

## **PENSION REFORM ACT, 2004 - IMPLICATIONS AND OBLIGATIONS TO AN EMPLOYER**

### **Introduction**

The Pension Reform Act, 2004 ("the Act") establishes a Contributory Pension Scheme for payment of retirement benefits of employees of the Public Service of the Federation, the Federal Capital Territory and the Private Sector. Although the Act came into effect for public sector employees on July 1, 2004, implementation for the Private Sector is scheduled to begin in January 2005 after guidelines must have been approved.

Before the promulgation of the Act, pension plans were optional in the private sector and not operative in many organizations. Where one existed, the retirement benefits were loosely administered, with employers managing the funds. In both the private and public sector, huge deficits in the pension funds were reported, with retired workers facing non-payment of their pensions, or queuing for days to claim what they are owed. The Nigeria Social Insurance Trust Fund ("NSITF") to which employees make provident contributions for retirement has also not been paying contributors' entitlements as and when due.

The Act repeals the Pension Act of 1979 (CAP 345 Laws of the Federation of Nigeria, 1990) and consequentially amends the Nigeria Social Insurance Trust Fund Act of 1993 which hitherto regulated retirement benefits in the Public and Private sector respectively. The Act became necessary to ensure that uniform regulations and standards apply to the administration of retirement benefits for the Private sector and the Public sector as well as to ensure that individuals save towards catering for their old age.

The focus here shall be on the provisions of the Act as they apply to the Private Sector.

### **I. CONTRIBUTORY PENSION SCHEME UNDER THE ACT**

#### ***Scope of the Scheme***

Section 1(2)(b) of the Act provides that the scheme applies to an organization with 5 (five) or more employees. However, employers need not make contributions under the scheme in respect of persons who before the commencement of the Act, were entitled to retirement benefits under a pension scheme and who have three years or less to retire.

#### ***Retirement Savings Account***

By virtue of section 11 of the Act, every employee is to maintain an individual Retirement Savings Account in his name with any Pension Fund Administrator ("PFA") of his choice and notify his employer of the identity of the **retirement savings account**. It should be noted that the Act allows the employee to transfer the retirement savings account from one PFA to another (although limited to once every year). The employee can retain the same **retirement savings account** in the event he changes employment.

#### ***Contributions to the Scheme***

Contributions to the Scheme are expected to come from the employee's "monthly emoluments". This is defined by the Act as the sum of basic salary, housing allowance and transport allowance.

Employees and employers are under an obligation to contribute at the rate of 7<sup>1/2</sup>% by the employer and 7<sup>1/2</sup>% by the employee although the employer may elect to bear the full responsibility of the contribution, provided that it is not less than 15% of the employee's monthly emoluments. The employee may also elect to make additional voluntary contributions, to the total contributions jointly made by his employer and himself.

It is important to note that it is the employer's responsibility to remit both the employee and its own contributions to the Pension Assets Custodian ("Custodian") specified by the PFA of the employee within 7 days from the day the employee is paid his salary. It is important to state that the National Pension Commission ("the Commission") may impose a penalty of not less than 2% of the contribution remaining unpaid on the employer for failure to remit contributions and such penalty shall be recoverable as a debt owing to the employee's retirement savings account.

### **Insurance**

In addition to the contribution, the employer is required to maintain a life insurance policy in favour of the employee for a minimum of three times the annual total emolument of the employee under section 9(3).

### **Tax**

Contributions made by the employee form part of tax deductible expenses in the computation of tax payable by the employee or the employer and amounts payable as retirement benefit are not taxable. However, any voluntary contribution made by the employee in addition to contributions already made by him and his employer which is withdrawn before the end of 5 years from the date the contribution was made shall be liable to tax at the point of withdrawal.

### **Retirement Benefits**

Section 4 of the Act provides that upon retirement or attaining the age of 50, whichever is later, the balance of the retirement savings account shall be utilized for the following:

- a. programmed monthly or quarterly withdrawals calculated on the basis of an expected life span;
- b. annuity for life purchased from a life insurance company with monthly or quarterly payments;
- c. a lump sum from the balance of the retirement savings account, provided that the amount left shall be sufficient to procure an annuity or fund programmed withdrawals that will produce an amount not less than 50% of his annual remuneration as at the date of his retirement.

It has to be stressed that by virtue of section 3, the employee is not allowed to make any withdrawal from the **retirement savings account** until he attains the age of 50, except for reasons of permanent disability of the mind or body, upon the advice of a physician or medical board or where the terms and conditions of employment so provide. In any of these exemptions, the employee may, after six months of retirement and failing to secure another employment, withdraw a lump sum not more than 25% of the balance of the retirement savings account.

### **Existing Pension Schemes**

The Act does not require that existing funded pension schemes should be liquidated and proceeds distributed to members. Rather, the objective is to transform existing schemes in order to achieve uniform regulation by the Commission.

