

RBA NEWS



MIXED REACTION TO 2008 BUDGET CHANGES

The retirement benefits industry has welcomed changes to the Retirement Benefits Act and Regulations introduced by the Honourable Minister for Finance in his Budget Speech for 2008. There was, however, disappointment that no significant additional tax incentives were extended to the retirement benefits industry with the only incentive being exemption of taxation on lumpsum retirement benefits received to persons aged 65 years and above.

Industry lobby group the Association of Retirement Benefits Schemes (ARBS) commented that "even though we can understand that the Treasury felt it had little room to manoeuvre on the taxation issues, the council of ARBS does feel that an opportunity has been missed to strengthen further the base for development of a vibrant retirement benefits industry."

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Assistant Minister for Finance, Hon. Dr. Oburu Odinga (right) makes his comments during a visit to the RBA offices on May 28, 2008 as RBA Chief Executive, Edward Odundo (left) and Chairman, Justus M. M'igweta take note .

BUDGET CHANGES

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James Oyugi, Manager, Life and Pensions, CFC Life makes a comment during the Stakeholders meeting on 2008 Budget Changes hosted by the Authority on June 20, 2008.

Notwithstanding the disappointment on the taxation side, the changes made under the Retirement Benefits Act will have a strong impact on developing the industry and enhancing member protection. First, the Minister amended the Investment Guidelines to allow schemes to invest upto 10 percent of their assets in the “other assets” category up from the previous 5 percent. This increases the opportunity for schemes to hedge their risks by investing more in products such as syndicated loans, non listed securities, venture capital, private equity funds and hedge funds. Such

investments however will still require the trustees to obtain prior approval from the Retirement Benefits Authority.

Second, the Minister enhanced the importance of the scheme Investment Policy document by requiring the policy to include asset liability matching in addition to previous requirements regarding asset allocation, risk and asset realisation. This will ensure that scheme investments are in line with the ultimate objective of the scheme which is to pay adequate benefits to the members. In addition, the Minister defined who qualifies to act as an investment advisor in preparing the policy and required both the advisor and the trustees to take ownership of the document by endorsing it. The strengthening of the Investment Policy will enable the Authority to shift to a risk based supervision model and is indeed the first step towards eventual removal of the Investment Guidelines.

**“65
age at which any retirement
benefit received is tax free”**

Members of defined contribution pension schemes have welcomed the introduction of income drawdowns as an alternative to annuities at retirement age. In addition, insurance companies will be required to publish their annuity rates in the media. These changes will enhance competition in the oligopolistic annuity market resulting in better products and pricing for the retirees. Members whose benefits arising from employer contributions are retained in defined benefits schemes will also welcome the provision for increases in pensions in deferment.

The requirement for schemes to have a vetted trustee will enable the Authority to work with the industry to introduce a certification requirement for scheme trustees. This will ensure every scheme has at least one trustee who has undergone adequate governance and trusteeship training. Governance will also be improved by the requirement that a trustee who fails to attend three consecutive meetings be disqualified and the provision for trustees to keep up-to-date bank account details for members.

These and the other changes introduced by the Minister have laid a solid framework for continued growth and development of the retirement benefits industry.

