ASSOCIATION OF RETIREMENT BENEFITS SCHEMES

BUDGET PROPOSAL FOR FY2022 / 2023

The Council of the Association of Retirement Benefits Schemes ("ARBS") is, as always, grateful for the opportunity to make submissions for consideration in the annual Budgeting process. We are pleased to submit a summary of ARBS's key proposals for consideration for adoption in the National Budget 2022 submissions by the Retirement Benefits Authority ("RBA" or "the Authority"). We have structured our proposals in 4 sections including an Executive Summary as shown below:

Section A. - Executive Summary

1. Recognition of ARBS as representative of retirement benefits sector
2. Conclusion of National Retirement Benefits Policy
3. Compliance with requirements of The Statutory Instruments Act

Section B – Regulatory matters

1. Employer contributions to Individual Schemes
2. Regulations for Takaful retirement schemes
3. Junior retirement accounts
4. Post Retirement Medical Funds
5. Development of a Regulatory "Sandbox"
6. Preservation of Benefits
7. Regulation in General
8. Incorporation under the Trustees (Perpetual) Succession Act
9. Term limits for trustees and exemption for trust corporations from term limits
10. Tax Exemption automatic on registration by RBA
11. Retirement Benefits Levy
12. Use of benefits to secure financing for certain member expenses during employment
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Section C - Regulation of Insured Funds

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Section D - Taxation

1. Taxation of lump sum benefits after age 65
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3. Separate KRA "registration" of Provident Schemes and Pension Schemes
4. Tax Treatment of Income Drawdown Funds
5. Tax Treatment of Death Benefits
6. Regulation in general
7. Revision of Income Tax Act

Section A - Executive Summary

For many years we have been submitting our Budget proposals, but with limited success. We are not sure if this lack of success is a reflection on the content of our proposals or of a more general lack of priority given to retirement benefits sector matters by the office in the National Treasury responsible for Budget matters. In prior years the Authority has provided feedback which has assisted us in enhancing the scope and quality of our submissions and so the chances of successful inclusion in legislation. This was not done in respect of our FY2021/22 submission and we fully understand that the exceptional circumstances prevailing last year contributed to that. We would very much wish to "get back on track" with that procedure. It would be helpful if we could receive feedback before the Authority's Budget Memorandum is finalised. We suggest a forum where ARBS can formally present its proposals and "argue" positions.

First we would again like to propose that recognition of ARBS as the main representative of the retirement benefits sector be anchored in law.

Close collaboration between the Regulator and the retirement benefits sector is in our view an important ingredient in the effective supervision of the industry, and in particular in its development and growth. All the parties involved need to believe in the collaborative approach to the challenges before us and this needs to be perceived and understood by all stakeholders. This collaboration needs to have a structural base. It cannot be truly effective if its existence and operation are reliant on the "goodwill" of the management of the Authority or the Council of the Association.

ARBS has the merit of representing the full spectrum of schemes, including sponsors, trustees and members, as well as service providers and others with interests in the retirement benefits sector. Although direct membership of ARBS by schemes is modest, "indirect membership" through service providers is comprehensive. We propose that the Association of Retirement Benefits Schemes be recognised in law as the main representative of the retirement benefits sector and point of contact for the Authority.

ARBS Council has been closely involved in the drafting of a National Retirement Benefits Policy. We believe that the absence of a formal National Retirement Benefits Policy contributes to an undisciplined an ill-defined approach to matters directly affecting the retirement benefits sector. While it is regretted that this is still not finalised and formally adopted, we note that a new task force has been established to work on this exercise and we appreciate having been invited to participate. We strongly recommend that this matter be finalised as matter of extreme urgency. In the meantime existing legislation, particularly relating to the purposes of retirement benefits band protection should be respected.

We also recommend that the legislative framework for amending legislation and regulation relating to retirement benefits should be divorced from the Budget process for greater efficiency and visibility. Also the role of Kenya Revenue Authority and its areas of influence need to be clearly defined and documented.

The Statutory Instruments Act sets out provisions for *"the making, scrutiny, publication and operation of statutory instruments and for matters connected therewith".* The objects of The Statutory Instruments Act are well set out in Section 4 of that Act. Two important provisions in that Act which have an impact on the Authority's operations and its dealings with the retirement benefits sector are Part 11 relating to consultations before making statutory instruments and Part 111 relating to regulatory impact statements. ARBS Council recommends that the Authority should develop and issue Guidelines for the proper application of these provisions of The Statutory Instruments Act to ensure that its purposes are well understood and achieved.

- **Regulatory matters**

  New Items

  - **Contributions by Employers to Individual Retirement Benefits Schemes**

    This issue has been raised in previous submissions but perhaps not clearly expressed.

