

Pension Benefits and Longevity Risks of the Nigerian Baby Boomers

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Abstract

This study examines the effect of longevity risk on retirement income by focusing on the mode of utilizing pension funds at retirement. The population of interest for this purpose comprised of the Baby Boomers (BBG) in Lagos Metropolis. The study is based on a sample size of 499. The objectives of the study includes the determination of average life expectancy, the proportion of the BBG in Nigeria who live up to at least 5 years to receive pension benefits and the relationship between the baby boomers' retirement income and expected lifespan. Statistical tools such as correlation and hypothesis tests were used to test the hypotheses set out in the study. The results of the study show that with an average lifespan of 56.57 years, fewer than 80 percent will live for at least 5 years to receive pension benefits. The study also revealed that there is no relationship between retirement income and lifespan of the baby boomers since more than 70 percent of them have monthly income less than N40,001.00 and because they did not make any additional contributions for long periods during their working career. The researchers therefore concluded that the life insurance industry may have obvious interest in helping individuals drawdown their retirement assets in an orderly way, but it is not capable on its own to address the challenge posed by longevity. Consequently, it was recommended that government should create incentives for all employers to introduce more lifetime income options in addition to the one available under the present defined contribution plans.

Keywords: *life expectancy, retirement income, baby boomers and annuities*

INTRODUCTION

The term "baby boomer" is sometimes used in a cultural context. It is also sometimes used to describe someone who was born during the post-World War II. The United States Census Bureau (2006) refers a baby boomer to be someone born during the demographic birth boom between 1946 and 1964. In other context, a **baby boomer** is a person who was born during the demographic Post-World War II. Therefore, it is impossible to achieve broad consensus of a precise definition, even within a given territory. Different groups, organizations, individuals, and scholars may have different opinions on what constitutes a baby boomer, both technically and culturally. However, for the purpose of this study, the term "baby boom generation" or "baby boomers" refers to employees whose date of birth fall within the year 1946 to 1964 and had retired or expected to retire before 2020. Some of these baby boomers in public sector who had retired were examined in the light of new pension reform using monthly retirement income paid in to their respective Pension Fund Administrators. This reform (Pension Reform Act 2004) is billed to wipe out all the pension arrears in the Old Pay As You Go (PAYGO) in the public sector as well as to ameliorate the plight of the elderly in both private and public sectors by introducing a contributing scheme. For instance, employee and employer are to

contribute 7 ½ percent each relating to employee monthly emoluments. The total contributions are to be used by employees for either programmed monthly or quarterly withdrawal calculated on the basis of an expected lifespan or annuity for life purchased from a life insurance licensed by the National Insurance Commission (NAICOM) with monthly or quarterly payments (Mojekwu and Adeyele, 2010) at age 50 or retirement, whichever is later. Also, the pension benefits of employees in the public sector who have not attained retirement age at that time were transferred to the responsibility of the pension fund administrators with their pension arrears, and their subsequent contributions was expected to be credited into their respective Retirement Saving Accounts (RSA). This means that defined benefit pension schemes in the public sector is being closed to new entrants (Daykin, 2007). The reform has changed the nature of employer-sponsored pension from unfunded pay-as-you-go to funded defined contribution scheme. Although, the reform also made provision for defined benefits, all employers in Nigeria have chosen to operate defined contribution thereby leaving employees with pension benefits that are less sensitive to career job changes, but more sensitive to asset return fluctuations (Bound and Waidmann, 2007; Holmer, 2009). The magnitude of the shift in pension offerings implies

that information about the pension benefits of current retirees provides little information about the pension benefits future retirees are likely to accumulate over their work careers (Holmer, 2009). In a defined contribution (DC) scheme, employees have to build up their own pension fund to provide an income during retirement (Bound and Waidmann, 2007).

