ODUJINRIN & ADEFULU

Pension Funds and the Nigerian Capital Markets: Impact, Challenges and Prospects

Introduction

The History of the Nigerian capital market can be traced back to 1946, with the floatation of a £300,000 bond by the then colonial government to implement its 10-year development plan.[1] Over time, the capital market has evolved from being dominated by heavy government interference to being run by private institutions. As a result, pension funds and other institutional investors have become significant players in the Nigerian capital market contributing to market liquidity and the overall growth of the Nigerian economy. As of July 7, 2023, it was reported that institutional investors (including pension funds) contributed over N2,000,000,000,000 (Two trillion naira) to the Nigerian Capital Market.[2]

In recent times, though pension funds participate in the Nigerian capital market, there is a need for deeper participation of pension funds in the capital market to unlock the full potential of the pension system to drive economic growth in Nigeria. In this article, we explore the impact, challenges, and prospects of pension funds in the Nigerian capital market.

Pension Funds & Pension Fund Administrators

Pension funds are institutional investors governed by the Pension Reform Act 2014 ("PRA"). The PRA defines a pension fund as an investment fund within the pension scheme that is intended to accumulate during an individual's working life from contributions and investment income, to provide income in retirement from the purchase of an annuity or in the form of a programmed withdrawal, with the possible option of an additional tax-free cash lump sum being paid to the individual.

Essentially, pension funds aggregate large sums of money which is to be invested into the capital markets, through the purchase of stock and bonds, to generate profit (returns). Hence, a pension fund represents an institutional investor and invests large pools of money into private and public companies quoted on the stock exchange. These institutional investors under the PRA are referred to as Pension Fund Administrators ("PFAs").

Furthermore, PFAs have an objective to ensure the safety and maintenance of fair returns on the amount invested. The funds can only be invested within the parameters provided by the PRA such as:

a) Bonds, bills and other securities issued or guaranteed by the Federal Government and the Central Bank of Nigeria;
b) Bonds, bills and other securities issued by the respective State and Local Government;
c) Bonds, debentures, redeemable preference shares and other debt instruments issued by corporate entities and listed on a Stock Exchange registered under the Investments and Securities Act;
d) Ordinary shares of public limited companies listed on a securities exchange registered under the ISA;
e) Bank deposits and bank securities;

---

[1]Financial System Strategy 2020 https://www.cbn.gov.ng/fss/tue/BSP/Financial%20Markets_Money,%20%20Forex%20&%20Capital%20Markets/FSS%202020%20-%20Capital%20Market%20Presentation.pdf Accessed on 9th June, 2024
[2]SEC Reports https://moneycounsellors.com/mutual_fund_news_detail/53 Accessed 9th June 2024

f) Investment certificates of closed-end investment fund or hybrid investment funds listed on a securities exchange registered under the Investments and Securities Act with good track records of earning;
g) Units sold by open-end investment funds or specialist open-end investment funds registered under the ISA;
h) Real estate development investments; or
i) Specialist investment funds and such other financial instruments as the Commission may, from time to time, approve.

Since the emergence of the uniform contributory pension scheme for public and private sectors in Nigeria because of the Pension Reform Act, 2014, Pension Fund Administrators (PFA) have been playing a crucial role in ensuring the security and safety of pension funds in Nigeria. From the initial seven (7) granted licenses by the National Pension Commission in 2005, there are now over 15 PFAs[3] in Nigeria with the mandate of managing and safeguarding the contributions of employees under the Retirement Savings Accounts (RSA).

Impact

Generally, pension funds are a significant source of capital for the capital market as they typically provide a stable source of funding for long-term investment, increase the availability of funds for businesses, act as a cushion in episodes of capital outflows, and ultimately stimulate economic growth and development[4]. In Nigeria, pension funds have improved the performance of the Nigerian capital market in terms of depth and liquidity. However, its impact on the Nigeria capital market is not as notable as in some other countries like the United States of America and the United Kingdom where pension funds play a great role in corporate governance because of their dominance in the class of institutional investors in the capital markets[5]. In addition, pension funds also drive innovation and privatization in these countries, which are built on sound macroeconomic policies, effective regulatory reforms and robust accounting, legal and information infrastructure. We therefore look forward to more pension fund investment in the Nigerian capital market to strengthen the capital market and make it more competitive.

Challenges

Having assessed the impact of pension funds in the Nigerian capital market, it is apposite to consider the challenges affecting deeper participation of pension funds in the Nigerian capital market, some of which are:
(a) inflation; (b) the need to strike a balance between generating attractive returns and ensuring safety of pension funds; and (c) insufficient requisite information required to navigate the complexities of the capital market, among others.

