GLOBAL JOURNAL OF INTERDISCIPLINARY SOCIAL SCIENCES
(*Published By*: Global Institute for Research & Education)
www.gifre.org

MANAGEMENT OF PENSION SCHEMES IN AFRICA: NIGERIA'S EXPERIENCE, CHALLENGES, AND THE WAY FORWARD

OVBIAGELE, Abraham Otaigbe
Department of Office Technology and Management, School of Business Studies, Delta State Polytechnic, Ozoro. Delta State, Nigeria

Abstract

In Nigeria the pension scheme that were operated before the Pension reform Act, 2004 did not meet the objective of ensuring pension payment as and when due. This Act established the new contributory pension scheme. In the new scheme. contributions are sent to Pension Fund Administrators (PFA's) for the credit of employees' Retirement Savings Accounts (RSA's). Credits in these accounts are invested and used to programme employee's monthly pension payments at retirement. Two hypotheses were formulated. The research assessed the level of compliance by employers with the new scheme, investment of the pension funds and general level of awareness. The hypothesis tests showed that employers' level of compliance and workers level of awareness are low and that investments of pension funds have not started to yield fair returns. The study recommends amendment to the Act for more severe penalties to be imposed on erring employers, inclusion of contributors from the informal sector and increase in the rate of contribution from employers. It also recommended that investment should be in less risky financial assets and that more sensitization campaigns should be embarked upon to raise the level of awareness of the scheme.

Keywords: Pension, Retirement Saving Account, Contributory Pension, Contributor, Financial Assets, Administrator.

INTRODUCTION

Pension is defined as specified sum paid regularly to a person who has reached a certain age or retired from employment, and pension scheme is an arrangement, the main purpose of which is to provide members of the scheme with such regular payment (Butler, 1997). Pensioners are people who have spent the useful part of their lives in rendering services for the progress of their countries.

In view of this, developed and developing countries have always made provisions for their senior citizens. Turner (2006), states that pensions are high on the policy agenda in many developed countries and increasingly in developing countries. In Nigeria, the first pension Scheme was introduced by the pension ordinance of 1951 which had retroactive effect from January, 1946. This law provided public servants with both gratuity and pension (Ahrmad, 2006). In 1961, the Nigeria Provident Fund (a pension scheme) was established by the Nigeria Provident Fund Act of that year. This was replaced by the Nigeria Social Insurance Trust Fund (NSTF) that was created by the NSITF Act of 1993.

While the last two schemes were contributory and private sector driven, the public sector pensions were fully funded by Government. They were typical pay As-You–Go (PAYG) system or Defined Benefits (Musalem and Palancions, 2004). The private sector pensions were fairly efficiently operated, but those of the public sector became nightmares to pensioners. Many collapsed while waiting on long queues to collect their meagre pensions. The administration of the public sector pension scheme was characterized by myriad of problems which included identification of the pensioners, determination of entitlements, reconciliation of amount paid, arrears and misappropriation of the funds. There was also the problem of determining overall government pension liability for budgetary and planning purposes.

As way of putting paid to these problems and to remove pressure on government's budgetary provision for pensions, a new contributory pension scheme was introduced by the Pension Reform Act, 2004. Actual implementation of the scheme started in 2006. According to Balogun (2006), the public sector debt burden could not be sustained as outstanding pension deficits amounted to #2 trillion (U$$6.9 billion) before 2004. Infact, other countries in Africa planned to introduce a contributory pension scheme to reduce pressure on the Government's budget Kenya inclusive (Odundo, 2004).

BACKGROUND TO THE STUDY

The new scheme is applicable to both the private and public sectors. It is designed to be fully funded (by the employers and employees), privately managed and its objective is to ensure that every pensioner who worked in either the public service or private sector receives his pension as and when due.

There is a regulatory body known as the National Pension Commission (PenCom). PenCom license Pension Fund administrators (PFA's) and Pension funds Custodians (PFA's). The employee registers with a PFA who gives him a Personal Identity Number (PIN) and open a Retirement Savings Account (RSA) for him. At the end of each month the employer deducts $7^1/2\%$ of employee's monthly emolument and also contributes his own $7^1/2\%$ for the employee (total 15%) and sends the contribution to the employee's PFA/PFC who credits employee's RSA. For the military, the contribution in $2^1/2\%$ by employee and $12^1/2\%$ by the employer. PFA's are obliged to give each contributor a quarterly statement of what has been received from his employers and credited to his account.

The employee has no access to his RSA until he retires. He can at that time withdraw a lump sum, provided the balance in his RSA is enough to fund a monthly pension (not less than 50% of his pay as at date of retirement) for the remaining part of his lifetime.

