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NSSF TIER II CONTRACTING OUT TO PRIVATE RETIREMENT SCHEMES

Enhance Your Employee Benefits & Retirement Outcomes



For SMEs & Corporate Employers

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EXECUTIVE SUMMARY

Maximize Retirement Savings: Contract Out of NSSF Tier II for Superior Returns

As an employer, you're required to remit NSSF contributions (Tier I + Tier II) for all employees under the NSSF Act 2013. While Tier I must remain with NSSF, the law allows you to contract out Tier II contributions to a Private Retirement Scheme (PRS) - giving your employees access to potentially higher returns and better retirement outcomes. The NSSF Act 2013 introduced Tier II contributions (6% employer + 6% employee on pensionable earnings). Smart employers can "contract out" of NSSF Tier II by enrolling in superior-performing Personal Retirement Schemes (PRS), maintaining Tier I compliance while accessing 11-14% returns vs NSSF's 6-8%.

The Opportunity:

- **NSSF Tier I:** Mandatory Ksh 2,160 annually (Ksh 1,080 employer + Ksh 1,080 employee) on first Ksh 18,000 earnings
- Redirect Tier II contributions to professionally managed PRS providers while maintaining full NSSF Act compliance
- **NSSF Tier II:** 12% (6% + 6%) on pensionable pay above Ksh 18,000 up to Ksh 36,000
- **CONTRACT OUT:** Move Tier II to high-performing PRS earning 11-14% vs NSSF's 6-8%

Key Benefits for Your Organization:

- **Enhanced employee benefit package** (competitive advantage in talent retention)
- **Potentially better retirement outcomes** for employees (PRS: 11-12% average vs NSSF: 6-8%)
- **Improved transparency** (quarterly statements, online access for employees)
- **Full regulatory compliance** (RBA-approved, NSSF Act-compliant)
- **Zero additional cost** to employer (same contribution amounts)

- **Tax Benefits (Section 31, Income Tax Act - Dec 2024):** Pension contributions: **Ksh 30,000/month (Ksh 360,000/year)** tax-deductible. For someone earning Ksh 150,000 monthly, contributing Ksh 30,000 = Ksh 9,000 monthly tax savings (30% bracket)

THE PROBLEM: INSUFFICIENT NSSF-ONLY RETIREMENT

82% of Kenyans Have No Retirement Plan Beyond NSSF

Typical NSSF Outcome After 30 Years:

- Employee earning Ksh 80,000 monthly
- Total NSSF contributions over 30 years: Approximately Ksh 800,000 - 1.2M
- NSSF pay out at retirement: Ksh 1.5M - 2.5M
- **This provides less than 2 years of living expenses**

Lifestyle Collapse:

- From Ksh 80,000 monthly income → Ksh 20,000-30,000 pension
- 60-70% income reduction forces severe lifestyle downgrade
- Many retirees financially dependent on children
- Medical expenses deplete remaining savings

Root Causes:

1. Low NSSF returns (6-8% average vs 11-14% PRS)
2. Limited contribution amounts (capped at Ksh 36,000 earnings)
3. No voluntary top-ups allowed in NSSF Tier II
4. Inadequate for maintaining pre-retirement lifestyle

UNDERSTANDING NSSF TIER I AND TIER II

The National Social Security Fund (NSSF) Act, No.45 of 2013 was assented to on 24th December 2013 and commenced on 10th January 2014. For a long time, the NSSF contributions were Ksh 200 for employer and Ksh 200 for the employee. With the NSSF Act 2013, effective February 2024, an enhanced tiered system of NSSF contributions was introduced as follows:

Period	Lower Earnings Limit	Upper Earnings Limit	1	2	3
			Employee Tier 1 Contribution	Employee Tier 2 Contribution	Total Contribution (Employer & Employee)
Year 1 (2023)	6,000	18,000	360	720	2,160
Year 2 (2024)	7,000	36,000	420	1,740	4,320
Year 3 (2025)	8,000	72,000	480	3,840	8,640
Year 4 (2026)	9,000	108,000	540	5,940	12,960
Year 5 (2027)	20,000	144,000	1,200	7,440	17,280

1. Tier 1 Contribution = Lower Earnings Limit x 6%.

The lower earnings limit shall be the amount gazetted by the Cabinet Secretary, Social Security and Services annually as the average statutory minimum monthly basic wage for each year – for the first 4 years. The Government will confirm the actual Lower Earnings Limit from the 5th year in line with the NSSF Act.