It has become fairly common for employers to contribute to individual retirement benefits schemes for all their employees rather than to umbrella schemes. The Retirement Benefits (Individual Retirement Benefits Schemes) Regulations envisage contributions by employers on behalf their employees who are members but do not bind them to the provisions of those Regulations or of the Trust Deed and Rules. This makes it very hard for the scheme trustees to enforce the contributions compliance terms or the other relevant provisions of the Retirement Benefits (Umbrella Retirement Benefits Schemes) Regulations which logically should apply. We propose that either the practice should be prohibited the and employers advised to adhere to umbrella schemes or the individual scheme regulations be amended to provide for similar and binding terms for contributing employers and access to retirement benefits.

- **Takaful Retirement Benefits Schemes**

  In 2017, the National Treasury undertook, through the Budget speech, to develop regulations in support of Takaful Retirement Benefits Schemes. We request the Authority to take this up. This will help to accommodate the Islamic community in saving for retirement which will in turn increase the penetration and growth of the industry.

- **Provision for Junior Retirement Accounts**

  Introduction of provision to allow parents to open for their children (who are below the age of 18yrs) a retirement account in an individual retirement scheme.

  The regulation would give those children upon attaining the age of 18 yrs or 21yrs (or 23yrs) the opportunity to continue with the saving plan (or possibly to withdraw the benefit for education expenses).

Brought Forward Items (in some cases with amendment)

- The Retirement Benefits (Post-Retirement Medical Funds) Guidelines 2018 ("PRMF" 20218) offer a very valuable opportunity to address one of the most important elements in old age poverty. It is inevitable that over time a number of areas for enhancement will arise, and at this stage we suggest:

  - PRMF 2018 defines a scheme which can establish a post-retirement medical fund as an "occupational scheme".

    This definition may be interpreted to preclude the establishment of post-retirement medical funds in Umbrella Retirement Benefits Schemes and Individual Retirement Benefits Schemes. This possible exclusion is unfortunate and we suggest that PRMF 2018 be amended to remove this apparent restriction.

    It may be appropriate to make other amendments to the Retirement Benefits (Occupational Schemes) Regulations, Retirement Benefits (Individual Schemes) Regulations and Retirement Benefits (Occupational Schemes) Regulations to clarify the definitions and to include other PRMF provisions specific to Umbrella Retirement Benefits Schemes and Individual Retirement Benefits Schemes.

    At the same time consideration should be given to provisions for establishing stand alone PRMFs as special purpose funds and for them to be recognised as such by KRA.

- Development of a regulatory "sandbox"

  The development of new products in any market is often driven by the market players and not the regulators of the sector; which most of the time means operating products that are beyond the scope of the existing regulations. This is not any different in the retirement benefits sector. It is our opinion that the Authority should consider creating a regulatory "sandbox" to accommodate innovations that may not be specifically regulated within the current framework.

- The Retirement Benefits (Occupational Retirement Benefits Schemes) Regulations ("ORBS") do not allow a member who has emigrated and reached the early retirement age to purchase an annuity or similar benefit arrangement in the country / currency to which he has emigrated. The rationale for this is uncertain and the result has been that such members are exposed to KES currency risk at a time in their lives when they are most averse to any risk. We recommend that such members be allowed to purchase annuities in the currency of their adopted country of residence.

- Preservation of Benefits has assumed even greater importance with the possible impact on accumulated values through approval of the Retirement Benefits (Mortgage Loans) (Amendment) Regulations 2020 (" MLAR 2020"). The increasing risks of old age poverty make it necessary to examine again one of the most important contributing factors i.e limited preservation of benefits.

- Regulations and forms have not been comprehensively reviewed since they were first issued and this is becoming a priority for action. Further the review and amendment of Regulations etc should be separated from the annual Budget process to improve efficiency.

- It is desirable that each Pension Trust is incorporated under the Trustees (Perpetual Succession) Act (Chapter 164 of the Laws of Kenya) in order to become a body corporate, particularly with the capacity to own property its own name. The current process for incorporation is lengthy and inefficient and we recommend that it be streamlined or that incorporation be made automatic upon simple request.

- While we understand the rationale for introducing term limits for trustees, we feel that 2 terms of 3 years is not entirely appropriate, given the costs of training (TDPK plus other relevant and scheme specific trainings) and the vagaries of trustee election processes. We suggest 3 terms of either 3 or 4 years.

  We also propose that reappointment should be permitted after a rest of 2 years.

  We also feel that term limits are not necessary or appropriate for corporate trustees and that they should be exempted.

- Tax Exemption approval by Kenya Revenue Authority should be granted automatically upon registration of a scheme by RBA. This would eliminate the need for separate "registration" of schemes, Deeds of Amendment etc with KRA

- ARBS Council is of the view that there should be a more regular review of the basis of charging the levy and that triggers should be introduced for automatic reviews. The Industry has grown from the time the levy was fixed. ARBS recommends the review of the levy by widening the brackets while maintaining the maximum Kshs.5 million. The Council also believes that the industry, as primary provider of funding for the Regulator's activities, should be invited to comment on how the resources it provides are utilised, particularly in areas of projects and other non-routine items**.** Of course this opportunity would exist if ARBS is given representation on the RBA Board of Directors.

