



The Supporting Pillar of the Nigerian Pension Industry

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The Concept of Pension & Evolution of Pension Systems



- The Concept of Pension
- Development of the Pension System
- The Nigerian Pension System Pre-Reform
- The Need for Reform
- The Reform Objectives

Background

- A major existential concern of man through the ages has been economic security.
- Economic security (financial security) is the condition of having stable income or other resources to support a standard of living now and in the foreseeable future.
- It includes: plausible continued solvency, predictability of the future cash flow of a person or other economic entity, such as a country.
- All peoples throughout all of human history have faced the uncertainties brought on by unemployment, illness, disability, death and old age. These inevitable facets of life are said to be threats to one's economic security.
- Maintenance of economic security was an individual responsibility in earlier times, until humans evolved into states.
- In the process of this evolution passed the responsibility on to States, which birthed pension.

The Concept of Pension

- The concept of a pension appeared in the 7th-century Rashidun Caliphate as a form of Zakat (charity), one of the Five Pillars of Islam, under early Islamic law.
- This practice continued well into the Abbasid Caliphate (8th-13th centuries).
- The taxes collected in the treasury of an Islamic government were used to provide income for the needy, which were classified as the poor, elderly, orphans, widows, and the disabled.
- Widows' funds were among the first pension type arrangement to appear.
- For example, Duke Ernest the Pious of Gotha in Germany founded a widows' fund for clergy in 1645 and another for teachers in 1662.
- 'Various schemes of provision for ministers' widows were then established throughout Europe at about the start of the eighteenth century, some based on a single premium others based on yearly premiums to be distributed as benefits in the same year

The Concept of Pension

Pension

derived from Latin word *pensiō*, which means payment

An Arrangement

an employer and, usually, an employee pay into a fund that is invested to provide the employee with a pension on retirement

Majorly Two Types

"**defined benefit plan**" - a fixed sum is paid regularly to a person. the benefit on retirement is determined by a set formula, rather than depending on investment returns; or

"**defined contribution plan**" - a fixed sum is invested that then becomes available at retirement age

Development of Pension

- Pension Systems were introduced by employers to protect their employees against old age poverty to provide income after retirement that could at least meet the basic financial needs of retirees.
- This soon became the cardinal objective of governments throughout the world
- Provisions were made for private sector employers to establish some form of retirement benefit scheme(s) for their employees, however difficult this was to implement
- Inherent challenges were experienced during the many years that retirement benefit schemes were implemented.

Development of Pension

- These challenges necessitated many countries to take stock of these systems and on many occasions make adjustments to the underlying laws or some aspects of regulations governing the implementation of the laws
- The numerous adjustments forced many countries to make complete paradigm shifts from the old systems.
- Beginning from Chile and some of its Latin American neighbors, a new system emerged that introduced a Contributory Pension System that is personalized to the contributor and managed by licensed private sector entities.
- Nigeria is the first African country to introduce a variant of the Chilean system with flavors of African peculiarities.

Development of Pension

- The reform of Nigeria's Pension System became necessary because of the many problems experienced in both the public and private sector schemes:
 - old system of defined benefits (DB) based on the Pay as You Go scheme became unsustainable:
 - lack of adequate and timely budgetary provisions
 - rising life expectancy,
 - increasing number of personnel, and
 - increase in wages and pensions,resulting in accumulation of huge pension liabilities that are yet to be fully settled.
 - poor implementation because of inadequate regulation and supervision of the system.
 - Inadequate coverage: many private sector employees were not covered by any form of pension scheme.

The Pre- Reform Pension System in Nigeria

The first Public Sector Pension Scheme in Nigeria was the Pension Ordinance of 1951, with retroactive effect from January 1, 1946.

The law allowed the Governor-General to grant pensions and gratuities in accordance with the regulations, which were reviewed from time to time with the approval of the Secretary of State for Colonial Affairs in the UK government.

