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Maintaining Adequate Financial Capacity at Retirement

Dr. Anthonia Uduak Ubom
Senior Lecturer, Department of Insurance, Banking and Finance/Insurance
University of Uyo, Uyo, Nigeria
Mfon Sampson Ukpong
Lecturer, Department of Insurance, University of Uyo, Uyo Nigeria
Bassey Ime Frank
Graduate Assistant, Department of Insurance, University of Uyo, Uyo, Nigeria

Abstract:
Often, many persons after retirement from active service find it difficult to maintain their financial capacity and life styles or stay close to what was obtainable immediately before retirement. On these bases, this paper aimed at examining ways in which retirees can still maintain at least at close range, their financial capacities. This paper examines the nature and concept of retirement, sources of retirement income, the role of PENSIONS in this perspective, factors influencing the maintenance and measures for maintaining the financial capacity. This paper is purely an essay type-descriptive in nature and the following issues are pertinent: retirement refers to a time when you are out of active service as a result of age, the major sources of retirement income are social pension, asset income, retirement savings and investment, work or other income-generating activities, pensions and home equity among others. Pensions play a vital role in maintaining adequate financial capacity. Knowledge, skills, attitudes, financial responsibilities affect this maintenance while effective management of money, planning ahead, maintaining adequate level of savings, making appropriate choices, investment in assets, leaving special skills for entrepreneurship among others are various ways that can assist in maintaining adequate financial capacity at retirement.

Keywords: *Retirement, pension, retirement income, savings, and financial capacity, maintaining*

1. Introduction

Retirement is an inevitable stage in one's life where the individual disengages from all mainstream active work as a result of age. Some retire and are still strong enough to engage themselves in one line of business or the other, while others retire and are completely inactive and weak. These pose serious challenges worldwide, thus the need to plan for retirement. Whatever name you call the planning, the fact is that the financial capacity of the retiree is lower than what it was before and sometimes no more especially when gratuities and pensions are not paid as at when due. In most cases, the retirees can no longer control or be fully in charge of themselves and their income including their savings and so the person taking care of that or the signatory to the bank account sometimes becomes funny thus diverting the funds. In other cases, rents are not duly paid to them (retirees) for those who have rented apartments and investments in financial assets. As a result, retirees who do not have relatives or siblings to take care of them are unable to feed properly, medical care is ignored, accommodation lacks, clothing and self-maintenance becomes serious problems. Some of them die off due to lack of care and good/proper maintenance and another person enjoys the money left behind by the retiree. It is on these bases that this article has been designed to examine the various waysin which retirees canmaintainadequate financial capacity at retirement.Specifically, the paper sought to review the nature and concept of retirement,examine the various sources of retirement income,assess the role of pensions in maintaining adequate financial capacity,identify the factors influencing the maintenance of adequate financial capacity at retirement, andexamine the measures that could be adopted to maintain adequate financial capacity at retirement.

This work is classified into five sections. Section one is the introduction which is about to be concluded. In section two, theoretical review is made, section three presents the research methodology while section four is made up of the theoretical review. In section five, the work is summarized, conclusion drawn and recommendations made.

2. Theoretical Review

This section reviews literature relevant to this study. Specifically, it covers the nature and concept of retirement, various sources of retirement income, the role of pensions in maintaining adequate financial capacity, factors influencing the maintenance of financial capacity at retirement and the measures that could be adopted to maintain adequate financial capacity at retirement.

2.1. Nature and Concept of Retirement

Buckley in Ali (2014) defines retirement as an inevitable stage of aging where the individual disengages from the main stream of active work, social work and is eventually replaced with younger ones. Cole (1997) defines it as the time an employee reaches the end of his or her working life. Retirement is the point where a person stops employment completely due to exhaustion of useful lifetime. It occurs when one stops work on a permanent basis, usually because of old age or illness.In Nigeria, the statutory age of retirement is sixty-five (65) years of age or thirty-five (35) years of active working service, whichever comes first, for staff of tertiary institutions other than professors. Those on the professorial cadre retire at the age of 70 years irrespective of years of service; however, the non-professorial staff of tertiary institutions retire at 65 years irrespective of years of service. Judges of the Court of Appeal and Supreme Court levels retire at 70 years while those at the High Court level retire at 65 years. Other arms of the public service and private sector retire at 60 or 35 years of unbroken active service, whichever comes first (FRN, 2004; Ali, 2014).

