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PENSIONS REFORM IN NIGERIA: A COMPARISON BETWEEN THE OLD AND NEW SCHEME

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Abstract

The history of the Nigerian Pensions administration dates back to the 1950s.The Pension Reforms Act of 2004 brought into limelight the new pension scheme in Nigeria which is a defined contributory scheme unlike the old scheme which was largely defined benefits. Although the new scheme is being adjudged to be better than the old scheme in that it is expected to help remedy the deficiencies and inadequacies prevalent in the old scheme, it is advocated that only proper coordination, supervision and regulation of the pension industry in Nigeria will make to happen.

Key words: Pension, pension scheme, retirement benefits, pension fund administrators

Introduction

The issue of pension has received much attention in many countries over the past decades. In fact, in recent times, pension has increasingly attracted the attention of policy makers in many countries as a means of facilitating privately funded retirement income savings by an ageing workforce (World Bank, 1994).Many countries have opted for various forms of contributory pension scheme where employers and their employees are supposed to pay a certain percentage of the employee’s monthly earnings to a retirement savings accounts from which they would be drawing their pension benefits after retirement. Besides pension funds are now among the most important institutional investment in the world capital markets (Klumpes and Mason, 2000). Nigeria adopted for the contributory pension scheme following her pensions reform in 2004.

Pension is the amount paid by government or company to an employee after working for some specific period of time, considered too old or ill to work or have reached the statutory age of retirement. It is monthly sum paid to a retired officer until death because the officer has worked with the organization paying the sum (Adam, 2005:468). Pension is also the method whereby a person pays into pension scheme a proportion of his earnings during his working life. The contributions provide an income (or pension) on retirement that is treated as earned income .This is taxed at the investors' marginal rate of income tax. On the other hand, gratuity is a lump sum of money payable to a retiring officer who has served for a minimum period of term year (now five years with effect from 1/6/92). A greater importance has been given to pension and gratuity by employers because of the belief that if employees' future needs are guaranteed, their fears ameliorated and properly taken care of, they will be more motivated to contribute positively to organization's output. Similarly various governments' organizations as well as labour union have emphasized the need for sound, good and workable pension scheme (Adebayo, 2006, Rabelo, 2002).

The objective of this paper is to consider the pension scheme in Nigeria by comparing the old scheme with the new pension scheme which came into existence through the Pension Reforms Act of 2004.The first part of the paper considers a brief history of the pension system in Nigeria. Thereafter, the problems and characteristic features associated with the old pension scheme is examined. In the next section, the Pension Reform Act of 2004 is explored in great detail by looking at some of the provisions. The last section compares the old and the new pension scheme.

History of the Nigerian Pension Industry

One of the oldest documents to discuss social support was the Code of Hammurability by King Hammurabus of Babylon in the 18th century (Momoh and Idomeh ,2008). For instance, the code defined the rights of evildoers and orphans to the estates of their relations. According to Bloom (2005), one of the first publicly financed social security systems was developed in the late 16th century in England from a series of legislature Acts known as "poor laws". Under these laws, local governments built large alms-house facilities that housed the people too old or unfit for work. Poor laws also established work houses and facilitated public housing for the employed. Moreover, these laws gave rise to the social insurance in Europe and social security in the United States (Momoh and Idomeh , 2008)

The pension system was introduced into Nigeria by the Colonial Administration. The first legislative document on pension in Nigeria was the 1951 Pension Ordinance which has retroactive effect from January 1, 1946. The Ordinance provided public servants with both pension and gratuity (Ahmed, 2006). The National Provident Fund (NPF) scheme established in 1961 was the first legislation to address pension matters of private organizations in Nigeria. This was the first social protection scheme for the non-pensionable private sector employees in Nigeria. It was mainly a saving scheme where both employee and employer contributed the sum of N4 each on monthly basis. The scheme provided for only one-off lump sum benefit (Ahmad, 2006).