From the perspective of an individual pensioner, the important questions that this move to DC raises are: how well is such a scheme likely to perform and how much risk is there in such a scheme? As attempts to provide answer to these questions, this study examines the effect of longevity risk on retirement income. In spite of the uncertainty about the present reform such as how accumulated savings are to be utilized at retirement by the baby boomers, the reform was applauded by many Nigerians with the expectation that it will lead to circulation of funds in the economy and also address the crisis of the pensioners' poverty – largely caused by fund misappropriation, and inadequate budgetary allocations (Olurankinse, 2010) by government as a regulator of pension schemes in Nigeria. Some even argued that it will enable them have control over their pension funds but little do they understand about how mortality issue affects pension funds. The policymakers placed enormous attention on the accumulation phase of retirement accounts, such as how individuals save and invest, but are not aware that asset accumulation is only part of the retirement security equation (James and Vitas, 1999; Brown, 2004). The other part is how individuals will convert their accumulated savings into a retirement consumption stream, particularly since most of us do not know how long we will live (Brown, 2004). Indeed, uncertainty about length-of-life is one of the most significant sources of financial risk today's pensioners is bound to experience. Projecting the behaviour of future survival patterns is a rather complicated process given the influence of future mortality rates on pension income. Some of these can be easily measured, such as age, sex and marital status, while the effect of others like social, economic, cultural and ethnic factors is difficult to measure or even to model (Brown, 2004). These factors affect different people differently, which makes the process of forecasting the future course of mortality change a challenge. In light of the above, the main object of this paper is to examine how the retirement income will affect the baby-boom generation and its implications to life insurance industry. This is especially timely since a large number of the baby-boom generation is now thinking about retirement income and the potential annuitization of retirement savings. The study examines the following specific objectives: average life expectancy of the baby boomers in Nigeria, the

proportion of the BBG in Nigeria who live up to at least 5 years to receive pension benefits and the relationship between the retirees' retirement income and expected lifespan.

LITERATURE REVIEW

In any design of pension, the uncertainty of life expectancy as relate to income distribution of the retirees is very crucial. Mojekwu and Adeyele (2010) found that retirement income is strongly related to mortality or life expectancy of retirees. While life expectancy in advanced countries has improved tremendously, the reverse is being experienced in some developing countries. World Health Organization (2009) reported that the average life expectancy in Nigeria is 49 years while NPC (2006) reported that life expectancy in Nigeria was 54 years in 1999. This suggests that life expectancy in Nigeria deteriorates at the rate of 9.25% every ten years. Contrary to this, in advanced countries as well as in a few developing ones, it is evident that individual live longer than at any other time in history. The apparently changing stochastic fashion of mortality (Blacke et al, 2006) is very important in fixing the retirement age. When Germany, under the Chancellor Otto von Bismarck, estimated the world's first formal public program in the 1880s, age 65 was set as that country's natural retirement age (Black and Skipper, 2000). With a life expectancy of 45 years at that time, few Germans actually live long enough to collect anything. Today, however, most retirees seems to enjoy relatively good health, and prospects are bright that tomorrow's retirees will be even healthier. This seems not to be glaring to the policymakers even though annuities were recommended. Annuities are the only retail instrument ever devised capable of hedging longevity risk (Black and Skipper, 2000). Without them, pension plan would have great difficulty in performing its fundamental task of protecting retirees from outliving their resources for however they live.

The performance of a pension business is highly sensitive to change in economic and demographic environment and that even moderate downturns of interest or improvements on longevity can produce devastating losses (Norberg, 2008). Adverse selection in this case cannot be ruled out even by the expert. Adverse selection means that those in super health condition will be more willing to purchase life annuities while individuals in a deteriorated health condition will automatically shy away from buying them but look for a programmed monthly withdrawals (Black and Skipper, 2000). James and Vitas (1999) noted that in the event of early death, remaining account balances of those who purchased fixed retirement income are inherited by their dependents, accommodating a bequest motive.

