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## ***Sovereign Wealth Funds in Nigeria: An overview of the Enabling provisions.***



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## **INTRODUCTION**

At last, Nigeria joins other nations with advanced Sovereign Wealth Funds (SWFs) to take its place in world economy, as studies indicate that SWFs have become major players in international financial and monetary transactions. There are estimations that by 2012, the assets managed by the SWFs around the world would be about USD\$12 trillion.<sup>1</sup>

The International Working Group of Sovereign Wealth Funds (IWG) defined SWFs as special purpose investment funds or arrangements that are owned by general governments.<sup>2</sup> The IWG identified that SWFs are generally established out of balance payment surpluses, official currency operations, the proceeds of privatizations, fiscal surpluses, and/or receipts resulting from commodity exports.<sup>3</sup> Countries with strong SWFs establishments include China with China Investment Corporation, Singapore with the Government of Singapore Investment Corporation, Kuwait with the Kuwait Investment Authority and Norway with the Government Pension Fund. Through their SWFs, these countries invest in a variety of assets ranging from equity and fixed income to alternative assets. Reports indicate that following the

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<sup>1</sup> Sovereign Wealth Funds available at <http://www.sovereignwealthfundsnews.com/glossary.php>

<sup>2</sup> *Sovereign Wealth Funds Generally Accepted Principles and Practices ("Santiago Principles")* October 2008 available at <http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf>; last assessed 28<sup>th</sup> June 2011.

<sup>3</sup> Ibid.



subprime crisis, a lot of international financial and investment institutions resorted to funds from SWFs to shore up their balance sheets.<sup>4</sup> Morgan Stanley received \$5 billion from the Chinese SWF China Investment Corporation, the United Arab Emirates SWF Abu Dhabi Investment Authority purchased a 4.9% equity share in Citibank, and Merrill Lynch received \$5 billion from Singapore's Temasek Holdings.<sup>5</sup> Given their antecedents in stabilization and development of world economies, the importance of SWFs cannot be overemphasized.

Nigeria recently expressed the desire to draw from the experience of some of these countries and established a Nigerian Sovereign Investment Authority (NSIA) to save and build assets for its present and future citizens from income from its oil reserves. Success in this venture could make Nigeria a competitive force in international financial transactions as China and the United Arab Emirates, not forgetting a host of other emerging markets, have been in recent years.

This newsletter examines the development of SWF in Nigeria. It examines the international principles and practices relating to SWFs and draws practical analysis from the Norwegian practice.

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<sup>4</sup> *Raising Capital: The Role of Sovereign Wealth Funds* by Anna L. Paulson, Senior financial Economist, Federal Reserve Bank of Chicago, available at [http://www.chicagofed.org/digital\\_assets/publications/chicago\\_fed\\_letter/2009/cfljanuary2009\\_258.pdf](http://www.chicagofed.org/digital_assets/publications/chicago_fed_letter/2009/cfljanuary2009_258.pdf), last assessed 28<sup>th</sup> June 2011.

<sup>5</sup>Ibid

## **SWF in Nigeria**

In May 2011, the Nigerian government passed into law the Nigeria Sovereign Investment Authority (NSIA) Act 2011 (the "Act") aimed at building a savings base for Nigerian citizens, enhancing the development of Nigerian infrastructure, providing stabilization support in times of economic stress; and carrying out such other matters as may be related to the stated objects. The Act provides for the appointment of a Managing Director of the NSIA whose role is to manage the affairs of the Fund.

## **NSIA's Framework and Objectives**

The Act makes NSIA an independent body capable of holding, acquiring and disposing assets and suing in its corporate name. NSIA will not be subject to the direction and control of any person or authority in Nigeria. The Act specifies that the NSIA will work to provide savings for future generations and also participate in stabilization measures to safeguard the Nigerian economy.

