Detailed Analysis of New Pension Reforms Act, 2004

Introduction

The collection of retirement benefits in Nigeria have continued to cause a lot of suffering to retirees (and their respective next-of-kin) especially the retirees in the public sector of the economy. There are reports of many beneficiaries who died in retirement benefit queues after waiting for days, without food or water, to collect their benefits. To remedy some of these problems, the Nigerian government recently passed into law the Pension Reform Act, 2004 (?the Pension Act?).

The Pension Act repeals all previous legislations regulating the administration of pension benefits in Nigeria . With the virtual collapse of the African welfare system, the new Pension Act attempts to have as its primary objective, the encouragement of savings among employees so that in retirement they are not impoverished and the establishment of a uniform set of rules, regulations and standards in the public and private sectors of the Nigerian economy on matters of pensions.

The explanatory note to the Pension Act captured the purpose of this legislation as it provides as follows: -

?The Act repeals the Pension Act, 1990 and establishes a uniform contribution pension scheme for both the public and private sectors in Nigeria with the features of:

- Contribution of funds by both the Employer and the Employee to fund retirement benefits;
- Crediting the Employees' retirement savings account with Pension Fund Administrators with funds contributed;
- Pension funds assets are to be privately managed and invested by professional Pension Fund Managers;
- Strict regulation of Pension Fund Managers under uniform laws and regulations for both private and public sector;
- The establishment of the National Pension Commission.?

The first innovation of the Pension Act is that for the first time in Nigeria , a Pension legislation is made to apply to employees in both the public and private sectors of the Nigerian economy.

Sector Applications of The Pension Act

For the provisions of the Pension Act to apply to employees in the private sector, the employer must have 5 or more employees in its employment.

Another new provision of the Pension Act is the requirement that an Employee will only be entitled to make withdrawals from the pension scheme (the scheme) upon the attainment of the age of 50 years or upon an employee being declared medically unfit to continue in an employment and therefore entitled to the payment of pension benefits.

Other Highlights of The Pension Act

Other provisions of the Pension Act, worthy of highlighting, include: -

- Every employee to the retirement scheme must have opened for him/her, by the Pension Fund Administrator chosen by the employee, a retirement savings account. The holder of a retirement savings account is allowed, upon attaining 50 years of age or upon being otherwise retired, to utilise the balance of the amount in his account to either (a) receive a monthly or quarterly pension payment; or (b) an annuity for life, purchased from a licensed insurance company, etc.

  On the death of the employee, his named beneficiary in a Will or his/her recorded next-of-kin or Court appointed Administrator would be entitled to the credit balance in the employee's retirement savings account;
- Benefits/payments under the Pension Act are not taxable provided that voluntarily contributions are not withdrawn before the end of 5 years from the date the voluntary contributions are made.
- Employees with less than three years or who are three years to retirement and contributors to an existing pension scheme are exempted from the new scheme under this Act.
- Judicial officers (i.e. Judges and Justices of superior Courts of record) mentioned in Section 291 of the 1999 Constitution are exempted from contributing to the scheme.
- Contributions by employers and employees are tax-deductible expenses when computing either Companies Income Tax or Personal Income Tax.
- The initial rates, in percentages, of total contributions by employers and employees, to the contributory scheme are as follows: -
  - Private and public sectors:

(i) Employer ? minimum of seven and a half percent

(ii) Employee ? minimum of seven and a half percent

- Military:

(i) Employer ? minimum of twelve and a half percent

(ii) Employee ? minimum of two and a half percent

A magnanimous employer is allowed by the Pension Act to bear the full contribution stated above provided it is not less than the 15% of the employee's total monthly emoluments.

Retirement Account & Remittance of Contributions

An employee is required by the Pension Act to maintain a ?Retirement savings Account? in his name with a Pension Fund Administrator (PFA) of his choice. This Law also allows the employee to transfer his retirement savings account from one PFA to another PFA provided the change is not done more than once in a year.

An Achilles heel of the old pension scheme was the problem of the collection and remittance of contributions. Under the new scheme, an attempt at improving the remittance of contributions is made as the employer is required to deduct the employee's contribution simultaneously with the payment of his salary, and within seven working days thereafter remit the sum deducted, together with the employer's contribution, to the Pension Fund Custodian (PFC) specified by the employee PFA.

