DEFINED CONTRIBUTION PENSION PLANS AS A STRATEGY FOR
PENSION MANAGEMENT IN KENYA: A CASE STUDY OF KENYA POWER &
LIGHTING COMPANY LTD STAFF RETIREMENT BENEFITS SCHEME

BY

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DECLARATION

This project is my original work and has never been submitted for a degree in any other university or college for examination/academic purposes.

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This research project has been submitted for examination with my approval as the student supervisor.

Signature…………………………………………………………..Date: ......................

CAREN ANGIMA
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I am indebted to the almighty God who has given me the grace to go through the course work and undertake the research to this far.

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I wish also to thank my family for the great support and encouragement throughout, my colleagues and employer for being supportive and for their co-operation during the research period.
DEDICATION

I dedicate this research work to my beloved family
ABSTRACT

Pension plans may be set up by employers, insurance companies, the government or other institutions such as employer associations or trade unions. The mostly used pension schemes were the Defined Benefits scheme. These traditional Defined Benefits pension plans are now slowly losing their authority in the occupational pension systems of many countries; over the past few decades there has been a gradual shift towards Defined Contribution pensions and, in some countries, Defined Contribution plans now account for the majority of invested assets in private sector occupational pension plans. This study sought to find the impact and challenges of adopting the Defined Contribution scheme in KPLC Staff Retirement Benefits Scheme. The data was collected from key employees of KPLC, the Board of Trustees and the Secretariat of KPLC-RBS. The data collected was analysed using content analysis and the results presented in prose form. The adoption of the plan has had great impact to the company in that it is easy to administer, it is also cheaper and members leaving before retirement and it has resulted to better governance. However, the study found that the conversion of the Defined Benefits to Defined Contribution faced setbacks such as resistance from the members, financial pressure on the sponsors in paying the deficits, lacked economies of scale which made it expensive to access services of service providers at early stages and compliance challenges. The study concluded that Defined Contribution plan was a better strategy to managing pension Scheme in KPLC RBS. Since the study was conducted in a government Parastatal, it is recommended that a similar study be conducted in other companies both private and public in Kenya and regionally to provide more information. The study also recommends a study on other pension strategies that can be used to manage pension schemes in Kenya.
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<thead>
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<th>Abbreviation</th>
<th>Description</th>
</tr>
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<tbody>
<tr>
<td>DB</td>
<td>Defined Benefit</td>
</tr>
<tr>
<td>DC</td>
<td>Defined Contribution</td>
</tr>
<tr>
<td>GAD</td>
<td>Government Actuary’s Department</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
</tr>
<tr>
<td>IOPS</td>
<td>International Organisation of Pension Supervisors</td>
</tr>
<tr>
<td>IPF</td>
<td>Individual Provident Fund Scheme</td>
</tr>
<tr>
<td>IPP</td>
<td>Individual Pensions Plan</td>
</tr>
<tr>
<td>KPLC</td>
<td>Kenya Power and Lighting Company</td>
</tr>
<tr>
<td>NAPF</td>
<td>National Association of Pension Funds</td>
</tr>
<tr>
<td>NSSF</td>
<td>National Social Security Fund</td>
</tr>
<tr>
<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
</tr>
<tr>
<td>PAYG</td>
<td>pay-as-you-go</td>
</tr>
<tr>
<td>PCA</td>
<td>Fuel Cost Adjustment</td>
</tr>
<tr>
<td>PPI</td>
<td>Pensions Policy Institute</td>
</tr>
<tr>
<td>RBA</td>
<td>Retirement Benefits Authority</td>
</tr>
<tr>
<td>SCADA</td>
<td>Supervisory Control and Data Acquisition</td>
</tr>
<tr>
<td>UNPS</td>
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</tr>
</tbody>
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CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Pension plans may be set up by organization employers, insurance companies, the government or other institutions such as employer associations or trade unions. A Pension Plan, also known as a Retirement Benefits Scheme, is defined under the Retirement Benefits Act (2003) as a scheme or an arrangement under which persons are entitled to benefits in the form of payments upon retirement, death or termination of service. In many countries, pension provision is covered by a mandatory public or government schemes usually referred to as social security schemes, which is usually supplemented by occupational pension schemes operated by employers. Occupational Pension Scheme is defined as a contributory or non-contributory, insured or self-administered pension scheme to which an employee may be eligible to join by reason of his or her employment in a firm or membership of a profession or trade (http://www.businessdictionary.com).

Occupational pension schemes can be classified into defined benefit (DB) schemes and defined contribution (DC) schemes. DB schemes offers employees more measurable post-employment income benefits; but they lack the portability that DC schemes offer employees when they switch employers in that you cannot transfer your benefits to another employer when you leave service. For funded schemes, this requires assessment of what the suitable contribution rates as a percentage of salaries into the pension fund should be to deliver the expected retirement income stream. For DB schemes, any asset
deficit arising from poor investment returns on pension assets becomes a liability of the schemes’ sponsor. For DC schemes, employees bear the risk that the post-employment income can be lower than what they had planned for, (Friedberg, 2011).

1.1.1 Concept of Strategy

The crafting of a strategy represents a managerial commitment to pursue a particular set of actions in growing the business, attracting and pleasing customers, competing successfully, conducting operations and improving the company’s financial and market performance (Johnson and Scholes, 2008). A Firm’s strategy is managements’ action plan for running the business and conducting operations (Thompson & Strickland 2007). According to Mintzberg et al (2009), the word strategy has long been used implicitly in different ways even if it has traditionally been defined in only one. Strategy can be defined as the balance of actions and choices between internal capabilities and external environment of an organization. Accordingly, strategy can be seen as a plan, play, pattern, position and perspective.

