CORONATION

How Pension Fund Administrators can leverage savings for national infrastructure development

Unlocking Nigeria's $33.4 billion pensions pot for growth

sustainable, independent infrastructure-funding key to future prosperity

As of March 2022, the assets under management of the Nigerian pensions fund industry were valued at the equivalent of $33.4 billion. Representing 19% of the Nigerian GDP, these funds, correctly invested and deployed, present an opportunity for the country to address its $100 billion annual infrastructure shortfall.

Despite recent Nigerian legislation revising pension fund allocation to allow a broader range of investments, Nigerian pension fund administrators continue to make only limited allocations to infrastructure funds. Even combined with private equity and real estate investments, recent allocations to infrastructure hovers between 1.5% to 2.1% of assets under management. By contrast, pension fund administrators in Australia, Canada, Japan, Netherlands, Switzerland, the United Kingdom, and the United Sates allocate well in excess of 26% of funds to real estate, private equity and infrastructure.

A combination of poorly understood regulation, limited knowledge of alternative assets, and the perceived risk-free returns offered by fixed income investments have kept Nigerian pension fund administrators away from alternatives in general, and infrastructure in particular. To date, the allocation of pensions investment to fixed income instruments (issued by Nigeria's Federal and State governments) has averaged 67% over the last 10 years, in line with government borrowing supported by monetary policy decisions in a volatile environment. Just as historically, the sizeable allocation to government instruments was regulatory driven, so too is the recent introduction of a multi-fund structure, a welcome legislative attempt to redress the concentration of fixed income investment in government securities.

Certainly, the preponderance of fixed income investment in Nigeria's pension funds produces mixed results. While Nigeria's top-five pension fund administrators delivered positive inflation-adjusted returns in 2019 and 2020 (averaging between 1.6% and 3.0%), real returns in 2018 were negative 7.2%. In 2021, average returns across the top five pension fund administrators were 9.9% lower than inflation, underlining the fact that average returns over the last four years have been largely negative, when adjusted for inflation, across the top five pension fund administrators.

With this in mind, it is surprising that more pension fund administrators have not taken the opportunity to increase their allocation to the power, transportation, communication, real estate and clean water investment opportunities that abound. These domestic opportunities provide a hedge against a volatile global macroenvironment by offering the potential to deliver consistent, long-term positive domestic returns.

The most recent changes to Nigerian pension fund legislation allows fund administrators to group age and risk profiles, allocating investment across four levels of risk and return appetite. Fund One, for example, is an optional fund, requiring contributors to formally opt in – in writing – to the fund. This fund caps alternative investment at 20%, depending on the composition of assets. Fund Two (with a cap of 10%), on the other hand, caters for younger pension contributors, below the age of 49, with greater risk appetites. As such, amongst this segment, and in line with what one sees globally, one would expect higher levels of investment in higher income-generating alternatives.

Instead, if Nigerian pension fund administrators use recent legislation to invest differentially for different age and risk profiles groups, as the legislation now allows, they can channel more of their pension fund investments into potentially higher-earning domestic infrastructure investment. This will provide individual Nigerians under the age of 49 the opportunity to earn more during their younger, more risk-resilient, years. It also represents a huge opportunity for Nigeria to actively leverage its large pool of pension fund assets to address the country's infrastructure backlog.

This Coronation Asset Management insight describes how Nigeria can independently marshal domestic pensions, rather than global debt, for national development, unlocking sustainable growth by leveraging the country's risk-managed long-term funds.