Pension Reform Process in Nigeria: Transition From Defined Benefits to Defined Contribution

BY

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OUTLINE

• Rationale & Objectives of Pension Reform
• Key Policy Options
• Comparing the Old and the New Schemes
• Institutional Framework for Management & Custody of Pension Assets
• Transition Arrangements
• Pension Reform Implementation Efforts
• Transition Challenges
• Prospects of the DC Scheme
Rationale & Objectives of Pension Reform

Rationale for Reforms

- Most schemes were under or unfunded
- Unsustainable outstanding pension liabilities
- Weak and inefficient pensions administration
- Demographic shifts and aging make defined benefit scheme unsustainable
- Most workers in the Private Sector not covered by any form of retirement benefit arrangements
- Schemes not regulated

Reform Objectives

- Ensure that every worker receives his retirement benefits as and when due
- Empower the worker & assist workers to save in order to cater for their livelihood during old age
- Stem the growth of pension liabilities
- Establish uniform rules, regulations and standards for administration of pension matters
- Secure compliance & promote wider coverage
Key Policy Options

- Nature of Reform
  - Parametric or Major Reform
- Speed of Transition
  - Radical or Gradual
- Rates of Contribution
  - Phased in or Initial reasonable rate
- Funding Transition including accrued pension rights
## Comparing the Old and the New Schemes

<table>
<thead>
<tr>
<th></th>
<th><strong>Old Scheme</strong></th>
<th><strong>New Scheme</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Type</strong></td>
<td>Largely Defined Benefit</td>
<td>Largely Defined Contribution</td>
</tr>
<tr>
<td><strong>Funding</strong></td>
<td>Mostly unfunded &amp; PAYG</td>
<td>Contributory &amp; Fully Funded</td>
</tr>
<tr>
<td><strong>Membership/Coverage</strong></td>
<td>Voluntary in private sector</td>
<td>i. Mandatory for all employees in public &amp; private (&gt;=5 staff) sector</td>
</tr>
<tr>
<td></td>
<td></td>
<td>ii. Exempts: Pensioners &amp; those with 3 yrs to retire</td>
</tr>
<tr>
<td><strong>Pension Portability</strong></td>
<td>Not Portable</td>
<td>Personalised &amp; Very Portable</td>
</tr>
<tr>
<td><strong>Management</strong></td>
<td>Largely State &amp; Management &amp; Union Influence</td>
<td>Private Sector &amp; Individual Choice</td>
</tr>
</tbody>
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<tbody>
<tr>
<td><strong>Retirement Benefits</strong></td>
<td>Discriminatory</td>
<td>Uniform Application</td>
</tr>
<tr>
<td><strong>Claiming Retirement Benefits</strong></td>
<td>Cumbersome</td>
<td>Straight forward</td>
</tr>
<tr>
<td><strong>Supervision</strong></td>
<td>Fragmented &amp; Unregulated (SEC, NAICOM, JTB)</td>
<td>Strictly regulated by PenCom</td>
</tr>
<tr>
<td><strong>Pension Liabilities</strong></td>
<td>Implicit &amp; not transparent</td>
<td>Explicit through Retirement Benefits Bond &amp; Capped</td>
</tr>
<tr>
<td><strong>Tax exemption</strong></td>
<td>Limited</td>
<td>Contribution &amp; Retirement Benefits</td>
</tr>
<tr>
<td><strong>Insurance Policy</strong></td>
<td>Voluntary &amp; mostly in private sector</td>
<td>i. Mandatory for all employers</td>
</tr>
<tr>
<td></td>
<td></td>
<td>ii. Three times the employees emolument</td>
</tr>
</tbody>
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<tr>
<td><strong>Dismissal from Service</strong></td>
<td>No Pension Benefits</td>
<td>Full Pension Rights</td>
</tr>
<tr>
<td><strong>Collateral for Loans</strong></td>
<td>Benefits could be used as collateral</td>
<td>Benefits cannot be used as collateral</td>
</tr>
<tr>
<td><strong>Deductions from Benefits</strong></td>
<td>Benefits can be subject to deductions especially by</td>
<td>Contents of RSA can be used for payment of retirement</td>
</tr>
<tr>
<td></td>
<td>employers on any outstanding financial obligations</td>
<td>benefits only</td>
</tr>
<tr>
<td></td>
<td>on the employee</td>
<td></td>
</tr>
<tr>
<td><strong>Minimum Service Years</strong></td>
<td>Generally: 5 years for gratuity 10 years for pensions</td>
<td>Month 1 of employment for all benefits subject to min age</td>
</tr>
<tr>
<td><strong>Gratuity</strong></td>
<td>Provided to those qualified</td>
<td>Provisions for Lump sum withdrawal</td>
</tr>
</tbody>
</table>
Institutional Framework for Management & Custody of Pension Assets

- Key principle of “ring fencing” of pension assets
- Pension Fund Administrators
  - PFA opens and administers Retirement Savings Account (RSA) for every employee in liaison with PenCom & appoints Pension Fund Custodian
  - PFA invests/manages pension fund assets and administers retirement benefits
- Pension Fund Custodians
  - PFC receives the total contributions & holds pension fund assets in safe custody on trust for the employees and beneficiaries of the retirement benefits
  - PFC execute transactions and undertakes other related activities on behalf of PFA
  - Guarantee of Pension Assets by Shareholders of a PFC
- Closed Pension Fund Administrators
  - Manages existing scheme for employees of a particular organisation
- Collecting Banks
National Pension Commission

