

HIGHLIGHTS OF THE CONTRIBUTORY PENSION SCHEME IN NIGERIA

BACKGROUND

As is typical worldwide, the Pay As You Go Defined Benefit Scheme that is currently operated in Nigeria is burdened with a lot of problems and has increasingly become unsustainable. Against the backdrop of a huge deficit, arbitral increases in salaries and pensions as well as poor administrative structures, the need for pension reform became glaring.

ELEMENTS OF THE NEW CONTRIBUTORY PENSION SCHEME

The key objectives of the new scheme are to:

- 1. Ensure that every person who has worked in either the public or private sector receives his retirement benefits as and when due;**
- 2. Assist improvident individuals by ensuring that they save to cater for their livelihood during old age;**
- 3. Establish a uniform set of rules and regulations for the administration and payment of retirement benefits in both the public and private sectors; and**
- 4. Stem the growth of outstanding pension liabilities.**

The new pension scheme is contributory, fully funded, based on individual accounts that are privately managed by Pension Fund Administrators with the pension funds assets held by Pension Fund Custodians. There will be strict regulation of the process.

Contributory System

Under this system, the employees contribute a minimum of 7.5% of their Basic Salary, Housing and Transport Allowances and 2.5% for the Military. Employers shall contribute 7.5% in the case of the Public Sector and 12.5% in the case of the Military. Employers and employees in the private sector will contribute a minimum of 7.5% each. An Employer may elect to contribute on behalf of the employees such that the total contribution shall not be less than 15% of the Basic Salary, Housing and Transport allowances of the employees.

An Employer is obliged to deduct and remit contributions to a Custodian within 7 days from the day the employee is paid his Salary while the Custodian shall notify the PFA within 24 hours of the receipt of Contribution. Contribution and retirement benefits are tax exempt.

Fully Funded

The contributions are deducted immediately from the salary of the employee and transferred to the relevant retirement savings account. By so doing, the pension funds exist from the onset and payments will be made when due.

Individual Accounts

The employee opens an account to be known as a '**Retirement Savings Account**' in his name with a Pension Fund Administrator of his choice. This individual account belongs to the employee and will remain with him through life. He may change employers or pension fund administrators but the account remains the same. The employee may only withdraw from this account at the age of 50 or upon retirement thereafter. This withdrawal may take the form of:

- A programmed monthly or quarterly withdrawal;
- A purchase of annuity for life through a licensed life insurance company with monthly or quarterly payments; and
- A lump sum from the balance standing to the credit of his retirement savings account: provided that the amount remaining after the lump sum withdrawal shall be sufficient to procure an annuity or fund programmed withdrawals that will produce an amount not less than 50% of his monthly remuneration as at date of his retirement.

With any of the above options, there is an assurance that the pensioner has sufficient funds available to him for his old age. Although many have contended that at the end of the working period, they should be allowed to collect their savings in one lump sum, experience has shown that very few individuals have the discipline to manage funds effectively over a long period of time. The above was considered a better process than to allow the individual withdraw his accumulated savings at once, spend it all and then have no income when he is no longer in a position to work.

Life Insurance Policy

Every employer shall maintain life insurance Policy in favour of an employee for a minimum of three times the annual total emolument of the employee.

Privately Managed: Pension Fund Administrators and Pension Fund Custodians

The new scheme requires pension funds to be privately managed by Pension Fund Administrators (PFAs) and Pension Fund Custodians (PACs).

Pension Fund Administrators (PFAs) have been duly licensed to open retirement savings accounts for employees, invest and manage the pension funds in fixed income securities listed and other instruments as the Commission may from time to time prescribe, maintain books of accounts on all transactions relating to the pension funds managed by it, provide regular information on investment strategy to the employees or beneficiaries and pay retirement benefits to employees in accordance with the provisions of the Act.

Pension Fund Custodians are responsible for the warehousing of the pension fund assets. It is envisaged that at no time will the PFAs hold the pension funds assets. The employer sends the contributions directly to the Custodian, who notifies the PFA of the receipt of the contribution and the PFA subsequently credits the retirement savings account of the employee. The Custodian will execute transactions and undertake activities relating to the administration of pension fund investments upon instructions by the PFA.

ELIGIBILITY FOR THE SCHEME

The law makes it mandatory for all workers in the Public Service of the Federation and the Federal Capital Territory, and workers in the private sector where the total number of employees is 5 or more to join the contributory scheme at commencement.

EXEMPT INDIVIDUALS

Existing pensioners and workers that have 3 years or less to retire are exempted from the scheme. Also, exempted are the categories of persons under Section 291 of the Constitution of the Federal Republic of Nigeria. However, they may join of their own volition. The existing Pensioners are also exempted.

TRANSITIONAL PROVISIONS FOR THE PUBLIC SECTOR

Existing Pensioners

There shall be established Pension Departments under the scheme to continue to administer the affairs of existing pensioners. The National Pension Commission will supervise the Departments. The responsibilities, funds, and assets of the relevant existing pension boards or offices shall be transferred and vested in the respective Departments. It is anticipated that these Departments shall cease to exist after the death of the last pensioner.

