APTAK
Association of Pension Trustees and Administrators of Kenya

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Our Ref: APTAK/RBA/2/2024

Your Ref: TBA

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Charles M. Machira, Esq
Chief Executive Officer
Retirement Benefits Authority
14th Floor; Rahimtullah Towers; Upper Hill Road
P.O. Box 57733 – 00200
NAIROBI

Dear Charles,

APTAK TECHNICAL CONCERNS IN RESPECT OF LEGAL NOTICE NUMBERS 18 TO 22 DATED 21st DECEMBER 2023 PURPORTING TO AMEND SOME REGULATIONS ISSUED UNDER THE RETIREMENT BENEFITS ACT

The Association of Pension Trustees and Administrators of Kenya (APTAK) is a non-profit national organization comprising Trustees and Administrators of retirement benefits schemes registered under the Retirement Benefits Act.

The objectives for which APTAK is formed, include to:-

1. Provide a forum for deliberations, discussions, consultations, and dialogue on prudent trusteeship and administration affecting the member schemes of the association and make recommendations, if any to the government and matters incidental thereto.

2. Facilitate the promotion of good retirement benefits trusteeship and administration awareness and training, and

3. Co-operate and work closely with the stakeholders in promoting retirement benefits trusteeship and administration development in the country.

Under its Constitution, some of the main functions of APTAK are to:-

Council Members:- Dr. Hosea Kili, OGW - President; CPA Charles S. Nyameino - Vice President; Bonface M. Mwangangi (ACILEx; CPM), Secretary - General; Peter Rotich - Treasurer; Caroline Kodo; CPA Sylvia Nashipae; Fredick Nzui; Margaret Osure; Sammy Njeru; Elijah Koskey; Tom Mulwa; Simon Wafubwa; Patricia Kiwanuka; Godwin Simba; Isaac Mitei.

1. Promote standards of legal and professional competence in the administration and management of retirement benefits schemes.

2. Ensure compliance with legal and good governance practices.

Subject to invitation or previous notice, APTAK would participate dynamically in the standards-setting process. This is achieved by APTAK actively commenting on any legal or administrative instruments when exposed to public participation or being drafted. Such action contributes to setting high-quality standards that enhance transparency, accountability, and competence of the stakeholders engaged in the administration and management of retirement benefits schemes.

Retirement Benefits Authority is an invaluable stakeholder in the pensions industry. We must acknowledge its contribution to the inordinate milestones achieved in regulating and supervising the pensions industry in Kenya.

On 2nd February 2024, APTAK through its Programs Committee held a consultative forum with key representatives of Scheme Administrators, Actuaries, Accountants, Auditors, Trustees, and Secretariats of Pension Schemes. The object was to discuss concerns related to the application and administration of the Legal Notices stated above more particularly concerning the proposed two valuation methods, amortization and mark to market that apply to three different financial accounting methods:-

1. Mark to Maturity = available for auction at maturity;
2. Mark to market = held for trading.
3. Mark to market = available for sale.

Nevertheless, APTAK has noticed some areas of practical and legal challenges regarding the enforcement of the Legal notices cited above. These are:-

1. Legal Notice Number 18 has amended Regulation 5(2)(e)(i) of the Retirement Benefits (Managers and Custodians) Regulations, 2000 as follows:-

"The manager shall submit to the scheme or pooled fund at least quarterly from the date of commencement of the financial year of the scheme or pooled fund -

(i) a valuation of the scheme fund or pooled fund and of all the investments representing the same including details of the cost of such investments and their estimated yields;

Provided that the investment report shall provide:

(a) with respect to financial assets that are available for sale, a one-year and three-year timeweighted performance figure calculated using a fair value approach; and

(b) with respect to financial assets intended to be held to maturity, a performance figure based on an amortized cost approach".

Auditors have maintained that the law goes against the International Financial Reporting Standards because it requires that the:-

(a) value of debt instruments held to maturity shall be reported at amortized cost; and

(b) that the fair value method shall be used to determine the value of debt instruments that are available for sale, as well as equities.

