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NATIONAL PENSION COMMISSION

Leveraging Pension Funds for Economic Development: Role of Supervisors

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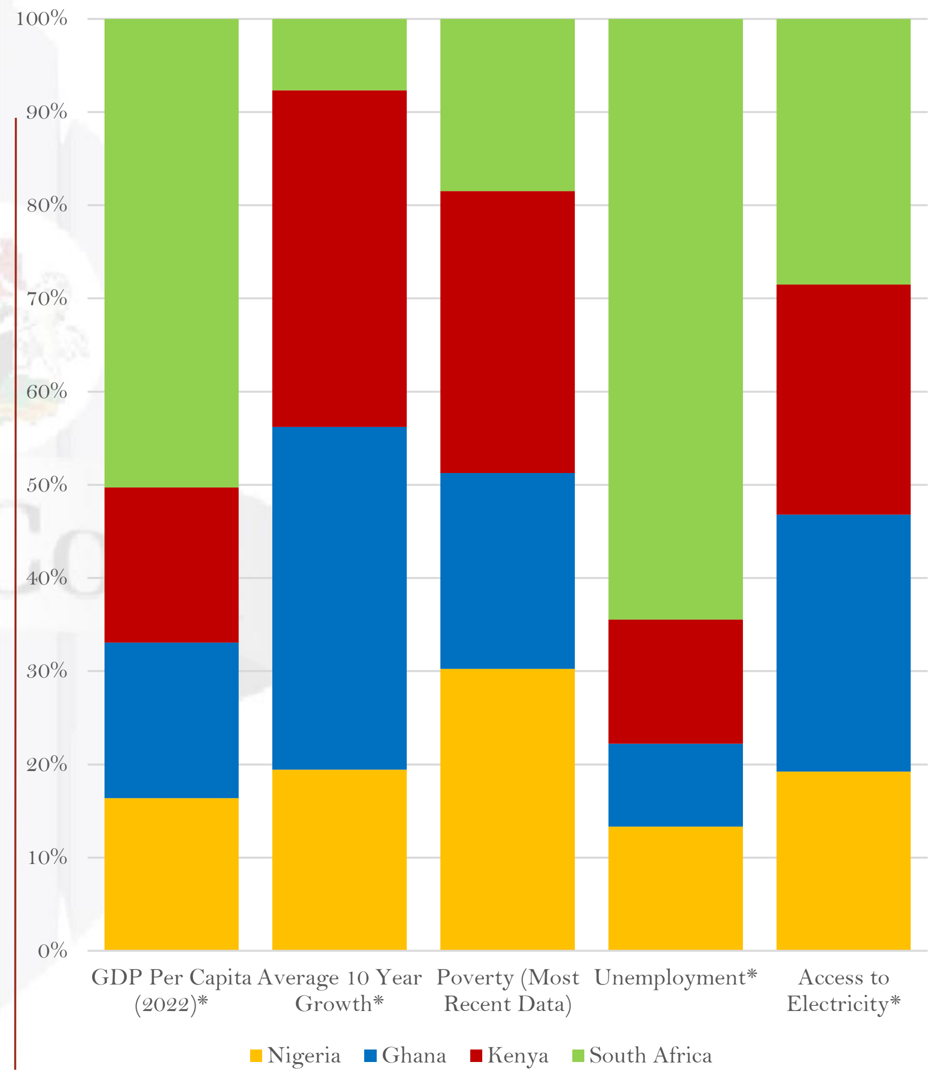
Economic Growth and Development - An African Perspective

- Many African countries have been affected by high poverty and un-employment, largely due to lack of access to long term funds that would drive economic development
- African countries with higher per capita GDP tend to be associated with better economic growth leading to lower unemployment and poverty rates



