SECURITIES AND EXCHANGE COMMISSION

Keynote Address

Deepening Nigeria's Capital Market through Maximum Utilization of Pension Funds

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1. Distinguished Ladies and Gentlemen, it is my great pleasure to participate at this edition of the BusinessDay Annual Capital Market Conference 2016. The BusinessDay Annual Capital Market Conference is quickly becoming an important calendar event for capital market stakeholders who are increasingly showing interest in partaking in conversations enabled through the platform. The Securities and Exchange Commission (SEC) values such platforms for the exchange of ideas on the best ways to develop our market. I wish to specially commend Mr. Frank and his team at BusinessDay for the laudable efforts.

2. I am particularly pleased about the focus of this year's edition which is "Deepening Nigeria's Capital Market through Maximum Utilization of Pension Funds". This is a conversation our country must continue to have in order to ensure that the impressive pool of savings we have been able to mobilize over the last decade is put to productive use for inclusive economic growth. Clearly, the growing chorus from different quarters on the best ways to deploy these savings should please all participants in the pension industry as it attests to the remarkable success achieved so far.

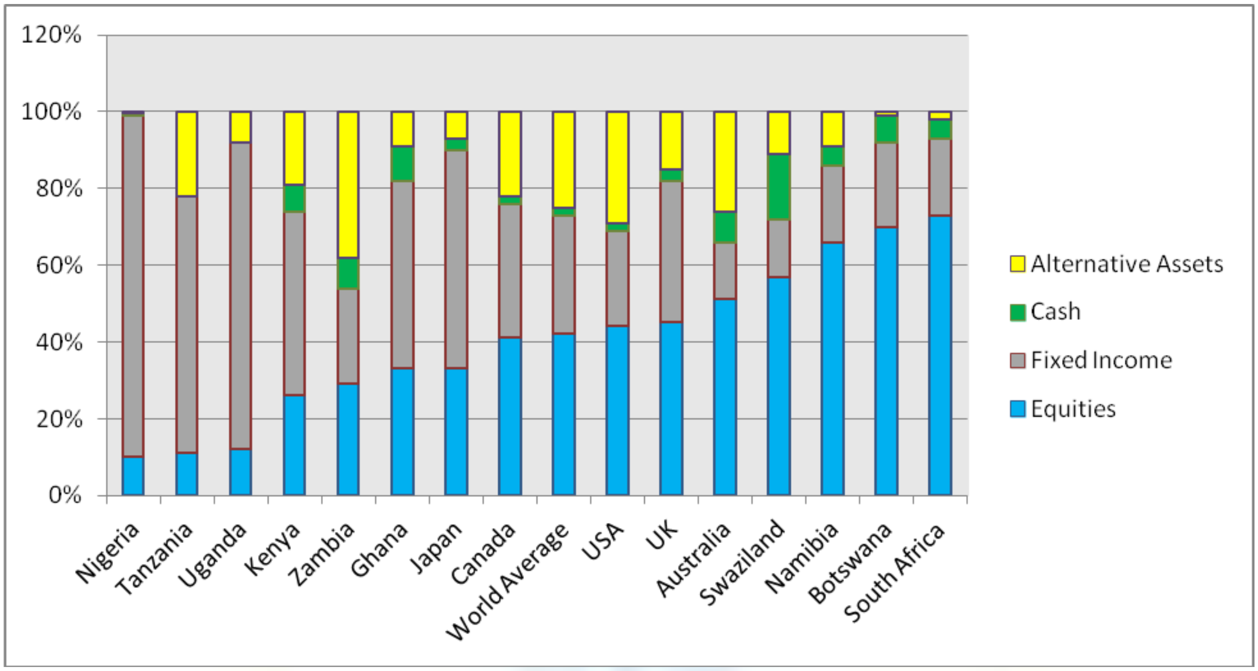
3. We are delighted that the National Pension Commission (PenCom) has been very proactive in making the necessary

adjustments to the Guidelines that allow Pension Fund Administrators (PFAs) sufficient flexibility to determine their optimal strategic asset allocation. The draft new regulation on investment of pension fund assets allow the investment of up to 30% in Equities (for Fund type 1) and up to 45% in corporate debt securities (for Fund types 3 and 4). As a whole, we believe the adoption of a multi-fund structure is a very positive development that should produce economies of scale, risk diversification and further deepening the Nigerian capital market through Pension portfolios and management strategies of PFAs. There is therefore an urgent need for the draft guidelines on multi-fund structure to be approved.

4. Virtually everyone agrees that all funds mobilized under the contributory pension scheme shall be invested by the PFA with the objectives of safety and maintenance of fair returns on the amount invested. The other goals are:
    a. Ensuring adequate, affordable and sustainable benefits to contributors
    b. Ensuring adequate liquidity to pay all pension benefits of contributors as and when due; and
    c. Achieving an optimal trade-off of risk and return through strategic asset allocation

    The question is: Based on the current asset allocation by Nigerian PFAs, are they paying sufficient attention to generating the necessary returns to provide sustainable benefits to contributors? Can we say that Nigerian PFAs have achieved an optimal strategic asset allocation or explored all viable investment outlets?

5. It is my considered opinion that these are pertinent questions that demand answers, which I hope this conference provides. March 2016 data from PenCom show that Nigerian PFAs invest only 8.16% of their assets in the domestic listed equities market and 1.24% of their assets in foreign equities. This translates to less than 10% of total assets invested in equities. At 9.4% allocation to equities, Nigeria has the lowest allocation to equities by pension funds among peer markets. In contrast, South African pension funds invest 73% of total assets in equities. Even Botswana (70%), Namibia (66%) and Swaziland (57%) with much smaller and shallower stock markets than Nigeria allocate far more of total assets to equities. The world average for allocation by PFAs to equities is 42% which is more than four (4) folds the level in Nigeria.