Scheduled withdrawals also allow participation in the likely higher returns achieved by pension funds compared to the rates offered by insurance companies (James and Vittas, 1999).

RESEARCH HYPOTHESES

The successful shifting from defined benefit (DB) plans to Defined Contribution (DC) plans transfers many of the risks related to retirement to the individual, including funding, investment, and longevity risks. It is often claimed and accepted by policymakers and some of the academic researchers that life expectancy in Nigeria is 49 years or less as reported by the WHO (2009). As far as the design of annuities is concerned, some of the practitioners are likely to use this to judge the proportion of the retirees that will live to receive pension income up to certain number of years. In order to verify this claim, the following null hypotheses were formulated:

$H_{0.1}$: Average life expectancy in Nigeria is equal to 49 years.

$H_{0.2}$: At least 80 percent of BBG in Nigeria will live for at least 5 years to receive pension benefits.

$H_{0.3}$: There is no relationship between the retirees' retirement income and expected lifespan.

METHODOLOGY

The descriptive research design was employed in this study. Egbugle (1996) cited in Ania (2009) noted that the descriptive research design is advantageous because it has a wide range of scopes, a great deal of information as well as representative samples with inferences and generalization of the entire population. Although the conclusions drawn are based on a more complete set of information about the subjects, one of the drawbacks of this method is that no matter how convincing data from descriptive study may sound, non-experimental designs cannot rule out extraneous variables as the cause of what is being observed. Also, it merely describes what is occurring, but cannot tell us "why" it is occurring. While no approach, including the experiment, is free from researcher's bias when in the hands of an incompetent or poorly trained researcher, some approaches are at greater risk for this problem even when conducted by capable people. The researchers, however, are aware of these weaknesses and carefully minimized them in the sample frame of the study. The population of interest for the study comprised of the Baby Boom Generation (BBG) in Lagos State. In order to determine life expectancy of the BBG, the duration of study ranges between 1988 to 2009. That is, the baby boomers who retired from public sector between 1988 and 2009. A research questionnaire format which enables the required information to be obtained was sent to 3 Pension Fund Administrators. However, only one of the pension funds administrators' data considered to be

fairly representative of the BBG in Lagos metropolis was used for the research. Others were discarded on the ground of inadequate information supplied to the researchers. The sample size for this study is 499 BBG. The minimum and maximum ages are 41 and 64 respectively with the associated income of N3226.56 and N11,744,107.90 respectively. The mean age and standard deviation of the BBG as shown in table 1 below are 57.11 and 5.488 respectively with associated monthly income of N36972.4658 and N67726.27091. Other characteristics of the sample size are as follows: Male, 370 (74.1%) and Female, 128 (27.9%). Statistical tools such as correlation and hypothesis tests, were used to test the hypotheses set out in the study.

ANALYSIS

The combined age distribution of the Baby Boomers who are still alive to receive pension benefits and those that are no longer receiving pension due to death is shown in Table 4. In this table, the age brackets less than 80% the retirees falls between 41 and 62 years, with a median age of 58 years (see, table 1 in appendix). Taken separately, that is, decomposing Table 4 into Table 5 and Table 6, Table 6 revealed that 44.1% of the surviving baby boomers' age brackets fall between 58 and 64 years of which about 37.5% of them occurring at ages of 59 (7%), 60(8.5%), 61(9.7%) and 64(12.3%). Similarly, it is evidence from Table 5 that about 56.6% of the baby boomers who already died, survived from ages of 46 to 57 years while the remaining 14.8% of them received pension benefits up to the age of 64 years. Table 8 showed that the mean age and its standard deviation of the surviving baby boomers are 57.14 and 5.14 respectively while those of the deceased baby boomers are 56.7 and 6.085. This finding suggests that on the average of 56.25 years (see, Table 5) more than 43 percent of the deceased baby boomers receive pension benefits for at least 5 years if the age 50 in the present reform were to be taken as normal retirement age. Table 2 revealed that about 94.6 % of the surviving baby boomers are still receiving pension benefits. Although about 71% of the baby boomers earn less than N40,001 per month, only 2.6% of them earns more than N140,000 per month (see, Table 7). The mean income per month as well as its standard deviation of the baby boomers is N36972.47 and N67,726.27. In order to establish the research findings, the formulated hypotheses are tested below

$H_{0.1}$: Average life expectancy in Nigeria is equal to 49 years.