According to Bateman and Zeithmal (1993), a strategy is a pattern of actions and resource allocations designed to achieve the goals of the organization. The strategy an organization implements should be directed toward building strengths in areas that satisfy the wants and needs of consumers and other key actors in the organizations’ external environment. A strategy of a corporation forms a comprehensive modern plan that states how the organization will achieve its mission and objectives, it maximizes competitive advantage and minimizes competitive disadvantage (Wheelen and Hunger, 2008). Grundy (1995) proposes that strategy is about getting from where you are now to a place where it is
worthwhile being. Strategy is also about getting there through competitive advantage, with least difficulty and in least time.

The changing and dynamic nature of the business world today has seen rise of challenges that the firms face in their day to day operations. Many strategic management theories have been created in a bid to guide management of firms into creating functional and efficient strategies such as the competitive advantage theory, profit-maximizing and competition-based theory, the resource-based theory, the survival-based theory, the human resource based theory, the agency theory and the contingency theory. The pension plan strategies derive their potency in a firm from the resource based strategic management theory (Wernerfelt 1984) and more specifically on the human resource based theory of strategic management. The resource based strategic management approach of competitive advantage differs from environmentally based strategic management paradigm (Porter 1981 & 1985) in that it emphasizes on the link between the internal resource of a firm and its strategy and performance.

A pension plan strategy therefore is a human resource based strategy aimed at ensuring employees remains working in a company until they retire. A Pension Plan is defined as a scheme or an arrangement under which persons are entitled to benefits in the form of payments upon retirement, death or termination of service according to Kenya Retirement Benefits Act (2003). A pension is also defined as sum of money paid regularly by the state or by trustees to an employee upon normal or ill health retirement (Dearborn 1999). The key purpose of a pension plan is to provide retirement income security for a member after leaving employment service. This is accomplished by setting aside funds during the
employee's working years so that at retirement age the accumulated funds plus returns from investing those funds are available to replace salary (Spiceland et al, 2007).

There are several pension plan strategies that employers, employees and even individuals who are not in formal employment can choose from. Firstly there are public Pension fund which are compulsory plans set up by government. This type of fund is regulated by public law, such as the National Social Security Fund (NSSF) in Kenya. Secondly there are the individual pension plans which are set up by independent entities such as insurance firms and other financial firms and is therefore open to all individuals an example of this is the CFC life individual pension plan. Thirdly there are occupational pension plans which are sponsored by an employer for its employees. A good example is the KPLC staff retirement benefits scheme. All these strategies are funded either through defined contribution scheme or defined benefit scheme depending on which scheme a pension provider finds appropriate.

Employers will choose a pension strategy that is easy to administer in terms of efficiency cost such as fund management costs, custody fees, and levies to the regulator. Pension liability to members is also a key consideration for every employer and this where the choice between a DB plan and a DC plan becomes important. Other factors include risk and return on investment, tax and also ability of the pension strategy to attract and retain talent. Equally employees looking for employment are keen about their retirement needs.

An employee will consider a retirement strategy that guarantees benefits on retirement, brings high returns, has tax advantages and is well managed. A survey conducted in the United Kingdom showed that establishing retirement benefits plans made employees
remain competitive with other companies in their sector. “A generous, well-run pension scheme is a source of differentiation and a tool for recruitment and retention. Companies do also recognize that they have a duty to provide for their employees in retirement”, (the Economist, 2010).

1.1.2 Defined Contribution Pension Plan

A Defined Contribution Plan is a retirement plan where the amount that a member shall receive upon retirement depends on the total amount of money contributed by the member and the employer and the performance of the fund’s investments over time. In a DC plan, the amount of money that has to be contributed to the fund is specified, but the benefits payout will be known only at the time of retirement.

While the evolution towards DC pension plans can be beneficial for both employees and employers, it nevertheless reallocates risks of investment to the member. In DB pension plans, liability for funding and investment management rests with the firm sponsoring the plan. In a DC plan these tasks and the associated risks are assumed by the employee. This shift of liabilities and risks from the sponsor to the employee has potential implications for financial stability.

1.1.3 Defined Benefits Pension Plan

Defined Benefits Plan is the retirement plan where the amount that a member shall receive upon retirement is based on a set formula. In the context of defined benefit plans, the important client is the sponsoring employer, usually in the shape of the Finance Director, (Blake, 2003).
Employees in DB pension plans may face liquidation risk if the sponsoring firm declares bankruptcy at a time when the plan is less than fully funded. Solvency risk has been partially mitigated in some countries through the creation of a pension benefit guaranty agency such as the U.S. Pension Benefit Guaranty Corporation (PBGC), or more recently, the U.K. Pension Protection Fund. In the event of bankruptcy these agencies will take over the responsibility for making some portion of the promised payments to retirees. In these types of arrangements the risks assumed by the guarantee fund may ultimately be passed on to taxpayers, (Blake, 2003).

In a DB pension fund the employer bears the risk of paying the employee a pension benefit that, as noted earlier, is typically expressed as a specific replacement rate of pre-retirement gross earnings. The employer also bears market timing or temporal risk, in that DB plan assets may fall short of what is required to meet this obligation at the time of the employee’s retirement. Through pooling of plan contributions across a number of employees, not all of whom will retire at the same time, the employer is able to manage market timing risk much better than an individual would be able to. In managing the overall financial risk associated with a DB pension plan the employer bears the investment risk ie the risk that actual returns on the assets set aside to fund accrued pension benefits may fall short of expectations; this could force employers to put in additional contributions if poor asset returns leave their pension plans sufficiently underfunded, (Bodie, 2003).

1.1.4 Retirement Benefit Schemes in Kenya

The pension industry in Kenya is regulated by the Retirement Benefits Authority a body established by an Act of Parliament to regulate, supervise and promote retirement
benefits schemes, to develop the retirement benefits sector and for connected purposes. The Government established RBA to assist in regulating and supervising the establishment and management of retirement benefits schemes in addition to protecting the interests of members and sponsors of schemes, (RBA,2008).

