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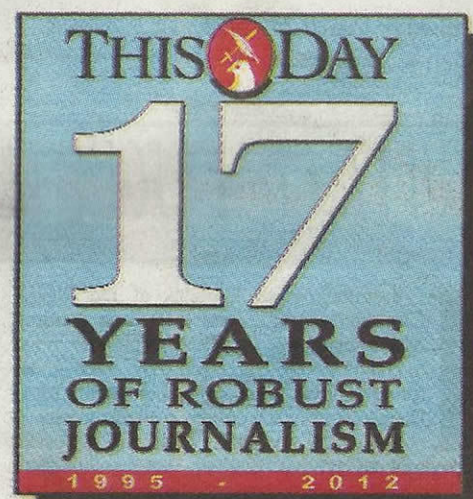
Travel should take you places.

Missile

Omisore to Aregbesola

"It is unethical to use thugs as security. Aregbesola should explain why he goes about with thugs. During the last elections, he rigged with the aids of thugs, but this time round, we are ready for him. Who wants to kill him? (Asiwaju Bola) Tinubu is more important than he is... If Aregbesola does not trust the SSS, let him resign. We are going to stop his convoy and search him."

—A Peoples Democratic Party (PDP) chieftain in Osun State, Senator Iyiola Omisore, threatening to stop and search the convoy of Governor Rauf Aregbesola.



Pensions, Private Equity, the Real Economy and Jobs

While the big headlines on pensions have focused on the mismanagement, corruption and theft of pension monies leaving many pensioners without their pension, some smaller headlines have picked up on the increase in pension assets that can be invested in our capital markets from 25% to 50%. These headlines tell (less than) half the full story. The devil, as they say, is in the detail.

Let me start by saying that all pension mismanagement allegations, that I have heard and read, are related to the old pay-as-you-go pension system and not the new contributory pension scheme. The proposed amendment discussed here are for the new scheme.

Current PenCom investment guidelines

In December 2010, PenCom amended the rules for investing pension assets. A key feature of the 2010 amendments was the expansion of the broad types of assets pensions could be invested in from 5 to 9 types of assets.

In addition to Government Securities, Corporate Bonds, Money Market Instruments, Ordinary Shares and Open/Closed-end Funds (including real estate), PenCom added 4 more asset classes – Infrastructure Bonds, Supra-national Bonds, Infrastructure Funds and Private Equity.

In expanding the investable asset types, PenCom also set upper limits on how much could be invested in each asset type, each issuer (company) and each issue (product). Based on these limits and the current level of pensions assets under management, approaching N2.6 trillion, we were able to estimate that the total maximum pool of Nigerian pension assets that could be invested in private equity stood at about \$800 million – 5% of total pension assets.

A Nod to Private Equity

This was exciting news for a private equity industry that had almost no domestic institutional investor base and had to depend on foreign governments through their national and multinational development financial institutions (DFTs) for life itself. By unlocking pension assets into high growth businesses backed by private equity, Nigerian policy makers had dealt the private equity industry in Nigeria a new lease on life – or so we thought.

A year and four months later, much to our chagrin, almost no investments have been made by Nigerian pension funds in Nigerian private equity. Naturally, this situation concerned private equity fund managers. Other stakeholders not least the PFA's and PenCom also understood the wider risk associated in pension funds not investing in private equity (and indeed other asset types) in line with well tested investment principles of diversification.

As I put it in my submission to the recent Senate and House Committee hearings on Pensions, "The risk that pension schemes are not able to meet their future liabilities because they are not diversifying their investments the way other global pension schemes appear to be doing, is a concern".

It is for this reason, that we are delighted to see the proposed 2012 draft amended guidelines address this issue, leaving the next steps fairly and squarely in the hands of 1) Private equity managers who need to develop investable products for pensions 2) Federal, State Governments, MDA's and Zones who need to sponsor these new products and firms and 3) Pension fund administrators management, investment committees and boards who need to actually invest in private equity products.

