PENSION FUND ADMINISTRATORS AND PENSION FUND CUSTODIANS: RETHINKING THE STRICTURES ON COMMON CONTROL

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1.0 Introduction

The Pension regime in Nigeria under the Pension Reform Act 2014 ("PRA" or the "Act") is structured in a such manner that it creates role bifurcation between Pension Fund Administrators ("PFAs") and Pension Fund Custodians ("PFCs"). The roles are stratified in such a manner that PFCs are restricted to keeping the Pension Funds within their custody while the PFAs are saddled with the responsibility of managing and investing the Pension Funds in viable investment portfolios as may be approved by the National Pension Commission (the "Commision").

Apart from this stratification of roles, the PRA equally places additional restrictions on the control of both PFAs and PFCs. By Section 77(2) of the PRA, a PFA is specifically prohibited from keeping pension funds or assets with a PFC in whom the PFA has any business interests, shares, or relationship whatsoever. This invariably means that PFAs and PFCs that, for example, are under the corporate umbrella of a holding company are prohibited from co-mingling pension funds or assets. In the last decade that the PRA has been in force, there have been conversations on whether this restriction accords with the modern realities of corporate governance and importantly, whether the objectives of the Act can still be actualized in the event that the industry adopts a more liberal approach on the issue of control of PFAs and PFCs. The answers to these posers form the crux of our discussions in this briefing note. It is however necessary to gain some insight on the administration of the pension industry and the roles of the key players, before appraising the legitimacy or otherwise of these calls for liberalization.

2.0 Administration of The Pension Industry in Nigeria

The pension industry in Nigeria is primarily regulated by the Commission. To ensure an efficient administration system for pensions in Nigeria and to actualize the reforms for which the PRA was conceptualized, the Act has created two main stakeholders, tasked with varying functions. These are:(a) PFAs; and (b)PFCs.

2.1The Role and Functions of Pension Fund Administrators (PFAs):

From the commencement of the Contributory Pension Scheme (CPS) in 2014, pension funds are now managed by licensed PFAs. The PFAs are tasked with opening Retirement Savings Accounts (RSAs) for employees, as well as the investment and management of pension funds and assets within the ambits of the Act. To ensure transparency and proper record-keeping, they maintain books of account on all transactions, provide regular information on investment strategy, market returns and other performance indicators to the Commission and RSA holders. The Act in Section 55 (a-h), mandates PFAs to provide customer service support to contributors, including giving them access to their account balances, making statements available on demand in addition to the calculation and payment of retirement benefits.

In recognition of the critical roles that PFAs play, the Act imposes stringent conditions on any entity desirous of carrying on the business of a PFA. For instance, Section 60 of the Act provides that the entity must be a limited liability company incorporated under the Companies and Allied Matters Act (CAMA) specifically to manage pension funds. This is in addition to meeting the minimum capital requirement set from time to time by the Commission, which currently stands at N5 billion following a recapitalisation exercise in 2022.

The roles and responsibilities of PFAs are summarized below:

a. RSA Management
PFAs are responsible for meticulously managing individual RSAs, maintaining accurate records, tracking contributions, and facilitating withdrawals according to regulatory guidelines.

b. Investment Decisions

Playing a crucial role in financial decision-making, PFAs strategically invest pension funds across diverse channels to optimize returns and ensure sustainable growth over time.

c. Retirement Benefits Processing
PFAs handle the processing of retirement benefits, ensuring a seamless transition for retirees by disbursing funds in adherence to regulatory requirements.

d. Education and Communication
Beyond financial management, PFAs engage in educational initiatives, providing contributors with essential information about their pension rights, available investment options, and the importance of effective retirement planning.

2.2 The Role and Functions of Pension Fund Custodians (PFCs):

All pension funds and assets are held by licensed PFCs who receive the funds on behalf of the PFAs and hold same in trust for the employees and beneficiaries of the RSAs. Within 24 hours of receiving the funds, PFCs must credit the accounts of the PFAs in their care and notify them.

