

THE GOOD, THE BAD AND THE UGLY SIDES OF NIGERIA'S NEW PENSION REGIME

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Faced with an estimated ₦2trillion public sector pension deficit, arbitrary increase in pensions due to poor administrative structures, near absence of an effective financial security system for old retirees and the weakening of the extended family support system due to urbanisation and increased mobility, the Government of Nigeria has had to radically reform pensions administration in Nigeria through the instrumentality of the Pension Reform Act (PRA) 2004.

The scheme of the *PRA* is to establish a compulsory contributory pension scheme with the aim of:²

- i. ensuring that workers in the public service and private sector receive their retirement benefits as and when due;³
- ii. assisting improvident individuals to save for old age;
- iii. establishing a uniform set of rules, regulations and standards for the administration and payment of retirement benefits for both the public and private sectors;⁴ and
- iv. stem the growth of outstanding pension liabilities.

The PRA which came into operation on June 25 2004⁵ has been greeted with mixed feelings. This article attempts to highlight what may be described as the good, the bad and the ugly aspects of the new regime under the PRA.

The Good Aspects of the PRA

A lot can be said about the positive effects the PRA will have, on a long term, in the lives of Nigerian workers in both the public and private sector. Some of the good features of the contributory pension scheme will be dealt with *anon.*

More Workers to Enjoy Pension

1. More workers, especially those in the private sector who hitherto did not have any pension or provident fund scheme or a retirement benefit plan, will have the opportunity of enjoying some modicum of pension on retirement. The guaranty stems from Section 1 of the Act

which provides that there *shall be* established for every employment in the Federal Republic of Nigeria a Contributory Pension Scheme for payment of retirement benefits of employees to whom the scheme applies under the Act i.e. all employees in the Federal Public Sector⁶ and those in organizations in the Private Sector with 5 or more employees.⁷

Indeed, the PRA permits any person not ordinarily covered under Section 1 or exempted under Section 8 to make voluntary contributions under the scheme.⁸

Employer and Employee to Contribute to the Pension Fund

2. Both the employer and employee will make contributions to the pension. Whereas employers and employee jointly funded majority of the pension and provident fund schemes in the private sector, the government solely funded public sector pension schemes [*on a pay as you go basis*] and this burden had become excruciating and unsustainable for the government.

Under the new dispensation, every employee shall maintain a Retirement Savings Account (RSA) with a Pension Fund Administrator (PFA) of his choice⁹ and notify his employer with particulars of the account¹⁰ in order to facilitate regular payments into the account by the employer of the employee's monthly contributions¹¹ deductible at source from the employee's salary.¹²

To fully secure the pensions of employees in the federal public service, the PRA stipulates that Federal Government's contribution to the pension of its employees shall be a charge on the consolidated revenue fund of the federation.¹³

Apart from the monthly contributions that an employer is required to make to the Scheme, the PRA also requires the employer to maintain a life insurance policy in favour of each employee, for a minimum

insured amount of three times the total annual emoluments of the employee.¹⁴ Upon the employee's death, his/her entitlements under the life policy would be paid into his/her RSA.¹⁵

Contributions made to the Scheme by both the employer and employees constitute tax deductible expenses for the purposes of computing both the employer's and employees' respective income taxes.

Restriction on the Employee's Right to Withdraw from the Funds

3. In order to avoid dissipation of the funds prematurely and to ensure that a reasonable amount of savings is made, the employee's rights to the funds in the Retirement Savings Account are seriously circumscribed and curtailed. The employee cannot have access¹⁶ or make any withdrawal from the account until he has attained the age of 50.¹⁷ If he retires before that age he would still be unable to gain access to the funds in the Retirement Savings Account unless he is no longer mentally and physically capable of carrying out the functions of his office or he has suffered total or permanent mental or physical disability.¹⁸

Restrictions on Utilization of Retirement Benefits

4. The PRA imposes restrictions on the utilization of the retirement benefits and further prescribes the manner in which the amount standing to the credit of the employee may be utilised on retirement or attainment of the age of 50, whichever is later.¹⁹ This is perhaps intended to ensure that the funds saved would be available for the employee for some years after retirement so as to maintain a reasonable lifestyle not too far below the standard he was accustomed to while in service.