The penalty for late remittance of contributions under the scheme or non-remittance is subject to the rates to be stipulated by the National Pension Commission (the Pension Commission). Pending when such a penalty stipulation is made, the Pension Act provides for a penalty of not less than 2 percent of the total contribution, which ought to have being remitted.

The Pension Act recognises the modern trend of free movement of labour and therefore allows an employee to maintain the same retirement savings account even when he/she leaves one employment for another.

Retirement Bonds

Outstanding pension benefits for public sector employees are reported to be in excess of over N 2.5Trillion (Two and Half Trillion Naira). To defray this huge deficit, the Pension Act requires the

Federal Government to establish a Federal Government Retirement Bond(s) to take care of pension schemes for federal civil servants (which are currently under funded) three years before the commencement of the enforcement of the provisions of the new Pension Act. The Central Bank of Nigeria is the manager of this Bond to which the Federal Government of Nigeria is required to contribute 5% of the total emolument of all federal civil servants.

Transitional Provisions for The Private Sector

Private pension schemes that were operating before the coming into force of the Pension Act and who have funds and assets in excess of N 500Million (Five Hundred Million

Naira) are described by the Pension Act as ? **Closed Pension Fund Administrators** ? and are permitted to continue to exist provided they apply to the Pension Commission for an operating licence and such private schemes satisfy the following:

- The private scheme is fully funded and the employer undertakes that it will always be fully funded;
- The pension funds and assets are fully separated from the funds and assets of the private company;
- The pension assets and funds are held by an appointed custodian;
- Every employee is given the right to exercise the option of moving his contribution to the new scheme established under the Pension Act;
- The employer demonstrates a managerial capacity, for a period of 5 years before the commencement of the Pension Act, to manage pension funds.

A Closed Pension Fund Administrator is required at the end of each financial year to submit its scheme to an actuarial valuation to determine the adequacy of the funds and assets under the scheme.

In addition, all existing pension schemes are required to submit to the Pension Commission, a statement of affairs of their present operating contributory pension scheme; the statement must state the assets, liabilities, list of members and pensionable salaries among others, of all the beneficiaries to that scheme. It is expected that the Pension Commission guidelines, when released, will define the modalities for undertaking an actuarial valuation and who bears the costs of such a valuation.

Transitional Provisions for The Public Sector

For the public sector and as mentioned above, the Pension Act makes provision for the establishment of a ?Retirement Benefit Bond Redemption Funds? (the Bond) to be managed by the Central Bank of Nigeria .

A further transactional provision is the establishment of a ?Pension Transitional Arrangement Department? consisting of the entire existing pension Boards in the public service. This department is established with the responsibility of assisting the transition to the new scheme by rending monthly returns of the comprehensive list of pensionable staff including the deceased ones and their next-of-kin, to the Pension Commission. The existence of this Department is provided for in Section 38 which says that: ?The Department shall cease to exist after the death of the last pensioner or category of employee entitled to retire with pension before the commencement of this Act?.

National Pension Commission

A National Pension Commission (the Pension Commission) is established under the Pension Act and it is the Regulator for this sector, as the Law requires it ?to regulate, supervise and ensure the effective administration of pension matters in Nigeria ?. It is a body corporate with perpetual succession and may be sued or sue in its own corporate name.

National Social Insurance Trust Fund

The National Social Insurance Trust Fund is a social insurance scheme for employees in the private sector alone. The rate of contribution to the scheme was 6.5% for employers and 3.5% for employees. The trust fund, unfortunately did not meet the principal objectives under which it was established by statute.

The failure of the National Social Insurance Trust Fund (NSITF) and the public sector pension schemes to effectively administer a social insurance and pension system in Nigeria metamorphosed into a crisis from which the Pension Act is founded. Non-remittance of contributions by employers, non-payment of benefits based on one excuse or the other, bureaucracy, very poor prosecution records of defaulters in our Courts, are but some of the problems associated with previous pension schemes.

The Pension Act has however not jettisoned the NSITF. In its stead, it requires the NSITF to establish an independent company to undertake the business of a PFA on its behalf. In the same vein, the PFA of NSITF must also appoint a PFC, as required by the Pension Act, to hold in trust NSITF funds and assets.

