”What PFAs Want from the Capital Markets”

- *Presented by Mr. Dave Uduanu on 27th October, 2011*

Outline

- Nigerian Pension Industry
- Challenges of Capital Market Investments
- What Needs to be Done??

THE NIGERIAN PENSION INDUSTRY

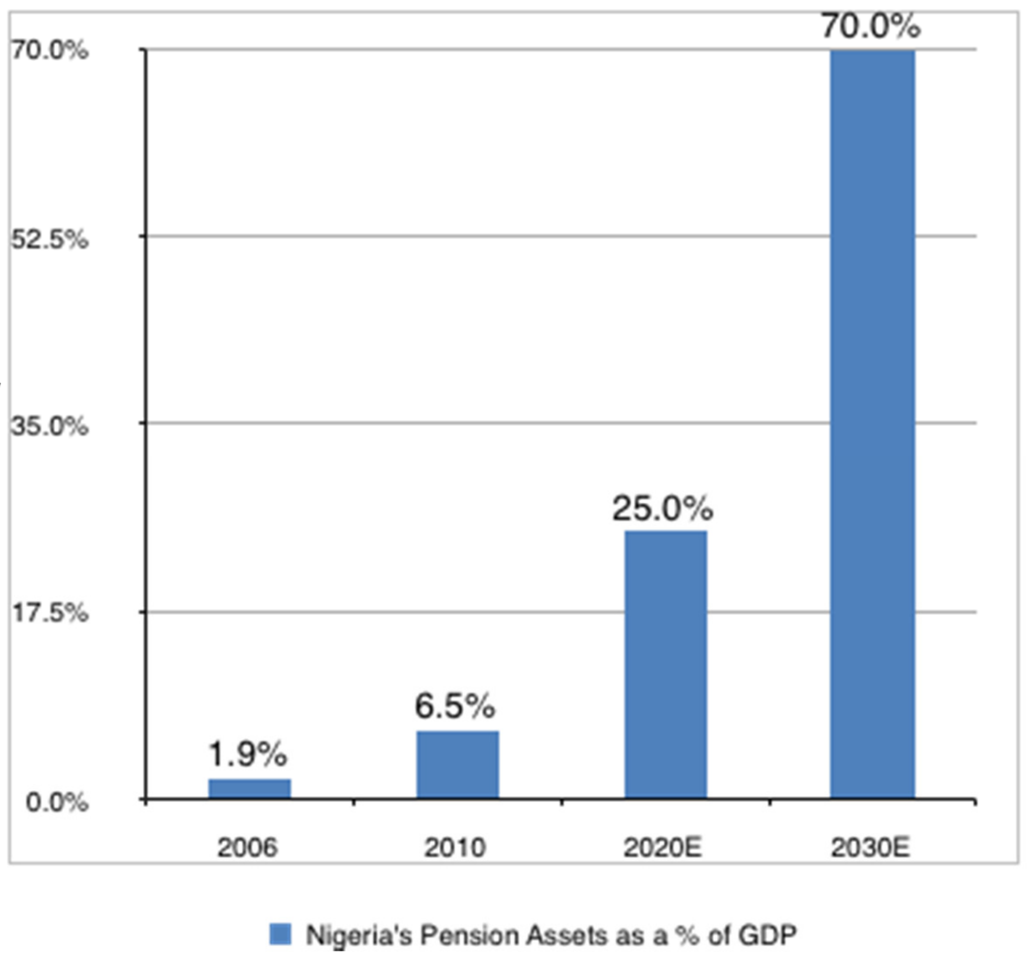
The Nigerian Pension Industry

- The Nigerian pension industry witnessed rapid growth and changes since the passage of the PRA of 2004; currently a DC scheme
- Industry structure:
  – 4 pension fund custodians (PFCs), 24 PFAs, 7 CPFAs
- Pension assets have grown at a CAGR of 24% in last 5 years
- About 5 million Retirement Savings Account (RSA) (as against a working population of about 54mn people; 10% enrollment rate)
- About 60% of the contributions are from the private sector.
- Globally, pension assets grew by 12% in 2010 to a record high of US$26.5trn

