

# INVESTING IN PRIVATE EQUITY

## THE NIGERIAN REGULATORY PERSPECTIVE

A Presentation by

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# Background

- What is Pension?
  - An arrangement to provide people with income when they are no longer earning regular income from gainful employment.
  - Has Political, Economic and Social Implications for every country, as recently witnessed in France, Greece, Ireland and United Kingdom.
  - Pension systems need to be situated within the financial markets spectrum; therefore regulators/pension managers cannot take their eyes away from the financial markets into which accumulated savings are channeled.



# Background...cont'd

- There are basically two broad types of Pension Schemes:
  - Defined Benefit (DB)
  - Defined Contribution (DC)
- Pension fund investments under a DC Scheme, especially if it is mandatory, is different from a typical DB Scheme, or other pension systems in developed countries in which participation is voluntary.
- Unlike a DB Scheme in which the investment risks are borne by the Employer, in a DC Scheme the Employee bears the ultimate investment risks, as there are no guaranteed Fund performance or recourse to the Employer.



# Background...cont'd

- In addition to other asset management processes, regulation on investing pension funds in mandatory DC Schemes are generally stringent and have qualitative and quantitative restrictions due to:
  - the need to protect the ultimate beneficiaries
  - level of development of the financial markets, into where funds may be deployed
  - likely political implications



# Features of the Pension Reform in Nigeria

- The Pension Reform Act (PRA) 2004 established the Contributory Pension Scheme in Nigeria (Mandatory Defined Contribution Scheme).
- National Pension Commission (PenCom) was established in December 2004 to regulate and supervise all pension matters.
- ◉ Covers the public service of the Federation and employers of 5 or more employees in the private sector. State Governments had also agreed to join the scheme.
- ◉ Both employer & employee to contribute minimum of 7.5% each of employee's monthly emoluments
- ◉ Employer to maintain life insurance cover for employees (300% of total annual emolument)



# Features of the Pension Reform..cont'd

- Private management/custody of pension assets. Currently, the licensed pension operators are:
  - 24 Pension Fund Administrators (PFAs)
  - 7 Closed Pension Fund Administrators (CPFAs)
  - 4 Pension Fund Custodians (PFCs)
- Existing DB Schemes (Approved Existing Schemes and CPFAs) are legacy (occupational) schemes transferred into the new system.
- Investment of accumulated funds are in instruments and asset classes allowed by law and regulations of PenCom.



# Implementation Efforts

- Pension Fund Operators were licensed and began formal operations in February, 2006
- Registration of contributors commenced in April 2006
- The Commission had issued and updated various Regulations and Guidelines to ensure smooth operations in the pension industry
- As at 30 June 2011, total registrations was:
  - 4.7million registered Retirement Savings Account (RSA) contributors, out of an estimated 8million workers in the formal sector
- The first set of retirees under the contributory pension scheme exited in July 2007. As at 30 June 2011, there were 35,878 existing retirees.
- Total Pension Fund Assets was NGN2.25trillion (approximately \$14.5billion) as at 30 June, 2011. Average monthly pension inflows of NGN2obillion (\$128million)





# Regulatory Philosophy/Framework

- Consultative: Seek inputs from relevant stakeholders in drawing up Regulations & Guidelines. This promotes voluntary compliance.
- Prudent and Conservative. Conscious of developments in the financial macroeconomic environment in the design or amendments to Regulations & Guidelines
  - Sequence of financial crisis (financial liberation => large capital inflows => sharp price increases in housing & equities => marked rise in government/corporate/individual indebtedness => Big Bang)
- Effective surveillance mechanisms to mitigate potential losses to contributors



## Regulatory Philosophy/Framework..cont'd

- Major investment objectives are safety of pension fund assets and that fair returns are earned on investments.
- Allowable securities are mostly regulated instruments, which are traded on transparent platforms, since DC Funds are priced daily.
- Investment activities must comply with the Regulations on Investment and Valuation of Pension Fund Assets, issued by PenCom. Costs/charges to Pension Funds are regulated.
- Regulation on Investment of Pension Fund Assets was revised in December 2010 to expand the allowable investment outlets to include alternative asset classes such as Private Equity (PE) Funds, Infrastructure Financing (Debt Instruments and Funds) and Supranational Bonds, amongst others.
- Before December 2010, only legacy pension schemes (CPFAs & Existing Schemes) had PE Investments, which were transferred into the contributory pension scheme.