Challenges of Economic Growth and Development in Africa

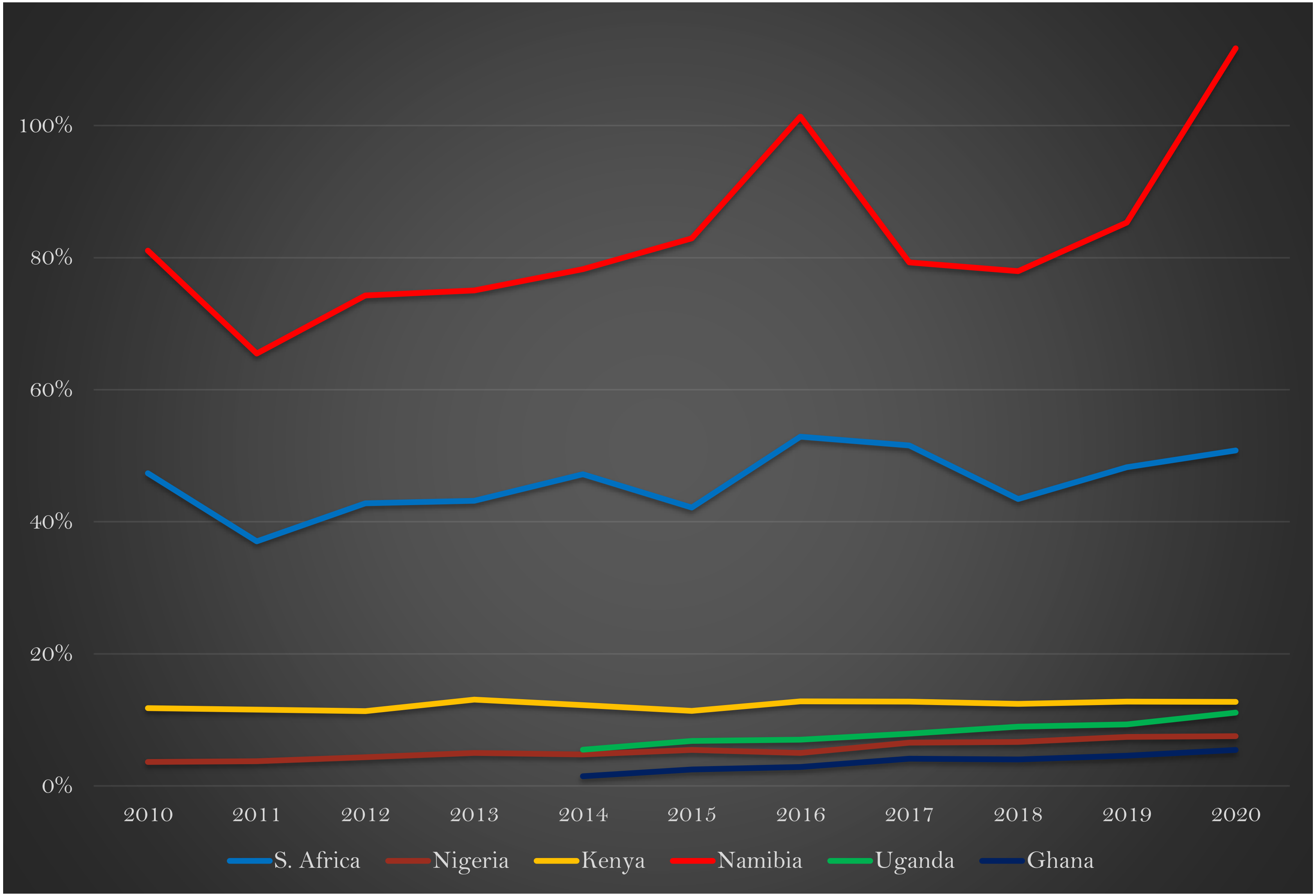
- Many developing/underdeveloped countries, including African countries, have common characteristics
  - Weak macroeconomic fundamentals
    - Mono-cultural economies with volatile growth due to significant dependencies on natural resources or subsistence production
  - Underdeveloped financial markets
    - Information asymmetry
    - The dearth of instruments that will facilitate diversification and growth
    - Limited depth and breadth of financial markets
    - Significant amount of money outside the financial system – financial exclusion
  - Weak infrastructure
  - Rapid population growth and its effect on limited infrastructure
  - Low skills and limited technology development and adoption

