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OFFSHORE INVESTMENT OF PENSION FUNDS: PROSPECTS AND BENEFITS FOR THE NIGERIAN PENSION INDUSTRY

INTRODUCTION

Nearly two decades after the introduction of the Contributory Pension Scheme (CPS), the Nigerian pension industry has witnessed transformative changes. Despite these advancements, persistent concerns remain regarding the value of savings remitted by employers and employees during the service year compared to the worth of the pensions received upon retirement particularly given the weakness of our local currency in the money market. To preserve and enhance the value of pension assets, Pension Fund Administrators (PFAs) are empowered to explore various investment options within their portfolios, in accordance with investment guidelines and the regulatory framework established by the Nigeria Pension Commission (the **Commission**).¹ These options include investments in government bonds, stocks, debentures, bank deposits and securities, etc.²

However, challenges such as inflation and exchange rate fluctuations, which lead to significant depreciation of the Nigerian currency make it difficult for retirees to maintain an adequate standard of living with the pensions they receive. In light of these challenges, there has been growing advocacy for the need to develop a legislative framework within which PFAs can take advantage of profitable offshore investments in a bid to achieve returns that hedge against inflation.

In this briefing note, we will highlight the prospects and benefits of offshore investments for the Nigerian pension industry.

A. THE CASE FOR OFFSHORE INVESTMENTS

- i. **Enhanced Returns:** By investing in global markets, PFAs have the potential to achieve higher returns compared to the returns from domestic investments alone. This can lead to improved pension outcomes for retirees, offering them better financial security in retirement. Enhanced returns from offshore investments can help bridge the gap between the current value of pension

¹ Section 85 of the Pension Reform Act 2014

² Section 86 of the Pension Reform Act 2014

savings and the required pension benefits, making retirement more comfortable for pensioners. Moreover, by reducing the concentration of investments in the domestic market, PFAs can mitigate the impact of local economic downturns on pension fund performance, contributing to the overall economic stability of the Nigerian pension system. This stability is crucial for maintaining the confidence of contributors and ensuring the long-term sustainability of the pension system.



- ii. **Diverse Investment Opportunities and Risk Management:** Offshore investment provides an opportunity for PFAs to diversify their portfolios beyond the domestic market. By investing in foreign assets, PFAs can spread risk across various economic and geopolitical landscapes, reducing the dependency on the Nigerian economy. This diversification is important in managing risks associated with local market volatility, currency depreciation, and inflation. Diversification through offshore investments allows PFAs to leverage global market trends, which can be less correlated with domestic market movements, further strengthening overall portfolio stability. The global market offers PFAs a broader range of investment opportunities compared to the relatively limited options available domestically. These include investments in developed markets with stable economies, emerging markets with high growth potential, and diversified asset classes such as international equities, bonds, and real estate. By tapping into these opportunities, PFAs can enhance the potential for higher returns on pension funds, thereby improving the financial outcomes for retirees.
- iii. **Inflation Hedging:** One of the critical challenges faced in Nigeria is the persistent depreciation of the Naira and the high inflation rate. Offshore investments in assets denominated in more stable foreign currencies can provide a hedge against inflation. This means that the value of pension assets could be better preserved and potentially grow in real terms, ensuring that retirees receive pensions that can sustain their living standards.

iv. **Innovation and Competitiveness:** Permitting offshore investments could drive innovation within the Nigerian pension industry. PFAs would be encouraged to adopt advanced investment strategies and develop new financial products that align with global best practices. This competitive environment can lead to better services for contributors and retirees, enhancing the overall efficiency and effectiveness of the pension system.

B. REGULATORY AND OPERATIONAL CONSIDERATIONS

To successfully implement offshore investments, it is crucial to enact a robust regulatory framework that addresses key concerns such as compliance, risk management, transparency and provides reliable foreign exchange channels that will eliminate the barrier to offshore investments by local PFAs. Additionally, there is a need to develop detailed guidelines on the types of permissible offshore investments, the proportion of funds that can be allocated offshore, and the selection criteria for foreign investment managers. Such a framework would ensure that offshore investments are conducted prudently to safeguard pension assets against undue risks.

In the same vein, conducting offshore investments requires PFAs to develop the necessary operational capabilities. This includes expertise in international financial markets, currency management, and the ability to navigate complex regulatory environments across different jurisdictions. PFAs may need to collaborate with experienced international fund managers to leverage their knowledge and resources to ensure the effective management of offshore investments.

Offshore investments require stringent compliance and monitoring to ensure adherence to both domestic and international regulations. The Commission must establish comprehensive oversight mechanisms to monitor PFAs' offshore investment activities. Regular audits and reporting requirements can enhance transparency and accountability, reducing the risk of non-compliance and financial misconduct.



C. JURISDICTIONAL EXAMPLES

Some African countries, including South Africa, Botswana, and Kenya, have established legal and operational frameworks that enable pension assets to be invested offshore. For instance, in South Africa, pension funds operate under the Pensions Fund Act (1956) and subsequent amendments, which allow for up to 45% of pension assets to be invested offshore, thereby diversifying investment portfolios and maintaining the overall stability of the pension system. The South African Reserve Bank (SARB) and the Financial Sector Conduct Authority (FSCA) regulate these investments to ensure compliance with prescribed limits. Similarly, Botswana's Pensions and Provident Funds Act (1987), regulated by the Non-Bank Financial Institutions Regulatory Authority (NBFIRA), allows for limited offshore investments. Botswana's pension funds are often invested in neighbouring countries like South Africa and other stable markets, capitalizing on economic opportunities beyond borders. These investments provide a hedge against currency risk, enhance economic stability, and offer better returns compared to domestic investments alone. Kenya's pension regulations also enable offshore investments within specified limits. Kenyan pension funds diversify their investments across various international markets, including Europe, North America, and Asia. These offshore investments have helped preserve Kenya's pension savings by reducing concentration risk and protecting against local inflation.

While the allowances for offshore investments in these jurisdictions are not without challenges, they demonstrate the substantial benefits of offshore investments for pension funds.

CONCLUSION

The offshore investment of pension funds presents significant prospects and benefits for the Nigerian pension industry. By diversifying portfolios, hedging against inflation, and accessing broader investment opportunities, PFAs can enhance the value of pension assets and improve financial outcomes for retirees. However, to realize these benefits, it is necessary to develop a concise regulatory framework and build the necessary operational capabilities to manage offshore investments effectively. As the Nigerian pension industry evolves, embracing offshore investments could be a strategic move to ensure the long-term sustainability and prosperity of the pension system. Also, looking beyond the pension industry, offshore investment will yield returns capable of growing foreign exchange remittances into Nigeria and boosting foreign exchange availability so that the pressure mounted on the Naira as a result of the unavailability of forex will be relieved.

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