Under the new regime, employees will utilize their pension funds in any of the following ways:

- i. monthly or quarterly withdrawals calculated on the basis of an expected life span;
- ii. purchase of annuity for life with monthly or quarterly payments;

- iii. a lump sum withdrawal provided that the amount left shall be sufficient to procure an annuity or fund programmed withdrawals that will produce an amount not less than 50% of the employee's annual remuneration; and
- iv. in the case of an employee retiring in accordance with the terms of his contract, he may withdraw a lump sum not exceeding 25% of the amount standing to his credit. The withdrawal will only be allowed if the request is made after six months of retirement and the employee has not secured another employment during that period.²⁰

Right to Convert Existing Schemes into Contributory Pension Scheme

- 5. Existing Pension Schemes, including provident fund schemes operated in the private sector not wound up before the coming into force of the PRA will be transmuted into a contributory pension scheme under the Act. The Act recognises such schemes and provides guidance on how to treat or deal with them in conformity with the Act.²¹

By virtue of *Sections 12(1)(b) and 39(1)(a)(e)* of the Act, such a Scheme may continue as a fully funded one, in which case contributions in favour of each employee together with attributable income shall be computed and credited to a Retirement Savings Account opened for the employee with any pension fund administrator of the employee's choice.

In the case of employees in the federal public service where the scheme is not funded, the Central Bank of Nigeria shall acknowledge the right to retirement benefit through the issuance of Federal Government Retirement Bonds in favour of the employees. The bonds shall be redeemed upon retirement of the employee. The amount redeemed shall be added to the amount standing to the credit of the employee in his retirement savings account.

Likewise, the funds contributed by certain private sector employees to the National Social Insurance Trust Fund (NSITF) prior to the PRA shall be computed and credited into the respective retirement savings accounts to be opened by the NSITF for each beneficiary.²²

Employer May Be Licensed As Closed Pension Fund Administrator

6. Where the employees decide to continue with an existing contributory pension scheme, the employer may apply to the National Pension Commission²³ to manage, either directly or through a wholly owned subsidiary, the pension funds as a closed pension fund administrator.²⁴ The employer need to be licensed as a pension fund administrator²⁵ because the Act makes it mandatory that pension funds shall only be managed by pension fund administrators licensed by the Commission.²⁶ It is noteworthy that only one closed pension fund administrator set up by a multinational oil company (Shell) was licensed in the last licensing round.

In such an event, the Act stipulates that the employer shall transfer all its pension funds and assets to a pension fund custodian²⁷ of its choice.²⁸

Pension Funds to be Professionally Managed by Private Sector

7. Pension fund assets are to be privately managed [*without government interference*] and invested by professional pension fund managers while private companies licensed as pension fund custodians will have custody of the pension funds and assets. The PRA has laid down strict rules and guidelines to regulate the activities of pension fund administrators and custodians of pension funds and most importantly separate the manager of the pension funds and assets (which are the PFAs) from the holder of the funds and assets (the PFCs).

Pension Funds Administrators and Custodians have obligations under the PRA to:

- i. act in the best interest of the employees;²⁹

- ii. report to the Commission any unusual occurrence with respect to the funds which could adversely affect the rights of the owner;³⁰
- iii. report to the Commission if an employer has defaulted in making remittances for more than 14 days;³¹
- iv. report to the Commission monthly the occurrence of any fraud, forgery, or theft in its organization and the name of any staff dismissed or terminated as a result;³²
- v. the custodian shall maintain all pension funds and assets in its custody to the exclusive order of the pension fund administrator;³³
- vi. the custodian shall not utilize any pension fund or asset in its custody to meet its own financial obligation.³⁴

To ensure the credibility of the scheme and check the excesses of the operators, PENCOM has come out with a Regulation on Investment of Pension Assets. Some of the highlights of the Regulations are as follows:

- i. the pension fund custodian shall maintain all pension funds and assets in its custody to the exclusive order of the pension fund administrator;
- ii. the pension fund custodian can only take instructions from the pension fund administrator regarding the investment and management of the Pension Fund Assets.
- iii. the pension fund administrators cannot contract out their duties to wit investment and management of the Pension Fund Assets to third parties, neither can the pension fund custodians give the custody of the Pension Fund Assets to third parties.

