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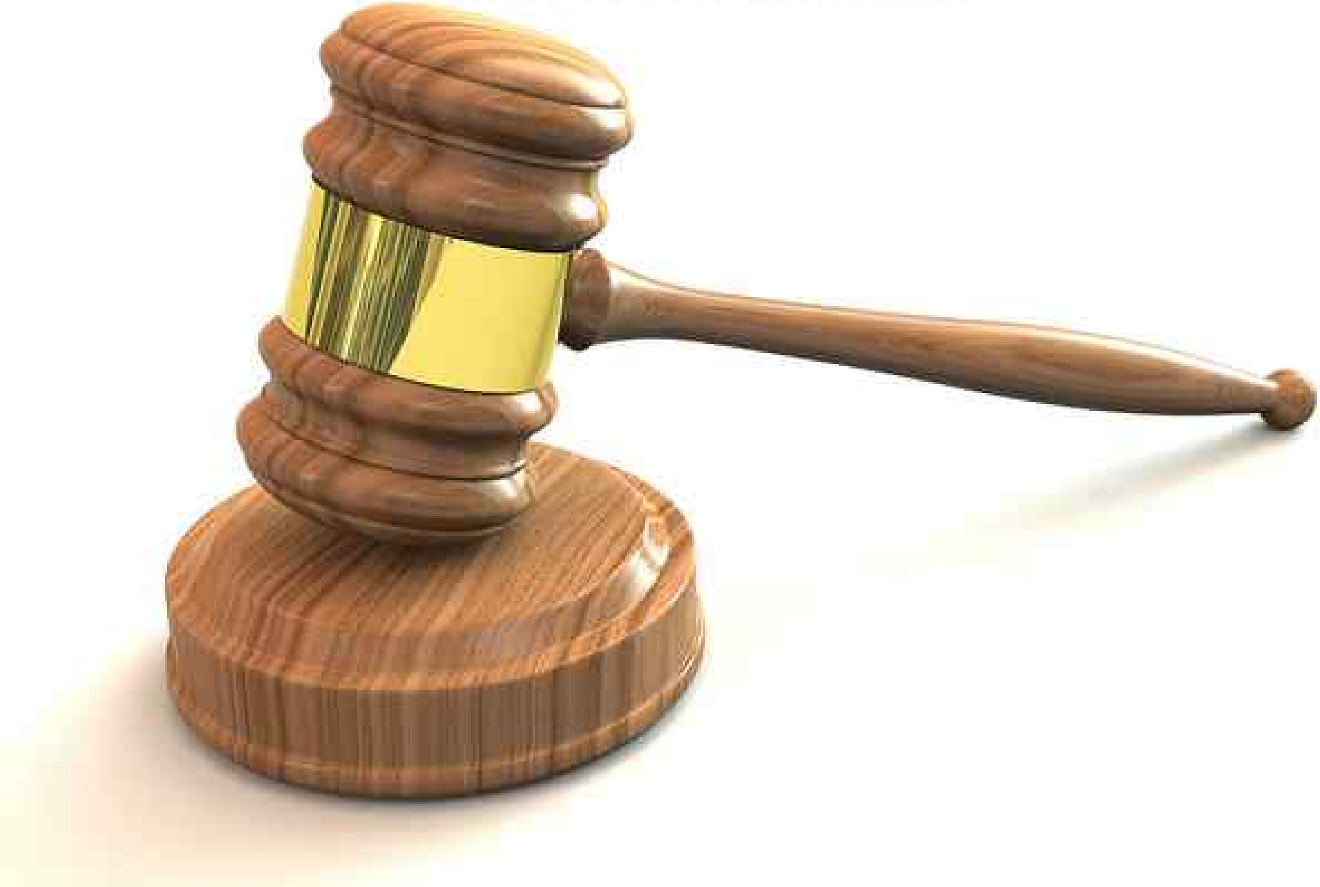
Q4 2019