CHANGES IN 2008 BUDGET AFFECTING THE RETIREMENT BENEFITS INDUSTRY

ISSUE	CHANGE	CLAUSE/EFFECTIVE DATE
CHANGES TO THE RETIREMENT BENEFITS AND INCOME TAX REGULATIONS		
Investment policy statement of retirement benefits schemes	An investment policy of a scheme to include asset liability matching and to be prepared under considered written advice from a registered Chartered Financial Analyst, actuary, investment advisor or fund manager registered under the Capital Markets Act or manager under the Retirement Benefits Act provided that the manager is not the scheme manager, related company or employee of the scheme manager. The investment policy to be signed by the trustees and the investment advisor.	Legal Notice No.77 Effective 12th June 2008
Forms and Fees	Maximum investment allowed under "other assets" increased from 5 percent to 10 percent while retaining requirement for prior approval from the Retirement Benefits Authority.	Legal Notice No.74 Effective 12th June 2008
Annuities	Pension schemes to have an income draw down as an alternative to annuities subject to a minimum drawdown period of 10 years.	Legal Notice No.77 Effective 12th June 2008
Trusteeship	<ul style="list-style-type: none"> - Every scheme to have at least one member who has been vetted by the Authority to undertake trust services and every trust corporation to have at least one director so vetted. - A trustee who fails to attend three consecutive board of trustee meetings will be disqualified from serving as a trustee. - Trustees to maintain up-to-date records of the bank accounts of their members for the purpose of payment of benefits. 	Legal Notice No.77 Effective 12th June 2008
Individual Schemes	Trust Corporation for individual schemes are required to have Kshs. 10 million paid up capital inclusive of unimpaired reserves.	Legal Notice No.75 Effective 12th June 2008
Annual Increment in deferred pensions	Members with deferred pensions in a defined benefit scheme to receive annual increments as recommended by actuaries during actuarial valuations.	Legal Notice No. 77 Effective 12th June 2008
Treatment of surplus at winding-up of a scheme	<ul style="list-style-type: none"> - At winding up, surpluses in a defined benefit scheme will be apportioned between the sponsor and the members in the proportions of the contribution rates. - Income Tax restrictions on treatment of actuarial surplus removed 	Legal Notice No.76 & 79 Effective 12th June 2008
PROPOSED CHANGES TO THE RETIREMENT BENEFITS ACT		
Board of Directors	Private sector Retirement Benefits Authority board appointees shall not include such person who is an employee or director of any company, firm or institution where such employment or directorship may lead to conflict of interest.	Finance Bill, 2008
Authority's powers to adopt a supervisory model	Authority may from time to time issue supervisory guidelines, practice notes and codes of conduct for better administration of the retirement benefits schemes.	Finance Bill, 2008
CHANGES UNDER THE INCOME TAX ACT		
Taxation on lump sum pension	Lump sum pension granted to a person sixty five (65) years of age or more to be exempt from tax.	Finance Bill, 2008, Effective Date June 13, 2008
PROPOSED CHANGES TO INSURANCE ACT		
Annuities	Every insurer who provides annuities shall publish information regarding annuities on a quarterly basis in the manner specified by the Commissioner of Insurance.	Finance Bill, 2008

DOES THE DESIGN OF A SCHEME MATTER

by Lazarus Keizi, Research & Development Department, RBA

Retirement income is a very important component of every working individual's life cycle. It can come from one of the four key pillars of support in old age: unfunded state pensions (transfers from the current working population via the tax system), funded private pensions (from savings accumulated in private sector pension schemes), direct private savings, and post-retirement work. Individuals will therefore be concerned with the ability of these schemes to deliver the pension promise that they make. This is dependent on a range of factors, the most important of which are the ratio between the number of people in retirement and the number of people in work (the so-called dependency ratio), the productivity of the working population, and the rate of return generated on assets accumulated in pension funds. The relationship between these factors will determine which type of pension scheme, funded or unfunded, is likely to be more effective in delivering pensions; indeed they will affect the very viability of each type of scheme. Other factors are also important. The capital markets will be important in determining the efficiency of the two main types of funded schemes: the defined benefit (DB) and the defined contribution (DC) scheme.

A pension scheme can be thought of as a long term savings programme to transfer resources from the young to the old (in the case of an unfunded or Pay As You Go (PAYG) scheme) or from youth to old age (in the case of a funded scheme). The government pension scheme is financed on a PAYG basis. The pensions of the retired generation are paid from the contributions of the current working population through taxes. To be viable over the long run, they require sufficient people in work, making sufficient contributions to pay for those who have retired. Technically, we need the sum of the growth rates in the working population and labour productivity (output per worker) to exceed

the sum of the growth rates in the retired population and real pensions (for contribution rates not to rise). This is equivalent to assuming that the real growth rate in the national wage bill must exceed the real growth rate in the national pension bill.