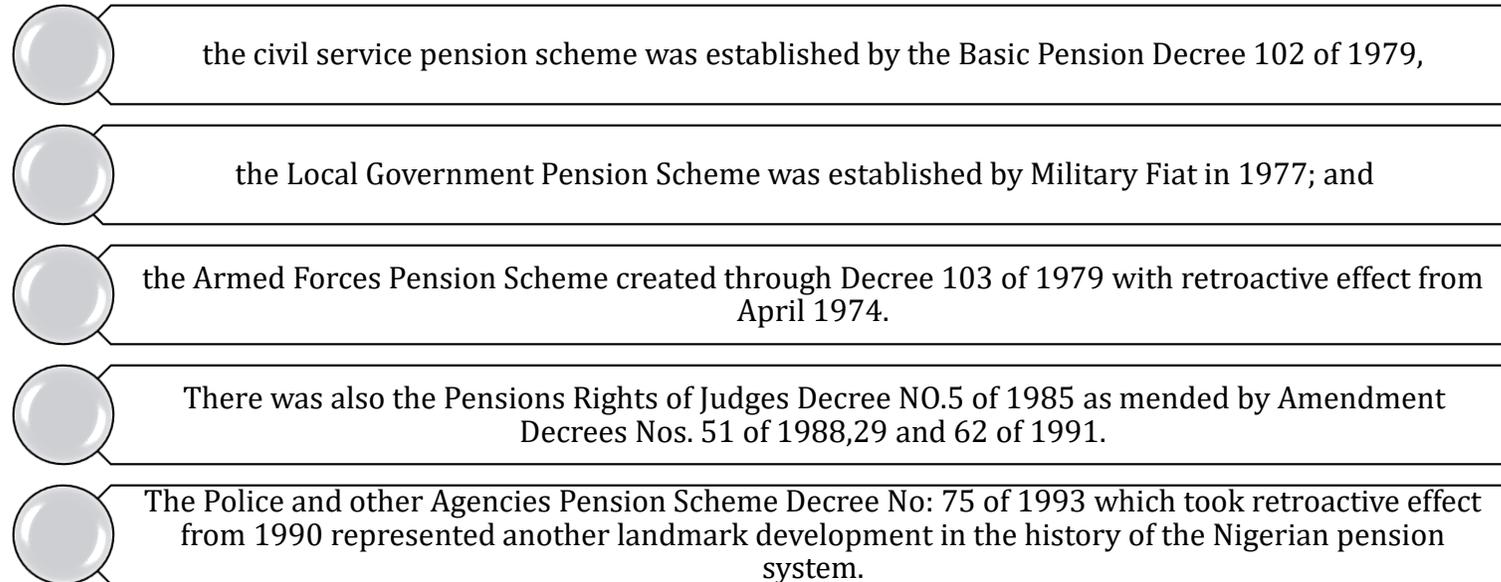
Vesting period was fixed at 10 years of service.

Pensions and gratuities provided for in the legislation were not a right

- could be reduced or withheld altogether if it was established to the satisfaction of the Governor-General that, the officer was found guilty of negligence, irregularity or misconduct.

The Pre- Reform Pension System in Nigeria

- The pension scheme in the public sector underwent various developmental stages after the first Pension Ordinance, viz:



- Governmental Parastatals and agencies directly funded by the Treasury had a unified pension scheme that was managed by insurance companies and many were unable to honor their pension obligations.
- The pension schemes of the self-funded agencies were better managed.

The Pre- Reform Pension System in Nigeria

The first private sector pension scheme in Nigeria was set up for the employees of the Nigerian Breweries in 1954, which was followed by United African Company (UAC) in 1957.

National Provident Fund (NPF) was the first formal pension scheme in Nigeria established in 1961 for the non-pensionable private sector employees. It was largely a savings scheme, where both employee and employer would contribute a sum of Four Naira (N4) each on monthly basis. The scheme provided for only one-off lump sum benefits.

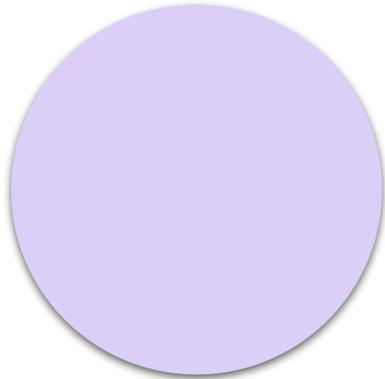
The Nigeria Social Insurance Trust Fund (NSITF) was established by Decree No. 73 of 1993 to take over the NPF Scheme and provide enhanced pension scheme to private sector employees.

These Decrees remained the operative laws on public service and military pension in Nigeria until June 2004.

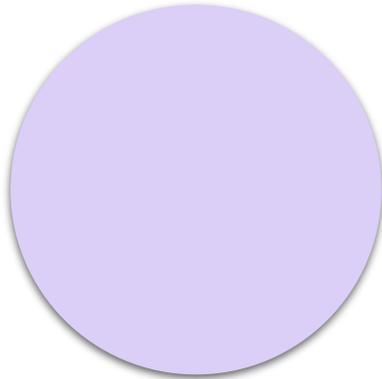
Why Reform?