PenCom

NATIONAL PENSION COMMISSION



THE NIGERIAN CONTRIBUTORY PENSION SCHEME: THE LEGAL PERSPECTIVE

INSIDE TOKUNBO ORIMOBI

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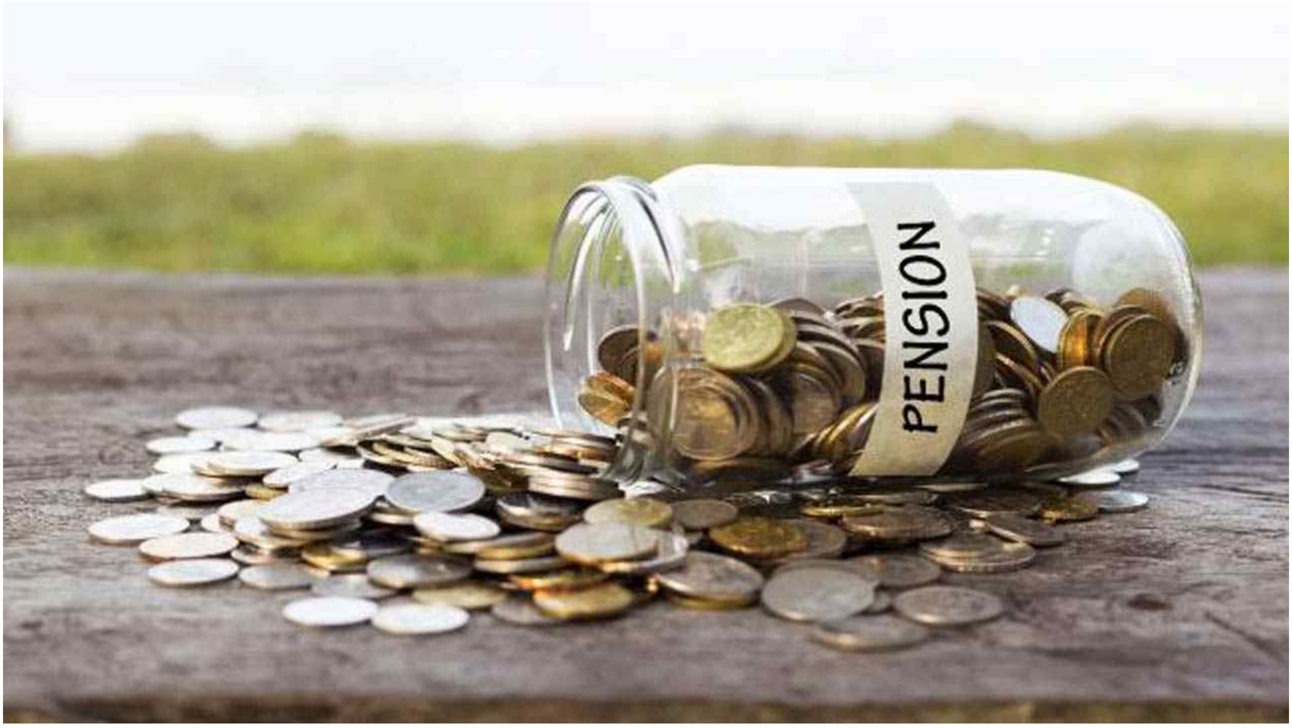

From time immemorial, an essential concern of every man has been the certainty of economic security. Economic Security is the state of having stable income or other resources to support a present or future standard of living. It connotes social security which is defined by unfettered access to basic needs such as infrastructure, education, and social protection on one hand, as well as employment security on the other. Following the history of mankind, people have faced the uncertainties brought about by unemployment, illness, disability, death and old age and these inevitable facets of life have been identified as threats to man's economic security. An attempt to mitigate risks pertaining to economic security propelled the establishment of a scheme by the Government to ensure financial balance of the unemployed and old retirees. This institution is referred to as the Contributory Pension Scheme.

In plain parlance, a Pension has been defined as any plan, fund or scheme which provides retirement income whilst some view Pension as an arrangement by the Government to provide people with an income when they are no longer earning a regular income from an active employment.