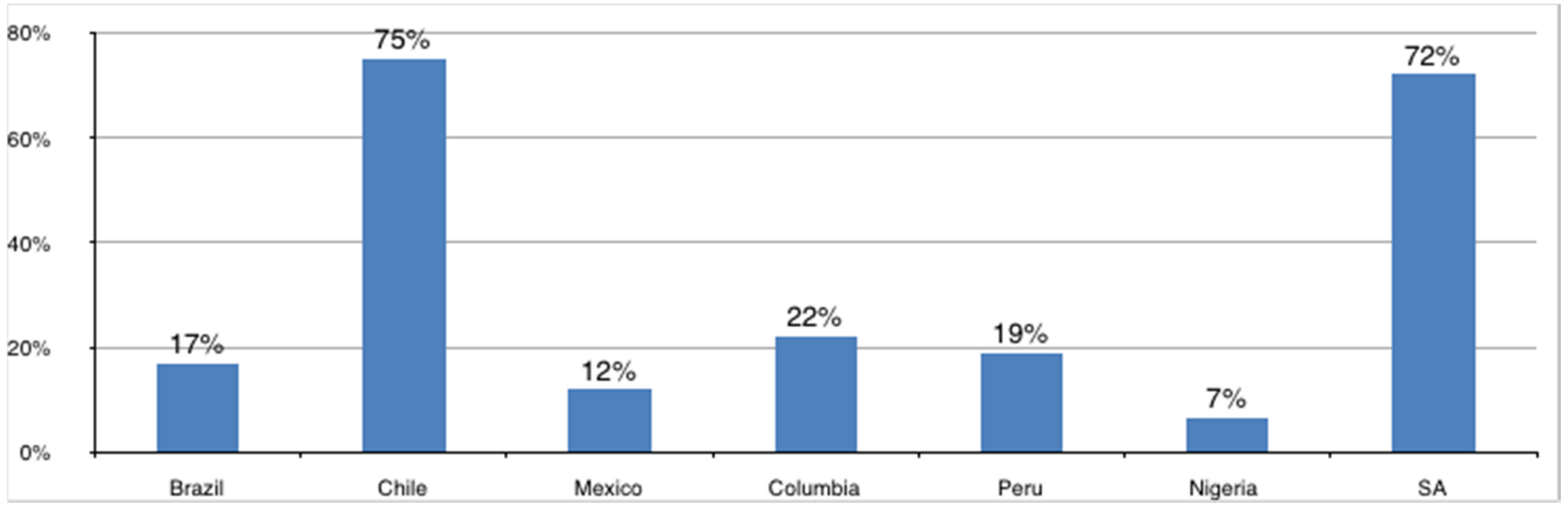
The Nigerian Pension Industry

- Average contribution: **$130mn/month or $1.6bn p.a.**
- **Current AUM of $14bn**
  - Represents about 7% of Nigeria's GDP from 1.9% in 2006
- Still marginal when compared to other emerging markets
- Nigeria's GDP is estimated to reach approx. $403bn by 2020 and pension assets $100bn
  - Approx. 25% of GDP based on a sustained annual growth rate of 15%