PFCs are primarily tasked with the settlement of transactions and undertaking activities relating to the administration of pension fund investments including the collection of dividends, bonus, rental income, commissions, and related activities — on behalf of the PFAs.

PFCs are required to report to the Commission regularly on the assets in their custody, undertake statistical analysis on the investments and returns on investments, provide data and information to the PFAs and the Commission, and pursuant to Section 57 (c) of the Act, execute in favour of the PFAs, relevant proxy for the purpose of voting in relation to the investments.

Any entity intending to operate as a PFC must be licensed by the Commission based on laid-down conditions. Similar to PFAs, a PFC must be a limited liability company incorporated under CAMA. However, in addition to the requirement for incorporation, a PFC must be wholly owned by a financial institution and be licensed for the sole purpose of keeping custody of pension funds and retirement benefits. At present, the minimum capital requirement for PFCs stands at N25 billion in addition to which the PFC's parent company must have issued a guarantee in favour of the PFC (the subsidiary) to the full sum and value of the cash flow of pension funds and assets, as may be determined by the Commission, from time to time.

The roles and responsibilities of PFCs are summarized below:

a. Safekeeping of Assets
PFCs are entrusted with safeguarding pension fund assets and implementing robust security measures to prevent unauthorized access or misuse.

b. Settlement of Transactions
All financial transactions related to pension fund assets pass through PFCs, who act as intermediaries, facilitating seamless settlement of trades by regulatory guidelines.

c. Asset Valuation
Conducting regular valuations, PFCs provide accurate assessments of pension fund assets, contributing valuable insights for informed investment decisions by PFAs.

d. Regulatory Compliance
Operating within a stringent regulatory framework set by the Commission, PFCs ensure compliance to maintain the integrity of the pension system.

The Roles of PFAs and PFCs are summarized below:

S/N		Pension Fund Administrators (PFAs)	Pension Fund Custodians (PFCs)
1	Primary Role	Manage individual RSAs.	Safeguard and warehouse pension fund assets.
2	Responsibilities	RSA management and making Investment decisions.	Involved in Safekeeping of assets, Settlement of transactions, Asset valuation, and regulatory compliance.
3	Function Relationship	Active involvement in growing and managing pension contributions.	Provide a secure foundation, shielding pension funds from risks.
4	Examples of Activities	- Investing pension funds; - Processing retiree benefits; - Educating contributors.	- Safekeeping of pension assets; - Facilitating transactions; - Valuating pension fund assets. Ensuring regulatory compliance.
5	Outcome Focus	Growth and management of individual pension contributions.	Secure handling and custody of pension fund assets.
6	Collaboration Dynamics	Collaborates with PFCs for secure custody and settlement of pension funds.	Collaborates with PFAs to ensure seamless fund management.
7	High-Level Objective	Ensure contributors' funds grow and are well-managed for future benefits.	Safeguard pension assets and maintain the integrity of the pension system.

Relationship between the PFAs, PFCs and the Beneficiaries of RSAs.

An RSA is an account opened by an employee with a PFA of his or her choice into which all pension contributions and returns on investments are remitted. It is from the RSA that retirement and death benefits are paid to the contributors in the pension scheme. Pension contributions are paid directly to the PFC by the employer to be held on the order of the PFA. The PFC notifies the PFA within 24 hours upon receipt of the contributions. The PFA manages and invests the pensions on behalf of contributors while the PFC keeps the pension funds and assets in safe custody and carries out transactions on behalf of the PFA. The relationship between PFAs, PFCs and the beneficiaries of RSAs is encapsulated below:

Entity	Description	Responsibilities
PFAs	These are licensed companies responsible for managing the RSAs of contributors.	- Enroll individuals into the CPS; - Collect contributions from employees and employers; - Invest pension funds in approved instruments; - Provide retirement benefits administration services.
PFCs	These are financial institutions responsible for the safekeeping of pension fund assets.	- Hold and safeguard pension fund assets; - Execute investment transactions as directed by PFAs; - Provide custody and settlement services for pension funds.
Beneficiaries of RSAs	These are individuals who contribute to the pension scheme and are entitled to retirement benefits.	- Contribute a percentage of their income to their RSAs; - Monitor the performance of their pension funds; - Receive retirement benefits upon reaching retirement age or meeting specific criteria.

