INVESTING PENSION FUND ASSETS SECURELY AND PROFITABLY

Introduction

In September, the World Pension Summit (WPS), a platform for the global pension industry held its 2015 summit at The Hague, Netherlands. The theme of the global summit was "Building Better Pensions: Creating Long Term Value". Even more recently, the WPS held its regional meeting for the continent, the *World Pension Summit Africa Special 2015* between October 5 – 6 in Abuja, focusing on crucial pension matters such as; investing pension fund assets, security and regulation of pension assets, investing in alternative asset classes, infrastructure funds/bonds, and developing enough pipelines of profitable yet secure investment opportunities, among others.

The role of Pensions in economic development is gaining traction the world over. At a time when paucity of funds is commonly becoming a major impediment to economic growth, and panic exit of foreign direct investments (FDI) has left many developing economies' financial markets in turbulence; advocacy for developing locally sourced capital such as pension funds for national development, is now a popular strategy discussed at development fora.

In this article, we take an analytical look at the relatively young but promising and potentially deep pension industry in Nigeria. While the revisited pension reforms of 2014 and the recently proposed regulations on investment of pension fund assets, are focused at deepening the pension market, particularly by enlarging the list of allowable investment instruments open to pension fund operators, the market may be open to more risks given the sensitivity of pension assets. The primary focus of this article is how to strike an appropriate balance between profitable investments on the one hand, and the security of investible assets on the other.

Current trends

Prior to 2004, the Nigerian pension industry under the old defined-benefit system (in which retirement benefits are fixed) had a deficit of over ₦2 trillion (about $12.9 billion). Since the 2004 reforms introduced the Contributory Pension Scheme (**"CPS"**), the industry has witnessed exponential growth. As at the end of September 2015, total pension contribution in the custody of Pension Fund Custodians (**"PFCs"**) and under management of Pension Fund Administrators (**"PFAs"**) including Closed Pension Fund Administrators, was in excess of ₦4.8 trillion (about $26 billion). However, according to an analysis by The Economist, this figure is only 5% of the country's $510 billion GDP compared to 170% in the Netherlands, 131% in Britain and 113% in the US. The same analysis estimates Nigeria's working population at about 80 million people, out of which only 6.5 million are currently enrolled into the CPS. These statistics show there is great potential for further growth.

Mrs. Chinelo Anohu-Amazu, the Director-General, National Pension Commission (**"PenCom"**), the regulator of the pension sector, recently observed that the industry has been growing at 25% over the past nine years. She also noted that the industry outlook gives an expectation that this rate will at least be maintained, regardless of the economic down turn occasioned by falling oil prices and the national infrastructure deficit. This huge investible fund is a potential game changer and a key growth driver if securely and profitably invested.

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PenCom has constantly reviewed its rules/guidelines on investing pension funds, since the enactment of the now repealed Pension Reform Act 2004 (**"the old regime"**). There were the reviewed regulations of 2007, 2008, 2010 and 2012 made under the old regime. Provisions of the 2012 version (**"the current regulations"**), like that of previous regulations substantially limit investment of pension fund assets to the more secure federal government bonds and other core assets. In order to improve upon and replace the old regime, the new Pension Reform Act 2014 (**"the Act"**) was enacted, and on July 1, 2014 signed into law.

<u>Legal framework</u>

In Nigeria, investment of pension fund assets is regulated by PenCom as provided for under Part XII (Sections 85-91) of the Act. Section 85(1) stipulates that all funds realized under the CPS shall be invested by the PFA with the objectives of safety and maintenance of fair returns on the amount invested. Section 85(2) states that pension funds and assets shall only be invested in accordance with regulations and guidelines issued from time to time by PenCom.

Section 86 lists the modes of investment of pension funds, subject to PenCom regulation to include: (a) bonds, bills and other securities issued or guaranteed by the Federal Government and the Central Bank of Nigeria (**CBN**) (b) bonds, bills and securities issued by the States and Local Governments (c) bonds, debentures, redeemable preference shares and other debt instruments issued by corporate entities and listed on a Stock Exchange registered under the Investments and Securities Act (**ISA**) (d) ordinary shares of public limited companies listed on a securities exchange registered under the ISA (e) bank deposits and bank securities (f) investment certificates of closed-end investment fund or hybrid investment funds listed on a securities exchange registered under the ISA with good track records of earning (g) units sold by open-end investment funds or specialist open-end investment funds registered under the ISA (h) real estate development investments; or (i) specialist investment funds; and such other financial instruments as PenCom may from time to time approve.

Under Section 87, the Act also permits a PFA to invest pension funds in units of any investment outside Nigeria within the categories of approved portfolios. In this case, PenCom may recommend for the President's approval, subject to the subsisting foreign exchange rules of the CBN, the portfolio limits for investment of pension fund or assets outside Nigeria. However, Sections 88 – 90 place restrictions on certain areas of investment. By these provisions, pension funds shall not be invested in the shares or securities issued by the concerned PFA or its PFC. Neither shall any PFA sell pension assets to itself, its PFC or any person or body corporate affiliated or associated with it, nor shall it utilize the fund assets to acquire assets or apply it as loans or collateral for loans, except where a percentage of the pension contribution of a holder of Retirement Savings Account (RSA), is applied towards the payment of equity contribution for residential mortgage as permitted by Section 89(2). The scope of the restrictions on areas of investment or allowable instruments may be widened or altered through regulations or guidelines made by PenCom – Section 90(1).

