as a mandatory requirement of all pension schemes in Kenya which should be provided by a government institution.

In the case of Switzerland, the guarantee fund covers both defined benefit schemes and defined contribution schemes. However, protection is provided for the Fund itself and not the sponsoring firms.[151] The protection in this case is therefore is not very relevant to the current study which seeks to provide protection where the sponsoring firms suffer insolvency.

4.1. THE PENSION BENEFITS GUARANTY CORPORATION, USA

The Pension Benefit Guaranty Corporation (PBGC) was established by the Employee Retirement Income Security Act (ERISA) of 1974 to provide guaranteed basic benefits in the event that the occupational benefit plans become insolvent and the pension fund has too little money to meet its future obligations. The PBGC provides a safety net by insuring the participants' benefits under the covered plans. It covers retirement pension, early retirement earnings, survivor's benefits

[150] Fiona Stewart, 'Benefit Security Pension Fund Guarantee Schemes' OECD Working Papers on Insurance and Private Pensions, No. 5, OECD (2007) pp 28.
[151] ibid pp 30.

and disability payments for those receiving such payments before the covered plan terminates.[152]

The Pension Benefit Guaranty Corporation is headed by a Director who reports to a Board consisting of the Secretaries of the U.S. Commerce, Labor, and Treasury Departments, with the Secretary of Labor serving as Chairman.[153] There are two plans that participate in the programme: the single-employer plans and multi-employer plans. The two plans are funded separately and operate under different rules.

A multi-employer plan is defined as one in which more than one employer is required to contribute and that is maintained according to a collective bargaining agreement between one or more employee-organizations or employers. A single employer plan is one that is maintained by one employer, either through a collective bargaining agreement or unilaterally[154] and will be the focus of this part.

PBGC guarantees the basic benefits earned before the pension plan's terminates (or the date the employer's bankruptcy proceeding begins, if applicable). The Congress sets the legal limits of the cover each year. Generally, PBGC does not guarantee any monthly pension amount that is greater than what the plan would pay if one had retired at their normal retirement age. The benefit depends on the age of retirement or the date when the plan terminates or the employer becomes bankrupt.[155] The determined benefit for a person aged 60 years in 2018 is a maximum of $3,523.29 per month.[156]

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[152] PBGC website www.pbgc.gov/about/faq/pg/general-faqs-about-pbgc accessed 25th September 2018.
[153] ibid.
[154] Jeffrey R. Brown, 'Guaranteed Trouble: The Economic Effects of the Pension Benefit Guaranty Corporation' National Bureau of Economic Research, Working Paper 13438, September 2007 pp 9
www.nber.org/papers/w13438 accessed 25th September 2018.

[155] ibid.
[156] ibid.

The PBGC takes over the plan upon insolvency. It becomes the trustee of the plan assets and administers the payment of future plan benefits up to a certain maximum.[157] Early retirement reduces the benefits and death which occurs after the plan ended is not covered by PBGC. Further, if a pension had been amended so as to increase the benefits and it collapses within 5 years of being amended, such increases may not be covered.[158]

It is noteworthy that PBGC is not funded by government taxes. Its source of funds include collecting premiums from employers that offer defined benefit pension plans and by taking over investments which remain in the pension funds of failed companies as well as returns from its investments.[159] The PBGC has been reported to experience financial challenges in the years. It had assets in excess of liabilities of 9.7 billion dollars at the end of fiscal year 2000. In 2009, PBGC owed about 11 billion dollars more that its assets.[160] It had a deficit of $18.9 billion at the end of fiscal year 2006, with $61.1 billion and $80.0 billion being assets and liabilities respectively. [161] By 2005 fiscal year end, it had 23,111 million dollars in debt.[162]

The question arose as to why a program which ought to be sufficient to compensate members of collapsed schemes had itself become financially insufficient. Part of the problem was attributed to increased claims and decline in stock market prices which led to reduced pension assets and

