



PENCOM RELEASES THE AMENDED REGULATIONS ON INVESTMENT OF PENSION FUND ASSETS, 2017

Background

In February 2015, the National Pension Commission (“**PenCom**”) took the first step towards revamping the existing framework for the investment of pension fund assets in Nigeria, by issuing an exposure draft of proposed amendments to the Regulation on Investment of Pension Fund Assets, 2012 (the “**2012 Regulations**”) for review by various stakeholders. The thrust of the amendments was to expand the asset classes in which pension fund assets under management by Pension Fund Administrators (“**PFA**s”) can be invested, as well as the thresholds/limits of such investment.

The review process has now culminated in the release of the **Regulation on Investment of Pension Fund Assets, 2017 (“Amended Regulations”)** by PenCom. It is instructive to note that the 2012 Regulations were issued pursuant to the repealed Pension Reform Act, 2004. Thus, the Amended Regulations are the first set of investment rules to be made under the extant Pension Reform Act, 2014 and take effect from April 2017.

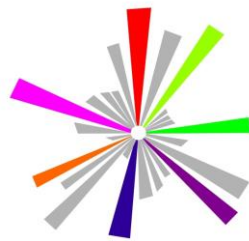
As a general observation, some key provisions in the 2012 Regulations have been retained in the Amended Regulations with few changes made to some of the strategic areas, conditions and requirements for investments by PFAs. These provisions are in respect of Institutional Framework; General Principles; Authorized Markets; Allowable Instruments; Quality of Instruments; Conflict of Interest Issues; Investment Limits; Performance Benchmark; Violation of Investment Limits; Voting Rights; Closed Pension Funds and Approved Existing Schemes; and Review. However, separate provisions for “RSA Retiree Fund” which existed under the 2012 Regulations have been expunged whilst new provisions on “**Multi-Fund Structure**” are introduced to provide for different categories into which RSA Funds would be divided (with the Retiree Fund constituting a category in the new structure) for investment purposes.

This newsletter discusses below, the various changes which the Amended Regulations have brought to the rules governing the ways in which PFAs are to invest the pension fund assets under management and in custody of the Pension Fund Custodians (“**PFC**s”).

Introduction of the Multi-Fund Structure

Compared to the 2012 Regulations wherein the general principles and criteria for investment for both the “Active Fund” and “Retiree Fund” are similar, the Amended Regulations introduced in its section 7 a Multi-Fund Structure, which classifies assets into four (4) **Fund Types**, based on the overall exposure to variable income instruments. Other factors to be considered for the classification of assets under which of the Fund Types they can be invested include age of the contributors, work status and the risk exposure elements.

Specifically, pension fund assets in the Retirement Savings Accounts (“**RSAs**”) managed by PFAs are now classified as follows:



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Fund Types	Contributors/Investors	Thresholds
Fund I	Strictly by formal request from a contributor and suitable for contributors who want to invest in high risk projects with higher rewards.	75% maximum and 20% minimum of Portfolio Value
Fund II	Active contributors who are 49 years and below as at their last birthdays.	55% maximum and 10% minimum of Portfolio Value
Fund III	Active contributors who are 50 years and above as at their last birthdays.	20% maximum and 5% minimum of Portfolio Value
Fund IV	Exclusively for retirees	10% maximum and 0% minimum of Portfolio Value

Active Choices and Transfers between Fund Types within a PFA

Subsequent to the implementation of the Multi-Fund Structure, contributors are allowed to choose the Type of Fund in which they desire to be assigned, subject to the following conditions:

- (a) An active Contributor in Fund II who wishes to be assigned to Fund I shall make a formal request to the PFA;
- (b) An active Contributor in Fund III who wishes to be assigned to Fund II shall make a formal request to the PFA.
- (c) An RSA Retiree or active Contributor who is 50 years and above shall not be allowed to choose Fund I.

The Amended Regulations also allow an active contributor to switch from one Fund Type to another Fund Type within a given PFA, once within a 12 month period without paying any fees, subject to a formal application to the PFA by the contributor.

Inclusion of Islamic Bond (Sukuk) in the Class of Allowable Instruments

Sukuk Instruments (Islamic Bond) issued by eligible State and Local Governments or State Government Agencies or wholly owned companies of a State Government, as an asset class, have now been included in the list of Allowable Instruments (under section 4) in which PFAs may invest the pension fund assets under management. It should be noted that Sukuk, as a type of Bond, was not mentioned in the 2012 Regulations.

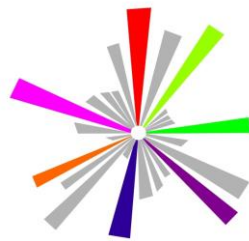
New Quality Requirements

1. **AUDITING OF ANNUAL FINANCIAL STATEMENTS** – Under the 2012 Regulations, where a PFA intends to invest the pension fund assets in an Infrastructure Fund or a Private Equity Fund (PE), the PFA was required to ensure that “all annual financial statements of the Infrastructure Fund or PE shall be audited by reputable firms of chartered accountants”. However, by sections 5.2.3(iii)(c) and 5.2.11(i) of the Amended Regulations, the accounting firms required to audit the annual financial



statements of the Funds in which the PFA seeks to invest, must in addition to being reputable firms of chartered accountants, be registered by the Financial Reporting Council of Nigeria (FRC).