Pension Funds to be Invested to Yield Returns

- 8. Part IX of the Act sets out the nature of investments which a pension funds administrator may make with its pension funds and it appears that the overriding objective of the investment should be maintenance of fair returns on any amount invested. The administrator is permitted to invest the funds in:

- i. bonds, bills and other securities issued or guaranteed by the Federal Government and the Central Bank of Nigeria;
- ii. bonds, debentures, redeemable preference shares and other debt instruments issued by the corporate bodies listed on the Nigerian Stock Exchange and registered under the Investment and Securities Act 1999;
- iii. ordinary shares of public companies listed on the Nigerian Stock Exchange and registered under the Investment and Securities Act 1999 with good track records having declared and paid dividends in the preceding five years;
- iv. bank deposits and securities;
- v. investment certificates of closed – end investment funds or specialist open-end investment funds listed on the stock exchange;
- vi. real estate investment; etc.

In this regard, the Regulation on Investment of Pension Assets³⁵ stipulates that PFAs shall not trade in financial instruments with the Pension Funds Assets at a price lower than the market price of the instrument.

The Regulations on Investment also provide for limitations i.e. the extent to which the PFAs can invest in a particular sector in its fifth Clause as well as the Schedule to the Regulation. The Regulation on Investment goes further to provide that existing investment which runs contrary to the provisions of the PRA and the Regulation itself may continue to exist, subject to further directives as may be prescribed by PENCOM.

Pension Fund Administrators are prohibited from investing the funds in the shares or any other security issued by itself or a Pension Fund Custodian, or a shareholder, director, affiliate, employee or spouse, of an administrator or custodian. The administrator is further restrained from applying pension fund assets under its management by way of loans and credits or as collateral for any loan taken by any person.³⁶ In

the same vein, PFAs are prohibited from purchasing or selling the Pension Funds Assets to itself, its shareholders, directors, affiliates, employees, their spouses, affiliates of the shareholders and the PFC holding the Pension Funds Assets.

Pension Funds and Pension Assets are Fully Protected

9. Pension of funds and pension assets kept with a pension fund custodian are fully protected in the event of liquidation of the custodian. Under no account will the funds or assets be attached or be subject to execution of a judgment debt by the creditors of the custodian. Such funds and assets shall be transferred to another custodian.³⁷

Prescribed fees for the PFAs, PFCs and PENCOT.

10. To guard against arbitrary and excessive charges by operators, pursuant to section 70 (1) of the PRA which provides that the fees, charges, costs and transactional expenses incurred by the pension funds administrators are to be deducted from the income earned from investment of pension funds, the PENCOT has come up with a Regulation on Fee Structure³⁸ stipulating the maximum amounts chargeable by PFAs, PFCs, and PENCOT for services rendered.

This Regulation will bestow a higher degree of credibility on the new pension scheme as the PFAs, PFCs, and the National Pension Commission cannot charge any fees outside those stipulated by the Regulation; neither can these institutions charge an amount higher than that stipulated by the Regulations, albeit the amount can be negotiated within the stipulated rates.

The Regulation stipulates the various types of fees payable. These are:

- i. Administration fees which may be charged by PFAs on every account to cover the cost of registration and administering each Retirement Savings Account. It is to be calculated at a flat

rate and paid monthly from contributions. This shall not exceed ₦100 per month per account holder. It is noteworthy that this amount is negotiable as it could be lower but not higher.