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[157] Fiona Stewart, 'Benefit Security Pension Fund Guarantee Schemes' OECD Working Papers on Insurance and Private Pensions, No. 5, OECD (2007) pp 14 www.oecd-ilibrary.org/finance-and-investment/benefit-security-pension-fund-guarantee-schemes_260604113335.
[158] ibid.
159 Douglas J. Elliott, 'A Guide to the Pension Benefit Guaranty Corporation' *The Brookings (USA,*20th May 2009).
[160] Supra n 158.
[161] Jeffrey R. Brown, 'Guaranteed Trouble: The Economic Effects of the Pension Benefit Guaranty Corporation' National Bureau of Economic Research, Working Paper 13438, September 2007 pp 2 www.nber.org/papers/w13438 accessed 27th July 2018.

[162] ibid.

the fall in interest rates thereby boosting the value of pension liabilities. The PBGC had also been blamed for certain flaws. It had failed to properly price insurance and thus encouraged excessive risk-taking by plan sponsors, it failed to promote adequate funding of pension obligations; and failed to promote sufficient information disclosure to market participants.[163] Many firms also failed to fund their pension obligations relying on the PBGC to fund their liabilities.

4.2. THE PENSION BENEFIT GUARANTEE FUND, ONTARIO, CANADA

Among the 10 jurisdictions that regulate private pensions in Canada, Ontario is the only jurisdiction that has the Pension Benefit Guarantee Fund (PBGF).[164] It was established in 1980 to cover certain defined benefit pension plan benefits when they are wound up. This may be as a result of employer's insolvency and there is a shortage of funds. The PBGF is governed by the Pension Benefits Act and Regulations

The PBGF is managed by the Superitendent of Financial Services Commission of Ontario[165]. This Commission's regulates financial services with an aim to shield the interest of the public and boost public confidence in the sector. When a firm with an underfunded pension plan is incapacitated, the commission might consider appointing a plan administrator. The administrator

[163] ibid.

[164] Ontario Securities Commission website www.getsmarteraboutmoney.ca/plan-manage/retirement-planning/pension-savings-plans/how-your-db-pension-is-protected/ accessed 6th October 2018.

[165] Pension Benefits Act, Ontario, s 82(2).

makes a PBGF pronouncement to value the guarantee as promised by the company after which it allocates cover its liabilities.[166]

The PBGF gives members protection and the beneficiaries of privately sponsored single-employer defined benefit pension plans in case of a planned sponsor insolvency.[167] However, this is subject to specific maximums and specific exclusions. Currently, PBGF compensates a beneficiary to a maximum of $1,500 per month since 19th May 2017.

The Pensions Benefit Act stipulates the exemptions that PBGF does not cover:

i) benefits by defined contribution multi-employer pension plans (MEPPs) ;
ii) benefits related to employment outside of Ontario, or employment that is subject to federal pension regulation;
iii) benefits above $1,000 per month if the wind up date is before May 19, 2017;
iv) benefits in excess of $1,500 per month if the wind up date is on or after May 19, 2017;
v) benefits for pension plans that are less than five years old, before the date of the wind up;
vi) new benefit improvements that took effect within the last five years before the date of the wind up; and
vii) benefits where the employer is only obligated to contribute a limited fixed amount set out in a collective agreement. [168]

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[166] Fiona Stewart, 'Benefit Security Pension Fund Guarantee Schemes' OECD Working Papers on Insurance and Private Pensions, No. 5, OECD (2007) pp 19 www.oecd-ilibrary.org/finance-and-investment/benefit-security-pension-fund-guarantee-schemes_260604113335.

[167] Financial Services Commission of Ontario, 'Pension Benefits Guarantee Fund' https://www.fsco.gov.on.ca/en/pensions/pbgf/Pages/default.aspx accessed 19th July 2018.
[168] Pension Benefits Act, Ontario, s 85.