Denga (1996), Nwajagu (2007), Okechukwu and Ugwu (2011) and Ali (2014) identify three forms of retirement. These are:

- Voluntary or self-retirement: This occurs when the individual decides to quit active service for personal reason(s) irrespective of age, experience, length of service or retirement policies. This form of retirement mostly depends on the employee than the employer.
- Compulsory or forced retirement: A situation in which the individual is forced or compelled to retire against the individual's expectations, mostly when he is ill-prepared for it. This could be as a result of inefficiency, old age, ill-health, indiscipline etc. It is often in the interest of the organization.
- Mandatory or statutory retirement: This is the retirement that occurs when the person has reached the statutory age of retirement as specified in the condition of service of the establishment.

The International Risk Management Institute (2017) defines financial capacity as the capacity of an individual to manage his/her own money/financial affairs and make relevant decisions while keeping in mind all possible financial and legal consequences of his/her acts. For an organization, it is the financial limit of the organization's ability to absorb losses with its own funds or borrowed funds without major disruption. Financial ratios are used to measure a company's capacity to meet its obligations in the short-term and capacity to meet its capital obligations in the long term. Such ratios include liquidity and leverage ratios.

Low financial capacity leaves a huge part of the population with limited financial resilience to deal with unexpected life events. Societal influences encourage spending now rather than saving for the future. Every day, people are bombarded with marketing messages to spend and borrow. People tend to spend more than they can afford because they feel under pressure to match the spending behaviours of friends and family. In addition, social norms tend to prompt poor financial choices as people are primarily concerned with hiding financial problems by continuing to spend (Wolff, 2002; Bosworth, Barry, and Smart. 2009).On the other hand, adequate financial capacity refers to keeping substantial finances to deal with future unexpected life events and obligations. Retirees thatare financially capable are able to make informed financial decisions. They can budget and manage money more effectively. They understand how to manage credit and debt. They are able to access needs for insurance and protection. They can assess the different risks and returns involved in different saving and investment options. Moreover, they have an understanding of the wider ethical, social, political and environmental dimensions of finances.

2.2. Sources of Retirement Income

Upon retirement the retiree has an array of options to use in managing retirement income. According to Antolin, Pugh and Stewart (2008) an analysis of the main forms of benefit payment at retirement suggests considerable variance between countries. Some countries only allow one form of retirement payment, while others allow several forms or even a combination of them. The works of Cardinale and Orszag, (2002) suggest that some of the forms of retirement payments include lump-sums (a single payment), programmed withdrawals (series of fixed or variable payments generally calculated by dividing the accumulated assets by a fix number or by the expected life expectancy in each period), and life annuities (a stream of payments for as long as the retiree lives).

The sources of retirement income can be summarized as follows:

2.2.1. Social Security

This is otherwise referred to as social pension. According to Rooji, Lusardi and Alessie (2008), almost all retirees in the United States receive social security payments which many of them are dependent on. About 52% of Americans aged 65 and above receive at least half of their income from social security. The social security retirement benefit is calculated using a formula that takes into account one's 35 highest earning years. How much one receives depends on when they started taking benefits and the year they were born. Benefits increase each year that one delays taking benefits until the age of 70 (Mitchell and Moore 1998; Gustman, Alan, and Steinmeier, 2004).

Social pension which involves cash transfer to old people with eligibility based on residence could serve as an alternative source of finance at old age. According to Fapohunda (2013) such funds are financed from tax revenues and not from contributions. Holzmann and Hinz (2005) and Palacios and Sluchynsky (2006) maintain that the contribution of social pensions to relieving poverty in developing countries has been long advocated by the International Labour Organization and the World Bank. Expectedly, social pensions have led to positive developments in countries where they are used.

