

REVIEW OF GOVERNANCE PRACTICES OF RETIREMENT BENEFIT SCHEMES IN KENYA

25 October 2016

Prepared by:

Amos G. Njuguna
Peter N. Kiriri
Paul Ruto



Report prepared for;

Retirement Benefits Authority,
P.O Box, 57733-00200
Nairobi, Kenya
Tel: +2542809000

Prepared by:

United States International University - Africa,
P.O Box 14634-0800,
Nairobi Kenya,
Tel: +254713606419
amnjuguna@usiu.ac.ke

Table of Contents

EXECUTIVE SUMMARY	i
ABBREVIATIONS	ii
LIST OF TABLES	iii
LIST OF FIGURES.....	iii
1.0 INTRODUCTION AND BACKGROUND.....	1
1.1 Background of the Study	1
1.2 Statement of the Problem	2
1.3 General Objective.....	4
1.4 Specific Objectives.....	4
2.0 LITERATURE REVIEW.....	4
2.1 Theoretical Foundation of Governance	4
2.2 Governance in the Retirement Benefits Industry	6
3.0 METHODOLOGY.....	8
3.1 Study Design.....	8
3.2 Methodology used to collect data from service providers.....	8
3.3 Methodology used to collect data from Trustees and Members of RBS	9
4.0 FINDINGS.....	12
4.1 Current State of Governance of the Retirement Benefit Schemes.....	12
4.2 Extent of Implementation of Governance Practices specified in the RBA ACT	25
4.3 Governance Gaps.....	27
5.0 RECOMMENDATIONS FOR IMPROVEMENT	29
6.0 IMPLICATIONS OF THE STUDY AND SUGGESTIONS FOR FURTHER RESEARCH	37
7.0 REFERENCES	38

EXECUTIVE SUMMARY

The study purposed to document the current status of governance of the retirement benefit schemes, determine the extent to which the governance practices recommended by RBA are implemented, determine loopholes in the governance of retirement benefit schemes (RBS) and recommend practical measures that will enhance governance in the RBS.

It documents the activities and findings of the study conducted in 2016. The study reviewed important documents such as the Retirement Benefits (RBA) Act and the operational guidelines given by RBA to administrators, trustees, custodians, fund managers, Focus Group Discussions (FGD) with the service providers in the retirement benefits industry and a survey of members and trustees of retirement benefit schemes.

The findings show that the existence of RBA in the retirement industry in the last nearly two decades has brought order and discipline in the industry and the broad guidelines given by RBA on the management of the Retirement Benefits Schemes (RBS) are being implemented especially with regard to the use of specialized service providers, risk management, addressing conflicts of interest, fiduciary duties of trustees, accountability and the training of trustees through the trustee development program.

However with continuous growth of the industry, technology and alternative investments, new governance issues emerge that need to be addressed. These issues include investment in property, maintenance of the trustee accounts, term limits for trustees and service providers, government operated schemes, regulation of umbrella schemes, investment in guaranteed funds, investment in annuities and procurement of service providers.

Key recommendations point to the need to have RBA engage stakeholders more creatively for instance through industry briefs, issue directions on the legal definition of title to alternative assets, make the trustee development program more of a long-term learning experience, implement rotational retirement of trustees as opposed to blanket term limits, provide guidelines for appointment of service providers, work closely with the Insurance Regulatory Authority (IRA) to streamline investment policies in guaranteed funds, rethink the use of trustee accounts and craft enhanced guidelines to avoid conflicts of interest.

This report is structured as follows; section 1 gives the introduction and background of the overall study, section 2 describes the theoretical foundations of the study, section 3 details the methodology adopted in the study, section 4 discloses the findings, section 5 gives the recommendations that emerged from the study while section 6 provides the implications of the study and suggestions for further research.

ABBREVIATIONS

AGM – Annual General Meeting

CEO – Chief Executive Officer

FGD – Focus Group Discussions

IOPS – International Organization of Pension Supervisors

IRA – Insurance Regulatory Authority

REITs – Real Estate Investment Trusts

RBA – Retirement Benefits Authority

RBS – Retirement Benefit Schemes

USIU-A – United States International University, Africa

LIST OF TABLES

Table 1: Composition of the Service Providers.....	9
Table 2: Gender of the Respondents	10
Table 3: Age of the Respondents	10
Table 4: Education Level of the Respondents.....	11
Table 5: Reference or Advice on Matters relating to Retirement.....	13
Table 6: Duration Issues have been Outstanding.....	15
Table 7: Perception on Importance of Reports on Risk-Return Relationships and Factors Affecting Performance of the Fund.....	17
Table 8a: Perception on Understanding of Risk-Return Relationships	18
Table 9: Perception on Understanding of Factors Affecting Performance of the Fund	18
Table 10: Approaches Used in the Appointment of Service Providers.....	19
Table 11: Conflict amongst Service Providers.....	20
Table 12: Conflict between Service Providers and Trustees.....	20
Table 13: Presence of Written Policies to Address Conflict of Interest	21
Table 14: Factors attributed to less than 100% attendance to AGM - trustees	26
Table 15: Suggestions for Improvement	30

LIST OF FIGURES

Figure 1: Duration of Membership in a Retirement Benefit Scheme.....	11
Figure 2: Appointment of Trustees.....	12
Figure 3: Satisfaction on Resolution of Issues	14
Figure 4: Time taken to Resolve Issues	15
Figure 5: Compliance with the Investment Management Policy by the Fund Managers	16
Figure 6: Perception of Trustees on Term Limits.....	19
Figure 7: Reasons for Not Voting During Trustee Elections	23
Figure 8: Reason for less than 100% Attendance to the AGM	26

1.0 INTRODUCTION AND BACKGROUND

1.1 Background of the Study

Governance is defined in Carmichael and Palacios (2003:7) and IOPS (2007:4) as the “systems and processes by which a company or government manages its affairs with the objective of maximizing the welfare of and resolving the conflict of interest amongst stakeholders.” Therefore, governance in retirement benefit schemes addresses transparency, conflict resolution and prudent management of the assets that contribute to value adding for the scheme (Stewart and Yermo, 2008), which has become of great interest to financial supervisory authorities, including pension supervision authorities (IOPS, 2013).

Qureshi and McKay (2007:5) identify three broad approaches of viewing pension governance in the context of multi-national companies: (1) decentralized governance, which refers to where the pension fund governance is exercised in different pension funds in the same country; (2) compliant governance, which refers to following the law; and (3) efficient governance, which refers to making financial and operational efficiency gains. Qureshi and McKay (2007) recommend the efficient governance option. Therefore, efficient governance should enable the retirement benefit schemes (RBS) to achieve compliance with the retirement benefits regulations and control of the decentralized units that eventually contribute to increased efficiency in operations.

RBS are created by employers as investment vehicles for the retirement savings of the workers under trust deeds. As such the sense of entitlement by the workers as an investment is much less compared to corporate investors – who invest with certain clear objectives and expectations. Workers are automatically enrolled in to occupational retirement benefit schemes on employment. The RBS can be established using the defined benefit or defined contribution models depending on whether the employer guarantees the benefits payable on exit or the contributions payable (Bodie, Marcus & Merton, 1988). In a nutshell, the employer bears the investment and longevity risk of a defined benefit scheme while the same risks are borne by the workers in a defined contribution scheme (Bodie *et al*, 1988; Besley & Prat, 2003; Clark, 2004). It is therefore imperative that the defined benefit model gives the employer greater control and the defined contribution model gives more or equal control to the workers (Forman, 2000; Clark, 2004). For instance in Kenya, the employer nominates two-thirds of the board of trustees of a defined benefit scheme and one-half of the board of a defined contribution scheme (RBA, 2009). Given the choice most employers prefer the defined contribution model and consequently, most traditional defined benefit schemes are converting to defined contribution (Banks, Richard & Emmerson, 2005) a situation that leaves vulnerable investors with residuary risks of dynamic and complex markets. The dominance of defined contribution schemes is expected to prevail in to the future (NAPF, 2005) in a context where, employers have a duty to assure their shareholders that the investment the costs they incur on retirement benefits of the workers yield a return on investment to

the company. Members of the schemes must therefore be effectively and meaningfully engaged in the governance processes of their schemes as they are the residual claimants of the scheme.

Effective governance of retirement benefit schemes involves the processes and decision-making structures that ensure appropriateness of goals, information management procedures that support the goals, compliance with pension regulations and the pension fund's stakeholders' collectivism (Stewart 2009; Ambatchsheer *et al*, 2008). In order to achieve efficient pension fund governance, trustees should be allowed the opportunity to initiate action in response to their needs and preferences, adapt swiftly to changing situations with minimal interference from policy makers, and therefore reconcile economic efficiency with equity to the stakeholders (Clark, 2003). In other words, the design, administration and management of retirement benefit schemes should be closely attuned to the often-competing interests of those directly involved. According to Teisseire (2009:2) and Clark (2006:14), pension fund governance defines accountabilities, establishes authority levels, specifies mechanisms of enhancing compliance with the law and enables provision of accurate, timely and reliable financial information to the stakeholders.

Adhering to proper governance of retirement benefit schemes should lead to continuous improvement through improvement of risk management processes (Asher & Nandy 2006:14; Moriarty and Zadorozny 2008:1; Clark & Urwin 2008:2; Clark, 2015:9); development of structures and processes that meet the required standard of fiduciary care and documentation of the due diligence (Moriarty & Zadorozny 2008); improve performance and risk management of the scheme (Stewart 2009:2) and increase administrative efficiency (Tesseire, 2009).

In summary, governance in retirement benefit schemes can be conceptualized by reviewing the composition and expertise of the board of trustees (Hsin & Mitchell, 1997; Mitchell & Yang, 2005), reviewing the plan management practices (Mitchell & Yang 2005; Bikker & Dreu 2009) as well as decisions on whether the retirement schemes outsource their services (Bikker & Dreu, 2009).

The gist of this study was to provide the Retirement Benefits Authority (RBA) with a clear view of the current situation with regard to governance of retirement benefit schemes and provide recommendations to strengthen governance in these schemes.

1.2 Statement of the Problem

The value of retirement assets in Kenya as at 31 December 2015 stood at Kshs. 814 billion representing 14.7% of the country's GDP. The assets are held by close to 2000 RBS that service over 1.7 million members. The assets of each scheme are entrusted to a board of trustees that oversees their investment, custody and proper administration. As such it is imperative to ensure that the governance regulations specified in the RBA Act are implemented and possible loopholes sealed to protect these assets.