- Some thought has been given to how members could be allowed to make their accumulated benefits work for them during their working life while not putting the retirement value at risk. The Mortgage Guarantee Facility has not been widely taken up (it would be valuable for the Authority to publish results of studies into the reasons for this). ARBS proposes that these Regulations should be amended to eliminate the blocks to effectiveness which are (a) the requirement for the utilised portion of the benefit to be assigned to the scheme as security for the trustees' guarantee to the lending institution to be replaced by assignment of the benefit direct to the lender , (b) provision for schemes to place matching funding deposits with lenders to facilitate fixed modest margin lending and (c) clarification that the portion of the mortgage loan secured by assigned benefit should be clearly segregated and that the assignment relates only to that portion.

  Perhaps of much greater interest to scheme members would be a facility to permit members to borrow (against) a portion of their accumulated scheme benefits to finance certain large domestic / family expenses.

An alternative approach would be to permit schemes to lend to their members' cooperative societies (SACCOs) to fund loans to members. This would have the advantage of interposing the SACCOs between the financing and borrowing members so that the principal credit risk lies with the SACCOs.

- There needs to be established a maximum retention period for scheme documents, particularly those relating to members' benefit entitlements. This is quite a complex issue. Also to be addressed is the ownership and transfer of records and documents when service providers change, legal recognition of microfiche documents etc. This requires a detailed research of legal and practical issues.

- **Taxation**

  New Items

  - The Finance Act 2007 as amended by the Finance Act 2008 introduced Paragraph 53 which provides that monthly pension and/or lump sum retirement benefit granted to a person who is sixty five years of age or more is exempt from tax.

    Regrettably the exemption for lump sum benefits was not included in the 2020 Income Tax Act. When this was queried we were informed by representatives of the Authority, KRA and others that this was an error which would be rectified. We have recently seen advice from KRA that in fact the exemption for lump sum benefits has been removed.

    Persons aged over sixty five years of age are among the most vulnerable in our society and the introduction of tax on their lump sum retirement benefits will reduce the disposable income available to them.

    We recommend that the provisions be retained to cushion the senior citizens.

  Brought Forward Items (in some cases with amendment)

  The Retirement Benefits Authority has, in conjunction with Kenya Revenue Authority and ARBS established a Tax Committee to work on amendments to The Income Tax Act etc. We summarise below items which the Tax Committee has recommended for consideration

  - While the logic for exempting retirement benefits from taxation from age 65, being the NRA applied in most public sector schemes is understood, the reality is that age 60 is a much more common NRA. Therefore we propose that the age full exemption should be reduced to 50 to encourage active membership and saving in schemes.
  - The Income Tax Act continues to provide for separate "registration" by KRA of provident schemes and pension schemes. There seems to be no rationale for this and we recommend unified format and procedures for KRA "registration" of all retirement benefits schemes registered by RBA.
  - There is need to clarify and document the treatment of Income Drawdown Funds particularly relating to investment income and withdrawals.
  - Clarification of tax treatment of payment of death benefits to a scheme and to an individual where the exempt portions differ
  - Greater consideration needs to be given to the medium and long term impact of taxation policies, while recognising the short term demands of the exchequer. The current review of the Income Tax Act is very welcome and it should be accelerated.
  - Tax reliefs are rapidly losing value as salaries etc increase while reliefs expressed as fixed amounts do not. There is a real need for reliefs to be expressed *ad valorem* in order to maintain their value both in monetary terms as well as incentives to retirement savings.
  - The separation of roles and responsibilities of KRA and RBA needs to be brought to fruition. Ideally, and this should be achievable with relative ease, eligibility for tax relief should be

available to all schemes which are properly registered by RBA. Also technology should be used to provide simultaneous registration by RBA and exemption approval by KRA.

Some of our "secondary" proposals are not related to the national Budget but as they fall within headings included under the Budget proposals, e.g. allocation of RBA's financial resources, we have included them here.

Section B - Regulatory Matters

1. Contributing Employers in Individual Retirement Benefits Schemes

The Retirement Benefits (Individual Retirement Benefits Schemes) Regulations envisage contributions by employers on behalf their employees who are members but do not bind them to the provisions of those Regulations. This makes it very hard for the scheme to enforce the contributions compliance terms. Recently, to address this, the Authority has considered the possibility of execution of deeds of adherence by contributing employers which in their opinion shall be binding. While this may be a good step forward, it may not be possible to enforce as the individual schemes regulations in place do not provide for binding contribution terms for contributing employers.

There is growing use by employers of contributing to individual retirement benefits schemes as a way of providing retirement benefits to employees outside the "constraints" of occupational and / or umbrella retirement benefits regulations. While it is generally understood that in such circumstances the principles underlying occupational retirement benefits provision set out in the ORBS and URBS Regulations should apply, this is not categorically stated.

