

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

BY

M. K. Ahmad

**National Pension Commission
Abuja – Nigeria**

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

Pension Reforms



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

	Old Scheme	New Scheme
Type	Largely Defined Benefit	Largely Defined Contribution
Funding	Mostly unfunded & PAYG	Contributory & Fully Funded
Membership/ Coverage	Voluntary in private sector	i. Mandatory for all employees in public & private (≥ 5 staff) sector ii. Exempts: Pensioners & those with 3 yrs to retire
Pension Portability	Not Portable	Personalised & Very Portable
Management	Largely State & Management & Union Influence	Private Sector & Individual Choice

Comparing the Old and the New Schemes

	Old Scheme	New Scheme
Retirement Benefits	Discriminatory	Uniform Application
Claiming Retirement Benefits	Cumbersome	Straight forward
Supervision	Fragmented & Unregulated (SEC, NAICOM, JTB)	Strictly regulated by PenCom
Pension Liabilities	Implicit & not transparent	Explicit through Retirement Benefits Bond & Capped
Tax exemption	Limited	Contribution & Retirement Benefits
Insurance Policy	Voluntary & mostly in private sector	i. Mandatory for all employers ii. Three times the employees emolument

Comparing the Old and the New Schemes

	Old Scheme	New Scheme
Dismissal from Service	No Pension Benefits	Full Pension Rights
Collateral for Loans	Benefits could be used as collateral	Benefits cannot be used as collateral
Deductions from Benefits	Benefits can be subject to deductions especially by employers on any outstanding financial obligations on the employee	Contents of RSA can be used for payment of retirement benefits only
Minimum Service Years	Generally: 5 years for gratuity 10 years for pensions	Month 1 of employment for all benefits subject to min age
Gratuity	Provided to those qualified	Provisions for Lump sum withdrawal

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)

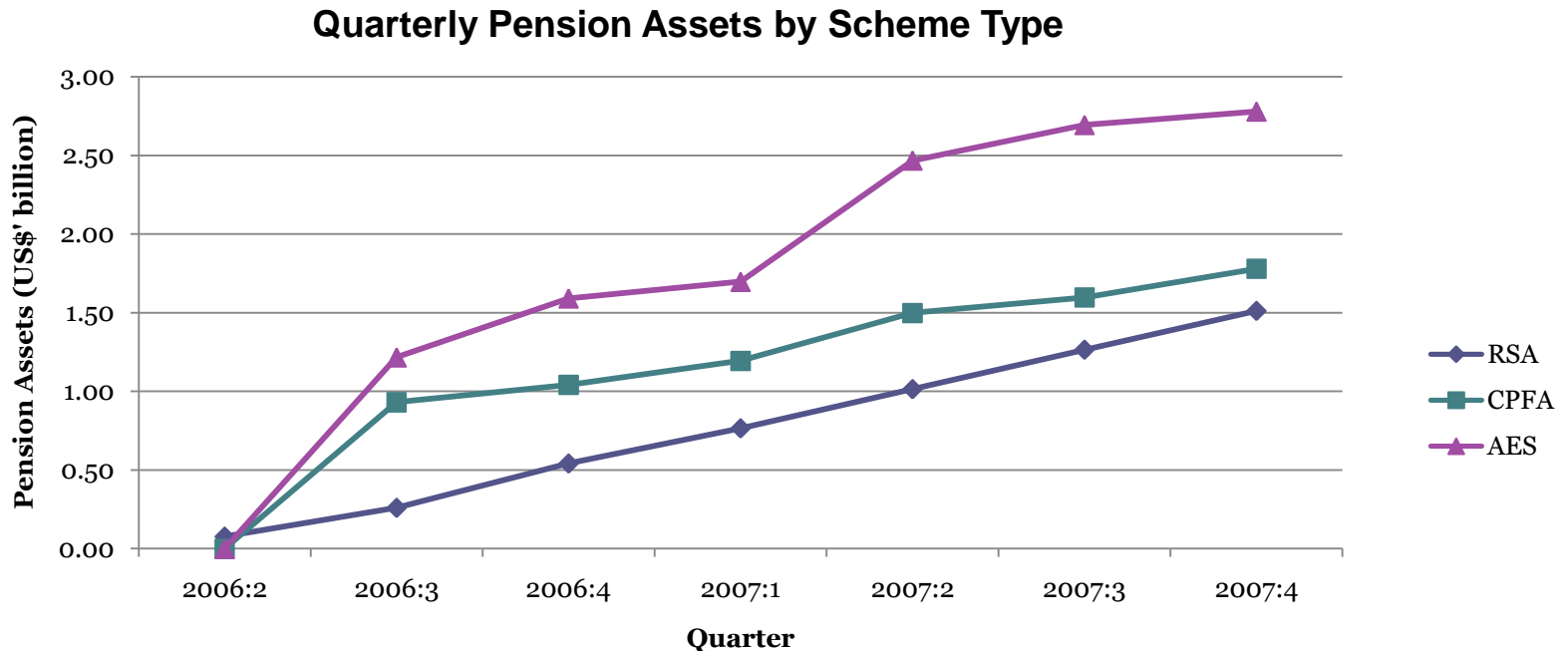
- **Nigeria Social Insurance Trust Fund (NSITF) has established a PFA**
- **Pension funds and assets held and managed by NSITF shall be transferred to the PFA and a custodian under the supervision of PenCom**
- **Contributors under NSITF Scheme can open RSAs with PFAs of their choices**
- **Contributions 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 ad 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
 - 72.13% of the registered contributors are from the public sector
 - 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



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!

***National Pension Commission
174, Adetokunbo Ademola Crescent
Wuse II, Abuja, Nigeria
+234 – 9 – 4138736 /40
+234 – 9 – 4133363 (fax)
info@pencom.gov.ng
www.pencom.gov.ng***