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# ANALYSES OF THE CONTRIBUTORY PENSION SCHEME IN NIGERIA

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Abstract
The federal government in June 2004 introduced a contributory pension scheme aimed at solving numerous problems of unfolded defined benefits pension system in Nigeria. The new pension system is based on individual retirement savings account to be managed by private financial institutions. This paper tries to analyze the challenges of the old pension policy by examining some reforms and their weakness to pensioners and lingering corruption in the pension policy, its contributions towards the retirement social benefits of employees in private and public sectors, the opportunities and the challenges of the scheme, the study uses the documentary research method. The study concluded that the old scheme was associated with problems like coverage, funding, transparency, lack of supervisory and regulatory authority and inadequate implementation. The authors recommend that there is need for continuous regulatory and strengthening of the institutional structure of the new scheme. Licensed pension fund administrators should be monitored and closely supervised to ensure compliance.

Key words: *Contributory Pension Scheme, Pension Commission, Corruption and Transparency*

## Background to the Study

The reform of Nigeria pension system became inevitable because of the problems surrounding both the private and public sector. The privilege of an employee receiving gratuity and pension appears to be the greatest manifestation of victory of labour in its fight against exploitation from employers. For the public sector, the old system of defined benefit became unsustainable because it depended largely on budgetary provisions at all tiers of government, lack of adequate and timely budgetary provisions coupled with rising life expectancy, increasing number of beneficiaries, increase in wages and pensions gave rise to untimely payment of benefit thereby resulting to huge accumulation of pension liabilities that are yet to be fully settled. In the private sector, there was poor implementation because inadequate supervision and regulation of the system; many private sector employees were not covered by any form of pension scheme.

The pension reform Act 2004 was enacted to address that weakness of the old defined benefit pension scheme (DBPS). The pension reform Act was put in place as a system that will be sustainable and be able to meet goal of providing stable, predictable and adequate source of retirement income for the workers in the country. The Act introduced a defined contributory system that is fully funded, privately managed and based on individual account for all workers in the public and private sectors. The regulatory authority established to oversee all pension matters is the National Pension Commission (PENCOM) in 2004.

Most private sectors pension fund were not separated from the funds of the company. Therefore in the event of a company collapsing, the fund also collapses alongside with the company. There were several laws, rules, regulations guiding the private sector pension scheme. Some of them are: pension Act 1979, Nigeria Social Insurance Trust Fund (NSITF) Act 1993 and investment and securities Act 1999, National Insurance Company (NAICOM), Security and Exchange Commission (SEC) and Joint Tax Board before the advent of National Pension Commission in 2004, IRO (2010).

A major advantage of the contributory scheme is the fact that it has decentralized the management of pension payment especially in the public sector which lacked transparency in its pension administration; it will allow all sorts of corrupt practices that are still bedevilling the payment of benefit to those exempted from the contributory pension scheme. These people are made to undergo much agony and are denied payment for so many years, some of them even died without collecting any money while a few public servants siphoned the money meant for the payments. For example in the police pension scheme, some officers have not been paid since October 2011 meanwhile a few individual shared N44Billion meant for the pension payment. it is very necessary to determine which category of pensioners can be managed as a department under the Act so that their claims can be treated as soon as possible. The contributory pension will greatly save pensioners the pain and indignity presently experienced by the old system.

Objective and Methodological Study

The study tries to highlight issues arising from the defined benefit pension scheme that has made it unsustainable and the need to make the contributory pension scheme a better system to manage the retirement benefits workers irrespective of public or private organizations. The study relied on general review scheme, especially, using documentary research method. Current documents and archival materials from both primary and secondary sources of the contributory pension policy in Nigeria were extensively used in this study, especially materials from the PENCOM, such as pamphlet, speeches and other publications. Relevant materials from other stakeholders, especially pension Fund Administration (PFAs), Contributory Pension Scheme (CPS), Pension Fund Custodians (PFC) were also consulted.

Literature and Theoretical Issues

According to Adam (2005) pension is the amount paid by government or company to employee after working for some specific period of time, considered too old or too ill to work or have reached the statutory age of retirement. It is equally seen as the monthly sum paid to retired officer until death because the officer has worked with the organization paying the sum.