Under the Canadian law, the court is expressly prohibited from sanctioning a proposal, compromise or arrangement or approving a sale of assets outside of the ordinary course, unless it is contented that the debtor has organized to pay an amount equivalent to the amounts secured by the wage and pension priority charges.[169]

The PBGF is funded by annual levy that is paid by sponsors of defined benefit pension plans.[170] The levy is based on certain considerations: the pension plan's financial status and the number of Ontario plan beneficiaries who are part of the pension plan. In setting the levy, the credit balance of the Guarantee Fund is also considered. It should be sufficient for settling claims without need for additional amount form a loan or grant.[171]

The concern is that the Canadian Government is not very open to guarantee funds in the other jurisdictions. This is more because pension guarantee funds cover defined benefits pension plans which account for a small percentage of all pension plans in Canada. As at March 2004, there were 420 defined benefit plans in Canada versus 3000 in Ontario.[172] The amount of compensation is also significantly small. Before 19th May 2017, it was $1,000 but was then increased to $1,500 per month.[173] The USA compensates about $5,420 per month for someone aged 65 years and the UK which pays 100% of their promised benefit for retired persons and

[169] McMillan LLP, 'Insolvency Proceedings in Canada', pp 9 http://mcmillan.ca/files/Insolvency%20Proceedings%20in%20Canada.pdf accessed 16th November 2018.

[170] Pensions Benefit Act, Ontario s 82(3) (3.1).
[171] ibid s 82(3) (3.3).
[172] Fiona Stewart, 'Benefit Security Pension Fund Guarantee Schemes' OECD Working Papers on Insurance and Private Pensions, No. 5, OECD (2007) pp 20 www.oecd-ilibrary.org/finance-and-investment/benefit-security-pension-fund-guarantee-schemes_260604113335.
[173] Pension Benefits Act, Ontario, s 82(3).

90% for early retirees up to a maximum of about $ 5,700 per month.[174] Ontarios' compensation is thus significantly small although it was increased by 50% in 2017.

4.3. THE PENSION PROTECTION FUND, UNITED KINGDOM

The Pensions Protection Fund was founded in 2004 under the provisions Act of 2004. It is a statutory fund intended to protect members of defined benefit pension schemes when the employer faces bankruptcy and assets are inadequate for compensation.[175]

The Fund commenced in April 2005 and was established due to political pressure owing to the high number of workers who were losing their pension benefits because their employers had become insolvent. Many pension scandals had arisen and the government had to pay about GBP 400 million as compensation to workers. There was need to put in place a different structure for compensation and new funding rules.[176] The Government hoped to not only provide compensation to those affected but to also restore confidence in pension schemes. As at February 2018, the scheme had 235,835 transferred members and had paid about GBP 3.6 billion in compensation.[177]

The Fund is managed by a Board which is responsible for making payments to members. Before the Fund assumes responsibility for a scheme, a valuation of the company's assets and liabilities

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[174] Michael McKiernan, 'A prayer or a promise? From guarantee funds to disclosable events regimes, the Sears Canada collapse has renewed the debate about the policy options available to ensure pensioners get their dues' (2018) Top 100 Pension Funds Report, 19th June 2018 https://www.benefitscanada.com/wp-content/uploads/2018/06/BC0618_DB-Top100.pdf accessed 6th October 2018.

[175] Pension Protection Fund website available at www.pensionprotectionfund.org.uk last accessed on 28th September 2018.

[176] Fiona Stewart, 'Benefit Security Pension Fund Guarantee Schemes' OECD Working Papers on Insurance and Private Pensions, No. 5, OECD (2007) pp 20-21 www.oecd-ilibrary.org/finance-and-investment/benefit-security-pension-fund-guarantee-schemes_260604113335.