Research reveals that one of the most reliable ways many old people, who are no longer in active employment, adopt in solving their financial problems in Nigeria is mostly through their pension payments. Sadly, it was observed that these monies are usually unavailable to them as and when due because of the misappropriation of Pension Funds. Due to this, many employees who are due for retirement manipulate and lower age records to prolong their period of service and remain in employment whether or not they are productive. Hence, the need to provide an adequate and effective method of managing the financial resources for old age in Nigeria became necessary and this led to the enactment of the defunct Pension Reform Act of 2004 (the **"PRA 2004"**).

Particularly, the defects of the defunct scheme include, political control of the public sector pension, pension payment default by state governments, pension record and disbursement flaws and tardiness in pension disbursements.

After the enactment of the PRA 2004, it became apparent that a crucial condition for promoting economic development is proper utilisation of labour and the defunct Law was insufficient for the Pension needs in Nigeria as employees continued to remain in service longer than the legal period. This assertion is informed by the rigours still involved in resolving Pension issues, the rate of unemployment and its effect on the Nigerian economy.

The need to correct this lacuna led to the introduction of a compulsory contributory pension payment policy across the country. The introduction of this initiative has helped to restructure the Pension Scheme in Nigeria as the rigours of pension related issues have reduced drastically. This article therefore seeks to examine the impact as well as the possible challenges of this initiative in the Nigerian economy.

THE MANDATORY CONTRIBUTORY PENSION SCHEME

The Pension Reform Act 2014 (the **"PRA 2014"** or the "**Act"**) outlines the framework and procedure for the administration of Pension in Nigeria.

By Sections 2(1) and 3(1), the Act established a mandatory Contributory Pension Scheme (the **"CPS"**) which applies to employment in the public service of the Federal Government of Nigeria, public service of the Federal Capital Territory, the public service of the States, the public service of the Local Governments and the private sector. [1]

Pursuant to Section 4 of the Act, employers and their employees are required to contribute and deposit a minimum of 12% and 8% respectively, of each employee's total emoluments into a Retirement Savings Account **("RSA")** maintained with the employee's preferred Pension Fund Administrator **("PFA")**. The total contribution is to be remitted on a monthly basis chosen by each employee. PFAs that are duly licenced by the National Pension Commission (**"PenCom"**) are vested with the power to manage the funds, invest them and upon retirement, a contributor shall have a right to draw benefits on retirement, in accordance with the provisions of the Act.

PenCom is empowered under Section 18 and 23 of the Act to regulate and supervise the scheme established under the Act; and to *enforce and administer the provisions of the Act; co-ordinate and enforce all other laws on pension and retirement benefits; and regulate, supervise and ensure the effective administration of pension matters and retirement benefits in Nigeria*. Furthermore, section 4(5) of the PRA requires every employer to maintain a Group Life Insurance Policy in favour of each employee for a minimum of three (3) times the annual total emolument[2] of each employee.

Since its establishment, the CPS has grown significantly and it has introduced an era of hassle-free access to retirement income as opposed to the unsustainable Pay-As-You-Go defined benefits scheme. This has improved the well-being of retired members of the scheme.

It is imperative to note that, the PRA 2014 expanded the scope of the CPS to self-employed individuals and persons working in organisations with less than three (3) employees[3]. Also, research reveals that this category of workers constitutes a larger percentage of the working population in the country and in order to achieve the Pension industry's objective of covering 30% of the working population by 2024, it is important to extend the scope of the Contributory Pension Scheme to this important segment of the economy.

In 2019, the PenCom introduced the **Micro Pension Plan** initiative which took effect in 2019[4]. The Micro Pension Plan is an arrangement whereby individuals save small amounts of money during their work life and the money is invested collectively to yield returns. It is targeted at low income earners, small business owners and self-employed non-salary workers who are often

1. *In the private sector, the CPS applies to employees who are in the employment of an organisation in which there are fifteen (15) or more employees.*
2. *Defined in Section 120 of the Act as the "gross emolument of an employee or a deceased person".*
3. *Section 2(3) of the PRA*

4. *https://pencom.gov.ng assessed 1/12/2019.*

without regular income to save for their retirement[5].