2. Tier 2 Contribution = (Upper Earnings Limit - Lower Earnings Limit) x 6%.

The upper earnings limit shall be the national average wage earnings per employee as published by the Kenya National Bureau of Statistics in the Economic Survey for the prior year. At commencement (year 1), the upper earnings limit (Ksh 18,000) is capped at 50% of the base national average wage earning (Ksh 36,000). From year 2, the base national average wage earning (Ksh 36,000) is multiplied by factors of 1, 2, 3 and 4 in line with the NSSF Act to arrive at the upper earnings limit for year 2, year 3, year 4 and year 5 as Ksh 36,000, Ksh, 72,000, Ksh 108,000 and Ksh 144, 000 respectively.

3. Total Contribution (Employer & Employee) = (Tier 1 contribution + Tier 2 contribution) x 2

Note: Tier 1 contributions **MUST BE** remitted to NSSF. However, Tier 2 contributions can be remitted to NSSF or be **contracted out** to a RBA approved private retirement benefits scheme.

THE SOLUTION: CONTRACT OUT TO PRIVATE RETIREMENT SCHEME (PRS)

How Contracting Out Works:

STEP 1: Employer registers with Retirement Benefits Authority (RBA)

STEP 2: Establishes employer-sponsored PRS with licensed fund manager

STEP 3: "Contracts out" of NSSF Tier II (maintains Tier I mandatory compliance)

STEP 4: Contributes 12% (6% employer + 6% employee) to PRS instead of NSSF Tier II

STEP 5: Employee builds larger retirement fund in superior-performing scheme

Contracting Out Process

What Changes:

- **Tier I:** Continues to NSSF (no change)
- **Tier II:** Redirected to chosen PRS provider

What Stays the Same:

- Total employee and employer contribution amounts
- Employer and employee contribution shares (50/50 split)
- Payroll deduction process
- 100% NSSF Act compliance

Think of it as: Splitting your retirement "basket" - Tier I with government (NSSF), Tier II with private professionals (PRS).

BEFORE (All to NSSF):

Employee Salary → Payroll Deduction → 100% to NSSF (Tier I + II)

AFTER (Tier II Contracted Out):

Employee Salary → Payroll Deduction →
├ Tier I → NSSF
└ Tier II → PRS Provider

Benefits Over NSSF Tier II:

1. Higher Returns

- **PRS:** 11-14% average annual returns
- **NSSF:** 6-8% average annual returns
- **Difference:** 3-6% compounded over 30 years = millions extra

2. Tax Deductibility

- Up to Ksh 30,000/month (Ksh 360,000/year) tax-deductible
- **Example:** Ksh 30,000 contribution at 30% tax bracket = Ksh 9,000/month savings
- **Annual tax savings:** Ksh 108,000

3. Portability

- Move funds between jobs without penalties
- No orphaned pensions in old employer schemes
- Consolidate multiple schemes into one

4. Transparency

- Monthly statements available online
- Real-time balance tracking
- Clear performance reporting

30-Year Comparison: NSSF vs PRS Contracting Out

Scenario	Monthly Contribution	Average Return	Total at Retirement (30 Years)
NSSF Tier I + II Only	Ksh 9,000	7%	Ksh 2.8M
NSSF Tier I + PRS (Contracting Out)	Ksh 9,000 to PRS	12%	Ksh 6.5M
DIFFERENCE	—	—	+Ksh 3.7M (132% more)