Steward and Yermo (2008) identified governance lapses in retirement benefit schemes across different countries. They singled out the main lapses as inefficient processes for the selection of trustees, inability of the boards of trustees to undertake internal self-evaluation, weak oversight on the commercial trustees, poor composition of board committees and inadequate mechanisms for disclosure of information to members. A 2014 study by the International Organization of Pension Supervisors (IOPS) concluded that serious governance lapses still exist in RBS despite advancement in technological and regulatory environment. This study sought to examine the governance weaknesses in the Kenyan RBS and provide practical solutions to address them.

Effort has been devoted in the study and review of governance in retirement benefits industry. Clark (2004) conducted a theoretical review of internal governance of pension funds focusing on codes of practice, rules and procedures for decision making and trustee competence and expertise. Stewart and Yermo (2008) investigated the challenges of pension governance and proposed solutions to solve the impasse in OECD countries. Kowalewski (2010) reviewed the relationship between corporate governance and pension fund performance and concluded that internal and external pension governance mechanisms in Poland were weak. Njuguna (2011) investigated the determinants of pension governance in Kenya and found that the governance practices were influenced by regulations, leadership and membership age. Ammann and Zingg (2010) and Ammann and Ehmann (2014) delved in to the relationship between governance and investment performance of occupational retirement schemes in Switzerland and found a positive relationship between the two variables. This paper contributes to knowledge as it uses key informants in the Kenyan retirement benefits industry to *first* determine the extent to which existing governance guidelines are adhered to in the industry *secondly* to expose emerging governance issues that the industry is experiencing as it grows and wades through the turbulent financial markets and the population ages (thus affecting the asset-liability structure of the schemes). *Lastly*, the study suggests recommendations that can proactively be used to manage the emerging governance lapses.

In practice, the governance structure of an occupational RBS consists of the Board of trustees consisting of trustees elected by the members and trustees appointed by the sponsor. The board is assisted by independent service providers namely the custodians, fund managers, administrators, actuaries and auditors amongst others appointed by the board of trustees. This structure has inherent governance issues that emerge. The members and the sponsors may elect and/or appoint loyal or popular members who are not necessarily qualified to undertake the tasks. In the absence of complete commitment to the best of the interests of the members, a fund manager can invest in its poorly performing self-developed investment products without due consideration or authority from trustees, sponsors can influence the board of trustees to make certain decisions, administrators may influence annuitants to take up annuity products from certain insurance companies, which may not necessarily be the best. Moreover, trustees may appoint external service providers, who are not necessarily the best in terms of service provision

but are “friendly” to them. Additionally, the custodians, fund managers and administrators may create relationships to ring-fence their businesses. Similarly, the service providers may advise the trustees to take certain decisions that are not to the best of the interests of the scheme. A review of the governance weaknesses that may emerge from this structure was the motivation of this study.

1.3 General Objective

The general objective of the study was to review the governance practices in the Kenyan RBS and provide recommendations on how the governance practices can be enhanced.

1.4 Specific Objectives

The study was guided by the following specific objectives;

- 1.4.1 To document the current state of governance in the retirement benefit schemes in Kenya with regard to risk management, conflicts of interest, internal controls, fiduciary duties of trustees and accountability and transparency.
- 1.4.2 To establish the extent to which governance practices specified in the RBA Act are implemented by the trustees, administrators, custodians and fund managers in the retirement benefit schemes in Kenya;
- 1.4.3 To determine governance gaps that may be prevalent in retirement benefit schemes in Kenya;
- 1.4.4 To provide practical recommendations to enhance governance in retirement benefit schemes, which can be documented as the official code of governance for retirement benefit schemes in Kenya.

2.0 LITERATURE REVIEW

2.1 Theoretical Foundation of Governance

The grounding of corporate governance can be credited to the agency, stewardship, stakeholder, resource dependency and political theories in addition to a myriad of ethics theories such as virtue ethics, discourse and postmodern ethics theories.

Agency theory postulates the conflicts of interest stemming from separation of ownership and management in contexts where human beings are self-centered and fail to act in the best of the interests of others (Berle & Means, 1932) granted that the firm is a nexus of contracts (Alchian & Demstz, 1972; Jensen & Meckling, 1976; Jensen, 2001). In this context, corporate governance is viewed as the framework that addresses how the inherent conflicts arising out of the agency problem are addressed within the firm and the inherent cost of managing such conflict.

The *stakeholder theory* is based on the notion that a corporate entity exists to serve its broad range of stakeholders who are primarily the shareholders (Abrams, 1951) granted that the firm impacts on parties who are external to it either directly or indirectly (McDonald & Puxty, 1979; Freeman, 1984; Clarkson, 1995; Sundram & Inkpen, 2004). Firms therefore have an obligation to identify the stakeholders (whether consubstantial, contextual or contractual) and their specific needs (Lashgari, 2004; Coleman, 2008) and develop policies to address these concerns. Corporate governance from this perspective is the framework that ensures that the often conflicting interests of all the stakeholders are addressed in a fair manner by the firm. Pension plans are organizations created to benefit current members, future pensioners, beneficiaries of current members (in the event that current members are incapacitated or deceased), the plan sponsor and the investors in the company.

The main tenet of the *resource dependency* theory is the environmental linkages existing between the firm and external resources (Pfeffer & Salancik, 1978) that are important for the firm's survival (Daily, Dalton & Canella, 2003). The theory places the responsibility of raising corporate resources (finance, information, skills and critical networks) on the directors (Canella & Paetzold, 2000; Rodriguez, Ricart & Sanchez, 2000) and therefore requires them to be astute and provide their own specialized expertise in the management of corporate affairs with a view of reducing transaction costs associated with hiring these resources from external providers (Abdulla & Valentine, 2009). The resource dependency view informs corporate governance practice by focusing on the need for a board of directors with diversified skills, appointment of independent directors and continuous training of the board.

The *political theory* derives its postulate from exercising influence through voting (Pound, 1993). Corporates have long history of control by ownership through shares hence corporate decisions are influenced by the majority determined by the ownership structure. The political theory determines who will serve in the board, powers and privileges that the board will have and the consequent strategic direction that the firm will take. The political theory therefore contributes directly to corporate governance practices of the firm (Abdulla & Valentine, 2009). Lashgari (2004) suggests that shareholder activism derives its legitimacy from the political theory as the level of activism depends on the decisions taken by the board that is appointed through the political process.

The *virtual ethics* theory is about "moral excellence, goodness, chastity and good character" (Abdulla & Valentine, 2009: 93) that is a matter of individual choices, which according to Aristotle comes from theoretical and practical knowledge. Accordingly, virtue ethics are multi-track personalities that influence emotional reactions, choices, values, desires and perceptions (Hursthouse, 2013). Proponents of the theory argue that positive feelings are a function of doing the right things and are exhibited by individuals. Bowden (2005) however argue against the theory insisting that it's built on a "false base", does not result to fulfillment and is not an answer when making complex moral decisions. In the context of corporate governance, virtual ethics may inform the need for an educated and experienced board

and the desire to conduct proper and fit tests (tests of character, competence and capability) before appointment in to the board.

On its part, the *discourse theory* of ethics focuses on establishment of the right, moral and political principles emerging from certain ideal conditions (Jones, 1997). It emphasizes on conflict resolution through communication where parties are deemed to be equals, absence of coercion in dispute resolution, rationality in argument in addition to open ended communication (Harbemas, 1929). Discourse theory informs corporate governance in two ways *firstly*; two-way communication with stakeholders is viewed and is widely accepted as a key tenet of corporate governance and *secondly*; corporate governance is about resolution of potential conflicts that inherently arise amongst the various stakeholders of the firm.

The postmodern ethics theory addresses the inner feelings of individuals beyond morality. It focuses on value driven firms.

2.2 Governance in the Retirement Benefits Industry

Governance in the retirement benefits industry is rooted in common law that defines trustee behaviour, fair treatment of beneficiaries and stewardship of the assets under trust (Clark, 2004; Stewart & Yermo, 2008) and should therefore focus on internal relationships and mechanisms to safeguard against abuse of the wide discretion allowed to trustees (Brown & Caylor, 2004; Kowalewski, 2012) as the external governance mechanisms are weak.

In their theoretical model Besley and Prat (2003) show that governance in retirement benefits industry cannot be reviewed without carefully considering who bears the longevity, investment and operational risks of the fund. Accordingly, plan participants bear more risk in defined contribution schemes compared to their counterparts in the defined benefit schemes.

To enhance protection of assets and enhance order in the retirement benefits industry, the roles of administration, fund management, custody, actuarial and external audits are separated and performed by different service providers in what Stewart and Yermo (2008:6) refer to as “contractual type pension fund”. Given that trustees may “lack knowledge or ability to manage” (Clark, 2004: 237) and interests of the service providers may not be expressly disclosed, the inefficiencies arising due to poor governance are borne by the participants of the retirement benefit schemes. The relationship is further complicated as the participants do not play an active role in governance or in scrutiny of decisions made by the trustees. Conventionally, shareholder activism options through exit, voice and loyalty does not apply to the retirement benefits industry (Clark, 2004).

Given the unique challenges of governance in the retirement benefits industry, regulations become a remedy, which according to Clark (2004) should cover moral imperatives, legislation and market mechanisms. According to Besley and Prat (2003), the optimal governance arrangement for the

retirement benefits sector ensures that beneficiaries control and monitor the trustees. The supervising authorities should focus efficiency of the pension system by specifically legislating licensing, monitoring activities, communication between parties and correction (IOPS, 2008). From the classical view, regulations should promote stability, security and good governance for the benefit of the stakeholders.

Governance codes of conduct have gained prominence after the astonishing financial catastrophes experienced in the 21st Century (for example the OECD code of governance) (Rudolph, Antolin & Yermo, 2010). The codes may however be difficult to implement as the retirement benefit schemes differ in the value of assets, membership numbers and composition and the nature of sponsors (Miller & Funston, 2014). Clark (2004) opines that such codes should ensure consistence with internal governance rules, coherent internal governance and compatibility with the general laws.

3.0 METHODOLOGY

The study objectives were broad hence it was important to use different approaches to reach the different stakeholders in the Kenyan retirement benefits industry namely; the service providers, the regulator and the members of the retirement benefit schemes and collect the data from them. The approaches used to reach the constituents are discussed in sections 3.1 and 3.2.