In summary, the notable features of the CPS are voluntary contributions, individual accounts, choice of PFA and wide coverage.

EFFECT OF THE CONTRIBUTORY PENSION SCHEME ON THE EMPLOYEE AND EMPLOYER

It is important to outline the effects of the CPS on both the employers and employees. Some of the effects on the employees are considered below:

- *the contribution taken from the gross pay of the employee's salary reduces the total take home (net pay) unless the employers choose to increase salaries to accommodate the additional contribution;*
- *also, employees may find some satisfaction in the fact that employers would contribute at least 10% of their monthly emoluments but only for those who are lucky to get a paid job or keep their jobs since the Scheme only governs employees in public and private sector; and*
- *the CPS is only applicable to both public and private organizations in which there are 15 or more employees. The scheme does not cover self-employed and organization with less than 15 employees. However self-employed (artisan, traders) individuals and organizations with less than 3 employees who do not qualify for the Contributory Pension Scheme can enroll for a Micro Pension Plan initiative which allows individuals to save small amount of money at their convenience and the money is invested collectively to yield returns[6].*

While the effect on the employers are stated above, the CPS also has effects on the employers:

- *due to the CPS, employers have been made to decide either to incur an increase in their staff costs or engage in some creative restructuring of staff compensation to limit the costs of remitting the 10% contribution on each employee's emoluments to the PFAs and Pension Fund Custodians (the "PFCs");*
- *it has increased the cost of employment and may force many employers to take drastic measures such as rationalization of staff strength; and*
- *employers have the legal obligation to remit the 10% contribution irrespective of profit made by the Company.*

The pension reforms can contribute significantly to the economic growth of the country. In Chile after similar reforms between 1984 and 1997, the country's economy grew at about 7% on average per year, investment and savings boomed and inflation was reduced from around 25% to 2 - 4% range. Large pool of internal savings will typically fund long term investment projects like real estate development.

There is no doubt that the mandatory Contributory Pension Scheme has created a lot of opportunities for individuals within the country. The Scheme has boosted the capital & money markets and this brought tremendous growth to the economy since all Pension Fund Administrators have their funds invested in the capital market through equities and bonds[7].

As a matter of fact, the Pension Fund Administrators and Pension Fund Custodians that were the offshoot of the scheme have created employments opportunities in the country and savings for employees amongst other things[8].

THE ADVANTAGES OF THE CONTRIBUTORY PENSION SCHEME

It is trite to say that the significance of the adoption of an effective Pension Scheme on any economy cannot be overemphasized and some of them include:

- pension contributions are not subject to taxation. Employers usually deduct pension contributions from salaries before deducting tax. Therefore, it is only the remainder of the salary that is subject to tax;
- it is an economically efficient way to fund retirement;
- there is transparency as each employee has an individual account and information on the account is disclosed to each individual from time to time;

5. https://www.armpensions.com assessed 1/12/2019.
6. https://www.pencom.gov.ng/wp-content/uploads/2018/09/GUIDELINES-FOR-MICRO-PENSION-PLAN.pdf assessed 1/12/2019.

7. Edogbanya Adejoh (2018). An Assessment of the Impact of Contributory Pension Scheme to Nigerian Economic development: Global Journal of Management and Business Research, Vol 13.
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- at retirement, people typically experience a reduction in income and a Pension makes up for some of such loss of income in retirement;
- it helps to mitigate financial **risks**. Pension Funds are managed by the Pension Fund Administrators and are fully protected in the event of liquidation of the PFA. Under no account will the funds be attached or be subject to execution of a judgment debt by the creditors of the PFA. Also, the Pension Funds do not belong to the employer and as such it cannot be seized or attached if the business goes bankrupt;
- these Pension Funds are a life time security asset and it is easily accessible at retirement;
- employees continue to have the right to choose their PFA. This right has been extended by the Pensions Reform Act 2014 to cover employees whose employers operate a closed pension scheme. Such employees now have the right to choose an external Pension Fund Account (PFA). Where an employee fails to open a Retirement Savings Account (RSA) within 6 months after assumption of duty, his employer shall, subject to guidelines issued by the Commission, request a PFA to open a nominal RSA for such employee for the remittance of his pension contribution pursuant to section 11(5) of the Pension Reform Act 2014; and
- it ensures portability of retirement savings.