Kenya has several types of schemes which offer social security which can be divided into three broad categories as defined in RBA, (2008). These include Public Schemes such as NSSF; the Civil Servants Pension Fund; the local Authorities Pension among others; Occupational Scheme which are run by employers for their employees and are underwritten by private insurance companies; self administered Schemes which are trust-based and established individually, usually by directors of limited companies for specified employees of the company and run in conjunction with service advisors. Individual Schemes which are private schemes designed for the employed, self-employed and/ or for those in non-pensionable employment such as the mbao pension plan introduced by RBA recently.

The public schemes, occupational and individual schemes cover workers mainly in the formal and informal sector. Public plans form the first pillar where membership is compulsory. The Occupational schemes form the second pillar where membership is either voluntary or mandatory and are privately managed by the organisations or are outsourced to insurance firms. The voluntary schemes form the last pillar where membership is voluntary. Currently, the Retirement Benefits Authority (RBA) has registered 1350 pension schemes and covers 15% of the Kenyan Labour force. Total industry assets stood at Kshs. 548.8 billion as at December 31, 2012.
1.1.5 KPLC Staff Retirement Benefit Scheme

The Kenya Power & Lighting Company Staff Retirement Benefits Scheme-DB was established by a Trust Deed dated 1 January 1970 as a defined benefits (DB) scheme. The Scheme was formed for the employees of the then East Africa Power & Lighting Company Limited, which later changed its name to the Kenya Power & Lighting Company Limited (KPLC). Its main purpose is the provision of cash benefits and pensions to the members upon attainment of the retirement age of sixty years, and where applicable, benefits for the dependants of deceased members. The affairs of the Scheme are the responsibility of the trustees, who are appointed jointly by the Board of Directors of the KPLC and members of the Scheme. KPLC RBS, (2012).

The KPLC RBS has gone through two shifts in a bid to establish a sustainable pension Scheme strategy that will ensure the company does not run into liabilities as well as give decent retirement packages to its staff members. The first shift was from provident fund plan in December 1993 to pension defined benefits Pension Plan. The Provident plan was established in 1970 for members whose income was less than kshs 2,000 and it ran concurrently with defined benefit plan till December 1993 when it was closed and all members joined the DB plan regardless of the salary scale. The second shift was from defined benefits plan to defined contribution plan in June 2006.

The DB Scheme closed to new members in June 2006 but continues being a defined benefit registered fund for members who were already in the plan then. A member who retires on his normal retirement date receives a pension while a member who leaves before normal retirement date can elect to transfer the benefits to another pension scheme. According to actuarial valuation report of the Scheme (KPLC RBS) (2005) there
was a past service actuarial deficit of Kshs 5,189.4 million. The funding level (the ratio of the value of the assets to the past service liability) was 50.2% and hence the decision to close the scheme and set up a DC scheme.

The DC was established by a Trust Deed and started operations on 1 July 2006 as a defined contribution (DC) scheme. Its main purpose is the provision of cash benefits and pensions for employees of the Sponsor upon their retirement from the Sponsor’s service and where applicable, relief for the dependants of deceased members. The Scheme works like a savings account where every month an employer and employee pay money into employee’s account in the Scheme. The Member Account is invested by the Trustees with professional advice from fund managers and grows broadly in line with the returns achieved each year on the investments. At retirement the value of the Member Account determines the cash lump sum and monthly pension payable.

1.2 Research Problem

Traditional DB pension plans are slowly losing their dominance in the occupational pension systems of many countries; over the past few years there has been a gradual change towards DC pensions and, in some countries, DC plans now account for the majority of invested assets in private sector occupational pension plans. There is a changing landscape in the retirement benefits sector by employers in Kenya from previously preferred defined benefits schemes that guarantee members benefits and whose intention is to encourage workers to stay in one job for long RBA (2010), to DC which has become the most preferred strategy for managing members.
In the previous studies Owiro (2006) studied the comparison of the actuarial methods and assumptions used by University of Nairobi pension scheme (UNPS). The suitability of each of the methods depends on the requirements of statutory bodies and the purpose of reserving exercise. Okioma, (2005) did a study on the impact of retrenchment on retirement benefits to establish time at which individuals are expected to be retrenched at any time in the future. The variable of interest was length of time between employment and leaving company, and here the event was retrenchment. Mghali (2003) looked at the employee pension and its effects and concluded that firms should conduct pension schemes where the employer contributes a certain percentage together with the employee contribution and then invested and trustees should control the fund.

Broadbent et al, (2006) looked at the shift from defined benefit to defined contribution pension plans and found that there is a large body of evidence to suggest that there is considerable inertia and myopia regarding retirement decisions, which may ultimately threaten the capacity of DC, plans to provide retirement security. Antolini, Payet, and Yermo, (2010) studied the default investment strategies in defined contribution scheme and claims that the relative performance of investment strategies depends on the type of benefits during the payout phase. Srichander (2012), in his study on the sustainability of pension schemes claims that for occupational DB schemes that face large funding shortfalls, employer contributions will have to rise to improve the coverage ratio of these schemes.

According to the previous studies done, there are few known studies in Kenya done on adoption of defined contributions pension schemes as a strategy for pension management by retirement benefit schemes in Kenya. This study therefore sought to fill this gap by
answering the question: why is defined contribution pension plan a preferred strategy for managing pension schemes in Kenya?

1.3 Research objectives

The objectives of this study were:

i. To determine the impact of the adopting DC as a strategy to managing pension Schemes in KPLC staff retirement benefits scheme

ii. To establish the challenges of adopting defined contributions pension plan by KPLC retirement benefits Scheme.