In respect of existing pension schemes, they may continue under the Act, provided the scheme meets the following requirements:

- a. the scheme is fully funded
- b. each employee is given the option of continuing with the employer's scheme or coming under the scheme established under the Act
- c. the contributions and distributable income earned by each employee as at the date the option is exercised by him is computed and credited to his retirement savings account with a PFA of his choice
- d. in the case of defined contribution schemes (where benefits are clearly provided for), the attributable income of each employee, is computed and credited to a retirement savings account opened for him
- e. the pension funds and assets are fully segregated from the funds and assets of the company
- f. the pension funds and assets are held by a custodian
- g. investment of the pension funds and assets are in accordance with the provisions of Section 73 of the Act and are as regulated by the Commission
- h. the employer undertakes to the Commission to keep the pension fund fully funded at all times and ensure any short fall is made up within 90 days
- i. the employer performs at the end of every year, an actuarial valuation to determine the adequacy of the pension fund assets
- j. In respect of existing schemes with funds and assets held amounting to less than ₦500,000,000.00 (Five Hundred Million Naira), wishing to continue, the scheme must be administered by a licensed PFA on behalf of the employer
- k. and in respect of schemes where the funds and assets held amount to ₦500,000,000.00 (Five Hundred Million Naira) or more, the scheme may continue only if the employer is licensed by the Commission as a Closed Pension Fund Administrator ("Closed PFA") to manage the pension funds either directly or through a wholly owned subsidiary.

In order to be a Closed PFA, the employer or its wholly owned subsidiary must satisfy among others, the following requirements:

- a. it must be a limited liability company whose object is to manage pension funds
- b. it must not be involved in any other business apart from the management of pension funds
- c. it must satisfy the Commission that it has the professional capacity to manage pension funds and administer retirement benefits
- d. none of its directors, officers or subscribers must have been involved in the mismanagement of any fund.

**NSITF**

Under the Act, contributors to NSITF are not obligated to continue to make their pension contributions to NSITF. Rather, pension contributions made up till the commencement of the Act together with any attributable income shall be transferred into the retirement savings account opened for each contributor by the NSITF. NSITF itself is to establish a company to undertake the business of PFA under the Act.

However, the contributor is prevented from selecting a PFA of his choice for the funds standing to his credit under the NSITF scheme until 5 years after the commencement of the Act.

## II. IMPLICATIONS OF THE ACT

### A. *Transition*

Making a successful transition to the Contributory Pension Scheme requires the following steps:

#### 1. *Where the employer operated a pension scheme before the coming into force of the Act*

- Perform an actuarial valuation to determine the value of the pension fund assets i.e. whether less than or more than ₦500,000,000.00 (also take into consideration the liquidity or otherwise of the fund assets)
- Determine the income distributable/attributable to each employee under the former scheme
- Provide for claims of any employees the Act does not apply to (i.e. with 3 years or less to retirement)
- Review the erstwhile Trust Deed in the light of the provisions of the Act and take necessary action (e.g. winding up the trust if there are no employees exempt from the Act or modifying same to cater for only exempt employees)
- Consider any existing labour issues (e.g. redundancies, lay-offs, unions)

#### 2. *Where the employer did not operate any pension scheme*

- Decide on the structure of the scheme to be adopted, taking into consideration the outcome of the preceding exercises
- Present to employees the terms of the scheme to be adopted particularly, options available to employees who exercise the choice of opting out of the company scheme (if any).
- Review employment contracts, staff collective bargaining agreements, (e.g. staff handbook) and any other employee-employer contracts of similar nature to bring same in consonance with the provisions of the Act in the light of the scheme adopted
- Identify the retirement savings account of each employee and transfer the income attributable to each employee under the former pension scheme to the retirement savings account indicated
- Set up a life insurance policy for each employee

Where the scheme adopted is to operate under a Closed PFA,

- Incorporate a subsidiary with the singular function of managing pension funds.

Both where the scheme adopted is to be administered by a PFA on behalf of the company as well as where it is to operate under a Closed PFA,

- Provide for

- o vesting the assets of the fund in a Custodian
- o the management of such funds by the PFAs
- o regulating the relationship between the contributories and the PFA or Closed PFA as the case may be.

### **B. Obligations**

Under the Act,

1. it is mandatory for the employer to contribute to a Pension Scheme on behalf of each employee, irrespective of length of service
2. it is also mandatory for the employer to maintain a life insurance policy on behalf of each employee, irrespective of length of service
3. the employer is prohibited from having custody of or managing pension assets
4. the employer is responsible for remitting contributions to the PFA chosen by each employee
5. it is necessary for the employer to incorporate a subsidiary to operate as Closed PFA if the option is chosen

### **C. Implications**

It is necessary to understand that

1. the provisions of the Act apply to all organizations with at least 5 employees
2. persons who are entitled to benefits under another pension scheme and have 3 years or less from the commencement of the Act to retire are exempt from the scheme established under the Act
3. each employee must have the option of deciding what pension scheme to adopt
4. pension assets are to be privately managed and invested by professional fund managers
5. employers are subject to regulation and supervision by the Commission in relation to the administration of pensions and defaults attract penalties from the Commission
6. the employee's contributions qualify as tax deductible expenses
7. contributions to NSITF are to be discontinued.

The information contained in this publication is only intended as a general review of the subject concerned and should not be treated as a substitute for specific advice concerning specific situations.

If you need further information about any issue discussed above, please contact Funmi Oyefuga on 2646332-3 or at [foyefuga@babalakinandco.com](mailto:foyefuga@babalakinandco.com)

**BABALAKIN & CO.**  
8<sup>th</sup> -10<sup>th</sup> Floors, 24A Campbell Street, Lagos  
Phone: +234-1-2632185  
Fax: - +234-1-26237136  
[http: www.babalakinandco.com](http://www.babalakinandco.com)  
E-mail: [mails@babalakinandco.com](mailto:mails@babalakinandco.com)