CHALLENGES OF THE CONTRIBUTORY PENSION SCHEME

As laudable as the CPS appears to be, there are certain challenges and some of them are identified below:

- **Lack of Access/Control:** This is a major disadvantage of the pension scheme for many people due to their inability to access and control their Pension Funds until they are 50 years of age or have been unemployed for a period of four (4) months. Another lacuna in this scheme is that, in time of dire financial need, an individual cannot apply for a loan from some of his pension to settle immediate needs.

- **Lack of Awareness:** Most pensioners and would-be-retirees are not aware of the operations and processes of the scheme. They do not know how much is invested by the (PFAs) or where the monies are invested neither do they have a say on the kind of investments their PFAs should pursue. Lack of knowledge on the tenets and mechanics of the pension scheme is one of the reasons PFAs can get away with illegal acts with respect to employees' monies. It has therefore been recommended that there should be adequate sensitization by the Nigerian Pension Scheme, the PFAs and PFCs, in order to enable retirees know the operations of the scheme fund.

- **Non-compliance on the part of the Employers:** Employers have been mandated to deduct at source the monthly contribution of the employee and not later than seven (7) working days after salary payment, remit such amount inclusive the employer's contribution to the Pension Fund Custodian specified by the PFA of the employee. However**,** failure of an employer to remit the contributions within the specified time shall result in liability to pay penalties imposed by the Commission. Furthermore, the PRA empowers the Commission, subject to the fiat of the Attorney General of the Federation, to institute criminal proceedings against employers who persistently fail to deduct and/or remit pension contributions of their employees within the specified time.

- **Regulation Coverage**: The PRA 2014 has foreclosed new entrants into the Closed Pension Fund Administrators. Thus, all new employees of the sponsor companies must join the CPS and open RSA with PFAs of their choice. However, does the Commission have regulations that cover the failure of CPFAs to deliver on pay day? This is very important, in order to guard against CPFAs becoming a den for private manipulation.

- **Sub-Optimal Returns from PFAs:** The PFAs manage and invest these contributions over the long period of time. However, the return on investment (ROI) that they provide to employees are not competitive. In fact, employees would get much better returns on those funds if they invested the funds themselves. We are of the view that PFAs should be compelled to provide optimal and competitive returns to employees on the contributed funds.

CONCLUSION AND RECOMMENDATION

No doubt, the CPS was designed to facilitate an efficient and effective Pension Scheme in Nigeria and it has been observed that a strong relationship exists between the CPS expenditure and the Gross Domestic Product (the **"GDP"**) of Nigeria as the CPS contributes significantly to the GDP. Also, it has been observed that the CPS has significantly impacted the development of the Nigerian Capital and Money Market. In addition to the above, the measures already set in place by the Commission to ensure the sustainability of the CPS in Nigeria cannot be overemphasized.

The CPS has significantly moved the Nigerian Pension Scheme from the shambles that it was in the last decade and it has eradicated the problems of the Defined Benefit Scheme. Its immense contribution to the growth of the economy cannot be overemphasized neither is the hope of future financial security that it has promised the work force.

In a developing country faced with high level of corruption, surely no initiative is too big to fail and this is the reason why all hands must be on deck to ensure the sustainability of the CPS.