Proposed Pencom 2012 Amendments

The proposed amendment to the contributory pension scheme is anchored on a new multi-fund structure. Under the proposed multi-fund structure, PFA's would have to maintain 4 separate funds instead of 1 fund. Each fund will be invested differently. Each fund primarily targets a different age group – Fund 1 targets 35 year olds and under,

GUEST COLUMNIST

Barbara James



•Minister of Finance, Dr Ngozi Okonjo-Iweala

Fund 2 targets 45 year olds and under and Fund 3 targets over 45s.

The big idea being that in general each age group has a different risk profile, and their pensions should be invested in a way that reflects their risk profile. Younger people can take more risk with their pensions and older people nearing retirement need more secure less risky assets. PFA's also need to offer a 4th Sharia compliant fund – Fund 4 – for those who want their pensions invested in Sharia compliant instruments.

By separating and pooling pension contributions into their risk profiles, PenCom is able to and have indeed given each group different investment guidelines to suit their risk profile. For example, up to 50% of Fund 1 (aimed at for 35 year olds and under) can be invested in the capital markets.

Under the proposed amendments, up to 10% of Fund 1 can be invested in private equity. Up to 5% of Fund 2 (aimed at 45s and under) can be invested in private equity, 0% (none) of Fund 3 (aimed at over 45s) can be invested in private equity and up to 5% of Fund 4 (Sharia compliant fund) can be invested in private equity.

Similarly, up to 50% of Fund 1 (aimed at 35s and under) can be invested in the capital markets, up to 30% of Fund 2 (for 45's and under) can be invested in capital markets, up to 10% of Fund 3 (for over 45's) can be invested in the capital markets and up to 25% of Fund 4 (Sharia compliant fund) can be invested in the capital market.

This profiling is cleverer than you think, because if you are forty and feeling like a twenty something year old, you can actually switch your own retirement saving account to Fund 1 (which is targeted at 35's and under). Switching rules and restrictions apply of course.

Variable Income Instruments

The icing on the cake, for the capital markets, private equity, infrastructure and real estate instruments, which PenCom refer to as 'variable income instruments' is that each (risk profile) group not only has a maximum limit that can be invested in 'variable income instruments' but they also have a minimum limit – yes minimum. Fund 1 (primarily targeted at 35's and under) must invest at least 10% in the capital markets, private equity, infrastructure and real estate instruments.

These minimum investment requirements should jump-start pensions investment in private equity. Indeed a further recommendation to assign

minimum investment levels for each of the variable income instruments e.g. a minimum of 2% of Fund 1 should be invested in private equity, should nail this on the head.

It is these, 'variable income instruments' as opposed to government securities and money market instruments that most penetrate the real economy visibly. They translate to housing, roads, ports, refineries, power plants, successful entrepreneurs backed by private equity, schools, healthcare centres etc.

Pensions and Private Equity

Private equity is unique among the 'variable income instruments'. A recent IMF global survey of pension asset allocations showed that between 2006 and 2010, private equity received the largest increase in global pension asset allocations of all the asset classes.

Among its many attractive features is the fact that private equity backed businesses are typically an important source of new listings (IPO's) on capital markets. The recent recovery from the global financial crisis of other capital markets around the world has been in part due to private equity backed listings. An interesting example was the 2011 listing of Nashville's healthcare company HCA, the largest private-sector hospital operator in the U.S., with 164 hospitals and 106 surgery centers.

Pensions and Capital Markets

The number of private equity backed initial public offerings (IPO's) listed on the US capital markets was 191 in 2010 and 159 in 2011, up from 69 in 2009. Recovery of the US capital market will be further deepened by Facebook, another private equity backed IPO expected anytime now. Facebook is looking to raise \$5 billion from the US stock markets based on a valuation of \$100 billion. Asia recorded \$14 billion from 89 Private Equity and Venture Capital backed IPOs in 2011.