Impact of Pension Funds on the Nigerian Economy

- The Nigerian pension industry has grown rapidly since its establishment by the Pension Reform Act of 2004 and has become one of the important sources of investment funds in the domestic financial market
  - Total Pension Fund assets as at 31 August 2023 stood at ₦17.29 trillion ($22.84 billion)
  - The proportionate distribution of Pension Fund investments was mainly in Federal Government Securities 66.22% of total Assets under Management (AuM), Corporate Debt Securities 10.74%, Money Market instruments 9.55% and others assets 13.49%
  - Total Contributors 10 million as of 31 August 2023

- Pension Fund Assets have significantly contributed to the growth of the Nigerian Economy through the following key areas:
  - Financial Market
  - Capital Market Development
  - Banking and Insurance Industry
  - Infrastructure financing
  - Housing Development
- Governance Structure
- Financial Inclusion
- Improved quality of life
- The Nigerian experiment provides several pieces of evidence as to how pension funds can spur sustainable economic growth and development

Growth in Pension Assets Amongst Some African Countries



Source: OECD

Pension Funds and Financial Market Development

- A sound financial market encourages growth by efficiently allocating resources and providing liquidity for business and entrepreneurship to thrive
- The pension industry contributes to the development of the Capital Market (Equity and Bond Market):
  - Providing liquidity
  - For example, the Nigerian Pension Industry accounted for over 20% of Sovereign Domestic Debt in June 2023
  - Provide long-term Capital to corporate issuers and sub-national governments
  - Reinforcing support levels, particularly during bearish economic conditions
  - Minimizing volatility due to the patient nature of long-term capital
  - In Nigeria, pension funds adopt a life cycle approach that matches the asset allocation to the "presumed" risk appetite of contributors
  - The demography of pension funds in Africa supports long-term investments
  - Encourage development of innovative financial products
- Contribution to the Banking Industry:
  - Stable source of short-term liquidity to the banking industry
  - Long-term capital for expansion to the banking industry
- Contribution to the Insurance Industry:
  - Reinforce the group life insurance product
  - Annuity as an option in accessing benefits, which expands insurance uptake and deepen the insurance industry

Pension Funds and Infrastructure Development

- Generally, infrastructure development is capital-intensive, Long-term in nature, and Illiquid
  - The patient nature of pension funds makes them suitable for financing infrastructure development as is evident in many countries
- The Nigerian Pension Regulation allows investment in infrastructure through:
  - Infrastructure bonds: investment in infrastructure bonds targeted at financing waste management, independent electricity generation, and road construction (Sukuk). Already, ₦170.25 billion ($224.74 million) has been invested in infrastructure bonds as of 31 August 2023
  - Infrastructure Funds (Debt and Equity) focused on transport, energy, housing, and utilities – Total investments in infrastructure fund was ₦136.03 billion ($179.57 million) as of 31 August 2023
  - Some infrastructure projects financed by pension funds include the Akute Power plant, Island Power plant, Pipp Genco, Gasco Marine limited, and the Construction of 1200 Hostel rooms in the University of Calabar
  - However, combined investment in infrastructure securities accounted for less than 2% of pension fund assets, due to limited number of deals

Pension Funds and Quality of Life

- Pension Funds provide economic buffers for retirees, particularly in countries with non-existent or weak social safety nets
- This is consistent with the overall objective of the Nigerian CPS, which specifically targets the following:
    - Reduction in old age poverty
    - Reduction in dependency ratio at retirement
    - Improvement in Life expectancy

