PENSION REFORM ACT 2004 AND ITS CONTROVERSIES: REPEATING OR LEARNING FROM PAST MISTAKES?

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Abstract:
This study reviews briefly the causes of pension crisis in Nigeria in the previous pension schemes and discusses how the present pension reform will affect active employees when they retire. It also examined the level of compliance of the participants to some of the provisions of the present reform since its implementation. One of the reform provisions discussed in this paper states that retirees' contributions be used to purchase life annuities from life insurance companies. However, the policy-makers seem not to be aware that mortality table based on life insurance experience is not suitable for use in connection with annuities for several reasons. This calls for the inclusion of actuarial profession as one of the implementing committee entrusted with the responsibility of investigating mortality experience of people in the country. This study examines some of these issues and suggests need to redesign pension schemes in Nigeria.

Keywords: Pension reform, annuities, retirees, schemes implications

Introduction

Over the years, effort has been made in various pension reforms by focusing on circumstances that led to deviation from fundamental idea it was established. Oredugba (1998) revealed that "the fundamental idea of pension scheme is to ensure that an employee retires in comfort". Ezeilo (1997) also revealed that pension scheme must be designed to reward employees for service rendered during the period of service and to compensate employee who may become victims of disabilities whilst in the service of the employers.

Contrary to the above, pension schemes in Nigeria before the pension reform act 2004 (hereafter referred to as the new scheme) was both a psychological and financial shock to the pensionable workers (Adeyele, 2004). Fashina, reported in Adeyele (2004) revealed why previous schemes failed:

> The old pay-as-you-go (PAYG) in public schemes under the supervision of National Provident Fund (NPF) was wound up for public servants after it lost N2 billions. Such scheme broke down for three main reasons
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> i. Although the proportion of contributions by workers was duly and regularly deducted from their monthly salaries at source, that of the employer was not equally and regularly made to the scheme.
> ii. The money was sometimes embezzled by the very pension officers who were entrusted with its management.
> iii. When the workers disengaged their voluntary or compulsory service, it became very difficult to have access to the fund.

Consequently, NPF was converted to National Social Insurance Trust Fund (NSITF). The conversion exercise was carried out by the Technical Committee on Privatisation and Commercialization (TCPC) as part of government's reform packages for public and corporations in the country (Ezellio, 1998). The scheme (NSITF) was established by government as loss protection for workers in the private sectors and this came to effect on 1st July 1994 by the virtue of Decree 73 of 1993.

Instead of the NSITF then to address the pension problem at hand, it followed the footsteps of defunct NPF by leaving the scheme to a deficit of N70 billions. This article discusses how the new scheme will affect the present retirees and touches issues that need resolution. This is especially timely as massive number of retirees is now thinking about retirement income and the potential annuitization of retirement savings.

Overview of the Pension Reform Act 2004

Better pension and retirement benefit for all Nigerians is something that touches the pensionable workers and the future generations. The government's interest in better retirement benefit for its citizenry derives from the fundamental fact that in democracies, people (young, old and retired) is the primary purpose of government. To meet this responsibility, government is expected to promote job creation for the young and able as well as encouraging people to plan and save for their old age and retirement through regulatory framework.

Already, federal government of Nigeria has passed into law a monolithic pension and repealed the pension Act 1990 and established a contributing pension scheme in its public sector. This development has received feelings of great happiness by some as a way to eliminate humiliating and embarrassing circumstances in the old Pay-As-You-Go (PAYG). Many also hoped that this reform will address the crisis of the pensioner poverty – largely caused by weak and inefficient administration and underfunded or non funding of most schemes by the government. Effective regulation and supervision oversight of the financial situation of pension funds is indispensible for the development of sound pension systems (Blommestein, 2000). In the aspect of weak and inefficient administration of pension scheme experienced before this scheme is also been observed in the present scheme. In fact, it has been observed that some employers do not pay their own monthly contribution to the scheme as directed by the pension commission.

This of course has also been a source of concern to the affected employees as the pension commission has not taken a positive step to correct this anomaly. It will now be interesting to see large proportion of employees whose contributions are deducted on monthly basis but not remitted to their retirement saving accounts.

This has no doubt generated great concern among members who will now be aware that their pension benefits may not be secured as they initially believed.

Issues about the new scheme

The main objective of this scheme is to ensure that all employees who worked in either public or private sector receive retirement benefits as and when due; and to establish a uniform set of rules, regulations and standards for the administration and payment of retirement benefits for all workers. In order to accomplish this noble objective, pension commission is entrusted with the responsibility to regulate, supervise, and ensure the effective administration of pension matters in Nigeria. However, the discussions below are attempts to reveal the extend the new scheme has deviated from its main objective and the danger this is likely to impose on the retiring workers.