Sources: PenCom, OECD and mercer.com

6. Therefore, even if our PFAs were to invest at the maximum allowable limit of 30% in equities, it would still not be up to the global average of 42%. This should be a cause for concern for all stakeholders. In the interest of contributors, we need an optimal strategic asset allocation that pays much attention to safety of funds without neglecting optimal return on investment.

7. Over the last 10 years, market capitalization of listed equities has moved from N2.75 trillion in 2006 to about N9.93 trillion currently. This translates to gross annual return rate of 13.7%. During the period inflation averaged at around 9.2% implying average real annual returns of 4.5% during the period. In contrast, the FGN 10-year annual yield averaged 12% since

2008. Deducting inflation rate leaves average real annual returns on FGN bonds at only 2.8%. Indeed, since 2012, the Nigerian Stock Market featured among the 10 best performing in the world in 2 of the last 4 years (2012 and 2013). In 2012 the stock market returned 37% and returned a remarkable 47% in 2013.

8. In addition to equities the capital market provides PFAs with a range of investible products capable of bring in decent returns. These include corporate bonds and various types of collective investment schemes like mutual funds, Exchange Traded Funds (ETFs), Real Estate Investment Trusts (REITs), Infrastructure Funds and Private Equity.

9. For a growing economy with Nigeria's potential, the expected returns from these capital market products are poised to outpace inflation. If our PFAs continue to maintain the current asset allocation, contributors would be missing a great opportunity to capture this expected growth. This is even more important considering the rising inflationary pressures we have witnessed so far this year. Inflation has notched up month-on-month since the beginning of this year and there are no signs of it abating with the Naira devaluation and more challenging production environment.

10. In my opinion, this current macroeconomic environment presents all stakeholders in the pension industry an opportunity to reevaluate their current asset allocation and aim to improve it. This makes sense for asset safety and for ensuring PFAs beat inflation consistently. Our PFAs can certainly not afford to continue allocating over two-thirds of contributors' assets to FGN securities with the array of available investible products, especially in an increasingly inflationary environment.

11. Let me take a moment to talk about the most common challenges usually blamed for such low allocation to equities by PFAs which are volatility and risk. Regulators and PFAs are rightly worried by the bearish trend on the Nigerian Stock Exchange (NSE) since the price of crude oil started falling in Q3 2014. The stock market in any economy usually reflects the general macroeconomic environment and ours is no exception. Already, there are signs of recovery with light at the end of the tunnel. Within the first 3 weeks of January 2016, the NSE All-Share Index lost almost 22% of its value falling from 28,642 points to 22,456 points. Since then however, the market has recovered some of the losses with year-to-date returns now at about -3%.

12. PFAs have actually missed an opportunity to increase allocation to equities when asset prices were depressed and

very cheap. Going forward however, PFAs can play a crucial role in deepening the market and maintaining its relative stability. For example, the major reason for the declines we have witnessed is the exit of foreign portfolio investors. Within January 2016, net foreign portfolio outflows of N9.35 billion accounted for much of the panic witnessed in the market. Under such scenario, if PFAs had increased their allocation to domestic equities by only 1.6% of the current N538 billion they invest in the market, it would have largely covered for the exit by foreign investors in that month.

13. With the massive infrastructure investments needed in our country, PFAs are poised to play a very prominent role provided the instruments are de-risked. We welcome efforts from market participants on setting up monoline insurance capable of de-risking investment in infrastructure.

14. One of the great benefits of our current pension system is the domestic investor base it has created. This is a very good development for our market, especially to insulate the market from the whims of foreign portfolio managers. Pension funds should endeavor to play this critical role of enhancing market stability.

15. In 2013, the Commission put robust rules in place for securities lending, however no PFA has taken advantage of this platform

which can play a critical role in deepening the capital market. Securities Lending entails lending out the securities owned by the PFAs and taking advantage of the spread and fee paid by the borrower on the securities. The securities remain owned by and returned to the PFAs. This portends a win-win situation for the PFAs, the borrower and the contributors and serves to create additional liquidity in the market.

16. The SEC under my leadership is committed to developing a robust market capable of meeting the needs of PFAs and all investors. You may be aware of the strategic 10-year Capital Market Master Plan which we started implementing in 2015. The master plan actually calls for greater participation by pension funds in enhancing the liquidity of the domestic capital market. We have successfully inaugurated a high-powered Implementation Council (CAMMIC) to drive advocacy for the master plan at the highest levels. Within the first year of the master plan implementation, we have achieved remarkable results on key initiatives including:
    - Designing and launching the SEC Corporate Governance Scorecard
    - Launching and fully operationalizing the National Investor Protection Fund (NIPF) which has already compensated hundreds of investors
    - Conclusion of the recapitalization exercise of CMOs

- ❖ Achieving 97% dematerialization of share certificates
- ❖ Launching of the E-Dividend mandate enrolment system
- ❖ Commencement of Direct Cash Settlement
- ❖ Robust public enlightenment
- ❖ Strengthened capacity of the regulator
- ❖ Deepening non-interest capital market
- ❖ Adopting a zero tolerance to market infractions, etc

17. So far this year, we are focusing on initiatives including attracting more listings, strengthening commodities exchanges, reducing transaction costs, pursuing a unified licensing model to support market making, and market-wide ICT infrastructure upgrade. I have given my personal commitment to faithfully implement the master plan as my only agenda for the capital market. We are confident that with greater participation by PFAs and return of retail investors, our capital market will emerge as one of the world's biggest and most liquid market capable of supporting the socioeconomic development of our country. I hope that this conference will bring up valuable insights on the ways to ensure PFAs play a more prominent role in achieving this objective.

Thank you for your kind attention.