- Pension deficit of about N2.3 trillion in 2004.
 - Most public sector schemes were unfunded
- Unsustainable pension liabilities
- Weak and inefficient administration of schemes in both public and private sectors
- Demographic shifts and ageing make defined benefits schemes unsustainable
- Many workers in the private sector were not covered by any form of retirement benefits arrangement
- Existence of diversified arrangements which were largely unregulated in the private sector
- Credibility crisis inherent in the old pension scheme:
 - Clumsy payment procedure that often resulted in unethical practices
 - Discriminatory payment of pension benefits
- Bankruptcy of insured or unified pension scheme due to failure of insurance companies to honor their obligations
- Limited coverage of the old pension scheme

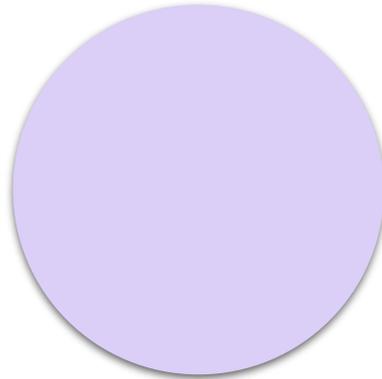
Objectives of the Pension Reform



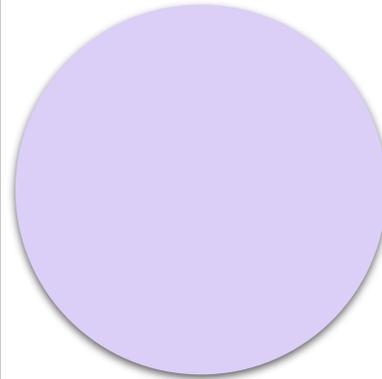
Ensure that every worker receives his retirement benefits as and when due



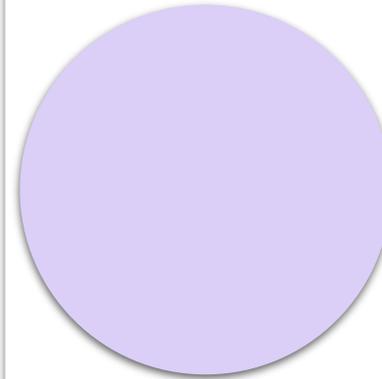
Empower the worker



Assist workers to save in order to cater for their livelihood during old age



Establish uniform rules, regulations and standards for administration of pension matters



Establish strong regulatory & supervisory framework



The Reform

- Nigeria operated Defined Benefit Scheme (DBS) between January 1, 1946 and June 2004.
- The Pension Reform Act was enacted on 25th June and came into effect on 1st July 2004.
- Reform established a Contributory Pension Scheme (CPS) as against the erstwhile DB Scheme so as to solve pension crisis.
- The CPS is also known as the Defined Contribution plan.

The Contributory Pension Scheme

- Mandatory
- Inclusive in terms of Coverage
 - Covers the public service of the Federation and Federal Capital Territory and employers of 5 or more employees in the private sector
 - Scheme not mandatory on informal sector
 - The Micro Pensions Plan has been established for informal sector to voluntarily buy into the scheme
- Contributory
 - Both employer & employee to each contribute 10% and 8% of employee's monthly emoluments respectively (basic salary, transport and housing allowances)
 - Contributors are allowed to make additional voluntary contributions
- Individualized Retirement Saving Accounts (RSAs)
 - Portable
- Privately managed
 - by PFAs and PFCs
- Group Life Insurance cover

The Contributory Pension Scheme

- Lump sum withdrawal at exit
- Monthly/Quarterly pension payments
- Option of Programmed Withdrawal or Annuity purchase
- Right to change to another PFA in case of Programmed Withdrawal
- Right to switch to Annuity from Programmed Withdrawal
- RSA balance to be paid to beneficiaries of deceased contributor (including group life insurance sum)

The Contributory Pension Scheme

Safeguards Within the Scheme

- Access to RSA allowed only on retirement
- Separation of the functions of pension operators
 - Pension Fund Custodian Guarantee
 - Pension funds held by custodians in the name of the Contributors
- Pension assets cannot:
 - be used to meet the claim of creditors of pension operators
 - be seized or subject to execution of judgment debt or stopped from transfer to another Custodian
 - be sold, or granted as loan or used as collateral
- Government contribution shall be a charge on Consolidated Revenue Fund of the Federation
- Scheme is strictly regulated and supervised

Challenges of the Reform

- Compliance issues
- Misinformation and inadequate education about the scheme
- General knowledge gap in the industry
- Coverage: Formal & informal sectors
- Investment outlets to absorb growth of savings

Conclusion

- On the global scale, the percentage of defined contribution (DC) plans rose from 40% in 1983 to 79% in 1998.
- The percentage of defined benefit (DB) plans declined similarly, from 87% in 1983 to 44% in 1998.
- The trend shows there is a continuous evolution of pensions towards DC plans.
- The DC plan is fraught with its own issues, and recently there have been variations to the DC scheme
- Examples of this are
 - The Defined Ambition Plans
 - Collective Defined Contributions
 - Target Retirement Income
 - Etc.
- While Nigeria is at the fore of the trends, it is essential that variations to the DC plan be explored to mitigate some of the limitations of the CPS.

Thank you & Questions