Nigeria's Pension Assets as a % of GDP



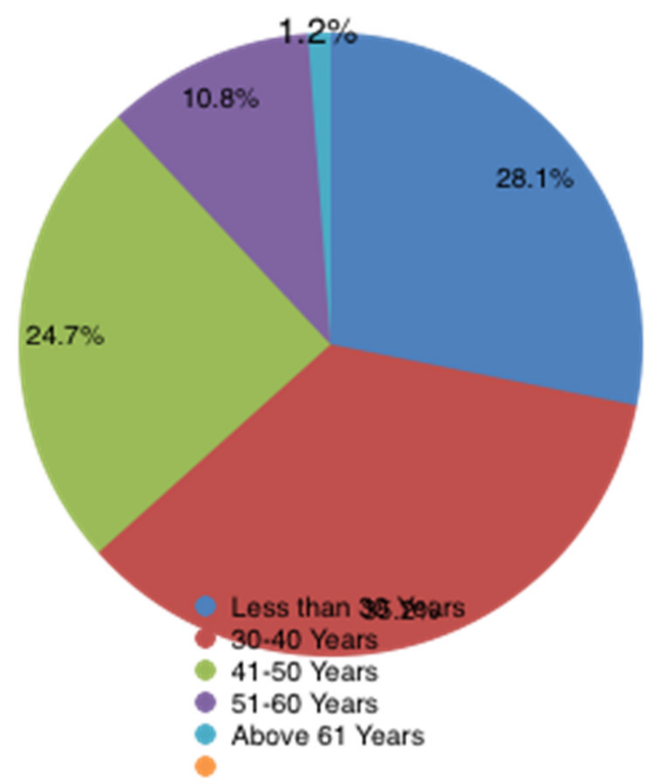
Comparative AUM as a % of GDP



Country	Brazil	Chile	Mexico	Colombia	Peru	Nigeria	SA
Pension Assets ($'bn)	***342***	***153***	***120***	***62.7***	***28.8***	***14***	***256***

Industry Structure

% of RSA Registrations in 2010



Less than 40 years account for 63% of industry

Industry Size by Assets

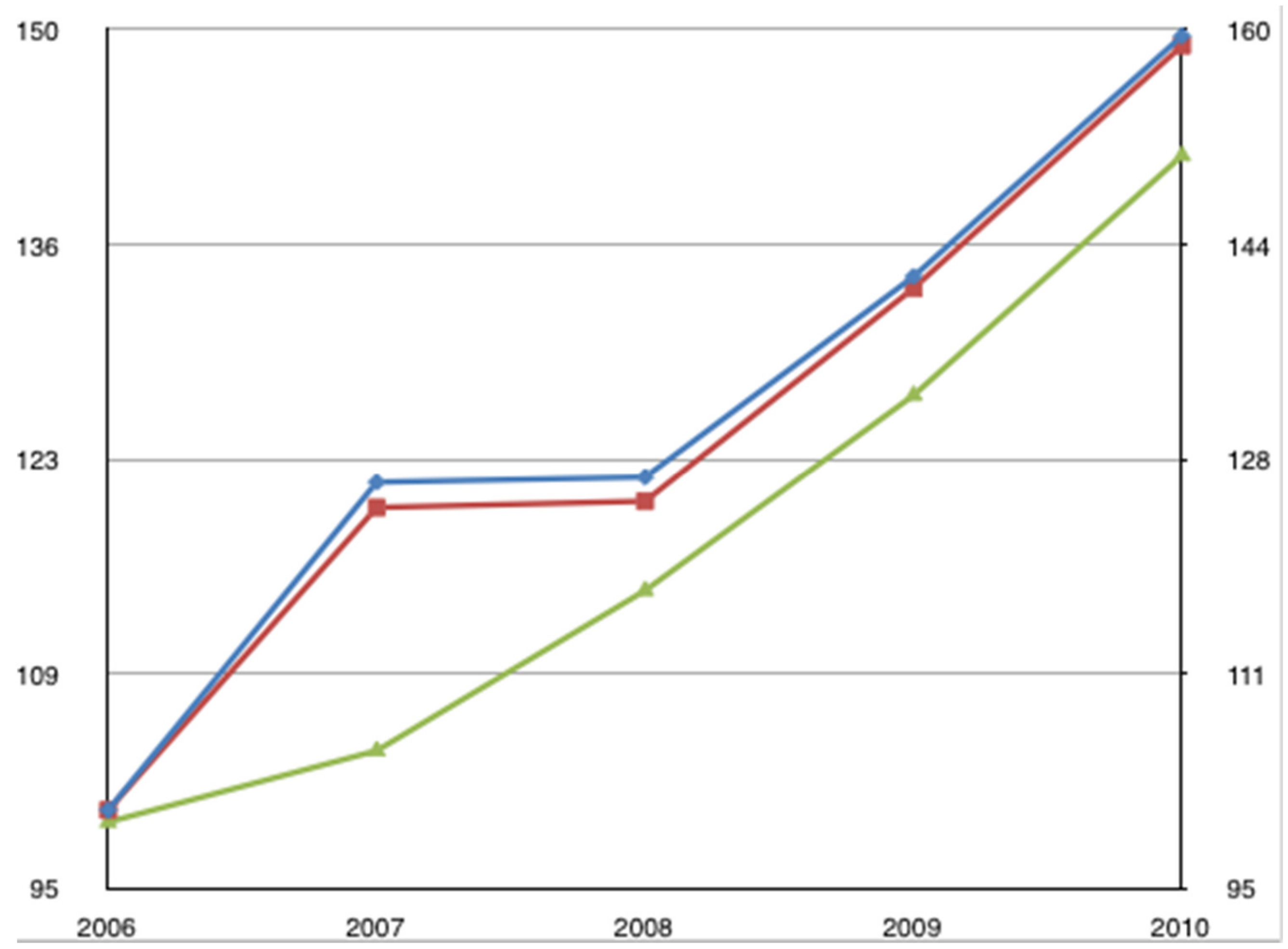
	% of AUM
RSA -Active	***48.2%***
RSA- Retiree	***6.2%***
Legacy DB Schemes	***25.5%***
CPFA	***19.9%***
Total	***100%***