[177] Pension Protection Fund website available at www.pensionprotectionfund.org.uk last accessed on 28th September 2018.

is carried out. If the findings show that through a scheme, it is possible to purchase members annuities above compensation level that the PPD would offer, then that scheme is left to independently wind up. If the scheme lacks the capacity to purchase such benefits to its members, then the scheme's assets are reassigned to the fund and the board assumes the responsibility to pay members compensation.[178]

The Fund constitutes of defined benefit occupational pension scheme and defined benefits (elements of hybrid scheme). The fund is useful when the employer is insolvent. Thus, schemes that comprise of crown guarantee are exempted from protection of this fund.[179]

The PPF shields 100% pension for members that exceed the age of the pension scheme, and 90% of the (promised) members pension below the age of the pension scheme.[180] The compensation is a maximum of about $ 5,700 per month.[181]

The PPF is financed through taxes from appropriate schemes. This levy charged at a flat rate per member belonging to the scheme in the first year, it is based on a scheme based element as well as a risk based element for later years.[182] The scheme based levy is based on an amount of a scheme's liabilities with regard to members and other factors which the board might consider. Risk based levy is evaluated based on the difference amid the value of asset scheme and the amount of protected liabilities, the possibility of an insolvent event taking place in line with the

[178] ibid.
[179] ibid.
[180] ibid.
[181] Michael McKiernan, 'A prayer or a promise? From guarantee funds to disclosable events regimes, the Sears Canada collapse has renewed the debate about the policy options available to ensure pensioners get their dues' (2018) Top 100 Pension Funds Report, 19th June 2018 https://www.benefitscanada.com/wp-content/uploads/2018/06/BC0618_DB-Top100.pdf accessed 6th October 2018.

[182] Pensions Act, 2004, UK, s 175(1).

employer, including other factors which the board might consider.[183] Some of these other factors include: risks related to the nature of an investment scheme in comparison to the nature of liabilities, number of members of any scheme including the cumulative annual amount of pensionable income generated by members of the scheme, among others.[184] At least 80% of the pension protection tax ought to be increased through risk-based levy.

It was expected that the Pension Protection Fund would increase the cost of defined benefits schemes thus causing a shift to defined contribution plans. The risk of asset-liability mismatch where asset investments fail to match the nature of likely liabilities and funding problems were also anticipated. The problem of mispriced premiums had also been highlighted whereby, in remedy, the Fund had to consider the risk and match it with the premiums to be paid while at the same time maintaining affordable premiums to prevent closure of defined benefit plans.[185]

A review done in March 2017[186] reveals that some of the above expected challenges actualized. This paper highlighted the need to look at the funding arrangements which arguably influence trustees to make overly cautious investment decisions. Since the defined benefit schemes have since significantly increased after the global crisis in 2008, the issue of employer contributions and affordability has to be considered against best interest of sponsors, members and the Fund itself. The Paper also proposed increased member protection and consolidation of small schemes.

[183] ibid, s 175(2).
[184] ibid, s 175(3) and (4).
[185] Fiona Stewart, 'Benefit Security Pension Fund Guarantee Schemes' OECD Working Papers on Insurance and Private Pensions, No. 5, OECD (2007) pp 23-24 www.oecd-ilibrary.org/finance-and-investment/benefit-security-pension-fund-guarantee-schemes_260604113335.
[186] Norton Rose Fulbright, 'Green Paper: Security and sustainability in defined benefit pension schemes' March 2017 http://www.nortonrosefulbright.com/files/pensions-briefing-green-paper-march-2017-pdf-147843.pdf accessed 7th October 2018.

There is likelihood of the Fund having strained funding as result of the **Court of Justice of the European Union's judgement on Hampshire v PPF.**[187] The Court of Justice of the European Union (CJEU) on 6th September 2018 ruled that individual members ought to get at least fifty per cent of the value of accrued pension (old age) in any event the employer becomes insolvency. As a result, the PPF announced new levies for the year 2019/2020 which are undergoing consultations.

