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REVIEW ARTICLE

DYNAMICS OF NIGERIAN PENSION REFORMS: THE GATEWAY TOWARDS WORKERS' WELFARE GUARANTEED RETIREMENT

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ABSTRACT

The paper provides an outlook on the development of the contributory workers' retirement pension scheme in Nigeria. Insights were presented into the emergence of pay-as-you-earn retirement benefits scheme, a condition in which final entitlements were based on length of service and terminal emoluments. The payment of pension and gratuities to retiring workforce financed by the government at the outset becomes a burden because there were no fiscal considerations consequent on inadequate management and administration of pension funds for both public and private employees. The new contributory pension scheme tends to uplift pension fund management in Nigeria with obvious benefits for employers, employees, government and the society. The Pension Reform Act 2004 mitigates those risks which can hinder the pension industry's operations as stipulated in the Act for smooth operations of the Pension Fund Administrators.

INTRODUCTION

The privilege of receiving gratuity and pension appears as the manifestation of the victory of Labour in its fight with employers over exploitation. Nigeria's first ever legislative instrument on pension matters was the pension ordinance of 1951 which had retrospective effect from 1st January, 1946. The National Provident Fund (NPF) Scheme established in 1961 was the first legislation enacted to address pension matters of private organizations followed by the Pension Act No. 102 of 1979, and 18 years later, the Armed Forces Pension Act No. 103 The police and other government Agencies' pension scheme were enacted under Pension Act No. 75 of 1987, followed by the Local Government Pension Edict which culminated into the establishment of the Local Government Staff Pension Board of 1987. The National Social Insurance Trust Fund (NSITF) scheme was established in 1993 to replace the defunct NPF scheme to cater for employees in the private sector of the economy against loss of employment income in old age, invalidity or death (Komolafe, 2004; Adegbayi, 2005).

Development of Pension Reforms in Nigeria

Prior to the Pension Reform Act 2004, most public organizations operated a Defined Benefit (pay-as-you-go) Scheme, a condition in which final entitlements were based on length of service and terminal emoluments.

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The Defined Benefit (DB) Scheme was funded by the Federal through budgetary allocation, and administered by pensions Department of the Office of Head of Service of the Federation (Balogun, 2006). The pension scheme became a great burden on the government, as it could no longer cope with the payment of pension and gratuities to retiring workforce. For instance, between 1998 and 2000, pension entitlements increased by about 750% meaning that a pensioner on a monthly allowance of ₦10,000 in 1998 receives about ₦75,000 per month in 2000. These increments in the pension entitlements were done with little or no thoughts to the fiscal consequences which apparently led to inadequacies in managing and administering pension funds, a major challenge to government in Nigeria (Okotoni and Akeredolu, 2005).

In a Pay-As-You-Go system, the Government taxes active workers to pay for the benefits of retired workers. Under this system, retirement benefits are a function of the rate of growth of the tax base, which in turn depends on the rate of growth of the labour force and of real wages per worker, that is, increases in labour productivity. The existing Defined Benefit Pay-As-You- Go (PAYG) pension scheme later became unsustainable with outstanding liabilities nationwide estimated at ₦2 trillion, or approximately 25% of the Gross Domestic Product (GDP). The increase in government spending on pension estimated at 4.8% of the national budget and 1.15% of GDP is not near enough to cover the gap. Yet, pension which guarantees an employee certain comfort in his or her inactive years is critical to the sustenance of life of the individual and the society (Nkanga, 2005).

On the other hand, the private sector operated a combination of defined benefits and defined contribution schemes, most of which took the nature of "resignation", rather than retirement schemes. In some instances, many workers were not covered by any form of retirement benefits arrangement. For the few schemes that existed, they were governed by diverse operational rules and standards and in some cases full of malpractices between the Fund Managers and Trustees of the pension Fund. These scenarios necessitated a paradigm shift to a more sustainable defined contribution pension scheme (Ahmad, 2006). The Federal Government changed the management and administration of pension funds with the enactment of the Pension Reform Act 2004. The Pension Reform Act 2004 introduced the new Contributory Pension Scheme in the public and private sectors. The Act led to the establishment of the National Pension Commission to regulate, supervise and ensure effective administration of pension matters in Nigeria. The Commission ensures payment and remittance of contributions, and that retirement savings of beneficiaries are paid as and when due. The Commission has the mandate of safety of the pension funds by issuing guidelines for licensing, approving, regulating and monitoring the investment activities of Pension Fund Administrator and Custodians (Pension Reform Act, 2004).

The Act established a Contributory Pension Scheme (the Scheme) for the Federal Civil Servants, Employees of the Federal Capital Territory (FCT) and employees of any Private Sector organization with five employees or more. However, existing pensioners and employees who had three years or less to their mandatory retirement as of June 2004 were exempted from the Scheme. Judicial Officers who are covered under Section 291 of the 1999 Constitution of the Federal Republic of Nigeria were also exempted. The Act also instituted a uniform pension scheme for both the Public and the Private Sectors. It established the National Pension Commission (the Commission) as the sole regulatory authority on all pension matters in Nigeria.

The Contributory Pension Scheme

The new Contributory Pension Scheme obliges both employers and employees to contribute a minimum of 7.5% of the total monthly emolument of the employee and the minimum rate of 12.5% contribution from the employer but 2.5% are set out for employees in the military. In all cases, however, the employer may elect to make the whole contribution provided that it would not be less that 15%. The Scheme is also fully funded in the sense that contributions, deducted immediately from the salary of the employees, together with the employers' portion, are transferred to the relevant retirement savings accounts. Adekunle (2008) further observed that such arrangement, the pension funds exist from the onset and payment would be timely as and when due. Pension fund assets are privately managed by Pension Fund Administrators (PFAs), in the custody of Pension Fund Custodians. These private pension operators are licensed, and strictly regulated by the National Pension Commission.