“..in the long run funded pension schemes are superior to unfunded schemes”

The unfunded pension schemes are not viable in the long run in any major country if real pensions grow in line with the growth rate in labour productivity. They would be viable in the long run if the real growth rate in pensions was zero; but this implies that pensioners would receive a constantly falling share of their country's resources. The unfunded pension schemes could also be made viable if there was a sufficient increase in the effective working life and a corresponding reduction in the retirement period. However, increasing the normal pension age will do little to increase the average effective working life in an economy where many workers have in reality left the labour force well before the existing normal pension age.

If PAYG state pension schemes are likely to become increasingly unviable (unless state pensions are constrained from growing in real terms or the effective working life is increased), then governments have little alternative but to transfer the burden of pension provision to funded pension schemes; and while these funded schemes could be in the public sector (as in the case of Sweden, for example), they are most likely to be in the private sector. In fact, there is a result in the pension economics literature which shows the condition under which, in the long run, funded pension schemes are superior to unfunded schemes. It requires the real rate of return on the assets in funded schemes to exceed the real growth rate in the wage bill (which is

equal to the 'rate of return' on a pay-as-you-go system). There is also a good theoretical reason for supposing that, in long run equilibrium, the average return on assets will exceed the growth rate in the wage bill (which, in turn, equals the growth rate in national income if the share of wages in national income is constant). This has to do with the 'dynamic efficiency' of the economy. Saving through a pension fund helps the process of capital accumulation, which, in turn, improves the productivity of workers. However, it is possible to accumulate so much capital that the rate of return on capital assets falls below the growth rate in national income and the economy becomes 'dynamically inefficient': people could be better off by saving less and consuming more.

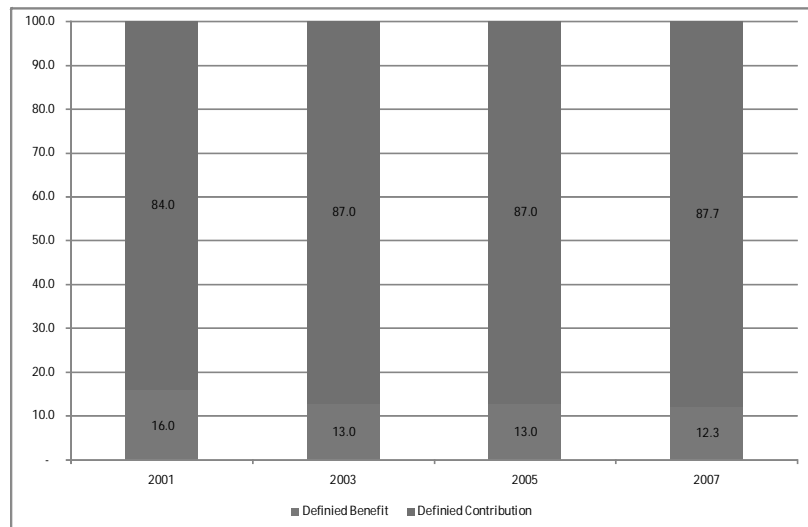
Dynamically inefficient economies are unlikely to be sustainable in the long run, since the owners of capital are likely to transfer their capital to economies offering higher returns. However, funding is not a panacea as argued by economists such as Diamond. Funded pension arrangements can give an illusion of security which disregards the political risks associated with the presence of a large pool of financial assets that has accumulated on the basis of generous tax breaks. Diamond further argues that mandatory unfunded state pensions provide the mechanism for insuring these risks collectively, although there is still the problem that unfunded schemes face a risk from the demographic time bomb that funded schemes do not.

There are other potential benefits from a switch to funding include positive externalities in the capital markets (e.g., greater capital market deepening), access to international risk diversification, more transparent fiscal accounting and greater (although as indicated above not complete) insulation from political risk.

The funded scheme can be a DB scheme (final salary scheme) or a DC scheme (money purchase scheme). With a DB scheme, it is the pension benefit that is defined while a DC scheme, what is defined is the contribution rate into the fund, e.g. 10 per cent of earnings. The resulting pension depends solely on the size of the fund accumulated at retirement.