Industry Asset Allocation

Asset Class	2008	2009	2010
Equities	***20.07%***	***14.43%***	***17.64%***
Fixed Income	***33.3%***	***36.85%***	***46.78%***
Money Market Sec.	***30.25%***	***35.45%***	***24.10%***
Off-Shore Assets	***1.77%***	***1.34%***	***1.55%***
Real Estate	***11.42%***	***9.35%***	***8.40%***
Others	***3.19%***	***2.58%***	***1.52%***

- Highly skewed towards fixed income (47% in bonds;24% in MM
- Vulnerable to short term monetary policies and inflation
- Money market rates are largely below inflation rate.
  - However, the CBN's continuous rate hike is combating inflation and resulting in real positive interest rates
- Investments in equity have declined in value leading to unrealized losses by pension funds.
  - In Dec. 2008, investors including pension funds experienced unrealized loss estimated at N3.22bn.

Weighted ROI ($ n N) vs Inflation



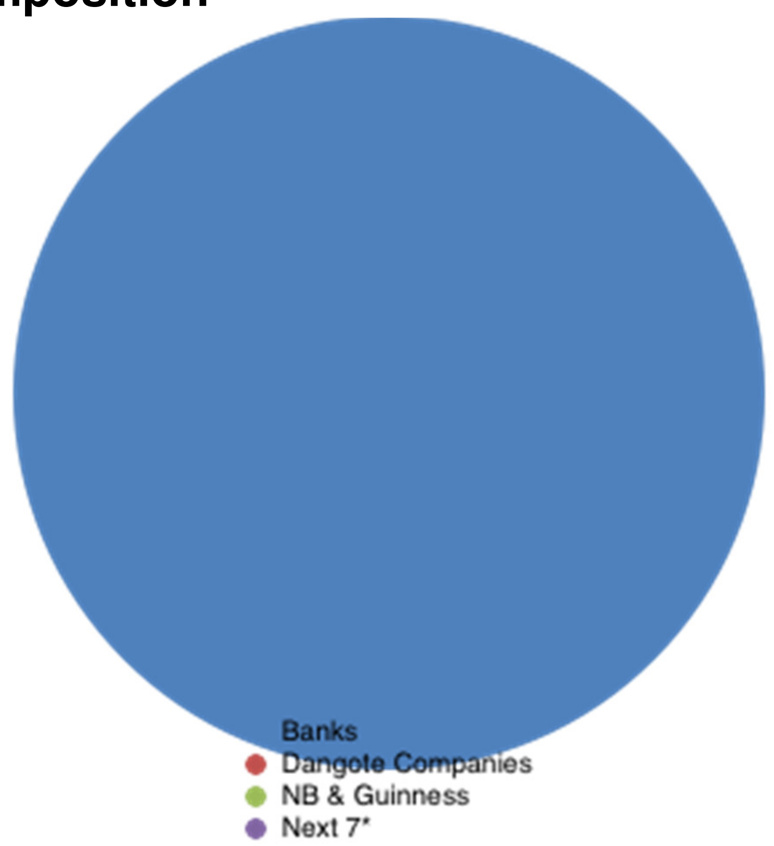
- CAGR of 11%, 10% & 11% for ROI ($), ROI (N) and Inflation resp.
- This makes the case for alternative investments such as PE, Hedge Funds & infrastructure funds to improve overall returns