3.1 Study Design

In this study, a mixed design was adopted. The design adopted incorporated both qualitative and quantitative techniques in data collection and analysis in order to address the study objectives. Various data collection methodologies were used including review of documents, surveys, Focus Group Discussions (FGD) and key informant interviews. Various participatory approaches were used in this study. Multiple triangulation was used which included data triangulation, investigator triangulation, methodological triangulation and analytical triangulation. Triangulation aided in quality control and helped in ensuring the completeness of data; balance and objectivity; reliability of the data (the degree the collected data is consistent among different observers or same observer at different times), and; validity of the results (the extent to which provided data reflects the reality).

3.2 Methodology used to collect data from service providers

A list of fund managers, administrators, actuaries and custodians was obtained from RBA. A letter was sent to the Chief Executive Officers (CEO) of the responding organizations asking them to nominate two individuals who deal with retirement benefit schemes to attend FGD at certain specified dates. In total, 42 respondents were nominated and were drawn from all the categories of the service providers (12 fund managers, 6 actuaries, 15 administrators and 9 custodians). The FGD were conducted on 4th March 2016, 11 March 2016, 18th March 2016 and 1st April 2016 for the fund managers, administrators, custodians and actuaries respectively.

At the onset, the research team from both USIU and RBA explained the purpose of the study to the respondents. The respondents were also made aware of the ethical issues that the researchers subscribe to namely; confidentiality, right to be treated fairly, right to withdraw from the interview any time if they felt offended, right not to be recorded without their consent and the freedom of expression and thought.

After the introduction, the respondents were split in to manageable groups (minimum 4 and maximum 6) to enhance effective discussions. RBA officials did not participate in the FGD. The members of the research team guided the discussions and moderated the debates using a standard set of questions that were developed on the basis of the research questions. The respondents were allowed to digress in to relevant issues that were not necessarily captured in the interview guide.

All the 42 respondents were directly involved in the management of retirement benefit schemes as service providers and therefore had an in-depth understanding of the issues under discussion. A total of 7 FGDs were conducted with the average membership in each FGD being 6 members. Each FGDs took between 1½ hours to 2 hours and were all recorded. The recorded data was then transcribed in to specific themes that informed the findings in section 3. Table 1 below shows the composition of the service providers and the number of respondents who informed the findings of the study.

Table 1: Composition of the Service Providers

Service Providers	Firms invited to participate	Firms that responded	Total Number of Respondents
Fund managers	20	10 (50%)	12
Administrators	29	14 (48.2%)	15
Custodians	11	9 (81.8%)	9
Actuaries	4	4 (100%)	6

The findings of the FGD were presented to the officials of RBA. The questionnaires that were administered to the trustees and members were informed by the findings from the FGD and also the feedback given by RBA officials.

3.3 Methodology used to collect data from Trustees and Members of RBS

Multi-stage sampling was used to first sample 301 retirement benefit schemes to participate in the study. The first stage involved the identification of the schemes to participate in the survey while the second stage involved the selection of trustees and members from the identified schemes.

The findings of the FGD with service providers concluded that retirement benefit schemes that have invested in alternative assets, schemes sponsored by government agencies and schemes that have co-fund managers faced special governance challenges and hence the overall sample had to include these schemes. This finding necessitated the use of purposive and random sampling of the schemes. RBA provided the list of the schemes with investment in alternative assets, those sponsored by government and schemes that have co-fund managers, which totaled 46 (15% of the sample). The sample of the schemes was therefore drawn using two approaches namely; purposive for the 46 retirement benefit schemes and 255 retirement benefits schemes randomly drawn from the remaining schemes in the sample frame.

The members and trustees were then randomly chosen from the selected schemes. A sample of 1100 members (response rate 92%, n=1016) and 350 trustees (response rate 90%, n=314) was drawn.

The demographic details of the responding members and trustees are included in tables 2, 3 and 4.

3.3.1 Gender of Respondents

In both the trustee and member samples, the number of male respondents was higher than the number of female respondents but the mean composition was not statistically different. Table 2 below presents the gender of Member and Trustee respondents.

Table 2: Gender of the Respondents

Gender	Members		Trustees	
	Frequency	Percent	Frequency	Percent
Female	460	45.2	132	42.0
Male	556	54.6	182	58.0
Total	1016	100.0	314	100.0

3.3.2 Age of Respondents

Sixty six percent of the members (n=674) were within the 18-41 years range compared to 47.4% of the trustees who were within the same age bracket. The mean difference in the age of members and trustees was statistically significant with trustees being older. However, the correlation between age and position shows no relationship. These results are indicated in table 3 below.

Table 3: Age of the Respondents

Age	Members		Trustees	
	Frequency	Percent	Frequency	Percent
18-23	33	3.2	2	.6
24-29	211	20.8	33	10.5
30-35	252	24.8	51	16.2
36-41	178	17.5	63	20.1
42-47	156	15.4	62	19.7
48-52	114	11.2	59	18.8
52+	72	7.1	44	14.0
Total	1016	100.0	314	100.0

3.3.3 Education Level of the Respondents

In both the trustee and member samples, 94% of the respondents had pursued their education beyond high school as indicated in Table 4 below. There was no significant difference in the education level of members and trustees.

Table 4: Education Level of the Respondents

Education Level	Members		Trustees	
	Frequency	Percent	Frequency	Percent
Primary School	11	1.1	3	1.0
High School	53	5.3	15	4.8
College or Polytechnic	335	33.4	71	22.6
University first degree	417	41.6	110	35.0
University master's degree	177	17.7	106	33.7
University doctorate degree	9	.9	9	2.9
Total	1002	100.0	314	100.0

Most of the members (68.6%, n=697) had work experience of 15 years or less compared to 51% (n=158) of the trustees who had similar job experience. There was a significant difference in the mean number of years of experience between members and trustees. The implication is that trustees had more years of experience compared to the ordinary members. Figure 1 indicates this.

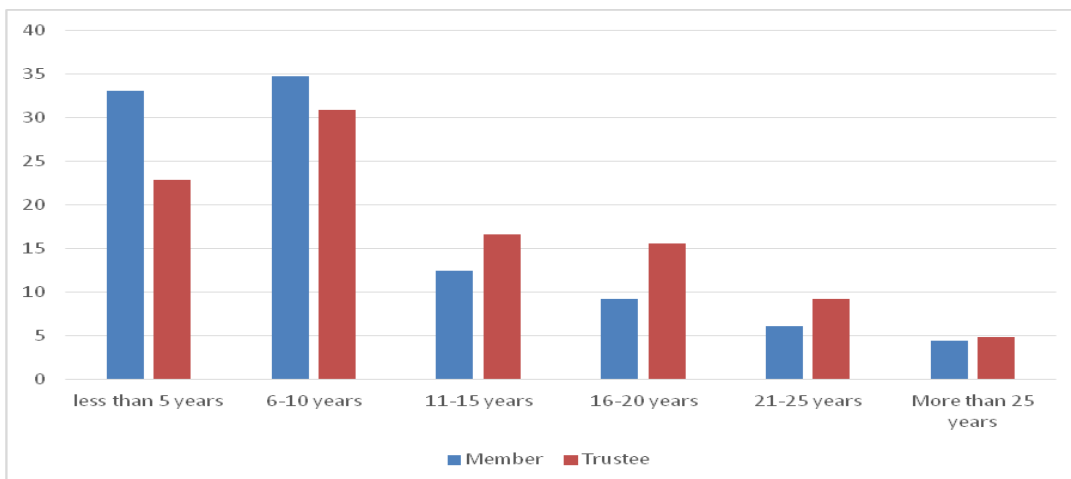


Figure 1: Duration of Membership in a Retirement Benefit Scheme

3.3.4 Appointment of Trustees

Eighty percent of the members sampled had been members of respective retirement benefit schemes for 15 years or less. Seventy percent of the sampled trustees had been members of retirement benefit schemes for 15 years or less. Additionally, 74% of the members sampled had never held a trustee position while 26% are former trustees. The sample of trustees consisted of 68.5% elected by the members and 31.5% nominated by the sponsors as indicated in Figure 2 below.



Figure 2: Appointment of Trustees

FINDINGS

4.1 Current State of Governance of the Retirement Benefit Schemes

4.1.1 Establishment of RBA

There was a general consensus amongst the fund managers, custodians, actuaries and administrators that progress had been observed since establishment of RBA in 2000, which had resulted to greater stability in the sector, growth of retirement benefit assets, more registered schemes, members of schemes being more aware of their responsibilities and rights with regard to the management of their schemes and more compliance with sector regulations. Additionally, the structures put in place have broadly enhanced separation of duties thus better execution of roles by the various stakeholders with the two major achievements being the separation of retirement benefit assets with the sponsor's assets and harmonization of pension legislation so that stakeholders have a one stop shop for the industry issues affecting them. This finding is triangulated by 56% (n=569) of the members who felt that their retirement benefit scheme was operated independently of their employer's business.

The data from the survey indicated that the arrangement put in place for governance of retirement benefit schemes has created avenues for members to lodge complaints or seek redress on retirement matters. Of the members, 21.5% (n=219) indicated that at some point, they had a complaint or had

matters that they needed sorted of which 34.7% sought advice from trustees, 18.7% from the administrators and 8.7% from RBA. Similarly, 31.5% of the trustees (n=99) had issues that needed to be solved at some point within their term in office. While 17.2% sought advice from fellow trustees, 35.4% consulted the administrators, 4% the custodians, 14.1% the fund managers, 18.2% the sponsor and 8.1% consulted RBA while 3% consulted other professionals such as lawyers, actuaries and tax consultants. Table 5 summarizes this information.

Table 5: Reference or Advice on Matters relating to Retirement

Point of Reference	Members		Trustees	
	Frequency	Percent	Frequency	Percent
Trustees	76	34.7	17	17.2
Administrators	41	18.7	35	35.4
Custodians	0.0	0.0	4	4.0
Fund managers	0.0	0.0	14	14.1
Sponsors	0.0	0.0	18	18.2
RBA	19	8.7	8	8.1
Immediate supervisor or other colleagues	77	35.2	0.0	0.0
Tribunal and courts	6	2.7	3	3.0
Total	219	100.0	99	100.0

4.1.2 Resolution of Members and Trustees Issues'

The main finding is that 62% of the members directed their issues to the formal systems set by RBA as opposed to 38% who directed their issues to colleagues and relatives. All the trustees directed their issues to the formal systems set by RBA.