Oxford Advance Learner's Dictionary defined pension as a “sum of money paid regularly by a government to people above certain age and to widowed or disabled people or by a former employer of financial institution to retired people”. Micro word Encarta dictionary has two (2) definitions of pension:

1. Retirement Pay: this is a fixed amount of money paid regularly to somebody during retirement by the government t, a former employer of insurance company.
2. Regular sum of money paid regularly as compensation for an injury sustained on a job, or

as a reward for service.

According to Ozor, (2006) Pension consists of lump sum payment to an employee upon his disengagement from active service upon completion of 35years or attainment of 60years of age, payment is made in monthly installments. According to Idowu and Olanike (2009), pension is a regular payment made by the government or by private companies or organizations to their retirees as a form of social security against old-age, risk and uncertainties. Sule and Ezugwu (2009), says a good pension guarantees employees comfort and commitment to the organization during his / her active years.

Olaniji (2008) as cited in Iro (2010) has given us comprehensive definitions of pension that is relevant and simple to understand by a layman. According to him, it is the sum of many paid regularly to a person who no longer works because of old age, disablement, etc or to his widow or dependent children by stat, by his former employer or from fund to which he and his employer had contributed. Pension as a social security scheme varies from country to country in its management as well as labour unions have emphasized the need for sound, good and workable pension scheme.

The new pension scheme is contributory, fully funded, based on individual accounts, privately managed by pension fund administrators with pension funds assets hold by pension fund custodians, to enable strict regulation of the process with the National Pension Commission (PENCOM) as a regulatory body. Some of the pension commissions in Nigeria and other administrative units with their respective responsibilities, challenges and prospects are as follows,

1. National Pension Commission: this is the body established to regulate, supervise and ensure the effective administration of pension matters in Nigeria. The commission is to ensure that payment and remittance of contributions are made and the beneficiaries of retirement savings accounts are paid at due time. The commission will also ensure the safety of pension funds by issuing guidelines for licensing, approving, regulating and monitoring the investment activities of pension fund administrators.

2. Contributory System: employees contributes a minimum of 7.5% of basic salary, housing and transport allowances and 2.5% for military employers while employees shall contributes 7.5% in the case of public sector and 12.5% in case of military. Employers and employees in private sector will contribute a minimum of 7.5% each.

3. Fully Funded: the contributions are money deducted from salary of an employee and then transferred to relevant retirement savings account.

4. Retirement Saving Account (RSA): it is an account opened by an employee in his name with a pension fund administrator of his choice. This account belongs to the employee and will remain with him throughout his life, he may change the pension fund administrators but the account remains the same.

5. Pension Fund Administrator (PFA): they are dully licensed to open retirement saving account for employees. They invest and manage the pension fund in fixed and income securities listed, maintained books of accounts on all transactions relating to the pension fund managed by it, provide regular information on investment strategy to beneficiaries and retirement benefits to employees in accordance with the provision Act.

6. Pension Fund Custodians (PFC): They are responsible for the warehousing g of pension funds assets. The employees contribution are sent directly to the custodians who notify the pension fund administrators of the receipt of the contribution of and the PFA

subsequently credit the account of the employee. The custodian will execute transactions and undertake activities relating to the administration of the pension fund investment.

## Pension Scheme Policy Development in Nigeria

It is a well known fact worldwide that the defined pension scheme is burdened with a lot of problems and has become increasingly unsustainable largely due to huge deficit increase in salary and poor administrative management. The pension reform Act of 2004 seeks to replace the defined benefit pension scheme. A worker who joined the public service to work for 10years to qualify for a lump-sum payment, usually 100% of annual emolument called gratuity with no pension. When an employee works for 15years and above, he is then qualified for both pension and gratuity which is normally expressed as percentage of total emolument graduated according to the number of years in service.

The retirement age is 35years in service or 60years of age, whichever comes first. An amendment of the pension law in 1992 reduced the qualifying years of service to 5 and 10years respectively and exception to the 60years retirement for judicial officers and university lecturers. A person who retires voluntarily will only get pension from the age of 45. Gratuity payment is a maximum of 300% and pension 80% of total emolument.

## Problems Associated with the Old Pension Scheme

The federal government as at 2004 acknowledged pension obligation arrears of N2 Trillion. With high level of inflation and infrequent revision in pension amounts, the old pension scheme in Nigeria was deficient and was not regularly paid. Only few private organizations in Nigeria have pension schemes while other the publicized pension problems were with respect to public pension scheme. These includes delay in payment of gratuities for fresh retirees, arrears in pension payment for old pensioners, mismanagement and misappropriation of pension funds, disparities in pension practices among organizations even among public agencies and a lot unverified claims. These reasons necessitated the need for reforms in the pension policy that gave birth to the contributory pension scheme Act 2004 by Obasanjo administration, which took effect from July 2004 whose key objectives are stated in section 2 of the Act.