Like other financial services, the PPF is subject to certain risks such as moral hazard, systemic risks, and adverse selection.[188] The moral hazard can be seen in the amount that has been paid as compensation by the PPF. As at February 2018, the scheme had paid about GBP 3.6 billion in compensation.[189]

4.4. SICHERUNGS-VEREIN VERSICHERUNGSVEREIN AUF GEGENSEITIGKEIT (PSVAG), GERMANY (Pensions Mutual Insurance Association)

The PSVaG was established in 1974 via the Law on Improvement of Occupational Pensions to provide mandatory pension termination insurance. It handled the first major loss in 1976. Before the emergence of a guarantee system, pensions were handled as bankruptcy wage claims and reserve system workers were compelled to take high risks. The guaranteeship was thus a way of

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187 Grenville Holden Hampshire v. The Board of the Pension Protection Fund [2016] EWCA Civ 786. Mr. Hampshire was challenging the level of compensation he was entitled to from the PPF following the insolvency of his employer. He was 4 years less the retirement age when his employer became insolvent and he would have suffered reduction of his benefits by 67% as a result of the PPF cap. The case went up to the CJEU.

188 David Blake, John Cotter & Kevin Dowd, 'Financial Risks and the Pension Protection Fund: Can it Survive Them? 2006, pp. 21-22 https://link.springer.com/article/10.1057/palgrave.pm.5950054 accessed 20th September 2018.

189 ibid.

maintaining requisite public support for book reserve fund.[190] The Institution is mandated to guarantee the company pension scheme (PES) in the event of insolvency of the employer based on the provisions of the Occupational Pensions Act (BetrAVG) .[191]

The PSVaG is supervised by the Federal Financial Supervisory Authority. The PSVaG has a different model compared to the PBGC in USA. Whenever a company becomes insolvent they do not take over the assets but they purchase annuities from insurance companies. There is a consortium of 49 life insurance companies from which the annuities are bought.

When a company is declared insolvent, the PSVaG assumes responsibility for paying benefits to all employees and pensioners who are entitled to occupational pension benefits covered by the pension protection scheme (PPS). As a rule, the PSVaG covers 100% of the claimants and pensioners who are entitled to an occupational pension that is protected against insolvency in Germany and Luxembourg.[192]

It covers occupational pensions where employers become insolvent. The PSVaG however ignored retirement annuities which were directly purchased from life insurance firms.[193] The PSVaG is funded through contributions which are in form of insurance premiums. These premiums are determined according to estimated losses in the previous 12 months divided by the

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[190] Fiona Stewart, 'Benefit Security Pension Fund Guarantee Schemes' OECD Working Papers on Insurance and Private Pensions, No. 5, OECD (2007) pp 25 www.oecd-ilibrary.org/finance-and-investment/benefit-security-pension-fund-guarantee-schemes_260604113335.

[191] PSVaG Website available at https://www.psvag.de/mitglieder-beitrag/allgemeines-zur-melde-und-beitragspflicht.html accessed 20th July 2018.

[192] ibid.

[193] ibid.

contribution (the insured pension liabilities) to get the rate of contribution.[194] Employers are thus required to submit information on amounts relevant for assessment of contributions in September every year. For subsequent years, they receive questionnaires automatically every end of the first quarter in each year.[195] Just like other pensions guarantee funds, PSVaG has been reported to suffer from financial challenges.[196]

The similarities between the highlighted pension funds is that their scope covers pensioners where pension schemes fall insolvent. This limited scope is to ensure that the guarantee benefit is achieved. If the scope is to wide, it may not be realistic to cover all eventualities hence the fund will be strained. The pensions guarantee fund in Kenya should thus be very specific on its scope as well. These guarantee funds also have a formula of determining the compensation payable to a scheme plan holder. The USA and Canada have a minimum and maximum amount payable respectively whereas Germany and the UK compensate the policy holders hundred percent. It is important for the Kenyan pensions guarantee fund to have a formula of determining compensation as it starts. As its operations get stable, and it is determined that its funding and financial status can allow full compensation, then the same can be adopted over time.

An independent body is also necessary to managing the fund. As highlighted, the four funds are managed by independent boards which allows for independent operation and decision making. Further, the funds are self-sustaining and they are not funded through tax payer's money. Their main sources of income include the assets/funds of the insolvent sponsoring firm, any income they generate and contributions levied from members among others. It is important for the fund

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[194] Fiona Stewart, 'Benefit Security Pension Fund Guarantee Schemes' OECD Working Papers on Insurance and Private Pensions, No. 5, OECD (2007) pp 26 www.oecd-ilibrary.org/finance-and-investment/benefit-security-pension-fund-guarantee-schemes_260604113335.