1.4 Value of the study

The findings of this study will be of value to the government –policy makers, the public, the pension schemes organizations and the scholars. To the government the study findings will provide crucial information which can be used by the planners and policy makers to make effective policies on pension schemes in Kenya. The findings of this study will also be of great use to the public as they will use the findings of this study to make and engage in pension schemes which are effective and convenient to them.

The National Social Security Fund (NSSF) management will benefit from the findings of this study as they can use the results on the impacts of the pensions schemes by the private companies to make appropriate changes on the pension scheme in Kenya with a view of making it more beneficial to the people.

The private companies will benefit from the findings of this study as the study will produce information on the impacts of the schemes which will help them define the rates and the policies to adopt in their companies’ for their employees. The study findings will
add value to the existing body of knowledge on pension schemes and will act as future reference to the researchers and scholars who will pursue the subject.
CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter presents the literature review of the study. The chapter discusses the literature reviewed on theoretical foundations of the study, the defined contributions pension schemes, pension design and governance and the challenges facing the Retirement Benefit.

2.2 Theoretical Foundation

The main objectives that business organizations strive to achieve is competitive advantage and to enhance firm performance relative to their competitors. Competitive advantage is a concept that remains as a major research area as far as management is concerned. Moreover, as far as global and local businesses are concerned, competitive advantage is important. In order to compete and sustain successfully, locally and globally, businesses must not only excel in their area but also persevere in the long run. Achieving such a “sustainable competitive advantage” status is not an easy task without a proper road map or strategy being outline and put into practice.

Competitive advantage has been associated with a long list of contributing factors. Such factors include operational efficiencies, mergers, acquisitions, levels of diversification, types of diversification, organizational structures, top management team composition and style, human resource management, manipulation of the political and/or social influences intruding upon the market, conformity to various interpretations of socially responsible behaviours, international or cross-cultural activities of expansion and adaptation,
various other organizational and/or industry level phenomena (King, 2007b). This study looks at a theoretical foundation of strategic management theory that is concerned with directing firm’s operations through implementation of preconceived policies and plans aimed at organisation sustainability.

Strategic management is the process and approach of specifying an organization’s objectives, developing policies and plans to achieve and attain these objectives, and allocating resources so as to implement the policies and plans. In other words, strategic management can be seen as a combination of strategy formulation, implementation and evaluation (Haim, 2005). Based on the Management Theory, it could be observed that the strategic management theories stem mainly from the systems perspective, contingency approach and information technology approach. In light of this background, following David (2005) and Mohd (2005), among the common strategic management theories noted and applicable are the resource-based theory, the survival-based theory, the human resource based theory, the agency theory and the contingency theory.

The resource-based theory stems from the principle that the source of firms competitive advantage lies in their internal resources, as opposed to their positioning in the external environment. That is rather than simply evaluating environmental opportunities and threats in conducting business, competitive advantage depends on the unique resources and capabilities that a firm possesses (Barney, 1995). The resource-based view of the firm predicts that certain types of resources owned and controlled by firms have the potential and promise to generate competitive advantage and eventually superior firm performance (Ainuddin, Beamish, Rouse, & Hulland, 2007).
On the other hand, the survival-based theory centres on the concept that organization need to continuously adapt to its competitive environment in order to survive. This differs to the human resource-based theory, which emphasizes the importance of the human element in the strategy development of organizations. In addition, the agency theory stresses the underlying important relationship between the shareholders or owners and the agents or managers in ensuring the success of the organizations.

Finally, the contingency theory draws the idea that there is no one or single best way or approach to manage organizations. Organizations should then develop managerial strategy based on the situation and condition they are experiencing. In short, during the process of strategy formulation, implementation and evaluation, these main strategic management theories will be applicable to management of organization as tools to assist them in making strategic and guided managerial decision (Zainal, 2005).

2.3 Empirical Review

From the definition of pension as a contract for payment of a fixed sum of money to be paid regularly to a person following their retirement from service which is funded by either employee, employers, insurance companies, the government or other institutions such as employer associations or trade unions, (RBA, 2003), there is a need to plan for the occasion and create strong strategies that will help the scheme meet its mandate, (Dimson, Marsh, & Staunton, 2002). Pension plan is either in the form of defined benefit scheme or the defined contribution scheme. Defined benefit scheme offers predetermined benefits by a set formula, rather than depending on investment returns while defined contribution scheme requires contribution of a defined amount of money for each member which is invested and the returns on investments credited to the members who
bear the investment risk. Recently, DC plan has gained popularity over the earlier DB Plan creating a massive shift due to its higher portability and higher returns.

Empirical studies have shown that the average and median pension benefits are higher for defined contribution plans than for defined benefit plans Dafria (2002) gives DC plan the following four factors that includes: Incentives for long-term employment and savings; Attractive returns from equity investments; rising per capita income; and finally, the growth in levels of interest rates which practically increase returns from savings and investment, thus increasing both the flows and the overall levels of saving. More recently, Kazuo & Yutaka (2012) have listed the contributory factor to this shift to improved risk management, prevailing underfunded pension liabilities in DB, tax consideration, stock leverage question, age factor, plan’s administrative cost, portability, negotiation cost, and informational dissemination cost.

2.4 Defined Contribution Pension Plan

Defined contribution plans have become widespread all over the world in recent years, and are now the dominant form of plan in the private sector in many countries. For this arrangement, the contribution is known but the benefit is unknown (until calculated). Money contributed can either be from employee salary deferral or from employer contributions which are then invested. Despite the fact that the participant in a defined contribution plan typically has control over investment decisions, the plan sponsor retains a significant degree of responsibility over investment of plan assets, including the selection of investment options and administrative providers.
Advocates of defined contribution plans point out that each employee has the ability to tailor the investment portfolio to his or her individual needs and financial situation, (Brown & Liu, 2001). A minimum contribution level may be imposed under mandatory defined contribution systems which form an essential part of the basic social security structure. Maximum contribution levels may be imposed by the tax authorities. There could also be rules regarding the marketing of defined contribution open pension schemes to the general public, covering issues such as the training and competence of sales agents, required disclosures about investment policy, commission and other charges and the types of projections of future benefits which are permitted (Friedberg, 2011).