Of the complaints, advice or matter relating to retirement raised by the members, 55.3% (n=121) stated that the issues were solved to their satisfaction, 23.3% (n=51) stated that the matter was not solved to their satisfaction and 21% (n=47) indicated that the matter was yet to be solved. On the same issue, 45.8% of the trustees felt that the issues they raised were solved to their satisfaction, 13.9% stated that the issues were not solved to their satisfaction while 40.3% stated that the issues they raised were yet to be addressed. Figure 3 summarizes this information.

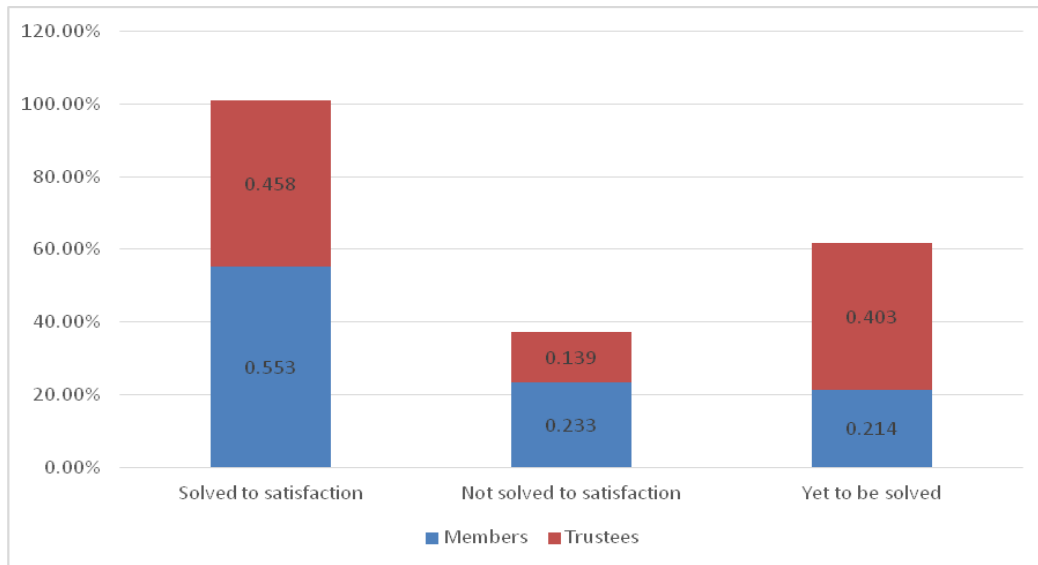


Figure 3: Satisfaction on Resolution of Issues

Fifty five percent (n=121) of the members and 46% of the trustees felt that their issues were resolved to their satisfaction. However 40% of the issues raised by trustees were yet to be resolved compared to 21% of the issues raised by members.

Data on the period taken to resolve the issues indicated that 58.2% (n= 128) of the affected members had their issues solved in less than 30 days, 6.6% took 31-60 days, 8.1% took 61-90 days, 21% took more than 120 days. Thirty one percent (n=18) of the trustees indicated that the issues they had were resolved in less than 30 days, 18.8% took 31-60 days, 4.7% took 61-90 days while 42.2% took more than 120 days to solve. This information is summarized in Figure 4.

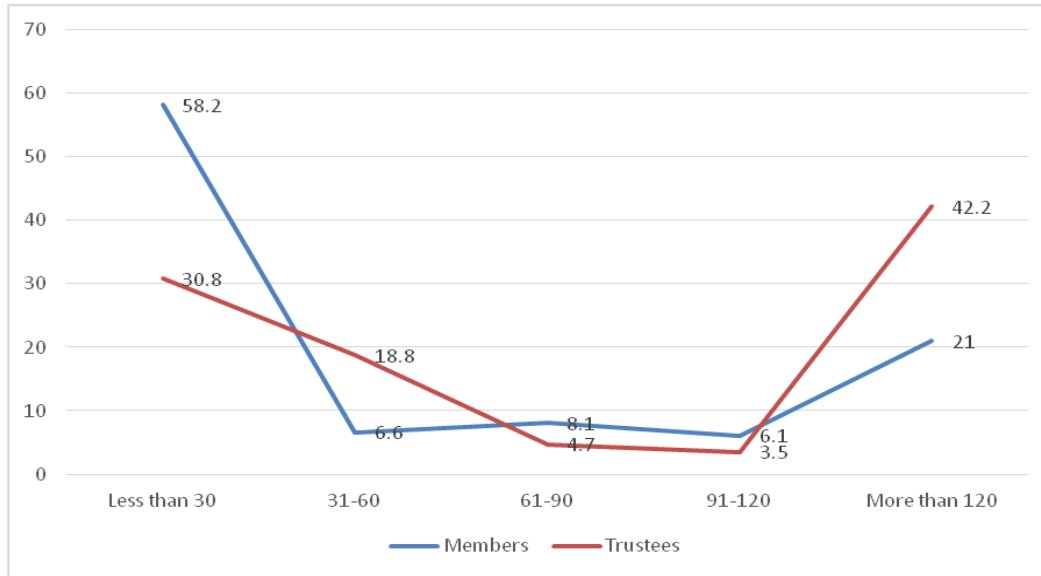


Figure 4: Time taken to Resolve Issues

The issues raised by the trustees took longer time to resolve probably because the issues were escalated by the members and were possibly more technical than those raised by the members.

Of the members who indicated that the issues were still outstanding 23.5% (n=) indicated that the issue has been pending for less than 30 days, 41.2% between 31 and 60 days, 11.8% between 61 and 90 days and 23.5% for periods exceeding 90 days. This information compares with the issues raised by trustees that have remained outstanding for less than 30 days (33.4%), 31 days (25%), 61-90 days (33.3%) and more than 90 days (8.3%). This information is summarized in table 6.

Table 6: Duration Issues have been Outstanding

Days	Members		Trustees	
	Frequency	Percent	Frequency	Percent
Less than 30	11	23.5	14	33.4
31-60	19	41.2	10	25.0
61-90	6	11.8	13	33.3
More than 90	11	23.5	3	8.3
Total	47	100.0	40	100.0

Twenty four percent of the members have had their issues pending to be solved for more than 90 days compared to 8.3% of the issues raised by the trustees.

4.1.3 Risk Management

RBA was created at a time when the risk management practices in the industry were deficient. A participant in the FGD reported that *“RBA has minimum requirements on risk management and leaves enough room for industry to exercise prudent risk management strategies. The separation of custody, investment management and administration functions was a brilliant idea.”*

The move from the compliance supervision model to risk based supervision model was viewed by the service providers as a step in the right direction as it introduced proactivity in risk management. However, players were not sure how the risk score is determined hence there is mismatch in the sense that the players use compliance risk assessment and management while the regulator uses risk based assessment of the risks.

Amongst all the service providers, the fund managers were found to be more cautious in risk identification and management and more specifically the investment risk. In all cases they reported adhering to the regulatory requirements with regard to investment limits in various asset classes as required by RBA. Additionally, new options of investment are seen to help in diversification of risk for instance the introduction of derivatives instruments in Kenya’s capital markets and growth of the private equity market. The trustee survey supported this finding with 70.8% of the trustees supporting the statement that their fund managers strictly applied the stipulations of the investment policy statement in view of the assets they invested in. This information is included in Figure 5.

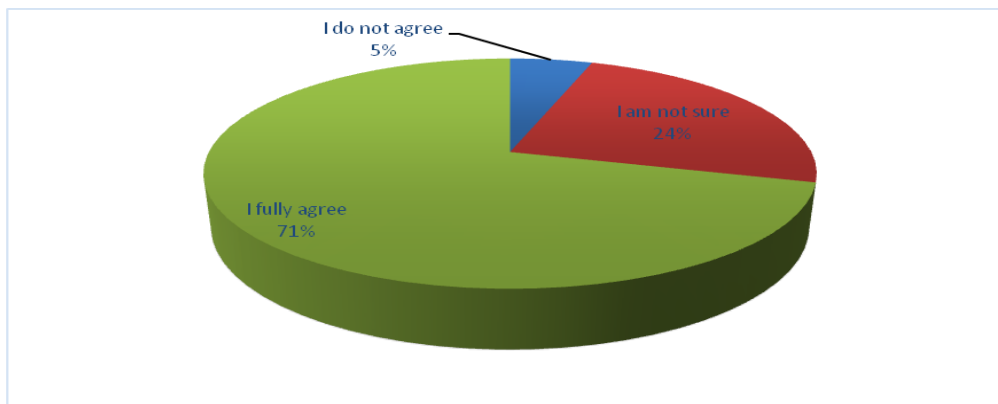


Figure 5: Compliance with the Investment Management Policy by the Fund Managers

The service providers however stated that most members and trustees do not understand the risk-return relationships and the factors that affect performance of the fund and hence do not take reports on these two aspects seriously or do not consider them to be important.

However, the member survey shows that 91.9% of the members (n=934) considered the annual report on the risk-return relationship presented by fund managers as very important to them. Similarly, 89.4% (n=908) indicated that the presentation of the factors affecting performance of the retirement benefit

schemes (including the measures that fund managers take to address negative factors) was very important to them as well. On the other hand, 93.1% and 64.9% of the trustees indicated that the report on risk-return relationship and factors affecting performance of the retirement benefit schemes were very important to them with 67.4% and 67.5% stating that they fully understand those issues as indicated in table 7.

Table 7: Perception on Importance of Reports on Risk-Return Relationships and Factors Affecting Performance of the Fund

	Members		Trustees	
	Frequency	Percent	Frequency	Percent
Report on Risk-return relationships is important	934	91.9	292	93.1
Report on factors affecting performance of the fund is important	908	89.4	204	64.9

This finding contradicts the assertion made by the service providers suggesting that trustees and members do not consider the information on risk-return relationships and factors affecting performance of the fund as important.

The custodians on the other hand alluded to the risk that they could be holding assets whose title cannot be accurately verified. These assets relate to unquoted investments and guaranteed asset classes offered by insurance companies. One of the participants reported *"sometimes we only hold letters indicating that such investments exist.....RBA needs to give direction on what exactly constitutes title to such assets."* The concern with the guaranteed funds offered by insurance companies is that the insurance companies are not reporting the assets of those funds separately from the aggregate assets of the companies as a whole. Eighty eight percent of the members indicated that the custodian's report was very important to them; however the investment in specific classes of assets was not clear to 64.2% (652) of the members. Similarly 52% of the members (n=528) did not know the returns on investment that were generated by their retirement benefit schemes in the last one year.