[195] Supra n192.

[196] Supra n 192.

to be self-sustaining so that its operations are not crippled by lack of finances and the pensioners can realize their pension benefits as expected. It is however noteworthy that all these funds have challenges with funding and therefore it is important to look at this issue more closely when establishing the Kenyan pensions guarantee fund to safeguard against similar challenge.

CHAPTER 5

CONCLUSION AND RECOMMENDATIONS

5.1. CONCLUSION

This research paper is about making a case for the establishment of a Pensions Guarantee Fund in Kenya. The paper specifically looked at establishing a fall back mechanism for pensioners in cases where pension schemes suffer insolvency. Chapter 2 analysed the legal framework governing pension while highlighting how the law protects pensioners money or savings. However, the legal framework does not protect pensioners in cases where the pension schemes collapse. This is the gap that this research seeks to close by proposing the establishing the pensions guarantee fund to afford protection and thus secure the right to social security.

In Chapter 3, this research paper finds that the case for and against establishment of a pensions guarantee fund have to put on a weighing scale in order to determine the necessity of it based on the overall impact of the fund. The overall objective is to have a fall back mechanism for pensioners and afford them some protection when schemes collapse or suffer insolvency. As highlighted, other reasons such as market failure, problem of diversification, systematic risks and lack if available effective mechanisms justify the need for a pensions guarantee fund. Whereas some of these problems can be canvassed, e.g. market failure by addressing information asymmetry between sponsors of pension schemes and contributors to pension funds, this may not be out rightly achieved in any imperfect market. The problem of diversification may be

addressed by providing alternative and secure investment options, security in investments is still hard to guarantee yet the income earners may not have enough money to invest in various options. Further, affording effective alternatives by prioritizing pension payments in insolvency and ensuring pension schemes are fully immunized and having strict funding rules requires amendment of the laws. It is also difficult to ensure that schemes are funded 100% in light of fluctuating market returns or when full immunization of assets is not available. The existence of other protection funds in the financial sector also justifies the need for a pensions guarantee fund. This paper also analysed these funds and highlighted their challenges which will help in making recommendations on how the pensions guarantee fund can be effectively administered.

The issue of increased wage bill, the moral hazard and the expected challenges may also discourage establishment of the pensions guarantee fund. However, the wage bill can be addressed by increasing premiums so that the fund can handle its own administrative costs. The moral hazard is cured by strict funding and investment rules as well as employing the fund only as a measure of last resort. The challenges always put forth lessons from which the new fund can learn from to avoid similar challenges.

The following have been identified as the main concerns affecting protections funds.

i) Funding – funding for the Funds is not sufficient to cover contingencies when they arise;
ii) Delays in payment of compensation due to time taken in liquidation or asset recovery processes;
iii) Amount of compensation paid is minimal- compensation paid is not commensurate to one’s savings or investments;

iv) Independence in administration of the funds- Board in charge of administration being housed by the regulator e.g. Policyholders Compensation Fund is housed by the Insurance Regulatory Authority which regulates the insurance business in Kenya.

These challenges will be addressed as this paper makes recommendations on how the pensions guarantee fund will be administered. They will borrow from the best practices and operations of some of the effective protection funds discussed in Chapter 4.

This research has therefore achieved the main objective as well as the sub-objectives set out in Chapter 1. This research paper proves the case for establishment of a pensions guarantee fund in Kenya. The ultimate goal is to afford protection to pensioners in cases where pension schemes collapse. Further, this kind of protection provides confidence in the sector as the individuals realize that their contribute to pension schemes are safeguarded and their benefit is guaranteed even when the scheme sponsor becomes insolvent. Further, this study has proved its hypothesis that there is no assured means of compensating contributors of pension schemes in cases where schemes collapse. Whereas the law offers protection, this does not extend to insolvency of fund sponsors. This thus makes the case for establishment of the fund.