It should be made clear that an employer's agreement to contribute to an employee's IRBS does not in itself create an enforceable obligation to contribute. WQ raised this in our 2019 submissions and in other forums.

RBA Response to 2019 Budget proposal was "It is a voluntary set-up and employers who are willing may support their employees. It is not clear which law is being violated"

ARBS Comment on RBA response is:

No law is being violated because IRBS regulations are silent on employer contributions. It is that silence which offends the spirit of employer provision of retirement benefits. Ideally umbrella schemes should be the vehicle for employers to provide retirement benefits outside an occupational scheme. We understand that this approach has been considered but has not been adopted. We have not been told why.

The basic structure of the retirement benefits sector is quite appropriate, comprising ORBS and URBS for employment based provision and IRBS for personal based provision. There may well be circumstances in which an employer may be willing to contribute to an employee's IRBS but these should not be common.

What is happening in Kenya currently is something altogether different. Employers are using IRBS as if they were URBS. The origins of this practice are not well documented. It could be that it pre-dated the first URBS. Why the practice should continue today defies logic, unless it is to permit employers to avoid the employer responsibilities set out in ORBS and URBS regulation e.g enforceable obligation to contribute, enforceable obligation not to discriminate, enforceable obligation to monitor governance etc, enforceable obligation to facilitate / support scheme operations etc. That is a very undesirable notion.

We believe that the Authority should take early steps to arrest this circumvention of regulation and best practice by:

(a) Directing that the practice discontinues immediately and no new arrangements be permitted for employers to contribute to IRBS for their workforce. All such new benefits provision should be through adherence to URBS
(b) Encouraging employers in existing IRBS based arrangements to migrate to URBS. Sponsors and administrators should be able to facilitate this without cost.

(c) Overhauling IRBS Regulations to provide that the principles, standards, procedures and controls etc in the ORBS and URBS regulations should apply to all retirement benefits derived from employment-based funding.
(d) Liaising with KRA to ensure that no tax related hurdles exist

***ARBS therefore recommends that** the above measures are implemented and IRBS Regulations are reviewed and amended to take account of this*

2. Regulation of Takaful Retirement Benefits Schemes

In the year 2017, the National Treasury undertook, through the Budget speech, to develop regulations in support of Takaful Retirement Benefits Schemes. We request the Authority to take this up. This will help to accommodate the Islamic community in saving for retirement which will in turn increase the penetration and growth of the industry.

***ARBS therefore recommends that** priority attention is given to development of Takaful Retirement Benefits Schemes Regulations – in need appointing consultants for the purpose*

3. Provision for “Junior Retirement Accounts”

- Introduction of regulation to allow parents to open for their children (who are below the age of 18yrs) a retirement account in an individual retirement benefits scheme.
- The regulation would give to adult children (those who have attained age of 18 yrs or 21yrs (or 23yrs) option to continue with the saving plan or transfer to an employment related registered scheme.
- This provides a competing product to some life insurance policies since the parent will have to save/contribute in the Junior Retirement Accounts for a longer period of close to 18yrs before the child has the option to access the benefits.
- Parents can be given the option to choose to have a trust fund automatically established for the child should they die before the children reach the age of majority so that the monies in the Junior Retirement Account can be used to pay school fees etc

***ARBS therefore recommends that** priority attention is given to development of Takaful Retirement Benefits Schemes Regulations – in need appointing consultants for the purpose*

4. Post-Retirement Medical Funds

PRMF 2018 defines a scheme which can establish a post-retirement medical funds as an “occupational scheme”. The definition of occupational scheme in the Retirement Benefits (Occupational Schemes) Regulations is “*a retirement benefits scheme established by employers for the benefit of the employees including schemes established under a written law* while the definition of an umbrella retirement benefits scheme in the Retirement Benefits (Umbrella Schemes) Regulations is “*a special purpose fund established by a registered administrator for purposes of aggregating scheme funds for collective administration and investment”.*

These definitions may be interpreted to preclude the establishment of post-retirement medical funds in Umbrella Retirement Benefits Schemes and Individual Retirement Benefits Schemes. This possible exclusion is unfortunate and we suggest that PRMF 2018 be amended to remove this apparent restriction.

It may be appropriate to make other amendments to the Retirement Benefits (Occupational Schemes) Regulations, Retirement Benefits (Individual Schemes) Regulations and Retirement Benefits (Occupational Schemes) Regulations to clarify the definitions and to include other PRMF provisions specific to Umbrella Retirement Benefits Schemes and Individual Retirement Benefits Schemes.

At the same time consideration should be given to provisions for establishing stand alone PRMFs as special purpose funds and for them to be recognised as such by KRA.