2. Legal Notice Numbers 19, 20, 21, and 22 have introduced Minimum Disclosure Requirements for Income Drawdown Funds, Individual Retirement Benefits Schemes, Occupational Retirement Benefits Schemes, and Umbrella Retirement Benefits Schemes relating to The Net Rate of Return Credited to Members' Accounts stating that the financial statements of a scheme shall be in the prescribed form and shall disclose:-

"*Returns on investments as per each category of investment; the net rate of return credited to the member's account;*

Provided that:

"*Unrealized gains and losses arising from the valuation of financial assets using the fair value approach shall not form part of the distributable income*".

The Auditors have advised us that the impact of the above legal notices on financial accounting and reporting by **INCOME DRAWDOWN FUNDS, INDIVIDUAL RETIREMENT BENEFITS SCHEMES, OCCUPATIONAL RETIREMENT BENEFIT SCHEMES,** and **UMBRELLA RETIREMENT BENEFITS SCHEMES** in Kenya with effect from 21st December 2023 is as follows:-

IMPACT	**PREVIOUS POSITION**
LEGAL NOTICE NO. 18 *THE RETIREMENT BENEFITS (MANAGERS AND CUSTODIANS) (AMENDMENT) REGULATIONS*	
• Fund Managers are allowed to measure and report the performance	□ Fund Managers were only allowed to measure and report the performance of financial

of financial assets available for sale at fair value (market value). *Consequently, schemes are to report financial assets available for sale at fair value (market value based on exchange prices on the reporting date).* • Fund Managers are allowed to measure and report the performance of financial assets intended to be held to maturity at amortized cost. *Consequently, schemes have the option to report financial assets intended to be held to maturity at amortized cost (nominal value payable on maturity plus accrued interest on reporting date)*	assets at fair value (market value) regardless of whether they were intended for sale or to be held to maturity. *As such, schemes were only allowed to report financial assets at fair value (market value based on exchange prices on reporting date) regardless of whether they were intended for sale or to be held to maturity.*
LEGAL NOTICE NUMBERS 19, 20, 21 AND 22 *THE RETIREMENT BENEFITS (INCOME DRAWDOWN FUNDS/INDIVIDUAL RETIREMENT BENEFITS SCHEMES/OCCUPATIONAL RETIREMENT BENEFITS SCHEMES/UMBRELLA RETIREMENT BENEFITS SCHEMES*	
□ Unrealized gains and losses also known as changes in fair value arising from measurement and valuation of FINANCIAL ASSETS at fair values (market values) shall be excluded when determining income distributable to the member balances. This implies that income distributable to member balances will be calculated using the following formulae: ***Illustration**: Distributable Income = Net realized income (realized income less expenses) plus unrealized gains or losses of non-financial.*	□ Unrealized gains and losses also known as changes in fair value arising from measurement and valuation of FINANCIAL ASSETS at fair values (market values) were included when determining income distributable to member balances i.e. ***Illustration:** Distributable Income = Net realized income (realized income less expenses) plus unrealized gains or losses of financial and non-financial assets*

□ Due to the non-distribution of unrealized gains or losses arising from the valuation of financial assets at	□ Due to the distribution of unrealized gains or losses arising from the valuation of financial