Particularly, we have outlined the following recommendations:

- The PenCom should ensure that the highest level of corporate governance is put in place by enforcing very strictly the National Code of Corporate Governance 2019 and imposing same on the PFAs and PFCs in other to mitigate the risk of mismanagement of pension funds;
- The PenCom should put in place an initiative that includes the contributors in the investment decision of pension funds;
- The PRA 2014 should be amended to give room for individuals to apply for some of their pension contribution as loans or in any other approved manner in circumstances of serious financial need such as illness;
- The interest being paid on pension funds annually by PFAs should be increased from 2% to competitive returns;
- There is a high level of poverty in the country and the Pension Scheme is one of the ways of mitigating poverty. Instead of having to wait to clock 50 before having access to pension contributions, the Act should be amended to allow a certain percentage of pension contributions to be paid to individuals every 5 or 10 years. This way, the contribution does not only cater for needs at the old age or retirement but it also covers intermittent expenditure and helps people make other investments which they can benefit from in the future; and
- PRA 2014 does not make adequate provision for the security of Pension Funds, neither does it contain a fallback provision for employees who choose PFAs that invest poorly and cause a loss. Section 91 of the Act merely imposes a penalty on PFAs who do not comply with the provisions of the Act. It is recommended that the regulations governing the administration of Pension Funds should specify modes for complete reparation in the event that these circumstances occur.

INSIDE TOKUNBO ORIMOBI

1. TMT FINANCE AFRICA

Our Global Chairman, Mr. Michael Orimobi on Thursday, November 28, 2019 chaired the session on "Enterprise Cloud & Data Centres - How to best support the growing demand for data". The Panel comprised of leading experts, investors and seasoned professionals in Data Centres across Africa - Stephane Duporz, CEO, Africa Data Centres, Wouter van Hulten, CEO & Founder, PAIX Data Centres, Michael Tobin OBE, Founder, Tobin Ventures and Zahid Saddiq, CFO, Zircom Data Centre.

Our Global Chairman was also a Speaker alongside other seasoned professionals including Ebrima Fatty, CEO, Africa Sokoni, Andrea Traversone, Managing Partner, Amadeus Capital Partners and Jacques Ludik, Founder & Executive Chairman, Cortex Logic, at the session on 'Investing in Digital Innovation'. The session was chaired by Yusuf Hoosen, CEO & Founder of Signific.

The sessions were indeed enlightening as the speakers were able to drive an insight into the investment opportunities available in the TMT space in Africa - Data Centres, Fintech, E-Commerce etc.

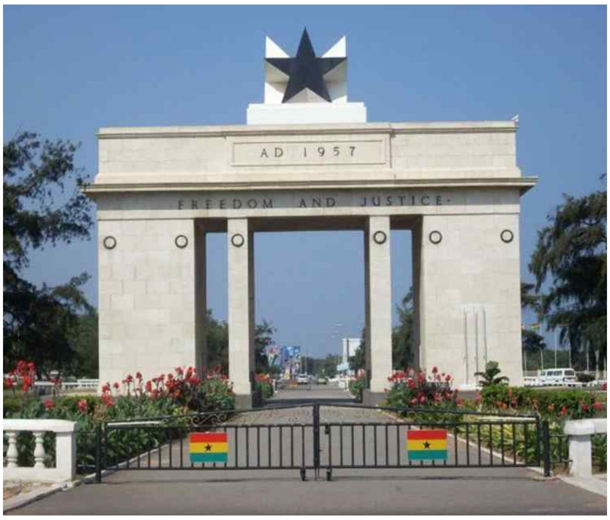
We must commend the organizers of the TMT Finance Africa 2019 for a job well done.

2. OPENING OF TOKUNBO ORIMOBI, ACCRA OFFICE

In a country ranked as the best place for doing business in West Africa and regarded as the fastest growing economy in the world, according to the World Bank's Ease of Doing Business Report 2019; Tokunbo Orimobi's office in Accra offers clients the best legal services available in the West African market. Specifically, having an office in Accra gives our firm the opportunity to cater specifically to the legal needs of West Africa.