- ii. Asset based fees are charged on Pension Funds Assets by PFAs, PFCs, and PENCOM for the collection, administration, investment and supervision of the Pension Funds Assets. This shall accrue daily upon portfolio and paid monthly. The total amount charged as Asset Based Fees shall be a total of 3% per annum on the Net Assets Value in the following manner - the PFA takes 2%; the PFC takes 0.60% while PENCOM takes 0.40%.

All bank charges in relation to the process of collections are to be borne by the PFCs. All statutory charges as well as the cost of all fees to brokerage companies shall be borne by the Pension Fund Assets managed on behalf of the Contributors.

Another aspect of this Regulation that adds to the credibility of this scheme is the fact that though the PFCs hold the funds the calculation of all fees to be charged shall be done by the PFAs. The PFAs send an invoice showing the calculation to the PFC and PENCOM. The Commission has the power to make comments on the invoice sent and when it has no comments the PFC pays the amount in the invoice.

Potential Criminal Liability for Defaulters

11. The PRA creates specific offences and penalties for non-compliance with its provisions.³⁹

The Bad and Ugly Aspects of the PRA

Encumbrance on Existing Retirement Benefit Schemes

1. Section 12 dealing with defined benefit schemes existing prior to the commencement of the Act may well be the most controversial provisions in the PRA that has vexed employees in the private sector.

For the avoidance of doubt *Section 12(1)(b) of the Act* provides that as from the commencement of the Act:

"...the right to retirement benefits of any employee who is already under a pension scheme existing before the commencement of the Act and has over 3 years to retire shall ... in the case of the private sector, credit the retirement savings accounts of the employees with any fund to which the employee is entitled ..."

This provision has been interpreted to mean that the funds contributed under a pension scheme existing prior to the Act shall be transferred to the employee's retirement savings account and be subject to the restrictions imposed by Sections 3 and 4. The implication is that the affected employees would be unable to withdraw the funds until they are 50 years old and upon retirement they would be unable to withdraw their savings in lump sum.

Employees in the private sector whose retirement benefit schemes were fully funded regard the provisions of Section 12 as an expropriation of their legitimate life saving. Generally speaking, employees used to see pension schemes as a means of saving to buy a car or build a house in future on account of the lump sum payment they would receive. This aspiration may largely be unachieved under the new regime unless the law is amended to allow employees use their savings as a security to obtain loans to meet capital projects.

Undefined Mortality and Interest Rates

2. Another sore issue that is likely to backlash employees is the absence of any clear indication of the amount of income that will accrue to the employees at the end of the day from investment of their funds. At present, there are no guidelines or prescriptions from PENCOM on the mortality rates and interest rates which PFAs and life insurance companies must assume for purposes of converting an account balance at retirement into a monthly or quarterly benefit stream.⁴⁰

Although there is a guideline regulating the charges by the PFAs, life insurance policies required to be entered into by employers on behalf of their employees, and valuation of assets, there is no mention of the interest rates or mortality rates.

By implication, PFAs and life insurance companies are allowed to develop without any apparent restraint, their own mortality and interest rate assumptions. Expectedly, these assumptions would vary among PFAs and life insurance companies. Clearly from the basis of these critical assumptions show a lack of transparency.

Non-disclosure of critical assumptions is especially worrisome for future retirees who are considering programmed or scheduled withdrawals because it may be too late to switch to another PFA. In contrast, future retirees who contemplate buying annuity contracts have the luxury of time to shop for a life insurance company with the best benefit payout.

It is no consolation that Section 71 of the Act guarantees a minimum pension to the holder of a retirement savings account who has been contributing for a number of years. Considering the time value of money, it is not good enough that after contributing for a number of years the employee can only be guaranteed a minimum pension.