The Pension Reform Act (2004) posits that the objectives of the new Contributory Pension Scheme shall be to:

- ensure that every person who worked in the public service of the Federation, Federal Capital Territory or private sector receives his retirement benefits as and when due;
- assist improvident individuals by ensuring that they save in order to cater for their livelihood during old age;
- establish a uniform set of rules, regulation and standards for the administration and payments of retirement benefits for the public service of the Federation, Federal Capital Territory and the private sector;
- establish a sustainable pension system that empowers employees to have control over their Retirement Saving Accounts (RSA), promotes labour mobility and minimizes incentives for early retirement;
- ensure transparent and efficient management of pension funds; and
- promote wider coverage of pension scheme in Nigeria.

The Contributory Pension Scheme is based on individual accounts. An employee opens a "Retirement Savings Account" (RSA) with a Pension Fund Administrator (PFA) of his choice. The account would remain with him throughout life. Thus, the account becomes very portable as the employee may from time to time change employers or PFA but the account remains the same. The employee may only withdraw from the account at the age of 50 years or upon retirement. This withdrawal may take the form of a programmed periodic withdrawal based on an expected lifespan, or the purchase of annuity that guarantees periodic receipts for life through a licensed life insurance company. There is an assurance that the contributor has sufficient funds available for his/her desired quality of retirement life with these options. The Act compels employers to maintain Group Life Insurance Policy in favour of the employee for a minimum of three times the annual total emolument of the employee. This is expected to provide a cushion for the employee's beneficiaries in the event of death as the proceeds of the policy is payable into the RSA.

Pension Fund Operators

Asset and Resource Management Company (2004) identified that the major features of the pension reform in Nigeria is the requirement that pension funds and assets are to be privately managed. One of the key players under the new arrangement is the Pension Fund Administrator (PFA). A PFA is licensed by the Commission to register contributors and open RSAs for them. In addition, the PFA gives instructions to invest and manage the pension funds, maintain books of account on all transactions relating to the pension funds under its management, provide regular information and other related customer services to the employees or beneficiaries and pay retirement benefits to contributors upon retirement in accordance with the provisions of the Pension Reform Act 2004. Similar to the PFA is the Closed Pension Fund Administrator (CPFA). The Act provides that an employer may apply through a wholly owned subsidiary for a CPFA license to manage its own existing scheme provided the pension fund assets are not less than ₦500million. On issuance of the license, the Commission will supervise and regulate the activities of the CPFA. A CPFA registers and manages the pension fund of only employees of the company.

The other key player in the new Scheme is the Pension Fund Custodian (PFC). A PFC has the responsibility to receive contributions from employers on behalf of PFAs, hold pension funds and assets in safe custody, execute transactions and undertake activities relating to pension fund investments on behalf of the PFA. Thus, the function of warehousing pension fund assets was separated from its management. It is envisaged that at no time would the PFAs hold pension fund assets (Kantudu, 2005).

The National Pension Commission

The Act established the National Pension Commission, to regulate, supervise and ensure the effective administration of pension matters in Nigeria. The Commission, as the regulator of Pension matters, shall approve, license and supervise all pension fund operators as well as establish standards for the management of pension funds. The Commission stands as a watchdog, with the overriding motive of ensuring that all pension matters are administered in a standard way such that all stakeholders are aware of their rights and obligations under the Act.

Transitional Arrangements

In the event of any unfunded public sector scheme, the accrued pension rights (gratuity and pension) for past services prior to the commencement of the Act, are guaranteed and will be actuarially determined for each employee transiting to the new Scheme. The Act provides that a bond known as Federal Government Retirement Bonds shall be issued to such employee to the tune of the accrued pension rights. The Act hence requires the Federal Government to set aside 5% of its total monthly wage bill into a Retirement Benefit Bond Redemption Fund (RBBRF/Redemption Fund) maintained with the Central Bank of Nigeria (CBN). Upon retirement, the retirement bond will be redeemed into the respective RSA of the employee from the proceeds of the Redemption Fund. Payment by the Federal Government into the Redemption Fund will cease after the entire retirement bond issued have been claimed (Adegbayi, 2005).

An employer may apply to the Commission to continue with its existing pension scheme provided that it meets certain conditions among which are to demonstrate that the scheme is fully funded at all times and any shortfall to be made up within 90 days; that assets of the pension fund are fully segregated from the company's assets; that pension fund assets shall be held by a custodian; that the employer has the requisite managerial capacity for the management of pension fund assets, amidst other stipulated requirements before it licenses existing schemes.

Summary and Conclusion

The new contributory pension scheme is obviously a new dawn for pension fund management in Nigeria with obvious benefits for employers, employees, government and the society. The Pension Reform Act 2004 recognized several risks can hinder the pension industry's operations which necessitated the introductions of various mitigation actions that the Act stipulated in the operation of the Pension Fund Administrators. Hopefully, if all rules and regulations for the investments of the pension fund Administration (PFAs)'s Assets are applied to the letters, huge success can be guaranteed in the management of public and private retirees savings benefits. The objective of the new contributory pension scheme will be devoid all moral risks.

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