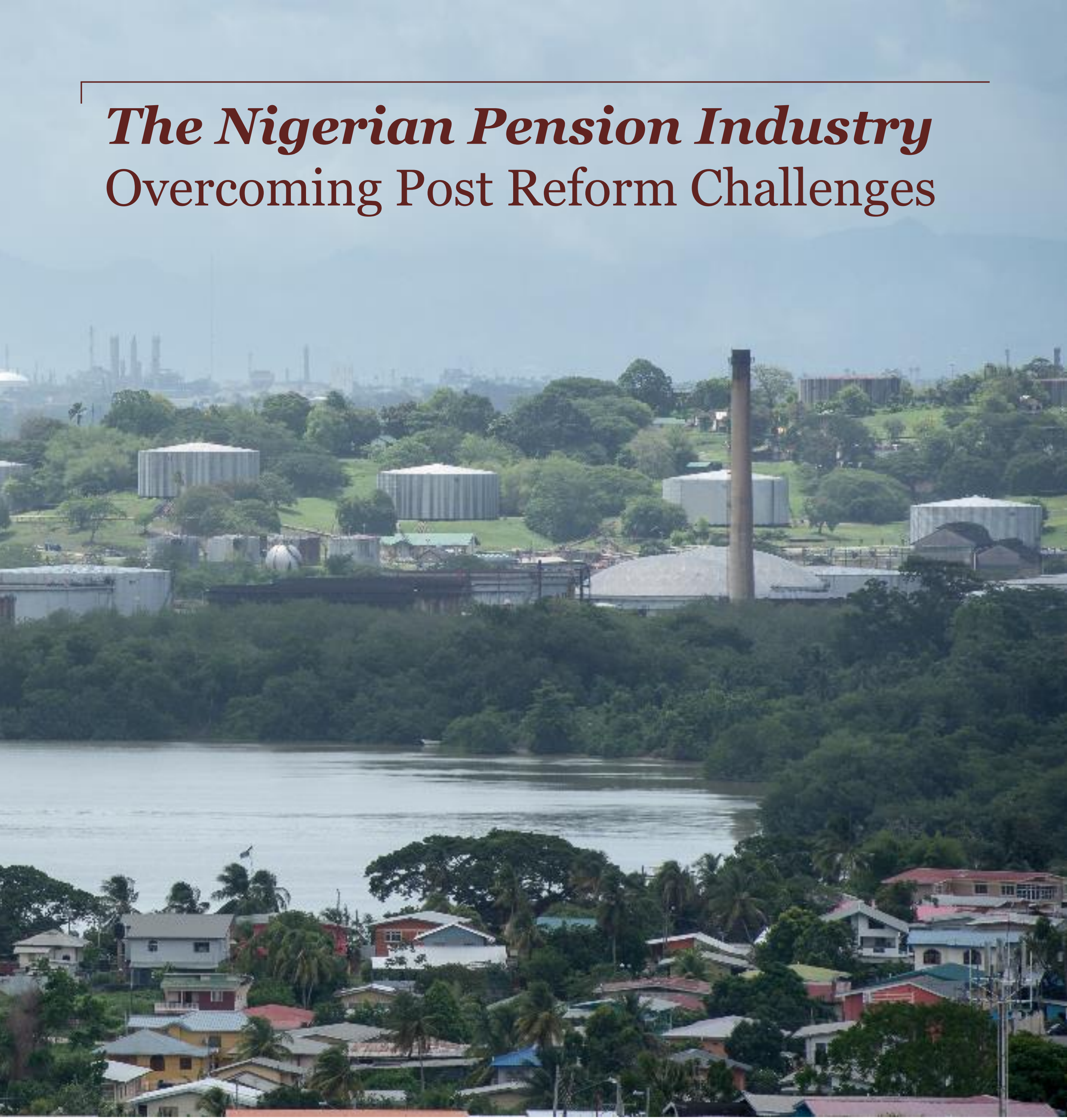
The Nigerian Pension Industry
Overcoming Post Reform Challenges



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Introduction

Remarkable success has been recorded since the introduction of the Contributory Pension Scheme in 2004 – yet key challenges continue to persist.