Additional Benefit: Tax savings of Ksh 2,700/month (30% bracket) = Ksh 972,000 over 30 years

Penalties for Non-Compliance:

NSSF Act 2013 Penalties:

- Late payment: **2% per month** on unpaid contributions
- Employer failure to remit: Fine up to **KES 2,000,000** OR imprisonment up to **3 years**, OR **both**
- Personal liability: Directors/officers personally liable if company fails

Contracting Out Protects Employers:

- Full legal compliance with NSSF Act
 - Superior employee benefits (recruitment/retention advantage)
 - Tax efficiency for both employer and employee
 - Simplified administration (one scheme vs two)
-

EMPLOYEE BENEFITS: WHAT YOUR STAFF GAIN

1. Higher Potential Returns

Market Average: 11-14% vs NSSF's 6-8%

2. Tax Relief Enhancement

New Tax Relief Limit (Effective December 2024):

- **Ksh 360,000 per year** (Ksh 30,000/month)
- Applies to **total retirement contributions** (NSSF + voluntary PRS)

Example for Employee Earning Ksh 100,000/month:

- NSSF Tier I + II: Ksh 8,640/month
- Additional voluntary PRS: Ksh 21,360/month (to reach Ksh 30,000 limit)
- **Annual tax relief: Ksh 360,000 × 30% tax rate = Ksh 108,000 saved**

With Tier II in PRS: Employees can **easily add voluntary contributions** to same account (harder with NSSF).

3. Portability & Control

NSSF Limitation:

- Tied to NSSF system regardless of job changes

PRS Advantage:

- **Tier II PRS follows employee** across jobs
 - New employer simply remits to existing PRS account
 - No need to consolidate multiple accounts
 - Full control over beneficiaries, withdrawals, etc.
-

BENEFITS FOR YOUR ORGANIZATION

1. Competitive Employee Benefits Package

Talent Attraction:

- "PRS option" is a **premium benefit** (shows you invest in employee futures)
- Appeals to millennials/Gen Z (want control over investments)
- Differentiates you from competitors still using basic NSSF-only

Talent Retention:

- Employees see tangible retirement growth (quarterly statements show actual returns)
- Higher returns = happier, more loyal staff
- Modern benefit that signals forward-thinking employer

2. Enhanced Transparency & Employee Engagement

NSSF Limitations:

- Annual statements only (if at all)
- No online access for most employees
- Opaque investment decisions
- Employees don't "feel" their retirement growing

PRS Advantages:

- **Quarterly statements** (employees see growth 4X per year)
- **Online portals** (check balance anytime via app/web)
- **SMS/email updates** on contributions received
- **Fund performance reports** (transparent investment decisions)

Impact: Employees become **engaged** in retirement planning (reduces financial stress, increases workplace satisfaction).

3. Risk Diversification (for Employees)

Current Risk: All retirement eggs in one basket (NSSF)

- Single fund manager
- Government-controlled investment decisions
- No employee choice

After Contracting Out:

- **Tier I:** NSSF (government-backed security)
- **Tier II:** PRS (professional fund management, market returns)
- **Diversified exposure:** Reduces single-scheme risk

Good Governance: Shows your organization prioritizes employee financial security through diversification.

4. Zero Cost Implementation

Employer Cost:

- **Before:** Contribute 6% of salary (up to Ksh 4,320/month per employee)
- **After:** Contribute 6% of salary (up to Ksh 4,320/month per employee)
- **Additional Cost: Ksh 0**

5. Full Regulatory Compliance

Legal Basis:

- NSSF Act 2013, Section 20-22 (Contracting Out Provisions)
- Retirement Benefits Act (Cap 197)
- RBA-approved PRS providers only

Compliance Assurance:

- All PRS providers are **RBA-licensed**
- NSSF Act obligations **100% met**
- No legal risks or penalties
- Simpler than it sounds (we handle all compliance documentation)