The Case for More Asset Classes

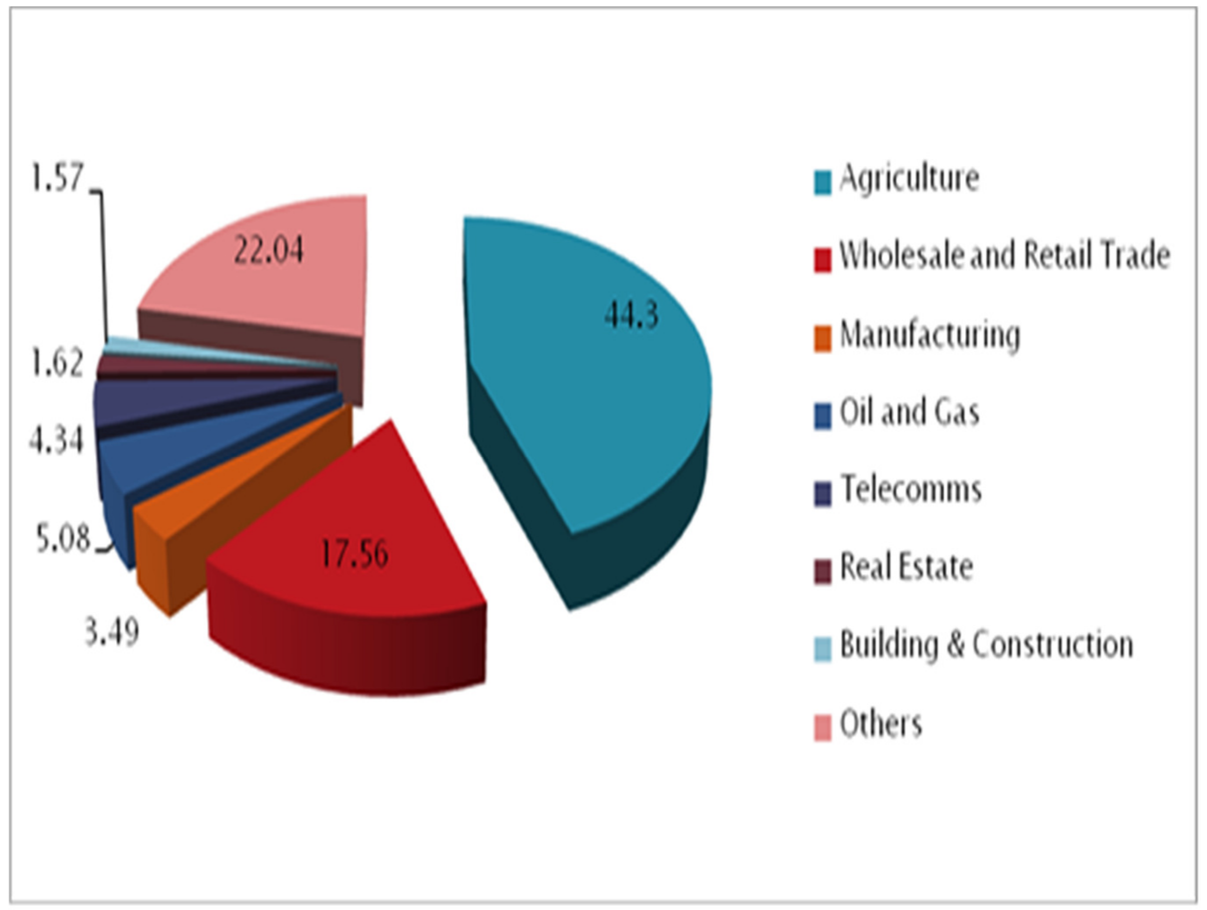
- Current allocation unduly skewed towards sovereign debt instruments
  - Diversification: country and currency (international funds)
  - Sector diversification, especially those not represented on the NSE
- Economic and Developmental impact of private equity
  - Intelligent capital; Access to expertise and markets; Economic development and job creation
- NSE investible universe – shallow and over-concentrated
  - NSE Market Cap.= $42bn with 203 stocks
  - Pension universe = 68 stocks (but only about 30 quality stocks-based on fundamentals, liquidity and upside potential)
- Nominal versus real returns
  - Need for real assets that better matches pension assets and liabilities (inflation index bonds, PE, real estate, infrastructure)
- Search for Alpha
  - A 10% allocation to PE with a target return of 30% adds an additional annual return of between 2-3%

