Kenya Approach to Risk Based Supervision

IOPS CARIBBEAN REGIONAL WORKSHOP ON PRIVATE PENSION SUPERVISION

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RETIREMENT BENEFITS AUTHORITY, KENYA

Retirement Benefits Authority

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- Retirement Benefits Industry in Kenya
- Overview of Risk Based Supervision Model in Kenya using IOPS RBS Toolkit Framework
- Challenges in Implementing Risk Based Supervision Model in Kenya

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Kenyan Retirement Benefits Industry

	Civil Service Scheme	**National Social Security Fund**	**Occupational Schemes**	**Individual Schemes**
Legal Structure	Act of Parliament	Act of Parliament	Trust Deed	Trust Deed
Membership	all civil servants	formal sector workers in companies with 5+	formal sector workers in companies that have schemes	individuals formal/informal sector join voluntarily
Funding	Non-funded	funded	funded	funded
Regulation	Exempt from RBA	Subject to RBA	Subject to RBA	Subject to RBA
Assets March 2009	nil	US$ 1.0 billion	US$ 2.5 billion	US$ 40 million

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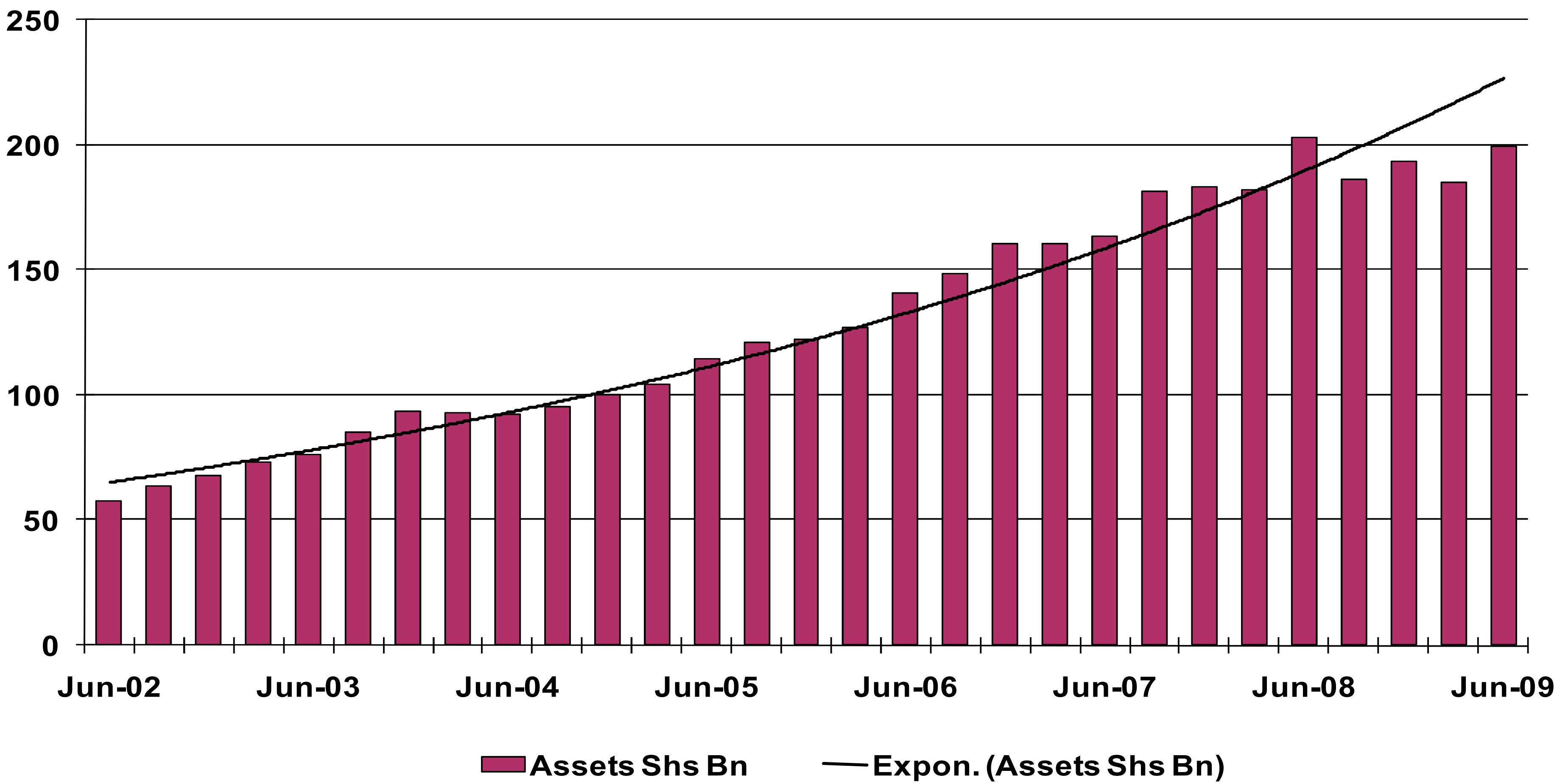
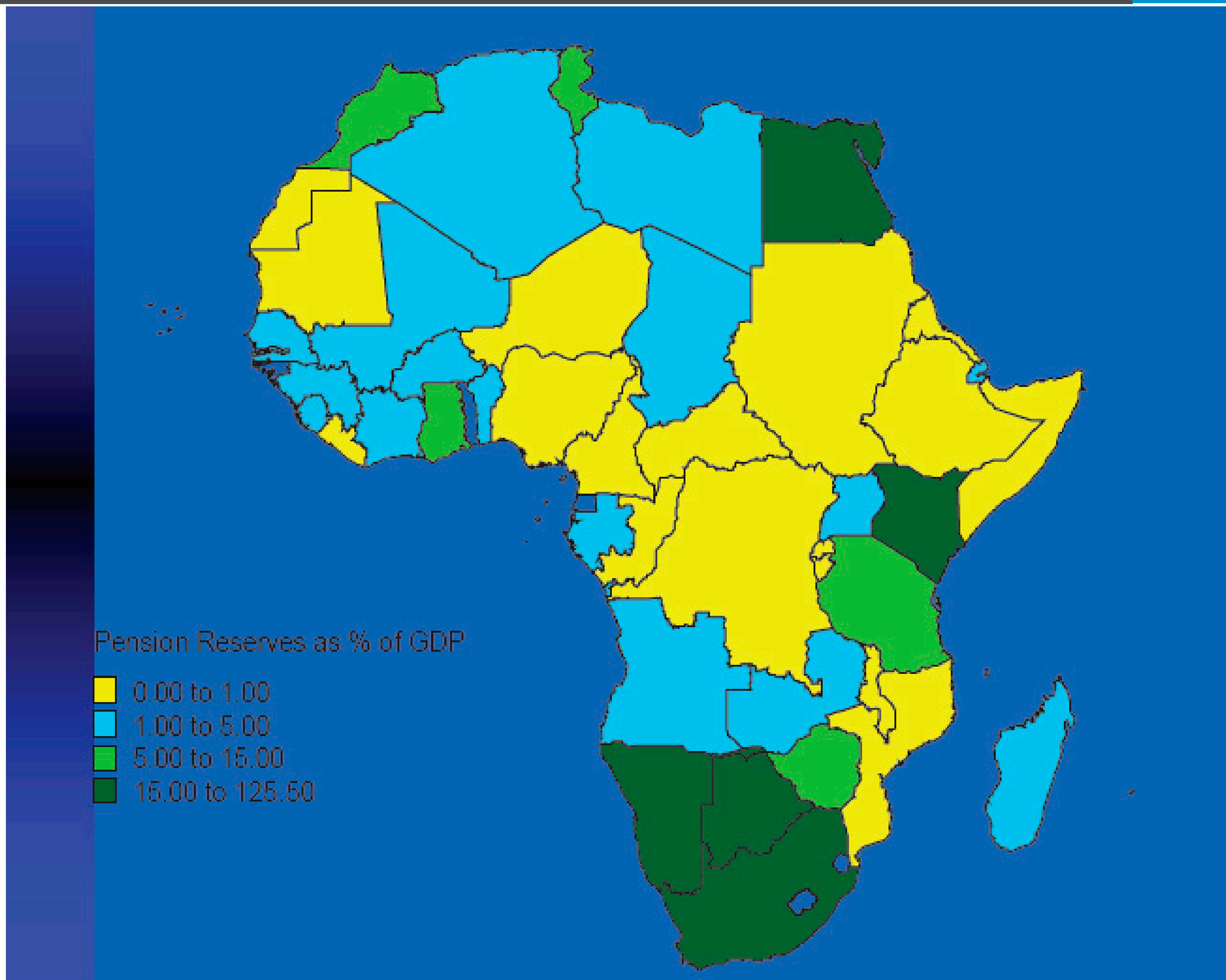
Growth of Retirement Industry Assets