Good or bad investment performance by DB and DC pension schemes has very different consequences for scheme members. With DB schemes, the investment performances of the fund's assets are of no direct relevance to the scheme member, since the pension depends on the final salary and years of service only and not on investment performance. The scheme member

SCHEME DESIGN IN KENYA, %



“Investment performance is critical to the size of the pension in a DC scheme”

DOES SCHEME DESIGN MATTER

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RBA Chairman, Justus M. M'igweta hands over the signed RBA performance contract to the Financial Secretary, Treasury, Mr. Mutua Kilaka (right) during a contract signing ceremony held at the Treasury on June 22, 2008

can rely on the sponsoring company to bail out the fund with a deficiency payment if assets perform very badly (i.e. the member exercises the implicit put option against the sponsor).

However, investment performance is critical to the size of the pension in the case of a DC scheme: members bear all the investment risk in such schemes. Scheme members, especially those in personal pension plans, can find

themselves locked into a poorly performing fund, facing very high costs of transferring to a better performing fund. In addition, the type of funds in which personal pension scheme members invest can and do close down and then the assets do have to be transferred to a different fund.

It is of great importance to know what type of pension scheme you have. It also matters whether the scheme is funded or unfunded. Funding provides greater potential pension security than PAYG which, given demographic and labour market developments, has become an increasingly unreliable vehicle for delivering the pension promise: there can be no guarantee that future generations will be prepared to pay the increasing burden that PAYG now represents. This is the case even though, as a result of market failure, there is a range of risks (relating to job and asset security and to mortality) that cannot be efficiently insured in the private sector.

It also matters whether the scheme is defined benefit or defined contribution. Your preference between the two types of scheme will depend on both your behaviour and your characteristics, for example, how often you change jobs and your attitude to risk. The more frequently you change jobs and the more risk tolerant you are, the more suitable it will be for you to choose a DC scheme.

A DB scheme is in reality a DC scheme which is managed in such a way (using asset-liability management techniques) that generates a target pension benefit. Whether the scheme is DB or DC, the investment performance is critical: it affects the net cost to the sponsor of a DB scheme and the net pension benefit to the member of a DC scheme.

**INVESTMENT PORTFOLIO OF RETIREMENT BENEFITS
SCHEMES BY MANAGER AS AT MARCH 2008, SHS M**

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Manager	No. of Schemes	Cash	Fixed Deposits	Fixed Income	Government Securities	Quoted Equity	Unquoted Equity	Offshore	Immovable Property	Guaranteed Funds	Other	TOTAL
AFR	11	71.19	-	149.42	180.01	111.73	-	29.73	-	-	-	542.09
AIG	34	299.31	1,838.78	905.99	22,182.99	12,265.60	60.79	1,208.09	2,759.80	280.76	-	41,802.10
CFC	67	64.33	311.47	142.12	1,821.53	1,618.17	-	-	-	1,405.84	-	5,363.46
COOP	98	1,303.64	1,963.34	232.00	9,055.28	3,333.40	181.80	522.28	241.00	-	-	16,832.75
GEN	61	718.92	966.38	1,101.48	13,088.51	7,294.61	1.04	1,620.32	-	173.32	137.00	25,101.57
ICEA	360	354.01	475.12	59.81	2,548.31	846.11	0.42	237.93	1,796.00	11,203.34	-	17,521.03
JUBI	115	27.83	11.79	10.20	104.59	148.93	-	-	-	4,886.37	-	5,189.70
KENI	113	-	-	-	-	-	-	-	-	3,442.46	-	3,442.46
MADI	29	-	-	-	-	-	-	-	-	665.13	-	665.13
OM(EA)	5	1,249.92	80.50	213.03	3,263.54	6,063.63	28.05	381.09	565.43	-	-	11,845.19
OM(K)	118	3,216.59	2,381.03	1,249.97	13,585.02	14,851.03	51.91	3,967.08	1,646.96	-	0.00	40,949.59
SIMS	55	977.32	71.58	540.08	6,286.89	3,650.31	1.18	959.17	316.94	332.65	-	13,136.12
TOTAL	1,066	8,283.06	8,099.99	4,604.10	72,116.65	50,183.52	325.19	8,925.70	7,326.13	22,389.87	137.00	182,391.20
<i>memo item. NSSF</i>	<i>1</i>	<i>1,870.34</i>	<i>426.75</i>	<i>-</i>	<i>7,484.42</i>	<i>38,811.62</i>	<i>1,380.50</i>	<i>-</i>	<i>30,942.38</i>	<i>-</i>	<i>394.86</i>	<i>81,310.87</i>