5.2. RECOMMENDATIONS

The main goal of this research paper was to make a case for the establishment of a pensions guarantee fund in Kenya. Having established the need for a pensions guarantee fund, the following recommendations will give guidance on how such a fund can be administered to ensure it is effective.

5.2.1. Establish the Pensions Guarantee Fund

This is a state governed entity to be established with the goal of providing protection to pension funds and more so compensating pensioners in cases where schemes collapse i.e. suffer insolvency. This proposal to establish a separate institution to handle pensions guarantee is informed by the issue of independence which some of the Kenyan protection funds e.g. Policyholders Compensation Fund face. Where a guarantee fund is housed by a regulator, issues of independence in handling the compensation are likely to arise. This is because as compensation is being handled, the role of the regulator may be put to question in determining why the scheme sponsor became insolvent in the first place.

The Fund should be established by enacting a law to provide for the same as well as other matters regarding the fund and its administration. This may be referred to as the Pensions Guarantee Act.

The role of the Fund may include the following:

a) levy contributions for the Pensions Guarantee Fund from pension scheme sponsor firms as per this Act;

b) reserve, manage and utilized the Fund based on the provisions of this Act;

c) pay compensation to pension scheme contributors or beneficiaries as determined;

d) execute other roles as might be conferred on it by this Act or any other written law

This Fund should be managed by a board which shall ensure continuous succession and a common seal, and able to sue and be sued in its own name as well as being able to acquire or dispose property in its own name. Matters regarding the composition of the board, the qualifications, term of office, remuneration and liability should also be set out in the law. The establishment a board is also drawn from among the jurisdictions in the comparative study. The USA has the PBGC which is a corporation managed by a Board while Canada has the Superintendent of Financial Services which is equivalent to the Board of RBA. UK's Pension's Protection Fund and PSVaG in Germany are also managed by a Board. The Board has collective responsibility over the Fund administration.

The Pensions Guarantee Fund should also have a fund for its monies and stipulate the sources of its funding. This may include the contributions to be made by the sponsor institutions, income from investments made, any interest or penalties levied on contributions, any donations or any other monies due to the Corporation. The UK system is very elaborate on determining contributions from member institutions. It has a great formula which will ensure that the amount contributed by each sponsor institution is not just a flat figure but takes into consideration the liquidity levels of the sponsor firm a s well as the size of its fund. The formula is worth to borrow and is as follows: the levy is a fixed charge for all the members of the scheme during the first year. For subsequent years, it is based on a scheme based element and risk. In addition,

every scheme pays an administrative levy each year to cater for operational costs. This is based on the number of members per scheme.[197]

The Act should also specify who is covered or not covered by the Fund and to what extent. The Pensions Guarantee Fund is expected to cover contributors of pension where the fund sponsor falls insolvent. Insolvency is therefore covered as defined under the Insolvency Act, 2015. Under this Act, a company is said to be insolvent[198] in the following cases:

i) if a company owes a creditor Ksh. 100,000 or more and the creditor provides the company with a written request which the company fails to satisfy within twenty-one days or fails to secure to the satisfaction of a creditor.
ii) if a court issues a judgment in favour of a creditor and the company is not able to satisfy it in whole or part.
iii) if the company is incapacitated in meeting its financial compulsions on time and sufficient proof of this is provided to the court.
iv) if the company's value of assets is little as compared to liabilities (including its contingent and prospective liabilities) and prove is provided to court.

Further, it is also important to determine the extent to which a pensioner will be covered by the fund. For instance, in Germany, the PSVaG covers 100% of the obligations for all claimants and pensioners of occupational schemes where employers become insolvent. In UK, PPF also pays 100% of the contributions for members who are above retirement age and 90% for those below

[197] Fiona Stewart, 'Benefit Security Pension Fund Guarantee Schemes' OECD Working Papers on Insurance and Private Pensions, No. 5, OECD (2007) pp 21 www.oecd-ilibrary.org/finance-and-investment/benefit-security-pension-fund-guarantee-schemes_260604113335.
[198] Insolvency Act, 2015 s 384.

the age. This is possible because occupational schemes are made up of employees. The number may thus be reasonable hence everyone is covered. In a case of a pension scheme made up of many employer organizations and individuals this may be difficult to protect everyone 100%. A limit thus needs to be set as to what extent they can be covered.