$H_0 = 49$ years, $H_1 \neq 49$ years. From table 1, the standard error of mean and sample mean are 0.246 and 57.11 respectively. The critical z-score which corresponds to $\alpha = 0.05$ using two tail hypothesis

tests is ± 1.96 . The interval limits $= \nu_{H_0} \pm z_c \delta = 49 \pm 1.96 (0.246) = 48.52$ or 49.48 . Since the sample mean did not fall between the limit calculated, the H_0 is rejected and we conclude that there is no enough information to suggest that life expectancy of the baby boomers is equal to the claimed 49 years but 56.57 as far as civil servants mortality is concerned.

Table 2: Distribution of the Baby Boomers' Survival Status

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Alive	472	94.6	94.6	94.6
Death	27	5.4	5.4	100.0
Total	499	100.0	100.0	

Source: Extracted from Pension Fund Administrator Records, 2010

$H_{0.2}$: Not fewer than 80 percent of BBG in Nigeria will live up to at least 5 years to receive pension benefits.

$$H_{0.p} \geq 0.80, H_{1.p} < 0.80, \delta_p = \sqrt{\frac{p_{H_0}(1 - p_{H_0})}{n}} = \sqrt{\frac{0.80(1 - 0.80)}{499}} = 0.02532$$

$$z_p = \frac{p - p_{H_0}}{\delta_p} = \frac{0.9457 - 0.80}{0.02532} = 13.659 = 13.66$$

The critical z-score for a one tail test with $\alpha = 0.05$ is $+1.64$. The calculated z-score of 13.66 is within the Rejection region. Since the calculated statistic is greater than critical z-score, the H_0 is rejected and we conclude that fewer than 80 percent of the baby boomers will at least live up 5 years at retirement to receive pension benefits.

Table 3: Model Summary of the Relationship Between Income and Life Expectancy

Multiple R	0.260338
R Square	0.67778
Calculated t- statistic	1.34818
Critical t- statistic	1.708

$H_{0.3}$: There is no relationship between the retirees' retirement income and expected lifespan.

Age at death was correlated with its associated income. The result suggests that there is low correlation of 0.260338 (see, Table 3). The critical t- statistic is based on $d.f = n - 2 = 27 - 2$ with $\alpha = 0.05$, $t_c = 1.708$ for one tail test. Because calculated statistic is less than critical t- statistic, we simply accept H_0 and conclude that there is no enough information to show any relationship between income and life expectancy. This result

contradicts the recent finding by Mojekwu and Adeyele (2010). This may be due to the fact that the baby boomers considered in the study are of low income earners. Take for instance, the wide income gap among the retirees (see Table 1)

In brief, below are the main findings of the study:

- Life expectancy of the baby boomers is not equal to 49 years but rather 56.57 years. That is to say it is longer than usually stated.
- Fewer than 80 percent of the baby boomers will live for at least 5 years to receive pension income, and
- There is no relationship between retirement income and life expectancy. This usual result may not be unconnected to income gap between the rich and the poor with latter dominating the sample.