fair value, the net rate of return to be credited to members will be *higher than the total net return earned in financial periods with unrealized losses* **and** *<u>lower</u> <u>than the total return earned in financial periods with unrealized gains</u>.*	assets at fair value, *the net rate of return credited to members was generally equal to the total net return earned in the financial period.*
☐ The possibility of members being credited with very low or negative returns in periods of depressed market prices has been greatly minimized.	☐ Members were highly likely to be credited with very low or negative returns in financial periods with significantly depressed market prices of assets.
☐ Ultimately, the cumulative unrealized gains or losses going forward shall be deferred for distribution to members until the time the underlying financial assets are disposed of.	☐ Unrealized gains or losses were distributed to members in each financial period without waiting for the underlying financial assets to be disposed of.
☐ As a result of the exclusion of unrealized gains and losses arising from the valuation of financial assets in the determination of income distributable to member balances, *in the future cumulative member balances are likely to be <u>higher or lower</u> than the value of the Net Assets Available for benefits depending on the fair value (market value) of the financial assets available for sale at a particular time.* ☐ The imbalance created between the value of NET ASSETS AVAILABLE FOR BENEFITS **and** MEMBER BALANCES as a result exclusion of unrealized gains and losses arising from the valuation of financial assets in the determination of income distributable to member balances will be accounted through a *<u>REVALUATION RESERVE FUND</u>* which	☐ The distribution of unrealized gains and losses arising from valuation of financial and non-financial assets to members' accounts in each financial period ensured that MEMBER BALANCES were <u>EQUAL</u> **to the value of** NET ASSETS AVAILABLE FOR BENEFITS and therefore no need for a REVALUATION RESERVE FUND.

will be carried and **<u>reported separately</u>** in the STATEMENT OF NET ASSETS AVAILABLE FOR BENEFITS such that: ***Illustration**: Member Balances Fund + Revaluation Reserve Fund = Net Assets Available for Benefits*	

Legal Notice Nos: 19, 20,21, and 22 only affect the determination of income distributable to members' accounts and DOES NOT affect the measurement, valuation, and reporting of financial assets in financial statements.

However, it is important to note that these Legal Notices have now ensured UNIFORMITY in the determination of net return to be credited to members' accounts irrespective of whether financial assets are measured and valued at fair value or amortized cost since unrealized gains or losses are no longer distributable.

The key areas of concern are:-

1. Classification of Financial Assets:

(1) What standard methodology will Trustees use to determine financial assets meant for sale or intended to be held to maturity?
(2) We consider it necessary for the Retirement Benefits Authority (RBA) to provide clear guidelines on the standard methodology for classification, ensuring uniformity across schemes. Consideration should also be given to industry sensitization.
(3) The legal notice mandates the classification of assets. However, there is uncertainty on how prior years should be treated under the new law.
(4) We consider it necessary for the RBA to issue clear directives on the treatment of assets from prior years under the new classification requirements. This guidance should encompass transition processes and ensure that schemes maintain accuracy and consistency in their financial reporting.

2. Treatment of Unrealized Losses and Gains in the Pension Scheme Balance Sheet - Statement of Account:

(1) Given the legal notice's requirement for the classification of assets, how should unrealized losses and gains that are not distributable be treated in the pension scheme's statement of account?
(2) We consider it necessary for the RBA to provide a comprehensive guideline on the appropriate accounting treatment of unrealized losses and gains in the statement of account. Clarity on alignment with reporting standards will enhance transparency and consistency across schemes.

3. Unusual Occurrences and Liquidation:
(1) In the event of unusual occurrences calling for partial determination or liquidation, how will a scheme bridge the gap between fair values and amortized values where unrealized losses exist?
(2) We consider it necessary for the RBA to provide guidelines on bridging the valuation gap during unusual occurrences, considering the implications on member benefits.

4. Possibility of having Reserve Funds for unrealized gains or losses and Limitations:

(1) How will reserve funds for undistributed revaluation losses and gains, with a legal limitation of 5%, affect members, especially if it exceeds the limit?
(2) We consider it necessary for the RBA to guide on the implications of exceeding the 5% limit, taxation considerations, and the impact on retiring members. Clear communication on reserve fund operations is crucial.
(3) Now that each member has an account of contributions that have vested in her, who is the owner of the money held in a Reserve Account?
(4) We consider it necessary for the RBA to guide on the ownership and use of the Reserve Account;
(5) If a retiring member is paid with income distribution based on realized gains, what happens to his portion of the unrealized gains or losses in the Reserve Fund?
(6) We consider it necessary for the RBA to clarify the treatment of unrealized gains, ensuring transparency and fairness to retiring members.

