Provisions of the NSSF Act 2013 Relating to Mandatory Contributions & Contracting Out, & Next Steps for an Employer

The National Social Security Fund Act, 2013 ("the Act") was enacted in 2013, but its implementation was challenged in the courts almost immediately thereafter. However, the Court of Appeal on 3 February 2023 issued a Judgement that effectively reinstated the Act.

The Act repeals the previous NSSF Act (Cap 258) and introduces a new Pension Fund and Provident Fund to replace the previous Provident Fund, which is now closed. The Act increases the coverage, range and level of benefits provided by the NSSF, allows for contracting out of making second tier contributions to the NSSF and introduces measures to strengthen the corporate governance of the NSSF.

The Act has implications on all employers, employees and existing retirement funds in the country.

Commencement Date

The Court of Appeal reinstated the Act in its Judgement on 3 February 2023. Hence, the Act is effective immediately from this date and the statutory contributions at the higher rates are effective from the month of February 2023. Hence, employers need to ensure the statutory contributions under the Act are deducted and paid starting from February 2023.

A notice of appeal has been filed indicating the intention of the County Pensioners Association to seek a review at the Supreme Court against the Court of Appeal's judgement. However, no formal application has been filed to the Supreme Court to delay the implementation of the Act.

Closure of Existing Provident Fund and Establishment of new Pension Fund and Provident Fund

The previous NSSF has been closed to new contributions and will be termed as the "Old Provident Fund". The assets and liabilities of the Old Provident Fund will be fully ring-fenced and benefits under the Old Provident Fund will remain unchanged as they currently apply. The Act appears to require that the liabilities of the Old Provident Fund must be settled within five years, but then is silent on whether the Old Provident Fund accrued benefits would be transferrable to the new funds established under the Act.

The Act establishes two new sub-funds within the Trust Fund:

- Pension Fund to cover all employed persons (i.e persons who are subject to the provisions of the Employment Act) who are 18 years old or above.

- Provident Fund to cover the self-employed, those who wish to make voluntary contributions to the NSSF and persons who may not meet the eligibility criteria for membership of the Pension Fund.

The contribution and benefit provisions for the new Pension Fund and Provident Fund are different and are outlined in the next sections of this Communiqué.

Registration of employers and employees

The Act requires every employer with one employee or more to register with the Fund as a contributing employer and to register their employees as members of the Fund.

Under the Act, an "employee' is defined as any person who has attained the age of 18 years and who is employed in Kenya under a contract of service. A contract of service is defined as an agreement entered into orally or in writing, and whether express or implied, to employ or to serve as an employee for a period of time and includes a contract of apprenticeship.

The definition of "employee" excludes anyone in full time instruction in school or an apprentice who is not in receipt of wages which provides the person wholly or substantially with a livelihood.

Under the Act, an employer includes an individual or corporate who has entered into a contract of service. Further the Government is included as an employer for the purposes of the Act and hence the Government and public service employees will also be required to contribute to the NSSF.

The only exemptions are persons entitled to exemption under any International Convention or persons not ordinarily resident in Kenya and employed for 3 years or less who contribute to a similar system in their home country.

The Act also requires that, for any employer who qualifies to register with NSSF, proof of registration will be required as a precondition of dealing with or accessing public services.

The Fund is to inform employers and employees of the requirement to register under the Act.

All members of the Old Provident Fund automatically become members of the Pension Fund other than those who were making voluntary contributions only.

Contributions

Rates of Contribution to new Pension Fund

Under the NSSF Act, the rates of contribution to the new Pension Fund are at 12% of Pensionable Earnings (split 6% by employees and 6% by employers). Pensionable Earnings are defined in the NSSF Act as all emoluments payable to an employee other than fluctuating emoluments, but subject to a ceiling (called the Upper Earnings Limit in the NSSF Act). However, the Regulations under the Act appear to have an error in drafting which will for the time being enable contributions to be deducted based on basic pay excluding allowances. This is however still subject to legal interpretation and clarification.

There is a phasing in of the mandatory contributions over a five-year period, which is being done by starting with a relatively low Upper Earnings Limit that will increase significantly over the first 5 years.