Nigeria's pension reform of 2004 was necessitated by the myriad of problems that plagued the "pay-as-you-go" schemes in the public sector and the varying types of pension schemes that existed within the private sector, which resulted in retirees not getting their benefits. The Pension Reform Act (PRA 2004), the subsequent review and enactment of PRA 2014, introduced the Contributory Pension Scheme (CPS), which made it mandatory for employers and employees in both the public and private sectors to contribute towards employee retirement benefits. The new pension scheme introduced a tripartite system with three key autonomous players – The Regulator, The Administrator and The Custodian - to minimise the possibility of misappropriation of pension funds.

Twelve years on, Nigeria has recorded remarkable success with the CPS having pension fund assets of over $25 billion, a contributor base of over 6.9 million workers and no incidence of pension funds being misappropriated. The 6.9 million people covered represents 8.1% of the Nigerian working population indicating significant headroom for growth within the industry. The anticipated growth will materialise if three key challenges plaguing the scheme are overcome.

1. **Benefit Adequacy:** Will the Nigerian worker on retirement receive adequate benefits such as to achieve the goals of the pension reforms?
2. **Coverage & Compliance**: Do all Nigerian workers have access to the CPS and does it cover the most economically vulnerable groups? Have all who are meant to comply under the provisions of the PRA 2014 done so?
3. **Financial Sustainability:** Can Nigeria fulfil its responsibilities in managing the CPS in the short, medium and long term? Can it fulfil the financial commitments associated with the transition from the previous pay-as-you-go scheme to the new contributory pension scheme?

Nigeria's lower class will not have sufficient funds in their RSAs to provide a meaningful income on retirement.

Benefit Adequacy

One of the major objectives of the Nigerian pension reforms was to "assist improvident individuals by ensuring that they save in order to cater for their livelihood during old age". The minimum contribution rate is set at 18% of pensionable emoluments (basic salary, transport and housing allowances). For the upper class which earn above $65,800 per annum this could translate into considerable savings on retirement. However, the most vulnerable group i.e. the lower class which constitute about 90% of the working population, retirement savings would not be sufficient to provide them a meaningful income on retirement as they may receive a meagre $25 per month as pension in present values (see table below).

Class	Income Band	Working Population (%)	Average Annual Salary	Contributions	Admin Fees	AuM Fees	Net AuM + RoI	Monthly Pension
				discounted to present values				
Upper Class	1	5%	65,800	149,469	59	51,211	313,560	**1,307**
Middle Class	2	3%	49,300	111,988	59	38,364	234,899	**979**
	3	2%	23,000	52,246	59	17,886	109,519	**456**
Lower Class	4	10%	9,900	22,489	59	7,686	47,067	**196**
	5	72%	4,000	9,086	59	3,093	18,939	**79**
	6	8%	1,300	2,953	59	990	6,068	**25**

PenCom, IMF, CBN, PwC Analysis

(Figures in USD)

Key Assumptions (Workings do not take into consideration lump sum payments)					
Average working years	25 yrs	Rate of Return (average over 25 years)	13.5%	Annual AuM Fees	2.25%
Pensionable years	20 yrs	Real Rate of Return	4.5%	Annual Admin Fees	$6
Salary Increment Rate	3%	Inflation Rate	9%	Contribution Rate	18%

(2015 fig.)

Overcoming the Benefit Adequacy Challenge

The PRA 2014 section 82 (1) has made provision for the establishment of a Pension Protection Fund which will be utilised towards guaranteed minimum pensions and the payment of compensation to eligible pensioners for financial losses arising from investment activities. However, twelve years into the reforms and several retirees later, this fund is yet to be set up. PenCom will need to expedite action on its creation to alleviate poverty especially amongst lower class retirees. It will also need to review the administrative fees charged on RSAs as it is not equitable across income bands.

Nigeria's contributory pension scheme has not been thoroughly subjected to a "means test". There is a need to determine, based on mortality rates, if there would be a sizeable pool of elderly retirees requiring a guaranteed minimum pension after exhausting their pension savings.

The workforce of the future will also be more fluid and will require more options for pensions and retirement ages to support that fluidity. Many developed countries have increased retirement age or seek to introduce a "pension window" to allow workers choose when to retire within an acceptable age band. This enables them to retire when their personal circumstances best dictates while affording employers more years of service from their highly skilled and most experienced employees. There are also contract workers for whom employers do not make pension contributions and individuals who cannot take up full time employment due to health reasons or family commitments. PenCom needs to consider these scenarios when designing the structure of the Pension Protection Fund.