At Tokunbo Orimobi, our pride is that we combine the highest global standards with local expertise to exceed the expectation and satisfaction of our clients. So, in Accra, we are present with a team of highly skilled lawyers devoted to the provision of bespoke and excellent legal services to individuals, corporate bodies as well as state, parastatal ad non-governmental bodies.

We situate our services within the particular context of our clients' peculiar situation and partner with other relevant service providers, where necessary, to deliver timely results to our clients. Our lawyers in Ghana are trained in different areas of practice- Corporate & Commercial, Litigation, Regulatory Compliance, Intellectual Property, Real Estate, Labour Law, Debt Recovery, Shipping & Admiralty and Company Secretarial Services etc- and regularly handle diverse and challenging transactions.



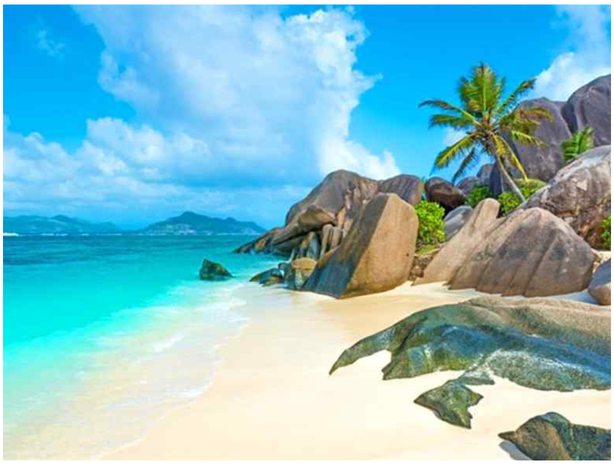
3 OPENING OF TOKUNBO ORIMOBI, SEYCHELLES OFFICE

Seychelles has grown to become one of the most attractive destinations for financial services and structuring as a jurisdiction in the Indian Ocean region.

Tokunbo Orimobi's Seychelles office is the preferred financial services company solutions provider for those looking for the right avenues to protect and grow their businesses and assets.

We are a team of professionals with immense experience in the world of international business consulting and wealth planning; a resource combination of reputable international lawyers, global finance experts and other industry professionals.

We are focused, highly dedicated and can provide knowledgeable and vital support to our clients. Our areas of expertise are tax planning/efficiency, offshore structuring, regulatory compliance etc.

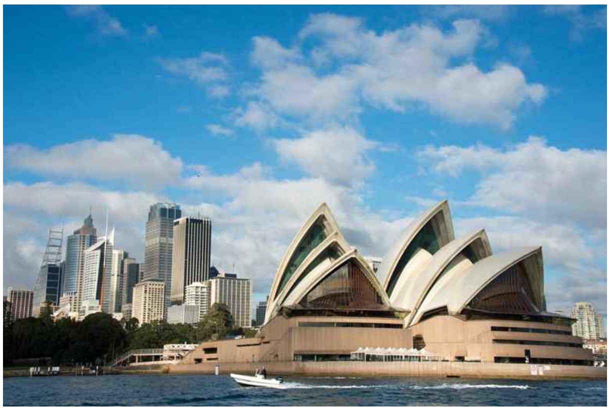


4. OPENING OF TOKUNBO ORIMOBI, SYDNEY OFFICE

Located in Sydney, the state capital of New South Wales and the most populous city in Australia and Oceania, Tokunbo Orimobi is perfectly placed to offer its internationally acclaimed bespoke legal solutions to clients in the pacific region.

At Tokunbo Orimobi, we have a true partnering model, working with clients and advisers to build long term relationships, where we originate opportunities solving our clients' capital and strategic needs.

We have built a people-centric business from day one. By making use of modern systems and technology, our team are freed up from bureaucracy and administration to really focus on doing what they do best – solving complex client problems. Our areas of expertise include Mergers & Acquisition, Capital Markets, Restructuring and Special Situations, Private Equity and Venture Capital, Finance, Alternative Lending and Debt Trading.



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