

Contact FCMB
Pensions Limited:

Head Office Address:
Plot 207, Zakaria
Maimalari Street,
Cadastral Zone AO,
Central Business
District, Abuja.

Customer Service:
234 (0) 8059580002,
234 (0) 8032752888,
234 (0) 7080633004

Email:
info@fcmbpensions.com

Facebook:
FCMB Pensions Limited

Twitter:
@fcmbpensions
& @fcmbpenhelp

LinkedIn:
FCMB Pensions Limited

Instagram:
@fcmbpensions &
@fcmbpensionshelp

Two Decades of the Contributory Pension Scheme (CPS): Impact on the Nigerian Economy



Introduction

As the **Contributory Pension Scheme (CPS)** marks two decades of adoption in Nigeria after transition from the **Defined Benefit (DB)** Pension System, this milestone presents an opportunity to reflect on the journey so far. This edition of our newsletter takes a look at the impact of the CPS on pensioners and Nigerian economic development.

What is the Contributory Pension Scheme (CPS)?

According to the National Pension Commission (PenCom), Contributory Pension Scheme (CPS) is an arrangement where both the employer and the employee contribute towards the payment of the employee's pension at retirement. It is fully funded through the monthly pension contributions remitted into an employee's Retirement Savings Account (RSA) managed by the Pension Fund Administrator (PFA). The Contributory Pension Scheme is mandatory and compels employees and employers in the public and private sectors to collectively save a minimum of 18% of an employee's monthly emoluments (Basic, Transport, and Housing Allowances) into the employee's RSA, from which the employee will be paid retirement benefits. The main objective of the CPS is to ensure that every person who worked in either the public or private sectors in Nigeria, including the self-employed, receives his/her retirement benefits as and when due.

History of Contributory Pension Scheme in Nigeria

Before the advent of the CPS, Nigeria's pension system operated largely on a Defined Benefit (DB) structure especially for workers in the public sector where the government bore the entire responsibility for pension payments for its retirees. For the private sector, there were pockets of schemes but without any umbrella regulator. The DB system was fraught with problems; pensioners often went for years without receiving payments due to insufficient budget allocations. Backlogs grew as governments struggled to pay pensions owed to retirees. The DB system was underfunded and financially unsustainable, especially as the workforce grew placing more responsibilities on successive governments for pension obligations. These challenges made a pension overhaul necessary, leading to the enactment of the Pension Reform Act of 2004, which established the CPS.

The CPS introduced by the Pension Reform Act 2004, marked a critical shift in Nigeria's pension landscape. The Pension Reform Act of 2014, which amended the 2004 Pension Act, further improved the CPS by increasing contributions to a minimum of 18% of total emoluments (from 15%) and tightening regulations to ensure compliance by private and public sector employers.

Structure of the Nigeria Contributory Pension Scheme

The Contributory Pension Scheme (CPS) is designed to ensure that workers have funds available upon retirement. The industry has grown significantly since 2004. Major institutions in the Nigeria Pension Space include the following:



National Pension Commission (PenCom): PenCom is the industry's regulatory body, responsible for supervising and regulating the pension sector. It ensures compliance with regulations, provides oversight, and protects pension funds and contributors alike.



Pension Fund Administrators (PFAs): PFAs are private entities responsible for managing Retirement Savings Accounts (RSAs) and other pension funds on behalf of employees and fund sponsors. The main functions of the PFAs are to open Retirement Savings Accounts (RSAs) for employees, invest and manage pension fund assets, pay retirement benefits, provide pension advisory services, and account for all transactions relating to the pension funds under their management. They perform these functions within regulatory limits to ensure growth and security. **Currently, there are 18 PFAs in Nigeria.**



Pension Fund Custodians (PFCs): PFCs are responsible for keeping safe custody of pension assets on trust for contributors and fund sponsors. The main functions of PFCs are to receive pension contributions on behalf of PFAs; settle transactions and undertake activities relating to the administration of pension fund investments on behalf of PFAs. **There are 3 licensed PFCs in Nigeria.**

FCMB Pensions Limited is one of the 18 duly licensed PFAs by the National Pension Commission (PenCom), to carry on business as a Pension Fund Administrator (PFA) as defined under the Pension Reform Act, 2014. FCMB Pensions is a member of FCMB Group PLC.

The Impact of CPS on the Nigerian Economy

According to National Pension Commission (PenCom), Nigeria’s Total Pension Asset stood at **N21.13 trillion** as at 31 August 2024. The CPS has created a steady pool of long-term funds, which has improved the Nigerian economy. PenCom regulations allow a portion of these pension assets to be invested in infrastructure, such as roads, railways, and power projects, which contribute to economic growth and development. Here are other ways the CPS has impacted the economy:



Capital Market Development: Pension funds under the CPS are invested in various asset classes, including government bonds, corporate bonds, equities, and real estate. The injection of funds into these instruments has significantly deepened the Nigerian capital markets. As at August 2024, 63% of the Total Pension Assets in Nigeria was invested in the Federal Government of Nigeria (FGN) Securities, 11% in Corporate Debt Securities, 10% in Ordinary shares, 10% in local money market Securities, etc.



Reduction in Government Pension Liabilities: The CPS has shifted the pension burden away from the government, which had struggled with pension liabilities under the previous Defined Benefit Scheme. By creating a contributory system, the CPS has reduced the fiscal pressure on government budgets, allowing funds to be redirected towards critical public services and developmental projects.



Stable and Regular Income for Pensioners: One of the advantages that the CPS has brought into the Nigerian social space is providing a reliable income stream after retirement. As workers transition from active employment to retirement, their primary source of income typically diminishes. Pensions help bridge this gap, ensuring that retirees enjoy regular flow of income. Knowing that a financial safety net is in place allows retirees to enjoy their retirement years with peace of mind. This peace is invaluable, enabling retirees to focus on personal pursuits, family, and leisure without worrying about financial strain.



Home ownership through 25% equity contribution for Residential Mortgage: The CPS has created a pathway for RSA holders to access part of their pension savings for residential mortgage purpose. This initiative contributes to reduction of the huge housing deficits in Nigeria. It is a vital step in making home ownership achievable, contributing to social welfare by enhancing housing access for contributors under the CPS.



Stabilization of Employment and Labor Market: The CPS has fostered greater employee retention and productivity as workers feel more secure about their future finances. Employers are more likely to attract and retain talent when they offer pension contributions, creating a more stable labour market. The growth of the CPS has led to the creation of specialized institutions including Pension Fund Administrators (PFAs) and Pension Fund Custodians (PFCs), which have increased employment opportunities and contributed to sector-specific skills development. The CPS has no doubt contributed to the growth of Nigeria's Gross Domestic Product (GDP).



Enhanced Transparency and Governance in the Financial System: The CPS is regulated by PenCom, with clear guidelines and regulations for investments, risk management, compliance, and setting standard for ethical behavior among operators etc. By instilling confidence in the pension system, CPS has attracted contributions from public and private sector employees, helping to propel the wheel of the National economy.

Summary

Conclusively, the CPS has positively impacted Nigeria's economy by creating a sustainable and well-regulated pension system that fosters savings, investment, and economic development. Through its contributions to the capital market, infrastructure development, and social security, CPS continues to support economic growth, financial inclusion, and stability, strengthening the foundation for a resilient Nigerian economy. The Regulator; PenCom continues to shape the positive trajectory of the industry by ensuring the growth and sustainability of the industry through regulation, engagement, and promotion of ethical behavior amongst operators in the Industry.

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