The industry also has to do more in encouraging voluntary contributions possibly through the introduction of innovative products and services centered around value added services. PenCom also needs to review its voluntary contributions regulations as several Nigerians have more than one source of legitimate income.

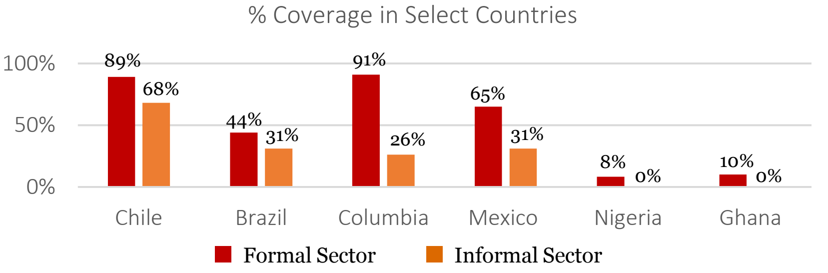
8.1% of Nigeria's working population has been covered by the contributory pension scheme in twelve years.

Coverage & Compliance

Coverage to date has been impressive considering the general distrust towards the pension industry and Nigeria's large population. However, Ghana has been able to achieve 10% coverage in eight years and Columbia though its reforms are 23 years old, has been able to achieve 91% coverage of the formal sector and 26% of the informal sector. The National Pension Commission (PenCom) needs to expedite action on several key coverage and compliance initiatives to achieve this level of coverage in the next 11 years.

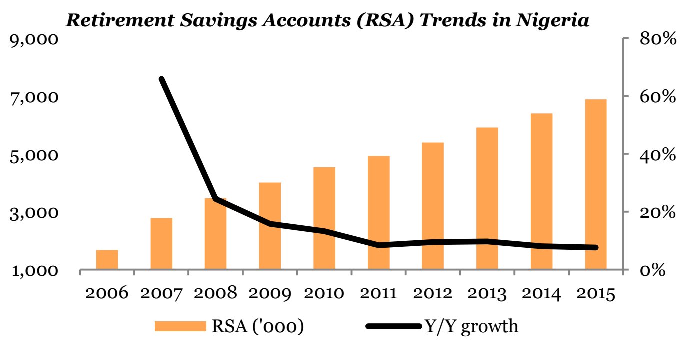
Several key CPS coverage and compliance challenges have been identified across Nigeria's formal and informal sectors as follows:

Formal Sector - Private: Several private sector employers have contravened the provisions of the PRA 2014 with some going as far as deducting employees' contributions and not remitting same to Pension Fund Administrators (PFAs). It remains difficult to differentiate between a micro, small or medium scale enterprise for compliance purposes.



BBVA Resarch, PwC Analysis

Country	Key CPS Reforms (Date)
Chile	1981
Brazil	1989
Columbia	1993
Mexico	1997
Nigeria	2004
Ghana	2008



PwC Analysis

Growth in the number of contributors to the CPS in Nigeria has also slowed to an average 8.7% over the past five years, from an average of 30% over the 2007-2010 period owing to slower growth in the labour force in recent years.

PenCom has tried to overcome this challenge by working with other Government agencies to make the PenCom Certificate of Compliance with the provisions of the PRA 2014, a prerequisite for obtaining Government contracts. However, this has created another challenge of unfunded and duplicated accounts whereby some contractors remit contributions to staff RSAs in order to comply but only when contracts are being sought.

Formal Sector –Public: Although it is now mandatory for State and Local governments to implement a CPS for their employees, only 8 states to date have been able to comply. Amidst the continued difficulty in meeting salaries and retirement benefits obligations, there is a perception of diminishing political will to implement the CPS even though it will be much cheaper to fund and as a result, a significant number of public sector workers who could have benefited from the CPS are being deprived of this privilege.

Informal Sector: Nigeria's informal sector has not been covered by the CPS and it employs about 59.7 million people which is approximately 70% of the country's working population. As this category of workers constitute the larger percentage of the working population in Nigeria, there is no doubt that to achieve PenCom's corporate objective of extending CPS coverage to at least 20 million Nigerians by 2018, coverage will need to be extended to the informal sector.

PenCom needs to expedite action on several key coverage and compliance initiatives.