Johnson and Williamson (2006) note that social pensions have contributed to improving women's health, fighting rural poverty, heightening the status of older people in the family and increasing school enrolment. However, they believe that in traditional settings like Nigeria, it is capable of weakening traditional systems of informal family care for the elderly. Also, as it relies on the old, unfunded pension scheme, there is instability of the revenue source, hence, the likelihood of payments falling into arrears.

2.2.2. Asset Income

A large proportion of retirement income is also being generated by assets such as interest, dividends, rental income and royalties. Retirees with assets tend to fare better at retirement. According to Bosworth, Barry, and Smart (2009) the median income of retirees with asset income appears to be more than twice that of senior civil servants with no income from investments. Retirees with assets must strike a balance between the desire to protect their existing savings and the need for continued growth to keep up with inflation in retirement. Braddon (2016) is of the view that workers should invest a reasonable sum of money in the stock market during their service years as a best hedge against inflation over the long term.

In planning for retirement, one of the most important consideration for a yet -to-retire is to understand where the retirement investment money will go, and for how long. As a basic strategy, the retirement funds or money may be invested in short term investments, medium-term investments or long term investments. The type of investment usually is determined by the retiree's number of years before retirement. Generally, the more time they have before having to sell off the investment for cash, the riskier the investment. If the time horizon is five or more years, which would be considered long term investments, they can choose investments that appreciate over time. Growth stocks and real estate are good long term investments if they have many years left before retirement. Volatile stock are considered as short term investments, that is investments that are held for a year or less, and should be re-evaluated several times a year.

2.2.3. Retirement Savings and Investment

Some investments such as certain types of annuities are designed to provide a guaranteed monthly income. Sometimes they yield an amount that varies periodically depending on the performance of the investments. Annual withdrawals from such account can help one achieve a better standard of living than retirement with only social security income. However, withdrawals from such account must be made gradually with discretion on an annuity basis to increase its longevity. Annuities come in various types and options, hence the assistance of a financial advisor should be considered in making a choice (Wolff, 2002; Bosworth, Barry, and Smart, 2009).

Life annuities have the advantage that payments are made for the entire lifetime of the retiree and therefore retirees are protected from longevity risk (Cardinale and Orszag, 2002). In this regard, life annuities are superior to other forms of benefit payments. Life annuities can provide a fix payment or a variable payment, and many times the latter can be escalating or tied to the performance of stock markets. Additionally, the distinction between deferred annuities and longevity insurance is important to bear in mind. Under deferred annuities, the capital is generally returned if the individual dies during the deferral period (Rusconi, 2008). However, under deferred annuities categorised as longevity insurance, the payments are conditional on surviving to the end of the deferred period. This is because they are pure insurance and the premiums are always significantly lower.

2.2.4. Work or other Income-Generating Activities

The works of Burtless, Gary, Quinn, and Joseph (2000) and Leonesio, Michael, Bridges, Gesumaria, and Del Bene (2010) reveal that post-retirement work is becoming an increasingly important component of improving financial capacity at retirement. Braddon (2016) asserts that the proportion of all retirement income emanating from post-retirement work has increased in recent years from 23.1%in 2000 to 32.2% in 2014. Levine (2015) maintains that richer people with less demanding jobs have an easier time working longer, for while finances are improved if one works an extra year, one inadvertently gives up a year of enjoying oneself. It has also been observed that retirees that engage in post-retirement work enjoy psychological benefits of satisfaction and accomplishment especially for jobs they find interesting and fulfilling. Some retirees also engage in small business ownerships after retirement. This also forms a viable means of financial security after retirement.

2.2.5. Home Equity

In many developed countries, retirees use equity from their homes to help finance their retirement. On taking out a reverse mortgage on the house, they are guaranteed a set of payment for as long as they live in the house. These payments are regarded as loans of which both the loan and any accumulated interest is eventually repaid by the last surviving borrower who either sells the house, permanently vacates it or dies. A second option to using one's house as an equity by selling the house, then downsizing or buying in a lower-cost region and investing that freed-up cash to produce income or be used as necessary (Wolff 2002).