2.4.1 Pension Design and Governance

Pension plans operated on defined contribution ideologies are better governed than those that are operated on defined benefit principles because; they involve members more in decision-making (Madrin, 2006; Bateman and Mitchell, 2004); The investment risk is borne by the members and not the sponsor hence members take all possible measures to avoid loss (Brady, 2008); There is lesser sponsor influence since the sponsor does not nominate majority of the members (Yang, 2005) and; there is more transparency in decision-making and communication to members (Nyce, 2005; Clark & Mitchell, 2005). It is therefore consistent with the observation that administrative costs are generally higher in DC plans than DB plan.

2.4.2 Defined Contributions Investment Management

Defined contribution schemes offer a flexible mechanism for saving for retirement, enabling the members to share in investment returns. In principle they are well-designed
to be able to cope with those who change jobs and with those members who have irregular or intermittent employment (Daykin, 2002). In some cases a minimum level of contributions is mandatory, but it will usually be possible to make additional voluntary contributions, so as to target the retirement savings to the desired level. However, defined contribution schemes potentially involve considerable risk for individual members.

Antolini, et al., (2010) claim that in defined contribution systems, a key concern of policymakers is that individuals for a variety of reasons may be exposed to excessive investment risk, raising the possibility that pension benefits may be significantly below expectations. The larger the DC system is in relation to public pensions, the greater is an individual's need for predictability and security of the DC portion. Governments may also be exposed to explicit or implicit liabilities in such systems, as they may be expected to help those whose pension benefits fall below a certain level. Therefore, investment management of DC schemes is expected to be more intrinsic have to invest heavily on risk management. It is therefore observed to manage investments in DC system than in DB system.

2.4.3 Administrative Structure and Fees.

High administration and investment fees reduce the ultimate level of retirement savings available to participants of defined contribution plans. Multiple vendor structures and agent-broker delivery models are generally more expensive than single record keeper administrative platforms. While investment choices may be supplied by several fund companies, there should be only one point of contact for employees for all aspects of the plan. Plan design, plan size (participants and assets), asset allocation levels, geographic service area, administrative and participant service levels are just some of the variables
affecting a plan’s administration costs and fees making it difficult to establish a “best practice” standard. Larger plans should be able to take advantage of available economies of scale to deliver plan services at lower cost (Daykin, 2002).

2.5 Challenges Facing Pension Benefits Administration

Challenges observed in management of pensions are those brought about by the regulatory framework. In Kenya this has been spearheaded by the introduction of RBA. RBA has brought order through clear guidelines in the operations of the retirement benefits industry in Kenya. However, the advent of RBA though vital has brought in new challenges such as: the associated costs of running schemes. For instance, schemes have to pay RBA levy in addition to other payments especially to the service providers. Schemes also have to comply with the investment guideline as put forward by RBA (RBA 2010).

The other challenge is that of frequent changes in the legislation appertaining to retirement benefits provision. At the annual National Budget, there have always been changes on the retirement benefit provision and schemes have to adjust their operations in tandem with these changes. The result has been an enormous work for the Trustees and their Service Providers. Some of these changes have meant annually changing the prevailing Trust Deed and Rules to capture them and this has been an uphill kind of task for all schemes.

Government interventions where the government passes laws that interfere with the normal operations of the Scheme is another challenge facing pension benefits administration. A recent case is the National Social Security Trust bill that proposes an
umbrella pension Scheme for the country hence killing the occupation Pension Schemes, rigidity in legal processes, and changing retirement policies, (Mugweru, 2001) - Rigidity in the sense that Retirement benefits do not form part of the deceased estate upon death of a member of the Scheme. Hence upon death of a member, the Trustees are at discretion to decide how the benefits are to be paid in case of disputes from the family, which may further give rise to more disputes.
CHAPTER THREE:
RESEARCH METHODOLOGY

3.1 Introduction

This chapter explains how the research was done. This includes the research design, data collection and data analysis procedure.

3.1 Research Design

The study adopted a case study design. The case study design was chosen since the research was specific to an organization and case studies allow a researcher to collect in-depth information with the intention of understanding situations or phenomenon. It also helps to reveal the multiplicity of factors, which have interacted to produce the unique character of the entity that is subject of study.

A case can be defined as a powerful form of qualitative and quantitative analysis and involves careful and complete observation of a social unit be it a person, family, cultural group or an entire community and/or institution.

3.2 Data Collection

The study used both primary and secondary data. Primary data was collected using an interview guide that was developed based on the research questions. Interview guide was favoured by the researcher because it was an inexpensive way to gather data from 30 respondents at Kenya Power and KPLC-RBS comprising of 2 employees to represent the Kenya Power top management team.
In addition, 20 staff who were members of the Scheme and whose interest were represented by the management’s decision, 3 Trustees of the KPLC RBS who were involved in the management of the Scheme and had been involved in the shift from DB to DC plans as a strategy for KPLC RBS and lastly the 5 secretariat staff of the scheme who are involved in the day to day administration of the scheme. Secondary data was collected from organization’s documents such as annual reports, strategic plans, newsletters and performance evaluation reports that provided historical information on the topic of discussion.

### 3.3 Data Analysis

Before processing the responses, the completed interview schedules were transcribed and edited for completeness and consistency. Data collected was analyzed through content analysis which was very useful in the study. This method suited the type of data collected which was qualitative in nature. The data was qualitative since the study employed the use of interview guides and secondary data as the source of information.