***ARBS therefore recommends that** the definitions of different schemes in the existing Regulations be revised and harmonised to ensure that they include all types of retirement benefits schemes for establishment of PRMFs*

***We also propose that** consideration be given to making provisions for stand alone PRMFs to be established .*

5. Development of a Regulatory "Sandbox"

The development of new products in any market is often driven by the market players and not the regulators of the sector; which most of the time means operating products that are beyond the scope of the existing regulations. This is also applies in the retirement benefits sector. It is our opinion that development of Regulations before or in the early stages of new products may not always be entirely effective as experience of operation is an important factor in such development. Therefore Authority should consider creating a regulatory "sandbox" to accommodate innovations that may not be specifically regulated within the current framework.

This should of course come complete with a monitoring and compliance team to support the industry innovators and gradually develop comprehensive regulations and structures. We believe this will encourage innovation by the industry for the ultimate benefit of the members of schemes

***ARBS therefore recommends that** the Authority consider establishing provisions for interim regulatory arrangements to apply for fixed periods to new products and services*

6. Preservation of Benefits

Preservation of Benefits has assumed even greater importance with the possible impact on accumulated values through approval of the Retirement Benefits (Mortgage Loans) (Amendment) Regulations 2020 (" MLAR 2020"). The increasing risks of old age poverty make it necessary to examine again one of the most important contributing factors i.e limited preservation of benefits.

Occupational Retirement Benefits Schemes Regulation 19 permits members upon leaving a scheme before attaining early retirement age to access the equivalent of 100% of member portion and 50% of employer portion upon early leaving from a DC scheme before being eligible for retirement, with no restrictions. This is a major contributor to the average low replacement ratio at retirement and as long as this situation continues the problem of old age poverty will be with us. Something must be done to address this issue.

For a start 100% preservation of employer portions should be restored. Furthermore consideration should be given to requiring that employer funded balances should be utilised to fund annuity purchase or income drawdown. It is unfortunate that similar good ideas which formed part of NSSF 2013 are bogged down because of an apparent combination of litigation and lack of commitment.

***ARBS therefore recommends that** priority should be given to restoring the purpose and effectiveness of formal retirement saving.*

7. Regulation in General

The procedures for review of existing Regulations and development of new Regulations seem to be very long and this does not serve the industry well. We feel that the requirement for these matters to be addressed through the National Budget process is inefficient and not altogether relevant.

A comprehensive review of the existing Act and Regulations is overdue. We are aware that a review of Regulations was commissioned by the Authority's Research and Strategy Department but that exercise does not appear to have resulted in revisions. ARBS was indirectly involved in the process through its membership of the Research Panel.

We have been informed that the Authority has embarked on this review and we would appreciate being kept informed of progress. ARBS would welcome the opportunity to review and comment on the drafts in tranches rather than waiting for the entire exercise to be completed.

ARBS therefore recommends that *the existing rules and procedures be amended to permit amendments to existing Regulations and promulgation of new Regulations to be effected by issuance of appropriate instruments outside the Budget process and that a comprehensive review of Regulations be concluded as a matter of priority.*

We also propose that *consideration be given to sending copies of draft amended documents to ARBS for review and input in tranches as they are developed.*

8. Incorporation under the Trustees (Perpetual Succession) Act

It is desirable that Pension Trusts are incorporated under the Trustees (Perpetual Succession) Act (Chapter 164 of the Laws of Kenya) in order to become a body corporate, more so with the capacity to own property in its own name.

The Trustees (Perpetual Succession) Act in section 4(1) provides that,

"Trustees who have been appointed by anybody or association of persons established for any religious, educational, literary, scientific, social, athletic or charitable purpose, or who have constituted themselves for any such purpose, may apply to the Minister …..for a certificate of incorporation of the trustees as a corporate body."

At present, most pension Trusts in Kenya own and acquire property and other interests in the name(s) of the Trustees. This poses a major challenge in the management of retirement benefit scheme not only with regard to property portfolio acquisition but also litigation and legal disputes that may befall Trustees from time to time, where they are sued in their own individual capacity or jointly unless incorporated as a body corporate. This leaves them exposed and liable to many underlying risks that may befall them. Incorporating the Trusts is therefore definitely a prudent option.

However, the critical questions to ask may be to what lengths do Pension Trustees have to go, in order to meet this great need or requirement to incorporate their Trusts? What would be the effect of incorporating versus not incorporating a Trust? Are Pension Trustees in Kenya well aware of the effects of incorporation? Is the regulator, RBA in a position to encompass this need within its Act?

EFFECT OF INCORPORATION

It is important to note that once the trustees have been incorporated, they become a body corporate with a perpetual succession and all other legitimacies appertaining to a body corporate.

Section 3(3) of the Trustees (Perpetual Succession) Act states that, once incorporated "the trustees shall thereupon become a body corporate by the name described in the certificate, and shall have perpetual succession and a common seal, and power to sue and be sued in their corporate name and, subject to the conditions and directions contained in the certificate, to hold and acquire, and by instruments under the common seal to convey, transfer, assign, charge and demise any movable or immovable property or any interest therein now or hereafter belonging to, or held for the benefit of, the trust concerned in the same manner and subject to such restrictions and provisions as trustees might so do without incorporation.''