Note: Excluding NSSF, June 2009 provisional

Comparison with African Countries



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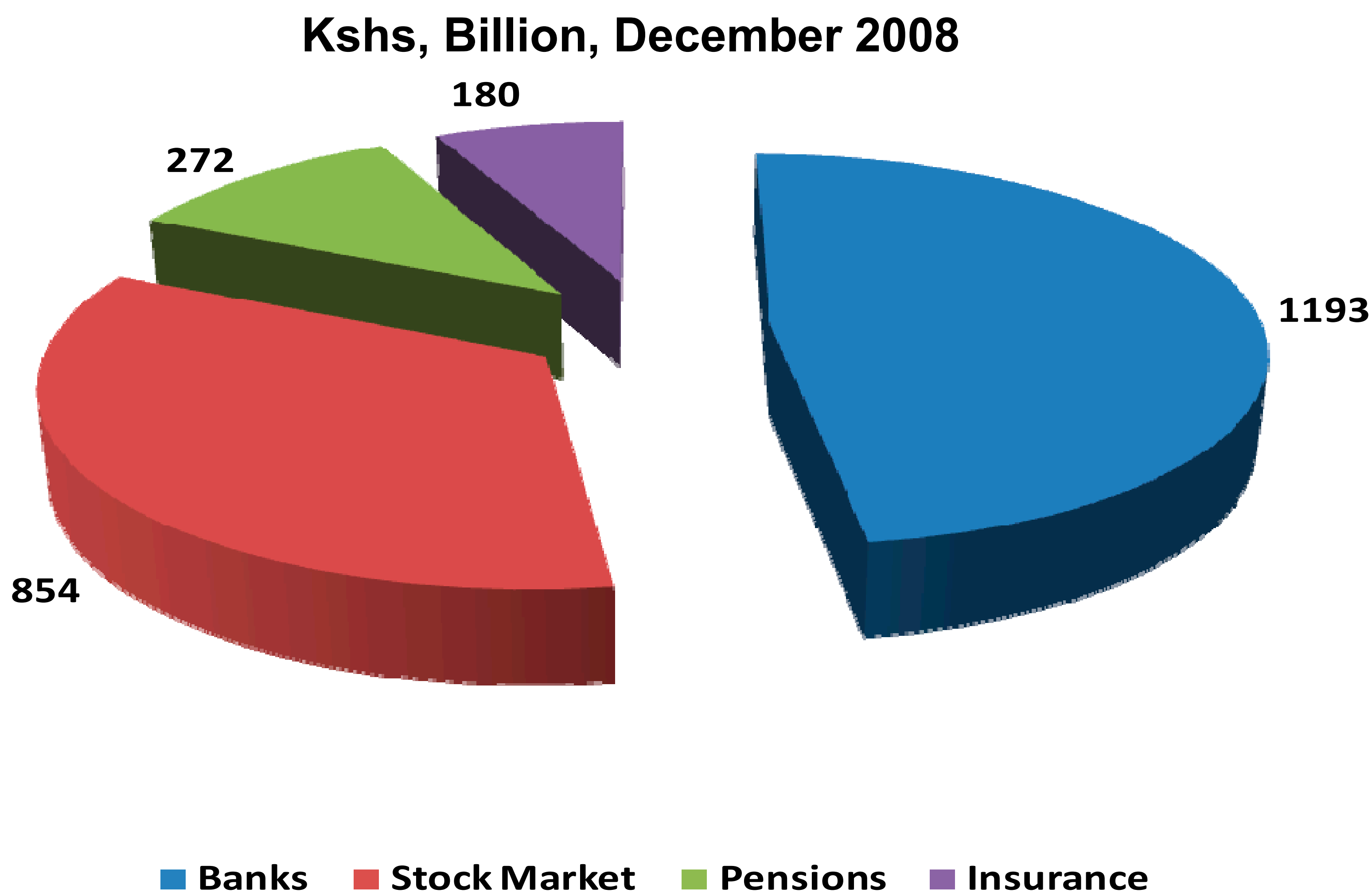
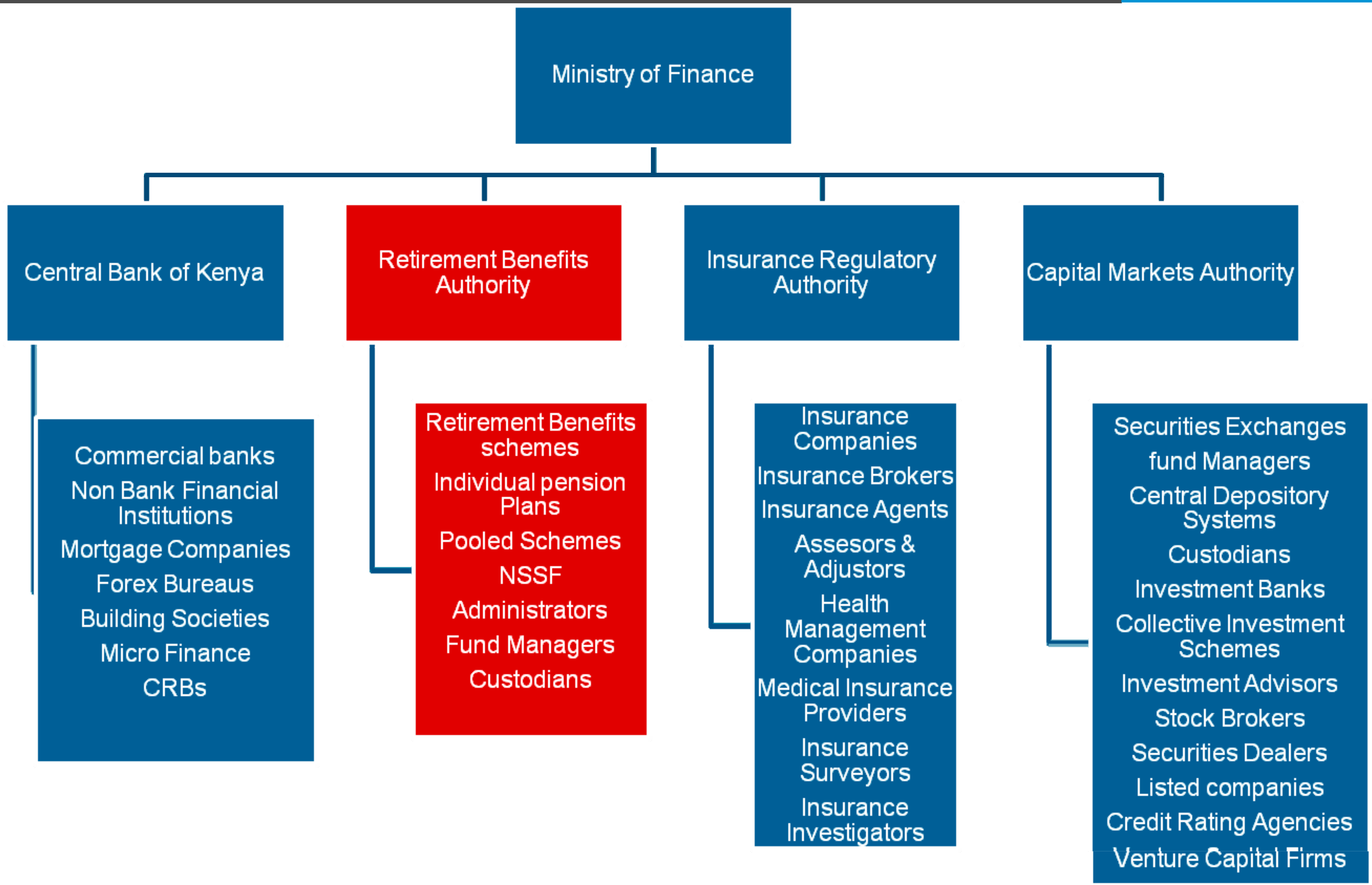
Financial Sector in Kenya