Content analysis has been used by various researchers such as (Weber, 1990) who claim that the method is very applicable especially in deriving meaning underlying physical messages and information. Content analysis was adopted because it was easy and conveniently used with textual types of data such as interviews, open ended survey questions or analysis of secondary data of various sorts.
CHAPTER FOUR

DATA ANALYSIS, PRESENTATION, INTERPRETATION AND DISCUSSION

4.1 Introduction

This chapter presents the findings of the study. The chapter presents the findings from the top management, the Trustees, the members and the KPLC-RBS secretariat. The chapter presents data on the demographics, the challenges, impacts, performance and the nature of the DB and DC schemes at KPLC Pension Scheme.

4.2 Response Rate

The study planned to acquire the requisite information from 30 respondents in Kenya Power Company and the KPLC RBS. All the 30 respondents were able to respond, giving the study a 100% response rate. The study acquired information from 2 top management representative; 20 KPLC staff who are members; 5 secretariat members and 3 trustees of KPLC-RBS. This response rate was 100% due to the fact that the sample size was small which enabled the researcher to interview all the participants. The researcher also works with KPLC RBS which made it easy to access all the information required as well as receive co-operation from the respondents.

4.3 Demographic information

The study was conducted through interviews done to top management team at KPLC, staff of Kenya Power who are members of KPLC-RBS scheme, trustees of the scheme and the secretariat staff. According to the findings, the two (2) respondents who
represented the top management in this study had worked at KPLC for a considerable amount of time such as for 8 years for one and 12 years for the other.

The study also established that most of the KPLC-RBS members who took part in the study had worked in KPLC for a period of more than 5 years with majority of them having worked with KPLC for 11 years. The study findings showed that some were members of DC since they joined the company on or after June 2006 while others are in both DB and DC i.e. those joined the Scheme before June 2006 and after the close of DB they joined DC. The DB is however a closed plan and as such no contributions are made to the Plan. The study found that members have different perception on the type of plans used by the company. Some members prefer the old scheme to the new DC plan while others prefer the new scheme to the old scheme citing that the new scheme has more benefits than the old one. The reason for the preference is the guaranteed benefits by the DB plans.

The trustees of KPLC-RBS were represented in the study and they were represented by three (3) Trustees who provided the requisite insights on DC-DB plans. These respondents were both observed to have been working with KPLC-RBS for more than seven (7) years. The study also collected data from the scheme secretariat personnel. It sought the requisite information from five (5) secretariat members most of whom had worked with KPLC-RBS for quite a long period of time of about 5 to 15 years. On average, they were found to have worked in the KPLC-RBS scheme within the last 6 years.
This indicates that the respondents of the study in the were all well acquainted with the operations of KPLC-RBS and the information provided was based on observation or experience and therefore can be taken as the real situation. This shows that the research information collected was credible and reliable to provide the insights required to make concrete understanding of the study.

4.4 Impact of DC Plan as a Strategy in KPLC-RBS

The study found that the adoption of the DC strategy has been of great impact to the company. The DC plan was observed to have the following impacts in the firm:

4.4.1 Ease in Administration

The KPLC-RBS indicated that between DB and DC schemes, DC has been easier to administer than DB. This is because it is less complicated when computing the amount of benefits for each of the employees. These views were replicated by the top management respondents who views DC plan as easier to administer and therefore it has eased the management and governance of the scheme to take care of the interests of all the members and the sponsors.

This was also because DB makes use of complicated formulas which are determined by many factors. The study found that the secretariat members are able to manage the benefits of the employees without much strain. The members who retire from the company are paid their total contribution and interest accrued over years which they use to purchase pension (annuity) from insurance firm as opposed to DB where the Secretariat used to manage benefits and pay pension monthly to retirees which increases administrative work.
4.4.2 Low cost of administration

The study established that adoption of DC plan lowered the cost of pension administration. As at December 2012 the percentage of administration costs of DC scheme on average to the fund value was 0.5%, a very low value compared to that of DB which was 4% of the fund value as at December, 2012. The lower cost of DC administration was attributed to available savings on such cost as actuarial valuation costs since DC Scheme does have to carry out the mandatory Actuarial valuation to determine funding levels as required by the regulator-RBA.

Use of ICT systems has been found to increase efficiency and effectiveness of operations. The study found out that it has been difficult for the KPLC RBS to get a DB administration system due to the complex nature of the plan with the formulas and factors involved from company to company while there are several administration systems available for DC plan.

4.4.3 Better Returns to members leaving the Scheme before retirement age

The members’ respondents claim that the return credited to their account from year to year has been better compared to that of DB plan. This is because from year 2009 DC plan introduced a policy of paying all the returns to members’ accounts. There are no reserves retained by the Scheme.

In DB Plan the Trustees are at discretion with advice from the actuaries not declare all the returns obtained by the Scheme since they have to caution themselves from future uncertainties. This is a great disadvantage to members who leave the Scheme before
retirement age or in case of death. The study obtained interest rates declared to members for both DC and DB plans as follows.

Table 4.4.3 Interest declared by DB and DC plans

<table>
<thead>
<tr>
<th>YEAR</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>Overall Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>DB Interest declared</td>
<td>10%</td>
<td>3%</td>
<td>3%</td>
<td>3%</td>
<td>10%</td>
<td>1%</td>
<td>10%</td>
<td>5%</td>
</tr>
<tr>
<td>DC Interest Declared</td>
<td>3%</td>
<td>3%</td>
<td>0%</td>
<td>7%</td>
<td>24%</td>
<td>-6%</td>
<td>27%</td>
<td>7%</td>
</tr>
</tbody>
</table>

Source: KPLC-RBS, 2012

Overall the study established that for members withdrawing from the Scheme before retirement age, DC is a preferred Scheme since they will have enjoyed all the returns from the contributions.