Level of employers compliance to the reform. Employers in public sector and private sector have not complied to section 11(5) that stipulates that all contributions, both employee's and employer's, must be paid to pension fund administrator within " 7 days working from the day the employee is paid his salary, remit an amount deducted including the employers contribution to the custodian specify by the pension fund administrator of employee". It has been observed among some employers in Nigeria that employees' contributions are regularly deducted at source but not regularly paid to the respective custodians (see table 1 in appendix). From the investigation made, only the multinational companies have complied to the scheme's provisions. One of these companies is contained in table 1 in appendix. It should be mentioned here that the previous schemes did not just failed for the want of not remitting funds to retirees accounts but simply inability of regulating body them to quickly step in to enforce compliance among the employers. This ugly situation must not be allowed to continue if reoccurring decimal is to be avoided. If this is not corrected in time, the affected employees stand the risk of losing their contributions.

Similarly, many employers ignore the need to maintain life insurance policy in favours of the employee for a minimum of three times the annual total emolument of the employee. This may be due to the fact that the scheme does not specify how employee will qualify for this benefit since the essence is to pay claims to employees who sustain injuries or die while in the service of employer. The main challenge in this provision is that, if employee has notified employer of his leaving but dies before intended date of leaving, one is not sure that the deceased's beneficiaries will be entitled to the benefits.

Employment of Compliance Officers. The employment of compliance officers should not be considered by the pension fund administrators as the role expected from them contravene the principal-agent relationship. The agent (compliance officer) owes the principal (pension fund administrator) the oath of allegiance and it will extremely difficult for the former to report the latter of any wrong doing to the commission. Consequently, the compliance officers should be the commission's employees posted to employers and pension funds administrators. By so doing, it will enable the commission achieve its principal aim of regulating, supervising, and ensuring the effective administration of pension matters in Nigeria.

Obstacles to regulator's role. The dual role of the national pension commission – as industry administrator and a distributive point for remittance of public employers' contribution is a threat to the success of this scheme. The regulator of pension scheme should not double up as the industry administrator. Just as National Insurance Commission is made independent of insurance industry, the business of pension commission should be limited to regulating and controlling pension system for optimal performance. Government need to facilitate the development of the proper infrastructure (in particular by providing an efficient regulatory and suppervisionary framework) that will enable pension funds to efficiently allocate retirement savings and risks (Blommestein, 2000).

Choice of Retirement Benefits. The new scheme permits retirees to use their accumulated funds for programmed monthly withdrawals or life annuities from life insurance industry. However, the policymakers did not specify how annuity markets are to be regulated. Some workers who have retired are compelled to choose monthly programmed withdrawals that does not protect against longevity risks by their respective pension fund administrators. These retirees are not aware of annuity products to be offered by the life insurance industry. The lost of fund by the National Social Insurance Trust Funds and the low level of how insurance products, life annuities, can be used to mitigate longevity risk create general distrust to insurance industry in Nigeria. Expect there is clear guidelines on how annuity market created by the new scheme should be regulated as well as education workers on how annuity products can be used to protect against possibility of outliving ones income, this scheme is billed to bring untold hardship on the innocent retirees.

Implications of the reform on retirees funds

Pension Reform Act 2004 makes provision for Defined Benefits and Defined Contribution with some laid out rules. However, since the implementation of this reform, all employers of labour in Nigeria has abandoned Defined Benefit in lieu of Defined Contribution. Consequently, change from defined benefit (DB) to defined contribution (DC) has increased the risk shoulders by individual employees (instead of the employers or the government) and it reduces the redistributive elements present in DB pension schemes. The retirement saving account introduces two elements of risk to pensioner income namely investment risk and administrative charges risk, and these may lead benefits to be significantly different from those available under the old PAYG of DB type of pension schemes (Zaidi, 2006).

The move from DB to DC also implies that contributions and benefits of an individual became directly linked which does not permit redistribution of risk. Thus such a move was negative for lower-income individuals, as progressive elements in pension formulae were removed.