Service providers reported that members and trustees did not understand risk and return relationship. A respondent stated *"trustees appear focused on short term returns as opposed to the long term in attempt to show that they have delivered good returns in a context where they have a fixed term to serve in the board."* In this regard, the fund managers' performance review is based on annual performance of scheme yet the schemes investment horizon is long term. Fund managers are therefore pressured to take higher risks for the scheme to meet this demand. However 69.3% of the members indicated that they believed that their trustees have capacity to manage the retirement benefit schemes and were good managers.

In triangulation, the respondents were asked to rate their level of understanding of the information contained in the risk-return relationship and factors affecting performance of the funds reports. Table 8a and 8b show the findings.

Table 8a: Perception on Understanding of Risk-Return Relationships

	Members		Trustees	
	Frequency	Percent	Frequency	Percent
I do not understand	89	8.8	5	1.5
I have fair or average understanding	505	49.7	97	31.0
I fully understand	422	41.5	212	67.5
Total	1016	100.0	314	100.0

Table 9: Perception on Understanding of Factors Affecting Performance of the Fund

	Members		Trustees	
	Frequency	Percent	Frequency	Percent
I do not understand	121	11.9	6	1.8
I have fair or average understanding	452	44.5	96	30.8
I fully understand	443	43.6	212	67.4
	1016	100.0	314	100.0

These findings contradict the assertion made by the service providers suggesting that trustees and members do not understand the information on risk-return relationships and factors affecting performance of the fund.

FGD discussions with the service providers gave the impression that the appointment of service providers was “uncompetitive” as the fund managers and custodians felt that administrators referred the trustees to certain service providers, which made the trustees, appear to be apparently biased. The trustee survey shows that several methods are used in the appointment of service providers namely; recommendation by other service providers, competitive bidding, recommendation by the sponsor and nomination of a few service providers who are then asked to submit proposals for consideration amongst other approaches. Table 9 summarizes these responses.

Table 10: Approaches Used in the Appointment of Service Providers

	Trustees	
	Frequency	Percent
Recommendation by other service providers	46	14.6
Advertisements are made and service providers submit proposals for consideration	119	37.9
Recommendation by the sponsor	44	14.0
Select a few providers and ask them to submit proposals for consideration	99	31.5
Other methods (Did it long ago or found them in office)	6	1.9
	314	100.0

The finding on appointment of service providers appears to be inconclusive as there are different approaches being used. Hence the service providers' view cannot be taken on the face of it.

According to the service providers, imposing term limits as a risk management measure was reported to be problematic in the sense that former trustees may be too active in criticizing newly appointed trustees. Newly appointed trustees are then put under pressure to require high short-term returns from the fund managers, who then respond by taking excessive investment risk to the detriment of the scheme. Additionally, the changes in board of trustees every three years can sometimes erode advantages gained by previous boards especially because the appointment is campaign based. It might also result to a situation where almost the whole board is not elected. However, 41.5% of the members were not aware of the regulation on the term limits of trustees (n=422). Nevertheless, 86.7% (n=881) were supportive of the proposal to have the term limits. However, only 63.2% of the trustees supported the idea as indicated in figure 6.

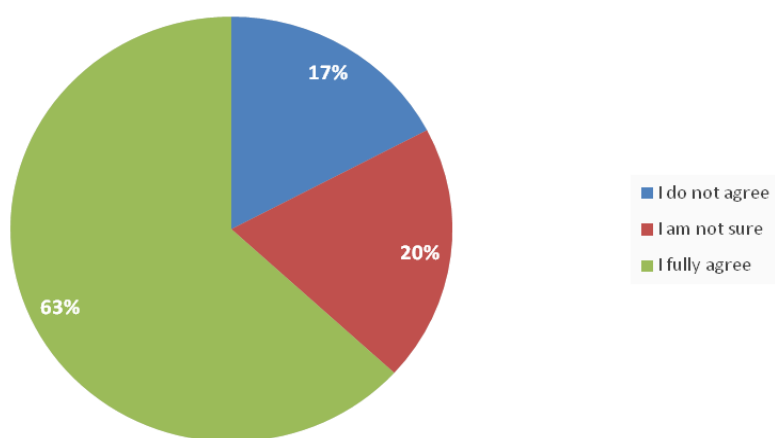


Figure 6: Perception of Trustees on Term Limits

Across the three categories of respondents (service providers, trustees and members), there appears to be consensus that the term limits for trustees is a good idea. However, the implementation needs to be done in a way that ensures succession planning and eliminates unnecessary competition.

4.1.4 Conflicts of Interest

There was general consensus that separations of duties amongst the service providers have helped reduce conflict of interest since stakeholders are aware of their roles and responsibilities. However, the trustees (except corporate trustees) are often employees in the company hence there is inherent conflict between their role as employees and as trustees in the schemes.

However, procurement of service providers is often affected by conflict of interest. The trustees often correspond with the administrators on the choice of the investment managers and custodians. A respondent stated *"trustees have left their roles to the administrators who are often biased and make recommendations on the "best" custodians and fund managers."* The administrators were reported to be "nosy" on the affairs of the fund managers and custodians – making them appear like supervisors of the other service providers. They offer training on investments, some make industry reports comparing the performance of fund managers (which may lack objectivity) and recommend the persons to be appointed to prepare investment policy statements. Trustees do not support this finding as indicated in table 15. Fifty six percent of the trustees refuted the claim that service providers acted in conflict as indicated in table 10.

Table 11: Conflict amongst Service Providers

Quite often, roles of service providers are in conflict	Trustees	
	Frequency	Percent
I do not agree	176	56.2
I am not sure	81	25.8
I fully agree	57	18.0
	314	100.0

The trustee survey did not also support the assertion on conflict between trustees and service providers. Eighty percent of the trustees were either not sure or disagreed with the assertion as indicated in table 11.

Table 12: Conflict between Service Providers and Trustees

There are so many cases of conflict between trustees and service providers	Trustees	
	Frequency	Percent
I do not agree	156	49.8
I am not sure	94	30.0
I fully agree	63	20.2
	314	100.0

The trustee survey further disclosed that retirement benefit schemes have written policies that help to address some conflict of interest issues as indicated in table 12.

Table 13: Presence of Written Policies to Address Conflict of Interest

	Trustees			
	We have policies		We do not have policies	
	Frequency	Percent	Frequency	Percent
We have policies to address				
Appointment of service providers	290	92.3	24	7.7
Operation of the trustee account	233	74.2	81	25.8
Disclosure of conflict of interest	203	64.8	111	35.2
Remuneration of trustees	53	59.8	36	40.2

Fund managers reported that some of the persons consulted to make investment policy statements are not licensed by either CMA or RBA, which disadvantages them and questions the code of conduct that they work with. This finding was however refuted by 89% of the trustees.

Another aspect of conflict of interest reported was on annuity products as the administrators are the focal contact points with the trustees and those who exit from the scheme. It was reported that administrators hurried to refer those exiting to specific insurance companies for annuities and did not explain for example the income drawdown option available to the leavers. The administrators however refuted the claim during the FGD.

In some instances, trustees appear to make personal gains when they make certain investment decisions especially in the procurement of property. A participant stated *“fund managers are supposed to be experts to advice in the management of bonds and stocks but not property. The trustees ask for our advice in one quarter and before we issue a detailed report the property is procured. What could explain this behaviour other than potential personal gains in the deal?”* The trustee survey on the retirement benefit schemes that have invested in property appeared to confirm this assertion as only 71.6% indicated that they always consulted the fund managers before making the investment decisions on property, the remaining 28.4% stating that they did not consult or were not sure whether the fund managers had been consulted while making the decision. A further probe indicated that some trustees managed the property bought as they felt that the involvement of the fund managers in procuring these properties was minimal.

Another issue noted is the delay to submit or transfer records of the scheme from one administrator to the other in the event of changes of the service providers despite existence of a regulation that requires such transfer to be completed in 30 days and RBA notified accordingly.

In the case of a group of companies, roles are played within the different arms of the company, may present cases of inherent conflict of interest for example a bank that has an insurance company is the custodian, corporate trustee, administrator of their employee's pension.

The fund managers asserted that guaranteed schemes have higher incidents of conflicts of interest, thereby creating a sense of lack of accountability in these schemes.

4.1.5 Internal Controls

According to the service providers, trustees do not seem to understand the need to maintain a proper system of control independent of the controls put in place by the sponsors. The trustee development program has enhanced understanding of their roles but they are broadly not implementing these measures. Corporate trustees were noted to have better control systems for the schemes compared to the member appointed trustees as this is their core business.

4.1.6 Risk Management by Trustees

The service providers were of the view that trustees do not understand the concept of risk management and therefore do not appreciate their role as risk managers of the scheme. As a result they tend to focus on the short term returns as opposed to the long-term returns. The data in tables 15a and 15b however suggests otherwise.

4.1.7 Appointment of Trustees

According to the service providers, the composition of the board of trustees is not satisfactory as the trustees are voted in on the basis of popularity as opposed to merit and value that they can add to the board. This is especially the case with regard to the making of investment decisions, applying stipulations in the trust deed, interpreting financial results of the scheme, reconciling balances reported by the fund managers and custodians and using the information reported by the custodians and fund managers to inform future decisions. Asked to arbitrarily rate the percentage of boards of trustees affected by the problem, the fund managers placed the number at 90% while administrators placed the number at 65%.

Of the members surveyed, only 51% (519) of them voted for the trustees. Those who indicated that they did not vote gave the reasons indicated in figure 7.