4.4.4 Improved governance

Improved governance is another impact that DC plan has had on the management of Pension benefits in KPLC RBS according to Members and Secretariat respondents. The regulator-RBA requires 50% of the Board of Trustees composition to come from members themselves and the other 50% to come from the Sponsor/ the company.

Member participation in the management of the Pension Scheme led to improved governance and growth of the Pension Scheme. This is due to the fact that the members are keen to safeguard their interests in the Scheme. They are interested in good returns from their contributions. They ensure that investments are done in the right way, costs
are maintained at minimum and are involved in making sure that the Pension Scheme achieve its targets.

4.5 Challenges facing adoption DC Plan at KPLC RBS

The study also looked at the challenges faced by the KPLC RBS in its adoption and use of DC retirement benefit plan in KPLC. The respondents explained some challenges the company faced when they were converting the DB scheme to DC scheme. These challenges are as explained.

4.5.1 Financial Pressure

According to the top management of KPLC, the sponsor-KPLC had to pay the deficit of 50% owed to the scheme which created a financial pressure to the company. The study found that the secretariat incurred initial establishment costs, costs of sensitization programmes, and advertisement of the change to all members among other activities. These required the newly formed scheme to fund these operations which therefore increased the initial cost of operations of the scheme.

4.5.2 Resistance from Members

Resistance from members who were in DB plan was a big challenge to the management of KPLC and the Trustees. The DC plan was enforced as a strategic response at KPLC to its staff by the company’s management and therefore the members were not prepared for the change. Bearing investment risks as is the case with DC plan made the members resist adoption of the DC plan at the initial stages. However upon members’ sensitization workshops and education, the members accepted the change and now appreciate the plan.
4.5.3 Conversion challenges
Compliance with the regulator was also a great challenge during the conversion period. The study found that there were major compliance challenges. RBA has set conversion guidelines and policies to be adhered to during conversion period. The approval of adopting DC was subject to compliance with those guidelines which are aimed at safeguarding members’ interest.

4.5.4 Economies of scale
Economies of scale was another challenge the management of KPLC and the Board faced. To have bargaining power in any market economies of scale is key to getting good returns on investment. The scheme was widely affected by the low economies of scale in the initial stages of adoption and conversion. It was not easy to negotiate good rates for investment returns as well as fees charged with fund managers, custodians, bankers, and professional advisers due to the fact that the small fund value at that time. This was a big cost considering the Pension was still new.

Currently the DC Pension Scheme has growth rapidly to command bargaining power from suppliers hence the cost has gowned down. The other challenge with lack of economies of scale according to the Secretariat of the DC plan is that the RBA levy paid to the regulator is based on a graduated scale up to a fund value of 5 billion. Any Fund value above 5 billion enjoys a flat levy of KShs 5 million.

4.5.5 Return dependent on economic performance
Dependence on Economic Performance was identified by all the respondents as the biggest challenge in operating a DC plan. The members cited that DC pension scheme are mostly better during good economic times. The members have to bear the investment risk
and suffer losses when performance is negative. They gave an example of year 2011 when the return of DC plan was -5.5% and this was credited to their account thus reducing their benefits.

4.5.6 Purchase of Annuity from insurance firms.

The study found that members are opposed to the DC plan of purchasing annuities from insurances especially at retirement as opposed to the DB where pension plan pays the pension on a monthly basis. They cite lack of trust on insurance firms to manage their benefits. According to members’ they felt secure being paid benefits by the Pension plan that has been managing their investments.
CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the summary of findings, conclusion and recommendations of the study. The study was motivated by the need to establish the impact and the challenges of adoption of DC at KPLC. The chapter is divided into sections. The chapter discusses the summary of the findings, conclusion, recommendations and suggestions for further studies.

5.2 Summary

The study was conducted at KPLC. The data was collected from senior management team, the staff members who are members of the pension schemes, and the trustees and secretariat members of KPLC-RBS. Most of the top management team members had very good work experience of above 8 years, though the members of the scheme had lower experience levels. Those who took part in the study had worked with the company for more than 5 years that ranged between 5-15 years. Most of the scheme secretariat staff had worked with the company for more than 8 years while the trustees had worked with the company for more than 7 years. Thus the respondents were well versed with the operations of the company and the Scheme. This shows a normal distribution, since the respondents had necessary characteristics of a study population. The respondent provided concrete information which was reliable and necessary for this study.
The study established that KPLC RBS introduced DC plan to replace the old DB scheme as a strategy to managing their Pension Scheme. Currently the staff of KPLC who joined after July 2006 are full members of DC plan. Those who joined the Company prior to 2006 are members of both DB and DC plan but DB remained closed and as such they do not receive new members or contributions from the old members. Only their Benefits contributed remained in DB.

The study also found that apart from the liability the Sponsor Company had as per the Actuarial report of 2005, the adoption of the DC plan had great impact to the company. The benefits enjoyed by DC plan as identified by the respondents included ease of administration, low administration cost, better returns for members leaving the company before retirement and improved governance.

The study also found out that despite the benefits there were challenges. Respondents identified the challenges as financial challenges on the part of the Sponsor as well as the Pension Scheme itself, there was resistance from members at first but the Trustees carried our member education and trainings as well as advertising to educate members on why the adoption of DC plan was importance for the company and members’. Conversion and compliance challenges were also experienced with the Pension being required to follow set regulations and policies by the RBA. Lastly the respondents from management and Trustees cited economies of scale as a challenge to access important services for the newly established DC pension plan.
5.3 Conclusion

Initially, KPLC-RBS used DB plan for their employees for funding but adopted DC plan as a strategy in July 2006. The study established that adoption of the DC pension plan at KPLC RBS had a great impact to the company. This study showed that the DC plan made it easy for the Trustees and the Secretariat to manage retirement benefits, the cost of managing DC plan was relatively lower than that of the DB, members who left the Pension Scheme before retirement age enjoyed higher benefits compared to those who were in DB plans and finally there was greater governance in DC plan due to involvement of members in the management of the Pension Scheme. These impacts therefore makes DC plan a better strategy for pension management in KPLC RBS.