2.2.6. Pensions

Friedberg, Leora, and Anthony (2005) maintain that pensions are the most common forms of adequate financial stability at retirement in most developing countries. It can be provided as a lump-sum payment or as a single annuity. It is worthy of note that providers of benefit payments differ from one country to another. Lump-sums and programmed withdrawals are generally provided by pension fund administrators in most countries. However, as regard life annuities,

providers vary from insurance companies, to pension funds, financial intermediaries and a centralized annuity fund.In the next section, we shall elaborate more on pensions as a means of improving financial capacity at retirement.

2.3. Pensions as a Means of Maintaining Adequate Financial Capacity

Fapohunda (2013) defines pension as the amount set aside either by an employer or an employee or both to ensure that at retirement there is something for employees to fall back on as income. It does not only provide financial protection to workers at old age, but also builds up plans that guarantee income to them when they retire or to their dependants when death occurs. In most organizations pension is determined by basing payment upon a percentage of employee's earnings computed at an average over several years multiplied by the number of years the employee served the company.

Pension reform according to Blake (2003) is not a new issue in any part of the world. It is mostly a continuous process especially with the ever changing economic and political processes witnessed everywhere in the world. Balogun (2006) affirms that Nigeria's first ever legislative instrument on pension matters was the Pension Ordinance of 1951 which took effect retroactively from 1st January, 1946 while the latest is the Pension Reform Act, 2014 (Oyedele, 2014). In addition to the successes recorded under the previous acts, the new Pension Act has the following merits:

2.3.1. Exemption from Tax

The Act clearly states that any profits, interests, dividends, investments and other income accruable to pension funds or asset are not taxable. In addition, withdrawal of voluntary contribution is no longer subject to tax if withdrawn within five years.

2.3.2. Withdrawal from Retirement Savings Account (RSA)

The new Act creates another condition in which a contributor may be allowed to withdraw from his retirement account. An employee who disengages from employment or is disengaged before the age of 50 and is unable to secure employment within four months of disengagement is allowed to make withdrawals from the account not exceeding 25% of the total amount credited to the retirement savings account.

2.3.3. Choice of Pension Fund Administrator (PFA)

Employees continue to have the right to choose their PFA. Their right have been extended to cover employees whose employers operate a closed pension scheme. Such employees now have the right to choose an external PFA. Where an employee fails to open an RSA within 6 months after assumption of duty, his employer can now request a PFA to open a nominal RSA for such employee for the remittance of his pension contribution.

2.3.4. Investment of Pension Funds

The Act expands the scope of investments in which pension funds can be invested and this includes specialist investment funds and other financial instruments the Pension Commission may approve. However, care must be taken not to lose sight of the need to protect and preserve contributor's wealth.

2.3.5. Dispute Resolution

Any employee aggrieved with his employer or PFA is obligated to approach Pen Com for a redress before exploring arbitration or commencing an action at the National Industrial Court (Oyedele, 2014)

3. The Problems and Challenges of Pension Fund Administration in Nigeria

The last two decades of pension administration in Nigeria has been fraught with challenges which have militated against the success of pension schemes in the country. Those problems are discussed below.

3.1. Poor Funding

Owing to inadequate budget allocation, budget releases seldom came on schedule and were far short of due benefits (Adesina, 2006). According to Abromovitz (2009) the situation also resulted in unprecedented and unsustainable outstanding pension deficits, estimated at over N2 trillion naira, before the commencement of the Pension Reform Act (PRA) 2004. The proportion of pension to salaries increased from 16.7% to 30% between 1995 and 1999.

3.2. Weak Administration

The administrative process of pension fund was very weak and was largely characterized by inefficiency and non-transparency. Abang (2006) adds that there were no authenticated records or data for the pensioners, and as much as fourteen documents were required to file pension claims. Inexperience and staff training equally posed a challenge to this weak administration.

3.3. Inadequate Framework

Generally, pension fund schemes in Nigeria were largely unregulated, and eventually, when it was regulated no proper supervision and monitoring were given to it, until the advent of the PRA 2004 (Abromovitz, 2009). The Nigeria pension system was generally fragmented and lacked overall policy. Most individuals employed and assigned as supervisors displayed unethical moral standards required of pension fund administrators.