# Pension Statistics

ASSET CLASSES	HALF YEAR ENDED		YEAR ENDED		YEAR ENDED		YEAR ENDED	
	30/06/11		31/12/10		31/12/09		31/12/08	
	N BILLION	%	N BILLION	%	N BILLION	%	N BILLION	%
DOMESTIC ORDINARY SHARES	386.30	17%	358.03	18%	220.71	15%	220.54	20%
FOREIGN ORDINARY SHARES *	34.88	2%	24.10	1%	2.80	0%	2.23	0%
FGN SECURITIES	1,059.97	47%	829.20	41%	498.88	33%	350.67	32%
STATE GOVT. SECURITIES	79.00	4%	69.60	3%	33.71	2%	0.16	0%
CORPORATE DEBT SECURITIES	57.22	3%	50.73	2%	31.18	2%	15.13	1%
LOCAL MONEY MARKET SECS	390.58	17%	489.25	24%	542.22	35%	332.44	30%
FOREIGN MONEY MARKET SECS*	0.19	0%	7.36	0%	17.72	1%	17.25	2%
OPEN/CLOSE-END FUNDS	13.02	1%	8.61	0%	5.74	0%	9.03	1%
REAL ESTATE PROPERTY *	178.07	8%	170.52	8%	142.96	10%	125.48	11%
UNQUOTED SECURITIES (PE) *	9.68	0%	8.18	0%	6.18	0%	6.86	1%
CASH & OTHER ASSETS	42.21	1%	14.19	1%	27.53	2%	19.20	2%
<b>TOTAL PENSION FUND ASSETS</b>	<b>2,251.12</b>	<b>100%</b>	<b>2,029.77</b>	<b>100%</b>	<b>1,529.63</b>	<b>100%</b>	<b>1,098.99</b>	<b>100%</b>

- Average Annual Growth Rate: 30% per annum
- Current average monthly inflow of Contributions: ₦20billion

\* CPFAs / AESs only



Variable	2007	2008	2009	2010
Real GDP Growth Rate (%)	6.45	5.98	6.66	6.80 (estimated)
Inflation Rate (%)	6.60	15.10	13.90	11.80
Domestic Savings (% of GDP)	13.0	16.9	23.3	NA
Monetary Policy Rate (MPR)	9.50	9.75	6.0	6.25
Stock Market Capitalization (N' trillion)	10.18	6.96	4.98	7.91
ROI on Nigerian Stock Exchange (based on All Share Index)	74.73%	-45.77%	-33.78%	18.93%
Pension Fund Assets in Stock Market (N' billion)	243.44	222.77	220.71	358.03
Returns on Investment (ROI) – RSA Funds	19.37%	0.34%	11.41%	11.64%



# Current Requirements for PE Investments

- Indirect investments, only through PE Funds
- Investment Criteria
  - Well defined and publicized investment objectives and strategies
  - Satisfactory pre-defined and pre-disclosed liquidity and exit routes
  - PE Funds and Fund Managers to be registered with Nigerian Securities & Exchange Commission (SEC)
  - Key Principals (CEO and CIO) shall each possess minimum of 10 years relevant experience in managing PE investments.
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# Current Requirements for PE...cont'd

## Investment criteria..cont'd

- Fund Manager to have minimum retainership of 5% of Cost Value of the Fund (i.e. at launching of the Fund), throughout tenor of Fund.
- Fund to have Multilateral Development Finance Organizations as Limited Partners.
- Minimum of 75% of Fund shall be invested in companies or projects within Nigeria (for political and economic considerations)
- Fund shall have an Advisory Board with representatives of Institutional Investors in majority
- Global Portfolio Limit: 5% of Assets under Management



# Regulatory Challenges

- Good Corporate Governance Structure
  - Expertise
  - Professionalism
  - Conflict of Interest
  - Integrity/Accountability
- Proper Valuation of Underlying Assets and Annual Auditing of the Fund by reputable Firm of Chartered Accountants – in line with acceptable global valuation and accounting standards



# Regulatory Challenges...cont'd

- Reasonable Fund Management Costs/Fees
- Reliable Performance Measurement, considering the long term nature of Investment
- Adequate and Timely Disclosures/Reporting of Investment Activities to Investors
- Effective Management of Exchange Rate Risks (for 25% of PE Fund allowed to be invested outside Nigeria)
- Capacity Building of Pension Operators' to enhance current knowledge and skills





# Future Outlook

- Encouraging the participation of the informal sector in the Contributory Pension Scheme
- Introduction of Multifund to address the various risk appetite of contributors. May widen the scope for PE and other alternative asset classes.
- Further deepening of the Nigerian financial markets and increased capacity (knowledge & skills) of market and pension operators.
- As a fall out from above, more flexibility in investment regulation.



# Conclusion

- Investment regime of pension funds under the mandatory DC Scheme are unlike the typical Asset Management. These are normally very prudent and conservative in nature, with focus on safety and optimal risk/return trade off – **“more money has been lost in the search for high returns than at the point of a gun”**.
- There is need for regulators/fund managers to carry out regular ‘drills’ and simulate possible negative scenarios, with a view to developing appropriate action steps to minimize the impacts, whenever they arise.
- The Nigerian Pension Industry is growing at a very rapid rate in terms of membership, pension contributions and portfolio size (average annual growth rate of 30%) – a veritable catalyst for economic and infrastructure development of our nation.



# Conclusion...cont'd

- Based on experiences in similar jurisdictions operating mandatory DC Schemes, the Commission has gradually been expanding the allowable investment outlets for pension fund assets, premised on increased public confidence, development of the financial market and improved skills/knowledge of industry operators. The investment regulation would be made more flexible as the Nigerian pension industry matures.
- The Commission will continue to engage and welcome useful suggestions from relevant stakeholders in its regulatory oversight in order to protect contributors' interests and further develop the Nigerian Pension Industry.



**Thank You!**

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