NATIONAL PENSION COMMISSION
174, Adetokunbo Ademola Crescent, Wuse II, Abuja.
P.M.B. 5170 Wuse, Abuja, Nigeria
Tel: +234-9-4138736-40, 09-6720091, 6720094, 4133398, 4133363
www.pencom.gov.ng

CIRCULAR

REF: PENCOM/TECH/ISD/HISD/2021/13

DATE: 27 January, 2021

TO: All Licensed Pension Fund Operators

SUBJECT: RE: RECLASSIFICATION AND VALUATION OF PENSION FUND ASSETS UNDER INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS 9)

As a follow up to the Commission's letter of 5 November, 2020 on the above subject matter, we write to clarify and direct as follows:

1. Since Pension Fund Administrators (PFAs)/ Closed Pension Fund Administrators (CPFAs) commenced the valuation of pension fund assets in line with the provisions of IFRS 9 in 2018, it was expected that Business Models (BMs) had been developed to guide the investment decisions for all existing and newly set up Funds under Management.

2. Please recall that the need to develop BMs per Fund under Management was highlighted in the Joint Circular issued by the Commission and the Financial Reporting Council (FRC) dated 4 August, 2017.

3. However, the Commission's review of the 2020 Half-Year Fixed Income Audit of Funds under Management of PFAs/CPFAs, revealed that though some Pension Fund Operators were already valuing their portfolios in line with the provisions of IFRS 9, they were yet to put in place duly formalized BMs for all Funds under Management. This was a major exception in the implementation of IFRS 9 by Operators.

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Consequently, the Commission's letter of 5 November, 2020 and subsequent clarifications were **NOT** for operators to **develop new BMs based on the bonds reclassified in year 2020**. Rather it was a call for Operators to formalize and forward the BMs that guided their pension fund investment activities, ***from the date of adoption of IFRS in 2018 till date.***

It should be noted that on adoption of IFRS in 2018, operators who seemingly **"took no action"** by opting to continue valuing their bonds on a straight-line basis (amortized cost methodology), effectively adopted the Hold-to-Maturity option. This option, which is allowable in IFRS also requires the PFAs/CPFAs in this category to put in place BMs to guide their investment activities under this option.

Accordingly, PFAs/CPFAs that are yet to forward the BMs put in place on the adoption of IFRS in 2018, have up to **Friday, 28 February 2021** to submit same to the Commission for review and reference purposes. Operators should always note that BMs for each pension fund MUST reflect the ages, risk tolerance levels and characteristics unique to Members.

In addition, our letter of November 5, 2020, **directed** PFAs to ensure that all exposures of the RSA Funds to Variable Income Instruments (including fixed income securities marked to market), are to be rebalanced and made to be in line with the provisions of the Regulation on Investment of Pension Fund Assets, within a four (4) month period, ending **4 March, 2021**. **Any excess over limit observed after this date will be treated as an Exception.**

4. Paragraph 4.4.1 and B4.4.1 of the IFRS 9 stipulated the conditions precedent for any entity to change its BM for managing financial assets, which as of date, has not been met by any PFA/CPFA.

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5. Furthermore, the Commission wishes to confirm that in addition to paragraph (4) above, operators in the Nigerian Pension Industry (PFAs/CPFAs inclusive), **CAN ONLY** consider a change in an existing BM **when the current liability structure of any pension fund under management has changed or is about to change.**

6. Such a change or expected change has to be significant and should be proven to represent a major deviation from the existing / previous trends of any Fund under Management. Specifically, such change / expected change in liability structure of any fund should lead to a need to alter / adjust the cash flow requirements needed to fund the resultant liabilities.

7. In the event that a PFA/CPFA meets the requirements for changing a BM as noted in paragraphs (4) and (5), any resultant increase in the portfolio limits set for either the Available for Sale (AFS) or Held-to-Maturity portion of the pension portfolio, can only be **met through designation of new investments made by the affected PFAs/CPFAs,** and **NOT** through the reclassification of previous/existing investments.

8. The exception to paragraph (7), is in a situation where the change in liability structure requires immediate liquidity that cannot be met by the Fund, without reclassification **and disposal** of assets. In such a case, the PFA/CPFA is to request and receive "**No Objection**" letter from the Commission, before the actual reclassification, followed by prompt disposal of selected assets, within a maximum of seven (7) working days from the date of reclassification.

   Such Requests forwarded to the Commission **MUST** be supported with adequate documentary evidence to prove that a change (or an expected change) in the liability structure of a pension fund / funds has occurred (or would occur), alongside the possible / estimated impact on the existing cash flow of the Fund/Funds.

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9. Notwithstanding the conditions stipulated in 4 – 8 above, Operators are allowed to sell instruments from the Held–to-Maturity (HTM) portfolios, provided that such sales are infrequent and insignificant in line with IFRS 9. For the purpose of clarity, the Commission shall consider **any value above 5% of the HTM portfolio as significant.**

   Once such a sale is done, the PFA/CPFA is to formally notify the Commission (within a five (5) working day period) in writing, outlining reasons for the sale, amount sold and the last time such a sale was carried out from the HTM portfolio.

Please be guided accordingly.

All enquiries regarding this Circular should be directed to the Head, Investment Supervision Department.

Yours faithfully,

Ehimeme Ohioma
Head, Surveillance Department