INVESTMENT OF PENSION FUNDS

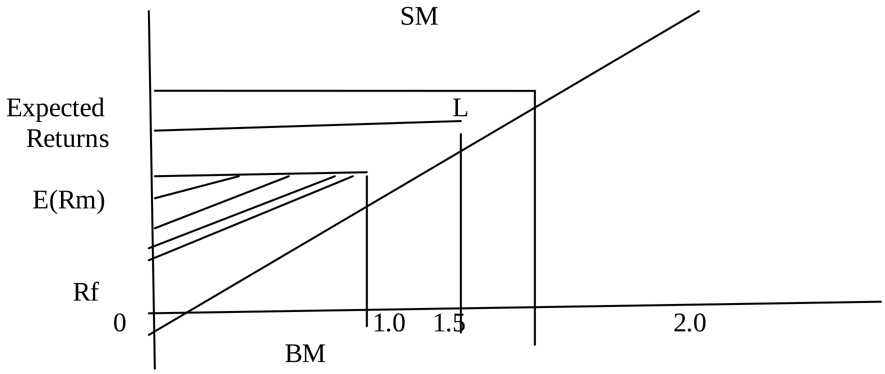
The number of contributors to the new scheme grew from 1.7 million in 2006 to 3.5 million in 2008, a growth of 106%. Total funds contributed also grew by 73% from #606 billion (US$4.2 billion) in 2006 to #1.05 trillion (US$7.2 billion) in 2008, and a projected figure of #1.2 trillion (US$11.3 billion) by year ending December, 2009.

Pension funds are institutional investors that have large pools of investible funds, and are therefore catalysts to economics development. Hirt and Block (1993) state that institutional investors represent organizations that are responsible or bringing together large pools of capital for reinvestment which include pension funds.

The investment portfolio of Pension Funds should be diversified to reduce risks, because diversification in modern portfolio theory is adjudged to be rational. Investors hold portfolios which consists of risk-free securities (Government Bonds Treasury Bill) and risky or market security (equities). Equities are subject to systematic (economy-wide) and unsystematic (industry-related) risks and their prices are volatile.

The above is demonstrated using the Security Market Line (SML). This line is used to describe the relationship between the risk (Beta) and the expected return of financial asset. It is positively sloped and linear (Ross, Jordan and Westerfield, 2002).

The Security Market Line



From the above graph E(Rm) is the expected return from the market portfolio (equities). Rf is the risk-free rate of return. Bm is the average systematic risk in the market. The shaded portion is the market risk premium which is equal to E(Rm)- Rf. The investment portfolio manager of pension fund, therefore, has to strike a trade-off between risk return by diversifying his investment.

Part IX of the pension Return Act, 2004 states that the objective of the investment of pension Fund is safety and fair returns. It stipulates areas in which Pension Fund should be invested. These include, Federal Government Boards, Treasury Bills, equities listed on the stock Exchange, bank deposit and real estates. Investment income from Pension Funds less administrative charges are credited to contributors' (RSA's). Pendey (2002) states that the rate on Return of shares is the Dividend Yield +Capital Gain and it is expressed as:

$$Rs = \frac{Div.\ I}{Po} \qquad \frac{PI-Po}{Po}$$

Where:
Rs = Rate of Share Return
Div.I= Dividend Declared
Po = Price of Share at beginning
P1 = Share Price at year end

The portfolio manager has to compare his Rs with the prevailing flation rate to assess the performance of his equity portfolio.

The new contributory Pension Scheme is being welcome by Nigerian workers, but with skepticism. To the Government it will free huge funds budgeted annually for other developmental needs. This paper sets out to assess or evaluate those problems that have the capacities of scuttling or jettisoning the good intentions of the new scheme.

To enable the researchers carry out their evaluation, two hypotheses were formulated.

Hypothesis 1:

Majority of employers have not keyed into the new contributory Pension Scheme.

Hypothesis 11:

Employer's level of awareness of the Scheme is not high.

METHODOLOGY

Simple survey design was adopted in this study. Out of the 25 Pension Fund Administrators (PFA's), 5 representing 20% of the entire population were selected. Employees and employers were randomly selected from the civil service and the private sector in Delta State of Nigeria. The instruments of data collection were questionnaires and oral interviews. A total of 30 questionnaires were administered on the PFA's employees and employers. Out of the 30 questionnaires 21 were returned which is a retrieval rate of 70%. The chi-square (c^2) statistical tool was used to test the data collected.

Operational Assumptions:

(i) Level of significance of 5%
(ii) Degree of freedom (df) = (R-1)(C-1)
(iii) R = 2, C- 2, df = (2-1)(2-1) =1
(iv) fe is equally distributed among all responses.

Responses to key questionnaires were used to construct chi-square tables as shown below:

(a) are employers complying with the Act in the area of making their own contributions and remitting both to employees Pension Fund Administrators?

RESULTS AND DISCUSSION

Table 1: Chi- Square

Response	Fo	Fe	Fo - fe	$(fo - fe)^2$	$\frac{(fo - fe)^2}{fe}$
Yes	7	10.5	-3.5	12.25	1.17
No	14	10.5	3.5	10.25	1.17

Source: Field Survey (2014)

Decision Rule: Accept Null Hypothesis if x^2cal < x^2tab; otherwise accept the alternate hypothesis. From the above analysis, x^2cal = 2.34. x^2tab at one df and 0.05 level of confidence is 3.84. The Null hypothesis is therefore accepted that majority of employees do not contribute as required by the Act, nor are those deducted from workers salaries remitted to employees' PFAs

(b) are employees aware of the modus operandi of the new Contributory PENSION Scheme?

