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Pension fund administrators react with caution as government encourages investment to meet Nigeria's infrastructure deficit. President Muhammadu Buhari (2015- present) approves \$5 billion external borrowing plans. However, low international oil prices and S&P Global Ratings downgrade may negatively impact investor appetite and result in Nigeria borrowing at higher interest levels. The Central Bank of Nigeria (CBN) holds its main lending rate at 14% as it looks to encourage offshore investment inflows. South Africa-based MTN Group subsidiary MTN Nigeria faces allegations that it illegally transferred \$13.9 billion out of Nigeria.

Government looks to pension funds for infrastructure investment

The **Securities and Exchange Commission (SEC)** and the **National Pensions Commission (Pencom)** have approved plans to facilitate pension fund investment in infrastructure bonds.¹ Mobilising better capitalised but under-used local pension funds for infrastructure investment will decrease pressure on the government budgetary deficit. Finance minister **Kemi Adeosun** said the SEC and NPC had approved an instrument to allow pension funds to invest \$20 billion in infrastructure outside the budget.² According to Pencom data, the current value of the pension contribution asset pool is only 5.3 trillion naira (N) (\$17.3 billion).³

Power, works and housing minister **Babatunde Fashola** is the leading advocate in the government for pension fund infrastructure investments, while Pencom director general **Chinelo Anohu-Amazu** is also supportive.⁴ The **Nigeria Labour Congress** opposes the move.⁵ Pension funds themselves are cautious, noting already high levels of exposure to federal government debt.

*"Pension fund administrator (PFA) exposure to federal government debt is close to 70%. A different fixed income regime would need to be in place to instill confidence in further exposure. Greening the fixed income market with its oversight requirements may be the needed first step."*⁶

There is also concern about implementation risks due to continued regulatory uncertainty until the government provides additional information about the new instrument.

*"A great idea to channel part of pension funds for infrastructure. What kind of infrastructure in particular: roads, power, airport, health or everything? Under what sort of arrangement, what are the risks? These questions are important so we do not fritter hard earned savings. In summary, no structure/viable framework at the moment. The risk is very high."*⁷

Other sources claim that Nigeria's insurance and pension sector is insufficiently developed to meet the government's plan.

*"There is need for a specialised insurance before you can do that. We do not have that currently in place. If not, long-term investments should be one of the various portfolio mixes."*⁸

¹ Bloomberg, 20 Sept 2016.

² Bloomberg, 20 Sept 2016.

³ Vanguard, 22 Feb 2016.

⁴ www.ametrade.org

⁵ www.ametrade.org

⁶ Source, investment manager, Abuja

⁷ Source, banker, Abuja

⁸ Source, business executive, Abuja

There are additionally concerns about currency volatility risks due to the poor performance of the naira amid government foreign exchange restrictions (see below).

*"Large infrastructure projects are typically dollar deals and with the ongoing fall of the naira against the greenback, foreign exchange volatility/risk has to be factored in before investment decisions using pension money are made. What may be more advisable at this stage would be for the PFAs themselves to determine if it's worth their while and what percentage of their portfolios they can expose."*⁹

PFAs additionally raise concerns about the difficulty of mobilising funds into infrastructure projects.

*"Lack of investment options, bankable projects, transparency, shortage of data as well as high risk related greenfield investment, among others, are challenges limiting investment of pension funds especially in infrastructure."*¹⁰

Pencom's **2012 Regulation on the Investment of Pension Fund Assets** – which was amended in 2015 although the Pencom board never approved the changes – established a multi-tier system of pension funds determined by the age of the saver. Fund 1 and 2 types offer higher yields and long maturities, and are only available to younger savers. Under the 2012 regulation, PFAs are obliged to invest a minimum 5% of Fund 1 and Fund 2 portfolios in infrastructure. Pencom has never enforced these minimum requirements.¹¹ While PFAs in Nigeria can currently invest up to 15% of the total value of their funds in infrastructure bonds and 5% in infrastructure funds, current Pencom regulations are burdensome and have deterred investment.¹² Reportedly, not a single infrastructure project currently meets Pencom standards for pension fund investment.¹³ According to the 2012 Regulation, pension funds can only invest in infrastructure projects that:

- Are worth more than N5 billion (\$15.8m);
- Were awarded through competitive and transparent bidding between qualified bidders in line with the **Infrastructure Concession and Regulatory Commission Act**;
- Can demonstrate economic and financial returns through business plans and financial projections;
- Have bonds with robust credit guarantees from either the federal government, commercial banks or SEC-approved development finance institutions; and
- Have a time limit for project completion, and a monitoring team to check project progress and standards.¹⁴

Pension funds can only invest in infrastructure funds that:

- Are worth more than N5 billion (\$15.8m);
- Have 60% of the fund invested in Nigeria;
- Have well-defined and public investment objectives and strategy as well as disclosures of pricing of underlying assets;
- Have either a development finance institution as a co-investor or a fund manager with a minimum 3% investment in the fund;
- Have audited annual financial statements, and an advisory board in which institutional investors are in the majority;
- Have satisfactory pre-defined liquidity/exit routes; and
- Are managed by SEC-registered fund managers.¹⁵

⁹ Source, business consultant, London

¹⁰ Source, pension fund executive, Nigeria

¹¹ www.financialnigeria.com

¹² www.ametrade.org

¹³ Vanguard, 7 Mar 2016.

¹⁴ Vanguard, 7 Mar 2016.

¹⁵ Vanguard, 7 Mar 2016.

Buhari approves \$5 billion external borrowing plan

President **Muhammadu Buhari** (2015- present) on 9 September approved \$5 billion external borrowing plans.¹⁶ Conditions for emerging market sovereign borrowing have improved in recent months since **China**-slow down fears have eased.¹⁷ The government is seeking funds from domestic and foreign lenders to meet a N2.2 trillion (\$7 billion) budget deficit, and to increase public spending as Nigeria looks to exit recession. Buhari said he had approved plans to borrow from the **World Bank**, **African Development Bank (AfDB)**, **Japan International Cooperation Agency** and the **Export Import Bank of China (China Exim)**.¹⁸ Buhari said the loans would be “*low cost, long term*”¹⁹ with interest rates of 1.25% and 20-year maturities.²⁰ Additionally, Buhari said the government would announce details of a **Eurobond** “*in due course*”.²¹

Total borrowing from multilateral, bilateral and international markets will reach \$5 billion.²² The government will channel the external borrowing into the agriculture, power, mining and healthcare sectors.²³ Parliament still needs to approve the international borrowing plan.²⁴ The 2016 federal budget allocated 35% of expected revenue to debt servicing.²⁵

AfDB president **Akinwumi Adesina** said on 26 September that the AfDB is looking to extend \$4.1 billion to Nigeria.²⁶ Expensive domestic borrowing means that Nigeria is dependent on external financing to bridge its budget deficit and develop capital expenditure infrastructure projects. The AfDB would provide the financing across 2016 and 2017.²⁷ In addition to \$1 billion budget support, the AfDB plans to provide \$300m for youth employment in agribusiness; \$200m for the development of infrastructure and agro-industrial zones; \$300m for the **Abuja Infrastructure Project** to improve utilities and roads; and \$250m to help rehabilitate northeastern Nigeria.²⁸ Nigeria has a strong relationship with the AfDB under Adesina, who earned a positive reformer reputation as agriculture minister under former president **Goodluck Jonathan** (2010-2015). There is speculation that Adesina will eventually return to Nigeria to pursue a political career.²⁹

Total AfDB investments in Nigeria may reach \$10 billion by 2019.³⁰ The funds would target the power and agriculture sectors to support economic diversification. Adesina’s comments followed meetings in **Abuja** with Adeosun and vice president **Yemi Osinbajo**.³¹ Adeosun said Nigeria had requested a \$1 billion loan to cover the 2016 budget deficit. The concessional loan will have an interest rate of 1.2%.³² AfDB pre-conditions will include improving public finance management, in terms of both monetary and fiscal policy.³³

Nigeria’s public external debt stock at both federal and state level is low, approximately 2% of gross domestic product (GDP).³⁴ Nigeria’s total debt to GDP ratio of 13.2% is the lowest in **sub-Saharan**

¹⁶ Punch NG, 9 Sept 2016.

¹⁷ Punch NG, 9 Sept 2016.

¹⁸ Punch NG, 9 Sept 2016.