NSE vs. GDP Composition

NSE Composition



GDP Sectorial Composition



**Next 7: PZ, Nestle, FM, JB, Oando, Total and Mobil*

The NSE is not a true representation of Nigeria's GDP

QUESTION: How do you buy into the Nigeria growth story??- Through PE

Case for Alternative Investments: Portfolio Structure

	Alloc.	Returns	**WR**	Alloc.	Return	**WR**
Sovereign Bond	55%	12%	**6.6%**	55%	12%	**6.6%**
Sub-nat./Corp Bonds	10%	13%	**1.3%**	10%	13%	**1.3%**
Money Market	25%	8%	**2.0%**	15%	8%	**1.2%**
Equities	10%	15%	**1.5%**	10%	15%	**1.5%**
Alternative Inv	***0%***		***0%***	10%	30%	**3.0%**
Total	100%		**11.4%**	100%		**13.6%**

- Industry ROI will increase from an average of 11.4% to 13.6% with the introduction of alternative assets e.g. PE, hedge funds, infrastructure funds, etc.

SHORTCOMINGS OF THE NIGERIAN CAPITAL MARKET

Overview of the Nigerian Bond Market

- Current size of the Corporate US$1Billion which is approx. 0.5% of GDP
- Corporates have been accessing the bond market such as: Flour Mills (Nxbn), WAPCO (Nx), GTB (Nx), UBA (Nx), NAHCO (Nx), UPDC
  - This is still marginal when compared to the size of the Nigerian economy
- State bonds issuance has also been on the increase e.g. Niger, Delta
- Potential issuers in the bond market include:
  - Multinationals
  - Regional champions (e.g. Dangote Group, Tier 1 Banks, OandO etc)
  - Domestic corporates - NAHCO,
- Market remains underdeveloped due to several challenges

Factors Limiting Multinationals from Accessing the Bond Market

- Cheaper source of credit from banks
  - Banks are cautious to lend since the CBN's 2009 special audit exercise
- Ratings requirement (at least 2 rating agencies)
- Local companies preference of accessing finance from their parent companies
  - To manage tax exposure
- Issuance cost (at time of issue) versus cost of sourcing finance via other means
- Depth of the market (absence of institutional investors)
  - Inability of local institutional investors to take up large issues e.g. say a $1bn issue
  - i.e. unwillingness of multinationals to come into the market since they perceive the market as very small

Factors Limiting Domestic Companies and 'Regional Champions' from Accessing the Bond Market

- Weak corporate governance practices
  - Issue of transparency
- Already leveraged balance sheets
- Inability to get investment credit ratings
- Lack of awareness
  - Most companies are familiar with the traditional means of raising capital e.g. via bank loans, equity market
  - Companies face a balance sheet mismatch due to overreliance on these traditional means

Why are PFAs not Investing in Bonds?

- Inadequate supply
- Pricing mechanism e.g. sub-optimal yields - UPDC raised money at 10% whilst equivalent FGN was at 10%.
  - Absence of inflation-protected yields or inflation-indexed bonds
- Market distortion - lack of premium for taking credit
  - Inadequate compensation for credit risk
  - Yields obtainable for corporate investments doesn't match the risk for investing in the company
- PenCom's investment guideline which stipulates a per issue limit of 20% subject to 5% of AUM- 35% allocation to Corporate Bonds
- Lack of liquidity in the secondary market
- Lack of transparency

Why are PFAs not Investing in Bonds?

- High bid-offer spread
- Current CBN’s contractionary monetary policy stance
  - Which will discourage corporates from accessing the bond market
- Poorly regulated sector – SEC regulates only the primary issue of corporate bonds. Who regulates the secondary market now?. How active is the NSE Platform?