The NPF was followed by Armed Forces Pension Acts No 103 also of 1972 and by the Pension Acts No. 102 of 1979, 18 years later .The Pension Acts N 102 of 1976 which commenced on 1st April, 1974 encompassed the recommendation of Udoji Commission which included all consolidated enactments and circulars on pension as well as repealing existing 113 pension laws hitherto in force. Other Pension Acts included: Pension Rights of Judges Act No 5 of 1985, the Police and other Government Agencies Pension Scheme enacted under Pension Acts No.75 of 1987 and the Local Government Pension edict which culminated in the setting of the Local Government Staff Pension Board of 1987.

In 1993, the National Social Insurance Trust Fund (NSITF) scheme was set up by Decree No. 73 of 1993 to replace the defunct NPF scheme with effect from 1st July 1994 to cater for employees in private sector of the economy against laws of employment men in old age, invalidity or death (Balogun, 2006). In 1997, parastatals were allowed to have individual pension arrangements for their staff and appoint Boards of Trustees (BOT) to administer their pension plans as specified in the Standard Trust Deed and Rules prepared by the Office of Head of Service of the Federation. Each BOT was free to decide on whether to mention an insured scheme or self-administered arrangement. It must be recall that the first private sector pension scheme in Nigeria set up for the employees of the Nigerian Breweries was in 1954.The United African Company (UAC) scheme followed in 1957.

The Chilean Model – the wrong Imitation by Nigeria

Dostal and Cassey (2007) argued that the Nigerian Authority saw the Chilean reforms (Chilean model) to be emulated and copied. But she failed to learn the lessons of Chile. In fact, at the time Nigeria was coping, Chile was preparing for an alternative social pension scheme. Again while the Nigerian government was beginning to give serious attention to pension reform (using the Chilean model) in early 2005 the Chilean model was being criticized by supporters of the scheme and the World Bank had come to conclude that the Chilean reform model has not delivered the benefits that it was set out for from the beginning because of the too many assumptions made. Therefore, it was advocated that to realize the claims, other reforms were also required to complement or precede pension reforms (Gill, Packard and Yermo, 2005, Holz and Hinz, 2005, World Bank 2005).

Similarly, the Chilean government announced wide-ranging changes to the pension provision since 2006, placing greater emphasis on solidarity and tax financing and higher controls on the operations of the individual accounts to which employees are subscribed (Gobierno de Chile, 2000). Again the World Bank has claimed that it advised against the establishment of a "multi-pillar system" in Nigeria on the grounds that the financial sector was insufficiently developed (World Bank, 2005). Notwithstanding the reforms undertaken in Nigeria was radical, involving the setting of a new basis for determining pensions and the establishment of new delivery structures.

Divisions of the Pension Scheme

Pension scheme is broadly divided into the defined contribution plan and the defined benefits plan. In defined contribution plan, a contribution rate is fixed. For instance, in Nigeria an employee contributes 7.5% of his monthly emolument while the employer also contributes same amount or more depending on the category of employee. The retirement benefit is variable depending on the performance of the investment selected. In defined benefit plan, the retirement benefits is stipulated usually as a percentage of average salary, but the contribution will vary according to the percentage of the average compensation a participant receives during his or her three earning years under the plan (Owojori, 2008).

Basically, the two pension plans create very different investment problems for the plan sponsors. While the defined benefit plan creates a liability pattern that must be anticipated and funded, the defined contribution plan creates a liability only as long as there is investment at any point in time. Investment is often left to the people who benefits from the decision or suffers from the consequences (Anthony and Bubble, 1997:575).

Problems with the Old Pension Scheme

A major problem of the pension fund administration in Nigeria was the non-payment or delay in the payment of pension and gratuity by the Federal and State governments. For instance, the pension backlog was put at about N2.56 trillion as at December, 2005. In fact, pension fund administration became a thorny issue with millions of retired Nigerian workers living in abject poverty and they were often neglected and not properly cater for after retirement (Orifowomo, 2006). Sadly, retirees went through tough times and rigorous processes before they were eventually paid their pensions, gratuity and other retirement benefits. At one time the money to pay their benefits is not available; and at another time, the Pension Fund Administrators were not there to meet the retirees' needs.