Implementation Headaches

3. Although the PRA came into force on June 25 2004 the new pension scheme did not take off until early 2006 necessitating the issuance by PENCOM of Guidelines for Transitional Arrangements⁴¹ pending the licensing of PFAs and PFCs.⁴² Some of the implementation and operational challenges experienced which has cast a not too complementary coloration on the new scheme are highlighted hereunder:

Temporary Retirement Savings Account

- i. the Transitional Guidelines require employers to whom the Act applies to open a Temporary Retirement Savings Account into which the contributions would be paid as from the date of the commencement of the PRA (i.e. 25 June 2004). Any amount standing to the credit of the employer is required to be credited into his RSA when he opens one upon the licensing of PFAs and PFCs. The challenges with this requirement are that:
 - a. the PRA did not contemplate nor provide for any such transitional arrangement as such it is arguable if PENCOM can enforce this directive;
 - b. the Guideline is silent as regards where the account is to be opened and it is only assumed that it is to be opened with a bank or any other financial institution;
 - c. in practice, this provision was generally ignored by employers;
- ii. the Transitional Guidelines also provide that the Nigeria Social Insurance Trust Fund (NSITF) is to compute the contributions made and the attributable income for each contributor or beneficiary under the old NSITF regime. NSITF shall open a RSA for each contributor or beneficiary and credit the account with the amounts computed. These provisions are fraught with many challenges, some of which are that:
 - a. NSITF was never computerized and its records were in shambles before now and it will be very difficult if not impossible to compute the contributions or the attributable income of each contributor or beneficiary;
 - b. the contributions by employees under the NSITF scheme were of two categories. The first was contributions against the contingencies of retirement, pension, death, invalidity and emigration. The second was contributions against the contingency of employment injury.⁴³ The PRA has made contributions against the contingencies of retirement and pension under the NSITF scheme no longer necessary as such contributions are now covered by the PRA. However, the PRA

does not cover contributions against the contingency of death, invalidity and emigration. Having regard to the fact that a single indivisible contribution was made with respect to contingencies of retirement, pension, death, invalidity and emigration it is not yet clear if the NSITF will attempt to separate the amount accruable to the employee for his contributions against retirement and pension from the amount accruable against death, invalidity and emigration. It is also unclear how the amount accrued to the employee would be computed.

Conclusion

Having regard to some unclear provisions of the PRA there is need for comprehensive guidelines to clear any lingering doubt about the provisions of the Act but this is still being awaited. Although some regulations and guidelines have been made, there is the need to issue more guidelines with respect to the other unclear provisions of the Act and to ensure its effective practicability in that without these guidelines the whole essence of the scheme however laudable may be lost.

It is however sad to note that the pension commission has directed employers to make deductions from their employees monthly emoluments under its transitional arrangement. This will no doubt create confusion assuming there is compliance on the part of the employers.

In the final analysis, it is imperative that there should be clear guidelines defining the minimum pension guaranteed to avoid a diminution of the income earned by employees from their contributions.

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² See Section 2 of the Act.

³ This ostensibly is intended to curb the trend in the past when pensioners of public service waited for years to receive their pension which sometimes may not be paid.

⁴ Prior to this there were different laws and regulations regulating pensions in the Federal and States Public Service as well as the private sector.

⁵ Though the PRA came into effect on June 25 2004 the new contributory pension scheme established under the Act did not become fully operational until February 20 2006 when the institutional structures i.e. pension fund administrators and pension fund custodians were issued licenses at a grand ceremony attended by Nigeria's President, Chief Olusegun Obasanjo. Out of the 17 operators who received their licences, 12 are Pension Fund