However the study showed that the adoption of DC was not smooth. The Management of KPLC and Trustees faced numerous challenges. The KPLC Company was required to clear the DB deficit owed to the Pension Scheme as a regulatory required before they could be allowed to adopt a new Scheme. The company committed to pay the deficit by making a monthly contribution until all the money was paid out. This put the company into financial pressure. The study established that KPLC Company has since cleared the deficit as per the actuarial valuation report 2010. At the time of the study an actuarial valuation was underway to establish the level of funding.

The process of starting anew Pension Scheme/conversion also put pressure on the finances of the Pension Scheme. There was also resistance from members who felt that DB was a more favourable Scheme for them. Conversion challenges associated with compliance was also challenging. Economies of scale limited the Scheme’s bargaining power with the suppliers which made the administration cost about high therefore leading
to low returns initially. But with the growth of the Scheme this has changed and the Scheme enjoys bargaining powers from the service providers.

Operating the DC plan also faced economic challenges in that the performance of the Pension Scheme went down. Members’ benefits had to reduce thus the need to ensure they take calculated risk while investing. The other challenge DC plan is facing is that of having to send members to insurance firms to purchase annuity. The members are opposed to the idea. The Board of Trustees together with the Secretariat staff need to educate members to give them assurance that purchase of annuity is as good as pension payment and therefore no need to worry.

The study concludes that despite the few challenges faced in the adoption of the DC plan at KPLC RBS, DC has on overall a great impact as a Pension Scheme management Strategy.

5.4 Limitations of the study

This research was a case study and therefore the research was limited to Kenya power & Lighting Company Ltd staff retirement benefits scheme. Thus the findings on defined contribution pension plans as a strategy for pension management in Kenya are limited only to that Scheme and as such they cannot be generalized to other firms.

The study focused on interviewing some of the very busy executive team members and scheduling appropriate interview timings was a challenge, in some instances we had to keep rescheduling the interviews. However, the study eventually managed to interview obtains information from the key decision makers of the Scheme.
It’s also important to note that the data collected from the respondents may have suffered from personal biases and may therefore not fully represent the opinion of the Scheme in some cases.

5.5 Recommendations

The study findings indicate that at KPLC there are some members who still have no information of the new scheme even though it has been in operation for the last 7 years. There is need to carry out more education to members of DC plan about the new plan and its advantages rather than having them use the plan as a strategic process. The study found the existence of the notion that the employees lost their DB benefits after the conversion to DC plan. The company therefore has the mandate to clarify the conversion process and educate members on how the DB plan benefits will be paid out on retirement alongside the DC plan benefits.

The study established that the use of DC is cheaper and easier to administer than the old DB method. It is recommended that other companies adopt the DC scheme to make their pension benefits administration affordable to the sponsors and enjoy ease of administration while at the same time ensure their employees have access to better returns and benefits at retirement.

The Study found that members were not comfortable with the DC annuity plan where they are required to purchase annuity using the benefits paid from the Scheme. They have great trust in the Scheme that receive and manages their benefits. The Board of Trustees and the Secretariat staff need to sensitise members and educate them about annuities since they don’t have the knowledge of how annuities work. They also need to educate
them on how annuities work and assure them that they are protected by the Retirement Benefits Authority. This will help to build their confidence with insurance firms.

5.6 Suggestions for Further Studies

The study was done in KPLC which is a government parastatal, the experiences, responses and the functionality of the corporate may be different in other companies. It is recommended that similar studies be done in other companies both private and public in Kenya and regionally to avail more knowledge on the DB and DC schemes. More studies should also be done countrywide to provide more information on the impact of pension schemes strategies in different sectors and firms in Kenya.

The study conducted centred on the DC plan as a strategy to managing pension industry in Kenya. It is recommended that other studies on other Pension strategies be done to avail information on Pension strategies.
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Appendix I

Interview Guide

Kenya Power Management

1. What led to the decision to close DB Scheme?
2. Why do you think DC plan was a better strategy to managing your Scheme?
3. How did your members react to the decision?
4. What challenges did you face in the process of conversion?
5. Would you recommend this strategy to any other company?
6. How has this decision affected the balance sheet of Kenya power?

Trustees

7. Do you think the Sponsor made the right decision by closing DB and adopting DC plan?
8. How has the management of the Scheme changed since adoption of DC Plan?
9. What challenges have you faced since the DB Scheme closed?
10. Has the adoption of DC strategy made a difference in management and governance of the Scheme?
11. What was RBA’s take on the Decision
12. Which Scheme would you recommend to other Trustees and why?

Members

13. For how long have you worked at KPLC?
14. Which pension schemes are you a member of?
15. With many of your colleagues retiring, what are some of their views on KPLC-RBS pension plan?

16. In the past, KPLC-RBS used defined benefit plan, may you please share your experience with DB pension plan especially on its advantages and shortcomings?

17. What challenges have you experienced in your interactions with the new KPLC-RBS defined contributions pension plan?

**Scheme Secretariat**

18. For how long have you worked at KPLC-RBS section?

19. What is the percentage of administration cost of DC Scheme on average to the fund value?

20. How has DC Scheme performed since its inception?

21. Considering you administer DB and DC Schemes, give a brief experience of your experience with the two Schemes?

22. In what ways has the adoption of defined contributions pension scheme affected your firm’s management structure?

23. In which ways does the Kenyan RBA regulatory framework affect the operations of your current plans?

24. In terms of operation and benefits calculation has DC made work better or worse?

25. In your own view which Scheme do you prefer and why?

**THANK YOU FOR YOUR PARTICIPATION**