Retirement Benefit Bond

This is a bond that will be issued to those who are currently in employment of the Public Service of the Federation and the Federal Capital Territory where the schemes were unfunded, who are not exempted from the new scheme but have worked for a specified number of years, in recognition of their accrued rights under the defunct pension scheme. This bond recognizes government indebtedness to them; however, it is only due and payable when they retire. This is a significant benefit to the Government, as it will not have to furnish immediately the entire funds required to change to the new system, known as Transition Cost. Since Transition Costs are typically huge and in most countries pose as the major hindrance to pension reform, the use of Recognition Bonds goes a long way to allaying a lot of the fears of the workers who are nearing the end of their service. In this circumstance, the use of recognition bonds defers government liabilities and spaces it over a long period.

Retirement Benefits Bond Redemption Fund

A fund known as the Retirement Benefits Bond Redemption Fund is to be established and maintained by the Central Bank of Nigeria. The Federal Government will pay an amount equal to 5% percent of the total monthly wage bill payable to employees in the public service of the Federation and Federal Capital Territory. The total amount in this fund shall be used to redeem any retirement benefit bond issued and payments into this fund shall cease after all retirement benefit bonds have been redeemed.

TRANSITIONAL PROVISIONS FOR THE PRIVATE SECTOR

Private Pension Schemes

Viable pension schemes in the private sector already in existence, shall continue to exist provided that they can demonstrate that they are fully funded at all times with any shortfall to be made up within 90 days; the assets of the company are fully segregated from the pension fund assets; the pension fund assets held by a custodian; and the company has the requisite capacity for the management of pension fund assets. The company must also show that they have managed pension schemes effectively for at least 5 years before the commencement of the new scheme. However, existing members shall have the option to join the new scheme. Where an employee exercises that option, the employer shall compute his retirement benefits to date and such amount will be transferred to his retirement savings account as maintained with a PFA of his choice.

A private pension scheme may retain all its existing investments subject to the regulations, rules and standards established by the Commission.

Any employer managing pension fund assets of N500, 000,000 and above shall apply to the Commission for a licence as a Closed Pension Fund Administrator in order to manage such funds directly or through a wholly owned subsidiary dedicated exclusively to the management of such pension fund assets. On issuance of the licence, the Commission will supervise and regulate the activities of the closed PFA.

Where an employer is managing pension fund assets of less than N500, 000,000 and desires to maintain its existing scheme, such an employer shall have such pension scheme administered by a duly licensed PFA.

NSITF has established and was granted licence to undertake the business of a PFA in accordance with the Provisions of the Act. Contributors under the NSITF Act shall, at least 5 years after the commencement of the Act, select a PFA of their choice for the management of Pension Fund standing to their credit. However, the pension funds and assets held by NSITF shall be transferred to a Custodian. NSITF shall also be supervised and regulated by PenCom.

SAFEGUARDS FOR THE PENSION SCHEME

The importance of safety of the pension fund assets cannot be overemphasized as the success of the pension reform is hinged on the availability of funds to contributors when they retire. Since the pensioner will utilize the fund at the end

of his working life, it becomes imperative that adequate measures be taken for its protection. Consequently, there are a number of stringent provisions contained in the Act with the singular objective of protecting the pension fund assets. The Act embodies a number of checks in order to preserve the pension fund assets. These include:

- **Separation of PFA and Custodian**

Although they both deal with pension fund assets, the functions of the PFA and Custodian are so clearly delineated that it is difficult for either to misuse the pension funds assets to the detriment of the contributor. At no time will the PFA have the custody of contributions of the employee. The contributions go directly from the employer to the Custodian. On the other hand, the Custodian will not invest the pension assets except to the order of the PFA.

- **Pension Fund Custodian Guarantee**

Applicant Custodian shall issue a guarantee to the full sum and value of the pension fund and assets held by it or to be held by it.

- **Government Pension Contribution**

Government contribution shall be a charge on the Consolidated Revenue Fund of the Federation.

- **Risk Rating Institutions**

These are institutions that will be responsible for rating the instruments that pension funds will be invested in. PenCom requires that these risk-rating institutions possess the professional capacity and are licensed to rate the risk of investment instruments.

- **Compliance Officers**

Every PFA shall employ a Compliance Officer who will responsible for ensuring compliance with the provisions of the law regarding pension matters as well as the internal rules and regulations of the particular PFA. They will be required to liaise with PenCom and the Board of Directors of the PFA with regard to the activities of the PFA.

- **Reporting Requirement for PFAs and PFCs**

In order to keep track of their activities, the licensed operators are required to make a regular report of its activities to. PenCom Many consider this an onerous requirement by PenCom but in view of the volume and nature of the funds the PFAs will handle, it becomes necessary to be able to spot any wrongdoing early. Besides this information is expected to be passed on to PenCom electronically and would not constitute a hardship for any fully automated operators.