Regulatory Structure



RBA Statutory Objectives

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- Regulate and supervise establishment and management of retirement benefits schemes.
- Protect the interest of members and sponsors of retirement benefits schemes.
- Promote the development of the retirement benefits industry.
- Advise the Minister for Finance on the national policy to be followed with regard to the retirement benefits industry.
- Implement all government policies relating to the retirement benefits industry

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Risk Based Supervision - Introduction

- RBA has formally adopted Risk Based Supervision as its model of supervision for the retirement benefits industry.
- Previously RBA placed more attention on compliance status of retirement benefits schemes with little regard to potential risks
- Risk based supervision marks a shift to a more proactive approach as opposed to the previous reactive approach
- In implementing RBS, RBA received technical assistance from the World Bank as well as input from a consultant funded by the Government of Kenya and the World Bank.

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Why did RBA adopt RBS?

- Gain a better understanding of the quality of management, the characteristics and risks in a scheme and apply consistency in supervision and in assessing compliance
- Schemes will benefit from the improved focus of supervision and understand why particular supervisory tools are used
- Improved governance, transparency and efficiency in schemes
- Higher returns at lower risk resulting in reduction in scheme failures
- Allocation of RBA resources more efficiently
- Greater development , innovation and confidence in the industry

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Pre Conditions for RBS – Module 1

Legislative	• Governing law was amended in 2008 to allow RBA to issue practice notes • Proposed removal of most quantitative investment restrictions – pending
Supervisory Readiness	• RBS implementation committee formed • Trained staff in RBS • New IT system to be implemented
Industry Skills and Readiness	• Supporting professionals are present in market • Pension funds risk management systems weak • Capital markets lack full range of investment grade securities

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Obtaining Information– Module 2

Sources of Information

- Mandatory exception reports – whistle blowing required
- Periodic Scheme Returns
  - Annual Accounts
  - Investment returns – six months
  - Contribution returns – quarterly
  - Actuarial Valuations Tri - annual for DB Schemes only
- On site inspections
- Third Party reports – Interim administrators
- Interrogatories and scheme self risk assessment - pending

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Quantitative Assessment of Risk – Module 3

Regulatory Requirements for DB Plans supporting QAR

- DB scheme actuarial valuations every three years. Law amended in 2008 to allow RBA in consultation with Actuarial profession to prescribe minimum basis for valuations through practice notes
- Minimum funding Level for DB schemes raised from 80% to 100% in 2009

Regulatory Requirements for DC Plans supporting QAR

- Schemes mandated to use independent fund manager and custodian registered by RBA
- Quantitative asset restrictions – Broad Maximums – on investments

Techniques of Quantitative Assessment of Risk

	DB	DC	Comment
Comparison of assumptions	✓	NA	
Sources of earnings	✓	NA	
Roll forward calculations	✗	NA	
Duration analysis	✗	✗	
Sensitivity testing	✓	✗	Required by regulation
Deterministic stress tests	✓	✗	Done in collaboration with IMF FSAP mission
Stochastic stress tests	✗	✗	
Value at Risk Calculations	✗	✗	

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Risk Scoring– Module 4

Risk	Inherent risk	Management and control	Capital support
Weight	30%	35%	35%
Indicator	1. **Investment risk** •Investment Policy •Investment returns •Risk Measures 2. **Insurance risk** •insurance risk insured •capacity to handle non-insured risk **3. Non-financial risk** •simple plan provisions and procedures •transparent outsourcing •capacity to handle greater complexity	**1. Trustee oversight** •self-assessment •fit and proper criteria •lines of responsibility **2.Operations and Control** •Interrogatories •filing & contribution record •Number & resolution of complaints •expenses **3. Independent review** •use of independent professionals •reports without qualifications	**1. The Fund** • Funding / solvency ratio • Deficit recovery plan • Actuarial basis • Rates of return **2. The Employer** • Timely remittances • DB actuarial assumptions • DC communication to members • Industry shape

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Overall Risk Scoring

- For each indicator a score of zero is given if the outcome is satisfactory and a score between 0.25 and 1 for an unsatisfactory outcome depending on the indicator and the degree of the breach.
- The total score from each of the risk indicators for each of the three risk categories are aggregated .
- The aggregate score per risk category is weighted (30: 35: 35) so as to establish the overall risk score for every scheme.

Supervisory Response– Module 5

Overall Score	Classification	Supervisory Response
Less than 0.5	Green	No Action
0.5 – 1.5	Light Amber	Monitoring
1.5 – 2.5	Dark Amber	Intensive Monitoring
2.5 – 3.5	Red	Recovery Plan
3.5 – 4	Ultra Red	Intervention

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Implementation Challenges

- Systemic issues arising from historical problems in some schemes and the impact of the global financial crisis which means many schemes may yield adverse risk scores.
- Lack of available data for a number of schemes which makes it impossible to score them.
- Difficulty in identifying and financing a suitable IT system in line with the new system as well as challenge of shifting industry towards electronic filling of returns in suitable format.
- Educating scheme trustees and service providers on the new system and enabling them to complete interrogatories satisfactorily.

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Thank You

Asante

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