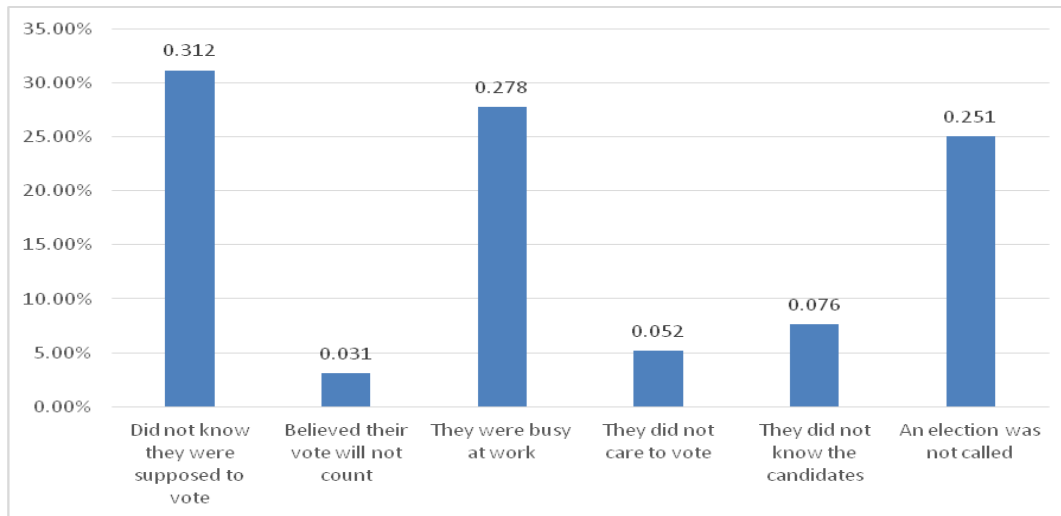


Figure 7: Reasons for Not Voting During Trustee Elections

Of those who voted, 69.3% (n=704) members stated that they voted for the trustees of their choice as they believed that they were knowledgeable and would do a good job if appointed as trustees. The other 30.7% voted for the trustees as they worked in the same department (5.8%), is a friend (2.7%), they campaigned vigorously (6.7%) or they were recommended by friends (15.5%). The assertions of the service providers were therefore not supported by the member survey.

The use of corporate trustees was applauded by the service providers as a better option to individual trustees as the corporate trustees were seen to be more knowledgeable. The problem however is that other than the big corporate trustees namely; KCB, ICEA and Cooperative Bank, the others are “not corporate trustees” in terms of their operations as they are not properly organized; in fact respondents in the FGD rated their performance as below average.

4.1.8 Accountability and Transparency

The main areas where accountability and transparency was viewed to be inadequate are; procurement of property, procurement of unquoted equity, appointment of service providers and investments in guaranteed funds offered by the insurance companies. In some cases, service providers reported that trustees were investing in the property market without consulting the fund managers and contrary to the stipulations in the investment policy statement. Additionally, they would instruct custodians to transfer funds to a trustee account, from which they would make payments for both revenue and capital expenses on the property in which case the payment of the expenses, are not expressly verified. Moreover, revenues from such “off shoot” investments would be deposited in separate accounts and managed by the trustees independent of the fund managers. This presents a significant loophole that leads to inefficient investments, excess costs and lack of coordination of the investments and revenues of the scheme. Seventy two percent of the trustees agreed that they maintained the trustee account and was mainly used to pay dues to members, fees due to service providers, investments (14.3%) and

investment management expenses to the extent that the investments were done by the trustees (13.5%). In a discussion with some of the trustees who are affected, it was indeed confirmed that in some cases, trustees used the trustee account to pay for certain investments. The survey could not confirm if such investments are eventually included in the overall portfolio of assets of the scheme.

According to the service providers, transparency and accountability is lacking where the schemes have co-fund managers occasioned by their large sizes and high volume of assets. The problem according to the respondents is that the co-managers do not see portfolio as a whole but only the proportion that they manage. In fact they do not attend the quarterly trustee meetings together, hence trustees are disoriented in terms of the performance evaluation. Similarly, the co-managers compete at the expense of the scheme. A discussion with trustees of the affected schemes were of a different opinion stating that the use of co-managers was to allow for "competition in investment and generation of returns" for the overall benefit of the retirement benefit scheme and did not see anything wrong with the arrangement.

Undercutting on fees structure is rampant in the industry in a bid for fund managers to acquire and retain clients. This presents a challenge in determining the true cost of services, thus difficult to set a base. This is broadly expected in highly concentrated markets where most of the business in the industry is held by a few players.

Lastly, service providers were of the view that the reserves retained by the RBS remain controversial and shrouded in pellucidity. Commenting on this issue, one participant stated "*...whose money is it? Does it belong to present members, those who have already exited the scheme or the future members (who will surely partake those reserves in the future?)*". A discussion with the trustees affirmed this assertion.

4.1.9 Trustee Development Program

The trustee development program has created more awareness on the roles and responsibilities of trustees and enhanced their understanding on risk and governance. It is however viewed to be too costly for small and new schemes. Additionally, it is not clear on what will happen to the schemes that will not have met the certification requirement by the set dates.

The trustee survey showed that 51.4% (n=162) of the trustees had attended the trustee development program and were indeed certified. Of those who had attended the training, 97.2% (n=157) stated that the training had led to an improvement in the way they conducted the business of the retirement benefit scheme especially on their fiduciary duty as trustees. One of the trustees stated that "*when I attended the training, I realized the immense responsibility that we have as trustees.....It is a huge responsibility with very high risk.*" The trustees who had not attended the training gave reasons for not attending as; been too busy at work, lack of funds to cater for the training as the scheme is young or quite small, they have appropriate knowledge to manage the schemes in the absence of the training, they are not able to get time off their duties and the fact that the venue of the training is too far.

4.1.10 Organization of the Service Providers

The study established that service providers are not explicitly organized as providers to retirement benefit schemes. As such service provision to retirement benefit schemes is only part of the business that they undertake, which according to one of the respondents is a “growing revenue stream”. Following the financial services model in Kenya, one service provider can offer more than one service in the main areas of insurance, administration, custody of assets and asset management. It is therefore plausible to conclude that the governance of the service providers that consequently affect the governance of retirement benefit schemes is determined by the nature of the license that is held by the service provider and the consequent regulations that are issued by the regulators of the “tributary” services. In other words, proper governance of retirement benefit schemes is an outcome of proper governance mechanisms put in place by other regulators in the financial services industry such as the Central Bank of Kenya, Insurance Regulatory Authority and the Capital Markets Authority.

4.2 Extent of Implementation of Governance Practices specified in the RBA ACT

Generally, participants were of the view that the governance practices specified in the RBA Act are implemented to a large extent by the stakeholders. Specifically high level of compliance was noted in the remittance of contributions by sponsors to the custodians, appointment of trustees, composition of the board of trustees, appointment of the board chairs by fellow trustees, sending annual statements to members, investment of funds within the RBA guidelines, appointment of auditors, holding of quarterly meetings between the trustees and service providers, submission of final accounts and returns and restrictions on attachment of scheme assets.

However, some limitations were noted. These are;

Service providers reported that the requirement for schemes to have an information system is widely not implemented. Given that the schemes outsource their services to the service providers, only 58.6% of the trustees confirmed that they have an elaborate information system that they use to track the activities of the scheme.

The schemes lack objective risk assessment and performance management frameworks. This was also confirmed by 79.6% of the trustees.

The requirement to hold AGM is enforced but the attendance to the meetings is quite poor. Service providers estimated the best attended AGM to be at 15-20% of the members. This finding was confirmed by the trustee survey as the mean attendance of the AGMs was determined at between 50.6%. The member survey indicated that 53% (n=538) of the members attended the last AGM of the retirement benefit scheme.

The trustee survey (results in table 14) gave the reasons for members failing to attend the AGM as;

Table 14: Factors attributed to less than 100% attendance to AGM - trustees

	Trustees		
	Not at all	less extent	large extent
Members not being aware	67.8	24.8	7.4
Members being busy at work	22.3	31.6	46.1
Members not getting time off to attend AGM	64.3	23.8	11.9
Members having less interest in the scheme matters	28.4	44.4	27.2
The venue of the meeting being too far	52.9	34.9	12.2
Failure to understand the issues being discussed	39.7	45.1	15.2

The member survey gave the reason for not attending the AGM as being unaware of the AGM taking place, busy at work, could not get time off to attend the AGM, saw no need attend (no apparent reason), the venue was too far and failure to understand the issues that were discussed at the AGM. Figure 8, that follows indicates this.

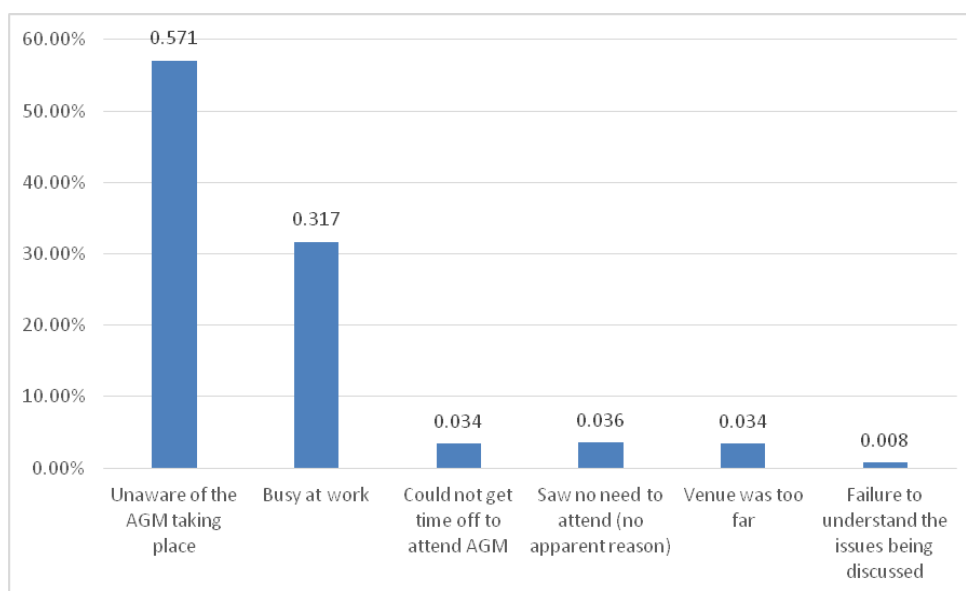


Figure 8: Reason for less than 100% Attendance to the AGM

Further findings show that some schemes give cash rewards to members who attend the AGM thus increasing the expenses associated with the AGM. Additionally, schemes with branches in different parts of the country hold as many AGM as there are branches hence increasing the costs of the AGM significantly as service providers and trustees have to go the branches to conduct the AGM. The remuneration to members took the form of reimbursement of transport expenses.

4.3 Governance Gaps

Participants were asked to state the major issues that they considered to be governance gaps or “governance time bombs” that if not urgently addressed will lead to inefficiency of the retirement benefits industry. The lapses noted were; investment in property and private equity, management of the trustee account, term limits for trustees and service providers, governance of government sponsored schemes, regulation of umbrella schemes, management of guaranteed funds, investment in annuities and procurement of service providers. These gaps are explained in the next sections;

4.3.1 *Investment in Property, Private Equity and Unquoted Equity*

Current RBA regulations allow investment in property and unquoted equity as investment classes for retirement benefit schemes. While this is a noble idea, the processes that some trustees are using to procure the assets raise serious governance concerns. Participants reported that some trustees procure property and unquoted equity in disregard of the fund manager’s advice and actually maintain separate records and accounts for this class of assets. The trustees then become “investment managers” for unquoted equity and property owned by the scheme. The main risks here are that (i) the investment in these assets may not be prudent given the scheme’s position and liability structure, (ii) titles to these assets in the Kenyan context may require extra due diligence and (iii) trustees may not have requisite capacity to manage these assets profitably.