3. Co-Mingling of Roles of PFCs and PFAs: A Time to Explore?

It is said that a robust pension scheme guarantees a secure future for the contributors. Meanwhile, for there to be contributors or participants, there has to be some level of confidence and trust in the safety of the funds. To this end, the National Assembly enacted the Act with the principal aim of revolutionizing the pension industry in Nigeria and establishing a robust pension scheme into which employees and employers of labour alike would confidently commit their resources.

In order to achieve this, enormous powers were conferred on the Commission such that the PFAs and PFCs cannot perform outside the guidelines set by the Commission. Specifically, under **Sections 23** and **24** of the PRA, the Commission is empowered to do the following:

a. Approve, license, regulate, and supervise the PFAs and PFCs, and any other institution related to pension matters;
b. Establish standard benchmarks, guidelines, procedures, rules, and regulations for management of pension funds;
c. Issue guidelines, rules and regulations for investment and administration of pension funds;
d. Ensure maintenance of national data banks on pension matters;

e. Receive, investigate, and mitigate complaints of impropriety made against a PFC, PFA, or any of their staff or agent;
f. Formulate, direct, and oversee overall policy on pension matters in Nigeria;
g. Request or call for information from any employer, PFC, PFA or any other person or institution on matters relating to retirement benefits.

Prior to the enactment of the Act, the pension industry in Nigeria was bedeviled with wanton mismanagement, abuse, and minimal checks and balances. To address these concerns, provisions of the Act were deliberately enacted to be as sweeping as they were detailed. Section 77 (2) of the Act is one such provision. The said Section which prohibits a PFA from depositing pension funds or assets with a PFC in whom the PFA has any business interest, shares or relationship whatsoever was enacted to curb abuse in an industry that had hitherto been saddled with mal-administration. With this background in mind, it is easy to appreciate why the industry would have readily accepted such a provision at the time. Nevertheless, the pension industry in Nigeria has matured in leaps and bounds in the last decade. The days when the industry was dominated by players of questionable pedigree are largely now in our rear-view mirror. The entities that operate as both PFAs and PFCs presently are for the most part, large corporates with sufficient corporate governance structures in place to prevent abuse. Interestingly, for an entity to operate as a PFC, such an entity must be wholly owned by a financial institution and must also maintain the same minimum capital requirement as commercial banks in Nigeria (currently, N25billion). To assuage any concerns, the regulator of the industry (the Commission) has been vested with enormous powers by the PRA (some of which we discussed above) to ensure that the industry continues to operate seamlessly.

These powers are far-reaching and are of such a nature that it will be almost impossible for either a PFA or PFC to mismanage the pension fund or assets in its control.

In the light of the foregoing, it would therefore be unconscionable to argue that without more, the common 'parenthood' of a PFA and PFC would imply the likelihood of abuse where such a related PFA deposits its pension funds with a 'sibling' PFC. The prevailing argument to which we subscribe, is that provided that there are sufficient checks and balances in addition to ample regulatory oversight, such dealings by related parties in the pension industry ought not to be prohibited.