The mandatory contributions, as described above, are split into two categories or 'Tiers':

- Tier I contributions are 12% of earnings up to the Lower Earnings Limit (broadly defined as the minimum wage).
- Tier II contributions are 12% of earnings between the Lower and Upper Earnings Limit.

The appendix shows illustrations of the contributions for various salary levels (including the breakdown between the two tiers) as well as the provisions of the 5-year transition period.

Both the Tier I and Tier II contributions are mandatory. Tier I contributions must be remitted to the NSSF. The default position is that Tier II contributions must also be remitted to the NSSF, unless the Employer has elected to 'contract out' of making Tier II contributions to the NSSF and instead remit the Tier II contributions to an approved contracted out scheme. Contracting-out does not mean not making Tier II contributions, it simply changes where they go.

Contracting Out

Under the Act, the decision to contract out is an employer decision. Therefore, you will need to consider whether you wish to contract out or make all the statutory Tier I and Tier II contributions to the NSSF.

The application to the RBA must be submitted 60 days before the intended contract out date.

Requirements for Contracting Out

The scheme receiving the Tier II contributions must meet a Reference Scheme Test, with the key requirements being that the Scheme:

- is registered with Retirement Benefits Authority and the Kenya Revenue Authority;
- is compliant with the investment guidelines under the Retirement Benefits Act;
- maintains an accurate record of the Tier II contributions (which will be known as Protected Rights); and
- provides benefits that in the same form as required to be paid under the Act for Tier II contributions.

Rates of contribution to new Provident Fund

All contributions to the new Provident Fund are on a voluntary basis. The minimum voluntary contribution payment to the Provident Fund is KShs 200. The Act provides for the aggregate voluntary contributions during a year to be at least KShs 4,800.

Benefits

Individual member accounts

Each member of the Pension Fund and Provident Fund will have an individual member account to which the statutory contributions will be credited.

For Pension Fund members, each member's individual account will show the Tier I and Tier II employee and employer contributions separately and the interest thereon. The Tier I contributions will have a deduction for the estimated annual cost of the minimum benefits on death and invalidity and this deduction will not exceed 2% of the LEL.

Each member of the Provident Fund will also have an individual member account to which voluntary contributions will be credited.

Annual benefit statements

Each member shall receive an annual benefit statement showing the total Pension Fund or Provident Fund Credit. Statements are also available at any other time upon request, and online access is provided for in the Act.

Defined contribution basis of operation

Both the Pension Fund and Provident Fund will operate on a defined contribution basis (i.e. the quantum of benefits will be based on the contributions credited to the individual member account with interest thereon). For the Pension Fund, there are additional benefits on death and invalidity which will be funded through the Tier I contributions reserve of 2% of the LEL.

Pension Fund Benefits

Pension Fund benefits include a retirement pension, an invalidity pension, a survivor's pension, an emigration benefit and a funeral grant. Members may elect to receive a part of their benefits as a lump sum at retirement (not exceeding one-third of the accumulated Tier II Contributions) with the balance paid as a pension. Retirement age has been set at 60 years with early retirement available from age 50. The benefits will be on a defined contribution basis and members will have their pension secured as an annuity from an insurance company of their choice using the total funds in the individual member account. A member may also opt for income drawdown (or a phased withdrawal of the funds in their individual member account) from an approved drawdown provider.

Both the invalidity and survivor's benefit provide for an enhanced benefit subject to a requirement that a minimum of 36 months' contributions to have been made by the member. The enhancement is to the Tier I Credit which will be increased to allow for half the lost potential service (due to early ill heath retirement or death), subject to a maximum. The funeral grant is in addition to the survivor's pension and is currently set at K Shs 10,000. It requires the member to have made at least 6 months' contributions.

Provident Fund Benefits

Provident Fund benefits are a replica of the benefits offered under the Old Provident Fund i.e. a one of lump-sum payment upon retirement, or upon attaining the age of 50 years or on death or invalidity. However, the Provident Fund benefits have no additional enhancements on invalidity or death in service. There is also no funeral grant payable under the Provident Fund.

Other Provisions

Reciprocal arrangements with other countries

The Act allows for portability and transfer of benefits to and from the NSSF from similar funds in other countries where reciprocal arrangements have been made. This will be important in the context of the East African Community and the move towards a single market and cross border job mobility.