Another implication of this reform is that all retiring employees must purchase annuity from insurance companies or use their lump sum for programmed monthly withdrawals from pension fund administrators. If retirees intend to purchase life insurance products, there is need to regularly updates mortality patterns for different categories of workers in the country on an annual basis (Mojekwu and Adeyele, 2010), if life insurance companies are to succeed. This is one of the areas actuarial profession is expected to perform credibly in this reform. However, its omission by the policy-makers in this reform will create financial challenge to both the insurance industry and the retiring workers. These policy-makers seem not to be informed that that a mortality table based on life insurance experience is not suitable for use in connection with annuities for several reasons. One important reason is that annuities generally are not purchased by individuals in poor health; and another important reason is that the constant improvement in mortality rate provides a generally increasing margin of safety for life insurance but has the opposite result for annuities (Black and Skipper, 2000:704). In fact, it is recognised that no annuity mortality table based on past experience can be used safely (Black and Skipper, 2000). What is needed is a table that shows the (lower) rates of mortality anticipated in the future rather than the rates that have been experienced in the past.

Insurance industry as it is today has not been able to produce indigenous mortality tables but relies on the foreign ones which might not suitably capture the mortality experience of prospective annuitants in Nigeria. As a result, there is a need to develop and validate mortality basis for statutory reserves for group annuity contracts and to provide data for pricing these annuities. Actuarial profession is highly needed in this area. This will, in turn, enable risk classification to be made for different classes of people.

In the United Kingdom, "risk classification in annuity pricing has created new rates for classes that include, smokers, those within medical impairment (diabetics, high blood pressure, higher cholesterol, stroke or heart attack victims), the overweight, and more recently, manual workers living in geographic areas displaying higher than average mortality" (Black and Skipper, 2000). Nigeria insurance industry may want to look at the United Kingdom as an example of a marketplace where the insurance industry has responded to individual needs to expand the range of available annuity products, and increase the sophistication used in the pricing.

The final implication discussed in this article is of global age and pension reform for policy is that the scale for a possible international systemic crises will become more important as pension funds and other international investors continue to diversify into international markets. One lesson from recent event is that the abrupt loss of access by individual countries to global capital market may continue to occur (Blommestein, 2000). Consequently, it is essential for those making the risk-return trade-off decisions on behalf of pension beneficiaries to be well-informed, to have proper incentives and to be adequately supervised (Blommestein, 2000). A super visionary framework based on prudent-man principles and sound risk management approach is better adapted to this purpose.

Conclusion

The above discussions briefly described how the pension reform Act 2004 will affect the potential retirees with special focus on annuity market. The shift from defined benefit towards defined contribution systems has put stoplight on the investment risks of employees and retirees (Blommestein, 2000). The reform has also given all employers in Nigeria to abandon defined benefit for defined contributions thereby shifting investment risk on employees. Moreover, pension commission as well as policy-makers need to ensure that individuals understand the choices before them, particularly the longevity risk associated with defined contribution and ensure that all the parties involved comply to the provisions of the reform. They need to remember that pension were not introduced by accident, but were the result of social consensus that poverty amongst the elderly must be eliminated (Zaidi, 2006). This study also revealed that the regulators have not paid close attention to non-remittance of employees funds to appropriate accounts was the major cause of pension crisis in Nigeria in the previous schemes. Intensive research is needed in the regulatory office as it is in the bodies that are subject to its regulation. As a result, the pension commission should actively promote actuarial education that will result to sound design and implementation of pension schemes in Nigeria. Ignoring the established actuarial profession and relying on entirely on the financial markets to come to retirees' rescue, is not a responsive strategies – as argued by Norberg (2008).

The role of pension commission should be limited to that of regulator and not that of industry administrator and should not hesitate to post its staff members to the bodies subject to its regulation to monitor the level of compliance.

Any erring employer or pension fund administrator should be punished as stipulated in the reform's provisions. The commission should consider the employment of compliance officers as its employees and not that of pension fund administers'. If compliance officer must be pension fund administrators' employees, then there should be provisions in the reform that covers them in order to enable them discharge their duties and responsibilities effectively.

Greater care is also needed to offer protection to pension beneficiaries and financial education as pension-related risk has completely shifted from governments and employers onto individual employees and households. As concerns pension beneficiary protection, there is need for the policymakers to follow other countries around the world to introduce pension guarantee funds to help insure against the risk of pension scheme failures. Their experience, as well as the inherent problems of moral hazard and adverse selecting, suggest the need for careful design, including limitations on the type and amount of benefits covered and the use of risk-based premiums (G-10, 2005). Such funds also need sufficient autonomy, powers, and resources to avoid political and market interference (G-10, 2005). These issues show the need to redesign the pension scheme to meet the needs of employees.

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