Note: See list of managers on page 8 for key to abbreviations
NSSF as at June 2007

Source: Manager quarterly returns submitted to RBA

**INSURANCE COMPANY NET RATES OF RETURNS TO
RETIREMENT BENEFITS SCHEMES**

Company	2000	2001	2002	2003	2004	2005	2006	2007
Apollo Insurance	10.00%	10.50%	10.00%	10.00%	8.00%	11.00%	12.50%	11.00%
British American	10.00%	9.60%	8.60%	10.00%	7.50%	10.25%	18.00%	10.50%
CFC Life	11.50%	11.50%	9.00%	8.00%	7.50%	8.50%	11.00%	9.50%
Corporate Insurance	10.00%	5.00%	5.70%	10.50%	5.00%	5.00%	10.00%	8.00%
Heritage Insurance	11.00%	10.50%	8.50%	8.00%	8.00%	8.75%	15.00%	13.00%
ICEA	10.00%	10.00%	6.50%	7.25%	6.00%	7.62%	9.00%	9.25%
Jubilee	12.00%	11.75%	10.75%	10.25%	9.50%	10.50%	12.75%	12.00%
Kenindia	11.50%	11.50%	10.50%	9.25%	8.50%	10.00%	11.00%	11.00%
Kenya Alliance	7.50%	7.50%	8.50%	8.00%	5.00%	10.00%	10.00%	11.00%
Madison	5.00%	7.50%	6.00%	6.00%	6.00%	7.00%	10.00%	9.00%
The Monarch	10.00%	10.90%	10.79%	5.60%	6.00%	9.00%	10.00%	10.00%
UAP	10.00%	10.50%	8.00%	15.00%	12.50%	12.50%	16.00%	10.00%

**“13%
highest rate of return paid to
a scheme by an insurance
company in 2007”**

REGISTERED ADMINISTRATORS

	Company	Box No	Code	Town	email:	Tel:
1	Aon Minet Insurance Broker Limited	20102	00200	Nairobi	ebd@aon.co.ke	2710053
2	Alexander Forbes Financial Services (East Africa) Limited	52439	00200	Nairobi	actuaries@aforbes.co.ke	2710722
3	Apollo Insurance Company Limited	30389	00100	Nairobi	insurance@apollo.co.ke	343585
4	British American Insurance Company (Kenya) Limited	30375	00100	Nairobi	britak@britak.co.ke	2710927
5	CFC Life Assurance Limited	30364	00100	Nairobi	csc@cfcilife.co.ke	2866000
6	Chancery Wright Insurance Brokers	55537	00200	Nairobi		2721555
7	Co-operative Bank of Kenya Limited	48321	00100	Nairobi	custoadfal@co-opbank.co.ke	3276000
8	Eagle Africa Insurance Brokers Kenya Limited	30076	00100	Nairobi	eagleafrica@broker.co.ke	2229741
9	Heritage Insurance Company Limited	30390	00100	Nairobi	info@heritage.co.ke	2783000
10	ICEA Trustee Services Limited	46143	00100	Nairobi	itsl@icea.co.ke	340365
11	Jubilee Insurance Company of Kenya Limited	30376	00100	Nairobi	jic@jubileekenya.com	340343
12	Kenindia Assurance Company Limited	44372	00100	Nairobi	kenindia@kenindia.com	316099
13	Kingsland Court Trusts and Benefits Services Limited	10285	00100	Nairobi	nrion@kingslandcourt.com	4343228
14	Liaison Financial Services Limited	58013	00200	Nairobi	fs@liaisongroupnet	2710181
15	Madison Insurance Company Kenya Limited	47382	00100	Nairobi	madison@madison.co.ke	2864000
16	Mercantile Insurance Company Limited	20680	00200	Nairobi	life@mercantile.co.ke	222697
17	Octagon Pension Services Limited	10034	00100	Nairobi	info@pension.co.ke	601948
18	Pacific Insurance Brokers (EA) Limited	50565	00200	Nairobi	info@pacific-group.co.ke	2717187
19	Pan Africa Life Assurance Limited	44041	00100	Nairobi	life-insurance@pan-africa.com	247600
20	Roberts Insurance Brokers Limited	73415	00200	Nairobi	roberts@wananchi.com	2710765
21	Sapon Insurance Brokers Limited	47628	00100	Nairobi	marketing@sapon.biz	601017
22	UAP Provincial Insurance Company limited	43013	00100	Nairobi	uapinsurance@uapkenya.com	2850000
23	Zimele Asset Management Company Limited	76528	508	Nairobi	admin@zimele.net	246273