Respondents expressed concern that the regulators have not defined “what constitutes legal title” to private equity and unquoted equity investments. Hence the custodians may not be able to provide full guarantee that the agreements they hold with respect to private equity and unquoted equities really constitute proper legal title that can be relied upon in the event of a challenge in court.

4.3.2 *Management of the Trustee Account*

Under the current regulations, trustees can authorize the transfer of funds from the scheme’s account held by the custodian account to another account designated as trustee’s account that may be held in the same bank or another bank altogether. The custodian has no mandate to require an explanation or the reasons for the transfer of funds as long as the right signatories have signed the requisite documents. In the absence of a proper control system and due scrutiny, these funds may be withdrawn from the trustees account for purposes that are not to the best interests of the scheme.

4.3.3 *Term Limits for Trustees and Service Providers*

The current regulations provide for trustees to serve for a maximum of three years in the board. The introduction of term limits, according to the participants impacts on the continuity of operations (especially as there is no succession planning for the schemes) and increases the costs of training new trustees. The participants observed that since the schemes are intended to serve members in the long-term a term limit may bring about a myopic view of the schemes by the trustees.

Similarly, term limits are not imposed on service providers, a situation that has resulted to complacency on the part of some service providers, to the extent that the schemes may not be getting value for money from some of the service providers.

4.3.4 Governance of Government Sponsored Schemes

According to the participants, governance of schemes sponsored by government agencies remain poorly executed with little compliance and enforcement of the laws. The main issues relate to access to contributions, conflicts of interest and conduct of annual general meetings.

4.3.5 Umbrella Schemes

There was general consensus that there are regulatory gaps observed for umbrella schemes, as there are no specific laws that govern them. The trustee representation is determined by the sponsor hence inadequate representation of members. Given that these schemes are growing, the issue needs to be addressed immediately.

4.3.6 Management of Guaranteed Funds

The current regulations allow retirement benefit schemes to invest in guaranteed funds that are regulated by the Insurance Regulatory Authority (IRA) and not by RBA. Participants reported that the insurance companies are not separating the assets of the retirement benefit schemes held in guaranteed funds separate from the assets of the company. This presents a serious governance concern as the collapse of the company will directly result to the loss of the assets of the retirement benefit scheme.

4.3.7 Investment in Annuities

The current regulations allow the investment in annuities. While this is a noble regulation, there are problems in that members are not effectively capacitated to choose the best annuity products for themselves. They therefore end up relying on the advice given by the trustees and administrators to choose the annuity products. Participants reported that some trustees and administrators collude with insurance companies and actually earn a commission of between 2-4% of the value of the annuities procured by the retiring members.

The draw down option allowed by RBA is not effectively communicated to members and some trustees have failed to amend the trust deeds to accommodate this arrangement.

4.3.8 Procurement of Service Providers

Participants felt that there are no clear guidelines on the procurement processes within the schemes, a situation that results to extreme discretion to the trustees in the choice of trustees. Most respondents observed that they were themselves appointed through single sourcing in some schemes. Non-ethical practices have consequently been observed in the selection of service providers. This gap is linked to the fact that service providers do not have term limits.

5.0 RECOMMENDATIONS FOR IMPROVEMENT

This study has unearthed important issues and gaps relating to governance in the retirement benefits industry in Kenya. These issues revolve around four main themes namely; interaction between the regulator and the industry, risk exposure and management, conflicts of interest amongst the service providers and trustees and accountability and transparency. These themes form the basis of the recommendations stated in table 22. The recommendations are also supported by a review of the principles of good governance formulated by OECD and IOPS.

Table 15: Suggestions for Improvement

Finding	Comment	Recommendations
1.	With the growth of the retirement benefits industry, RBA seems to have less interaction with stakeholders	Reported by service providers and trustees RBA to find more creative ways of involving the stakeholders. More interactions can take place through the associations, regular industry briefs, open days and communication of research findings.
2.	Stakeholders do not know the variables used in the computation of the risk scores in the risk based supervision model.	Reported by service providers Disclose these variables in the RBA website and inform the stakeholders to encourage “risk based” management of the schemes as opposed to compliance based risk management.
3.	Legal definition of title to investments in private and unquoted equity.	Reported by custodians Provide the legal definition and title of the assets designated as unquoted equity as registered agreements and consequent amendments in the Articles of Association of the companies where the investment is made. Mandate special due diligence of investments in private and unquoted equities done by retirement benefit schemes. Mandate express disclosures in the financial statements of the private and unquoted equity owned by the scheme, these disclosures should explain the issuers and

			<p>the returns generated from these investments.</p> <p>Require auditors to expressly verify existence of property, private equity and unquoted equity at the end of the financial year.</p> <p>Encourage investment in Real Estate Investment Trusts (REITS) as opposed to own purchase, development and management of property.</p>
4.	Understanding of the risk-return relationship by trustees and members	Reported by the service providers but trustee and member survey seem to disagree	<p>The trustee development program should emphasize to the trustees, the need to have a long-term return evaluation of the scheme as opposed to the volatile short term returns.</p> <p>Schemes can also be allowed to have independent trustees to complement the capacity deficits in the boards. Such schemes should apply for approval by RBA indicating clearly the capacity gaps they need to fill and the proposed persons to fill such gaps.</p> <p>Encourage annual and long-term reporting of the scheme's performance to the members.</p>
5.	Term limits for trustees	Term limits were supported by service providers, trustees and members. However, service providers expressed concern on implementation of the	Use rotational basis of retirement of the trustees for instance one-third to retire on annual basis. This will encourage continuity of the operations of the schemes when some trustees leave the board.

		term limits	
6.	Appointment of service providers	Different methods of appointment of service providers were used by trustees.	<p>RBA to provide specific guidelines for use by trustees in the appointment of service providers.</p> <p>RBA should independently scrutinize all investment advisors who are consulted in the development of investment policy statements, to ensure that investment policies are being developed by consultants who are licensed.</p>
7.	Delay in the transfer of scheme records and details from one administrator to another in the case of change of scheme administrators	Reported by administrators	Enforce the regulations as the regulations are explicit that the outgoing administrator must hand in the records and documents to the incoming administrator and trustees within 30 days and inform the authority accordingly.
8.	Investment in guaranteed schemes offered by insurance companies	Reported by custodians	RBA should liaise with IRA and develop regulations that will require insurance companies to separate and report guaranteed assets of the scheme independent of the company's assets.
9.	Voting of trustees on populism as opposed to merit	<p>Reported by service providers but member survey seems to disagree.</p> <p>Proposal for minimum education is supported by service providers,</p>	<p>Require diversity in the board of trustees to represent certain interests and skills and encourage use of corporate trustees</p> <p>This recommendation is already provided for under</p>

		trustees and members but it is conceptually difficult to implement as some schemes may not have members with the minimum required education.	<p>section 22A (b) of the RBA Act that provides <i>“The authority shall in determining whether a person is suitable to act as a trustee, manager, custodian or administrator shall consider education or other qualifications or experience of the person having regard to the nature of the functions which, if the application is granted the person shall perform.”</i></p> <p>Enforce section 26 of the RBA Act that excludes persons who have been imprisoned for 6 months or more, adjudged bankrupt, were involved in management or administration of schemes that have been deregistered or are barred by any law from being trustees. A certificate of good conduct should be mandatory for all trustees together with a declaration that they meet the conditions specified in this section.</p>
10.	Corporate trustees	Reported by service providers	Develop guidelines for licensing of corporate trustees. Were & Mutuku (2013) have found schemes served by corporate trustees to be more cost efficient, recorded fewer complaints, had lower compliance risks and more properly governed.
11.	Use of trustee accounts to pay for capital expenses	Reported by service providers and confirmed by trustees	<p>Restrict the payments that can be made through the trustee accounts.</p> <p>A scheme can operate without a trustee account where</p>

			<p>all payments are done by the custodian directly to the payees on the instructions of the trustees just the way it works with the fund managers.</p> <p>All funds from investment or otherwise must be channeled to the official custodian registered by RBA.</p> <p>Schemes can effectively maintain a capital account and income account with the custodian in which case, payments for administration and operation of the scheme can be separated from the payments for investments. Transfers from capital to income can be authorized by the trustees.</p>
12.	Schemes with co-fund managers hold separate meetings with the co-fund managers.	<p>Service providers and trustees have different views. While service providers feel that there is disconnect between co-fund managers of the schemes, trustee support competition of the co-fund managers to earn better returns.</p> <p>With retirement benefit schemes mandate being saving for retirement, long-term returns should be emphasized.</p>	<p>These schemes should be mandated to have common meetings between the co-fund managers, trustees and custodians to discuss investment management matters at least annually since they use the same investment policy statement.</p> <p>RBA needs to give guidelines on how the relationship with co-fund managers should be structured.</p>
13.	Trustee development	Program is supported by both service	Seek alternative means of undertaking the program, for

	program	<p>providers and trustees but small schemes feel disadvantaged due to costs.</p> <p>Attendance to the training is affected by work schedules of the proposed participants</p>	<p>instance online certification, Training of Trainers (ToTs), as well as Partnerships with Training institutions</p> <p>A special module on Corporate Governance with a strong emphasis on gaps identified in this study.</p> <p>Establish a mechanism for continuing education as opposed to a one off training.</p>
14.	Umbrella schemes	Reported by service providers	Develop guidelines and regulations for umbrella schemes.
15.	Addressing conflicts of interest	Reported by service providers and confirmed by trustees.	<p>RBA should develop a harmonized policy guideline on how to tackle the various conflict of interest issues arising in the schemes.</p> <p>Have a confidential whistle blowing mechanism for instance in the RBA website or email. Further, there should be awareness creation on this.</p> <p>Limit the number of meetings that trustees can hold as some of them create unnecessary meetings to earn allowances.</p> <p>Require sponsors to self-report in the event that they are</p>

			not able to make contributions to the scheme on time together with a commitment on when such contributions will be made.
16.	Reserves maintained by the RBS	Reported by both service providers and trustees	<p>RBA should give uniform guidelines on the treatment of these reserves in the interest of all members (past, present and future membership). The trust deeds should then be amended accordingly.</p> <p>Specifically, the reserves due to past members should not be allocated to current members of the retirement benefit schemes.</p>
17.	Exclusive investments by trustees without involvement of the fund managers	Reported by fund managers and trustees	Ban trustees from directly undertaking procurement of investments as they already have fund managers charged with this responsibility.