In Ontario, there is a formula for determining the maximum amount that a beneficiary can be paid. This is dependent on the age of the beneficiary, the date when plan collapses or employer becomes insolvent and contributions made into the pension plan. It would be important to develop a formula for the same in Kenya. This paper proposes a minimum amount to be identified as the basic minimum and to it be added an amount which will be determined by a combination of age, contributions paid and the number of years that contributions have been paid. This will provide an amount which will be directly proportional to contributions made rather than having a single amount for everyone irrespective of their savings like in the case of the Policyholders Compensation Fund or the Deposit Insurance Fund.

5.2.2. Prioritizing unremitted pension funds in liquidation

The Insolvency Act does not expressly provide for preferential treatment for unremitted pension contributions. The Insolvency Act, 2015 made an attempt to cover this in the Second Schedule.[199] This provides that second priority claims include the deductions made by a company from employees' salaries so as to meet their obligations to other people. Arguably, deducted pension contributions which remain unremitted to the respective pension schemes can fall under this class. Ms. Kimathi proposed an amendment to the Insolvency laws to allow this

[199] Insolvency Act, Second Schedule, Paragraph 3(1) (d).

preferential treatment[200] which is yet to be adopted. Under the Canadian law, the court is expressly prohibited from sanctioning a proposal, compromise or arrangement or approving a sale of assets outside of the ordinary course, unless it is contented that the debtor has organized to pay an amount equivalent to the amounts secured by the wage and pension priority charges.[201]

This research thus proposes that an amendment to the Insolvency Act, Second Schedule, to allow such unremitted contributions to rank at the same level with secured creditors in payment of debts by an insolvent sponsor. Further, the court should not sanction any arrangements or sale in an insolvency case unless pensioners' claims or would be claims are secured by setting aside the moneys required to pay them off. This will afford more protection for pension benefits.

5.2.3. Prioritizing liquidation cases

One of the issues with compensation payments by protection funds is the delay which arises during liquidation. In most cases, compensation is paid after liquidation process is finalized. Liquidation involves the court process and it may take a long time to complete. To ensure that the pensioners are not jeopardized by such long delays, it is prudent to expedite the liquidation process so it does not take an overly long period of time. This can be made possible by passing regulations to the Insolvency Act in this regard. As highlighted in Chapter 3, the need for pensions guarantee fund is heightened by having no effective alternatives. One of the possible alternatives is to give pension claims high priority in insolvency matters. Giving pension claims

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[200] Christine Gatwiri Kimanthi, 'A critical analysis on the role of the Retirement Benefit Act and Regulations in the Prevention of Loss of Retirement Benefits in the Occupational Pension Schemes' (Master of Laws Thesis, The University of Nairobi 2013).

[201] McMillan LLP, 'Insolvency Proceedings in Canada', pp 9 http://mcmillan.ca/files/Insolvency%20Proceedings%20in%20Canada.pdf accessed 16th November 2018.

high priority in bankruptcy or treating them as secured creditor rights, will have liabilities covered by the firm's assets, ahead of other creditors, in the case of bankruptcy of the plan sponsor.[202]

This research has achieved its objectives as set out in Chapter 1. It has established the need to establish a pensions guarantee fund to cover pensions in cases where schemes suffer insolvency. The recommendations set forth will also provide guidance in the development of a legal framework for implementation of the proposed Fund. It is my belief that this research will assist in the growth of our financial sector and more specifically that the establishment of the pensions guarantee fund will increase public confidence in the pensions sector and promote the right to social security.

[202] Supra n201 pp 9.

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