Thus, all pension funds and assets, held and managed by NSITF, before the commencement of the Pension Act are required to be transferred to a Pension Fund Custodian licensed by the Pension Commission. Old contributions to the NSITF are protected, as the NSITF is required to compute their benefits and credit them to each individual contributor's retirement savings account. Participants to the old NSITF scheme are allowed to continue to maintain their contributions through an NSITF appointed PFA.

NSITF is mandated to ensure that from the commencement of the Pension Act, it provides every contributory citizen, social insurance services other than pension and in accordance with the NSITF Act, 1973. What social insurance services means is unclear from the Act.

However, Section 42 of the Pension Act gives the impression that contributors under the NSITF scheme must wait for at least five years after the commencement of the Pension Act (i.e. 2004) before they can select a PTF that is not registered by NSITF. This may not be very equitable as it also gives the impression that government is creating business for NSITF to the disadvantage of other players in this sector of business.

Pension Fund Administrators and Custodians

On the coming into effect of the Pensions Act, all pension funds and assets shall only be managed by Pension Funds Administrators (PFAs) licensed by the Pension Commission.

The functions of the PFAs' under this Law include:

- Opening of retirement savings accounts for all employees under the scheme with a personal identity number (PIN) attached;
- Investing and managing pensions funds and assets;
- Keeping proper books of account of all pension fund transactions managed by it;
- Maintaining a data Bank and providing regular information on investment strategy, market returns and other performance indicators, to the Pension Commission;
- Providing all strata of customer service support to employees registered under the scheme;

- Paying retirement benefits to employees in accordance with the provisions of the Pension Act.

Pension Fund Custodians

Based on the wrong management and non-maximisation of previous pension schemes, the Pension Act separates the administration of the pension funds and assets from the actual custody and or safe keeping of the said funds and assets. This it does by the establishment of Pension Funds Custodians (PFCs) who must be licensed by the Pension Commission.

The primary functions of the PFCs include:

- To receive directly from the employers, the total pension contributions on behalf of the PFAs, and to advice the PFAs within twenty four hours, of the receipt of each contribution;
- To hold pension funds and assets in safe custody and on trust for the employees and his/her beneficiaries, in a retirement savings account;
- To assist the PFAs in the settlement of claims and in the administration of the pension funds' investment including the collection of dividends and other related activities;
- To undertake statistical analysis on investments and returns on investments with respect to the pension funds held by it in its custody and to provide data and information to the PFAs and the Pension Commission.

PFAs & PFCs Operating Without License

The Pension Act provides that any individual or corporate body that carries on business as a PFA or a PFC without a licence from the Pension Commission commits a criminal offence. The penalty for an individual is a fine of not less than N 5Million (Five Million Naira) or imprisonment for a term not exceeding 5 years.

For a corporate body, the fine is not less than N 10Million (Ten Million Naira) with a fine of N 2Million (Two Million Naira) for each Director or Officer of the PFA or PFC; the imprisonment term is also a period of not less than 5 years.

Reporting External Auditors

The Pension Act has imputed on external Auditors, appointed by either the PFAs or the PFCs, a reporting obligation directly to the Pension Commission.

The Pension Act requires the external Auditors to immediately advice the Pension Commission of any immediate danger to the funds and assets managed under the pension scheme. Examples of when to make a report include cases of suspected fraud, misappropriation of pension funds and assets, incompetence of the Directors and senior Managers administering the pension funds and assets, etc.

A failure by the external Auditor of a PFA or a PFC to report any of the above events carries with it a criminal liability of a fine of not less than N 10Million or imprisonment to a term of not less than 3 years or to both the fine and the term of imprisonment.

Reporting Staff of PFAs & PFCs

PFAs and PFCs are required by this Law to report to the Pension Commission all members of its staff whose employment were terminated or dismissed on grounds of fraud or misappropriation of funds.

The Pension Commission is also in turn required to maintain a data bank, for circulation to all PFAs and PFCs, of all dismissed or terminated employees on grounds of fraud or funds misappropriation.