Tax Treatment of Contributions, Investment Income and Benefits

The Act provides for:

- The statutory contributions at the prescribed rates to be tax deductible;
- The investment income on the statutory contributions to be tax exempt;
- The benefits in respect of statutory contributions (including where applicable Protected Rights in a contracted out scheme) to be tax exempt.

There is some asymmetry between the Income Tax Act and the new NSSF Act 2013. In particular, the Income Tax Act has an upper monetary limit on contributions that are tax deductible and provides for taxation of benefits from an exempt scheme. The provisions of the two Acts will need to be harmonized.

Penalties and Sanctions under the Act

The Act provides for sanctions and penalties for breaches of various sections of the Act. These include:

- Failure by an employer to register under the Act – fine not exceeding KShs 50,000
- Delay in remittance of contributions – penalty of 5% compound each month late
- Offence by employer on failure to keep proper records of employees and earnings
- Fine on misrepresentation when making benefit claims not exceeding KShs 300,000 or imprisonment for a term not exceeding 3 months or both
- Evasion/misrepresentation/over-deductions etc liable to payment of contributions with interest or jail terms and fines not exceeding KShs 500,000
- Fine not exceeding KShs 100,000 for any offence for which no penalty expressly provided

Corporate Governance

The increased mandate of the NSSF is accompanied with measures to strengthen the institutional structure and regulatory oversight of the NSSF.

Composition of the Board of Trustees

The Board of Trustees is to comprise a maximum of nine persons and includes the Principal Secretaries to the National Treasury and the Ministry of Labour and Social Security, two persons appointed by a representative employer organization, two persons appointed by a representative workers organization and three persons appointed by the Cabinet Secretary by virtue of their experience in relevant fields.

The Managing Trustee is an ex-officio member of the Board.

The Board and management shall be required to apply corporate best practices in the leadership and management of the NSSF respectively.

The term of the Board members and Managing Trustee is three years and renewable for a further and final term of three years.

Regulatory Oversight by Retirement Benefits Authority

The NSSF will be subject to the regulatory oversight of the Retirement Benefits Authority and will need to comply with the provisions of the Retirement Benefits Act.

The Act explicitly provides for the investments to be managed in accordance with the provisions of the Retirement Benefits Act and includes provisions for publication of annual audited accounts and greater disclosure requirements and more accountability and transparency in the management of the NSSF. an annual general meeting of the members of the NSSF will be convened in accordance with the Retirement Benefits Act

'Cap' on Expenses

The Act puts in place a legislative 'cap' on the NSSF's expenses (at 2% of assets reducing to 1.5% within six years of the commencement date).

Next Steps

The Act has implications on all employers, employees and existing retirement funds in the country. We recommend that employers undertake a full review of their existing arrangements (including remuneration structure, existing retirement benefit arrangements, end of service gratuity arrangements, etc).

Such review should include an assessment of available options, including cost implications of different options as well as consideration of existing contractual arrangements. Employers will also need to ensure that all their employees including "casual" and "seasonal" employees are registered and covered.

Employers who have or participate in existing retirement benefit arrangements will need to review the existing scheme provisions to understand what amendments will be required in order to have the scheme approved as a contracted-out scheme.

Those employers that do not currently participate in a retirement scheme will need to consider whether to make all contributions to the NSSF or join or establish a pension scheme that can become an approved contracted out scheme for Tier II contributions. Employers who have end of service gratuity benefits will need to consider how best to provide for the accrued gratuity benefits and how to modify future gratuity accrual in light of the new Act.

We recommend that you seek legal guidance as well as review your employment contracts and any collective bargaining agreements you may have.

How can Zamara help you?

As the leading pension experts and the market leaders in our industry, Zamara is well positioned to assist you to comply with the provisions of the Act, including undertaking an assessment of your existing arrangements and offering you with solutions tailor made to meet your pension and employment benefits needs.

For further information, please contact the Consultant with whom you already deal or our offices using the email address **nssfhelp@zamara.co.ke**

Appendix A – Illustration of the Mandatory Contributions under the NSSF Act 2013

As we mentioned above, the rates of contribution to the new Pension Fund are at 12% of Pensionable Earnings (split 6% by employees and 6% by employers). Pensionable Earnings are effectively an employee's gross consolidated wage subject to a ceiling called the Upper Earnings Limit. There is a phasing in of the mandatory contributions over a five-year period, which is being done by started with a relatively low Upper Earnings Limit that will increase significantly over the first 5 years.