The economic uncertainty associated with inflation in Nigeria makes pension funds more cautious and unwilling to take more investment risks in the Nigerian capital market. Also, the reduction of the purchasing power of pension funds because of the current inflation in Nigeria is a huge discouragement to pension funds' greater participation in the Nigerian capital

[3]Access Pensions Limited, ARM Pension Managers Limited (recently acquired by Access Pensions), Crusader Sterling Pensions Limited, FCMB Pensions Limited, Fidelity Pension Managers Limited, Guaranty Trust Pension Managers Limited, Leadway Pensure PFA Limited, Nigerian University Pension Management Company (NUPEMCO), NLPC Pension Fund Administrators Limited, Norrenberger Pensions Limited, NPF Pensions Fund Administrators Limited, OAK Pensions Limited, Pensions Alliance Limited, Premium Pension Limited, Radix Pension Managers Limited, Stanbic IBTC Pension Managers Limited, Tangerine APT Pensions Limited, Trustfund Pensions Limited, Veritas Glanvills Pensions Limited.

[4]"Macroeconomic Implications of Pension Funds and Capital Markets": Prepared by Chiara Fratto and Jungwan Mok, with inputs from Antonio Gabriel

[5]The World Bank (1996): Pension Funds and Capital Markets, Note No. 71

market.

In the same vein, the delicate balance between generating returns and ensuring the safety of pension funds amplified by the long-term nature of pension investments, which makes them susceptible to market volatility and economic downturn is also a great challenge militating against more investments of pension funds in the Nigerian capital market.

Insufficient requisite market information may manifest in several ways, including asset selection, risk management, governance and compliance etc. This gap decreases the performance of pension investments in the capital market and affects the overall contribution of pension funds to development of the Nigerian capital market.

Prospects

Despite the recent macro-economic reforms in Nigeria, particularly, the unification of the foreign exchange (forex) windows and the removal of the subsidy, there are still tremendous growth opportunities for pension funds in the Nigerian capital market. Some of the indices for growth of PFAs include:

i. Gradual conversion of existing conventional pension funds.
ii. More close alignment between Islamic finance and Sustainable/Responsible ESG investing as these two approaches are quite intertwined.
iii. Ethical/Non-Interest Fund otherwise known as Fund VI could fare better than other optional funds launched so far due to the strong value-based intent driving adoption.[6]
For other institutional investors in Nigeria, there are indications that sovereign wealth funds, insurance companies, and mutual funds have good prospects under the current economic regime in Nigeria. With the clearing of the forex backlog by the Central Bank of Nigeria ("CBN"), it is believed that foreign institutional investors and local asset management firms will also be encouraged to invest in the Nigerian capital market.

Conclusion

For greater participation of pension funds in the Nigerian capital market, laws, policies and regulations targeted at de-risking and driving private sector participation should be enacted by the Government to encourage pension funds and other institutional investors to increase their investments in the Nigerian capital market.

Furthermore, there is a need for closer collaboration between the capital market regulators and other regulators to achieve deepened financial markets that are constantly creating new asset classes or investment instruments that can absorb institutional investors' choice investment classes. Similarly, there is also a corresponding consequential obligation on PFAs and other institutional investors to develop capacity through programs, technical assistance, and knowledge-sharing platforms to keep up and develop skills for new kinds of asset classes

Conclusively, in removing barriers to deeper capital market participation, there must be a deliberate attempt to educate and empower pension contributors on the benefits of their participation in the Nigerian capital market, which impacts the overall growth of the Nigerian economy.

[6] *file:///C:/Users/ITAdmin/Downloads/Prospects-for-Pension-Assets-in-the-Nigerian-Non-Interest-Ecosystem-Abimbola-Sulaiman-ARM.pdf Accessed June 12, 2024*

Authors

Olubukola Olabiyi
Partner

E: olubukola.olabiyi@odujinri-nadefulu.com
T: +234 1 271 4961-2

Omotayo Akinrinwa
Associate

E: omotayo.akinrinwa@odujinri-nadefulu.com
T: +234 1 271 4961-2

Contact Address

Lagos Office
No. 1 Ademola Street, Ikoyi
Lagos, Nigeria.

T: +234 127149612,
+234 708 6450 720

Abuja Office
3rd Floor, WAEC Complex
10, Zambezi Crescent Maitama
Abuja, Nigeria

T: +234 805 090 2150

Port Harcourt Office
16A, Manilla Pepple Street, D'Line,
Port Harcourt, Rivers State, Nigeria

T: +234 70 869 53468