4. What a 'Liberal' approach portends for the Pension Industry

4.1 Creating A Robust Pension Regime with Sufficient Liquidity

Permitting affiliated entities to carry on the business of PFA and PFC will encourage sharing of potential investment ideas. This opportunity may not ordinarily exist where the current restrictions under the Act are in place. This is perhaps attributable to the fact that outside the strictures, such entities view themselves as affiliates but under the regime of strictures, there is the tendency to regard unrelated parties as competitors. This is most desirable because the PFCs are affiliated to financial institutions with good understanding and expertise on the workings of the financial sector and as such, their expertise is essential for the proper management and investment of pension fund. Thus, encouraging PFAs to domicile or invest pension fund assets in a PFC affiliated to them will create a robust pension fund pool with economies of scale and accordingly result in access to more investment opportunities with adequate capital reserves and sufficient liquidity to enable an expansion of its investment portfolio in new classes of assets. For the market, this would generally translate to increased investment activities that would ultimately further stimulate the economy and grow contributors' confidence in the safety of their funds. It is our view that the growth that this would engender would be akin to the unprecedented growth witnessed in the banking sector following the recapitalization exercise of 2005.

4.2 Improved Efficiency and Cost savings

Removing the restriction placed on PFCs and PFAs by Section 77(1)(2)(3) of the PRA will save costs for the management and administration of pension funds. This eliminates excessive administrative bottlenecks and operational costs because where the PFA and PFC share a common holding structure, it will improve efficiency, promote seamless communication, as well as ensure access to a unified database that would aid the Commission in its supervisory functions.

4.3 Enhanced Risk Management and Increased Accountability

Having entities of common shareholding perform the roles of custodian and administrator allows for better risk management within the pension fund. It helps them to have a uniform and comprehensive record of the fund's assets, transactions, administration, investment, and compliance requirements. It becomes easier to identify, monitor, and mitigate risks. It allows for increased accountability, apportionment of responsibilities and accountability for lapses. This can enhance transparency and trust among pension fund stakeholders.

4.4 Seamless Reporting and Compliance

Encouraging affiliate entities to perform the roles of custodian and administrator will ensure seamless reporting and compliance with regulatory requirements while eliminating unnecessary bottlenecks interfering with seamless reporting and compliance with regulatory requirements. This will allow the entity to have a holistic understanding of the fund's operations, making it easier to generate accurate reports and comply with relevant regulations.

5. Suggested Regulatory Actions to Derisk Perceived Risks with respect to Co-Mingling of Roles

Understandably, there may be concerns with the suggestion that the Nigerian pension industry ought to adopt a more liberal approach with regard to the control of the key stakeholders responsible for the management of pension assets. Expectedly, several of these concerns stem from the industry's experiences prior to the enactment of the PRA. As we have pointed out earlier, several of those pre-PRA issues emanated majorly from a dearth of legal and regulatory frameworks to prevent abuse. At present, the PRA contains sufficient safeguards to prevent any abuse or misuse of the system even where the Act is amended to accommodate the suggested liberalization. For example, PFAs and PFCs are subjected to stringent scrutiny by the Commission through periodic audits, supervision, regulatory sanctions, and the requirement for regulatory approvals prior to the investment of Pension funds. Notably, in the last ten years, the Commission has eminently discharged its statutory functions with regard to effectively managing the stakeholders in the industry. If necessary, and specifically to deal with any lingering concerns, the Act may also be revised to impose stringent conditions on related entities desirous of operating as PFCs and PFAs, albeit without stifling such entities with anachronistic regulations. In our well-considered view, a fusion of these safeguards would be sufficient to combat any malfeasance that may likely occur with the adoption of a more liberal approach in the control of PFAs and PFCs.

Conclusion

It goes without saying that licensed pension operators can make or mar the industry. They are, in practice, the engine room of pensions. The Commission understood this from the beginning and established platforms for regular conversations with the Pension Fund Operators Association of Nigeria (PenOp).

Be that as it may, the removal of the restraints in Section 77 of the Act will not only consolidate on the successes of the reform but will also build a sustainable pension industry that can effectively deliver on its primary social mandate of prompt payment of retirement benefits.

Please do not treat the foregoing as legal advice as it only represents the public commentary views of the authors. All enquiries on this should please be directed at the key contacts