6.0 IMPLICATIONS OF THE STUDY AND SUGGESTIONS FOR FURTHER RESEARCH

The study has raised important issues that will need to be addressed to enhance governance of retirement benefit schemes in Kenya. Specific policy guidelines need to be developed on engagement with stakeholders with regard to;

- Engagement with stakeholders to identify emerging issues including the reinforcement of risk based supervision of the retirement benefit schemes.
- Review guidelines relating to alternative assets to specifically address the issues of title to the alternative assets.
- The trustee development program to ensure continuous engagement with the trustees.
- Operation of the trustee account that can easily be manipulated by defiant trustees
- Conflicts of interest
- Reserves kept by the schemes to smooth the effects of future fall in market value of assets.

The study has left some inconclusive findings that should be addressed through further research. These findings include;

- The understanding of risk-return relationships and by extension other topics in the retirement benefits industry. Trustees think they know, the service providers think they do not know hence a common understanding would be appropriate. This should then inform improvement of the trustee development program.
- Throughout the present study, the investment management concept and how it is currently being done kept cropping up. Although the current study has addressed this concept in the context of governance, it will be important to have a comprehensive study on the review of investment management practices of retirement benefit schemes that will include a review of the bench marks used to evaluate investment performance.

7.0 REFERENCES

- Abdullah, H., & Valentine, B. (2009). Fundamental and Ethics Theories of Corporate Governance. *Middle Eastern Finance and Economics*. 4, 88-96.
- Abrams, F.W. (1951). Management's Responsibilities in a Complex World. *Harvard Business Review*, 29, 54-64.
- Alchian, A. & Demsetz, H. (1972). Production, Information Costs and Economic Organization. *American Economic Review*, 62 (5) 777-795.
- Ambachtsheer, K., Capelle, R. & Lum, H. (2008). The pension governance deficit: Still with us. *Rotman International Journal of Pension Management*. (1):14-21.
- Ammann, M. & Ehmann, C. (2014). Is Governance Related to Investment Performance and Asset Allocation? Empirical Evidence from Swiss Pension Funds. Online. Available; <http://www.asip.ch/assets/Corporate-Governance/Pension-Fund-Governance-Paper-2014-03-31.pdf>
- Ammann, M., Zingg, A. (2010). Performance and Governance of Swiss Pension Funds, *Journal of Pension Economics and Finance*, 9(01), 95-128.
- Asher, M.G, & Nandy, A. (2006). Governance and Regulation of Provident and Pension Schemes in Asia. United Kingdom: Edward Elgar
- Banks, J., Richard, B & Emmerson, C. (2005). The Balance between Defined Benefit, Defined Contribution and State provision. *Journal of the European Economic Association*, 3 (2-3) 466-476.
- Berle, A.A. & Means, G.C. (1932). *The modern corporation and private property*. Macmillan: New York.
- Besley, T., & Prat, A. (2003). Pension fund governance and the choice between defined benefit and defined contribution plans. CEPR Discussion Paper No. 3955.
- Bodie, Z., Marcus, A.J., & Merton, R.C., (1988). Defined Benefit versus Defined Contribution Pension Plans: What are the Real Trade Offs? in *Pensions in the US Economy*. University of Chicago Press.
- Brown, L.D., & Caylor, M.L. (2004). Corporate Governance and Firm Performance. Online. Available. www.papers.ssrn.com/sol3/papers.cfm?abstract_id=586423

- Bowden, P. (2005). Virtue Ethics, Aristotle and Organisational Behaviour. Australian Association for Professional and Applied Ethics. 12th Annual Conference 28-30, September 2005, Adelaide.
- Bikker, J., & Dreu, J., (2009). Operating Costs of Pension Funds: The impact of scale, governance and plan design. *Journal of Pension Economics and Finance*, (8) 63-89.
- Carmichael, J. & Palacios, R. (2003). "A Framework for Pension Fund Management". World Bank. 2nd Public Pension Fund Management Conference, May 5-7.
- Clark, G. (2004). *Pension Fund Governance: Moral Imperatives, State Regulation and the Market*. Oxford University Press: London.
- Clark, G. (2006). *Regulation of Pension Fund Governance: The Oxford Handbook of Pensions and Retirement Income*. Oxford University Press: London.
- Clark, G. & Urwin, R. (2009). *Leadership, collective decision making and pension fund governance*. United Kingdom: Oxford University Press.
- Clarkson, M.B.E. (1995). A stakeholder framework for analyzing and evaluating corporate social performance. *Academy of Management Review*. 20 (1) 92-117.
- Coleman, P.T., Hacking, A., Stover, M., Fisher-Yoshida, B. & Nowak, A. (2008). Reconstructing ripeness I: A study of constructive engagement in protracted social conflicts. *Conflict Resolution Quarterly*. 26 (1) 3-42.
- Daily, C.M., Dalton, D.R., & Canella, A. A. (2003). Corporate Governance: Decades of Dialogue and Data. *Academy of Management Review*. 28 (3) 371-382.
- Forman, J.B. (2000). Public Pensions: Choosing between Defined benefit and Defined Contribution Pension Plans. *Law Review*. 187-212.
- Freeman, R.E. (1984). *Strategic Management: A Stakeholder Approach*. London: Pitman.
- Harbemas, J. (1990) *Moral Consciousness and Communicative Action*. Cambridge: MIT Press.
- Hsin, P.L. & Mitchell O.S. (1997), Public Plan efficiency. In: Gordon, M, Mitchell O.S., M. Twiney, eds, Positioning pensions for the 21st Century. Pension Research Council. University of Pennsylvania Press, pp.187-208.
- Hursthouse, R. (2013). *Ethical Theory: An Anthropology*. New York: John Wiley & Sons.

- Jensen, M.C. (2001). Value maximization, stakeholder theory and the corporate objective function. *Journal of applied corporate finance*. 14 (3) 8-21. DOI: 10.1111/j.1745-6622.2001.tb00434.x
- Jensen, M.C., & Meckling, W. (1976). Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure. *Journal of Financial Economics*. 3, 305-360
- Jones, W.T. (1977). *Approaches to Ethics*. New York: McGraw Hill Book Company.
- Kowalewski, O. (2012). Corporate Governance and Pension Fund Performance. *Contemporary Economics*, 6 (1) 14-44. DOI: 10.5709/ce.1897-9254.32
- Lashgari, M. (2004). Corporate Governance: Theory and Practice. *The Journal of American Academy of Business, Cambridge*. 46-51.
- Mitchell, O., & Yang, T.S. (2005). Public Pension Governance, Funding and Performance: A Longitudinal Appraisal. *Pension Research Council Working Paper, University of Pennsylvania*. Available: <http://www.pensions-institute.org/workingpapers/WP2005-2.pdf>
- McDonald D & Puxty A G (1979). An inducement - contribution approach to corporate financial reporting. *Accounting, Organizations & Society*. 4 (1/2) 53-65.
- Miller, R. & Funston, R. (2014). Public Pension Governance that Works. Online; Available <http://www.nasra.org/Files/Topical%20Reports/Governance%20and%20Legislation/FunstonGovernance1403.pdf>
- Mitchell O.S. & Yang, T. (2005). *Public Pension Governance, Funding and Performance: A Longitudinal Appraisal*. Pension Research Council. PRC 2005 – 2.
- Moriarty, K., & Zadorozny, L. (2008). Excellence in Pension Governance: Real Life. No Drama. Available: <http://www.mecer.com/summary.htm?siteLanguage=100&idContent=1329495>. Accessed on August 2009.
- NAPF (2005). Pension Scheme Governance Fit for the 21 Century. NAPF Discussion Paper. Available Online. http://www.ecgi.org/codes/documents/napf_discussion_paper_jul2005.pdf
- Njuguna, G.A. (2011). Determinants of Pension Governance: A Survey of Pension Plans in Kenya. *International Journal of Business and Management*. 6 (11) 101-111. DOI:10.5539/ijbm.v6n11p101
- IOPS. (2007). Experiences and Challenges with the Introduction of Risk-Based Supervision for Pension Funds. IOPS. Working Paper No. 4.

- IOPS. (2008). Pension Supervision in Focus. *Summer 2008*, 1 (1-28).
- OECD. (2002). *International Network of Pension Regulators and Supervisors: Background and Research Activities*. OECD Publishing.
- OECD. (2004). *Recommendations on Core Principles of Occupational Pension Regulation*. OECD Publishing.
- Pfeffer, J., & Salancik, G. R. (1978). The External Control of Organizations: A Resource Dependence Perspective. University of Illinois at Urbana-Champaign's Academy for Entrepreneurial Leadership Historical Research Reference in Entrepreneurship. Available at SSRN: <http://ssrn.com/abstract=1496213>.
- Pound, J. (1993). "Proxy Contest and the Efficiency of Shareholder Oversight". *Journal of Financial Economics*. 20 237-265.
- Qureshi, I. & McKay, J. (2007). The Prize of Global Governance. *Benefits and Compensation International*, 8 (37) 5-25.
- RBA Reports 2006-2014. Available: <http://www.rba.go.ke>
- Rodriguez, M. A., Ricart, J. E., & Sanchez, P. (2002). Sustainable development and the sustainability of competitive advantage: A dynamic and sustainable view of the firm. *Creativity & Innovation Management*, 11(3), 135-146. DOI:10.1111/1467-8691.00246
- Rudolph, H., Hinz, R., Antolin, P., & Yermo, J. (2010). *Evaluating the financial performance of pension funds*. Washington DC: The World Bank.
- Stewart, F. (2009). Pension Governance: Challenge and Potential Solutions. OECD-IOPS MENA Workshop on Pension Regulation and Supervision. 2-3 February.
- Stewart, F. & Yermo J. (2008). Pension Fund Governance: Challenges and Potential Solutions. *OECD Publishing*.
- Sundram, A.K., & Inkpen, A. C. (2004). Stakeholder Theory and the "Corporate Objective Revisited": A Reply. *Organization Science*. 15 (3) 370-371.
- Teisseire, D. (2009). *Pension Governance*. OECD Publishing.