Overcoming the Coverage & Compliance Challenge

To overcome coverage and compliance challenges, the industry would need to expedite action on the following;

- **Enforcing Sanctions for Non Compliance:** PenCom has taken a step in the right direction by engaging recovery agents to recover unremitted contributed pensions and has recovered $37.5 million to date. It has also engaged the Economic and Financial Crimes Commission in its bid to prosecute employers who contravene the provisions of the Pension Reform Act. However, it is important to ensure that the process for sanctioning such financial crimes is done expediently and the applicable sanctions fully enforced so as to serve as deterrent to erring employers.

- **Alternative Pension Schemes?:** It is obvious that "one size does not fit all" and it would be unrealistic to insist that all states conform instantly to the provisions of the PRA 2014. PenCom should review its guidelines to make it easier for states to comply with the provisions of the Act. For example, state employees could be permitted to open RSAs immediately and begin contributions with the employers making their contributions at a later date. The statutory monthly administrative fee could be reduced to reflect the proportion being contributed.

- **The Introduction of a Micro-Pension Scheme:** A micro pension scheme is a voluntary, defined contribution individual account plan for the informal sector (or low income earners) and has been successfully implemented in many countries around the world. Though PenCom is currently in the process of developing appropriate structures and guidelines for a micro pension scheme in Nigeria, it would need to learn from the challenges countries such as Kenya, India, Bangladesh etc. faced in scheme implementation especially those relating to the multiplicity of the sector. These need to be properly understood and considered to come up with appropriate guidelines and the required communication framework to facilitate contributor enrollment. It would also affect the contribution aggregation methods and the technology platforms to be deployed.

- **Implementing Appropriate Technology Platforms:** The introduction of biometric technologies to capture contributor details will address the duplicity of Retirement Savings Accounts as contributors with multiple RSAs will be easily identified. It will also make it easier to introduce the transfer window which will enable contributors move Retirement Savings Accounts (RSA) between PFAs and ultimately drive the improvement of customer service.

Government will need to consider the introduction of a non-contributory pension pillar to cater to vulnerable retirees.

Financial Sustainability

Financial sustainability addresses the capacity to continually generate enough income to cover pension administrative costs. The key consideration is the capacity to fund pension obligations made to participants of the old pay-as-you-go scheme while sustaining the new contributory pension scheme. This is known as "transitioning costs"

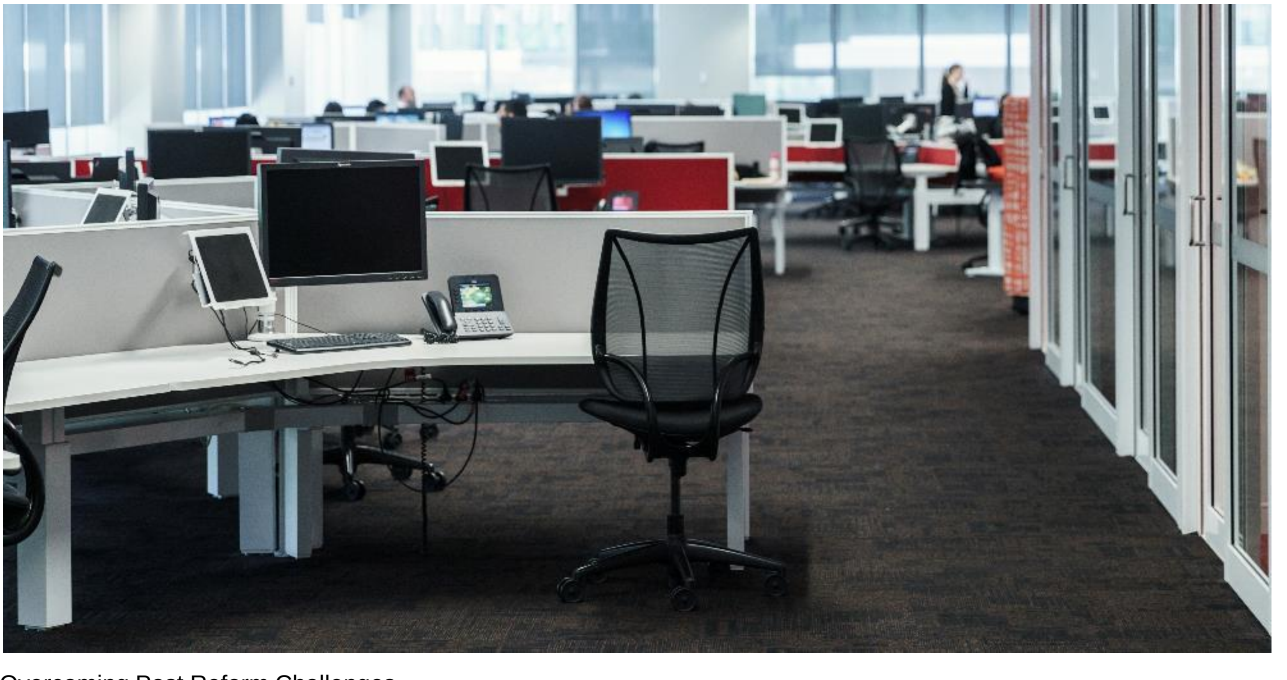
One of the major challenges plaguing both the Federal and State Governments is the obligation to pay the accrued pension rights of participants under the old scheme in addition to making employer contributions under the new scheme. This has placed considerable strain on the finances of the Federal Government while the State Governments have been in a quagmire on how best to transition within their current economic realities.