Basically, the old scheme has been beset with a lot of challenges and problems. Besides the aforementioned; other problems were: demographic challenges and funding of outstanding pensions and gratuities, merging of service for the purpose of computing retirement benefits. These problems coupled with the administrative bottlenecks, bureaucracies, corrupt tendencies and inefficiencies of the civil service, and the economic downturn have resulted in erratic and the non-payment of terminal benefits as at when due (Orifowomo, 2006; Ezeala, 2007, Abade, 2004). Other problems were: gross abuse of pensioners and pension fund benefits which were politically motivated in some cases, extended family and other traditional ways already broken down due to urbanization and increased labour and human mobility. Moreover, considering Statement of Accounting Standard (SAS) No. 8 "on accounting for employees' retirement benefits" the problems of the old pension scheme which led to the pensions reforms of 2004 include: wrong investment decision, wrong assessment of pension liabilities, arbitrary increases in pension without corresponding funding arrangements, non-preservation of benefits, some were mere saving schemes and not pension schemes, and serious structural problems of non- payment and non-coverage. There was no adequate safeguard of the funds to guarantee prompt pension and other benefits payments to retirees.

The old scheme was characteristically defined benefits, unfunded mostly pay as you go, discriminatory and not portable. The employee was not entitled to pension benefits if he is dismissed from service. Also there was no adequate provision to secure the pension fund. Following the unsatisfying nature of the old scheme, the unpleasant experiences face by retirees and pensioners and the huge pension liabilities, it became apparent the need for reform and change. Therefore, the need for the Federal Government to guarantee workers' contributions and accruing interest in the event of failure of the PFA was advocated. Besides, it was estimated that over N600 billion ($4.5 billion) investible assets could be amassed annually through the pension scheme in Nigeria. Hence, the government could not only pay the retirement benefits as they become due but also utilize the saved pension fund for long-term development purposes.

The New Pensions Reform Act of 2004

The Pensions Reform Act (PRA) of 2004 is the most recent legislation of the Federal Government of Nigeria which is aimed at reforming the pensions system in the country. It encompasses employees in both the public and private sectors. The PRA of 2004 came into being with a view to reducing the difficulties encountered by retirees in Nigeria under the old pension scheme. It is believed that the new scheme will: guarantee the prompt payment of pensions to retirees, eliminate queues of aged pensioners standing hours and days in the sun to collect their pensions and also increase their standard of living. But the fear is whether the programme will actualize the set objectives by the "power and people that be" when we call to remembrance the abysmal failure of the National Housing Fund which was set up by Decree No3 of 1993. Nevertheless, before the enactment of the PRA of 2004, the three regulations in Nigerian pension industry were: Securities and Exchange Commission (SEC), National Insurance Commission (NAICOM) and the Joint Tax Broad (JTB).The new scheme is regulated and supervised by the National Pension Commission. The Commission has the power to formulate, direct and oversee the overall policy on pension matters in Nigeria. It also establishes standards, rules and regulations for the management of the pension funds .It approves, licenses , sanctions and promotes capacity building and institutional strengthening of the PFA and PFCS

Objectives of the New Pension Scheme

The objectives of the Scheme according to Section 2, Part 1 of the PRA of 2004 include to:

- Ensure that every person who worked in either the public service of the federation, federal capital territory or private sector receives his retirement benefits as and where due.
- Assist improvident individuals by ensuring that they save in order to cater for their livelihood during the old age.
- Establish a uniform set of rules, regulations and standards for the administration and payment of retirement benefits for the public service of the federation, federal capital territory or private sector.
- Stem the growth of outstanding pension liabilities.
- Secure compliance and promote wider coverage.

It is envisaged that the various reforms measures put in place, which also clearly spelt out in the objectives of the new PRA of 2004 , would be able to remedy the situation by adequately tackling the difficulties in the old scheme by being adequate, affordable, sustainable and robust (Balogun,2006). It must also prevent old-age poverty and able to smoothen life-time consumption for the vast majority of the population. It must be able to withstand major shocks including economic, demographic and political volatility. Ahmad (2008) remarked that as part of the implementation efforts increased registration of contributions in public and private sector, membership of Contributory Pension Fund Administrators (CPFAs) and Custodians (CPFCs), growth in total Pension Fund assets to about $6.08billion in December, 2007.