Pursuant to Section 115 of the Act which empowers PenCom to make regulations, rules or guidelines for effective implementation of the objectives of the Nigerian pension regime, a new body of rules and guidelines on investment of pension funds was issued in February 2015 to replace the current regulations. PenCom refers to the whole body of rules and guidelines as "Regulation on Investment of Pension Fund Assets" (**"the draft regulations"**). The focus of the draft regulations is how to make investible pension fund assets align with developments in the financial market, and also make them responsive to the needs of registered contributors to the pension fund.

The draft regulations essentially expand the scope of investment windows available to the PFAs, who ordinarily may be tempted to make wrong investment choices with unintended negative long-term crisis for both the scheme and registered contributors thereunder. When the draft regulations become effective, previously prohibited technical and specialist investment portfolios in the capital and money markets will be opened to the PFAs. The most crucial challenge that is likely to confront the PFAs going forward, will be how to substantially invest huge pension fund assets to yield the highest possible returns while keeping same secure within legal, regulatory, and risk management frameworks.

It is therefore critical that PFAs be well guided by relevant financial and legal due diligence, conducted by professional and experienced advisers. This will ensure that operations of the PFAs are in conformity with the law, global best practices in investment risk management and corporate governance. Section 90(2) of the Act requires that, every PFA shall conduct extensive research and due diligence prior to investment as well as utilize the risk rating reports that have been undertaken by any risk rating company registered under the ISA, on investment instruments and securities.

To be lawful, investment of pension fund assets will also have to comply with the required stipulations of the Investments and Securities Act 2007 as enforced by the Securities and Exchange Commission (**SEC**). PFAs must also ensure compliance with relevant codes of corporate governance issued by the CBN, regulating investments in financial services.

Available Investment Windows in the Draft Regulations

Section 4 of the draft regulations specifies some of the technical and specialist areas of investment, where PFAs will need expert financial and legal advice when the draft regulations become operative. These include:

1. Bonds, Sukuk, Treasury Bills and other securities (including bonds denominated in foreign currencies) issued by the Federal Government and the CBN or their agencies as well as special purpose vehicles and companies created or owned by the Federal Government of Nigeria.

2. Bonds and Sukuk issued by eligible State and Local Governments or State Government Agencies or wholly owned companies of the State Government.

3. Bonds, Sukuk, Debentures, redeemable/convertible Preference Shares and other debt (non-interest) instruments issued by listed corporate entities; Bonds (including Sukuk) and debt securities issued by eligible unlisted companies; and Asset Backed Securities including Mortgage Bonds, Mortgage Backed Securities and Infrastructure Bonds or Sukuk.

4. Ordinary Shares of public limited liability companies listed on a securities exchange registered by SEC.

5. Money Market instruments of banks and Commercial Papers issued by corporate entities.

6. Open/Close-ended/Hybrid Investment Funds, including Exchange Traded Funds and Non-Interest (Shariah) Compliant Investment Funds, which are registered with the SEC.

7. Specialist Investment Funds, whose underlying assets are tangible physical assets, including Real Estate Investment Trusts (REITs); Private Equity Funds; and Infrastructure Funds which must all be registered with the SEC.

8. Supranational Bonds and Sukuk issued by a Multilateral Development Finance Organizations (MDFO) such as the World Bank Group, African Finance Corporation, African Development Bank and other MDFOs recognised by the SEC.

9. Global Depositary Receipts/Notes (GDRs/Ns), Eurobonds and Sukuk issued by listed Nigerian companies.

The draft regulations specify certain requirements to assure the quality of investments and assess the risks in investing in any of the allowable instruments. Issues of rating, approval by relevant authorities, risk level, liquidity and profitability are critical and important.

Similarly, PFAs must be well acquainted with and properly advised on the requirements in the draft regulations relating to institutional framework; authorized markets; conflicts of interest; multi-fund structures; investment limits; performance benchmark; violation of investment limits and penalties for same; voting rights acquired in the PFCs by the PFAs as a result of pension fund assets held by the PFCs on behalf of their respective PFAs; reviewed framework for Closed Pension Fund Administrators; as well as other important legal and regulatory compliance matters.

Considering the recent history of distress in our banking and pension sectors, it is imperative that all hands must be on deck to see that the more liberalized investment windows are not either unintentionally or deliberately abused by licensed pension fund operators, when the draft regulations are issued in final form. PFAs must always seek expert opinion and obtain sound advice in technical matters or those which require specialized skills. The era of negligent, reckless, unbridled and unethical risk-taking must be effectively replaced by a well governed, cultured and professional regime.

Conclusion

The Nigerian pension industry is still in its infant stages and the potential for growth is enormous. With the ongoing reforms, the scope for expansion and the enlarged windows of investment, total funds under management may grow as much as ₦10 trillion in the next four years. This initiative will not only secure the future of Nigerian workers, especially at retirement, but the huge investible fund can also catalyze our infrastructure development and heighten our chances of becoming one of the top economies of the world by the year 2025.

More support from government is needed for optimum performance of pension fund assets as engines of economic growth. Clearer guidelines should be developed on investments into alternative asset classes like Private Equity Funds while some forms of guarantee are needed to be given, especially by the Federal Government, to encourage PFAs utilize pension fund assets in infrastructure development.

To ensure that pensions are secure and the country is stimulated to move rapidly up the economic cycle curve, licensed pension fund operators, especially the PFAs, must be well administered and governed, their staff schooled in best practices and trained in essential and contemporary technical skills; as they venture into investments in the money and capital markets as well as other sensitive segments of the economy.

The Grey Matter Concept is an initiative of the law firm, Banwo & Ighodalo