INCORPORATION PROCEDURAL REQUIREMENTS

A certified copy of the trust deed and a petition for incorporation prepared in the prescribed form should be lodged with the Minister for Lands for incorporation of the trust.

The petition must state, among other things, that the trustees are desirous of being incorporated under the Act and give a pictorial representation of the common seal of the trust, which must be rounded in shape and with the name of the trust inscribed thereto.

The Minister for Lands normally takes about 2 to 3 months after presentation of the petition to issue the Trustees with a Certificate of Incorporation.

RBA's Response to 2019 Budget submission was "Currently there is no challenge with schemes owning assets"

ARBS Comment on RBA response is

The point is that (a) it takes 6+months for incorporation under Cap164, (b) need to regularly register changes in trustees especially since term limits introduced is cumbersome and (c) trustees should not be exposed to property risks.

Surely automatic incorporation is in the best interests of schemes to improve efficiency and reduce costs / risk.

Therefore:

RECOMMENDATION

In several forums, Trustees of pension funds have raised concerns on the need and importance to have their Pension Trusts incorporated more so for reasons of owning and acquiring property as Trusts.

ARBS shares the concerns of Pension Trusts and their Trustees and proposes that the Authority considers proposing a simplified procedure for incorporating schemes under the provisions of the Perpetual Succession Act.

9. Term Limits for Trustees and application to trust corporations

ARBS understands and generally supports the rationale for introducing term limits for trustees in order to improve governance. However we feel that a maximum of 2 terms of 3 years is not entirely appropriate, given the costs of training (TDPK plus other relevant and scheme specific trainings) and the vagaries of election processes. We also believe that a trustee who has made a valuable contribution to the operation and governance of a scheme should not be permanently excluded from trusteeship after only 6 years of service.

However it is important that the quality of service and input of individual trustees is carefully measured and that this monitoring process is an important part of the overall governance of the scheme and not just a form filling exercise. As long as the performance evaluation of trustees is carried out effectively it should form the basis for determining if an individual trustee should continue to serve even beyond a first term. This is now a requirement under Market Conduct Guidelines.

Nevertheless there is merit in ensuring that new thinking comes into the deliberations of the trustee boards from time to time. This can be achieved by applying "rests" at the end of the terms of office.

We also believe that the application of term limits to corporate trustees is not appropriate.

RBA's response to 2019 Budget submission was "The law was amended recently to provide for 2 term limit of 3 years. In general most corporate governance practice require 3 year term limits"

ARBS Comment on RBA response is:

Particularly in respect of individuals as founder nominated trustees, could consideration be given to reappointment after a rest?

Why / How should this apply to corporate trustees? We are not sure if corporate governance practice differentiates between individual trustees and corporate trustees. The risk profile of the two classes of trustees is quite different in many ways.

Therefore:

Recommendation

*For individual trustees **ARBS recommends** either 3 terms of 3 years each or 2 terms of 4 years each. We also propose that reappointment should be permitted after a rest of 2 years provided that the individual has satisfactorily undergone documented and appropriate performance evaluation at least every 2 years while serving.*

*With regard to corporate trustees **ARBS recommends** that similar term limits should not apply but appointments of trust corporations should be managed in the same manner as appointments of all service providers and be subject to critical review after periods not exceeding 3 years.*

10. Automatic approval of Tax exemption upon RBA Registration

Currently, new Retirement Benefits Schemes that have been registered with the RBA are also required to be registered with KRA for the purpose of tax exemption. This process is un-necessarily cumbersome resulting in delayed opportunities for members to start to save as Trustees seek to obtain the tax exemption approvals from KRA. In the past, some schemes have incurred heavy tax penalties as a result of trustee's failure to obtain the scheme tax exemption certificates from KRA.

Recommendation

We recommend that the income tax regulations be amended to provide for automatic tax exemption status of a retirement benefits scheme once the scheme has been approved and registered with the Retirement Benefits Authority. Trustees of the scheme can then forward the particulars of the scheme registration to KRA only for record purposes and future tax compliance monitoring by KRA.

11. Retirement Benefits Levy

Members of ARBS accept the principle that schemes should bear the cost of their supervision by an independent regulator. However the members believe that there should be a more readily identifiable linkage between the rate of the levy and the financial resources required by RBA to finance its activities. Members also believe that the industry, as providers of the funding for the Regulator, should have more of a say in the development of the Regulators budget and spending priorities.

We therefore have in mind a mechanism whereby the rate of the retirement benefits levy is automatically reviewed at intervals not exceeding 3 years and that it should be based directly on the financial requirements of RBA.

ARBS also has in mind a mechanism to enable it to play a positive role in the allocation of the resources provided by the industry through the levy. In this context we would like to see opportunities to comment on non-routine expenditure and to propose projects/additions etc.