3.4. Political Challenges

According to Adebiyi (2004), the Nigerian Pension system experienced minor Pension reforms that were repeated periodically because of political challenges associated with changes in government policies. When the new "defined benefit schemes" were redefined, they only created uncertainty in relation to retirement benefit and the old retirement benefit schemes were easily abandoned.

The introduction of Contributory Pension Scheme in the management of retirement pension in the country came with heightened hope. However, the problem and challenges that attend the current contributory scheme presents a new set of hurdle in the success of pension administration such as:

- Failure of the employees, federal and state governments to make specific provisions in their budgets for the payment of gratuities and pension.
- Inability of the government to pay its premium to the National Insurance Corporation (NICON) regularly. As a result, NICON is unable to remit funds for pension and gratuities regularly.

3.5. Poor Contribution

The National pension fund scheme on the contributory aspect of the scheme witnesses low contribution from the workers. In view of this, Adesina (2006) suggests the need for increase in pension payment following salary increases. This is to assist in the contribution and increase the assets and portfolio of pension funds in Nigeria. According to Balogun (2009), owing to challenges confronting the implementation of the new scheme in Nigeria, only 10 of the 36 states of the Federation have fully aligned with the pension reforms in the country. This implies that the amount realized from retirement savings accounts and invested in assets portfolio is low and need to be expanded so as to attract more contribution in the scheme.

4. Factors Influencing Financial Capacity at Retirement

Duflo and Saez (2003) in Rooji, Lusardi and Alessie (2007) consider retirement planning as being associated with a number of socio economic characteristics such as knowledge, skills and attitude. These factors, endorsed by the Financial Services Authority, London, provide basic financial literacy and efficient financial skills.

4.1. Knowledge

People require a basic knowledge and understanding in managing their financial affairs. This knowledge can be acquired in different ways: through experience, education, and training; and through passive receipt of information from different sources such as family and friends, the media and information materials produced by the financial sector. However, these relatively simple concepts and calculations are challenging for a sizeable minority. Researches carried out in the UK shows that one in five people could not read a bank statement despite the increased use of mobile banking. Similarly, people aged 75 and above tended to perform noticeably worse in understanding financial statements. These factors affect the individual's ability to manage money effectively and chose financial products and services that meet their needs.

4.2. Skill

Specific skills are needed to apply knowledge received in order to manage money and make appropriate financial decisions. Rooji, Lusardi and Alessie (2007) identify two sets of skills which need to be underpinned by basic levels of literacy and numeracy. These are:

- Gathering financial information and record keeping,
- Financial planning which entails saving, spending and budgeting.

An understanding of risk and return would be an additional skill together with skills required to evaluate information and make comparisons between different products or courses of action.

4.3. Attitudes

This involves the ability to take necessary steps in the appropriate application of knowledge in the exercise of their skill. Basic attitudes towards financial capacity include:

- A willingness to invest time and other resources required to apply knowledge and exercise skill
- An ability to gain access to information, advice and other resources, and
- Requisite confidence to exercise their skills and to act on the results.

Rooji, Lusardi and Alessie (2007) are of the view that these attitudes are influenced by experience, personality and circumstances. In an analysis carried out by Briscoe (2015) in the UK, around half of all adults have a mind-set that focuses more on current needs and wants at the expense of providing for the future. Moreover, three in ten people do not openly discuss their household finances regularly with anyone. People are more likely to save regularly if they have future-focussed attitudes or specific goals, plans or reasons to save.

4.4. Financial Responsibility

This is the ability to appreciate the wider impact of financial decisions on personal circumstances, the family and the broader community in line with social and ethical issues. Financial responsibility enables people to understand and appreciate their rights and responsibilities. They understand the need and have the right skills and attitudes to plan, analyse, decide, evaluate and monitor financial decisions and choices (Basic Skills Agency, 2004).

4.5. External Factors

These include societal factors like family demands or social networks and environmental factors such as access to financial products, financial infrastructure and consumer protection mechanisms.