The role of private equity in our capital market development is one I raised in my submission to the re-constituted House Committee on Capital Markets emphasizing that Nigeria needs to develop its private equity industry so we can see private equity backed IPO's being listed on our capital market, as they do elsewhere.

Pensions and Infrastructure

Above all, it is the physical and social infrastructure that pension fund assets can finance, that will speak volumes for the new contributory pension scheme in general and the proposed pensions investment guidelines in particular. At the moment, it is hard to see or touch exactly what this N2.6 trillion pension pool is being spent on. Pensions assets are clearly huge and growing but do they translate to tangible, recognisable physical contributors to society at large?

When young adults can see world class roads, hospitals, schools, shopping malls etc. and link them back to pensions, we will have succeeded in making a connection. That connection registers pensions in their minds a 'real' asset and I believe, subconsciously will encourage more Nigerians to participate in the contributory pension scheme.

Participation in the Contributory Pension Scheme

We hear that currently over 5 million of the estimated 40 million potential contributors participate

in the scheme. I can't help thinking that more visibility of the tangible uses of pension assets would increase this number significantly. Just as Lagos State tax collection has increased significantly with visibility of tangible projects their taxes are being spent on. Pension contributors would be stakeholders in these tangible assets and thereby seek to protect and maximise their value. This is pretty powerful stuff, if channelled properly. Increased 'tangible' use of pension assets would come with more investment of pension in private equity, real estate and infrastructure.

Power to the Youth

Herein lies the power of our youth – under the proposed new pension guidelines, pension contributions from 35 year olds and under, provide the largest pool, 10%- 70% of their pension assets, for investing in the 'variable income instruments' such as real estate, infrastructure and private equity.

Conversely, herein also lies the danger of not generating employment for our youth – we lose out on their pension contributions that would have been invested, at least 10% of it, and up to 70% of it, in real estate, infrastructure, capital markets and private equity. It is a simple mathematical construct if you understand the Nigerian demographic. Simply put, employed youth equals more infrastructure, unemployed youth equals less infrastructure.

Federal and State MDA's and geo-political zones can channel pension asset into their sectors and regions

Progressive Federal and State government MDA's and indeed geopolitical zones can channel pension assets into their sectors and areas by sponsoring new private equity products and other instruments that empower local entrepreneurs and harness their natural resources. A \$100 million innovative housing fund, like its South African equivalent, would go some way to meeting the 16 million housing deficit in the country, a \$200 million health fund could build hundreds of health centres across the country like HCA in the US, water utilities are big profitable businesses around the world and could form the focus of another private equity infrastructure fund. Similar opportunities in the solid mineral, agriculture ICT and the broader SME sector, to name a few, could form the focus of new private equity funds and firms.

Foreign governments and by extension their tax payers, through their various national and multinational development finance institution have for over 50 years sponsored very successful private equity firms in Africa and other emerging markets. The different levels of the Nigerian government can and should do the same. Nigerian development finance institutions (DFT's) should invest in Nigerian private equity the same way the UK, German, Dutch, Norwegian and American DFT's invest in Nigerian private equity.

Government supported private equity funds that also attract pension fund investments and even international institutional investors can unleash our latent entrepreneurial talent, harness our natural resources to help diversify our economy beyond oil, empower each state and zone to harness its own resources and provide a basis for a more equitable resource allocation instead of relying solely on one product from one zone, start businesses in information, bio and renewable technologies, grow businesses across all sectors and create much needed jobs especially for our youth. These jobs will lead to even more pension contributors and the amazing circle of life will continue.

Lack of Nigerian pension investment in private equity has strangled our economy for too long, the 2012 proposed amendments to Pensions regulations, if adopted, will go a long way to unleash this strangle hold, time then for private equity fund managers, progressive leaders in Government and Pension fund administrators to play their part.

•James is Founder and CEO of Henshaw Capital Partners, a private equity firm.