¹⁹ Punch NG, 9 Sept 2016.

²⁰ Punch NG, 9 Sept 2016.

²¹ Punch NG, 9 Sept 2016.

²² Punch NG, 9 Sept 2016.

²³ Punch NG, 9 Sept 2016.

²⁴ Punch NG, 9 Sept 2016.

²⁵ Reuters, 3 Mar 2016.

²⁶ Reuters, 27 Sept 2016.

²⁷ Reuters, 27 Sept 2016.

²⁸ Vanguard, 28 Sept 2016.

²⁹ Source, senior western diplomat, Lagos

³⁰ Reuters, 27 Sept 2016.

³¹ Reuters, 27 Sept 2016.

³² Reuters, 27 Sept 2016.

³³ Reuters, 27 Sept 2016.

³⁴ Bloomberg, 11 Aug 2016.

Africa.³⁵ The **Debt Management Office (DMO)** has a medium-term target of 60/40 domestic and external debt obligations.³⁶ However, despite these rates comparing favourably to the majority of emerging markets, low international oil prices may negatively impact investor appetite and result in Nigeria borrowing at higher interest levels.

S&P Global Ratings on 16 September downgraded Nigeria one level from B+ to B, and changed its outlook from negative to stable.³⁷ Nigeria's new rating is five levels below investment grade.³⁸ S&P cited decreased oil production, the restrictive foreign exchange policy, and delayed fiscal stimulus for the downgrade.³⁹ S&P noted that government debt remains low, but warned that servicing costs as a proportion of government revenue are high and increasing (see above).⁴⁰ S&P forecast that the government will borrow up to 1.5% of GDP on a blended basis from international sources. S&P forecast that the economy will contract 1% in 2016 before growth recovers to 2% in 2017 and 4% in 2018.⁴¹ S&P cited increased government spending, improved oil output from the fourth quarter 2016, reform of the **Nigerian National Petroleum Corp (NNPC)**, and liberalisation of the interbank foreign-exchange market for its growth forecast.⁴² S&P expects inflation to settle at 15.0% at end of 2016, while its exchange rate projection is N300 to the dollar.

CBN holds benchmark lending rate at 14%

The **Central Bank of Nigeria (CBN)** on 20 September retained its main lending rate at 14%.⁴³ The monetary policy committee had adopted a 'wait and see' stance to fully appreciate the implications of its last increase. The CBN monetary policy committee voted unanimously for an unchanged stance: the policy rate remains 14%; the banking sector's cash reserve requirement remains 22.5%; and the liquidity ratio 30%. The CBN had tightened the benchmark lending rate 200 basis points in July to encourage offshore fixed-income investment inflows into naira-denominated assets.⁴⁴ The CBN cited new capital inflows of approximately \$1 billion since July as evidence of the success of its strategy and the government's foreign exchange reforms. However, investors continue to report delayed repatriation and unmet demand.⁴⁵

The CBN believes that maintaining its lending rate will improve the functioning of the foreign exchange market.⁴⁶ Economists had, however, called for a rate hike to attract offshore portfolio investors seeking a more liquid foreign exchange market.⁴⁷ The CBN had greater space to act as month-on-month headline inflation has started to slow since August due to decreased household demand and a relatively stable exchange rate.⁴⁸ However, CBN governor **Godwin Emefiele** said the central bank's stance would further limit inflation, which has a benign outlook.⁴⁹ Emefiele also noted that the monetary policy committee believes that the Buhari administration's incomplete fiscal reforms continue to increase risks and uncertainty that encouraged monetary policy continuity.⁵⁰ Real interest rates are already negative due to upwards inflationary pressures and the foreign exchange market under pressure.⁵¹

³⁵ Bloomberg, 11 Aug 2016.

³⁶ Bloomberg, 11 Aug 2016.

³⁷ Bloomberg, 16 Sept 2016.

³⁸ Bloomberg, 16 Sept 2016.

³⁹ Bloomberg, 16 Sept 2016.

⁴⁰ Bloomberg, 16 Sept 2016.

⁴¹ Bloomberg, 16 Sept 2016.

⁴² Bloomberg, 16 Sept 2016.

⁴³ Bloomberg, 20 Sept 2016.