Types of Pension Reform Options

There are two broad types: parametric and the systematic pension reforms. Parametric reforms involves adjustments to the parameters of the pension system such as retirement age, contribution rate etc. These adjustments which may be ad hoc or discretionary tend to create uncertainty and problem in the system (Rabolin, 2005). On the other hand, systematic reform involves a complete shift in the pension systems by a country for example from say, defined benefit system to the defined contributory system or social pension or voluntary pension scheme. Systematic reform could be single-pillar or multi-pillars depending on the contribution of the various systems, e.g Nigeria (2004), Chile (1980), Argentina (1994) but it reversed later in 2007.

Basically, Nigeria embarked on a multi-pillars, systematic pension reform changing completely from the defined benefit to the defined contributory scheme. It has an individual's Retirement Savings Accounts (RSA), valued arrangement taking various forms (individuals, employer sponsored, defined benefit and defined contributory) which are flexible and discretionary in nature and informed intra-family or inter-generational sources of both financial and non-financial support to the elderly, including adequate health care (Holzmnann and Hinz, 2005).

Other key options in the new pension scheme

1. Nature of the scheme: The new pension scheme is a contributory pension scheme (Section 1 Part of PRA 2004). For the payment of retirement benefits of employees who are eligible under the scheme.
2. Rate of contribution: Section 9 (1) specifies the contribution by the individual and the employer as follows:
    (a) In the case of public service of the Federation and the Federal Capital Territory a minimum of 7.5% by the employer and a minimum of 7.5% by the employee.

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(b) In the case of the military, a minimum of 12.5% by the employer and a minimum of 2.5% by the employee.

(c) In other cases, a minimum of 7.5% by the employer and a minimum of 7.5% by the employee.

However an employer could bear full burden of the scheme provided. Section 11(5) empowers the employer to deduct at source the monthly contribution of the employee in his employment and remit the said amount not later than 7 working days from the day the employee’s salary is paid to the custodian specified by the Pension Fund Administrator (PFA). The PFC is to notify the PFA to credit the employee’s revenue savings account. There is 2% of total contribution fine on any employer who defaults for each month. The government contribution to the pension of public service employees of the Federation and FCT shall be a charge of the Consolidated Revenue Fund (CRF) of the Federation (Section 11(8)). The revision of the rate of contribution shall be agreement between the employer and the employee.

3. To encourage the employee, the contribution to the new scheme is to be part of tax deductable expense in the computation of the tax payable by the employee.

4. Retirement Bond Redemption Fund (RBRF) : Section 29 (1) of the Acts empowers the CBN to establish, invest and manage the RBRF for the Federal public service and the FCT. The Federal Government was to pay into the fund an equal amount of 5% of the total monthly wage bill payable to employee and the public service of the federation and the FCT. The Redemption fund account was to be used by the CBN to redeem any bond issue in respect of accrued retirement benefit (Section 29 (3)).

5. Management and Custodian of Pension Assets: Unlike the old scheme, the Act specifies an institutional framework for the proper management and custodian the pension assets –mainly based on the key principle of “ring fencing” to ensure effectiveness and effect in the administration by all those concerned. First, the Pension Fund Administrators (PFA) opens and administers the RSA

for the employee in liaison with PENCOM and appoint the pension fund custodian (PFC). They manage the pension fund assets and administer

6. Retirement benefits. On the other hand, the PFCs receive the total contributions and hold pension fund assets in safe custody on trust for the employees and beneficiates of the retirement benefits. They also execute transactions and undertake other related activates on behalf of PFA (Section 44-47, 59) .Both of them were to keep proper books of accounts and submit audited financial accounts not later then four months (120 days) from the end of the financial year (Sections 56 &57) to PENCOM.

Allowance was also given for closed pension fund administration whereby organizations manage existing scheme for employees in their outfits. There were heavy sanctions for default (Section 64) by them. Only the Pension Commission was to regulate, and suspense the scheme; direct overall pension policy matters, approve, license and supervise the PFA, PFC and other institutions relate to pension for maximum compliance. It has been argued that a two-tier system of the PFA and PFC was adopted to safeguard the fund, and their function interlock to act as a grid against financial impropriety. Nevertheless since both parties assume joint trust positions, an incidence of financial impudence is reduced but cannot be totally rule out.