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REGISTERED CUSTODIANS

	Company	Address	Code	Town	Tel:	e-mail:
1	Barclays Bank of Kenya Ltd.	40984	00100	NAIROBI	3267000	bssk@africaonline.co.ke
2	Co-operative Bank of Kenya Ltd.	48231	00100	NAIROBI	3276100	customer@co-opbank.co.ke
3	Equatorial Commercial Bank Ltd.	52467	00200	NAIROBI	2710693	
4	Kenya Commercial Bank Ltd.	30664	00100	NAIROBI	2852000	custody@kcb.co.ke
5	NIC Bank Ltd.	44599	00100	NAIROBI	2888000	custody@nic-bank.com
6	Stanbic Bank Kenya Ltd.	30550	00100	NAIROBI	3268000	stanbickenya@stanbic.com

REGISTERED MANAGERS

	Company	Address	Town	Telephone	e-mail address
1	African Alliance Kenya Ltd. (AFR)	27639 -00506	NAIROBI	2710978	info@africanalliance.co.ke
2	AIG Global Investment Company (East Africa) Ltd. (AIG)	67262- 00200	NAIROBI	2733400	admin@aigea.co.ke
3	Amana Capital Ltd. (AMC)	9480-00100	NAIROBI	313356	info@amanacapital.co.ke
4	British American Asset Managers Ltd. (BAM)	30375-00100	NAIROBI	2833000	baam@baam.co.ke
5	CFC Financial Services Ltd. (CFC)	44074-00100	NAIROBI	3753726	cfcfs@cfcgroup.co.ke
6	Co-opTrust Investment Services Ltd. (COOP)	48231-00100	NAIROBI	2854000	merchandinvestments@co-opbank.co.ke
7	Genesis Kenya Investment Management Ltd. (GEN)	79217-00100	NAIROBI	251012	genesis@swiftkenya.com
8	ICEA Asset Management Ltd. (ICEA)	46143-00100	NAIROBI	2221652	iaml@icea.co.ke
9	Jubilee Financial Services Ltd. (JUBI)	30376- 00100	NAIROBI	316099	jic@jubileekenya.com
10	Kenindia Asset Management Company Ltd. (KENI)	44372- 00100	NAIROBI	2721970	kenindia@kenindia.com
11	Madison Asset Management Services Ltd. (MADI)	47382-00100	NAIROBI	2730466	mams@africaonline.co.ke
12	Old Mutual Asset Managers (EA) Ltd. (OM)(EA)	11589-00100	NAIROBI	2711309	omam@omamkenya.com
13	Old Mutual Asset Managers (Kenya) Ltd. (OM)(K)	30356-00100	NAIROBI	2711335	omam@omamkenya.com
14	Sanlam Investment Management Kenya Ltd.(SAN)	7848-00100	NAIROBI	2781317	info@sim.sanlam.com
15	Stanbic Investment Management Services (East Africa) Ltd. (SIMS)	30550-00100	NAIROBI	3268000	sinvestments@stanbic.com
16	Zimele Asset ManagersLtd. (ZIM)	76528-00508	NAIROBI	246273	info@zimele.net