RBA's Response to 2019 Budget submission was "There is need to consider other avenues in which RBA can give back to the schemes. Currently, the Authority is not operating under optimal establishment, hence the mismatch between the budget absorption and the levy."

ARBS' Comment on RBA response is:

While we support paying for regulation, we believe that there should be greater accountability and consultation with the industry especially relating to development expenditure.

Therefore:

ARBS recommends that *the Act / Regulations be amended accordingly to provide for the levy to be reviewed and linked to RBA financial requirements and for RBA to be required to consult ARBS on RBS's budgetary matters*

12. Use of accrued benefits to finance/secure financing for member needs

Members have asked about the possibility of extending arrangements under the same principles as those existing for mortgage assistance to provide financing for other non-recurrent or extraordinary expenses e.g. medical, large-ticket household items etc.

ARBS Council believes that as long as the principle of protection of the retirement benefit is observed, it should be possible for scheme contributors to make their retirement savings work for them in this way.

We share the Authority's reservations about lending to members direct from schemes but also have concerns about guaranteeing lending's by commercial banks.

As an alternative we suggest for consideration that schemes be permitted to lend to cooperatives (SACCOs) who will lend to members. Schemes should be permitted to lend up to a maximum of 5% of their fund values to affiliated sound well governed SACCOs that will be approved by RBA with repayment terms of up to 1 year to fund the SACCOs' lending to scheme members.

RBA's response to 2019 Budget submission was "The SACCO's Act protect only the members. It is a violation of section 38 of the RBA Act."

ARBS' Comment on RBA response is:

The point is that the Act should be amended to allow for this facility. Furthermore the principle underlying section 38 of the Retirement Benefits Act has already been diluted.

Therefore

ARBS therefore recommends that *Regulations be amended to permit schemes to lend to affiliated SACCOs to fund the SACCOs' lending's to scheme members for specified purposes including school fees, medical costs, household good etc.*

13. Ownership and retention of documents

There needs to be established a maximum retention period for scheme documents, particularly those relating to members' benefit entitlements. This is quite a complex issue. Also to be addressed is the ownership and transfer of records and documents when service providers change, legal recognition of microfiche documents etc. This requires a detailed research of legal and practical issues, including the risks relating to absence of certain records and documents.

RBA Response to 2019 Budget submission was: "Records should be kept as long as the member is alive."

ARBS Comment on RBA Response is:

This should be documented in Regulations or Guidelines. The cost and physical requirements of long term storage of documents can be extremely burdensome. Therefore the legal acceptability of scanned copies of documents needs to be clarified

ARBS therefore recommends that *RBA undertakes a detailed research into all aspects of the ownership, transfer and retention of records and documents and issues appropriate guidelines*

Section C - Regulation of Insured Funds

1. Regulation in General

There is a "disconnect" between regulation of retirement benefits schemes under the Retirement Benefits ORBS and IRBS Regulations and regulation of retirement benefits arrangements delivered by insurance companies. This disconnect works to the detriment of retirement savers and the retirement benefits sector generally. The Council of ARBS believes that the structure and governance of the retirement benefits funds operated by insurance companies needs to be brought into line with the principles governing the retirement benefits industry and it is to be hoped that with the consolidation of financial sector regulations greater harmony will be introduced.

RBA Response to 2019 Budget submission was: "To be addressed during consultative meetings between AKI, ARBS, IRA and RBA".

ARBS Comment on RBA response is:

When? There are no structured multipartite consultative arrangements

ARBS therefore recommends that *Regulations (either within IRA or RBA or both) and/or the respective Acts relating to retirement benefits provision by insurance companies be amended/introduced to brings these schemes/arrangements into line with ORBS and IRBS Regulations.*

2. Disclosure of information in Guaranteed Funds

There are no standards in the Regulations relating to the information, particularly concerning investments, yields, operating costs and the costs of guarantees, which are required to be disclosed to scheme trustees and members. This makes it particularly difficult for sponsors, trustees and members to know if they are receiving good value from the Approved Issuer.

It appears that a number of Approved Issuers "hide" behind the existence of the guarantee to justify non-disclosure.

ARBS therefore recommends that *Regulations should be amplified to require disclosure of sufficient information to enable stakeholders to evaluate the funds.*

3. Disclosure of information on annuities

There is considerable merit in taking measures to broaden the understanding and transparency of the annuities markets. Without this retirees will be reluctant to purchase annuities which they do not understand. While regulation / supervision of annuities is the domain of the IRA we do believe that RBA has a responsibility to oversee that product and services sold to retirees meet certain minimum standards.

ARBS therefore recommends that *RBA engages the IRA to agree standards of disclosure of insurance company products sold to members of retirement benefits schemes*

Section D – Taxation Matters

1. Exemption from Taxation after age 65

While the logic for exempting retirement benefits from taxation from age 65, being the NRA applied in most public sector schemes, is understood, the reality is that age 60 is a much more common NRA. This age based tax exemption is appreciated but retiree question why it is only available from age 65, irrespective of retirement age.