Others checks include (1) PFC guarantee (2) strict intense supervision (3) Rigorous licensing procedures (4) Auditor report to PENCOM.

Investment of Pension Fund

The main concern of the new pension scheme is safety of the fund and the maintenance of fair returns on the amount invested (Section 72). The need for safety is emphasized in determining the quality of the instrument to invest in and a PFA is expected to adopt a risk management profile in making investment decisions with due regard to the credit rating of companies registered under the investment and Securities Acts of 1999. PFA was expected to appoint risk management and investment strategy committees. The risk management committee determines the risk profile of investment portfolio and ensures adequate internal control measures and procedures. The investment strategy committee determines the portfolio mix consistent with the risk profile, evaluate and review the performance of investment on periodic basis.

Against the guaranteed structure, the PFA is to invest in the any of the following as specified by Section 73(1):

(a) Bonds, bills and the securities issued by Federal Government or the Central Bank of Nigeria

(b) Bonds, debenture, redeemable preference shares and other debt instruments issued by listed corporate entities in Nigeria.

(c) Ordinary shares of public limited companies listed on the Nigerian Stock Exchange.

(d) Bank deposits and securities

(e) Investment certificates of closed-end investment fund or hybrid investment fund

(f) Quoted unitized investment (i) Bond and other debt securities issued by listed companies (ii) Real estate investment (iii) Other investments prescribed by the pension commission

However, the PFA shall not:

(a) sell pension fund asset to: (i) itself (ii) any shareholders director or affiliates of the PFA (iii) any employee of the PFA (iv) Either of 1-3 or those related to them (v) affiliates of any shareholders of the PFA (vi) the PFC.

(b) Purchase any pension fund assets and

(c) Apply pension fund assets under its management by ways of loans or credits as collaterals for any loan taken by any PFA.

However, due to the impact of the global financial crisis on the Nigerian capital market in 2008 , there were fears on how to invest over N700 billion pension funds on equity shares in the Nigerian Capital market because of the effects of institutional shareholdings and the global meltdown eroding such investments overnight (Daleng,2006, Ahmad, 2008).

Transitional Challenges in the New Pension Scheme

According to Admad (2008a), the transitional challenges in the new pension scheme include:

1. Knowledge gap and general misconceptions

2. Widening the coverage in the informed and private sector, many of the SMEs, private, small business are not yet to buy the idea
3. Securing system wide buy- in and initial reluctance from employees for register with PFAs.
4. Capacity building in the new pension industry.
5. Quantifying and transferring legacy funds and asset managed by employees, insurance companies and pension managers.

Balogun (2006) pointed to other areas which require further strengthening in order to make the new pension scheme effective and efficient to include:

1. Durability pension for employees who sustain minor or permanent injury/disability in the course of their duties.

2. In respect of section 71 (1) of the PRA, relevant guideline stipulated in the number of years an RSA holder is expected to contribute to be qualified for the Minimum Guarantee Pension (MGP).

3. The full involvement of state and local government in the new contribution pension scheme to include the large number of public sector employees currently not within PRA of 2004.

4. Enrichment and adequate funding of the data base by PENCOM.

Prospects of the Defined Contribution Scheme

Admad (2008a) rekindles some of the prospects of the defined contributory scheme to include:

1. Intensified Public Education & Enlightenment
2. Strong Support from and collaboration with stakeholders especially social.
3. Consistent support and strong political will from the executive and legislative arms of government.
4. Federal Government of Nigeria had consistently and religiously met her obligation to the pensions fund contribution.
5. Gradual adoption of the new scheme by other tier of government especially state government
6. Major corporations and institutions have bought idea of the new scheme