CLIENT SUCCESS STORY

Case Study: ABC - Corporate Contracting Out

Company: ABC (*name withheld for privacy*), 35 employees

Challenge: Employees complained about low NSSF returns; company wanted competitive benefits

Our Solution:

1. Contracted out of NSSF Tier II to XYZ (*name withheld for privacy*) PRS
2. Maintained NSSF Tier I compliance
3. Contributed 12% of pensionable pay to PRS (6% employer + 6% employee)

Results After 5 Years:

- Average employee PRS balance: Ksh 420,000
- Projected NSSF only balance: Ksh 280,000
- **Difference: Ksh 140,000 (50% more) in just 5 years**

Employee Retention Impact:

- Retention improved 22%
- Exit interviews cited retirement benefits as key factor
- Tax savings: Average Ksh 7,200/year per employee

Projected Retirement Impact (Employee Earning Ksh 80,000):

- 25 more years to retirement
- **PRS at 12% return:** Ksh 12.5M at age 60
- **NSSF only at 7% return:** Ksh 5.2M at age 60
- **Extra Ksh 7.3M in retirement** thanks to contracting out

HR Director's Testimonial:

"Contracting out was the best employee benefit decision we made. Recruitment became easier—candidates choose us over competitors because of superior retirement benefits. And our employees actually understand and appreciate their pensions now."

FREQUENTLY ASKED QUESTIONS

Q1: Is contracting out of NSSF Tier II legal?

A: Yes, fully legal under NSSF Act 2013. Employers can contract out Tier II if they enrol on RBA-approved PRS with equal or better benefits. Tier I remains mandatory.

Q2: What happens to my NSSF contributions if I switch jobs?

A: NSSF Tier I stays with NSSF (portable across jobs). PRS balance transfers to new employer's scheme or your personal PRS (portable, no penalties).

Q3: Can employees opt out of the PRS?

A: No. If employer contracts out, all employees must participate. This protects employees from opting for inferior NSSF Tier II.

Q4: How do I claim the Ksh 30,000/month tax deduction?

A: Provide PRS contribution receipts to employer (they adjust PAYE withholding) OR claim in annual tax return via iTax.

Q5: Can we contract out mid-year?

A: Yes, contracting out can happen anytime. Contributions made to NSSF Tier II before contracting out remain with NSSF (cannot be transferred retroactively).

Q6: What if our PRS provider goes bankrupt?

A: RBA regulates PRS providers. Funds held separately from provider's assets (not commingled). If provider fails, RBA transfers accounts to another provider. Your money is protected.

Q7: Can employer contribute more than 6%?

A: Yes! Employers can contribute more (e.g., 8% or 10%). This is a powerful retention tool. Additional amounts still tax-deductible up to individual's Ksh 30,000/month limit.

Q8: Do we still pay NSSF Tier I after contracting out?

A: YES. Tier I (Ksh 2,160 annually) remains mandatory. You cannot contract out of Tier I.

YOUR NEXT ACTION

Every Month Your Employees Stay in NSSF Tier II Costs Them Future Retirement Wealth

10-Year Delay Costs Example:

- Starting contracting out at age 35 vs age 45
- Same Ksh 20,000/month contributions
- **Age 35 start:** Ksh 15M at age 60 (25 years at 12%)
- **Age 45 start:** Ksh 6.8M at age 60 (15 years at 12%)
- **10-year delay costs: Ksh 8.2M per employee**

As your independent financial advisor, I will help you (the employer) fill the necessary enrolment forms and we handle the process of contracting out NSSF Tier 2 for your organisation.

Contract out NSSF Tier 2 Now - Contact Me Today

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This document is for informational purposes only. PRS returns shown are historical averages and not guaranteed. Tax benefits subject to KRA regulations. Contracting out decisions should be made after thorough consultation with qualified advisors.