4.6. Measures of Maintaining Adequate Financial Capacity after Retirement

To maintain financial capacity after retirement, certain measures must be adopted by the individual during his active years. Such measures include:

4.6.1. Effective Management of Money

This is concerned with being able to live within one's means. To maintain financial capacity, one must be well-organized particularly as regards paying bills and keeping and using financial records. Staying within one's means involves developing strategies to make ends meet and resisting pressures to spend or borrow money (Financial Services Agency, 2004).

The first method for consideration in management of retirement benefit is payment of lump-sum. This method is easy to administer, do not require complex calculations or record keeping, and the pension fund or plan sponsor do not have subsequent obligations after the initial pay-out to the retiree. The retiree takes up the responsibility of managing the lump-sum received. This grants them the right to invest part of the money, pay down debt, satisfy the bequest motive, and give them the ability to self-annuitize (Rusconi,2008). However, lumps-sums also have their disadvantages. Few retirees are really prepared to self-annuitize as they lack appropriate financial skills and discipline. Moreover, problems of moral hazard arise as retirees can squander their assets and fall into the social security safety net. Finally, lump-sums do not protect from longevity risk (Hafner, and Mader, 2007).

To address the challenges faced with lump sum payment, Programmed withdrawals method of fund management provide more financial discipline, as payments are prearranged. However, under programmed withdrawals there is also the risk that the capital will be completely exhausted while the retiree is still alive. Different country's practices on programmed withdrawals vary, from simply imposing a minimum payment requirement to setting both minimum and maximum limits, through to highly prescriptive formulas that leave no discretion to the individual (Antolin, Pugh and Stewart 2008).

4.6.2. Maintaining Adequate Level of Savings

Developing a saving culture can guarantee a level of financial security upon retirement. With more money in saving, the retiree has some level of confidence in his ability to manage his financial resources, and will not easily become bankrupt. This can also serve as a means of raising money for choice investment.

4.6.3. Plan Ahead

This enables one cope with unexpected events as well as makes provision for the long term expenses. Unexpected events can upset budgets and financial plans. To maintain financial capacity, one must be able to deal with a large fall in income, cope with large, unforeseen expenses and be aware of possible sources of financial help. This will greatly help in managing gratuities and pensions (Mason and Wilson, 2000).

4.6.4. Making appropriate choices

Given the array of financial products available, being aware of what is on offer and being able to choose those that are most appropriate to an individual's circumstances are key ways of maintaining financial capacity. Individuals should be able to choose products right for them by comparing costs and returns, assess risks and identify risky products.

4.6.5. Learning Special Skills for Entrepreneurship or Vocation

One sure way of ensuring a steady flow of income is by becoming an entrepreneur, or in other words meeting the needs of others for a fee. Being proficient in certain skills will ensure a retiree continue to earn incomes from his vocational skills even after retirement. This skill can also be transferred to others for a fee through mentorship or by organising trainings in that area of vocation (Basic Skills Agency, 2004).

4.6.6. Investment in Assets

Committing some resources in assets, especially tangible assets likes lands, mortgages etc., can ensure financial freedom upon retirement. These assets appreciate in value over time and are regarded asgood sources of retirement income. The land may be sold at a value higher than it was purchased. Houses can provide income streams from rents. The retiree can also invest in bonds and shares to earn passive incomes.

4.6.7. Getting Financial Help

There may be need to obtain financial help. One must know where and when to turn for financial advice and also be able to judge how much trust to place in the information and advice provided (Financial Services Agency, 2004; Mason and Wilson, 2000)

5. Conclusion

Yearly, the number of retirees increases globally, and many of them are always less prepared for the life post-employment. Being accustomed to steady flow of income from their employers, they tend to become confused, depressed and devastated when the salaries are no more forthcoming. They become entangled in the web of debts with daily increase in demand for expenditure on personal effects for survival. This often poses enormous financial challenges to the less prepared retirees. With adequate financial literacy many retirees face this phase of life with relative financial challenges. With the array of options, methods and strategies available, a retiree can live his life optimally, meeting his financial needs even after retirement.

With more years to invest, the retiree can have a better chance of recovering from any drops or bumps along the way. The longer their money is invested the better their chance of securing their future. By planning for retirement needs, their future financial capacity is secured and is in a better position to deal with most issues that may threaten them financially.

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