The Objectives of the Contributory Pension Scheme Act 2004 are:

1. Ensuring that every person who has worked either in public service of the federation, federal capital territory or private sector receives his retirement benefit as at when due.
2. Establishment of uniform set rules, regulations and standards for administration and payment of retirement benefit for the public service of the federation, federal capital territory and the private.
3. Assist individuals by ensuring that they save to cater for their livelihood at old age.

## Terms and Conditions of the New Pension Scheme

1) It is mandatory for organizations with 50% or more employees in both private and public sector of the economy to register for the new pension scheme.
2) Employees and employers are to contribute minimum of 7.5% of total emolument of the employee's salary.
3) An employer shall maintain a life insurance policy for each employee for a minimum of three times the annual total emolument of the employee. In the event of death, his entitlement under the life insurance policy shall be paid into his retirement saving account (RSA)
4) Every employee shall maintain a retirement saving account in his name with any pension fund administrators of his choice into which his contributions and accrued income from investment shall be paid into.
5) Pension Fund assets are to be held only by pension fund custodians licensed by Nigeria

Pension Commission (PENCOM).

6) The employer and employee contributions shall be tax deductively expanses in the calculations of income tax liabilities.

7) No withdrawals shall be made from the balance standing to the credit of the retirement saving account of an employee except on his retirement or attaining the age of 60years (whichever is later) and such withdrawal can be programmed monthly or quarterly, calculated on the basis of an expected life span or for the purchase of annuity for life from an insurance company licensed by national Insurance Commission (NAICOM) with monthly or quarterly payment.

8) Employees who had 3years to retire from the commencement of pension reform Act 2004 (July 2004) were exempted from the new pension scheme.

9) The Nigeria Social Insurance Trust Fund (NSITF) cease to take contributions from workers with the commencement of the pension reform Act 2004 and shall make arrangement to transfer funds contributed and any attributable income to their retirement saving account.

10) All pension funds and assets hold in and managed by Nigeria social insurance trust fund shall be transferred to the custodians, as from the commencement of the Act.

11) Pension funds and assets can be invested in certain specified instruments.

12) Pension commission shall undertake yearly inspection, examination or investment of pension fund administrators, pension fund custodians or the pension departments to determine whether or not they are discharging their functions as set out the pension reform Act 2004.

Functions of Nigeria Pension Commission (PENCOM)

i. Regulate and supervise the new pension scheme

ii. Issue guidelines for investment of pension funds

iii. Approve license, regulate and supervise pension fund administrators, custodians and other institutions relating to pension funds.

iv. They ensure the maintenance of a national data bank on all pension matters.

v. They establish standards, rules and guidelines for the management of pension funds.

There are basic problems associated with the Old Pension Scheme and this calls for concern. Base on these, certain findings are highlighted which provides the framework for conclusion and policy recommendations.

Findings and Conclusion

The idea behind the new contributory pension scheme was to do away with the bureaucratic structures that deepened corruption and rendered the old system ineffective. The delays were and are still costly under the old system. Example is the police pension scam whereby few officials of the commission embezzled the pension meant for retired police officers who served the country diligently, some retired officers have died while waiting endlessly for their pension and gratuity.

The new contributory pension scheme was inevitably in view of the problems associated with the old scheme, problems such as coverage, funding, transparency and lack of supervisory and regulatory authority resulting in inadequate implementation. The untimely payment which resulted to the huge accumulation of pension liabilities that is yet to be fully settled in the public sector is now a thing of the past for contributors under the new pension scheme.

Recommendations

There is need for continuous regulations and strengthening of the institutional structure of the new scheme. Licensed pension fund administration should be monitored and closely supervised to ensure compliance. There should be prompt reconciliation and statement of accounts should be given regularly. This will ensure transparency and prompt payment.

Negotiations of terms and conditions of employment in the public sector should be institutionalized, fixing of percentage contribution to pension scheme should be co-determined. There is need to transparency determine accrued interest at the time of payment of contributed sum, and accruable for those who are receiving their monthly pension.

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