5. Standardized Approach for Implementation Timing, Reporting, and Performance Measurement:

(1) The timing and process of implementation require a standardized approach not only for asset classification but also for reporting and performance measurement. How can service providers achieve uniformity in these aspects noting Scheme Audits are underway?
(2) We consider it necessary for the RBA to collaborate with industry stakeholders to align on standardized reporting formats and templates. Additionally, clear guidelines should be provided on the performance measurement metrics to ensure consistency and comparability across schemes.

6. Service Providers Fees – Valuation Methods Adoption:

(1) Which fund value will the service providers' fees be charged when a scheme has adopted both fair value and amortized cost valuation methods for reporting?
(2) We consider it necessary for the RBA to issue a guide on the appropriate valuation for fee pricing for service providers when schemes adopt a combination of fair value and amortized cost valuation methods.

7. Practical application of Legal Notices 18 to 22 of 21st December 2024

(1) The amortized cost approach reflects the original investment value, but concerns arise regarding market fluctuations.
(2) We consider it necessary for the RBA to clarify how the amortized cost approach will navigate market fluctuations and ensure an accurate representation of asset values.
(3) In events of retrenchment, bulk transfers, liquidation, or another event for which benefits are payable immediately.
(4) We consider it necessary for the RBA to clarify the legal implications and procedures for immediate benefit payouts in specified events.
(5) The fair value valuation method applies to non-debt financial assets.
(6) We consider it necessary for the RBA to guide the application of fair value to non-debt instruments for consistency and understanding.

8. Legal Concerns in the Legal Notices

(1) There are serious doubts about the result and effectiveness of the Legal Notices due to amendments based on non-existent law, public participation, and the effects of the Statutory Instruments Act;

(2) The uncertainties are:-

(a) Legal Notice Number **18** seeks to amend Regulation 5 of the Retirement Benefits (Managers and Custodians) Regulations, 2000. ***This amendment is NOT effective or efficient because by indentation of the Statutory Instruments Act on or about 26th January 2024 those cited Regulations ceased to have the force of law in Kenya.***

(b) Legal Notice Number **19** seeks to amend Regulation 16 of the Retirement Benefits (Income Drawdown Funds) Regulations, 2023. We have been unable to trace or access the purported Regulations. ***We are unable to take a position on the efficacy or efficiency of the cited Regulations.***

(c) Legal Notice Number **20** seeks to amend Regulation 28 of the Retirement Benefits (Individual Retirement Benefits Schemes) Regulations, 2017. ***This amendment is NOT effective or efficient because those cited Regulations are non-existent in the law.***

(d) Legal Notice Number **21** seeks to amend Regulation 36 of the Retirement Benefits (Occupational Retirement Benefits Schemes) Regulations, 2000. ***This amendment is NOT effective or efficient because by indentation of the Statutory Instruments Act on or about 26th January 2024 those cited Regulations ceased to have the force of law in Kenya.***

(e) Legal Notice Number **22** seeks to amend Regulation 42 of the Retirement Benefits (Umbrella Retirement Benefits Schemes) Regulations, 2000. ***This amendment is NOT effective or efficient because those cited Regulations are non-existent in the law.***

(f) We do not have any evidence to suggest that all or any of the Legal Notices are a product of public participation.

(2) We consider it necessary for the RBA to give guidance on the legal effect, and efficacy of the amendments.

9. The Way Forward:

(1) Consultation and dialogue are the way to go for the stakeholders to understand these laws and determine a suitable course of action.
(2) We request you to kindly organize as soon as possible a joint conference and invite other stakeholders to discuss the matters set out above in a bid to provide clarity and guidance to ensure the easy operationalization of the law.

10. Conclusion:

(1) The inquiries outlined aim to foster clarity, uniformity, and effective implementation of the legal notices.
(2) APTAK remains committed to collaborating with relevant authorities and stakeholders for the betterment of the retirement benefits industry.

Yours sincerely,

Dr. Hosea K. Kili, OGW
<u>PRESIDENT OF APTAK</u>

<u>CC:</u>

Secretary-General
APTAK