The penalty for non-reporting of cases of staff fraud includes a fine of not less than N 1Million and a possible revocation (in the case of a persistent contravention) of the PFA's or PFC's licence to operate a pension scheme business.

Insider Dealings

In addition to expressly prohibiting PFAs from holding any pension funds and assets, PFAs and PFCs are prohibited by the Pension Act from having any cross business interest, shares or any link whatsoever in their separate companies, i.e. PFA and PFC.

The above-mentioned restraint also applies to employees of the PFA or PFC organisations who may intend to do business with their subsidiaries or counter party in relation to pension funds or assets. Further, a PFA must not invest pension funds and assets in shares or other securities issued by its appointed PFC or by one of its shareholders or affiliated companies. Neither is a PFA permitted to sell pension fund assets to itself or to any of its shareholders, directors or employee, spouse or other affiliates.

Further High Points of The New Pension Act

- No Chief Executive Officer (CEO) of a PFA company can be appointed without the prior written approval of the Pensions Commission.
- Every PFA is statutorily required to employ a Compliance Officer who shall report directly to the CEO of the PFA and act as a contact between the Pension
- Commission and the PFA with regard to rules, regulations, statutory compliance issues, etc.
- The maintenance of a statutory reserve fund by the PFA as a contingency fund to meet claims. To this fund must be credited annually, 12.5% of the net profit after tax, of the PFA.
- All brochures, advertisements, communications, promotional materials and representations by PFAs must be truthful and meet the Pension Commission requirements.
- The Pension Act empowers the Pension Commission to remove from office any erring Director and officers of a PFA or a PFC where they violate the licence requirements of the exact business that they can engage in or where they misappropriate pension funds and its assets. This is notwithstanding the provisions of any existing Laws or penalties in Nigeria , to the contrary.
- Pension funds and assets are exempted from all liquidation or judgement enforcement proceedings. This means that a judgement of a Court, a winding-up or a liquidation Order shall not apply to dissipate pension funds and assets. Where such an event threatens to occur, the funds and assets of the pension fund are to be transferred to another PFC and the actual assets of the PFA or PFC can then be seized to meet the judgement claim.

Investment Criteria of Pension Funds

The Pension Act reiterates the age long rule in investment business by requiring PFAs to invest pension funds assets strictly within the objectives of safety and fair returns on the amounts or assets invested.

Therefore, subject to the guidelines issued by the Pension Commission from time to time, the Pension Act directs that pension funds and assets should be invested in any of the following investment vehicles: -

- Bonds, bills and other securities issued or guaranteed by the Federal Government of Nigeria (FGN) and the Central Bank of Nigeria (CBN).

- Bonds, debentures, redeemable preference shares and other instruments issued by corporate entities listed on the Nigerian Stock Exchange (NSE).
- Ordinary shares of public limited liability companies listed on the NSE with good track records having declared and paid dividends in the preceding five years.
- Bank deposits and securities.
- Real estate investment.
- Such other investments as the Pension Commission may from time to time prescribe.

The Pension Act allows the Pension Commission to recommend to the President of Nigeria, subject to CBN foreign exchange rules at the time, the investment by PFAs of pension funds and assets outside the territory of Nigeria .

The penalty for non compliance with the investment vehicles above stated is a fine of N 500,000 for each day that the non compliance continues including the forfeiture of the profits that accrued from that investment to the beneficiaries of the scheme. Where a loss occurs, the PFA will make good the loss.

Dispute Resolution Mechanism

Another novel provision in the Pension Reform Act is the settlement of disputes on pension matters through the alternatives dispute resolution mechanism (ADR), which saves time and expense. This is arguably the first time in Nigeria that an ADR process is being introduced directly into a statute.

In the event of a dispute or disagreement arising from a pension matter, it is mandatory to seek ADR resolution before availing oneself of the Courts. The first stage is for the aggrieved employee or beneficiary of a retirement savings account, to formally bring to the notice of his/her PFA, details of his complaint/dissatisfaction. Where he/she is not satisfied with the decision of the PFA, after notice of a complaint, the employee is required to forward the complaint to the Pension Commission for the review of the PFA's decision.

The Pension Commission must give the parties notice of the complaint and a fair hearing. A decision must be arrived at three months after a complaint is referred to the Pension Commission.