7. Consistent macroeconomic stability to downtrend in inflation
8. Relatively strong enforcement power of PENCOM.
9. PENCOM's effort to build capacity in the areas of risk management, supervision, corporate governance and information technology. However, Ahmad (2008b) argues that corporate governance in the pension industry in Nigeria is still being faced with a lot of challenges notwithstanding the efforts of the Commission. These challenges include: history of bad corporate governance by people in many organizations, inappropriate and adequate sanction for breaches, the "tyranny and immunity "of management, re-defining the roles of the external auditor and self regulatory organizations (SROs) under the PRA of 2004 to make them culpable on concealing breaches, possible conflicts of interest arising from PFA participation in companies' boards following fears that they might become major investors and be elected to boards and disclosure of confidential information. However, necessary economic, political and institutional framework must be put in place to support and enforce good corporate governance.
10. Development of a comprehensive accounting standards for retirement benefits

Table 1

Comparison between the Old and New pension scheme

Characteristics	**Old Scheme**	**New Scheme**
1. Type	Largely defined benefit	Defined contribution
2. Funding	Mostly unfunded and pay as you go (PAYG)	Contributory and fully funded
3. Membership	Voluntary in private sector	Mandatory for all employees in public and private sector except pensioners and those with 3 years to retire
4. Pension portability	Not portable	Personalized and very profitable
5. Management	Largely State and management union	Private sector and individual choice
6. Retirement benefit	Discriminatory	Uniform application
7. Supervision	Fragmented and unregulated (SEC, NAICOM and JTB)	Strictly regulated by PENCOM.
8. Pension liability	Implicit and not transparent	Explicit through retirement bond and capped
9. Tax exemption	Limited	Contribution and retirement benefits
10. Insurance policy	Voluntary and mostly in private sectors	i) Mandatory for all employers ii) Three times the employees emolument
11. Dismissal from service	No pension benefits	Full pension rights
12. Collateral for loans	Benefits could be used as collaterals	Benefits cannot be used as collaterals
13. Deductions from benefits	Benefits can be subjected to deductions especially employers in any financial obligations in the employee.	Contents of RSA can be used for payment of retirement benefits only.
14. Claiming retirement benefits	Cumbersome	Straight forward
15. Minimum service years	Generally 5 years for gratuity & 10 years for pensions	Month of employment for all benefits subjects to minimum age
16. Gratuity	Provided to those qualified	Provision for lump sum withdrawal
17. Risk Management	No provision	Adequate provision

Source: Admad, M.K. (2008a)

Comparing Between the Old and New Pension Scheme

A comparison of the old and new pension shows some remarkable difference between them as shown in table 1. For instance, starting from the type of scheme, funding, membership to risk management of the pension fund, the new scheme seems to be broader, inclusive and more adequately provided for. While the old pension scheme was largely defined benefits and unfunded, the new scheme is defined contribution and fully funded. The new scheme is very portable and enjoys uniform application unlike the old which was not. In fact, employees who leave one employment for another or even dismiss from service have no fear of losing entirely their pensions or other retirement benefits under the new pension scheme. The regulation and supervision of the new scheme is by PENCOM whereas the SEC, NAICOM and JTB were jointly responsible for the old scheme.

Akeni (2009) made a comparison of nine items in the old and new scheme by conducting a survey of the pension fund administrators, pension fund custodians and the beneficiaries in the public and private sector. He found that the new scheme was better that the old in terms of : accountability, accessibility, ease of payment of pension and gratuity, funding, management of pension fund, transparency, stakeholders' confidence in the scheme, auditor's control and corporate governance . Although there was agreement that the new scheme was applauded as far better than the old , he discovered that the new scheme may not address the difficulties currently encountered in the pension industry in Nigeria nor impact positive or the standard of living of retirees and pensioners unless there were proper coordination and supervision by the Nigerian Pension Commission of the pension fund administrators and custodians.

Therefore PENCOM must undertake periodic review of the investment guidelines of pension fund and create conductive environment for smooth operations by the pension fund administrators and custodians. It must ensure that the administrators and custodians abide by the rules of the pension game in order to ensure their efficient and effective performance. The public must be regularly enlightened and adequately keep abreast of development in the pension industry by the Commission and the administrators. The government must also continuously monitor the operations of PENCOM and conduct external checks to get rid of excesses.

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