- Apex body to regulate and supervise pension schemes
- Formulate, direct and oversee the overall policy on pension matters in Nigeria
- Approve, licence and supervise PFA, PFC and other institutions relating to pension matters
- Maintain National Data Bank on pension matters
- Receive and investigate complaints against any PFC, PFA and Employer
- Board Membership include Labour, Employer Association, Pensioner Association, Key Regulatory Agencies, Ministry of Finance & Head of Service of the Federation
Transition Arrangements: Public Sector

• Accrued Retirement Benefits are Guaranteed
  - Cover both gratuity and pension for services rendered prior to June 2004, when the defunct scheme was terminated, by the employees of the Federal Government and Federal Capital Territory (FCT)
  - Determined actuarially and covered by bonds
  - Bonds to be redeemed on retirement of an employee

• Retirement Bond Redemption Funds:
  - Established by the PRA’ 04 and is being managed by the Central Bank of Nigeria
  - Federal Government has been paying 5 per cent of its total monthly wage bill into the Fund
  - Redemption Fund Account shall be used to redeem any bond issued in respect of accrued retirement benefits
Transition Arrangements: Public Sector …Cont’d

• Establishment of Pension Departments:
  - Six Pension Departments were established for the Public Service of the Federation and FCT
  - The responsibilities, funds, assets & liabilities of all existing pension offices in the Public service of the Federation was vested in the Departments
  - The Departments shall continue to pay pension to existing pensioners and those exempted from the Contributory Pension Scheme
  - Each Departments shall cease to exist after the death of the last pensioner
Transitional Arrangements: Private Sector

• Employers may elect to continue with their existing schemes provided they apply and secure PenCom’s approval.

• An employer wishing to continue its existing scheme shall also apply for a CPFA licence if it intends to manage its pension funds.

• Applicants for continuation of their existing schemes/CPFA licence shall comply with the following minimum conditions:
  - Pension scheme must be fully funded and to be held by Custodian
  - Pension funds & assets segregated from employer’s
  - Employees at liberty to remain or opt out
  - Pensions funds must be not less than N500 million for a CPFA licence

• Other employers, fund managers & insurance companies must transfers legacy funds.
Transitional Arrangements: Private Sector (NSITF Scheme)

- Nigeria Social Insurance Trust Fund (NSITF) has established a PFA
- Pension funds and assets held and managed by NSITF shall be transferred to the PFA and a custodian under the supervision of PenCom
- Contributors under NSITF Scheme can open RSAs with PFAs of their choices
- Contributions under the NSITF Scheme shall not be transferred to another PFA until after 5 years from the commencement of the new scheme, ... July 2009
Pension Reform Implementation Efforts

• Issued Guidelines and Regulations

• Licensing of Operators
  - Licensed 25 PFAs, 7 CPFAs and 4 PFCs
  - Approved the continuation of 18 Existing schemes

• Scheme Memberships:
  - Registered over 2.8 million RSA Contributors as at the end of December 2007
    o 72.13% of the registered contributors are from the public sector
    o 27.87% are from the Private Sector
  - 34,041 membership of CPFAs
  - 34,062 membership of Approved Existing Schemes
Pension Reform Implementation Efforts..Cont’d

- Total Pension Fund Assets $6.08 billion
- Growth in Pension Funds Assets

![Quarterly Pension Assets by Scheme Type graph](image-url)
Pension Reform Implementation Efforts..Cont’d

- Computation of accrued benefits of current employees of Federal Government of Nigeria (FGN) was carried out and issuance of retirement benefits bonds had commenced.
- Current employees retiring under the new scheme are being paid their benefits since July, 2007.
- Verification and Quantification of pension liabilities owed to existing pensioners of FGN is being conducted in phases.
- About US$7.17 million has been paid to verified pensioners of FGN.
- Over 90% of the NSITF legacy funds & assets have been transferred to PFA/Custodian as required by law.
Transition Challenges

- General misconception & knowledge gap about the new scheme
- Securing system wide buy-in & initial reluctance of employees to register with PFAs
- Widening coverage especially in the informal businesses in the private sector
- Determining the total accrued pension liabilities and funding the shortfalls in pension assets in the private sector
- Quantifying & transferring legacy funds & assets hitherto managed by employers, insurance companies and fund managers
- Capacity building in the new pension industry
Prospects of the DC Scheme

- Intensified Public Education & Enlightenment
- Strong support from & collaboration with all key stakeholders especially social partners
- Consistent support and strong political will by the Executive & Legislative arms of Government
- FGN had consistently & religiously met its obligations
- Gradual adoption of the new scheme by the second tier of government: State Governments
- Major corporations & institutions have adopted the new scheme
Prospects of the DC Scheme. Cont’d

- Consistent macroeconomic stability leading to downtrend in inflation
- Relatively strong enforcement powers of PenCom
- PenCom’s efforts to build capacity and skills in the areas of risk management, risk based supervision, corporate governance and information technology
- Development of a comprehensive Accounting Standard for Retirement Benefits
Thank You!

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