DISCUSSIONS

The conversion of pension funds into retirement income might have informed the policymakers to recommend programmed monthly withdrawals or life annuities with main aim of avoiding retirement risk. Since the risk of outliving retirement income is real, these retirees are likely to be asked by life insurance industry to choose a target age for programmed monthly withdrawals (instead of life annuities) by using conventional planning techniques thereby shifting the risk of retirement to retirees. If life annuities were to be chosen by the retirees, life insurance industry may need to estimate the proportion of retirees that will survive to certain age in order to make an informed decision. This cannot be easily determined without being informed whether there is relationship between lifespan and income. This means if relationship exists between these variables, annuity providers might use this by recommending life annuities for high income earners while programmed monthly withdrawals would be imposed on the low income earners because life insurance industry will not want to shoulder retirement longevity risk. Based on this study, the researchers find that most of the retirees considered are not well off and so may not worry about outliving their money if they purchase life annuities.

The variability in longevity risk which is a main concern of annuity and pension providers, especially the possibility of mortality improvements for post-retirement ages have a significant financial impact as far as survival benefits are concerned. This was not taken into consideration before signing the pension reform bill 2003 into law in 2004. To ignore improvements would be to endanger the financial stability of the insurer selling policies providing such survival benefits, bearing in mind that longevity has a direct impact on the cost of survival benefits for

both annuitants and pensioners. The effect of longevity risk is even more important with the combination of improving mortality and falling interest rates, which have shaken the annuity market in recent years, especially for products in advanced countries. Since employees are expected to convert their retirement savings account to annuity, inappropriate fixing of retirement age otherwise life expectancy can lead to mortality risk.

CONCLUSION

The present pension reform scheme is linked to payment of annuity where mortality differentials of the retirees are critical. The total contributions during active years of service which are expected to be utilized for programmed monthly withdrawals or purchase of life annuities from life insurance companies may not guarantee retirement security. This study revealed that the 7 ½ percent of workers' salary deducted at source monthly as well as the 7 ½ percent of the employers' contributions seems not to be adequate and this will impact negatively on pension funds at retirement. This has been a source of concern to some pensionable baby boomers (especially a large group with monthly income less than N40,001.00) as the total contributions to their retirement saving accounts will be exhausted before their expected lifespan. This poses big challenge to life insurance companies on how they can help retirees convert their retirement wealth into income. For them to succeed, accumulating sufficient retirement savings has to be the first priority, because no lifetime income solution can compensate for an inadequate account balance at retirement (Brown, 2004). Life insurance industry has an obvious interest in helping individuals drawdown their retirement assets in an orderly way, but it is not capable on its own to address the change of longevity.

Consequently, there is need to come up with applicable models to incorporate different categories of participating workers. For this to succeed, everybody has important roles to play. The life insurance industry, pension industry, financial institutions in general and the regulators of these industries need to educate themselves as well as their clients on mortality trends, the latest product innovations and be ready to offer a wider range of solutions. The government should create incentives for all employers to introduce more lifetime income options in addition to the present defined contribution plans. Also, individuals need to seek advice from those who have access to the full spectrum of solutions (Steward, 2008). Research is needed in areas of mortality differentials to assist life insurance industry in improving its understanding of how retirees make retirement portfolio.

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APPENDIX

Table 1: Life expectancy of the BBG

	Age		Sex	Monthly Income	
N Valid	498	499	499	499	499
Missing	1	0	0	0	0
Mean	57.11			36972.4658	
Std. Error of Mean	.246			3031.84427	
Median	58.00			18520.9400	
Std. Deviation	5.488			67726.27091	
Skewness	-.477			10.938	
Std. Error of Skewness	.109			.109	
Kurtosis	-.889			167.527	
Std. Error of Kurtosis	.218			.218	
Minimum	41			3226.56	
Maximum	64			1174107.90	