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- Administrators; four are Pension Fund Custodians and one is a Closed Pension Fund Administrator.
- 6 The PRA does not apply to employees in the public service of the States of the Federation.
- 7 See Section 1(2) of the Act. Certain persons are however exempted from participating in the Contributory Pension Scheme under Section 8 of the Act. These are employees entitled to retirement benefits under any pension scheme existing before 25th June 2004 [when the Act took effect] and who has less than three years to retire and judicial officers mentioned in Section 291 of the 1999 Constitution of Nigeria.
- 8 See Section 10(4) of the Act.
- 9 See Section 11(1) of the Act.
- 10 See Section 11(3) of the Act.
- 11 Section 9 of the Act prescribes a minimum contribution by employers and employees in the private and public sectors of seven and half percent each of the monthly emolument of the employee. In the case of the military a minimum of twelve and half percent is to be contributed by the employer while the employee will contribute a minimum of two and half percent. Notwithstanding the foregoing, an employer may undertake to bear the full burden of the Scheme and in such case the employers' contribution shall not be less than fifteen percent of the monthly emolument of the employee. The rates of contribution of the parties may be increased by agreement and the employee is at liberty to make voluntary contributions to the account in addition to the seven and half percent. See Section 9(5) and (6) of the Act.
- 12 See Section 11(5) of the Act.
- 13 See Section 11(8) of the Act.
- 14 Emolument here refers to a sum total of the employee's basic salary, housing allowance and transport allowance.
- 15 See Guidelines for Life Insurance Policy for Employees 2006 jointly issued by the National Insurance Commission and PENCOM.
- 16 See Section 11(4) of the Act.
- 17 The Authentic age of the employee shall be the one submitted on entering the service or taking up the employment. See Section 3(4) of the Act.
- 18 See Section 3(1) (2) of the Act.
- 19 See Section 4 of the Act.
- 20 Any amount payable as retirement benefit under the Act is not taxable. See Sections 7(1) and 10 of the Act.
- 21 See Sections 12(1)(b) and 39(1)(d) of the Act.
- 22 See Section 42(2) of the Act.
- 23 Established under Section 14(1) of the Act.
- 24 The employer will be under the supervision and regulation of the National Pension Commission and all the provisions of the Act relating to the conduct and operations of a pension fund administrator shall apply to it. See Section 41 of the Act.
- 25 To qualify as a closed pension fund administrator, the employer is required to hold a minimum pension funds and assets of ₦500,000,000 and have a minimum paid up share capital of ₦150,000,000 and satisfy other conditions prescribed by Section 50(a)(d)(e)(f) and (g) of the Act. See Section 40(2) of the Act.
- 26 See Section 44 of the Act. The functions of pension fund administrators are set out under Section 45 of the Act and it includes investing and managing pension funds and assets.
- 27 Pension funds and assets are by Section 46 of the Act to be held by a pension funds custodian and the functions of the custodian are well set out under Section 47 of the Act.
- 28 See Section 40(1) of the Act. To be granted license as a custodian, the employer or its parent company must be a licensed financial institution registered under the Companies and Allied Matters Act 1990 with a minimum net worth of N5, 000, 000, 000 unimpaired by losses; the employer or its parent company must have a total balance sheet of at least N125, 000, 000, 000. See Section 52 of the Act for the requirements for grant of licence as a custodian.
- 29 See Section 59(b) of the Act.
- 30 See Section 59(c) of the Act.
- 31 See Section 59(d) of the Act.
- 32 See Sections 61 – 62(1) of the Act. The Commission shall maintain a list of employees dismissed, terminated or advised to retire on ground of fraud and circulate the list to pension fund administrators and custodians. See Section 62(2) of the Act.
- 33 See Section 60(1) of the Act.
- 34 See Section 60(2) of the Act.

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- 35 See Regulation on Investment of Pension Fund Assets 2006 issued by PENCOM on 1 May 2006
- 36 See Sections 75 and 76 of the Act.
- 37 See Section 98(1) and (2) of the Act.
- 38 See Regulation on Fee Structure 2006 issued by PENCOM on 19 May 2006.
- 39 See Sections 64, 78, 85 – 90 of the Act.
- 40 See article titled "*Pension Benefits: A ticking Time Bomb*" by Femi Odolana, published in The Guardian Newspaper of Sunday, July 2 2006 at page 19.
- 41 The Guidelines for Transitional Arrangement was issued by PENCOM on December 31 2004.
- 42 The Pension Fund Administrators, Pension Fund Custodians and Closed Pension Fund Administrator were issued licenses on February 20 2006.
- 43 See Section 12 of the Nigeria Social Insurance Trust Fund Decree (now Act) No. 73 of 1993.