Overcoming the Sustainability Challenge

The PRA 2014 makes provision in section 39(1) for the establishment of the Federal Government Retirement Benefit Bond Redemption Fund which shall be utilised in the payment of the pension liabilities of the Federal Government arising from voluntary and mandatory retirements as well as death of employees in service. Federal Government employees still in active service as at the 2004 reforms and who had more than 3 years active service were to be issued retirement benefit bonds to the value of their accrued rights under the pay-as-you-go system. State Governments were also required to open Retirement Benefit Bond Redemption Funds with the Central Bank of Nigeria or a Pension Fund Administrator for the domiciliation and management of accrued rights funds. The purpose of these redemption funds is to ease the burden of paying accrued pay-as-you-go pension liabilities at once, into RSAs of employees who are still in service, as the bonds are only redeemed when an employee retires.

However due to the inability of most state governments to honor their pension obligations and the large number of vulnerable low income earners, it will be necessary to create an additional non-contributory pillar of pension for poverty prevention. The industry today earns over $500 million in asset management fees annually which is growing exponentially. There may be the ability or capacity to apportion part of this fee income into a fund to support this non-contributory pillar. This should be in addition to or supplement the Pension Protection Fund.

Nigeria should learn from other countries such as Colombia which has a "Pension Solidarity Fund (FSP)" in addition to the "Minimum Pension Guarantee Fund" that subsidises the contributions of specific workers. Both funds are financed with money from the contributions of high-income workers. Indonesia also has a social security system "Jamsostek" which not only covers informal sector workers but also subsidises their contributions through formal sector contributions. A variant of these systems could be adopted for poor and vulnerable workers.



Conclusion

The contributory pension scheme was introduced to ensure that Nigerian workers on retirement have a steady income source to depend on when they could no longer work and earn a living. The pension reforms introduced a tripartite system with three key players to ensure that the entities involved in regulating, administrating and holding custody of pension funds were separate and the fraud which had been prevalent pre-reforms was eliminated.

Remarkable success has been achieved to date, however, Nigeria should not rest on its oars - coverage needs to be extended, compliance enforced, vulnerable retirees need a minimum level of economic security and sufficient funds need to be set aside for accrued pension liabilities.

State Governments yet to implement contributory pension laws need to do so as it is cheaper to sustain than defined benefit schemes. The long term savings also greatly outweigh the initial implementation costs and state employees have the benefit of owning a retirement savings account.

Pension Fund Administrators would need to assist contributors to the scheme in making the best retirement decisions by offering personalised pension advisory services which would eventually increase voluntary contributions. This can be achieved by putting in place the appropriate customer service delivery processes and technology platforms while training staff to become trusted advisors to contributors.

Pension Fund Custodians would need to improve upon internal procedures in order to process contributions efficiently and promptly pay retirees upon receipt of prerequisite advice from Pension Fund Administrators.

PenCom should expedite action on the introduction of the proposed micro-pension scheme and on the creation of the Pension Protection Fund. It should further review some of its guidelines to make compliance easier at the state level as well as enforce sanctions for non-compliance.

In order to take advantage of the security that the contributory pension system provides, the Nigerian worker would need to:

- Open a retirement savings account (if not already done)
- Report non-remittance of pension contributions by employer to PenCom
- Demand better returns on investment and service delivery from Pension Fund Administrator
- Make voluntary contributions

Only then would the major objective of the Pension Reforms be realised and Nigerians begin to appreciate the significance of the reforms.

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