Pension Funds and Housing Development

- Pension Funds invest in Real Estate through Real Estate Investment Schemes, Stocks of Real Estate Operating Companies and bonds issued by eligible mortgage companies
- In Nigeria, RSA holders can access a part of their retirement savings account towards payment of equity contribution for a residential mortgage
- The ultimate effect of improving access to mortgages for home ownership is to stimulate effective demand, increase home construction, generate employment direct/indirect along the various components of the value chain for home delivery and reduce poverty through income generation

Improving Corporate Governance

- Sound corporate governance improves the quality of institutions, reduces information asymmetry, improves the efficiency of capital allocation, increases investors' confidence, encourages capital accumulation, and provides the opportunity for the expansion of viable companies
- Pension funds promote sound corporate governance companies through the following:
  - Regulatory requirements for securities
  - The internal quality requirements of PFAs for investment in company securities
  - Participation at Annual General meetings of invested companies as fiduciaries

Financial Inclusion Initiatives

- Pension funds drive inclusion initiatives among the financially excluded and the informal sector
  - In Nigeria Micro Pension plan was launched as part of a national multi-sectoral strategy to drive financial inclusion, encourage "safe" saving behaviour, improve financial intermediation by attracting capital outside the financial system and improve economic growth
  - There are 51.9 million (49%) financially excluded persons in Nigeria based on a total adult population of 106 million
  - Ethical Fund (Establishment of the Non-interest Fund)
  - Contributes to the array of pension products and creates the opportunity for active choices.
  - Avenue for individuals who prefer to have their pension funds invested in non-interest bearing/ethical financial products (i.e sukuk bonds, green bonds)

Challenges

- Pension funds are not by themselves a silver bullet and as a result their contribution to economic growth and development is dependent on the level of financial system development and its relationship with the real sector. Some of the challenges include:
- Inflation pressure
  - Domestic macroeconomic factors coupled with rising global inflation have led to the double-digit inflation rate in about 25% of many countries
  - Inflation erodes the long-term value of pension funds that are focused on traditional asset classes
- Limited investable instruments
- Single market concentration risk
- Limited technical skills/capacity of the regulators as well as pension operators
- The breadth and depth of financial markets
  - Growth of pension funds tends to outpace the absorptive capacity of the financial markets
- The performance of the real sector attributed to the quality of public institutions and rule of law
- Lack of structured financial products that target small and medium-scale enterprises as a key sector for economic development
- A significant number of excluded population from financial services

Role of Supervisors

- Regulation protects and benefits consumers, businesses and the environment
- Pension regulation is to ensure safety of assets, fair return on investment and payment of retirement benefits as and when due
- Collaboration – as different regulators set standards, benchmarks, tariffs, access, etc
  - Would not be involved in project management
  - Need for managing monopoly and ensure that regulated entities provide the services for which they were licensed
  - Ensure fair pricing and sound corporate governance
  - Dispute resolution amongst regulated entities, particularly across industries
  - Promoting competition and avoiding arbitrage
- Portfolio reviews to accommodate new instruments
- Data mining to support delivery of their mandate
- Standard setting, particularly on use of technology
- Joint development of policy documents in order to fully capture governments' economic objectives
- Issuance of quality of regulations, but which allows discretion particularly with rapid changing markets
- Ensure that the rules and actions they take promote economic development

Way Forward

- Regulators should be innovative and work together in co-creating these innovations
- Use sandboxes, but should jointly pursue enabling laws through legislative processes, where necessary
- Focus more on outcomes and not be deterred by rules, when use of discretion is highly required
- Identify areas that inhibit cooperation and resolve them
- Build capacity to effectively handle external shocks
- Be agile as markets change very fast bringing huge systemic risks that need strong regulatory intervention
- Enhance market integrity, making sure that markets are effective, efficient and reliable
- Promote effective competition among market players
- Effective Portfolio diversification
- Encourage innovation in financial products such as inflation hedged/derivative instruments
- Promote engagement in the alternative investments such as in PEs and Infrastructure
  - Several countries in Europe, Latin America and Africa have successfully utilized part of the accumulated pension funds by investing in new infrastructure projects
- Effective judiciary and legislative processes

Thank you

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