Where either the PFA or the employee or beneficiary is dissatisfied with the decision of the Commission, the dispute is required to be referred to arbitration in accordance with the

Arbitration and Conciliation Act or to the Investment and Securities Tribunal (the Securities Tribunal). The decision of the Arbitration or Securities Tribunal shall be final and are enforceable by the Federal High Court of Nigeria, which is conferred with exclusive jurisdiction on matters of pensions.

Legal actions against the Pension Commission require a pre-action notice of at least 30 days. A pre-action notice usually states the full details of the complaint and gives the Federal government agency an opportunity to remedy the problem, if possible, without going into protracted litigation.

Comments to The Pension Reform Act, 2004

- Organised Labour has rightly argued that the Pension Act contravenes Section 173 of 1999 Constitution, which only empowers the Federal Government to make federal legislation on matters under which it is given exclusive jurisdiction, i.e. federal civil servants pensions. Thus pension matters for the private sector is ultra vires the powers of the Federal Governments.

  This must not however, in my view, distract from the benefits and innovations of the Act as the criticism can be ratified after further consultations with the stakeholders and necessary amendment(s) to the Pension Act.
- The Pension Act appears not to make any provision for civil servants employed by the State governments and Local Councils. This will be disastrous as these tiers of government are already under funded (under the revenue distribution formular) and will avoid any additional expenditure especially when it is not obligated by Statute to do so.
- No special qualification, apart from a minimum share capital, is required for the licensing of PFAs. Matters like the integrity of the PFA Board of Directors, skills, knowledge and capacity to manage pension funds are not sufficiently elaborated upon in the legislation under review.
- No guarantees provided for the pension funds and assets in the event that a PFA or a PFC goes into voluntary liquidation or winding up. A deposit insurance scheme like the one for the banks will be ideal to remedy such an unfortunate event.
- This Law does not place sufficient emphasis on integrity and professional competence of the Commissioners to be appointed to manage the Pension Commission. Appointments based on political patronage will ensure that the scheme does not succeed.
- The informal sector of the Nigerian economy constitutes over fifty percent (50%) of its

work force. Notwithstanding the constitutional restraint mentioned above, their non-inclusion in the Pension Act and the non-enlightenment of preparing for retirement posses a great challenge which need to be remedied.

- The administration of pension funds and assets requires significant investment in information technology and systems. As it is estimated that several PFAs and PFCs will be registered, it means that these licensees may operate several individual software systems. It would be preferred if the Pension Commission designates a standard or compatible information system(s) for all PFAs and PFCs which in turn can be monitored by the Pension Commission.
- Section 9 (3) of the Pension Act provides that employers shall ?maintain life insurance policies in favour of their employees for a minimum of three times the annual total emolument of the employees?. This provision is unclear and liable to different interpretation, as it will mean an addition to the rate of contribution to the pension scheme by employers. Will this not amount to an enlargement of the contributory burden of the employer and stifle employment?
- The role of the Pension Fund Custodian, who acts as an intermediary between the contributors and the PFA, is not exhaustively defined in this Law. A PFC acting as a ?Banker? for example does not add any thing new to the existing systems as many schemes currently have their own Custodians.
- The penalty of 2 percent (2%) for late remittance or non-remittance by an employer to a pension scheme is too nominal, as it will actually encourage non-remittance or late remittances of contributions in view of the fact that the costs of funds and doing business in Nigeria remains high.
- There is no detailed provision for voluntary withdrawal and collection of already contributed benefits to the scheme. A withdrawal can be warranted by many factors among which are a relocation of the contributor from Nigeria or a development of an independent alternative pension plan.

Conclusion

A lot of details including Pension regulations (with guidelines?) are expected from the Pension Commission, when it is constituted. It is hoped that the enthusiasm and positive criticisms that have greeted the Pension Act will mark the beginning of a new dawn in pension administration and management in Nigeria .

Further, a Law only works when the stakeholders maintain their respect for that Law and act in good faith concerning it.
I would gladly welcome fresh thoughts and experiences from other jurisdictions on this subject.

^ Return to top

EHIJEAGBON O. OSEROGHO
August, 2004.