Therefore we propose that the age for full exemption should be reduced to 50 to encourage active membership and saving in schemes.

ARBS therefore recommends that *RBA support a proposal that 100% tax exemption should be available on all retirement benefits paid after retirement at scheme NRA or upon early ill health retirement*

In addition the tax exemption on lump sums benefits paid after age 65 has been removed so that only monthly pensions are tax exempt. It seems that the removal of this exemption applies not only to provident fund lump sums but also to commutations of pensions.

This removal of exemptions on lump sums was effected in 2020 and when we and others protested we were informed that it was an error which would be rectified. We are now informed by KRA that the removal of exemption for lump sum benefits paid on retirement from age 65 will remain in force.

We have been given no reason for this change which we find unjustified, unreasonable, discriminatory and punitive. It will most certainly cause hardship since all retirees rely on the totality of their retirement savings to sustain them.

ARBS therefore recommends that *exemption from tax on lump sum benefits paid after age 65 be restored*

2. Separate KRA "Registration" of Provident Schemes and Pension Schemes

The Income Tax Act continues to provide for separate "registration" by KRA of provident schemes and pension schemes. There seems to be no rationale for this and we recommend unified format and procedures for KRA "registration" of all retirement benefits schemes registered by RBA.

An area of particular concern is the provision that members of provident funds on retirement cannot utilise their accrued benefit to purchase an annuity without first withdrawing and suffering the tax impact. An important part of policy has for long been the promotion of utilising lump sum benefits to fund income products such as annuities and income drawdown. If a retiree from a provident fund must withdraw and suffer tax before purchasing an annuity he becomes ineligible for the 100% tax exemption available for pensions/annuities payable from age 65. This is inequitable and does not support efforts to persuade retirees to purchase annuities.

ARBS therefore recommends that *KRA take early action to eliminate separate tax registration and treatment of pension and provident schemes and in particular to allow retirees from provident funds to utilise part of their accumulated scheme balance to purchase annuities*

3. Taxation Related to Income Drawdown Funds

Since Income Drawdowns were introduced as an option for accessing retirement benefits there have been no formal rules relating to tax treatment. It is our opinion that the Income tax Act should recognise Income Drawdown as a mode of payment of benefits just as it recognises lump sum, pension, and annuity. In this regard, the Act should then expressly define the tax treatment of income drawdown funds and pay-outs to members.

ARBS therefore recommends that *KRA take early action to develop tax treatment rules for income drawdown funds both in respect of investment income and drawdowns.*

4. Tax Treatment of Death Benefits

The Income Tax Act provides for different treatment when paying out death benefits to beneficiaries. On one part the Act provides that death benefits payable to a beneficiary from a retirement benefits scheme shall be taxed on the beneficiaries and that the beneficiaries shall enjoy tax exempt amounts equal to the amounts that would have been received by the member; maximum Kshs 600,000. It then provides on the second part that where death benefits are paid to an estate, the first Kshs 1.4 million shall be exempt from tax.

We do not understand the rationale to have the exemption amounts being different for the two options. We would like to submit that consideration is given to exempt all death benefits from taxation and if not then rationalise the tax treatment for payment of the benefits.

We would further like to submit that, if the benefits are to be taxed and given the circumstances in which the beneficiaries are receiving these amounts; on the death of seemingly a provider, the preferred tax treatment amount should be an exemption of the first Kshs 1.4 million

***ARBS therefore recommends that** KRA take early action to rationalise tax treatment rules for death benefits paid from a retirement benefits scheme*

5. Regulation in General

Our concern here revolves mainly around:

(a) Maintaining the purpose and value of the incentives granted in the Income Tax Act. These incentives play a valuable role in supporting the aims of the retirement benefits industry as a whole. When the value of the incentives is eroded, stakeholders lose faith in the reliability of retirement benefits provision through registered schemes, and this is clearly not in anyone's interests.

While we appreciate the short term pressures to meet fiscal targets it is important that the long term wellbeing and growth of the retirement benefits sector should be considered.

The importance of the retirement benefits sector as a source of long term investment capital cannot be overstated. Any measures, or lack thereof, which constrain the growth of this sector's resources, must be considered detrimental to the economic prospects of Kenya.

We would therefore like to see each of the incentives re-examined with this in mind.

(b) Focusing the responsibilities of RBA and KRA where they are appropriate and eliminating unnecessary regulatory duplication. The expertise in the management and regulation of the retirement benefits sector is housed in the RBA. KRA should therefore have no role in the regulation of retirement benefits schemes which have already been registered by RBA. KRA's involvement should be to regulate and manage the taxation aspects of retirement benefits schemes which have been registered by RBA. (item 5 below)

6. Review of Income Tax Act

- We understand that there is little prospect of improvement in the tax treatment of retirement benefits matters outside the review of the Income Tax Act. We therefore attach and refer to our submission to the National Treasury for that review.