- **Statutory Reserve Fund**

A PFA shall maintain a Statutory Reserve Fund, which shall be credited annually with 12.5% of the net profit after tax, or such percentage of the net profit as may be stipulated by PenCom to meet claims.

- **Sanctions**

Clear legal and administrative sanctions have been provided for non-compliance with rules and regulations.

- **Public Disclosure of Information**

PFAs and Custodians are required to disclose their rates on return and publish their audited accounts.

BENEFITS

Nigeria stands to benefit from the pension scheme. In the first instance, it addresses the pension liability by stemming its further growth and provides a platform for addressing this liability. Since the individuals own the contributions, the pensioner is no longer at the mercy of government or employer and is assured of regular payment of retirement benefits. Employee has up to date information on his retirement savings account. The scheme allows the contributor the freedom to choose who administers his retirement benefits account and this promotes competition among the PFAs. A major benefit of the scheme to the worker is that the individual accounts are portable and as such, the worker is able to change employment and still maintain the same account. He is merely required to provide the details of his account to the new employer.

The scheme imposes fiscal discipline on the nation and is a solid foundation for economic development. There is an expansion of convertible funds, creation of a huge pool of long term funds and enhanced accountability. The scheme introduces clear legal and administrative sanctions and there is a separation of investment, administration and custody of assets. Transparency is also ensured by the requirements for published rate of returns, regular statements of contributions and earnings and annual audited accounts.

THE NATIONAL PENSION COMMISSION

The Scheme will entail the establishment of a National Pension Commission (PenCom), to regulate, supervise and ensure the effective administration of pension matters in Nigeria. The Commission will achieve the above by ensuring that payment and remittance of contributions are made and beneficiaries of retirement savings accounts are paid when due. **Above all, the Commission will ensure the safety of the pension funds by issuing guidelines for licensing, approving, regulating and monitoring the investment activities of Pension Funds Administrators.**

Under the contributory pension scheme, the National Pension Commission as the regulator of Pension matters shall receive and investigate any complaint of impropriety leveled against any Pension Fund Administrator, Custodian or employer or any of their staff or agents. Basically, PenCom stands as a watchdog, with the overriding objective of ensuring that all pension matters are administered with minimum exposure to fraud and risk. PenCom will employ the use of approved risk rating agencies to determine the viability of an investment instrument.

Governance Structure of PenCom

The Board of Directors is under the Chairmanship of Chief Oluwole Alani Adeosun, OON. The Executive Members of the Board include Mr. M. K. Ahmad (Director General/CEO), Dr. Musa Ibrahim (Commissioner Inspectorate), Miss. Eyamba T. Henshaw (Commissioner Technical), Mr. M. T. Mamman (Commissioner Administration), and Mr. Pius Akubueze (Commissioner Finance & Investment). Mrs. Chinelo Anohu-Amazu is the Commission Secretary/Legal Adviser.

Other members of the Board of Directors representing various stakeholder organisations are Mr. Musa Al-Faki (Director-General, Securities and Exchange Commission), Mr. C. D. Ghali (Representing Director-General, Budget Office),

Mr. P.A.H Ataman (Representing Prof Charles Soludo, Governor of Central Bank of Nigeria), Dr. Sani Teidi Shaibu (Representing Permanent Secretary, Establishment and Pensions, OHSF), Mr. Segun Oshinowo (Director-General, Nigeria Employers Consultative Association), Alhaji Ali Abatcha (President Nigerian Union of Pensioners) and Mr. Ivor Takor (National Treasurer Nigeria Labour Congress).

Activities of PenCom

PenCom commenced operation in December 2004. In accordance with the powers vested on it by the Pension Reform Act 2004, the Commission has evaluated several applications for licences to operate as either Pension Fund Administrators (PFAs) or Pension Fund Custodians (PFCs). So far, twelve (12) PFA licences, four (4) for PFC licences and one (1) for Closed PFA licence have been issued. This has allowed employees that are covered by the new pension scheme to start opening RSAs with the PFAs of their choice.

In exercise of its regulatory role, the Commission has also issued regulations and guidelines for the supervision of the pension industry.

PenCom had compiled and printed copies of 'Frequently Asked Questions' on the Pension Reform in English, Hausa, Yoruba and Igbo. These documents have been circulated all over the country and serialized in 'Gaskiya-Tafi-Kwabo', 'Irohin' and Daily Champion newspapers. The translation in to Pigin English has been concluded. The exercise is intended to educate the general public on the new pension scheme and the role of the Commission as the supervisor and regulator of the scheme. The Commission has conducted sensitization seminars for public and private sectors' employees and employers.

Many State Governments have started to implement the contributory pension scheme. In its efforts to extend the benefits of the pension reform programme to all levels of Government, the Commission had drafted a model 'State Pension Law', which is being made available to State Governments.

NATIONAL PENSION COMMISSION **June, 2008**