2. MINIMUM INVESTMENT IN INFRASTRUCTURE FUNDS, PRIVATE EQUITY FUNDS AND BOND & SUKUK INSTRUMENTS ISSUED BY MDFOs – At least 75% of the pension fund assets invested in either Infrastructure Funds, PE Funds or Bond/Sukuk issued by eligible Multilateral Development Finance Organizations (“MDFOs”) was allowed to be invested in companies or projects within Nigeria under the 2012 Regulations. This threshold has however been reduced to 60% under the Amended Regulations (see sections 5.2.3(iii)(f), 5.2.11(ix) and 5.2.12(iii)).
3. SPECIFIED EXIT ROUTES FROM INFRASTRUCTURE FUNDS – Infrastructure Funds in which pension fund assets are to be invested were, under the 2012 Regulations, required to merely have “*satisfactory predefined liquidity/exit routes*”. In contrast, the Amended Regulations defines the exit routes to include “IPO, Sale to other Infrastructure Funds, Trade Sale, and Sale to a strategic investor” (see section 5.2.3(iii)(d)).
4. INVESTMENT IN THE ORDINARY SHARES OF UNQUOTED BUT PROPOSED TO BE QUOTED PUBLIC LIMITED COMPANIES NOW ALLOWED – By section 5.2.4(i) of the Amended Regulations, investment of pension fund assets in the ordinary shares of public limited companies is permissible, if “*the issuing companies’ shares are listed/quoted on a securities exchange registered by SEC or proposed to be listed/quoted through an IPO*”. This is a material departure from the position in under the 2012 Regulations which prescribed that pension fund assets could be invested in the ordinary shares of public limited companies provided, among others, that the issuing companies’ shares are listed/quoted on a securities exchange registered by the Securities and Exchange Commission (“SEC”).
5. INVESTMENT OF PENSION FUNDS IN A NEW COMPANY FORMED FROM COMBINATION ARRANGEMENTS OF EXISTING ENTITIES – In terms of section 5.2.4(iii) of the Amended Regulations, pension fund investments may be made in a newly established quoted company that evolved as a result of merger, acquisition or any other combination arrangement of existing corporate entities. This is however subject to the condition that, at least, one of the erstwhile companies had satisfied the minimum quality requirements for investment in ordinary shares, stated in section 5.2.4 (i) & (ii) of the Amended Regulations. This flexibility was hitherto unavailable under the 2012 Regulations.
6. INVESTMENT IN A NON-INTEREST COMPLIANT MONEY MARKET INSTRUMENTS – Another asset class introduced by PenCom under the Amended Regulations for investment by PFAs is non-interest (Islamic) money market instruments of banks and commercial papers of corporate entities. Stated under section 5.2.5(iii), the provision stipulates, among other conditions, that “*where the investment is in a Non-Interest Compliant money market instrument, it shall be in compliance with the CBN’s guidelines for the regulation & supervision of institutions offering non-interest financial services*”.



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7. INVESTMENT IN EUROBOND, GDRs AND GDNs – The Amended Regulations introduce different eligibility requirements for Global Depository Receipts (GDRs) and Global Depository Notes (GDNs) issued in other country and Naira-denominated GDRs/GDNs. Eligible and Federal Government-guaranteed Eurobond, GDRs and GDNs remain allowable instruments under the Amended Regulations but the regulations have been relaxed for foreign issuances. Under the 2012 Regulations, to qualify as an eligible instrument for investment by PFAs, GDRs or GDNs and Eurobond issuances were required to be registered and approved for issuance to Nigerian investors by the SEC, in addition to the required regulatory approvals that would be obtained in the country where the instruments were to be issued. However, under the Amended Regulations, only Naira-denominated GDRs and GDNs are now required to be approved by the SEC and be compliant with other SEC Rules (see section 5.2.13(iii & iv)).

Changes In Performance Benchmark

The quarterly and annual rates of return on all RSA Funds were, under the 2012 Regulations, required to be publicly disclosed both by the PFAs and PenCom without specifying the mode of such public disclosure. However, under section 9.1 of the Amended Regulations, only PFAs are now required to make the public disclosure on their websites.

Further, under the 2012 Regulations, the annual rates of return were to be based on the audited financial statements of the Funds; and on a 3-year rolling average performance of the Fund. The new regime under section 9.2 of the Amended Regulations is that the annual rates of return were to be based on the audited financial statements of the Funds; and on a 3-year Compound Annual Growth Rate (CAGR) of the Fund.

Concluding Remarks

With the release of the **Amended Regulations**, we believe that the Federal Government has taken a significant and commendable step towards unlocking the investment potentials of pension fund assets in Nigeria. Indeed, the newly-introduced Multi-Fund Structure presents PFAs with increased opportunities to make targeted and well-tailored investments and also spread the risks usually associated with undiversified portfolios. It is thus expected that the inclusion of new asset classes in the list of Allowable Instruments will widen the investment horizon for PFAs.

However, with the reduction in the percentage threshold of the pension fund assets allowable for investment in Infrastructure Funds, it remains to be seen how this veritable, home-grown, patient capital can be utilized for the widespread call from many quarters for plugging Nigeria's huge infrastructure gap. Nonetheless, it is anticipated that pension funds will boost activities/transactions in the money and capital markets, going forward.