It is important to note that after the 5-year transition period, the Upper Earnings Limit will be at a high enough level that for the vast majority of Kenyan workers, their entire salary will be subject to the NSSF contributions.

Remember, the mandatory contributions are split into two categories or 'Tiers':

- Tier I Contributions are 12% of earnings up to the Lower Earnings Limit (broadly defined as the minimum wage).
- Tier II Contributions are 12% of earnings between the Lower and Upper Earnings Limit.

The NSSF Act provides for the contributions to the Pension Fund to be phased in over a period of five years by having the Lower and Upper Earnings Limit increase as shown in the table below:

Year	Lower Earnings Limit (LEL) KSh	Upper Earnings Limit (UEL) KShs
1	6,000	18,000 (50% of *N.A.E)
2	7,000	1 times *NAE
3	8,000	2 times *NAE
4	9,000	3 times *NAE
5 and onwards	As will be defined by the Act	4 times *NAE

**N.A.E - National Average Earnings*

Thus, in the first year of implementation:
The monthly contribution by an employee will be 6% of the first KShs 18,000 of their salary and there are no required contributions on any salary in excess of KShs 18,000 (a maximum contribution of K Shs 1,080).

- Tier I Contributions will be at 6% of Pensionable Earnings up to K Shs 6,000 (equal to K Shs 360)
- Tier II Contributions will be at 6% of Pensionable Earnings that exceed K Shs 6,000 (a maximum of KShs 720).

The employer contribution will be exactly the same as described above.

Tier I contributions must be remitted to the NSSF. Tier II contributions must be remitted to NSSF, unless the Employer has elected to 'contract out' to an approved contract out scheme. Employers who contract out will instead remit the Tier II contributions to the approved contract out scheme.

The table below provides an illustration of the employee contributions required under the NSSF Act, for various earning levels. The employer contribution would be exactly the same amount. The contributions shown are for the first transition year, where the LEL is K Shs 6,000 per month and the UEL is K Shs 18,000 per month. The footnotes to the table provide detailed explanations of each column of the table.

Table 1 – Contributions by the Participating Employer and Employee (each) in TRANSITION YEAR 1

Monthly Wage [1]	Pensionable Earnings [2]	Required Contribution[3]	Tier I[4]	Tier II[5]
5,000	5,000	300	300	-
10,000	10,000	600	360	240
20,000	18,000	1,080	360	720
40,000	18,000	1,080	360	720
80,000	18,000	1,080	360	720
100,000	18,000	1,080	360	720
200,000	18,000	1,080	360	720
300,000 and above	18,000	1,080	360	720

The table below provides an illustration of the contributions required under the Act, for various earning levels. The contributions shown are assuming there was no transition, where the assumed LEL is K Shs 8,000 per month and the assumed UEL is K Shs 144,000 per month. The footnotes to the table provide detailed explanations of each column of the table.

Table 2 – Contributions by the Participating Employer and Employee (each) assuming NO TRANSITION

Monthly Wage [1]	Pensionable Earnings [2]	Required Contribution[3]	Tier I[4]	Tier II[5]
5,000	5,000	300	300	-
10,000	10,000	600	480	120
20,000	20,000	1,200	480	720
40,000	40,000	2,400	480	1,920
80,000	80,000	4,800	480	4,320
100,000	100,000	6,000	480	5,520
200,000	144,000	8,640	480	8,160
300,000 and above	144,000	8,640	480	8,160

1. Monthly wages are all emoluments excluding fluctuating amounts. Therefore fixed allowances are also included as wages under the Act.
2. As defined in the Act, these are wages subject to a maximum of the Upper Earnings Limit (UEL).
3. The contribution amount shown is 6% of Pensionable Earnings. This is the contribution payable by the employee and employer each. The total contribution is double this amount.
4. Tier I contributions are those in respect of Pensionable Earnings below the Lower Earnings Limit (LEL). Tier I contributions have to be remitted to NSSF.
5. Tier II contributions are those in respect of Pensionable Earnings above the LEL (and below the UEL, by definition). Those employers who contract out will remit these contributions to the contract out scheme instead of to NSSF.