Table 2: Chi square

Response	Fo	Fe	Fo – fe	$(fo - fe)^2$	$(fo - fe)^2$ fe
Yes	8	10.5	-2.5	6.25	0.6
No	13	10.5	2.5	6.25	0.6
Total	21	21		13.50	1.20

Source: Field Survey (2014)

From Table II above, x^2cal < x^2tab; the null hypothesis is therefore accepted that employees level of awareness of the modus operandi of the scheme is not high. The finding from the chi- square tests and interviews revealed that the new Contributory Pension scheme is yet take off on sound footing. Analysis of the data (Chi-square Table 1) showed that many employers are not complying with the requirements of the Pension Reforms Act, 2004 (PRA). Some do not contribute their portions, nor do they remit employee's deducted portions to PFAs. Many states have not bought into the scheme because of the non-enactment of State Pension Laws to that effect. As has been shown in table 11, majority of workers have neither registered with Pension Fund Administrators (PFA's) nor are they aware of the modus operandi of the scheme.

Section 9(3) of the PRA, 2004 which requires employers to take life assurance policies for their workers up to 3times the staff's annual emolument is not being complied with. Interviews with worker's unions revealed that not up to 20% of employers are complying with this section.

A review of the Act showed that it did not cover those in the informal sector who would want to save for their retirement. It is also silent on the gratuities which workers have always looked up to at retirement. Interviews with Pension Fund Administrators (PFA's) and also stock market report showed that investment of pension fund have not started to yield fair returns. Young (2008), stated that with the global financial meltdown, about 25% of pension funds invested in equities in the Nigerian Stock Market have been adversely affected. According to Emmanuel and Kolawole (2009), a foremost Pension Fund Administrator declared a loss after tax of #58 million ($0.45m) for the year ended 31st December, 2008.

CONCLUSION

The previous pension schemes in Nigeria did not meet the primary objective of providing pensioners with regular monthly pensions. Nigerian pensioners had been subjected to several harrowing and humiliating experiences in the process of collecting their entitlements. The Government, on the other hand, has been burdened by huge budgetary allocations, most of which were under-funded.

It is hoped that with the introduction of the new Contributory Pension Scheme, the unpalatable operational defects that trailed the previous schemes would be things of the past. But these can only be achieved when employees register with PFAs, employers remit contributions to PFC s and the fund are invested to achieve the twin objectives of safety and fair returns.

RECOMMENDATIONS

Consequent upon the findings, the following recommendations are put forward.

(1) The Pension Retorm Act, 2004 should be amended to

a. Empower PenCom to prosecute Chairman and Directors of non-compliant employers and impose more severe sanctions on them.

b. Cover those in the informal sector who want to contribute under the Act.

c. Increase employers contribution to a minimum of 15% because international best practices demand that employers should as a matter of necessity contribute more than the employees, more so since the Act is silent on gratuities.

(2) State legislatures should hasten the process of enacting their State Pension Laws to enable state governments commence the implementation of the new scheme.

(3) Since the higher risk of an investment, the higher the expected return, and vice versa. pension funds funds portfolio mangers have to maintain a trade-off between risk and return. In the interim, investment of pension funds should be in less risky financial assets (for example Govt. bonds, Treasury Bills, bank deposits and real estates) until the global financial meltdown ease off.

(4) In order to raise the level of awareness of the new svheme, PenCom should increase the tempo of its sensitization campaigns across the country.

References

Ahmad, M. K. (2006). The Contributory Pension Scheme, Institutional and Legal Framework. *Bullion,* Vol. 30. (2), Central Bank of Nigeria.

Butler, B, (1997). Financial and Banking, Oxford: Oxford University Press

Balogun, A. (2006). Understanding the New Pension Reform Act, 2004, CBN *Bullion,* Vol. 30 (2)

Emmanuel, J.O. & Kolawole, A.O. (2009).NLPC Pension Fund Administrators, Nigerian Tribune 9th October.

Hirt, G.A. & B,ock, S.B. (1995). Fundamentals of Investment Management, New York: R.D. Irwin Inc.

Odundo, E. (2004). Supervision of A Public Pension Fund: Experience and Challenges from Kenya. In Musalem, A.R. and Palacious, R.J. (ed.), Public Pension Fund Management. Washington: the World Bank.

Pandey, I.M. (2002). Financial Management. New Delhi; Vikkas Publishing House PVT Ltd.

Ross, S.A.; Westerfield, R.W. & Jordan, B.D. (2002). Fundamentals of Corporate Finance. New York; Irwin McGraw-Hill.

Turner, A. (2006). Pension in Aging World. In Finance and Development. Washington D.C.: I.M.F. Publication Services.

Bullion, Vol. 30 (2008). Pension and You. Vanguard 13th New.