⁴⁴ FBN Capital Research, 19 Sept 2016.

⁴⁵ FBN Capital Research, 19 Sept 2016.

⁴⁶ FBN Capital Research, 19 Sept 2016.

⁴⁷ Source, banker, Nigeria

⁴⁸ FBN Capital Research, 19 Sept 2016.

⁴⁹ Bloomberg, 20 Sept 2016.

⁵⁰ Bloomberg, 20 Sept 2016.

⁵¹ Source, banker, Nigeria

While the CBN is politically independent, Adeosun on 19 September called on it to lower interest rates to encourage domestic government borrowing.⁵² These comments came after the CBN monetary policy committee had opened, and placed it in a difficult position. They may have deterred committee members from leaning towards easing. The CBN was keen to distance itself from the entry into recession (see *ARC Briefing Nigeria August 2016*) and in its statement argued that the current downturn is beyond its influence. The CBN also argued that monetary policy alone cannot get Nigeria out of recession, calling for the effective implementation of the 2016 budget, the settlement of salary arrears and more productive lending by commercial banks.

MTN Nigeria faces allegations it illegally repatriated \$13.9 billion

South Africa-based MTN Group subsidiary **MTN Nigeria** faces allegations that it illegally transferred \$13.9 billion out of Nigeria.⁵³ The accusations highlight the challenges facing international companies in obtaining foreign exchange and transferring it out of Nigeria. The ongoing foreign exchange shortage – due to low international oil prices – has exacerbated investor concerns about obtaining foreign exchange and repatriating profits. The senate on 28 September ordered an investigation into the allegations that MTN illegally repatriated the funds between 2006 and 2012.⁵⁴ MTN allegedly breached Nigeria's foreign exchange regulations by transferring without proper documentation the funds through **Lagos-based banks**.⁵⁵ The dispute between the Nigerian government and MTN comes three months after the company agreed to pay a **Nigerian Communications Commission (NCC)** fine of N330 billion (\$1 billion) for failing to disconnect unregistered SIM cards. MTN originally faced a larger penalty of \$5.2 billion and Nigerian legislators have criticised the decision to compromise on the scale of the fine.

Implications

Pension funds looking at infrastructure investment is part of a broader pan-African trend where funds increasingly view infrastructure as a source of stable returns, reliable cash flow and low volatility, portfolio diversification, hedging against inflation, as well as long-term duration to match long-term liabilities. The detail of the government's proposed investment vehicle will determine whether or not pension funds make a significant contribution to bridging Nigeria's infrastructure deficit. PFAs are particularly interested in whether the proposed vehicle is a government-secured infrastructure bond or an infrastructure investment fund under a fund manager and investment committee. The government may also propose a structure for government-guaranteed corporate bonds on specific infrastructure projects. PFAs would encourage the government to establish an infrastructure sinking fund, setting aside a percentage of future budgetary allocations to support the delivery of projects and reduce risk. PFAs will additionally watch if Pencom offers appropriate pricing and repayment conditions for any bonds.

The government will hope that external borrowing will facilitate its expansionist budget, stimulate growth and lead it out of recession. However, concessional borrowing may come with politically unpalatable conditions including the reform and liberalisation of the oil and gas sector. A successful Eurobond launch will depend on investor appetite, which is uncertain while the foreign exchange market remains under pressure. Whether or not increased external borrowing will increase growth will require the government to improve its record of public financial management. Any substantial increase in Nigeria's debt burden could jeopardise future capital investment programmes, especially efforts to meet the infrastructure deficit.

The CBN decision to hold its rates in the face of political pressure to loosen monetary policy reinforces its credibility as an independent institution. Holding the rate will contribute to price and foreign

⁵² Vanguard, 19 Sept 2016.

⁵³ This Day, 29 Sept 2016.

⁵⁴ This Day, 29 Sept 2016.

⁵⁵ This Day, 29 Sept 2016.

exchange stability rather than growth. This will begin to shift in the coming quarters as the CBN eases its monetary tightening to stimulate private sector growth.

The senate investigation into MTN will exacerbate investor risk concerns about Nigeria. With government revenue under pressure, and until it improves the efficiency of its revenue collection, companies are at high risk of politically motivated one-off payment demands.

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