Investment Challenges in the Equity Market

- Overconcentration on about 30 stocks
  - Accounts for about 80% of market cap.
- Lack of liquidity – free float
- Transparency and disclosure issues
  - e.g. when the MD/Director of a company buys more shares/trades in his own shares which is not disclosed
- Delay in information transmission/dissemination which affects market efficiency
  - e.g. quarterly earnings, corporate announcements
- Inaccurate data from the exchange
  - E.g. errors in reports released, company financials posted on the NSE website
- Inefficient tracking of the stock market index. E.g. the trading portion of a company's stock should be separated from the non-trading . Use Float adjusted Index. E.g you cannot create an Equity ETF because the AsI is not Investible!!!. How do you mirror Dangcem influence on the NSE ASI when 75% is not tradable!!
- Dearth of qualitative objective equity research - Independent Buy side Research

Investment Challenges in the Equity Market

- Weak corporate governance practices of quoted companies
- High transaction costs – regulatory charges
  - Reduction in charges will influence market liquidty
- Lack of market makers to provide liquidity

WHAT NEEDS TO BE DONE....

Potential Solutions to the Challenges: **Bond Market**

- Corporate Bond Market
  - Disintermediation of banks (setting a global industry obligor limit for companies)
  - Ratings (Investment Grade ’BBB’)
  - Need for more rating agencies (with good quality and meet international standards)
  - Reduce cost of issuance
  - Improve liquidity at the secondary market level - Market Markers!!
  - Efficient fiscal policies which reduce bond spreads
  - and low interest rate environment which increases the search for yields

Potential Solutions to the Challenges: **Bond Market**

- FGN Bond Market
- Creation of a Bond Index - NSE should Champion the creation of a Bond Index
  - Alignment of monetary and fiscal policies to attract foreign investors
  - Need for more professional bond traders
  - Collaboration between the market operators and financial institutions
    - To ensure a well-regulated bond trading environment and protect illicit operations

Potential Solutions to the Challenges: **Equity Market**

- Two fundamental changes-
- Reduce emphasis of Unit Price and daily publication of Unit Price
- Introduce Funds with minimum equity allocation.!!!!!!
- Reduce transaction costs
- Enhance disclosure standards and Corporate Governance
- Harmonize operational, regulatory and technical infrastructure
- SEC and NSE should collaborate to provide incentives for corporates to get listed on the exchange
  - E.g. companies in the telecoms and oil and gas sectors

In Closing

In Closing

- The National Pension Pot - $100b by 2020
- It is a Big deal and I believe is one of the 10 Industries that could propel Nigeria to a top 20 Status
- PFA as Managers of this National Savings must be Professionals, Competent, cautious and Conservative
- WE ARE ASSET ALLOCATORS and not necessarily Asset Mangers - need open and efficient Capital markets with free and unfettered flow of information. & Many Market Participant - Domestic and Foreign II and a large Domestic Retail Market.
- Asset Managers and IB must develop high quality assets, with the attractive risk adjusted returns, right safeguards and risk mitigation mechanism to protect pension Fund Investments. THIS IS THE ONE AND ONLY WAY TO ATTRACT AND COMPETE ASSETS AWAY FROM SOVEREIGN PAPERS

In Closing

- This Industry can be a win win for Pension Funds, IB, Brokers and Asset Managers. But
- Corporate Bond Issuers must do the right things -
- Quality Obligors with Good Shareholders (Not Family Boards),
- Acceptable Corporate Governance Standards
- strong Management Teams, Reputable auditors, Full Disclosures, Accounting Standards(Transfer Pricing),
- Good and scalable business models
- & above all willing to pay risk adjusted interest on the Bonds

In Closing

- Equity Issuers
- Must be ambitious, Growth businesses with National and Regional ambitions
- Right mix of Shareholders - Domestic Institutional, Foreign and Retail
- Full and complete disclosures with good accounting standards and Auditors
- Above all must deliver competitive ROE and either a god dividend policy OR an aggressive expansion plan that will deliver high profit and dividend in future
- Stock Market must be a Vehicle for price and value discovery and must a Custodian/ Store of national savings
- Stock Market should be representative of the Country's GDP and Growth Drivers!!!!
- This should drive the National Competitive Policy Agenda.