Source: Extracted from Pension Fund Administrators' Records, 2010

Table 4: Age Distribution Pattern of the Death and Surviving Baby Boomers

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	41	1	.2	.2	.2
	42	1	.2	.2	.4
	43	2	.4	.4	.8
	44	1	.2	.2	1.0
	45	2	.4	.4	1.4
	46	5	1.0	1.0	2.4
	47	3	.6	.6	3.0
	48	20	4.0	4.0	7.0
	49	15	3.0	3.0	10.0
	50	36	7.2	7.2	17.3
	51	23	4.6	4.6	21.9
	52	23	4.6	4.6	26.5
	53	16	3.2	3.2	29.7
	54	17	3.4	3.4	33.1
	55	16	3.2	3.2	36.3
	56	23	4.6	4.6	41.0
	57	23	4.6	4.6	45.6
	58	31	6.2	6.2	51.8
	59	19	3.8	3.8	55.6
	60	41	8.2	8.2	63.9
	61	48	9.6	9.6	73.5
	62	28	5.6	5.6	79.1
	63	42	8.4	8.4	87.6
	64	62	12.4	12.4	100.0
	Total	498	99.8	100.0	
Missing	System	1	.2		
Total		499	100.0		

Source: Extracted from Pension Fund Administrators' Records, 2010

Table 5: Age Distribution of the Death Baby Boomers

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid 43	1	3.7	3.7	3.7
46	1	3.7	3.7	7.4
50	3	11.1	11.1	18.5
51	2	7.4	7.4	25.9
52	1	3.7	3.7	29.6
53	2	7.4	7.4	37.0
54	1	3.7	3.7	40.7
55	1	3.7	3.7	44.4
57	3	11.1	11.1	55.6
59	1	3.7	3.7	59.3
60	1	3.7	3.7	63.0
61	2	7.4	7.4	70.4
62	2	7.4	7.4	77.8
63	2	7.4	7.4	85.2
64	4	14.8	14.8	100.0
Total	27	100.0	100.0	

Source: Extracted from Pension Fund Administrators' Records, 2010

Table 6: Age Distribution Pattern of the Surviving Baby Boom Generation

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid 41	1	.2	.2	.2
42	1	.2	.2	.4
43	1	.2	.2	.6
44	1	.2	.2	.8
45	2	.4	.4	1.3
46	4	.8	.8	2.1
47	3	.6	.6	2.8
48	20	4.2	4.2	7.0
49	15	3.2	3.2	10.2
50	33	7.0	7.0	17.2
51	21	4.4	4.4	21.6
52	22	4.7	4.7	26.3
53	14	3.0	3.0	29.2
54	16	3.4	3.4	32.6
55	15	3.2	3.2	35.8
56	24	5.1	5.1	40.9
57	20	4.2	4.2	45.1
58	31	6.6	6.6	51.7
59	18	3.8	3.8	55.5
60	40	8.5	8.5	64.0
61	46	9.7	9.7	73.7
62	26	5.5	5.5	79.2
63	40	8.5	8.5	87.7
64	58	12.3	12.3	100.0
Total	472	100.0	100.0	

Table 7: Baby Boomers' Income Group

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid	2	.4	.4	.4
Less than 20000	253	50.7	50.7	51.1
20000-40000	104	20.8	20.8	71.9
40001-60000	56	11.2	11.2	83.2
60001-80000	30	6.0	6.0	89.2
80001-100000	25	5.0	5.0	94.2
100001-120000	12	2.4	2.4	96.6
120001-140000	4	.8	.8	97.4
Above 140000	13	2.6	2.6	100.0
Total	499	100.0	100.0	

Source: Extracted from Pension Fund Administrators' Records, 2010

Table 8: The Mean Age and Standard Deviation of Baby Boomers

Survival Status	Mean	N	Std. Deviation
Alive	57.14	472	5.451
Death	56.52	27	6.085
Total	57.11	499	5.482

Source: Extracted from Pension Fund Administrators' Records, 2010

Table 9: Distribution of Income Group to Survival Status of the baby boomers

Income Distribution	Marital Status	
	Alive	Death
(In Naira)	2	0
Less than 20,0001	238	15
20,000-40,000	101	3
40,001-60000	53	3
60,001-80,000	28	2
80,001-100,000	25	0
100,001-120,000	11	1
120,001-140,000	4	0
140,001 and above	10	3
Total	472	27