## **Institutional Framework**

The Act provides for the establishment of a Governing Council headed by the President.<sup>6</sup> Other members of the Governing Council include Governors of the 36 states, the Ministers of Finance, Justice and Planning, the Governor of the Central Bank, the Chief Economic Adviser to the President,

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<sup>6</sup> S.7(1) of the Act



Chairman of the revenue, mobilization, allocation and fiscal commission, two representatives of the civil society, four eminent academics, two representatives of the Nigerian youths and two representatives of the private sector. The Council shall in the discharge of its duties observe the independence of the Board and officers of the Authority.<sup>7</sup> The Board of Directors of NSIA to be headed by the Managing Director shall be independent in the exercise of its responsibilities under the Act.

### **Functions of the NSIA**

The NSIA is required to make investments which will provide supplemental stabilization funding based upon specified criteria and at such time as other funds available to the Federation for stabilization need to be supplemented.<sup>8</sup> All funds are to be invested in accordance with the set policies and procedures developed by the Authority. Some of the other functions of the Authority include:<sup>9</sup>

- developing and fostering skills in asset management, investment, operations, risk management and other related areas in addition to developing expertise in infrastructure project management and auditing capabilities in qualified Nigerian personnel in a manner

consistent with the overall financial objectives of the Authority;

- implementing best practices with respect to management, independence and accountability, corporate governance, transparency and reporting on performance as provided in the Act, having due regard as appropriate for the “Santiago Principles”<sup>10</sup> or other similar principles or conventions as may be adopted by the Governing Council;
- attracting co-investment from other investors, including strategic investors, sovereign and internationally recognized investment funds and private companies, to enhance the Authority's capital and maximize risk returns; and
- obtaining the best achievable financial returns on all capital and assets of the Authority having regard to factors including: internationally recognized asset allocation and risk management principles and practices; opportunities in the international equity, debt, private equity, real estate, infrastructure, fixed-income securities and all other asset classes generally utilized by best-in-class investment fund

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<sup>7</sup> S.7(2) of the Act

<sup>8</sup> Ibid

<sup>9</sup> S.4(2) of the Act

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<sup>10</sup> A set of generally accepted principles and practices for SWFs developed by the IWSG and discussed below.



managers; and also having regard to opportunities and challenges of investing in the international investment market.

### **Powers of NSIA**

The Act grants NSIA power to open branches and subsidiaries in Nigeria and other jurisdictions. NSIA and its subsidiaries may issue bonds or other debt instrument, borrow or raise money in any currency and appoint agents and correspondents to assist in the performance of its functions.

### **Source of Funds**

The initial Fund to be managed by the NSIA shall be the equivalent of the sum of USD \$1 billion, contributed by the various levels of government in Nigeria.<sup>11</sup>

In addition, the Act provides that subsequent funding shall be derived from residual funds from the Federation Account provided that the derivation portion of the revenue allocation formula is not included as part of the funding.<sup>12</sup>

### **Investment vehicles**

The Act creates three vehicles for investment namely: Future Generations Fund, Infrastructure Fund and the Stabilization Fund.<sup>13</sup> The NSIA is to develop investment plans pursuant to the most effective policies and guidance targeted at

achieving the aim of such investments.<sup>14</sup> Furthermore the NSIA is empowered to reinvest all realized proceeds and dividends from and interest on portfolio investments of Funds into new or existing assets of the Funds.<sup>15</sup>

**Future Generations Fund (FGF)** –The NSIA is required to develop a rolling five-year investment plan for the FGF annually, targeted at providing future generations with a solid savings base for such time as the oil reserves of Nigeria are exhausted, with due regard to macroeconomic factors.<sup>16</sup>

**Nigeria Infrastructure Fund (NIF)** - The NIF is targeted at making investments specifically related to and with the aim of assisting the development of critical infrastructure such as power generation, distribution and transmission, agriculture, dams, water and sewage treatment and delivery, roads, port, rail, airport facilities and similar assets in order to stimulate the growth and diversification of the Nigerian economy.<sup>17</sup> The NSIA is empowered to make financial investments with funds of the NIF pending investments in infrastructure.

**Stabilization Fund** -The Stabilization Fund is to be established to effectively conduct a sound and responsible fiscal policy, while reducing the effects of the “boom and bust”

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<sup>11</sup> S.29(1) of the Act

<sup>12</sup> S.30(1) of the Act

<sup>13</sup> Part iv, V and VI of the Act

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<sup>14</sup> Part IV, V & VI of the Act

<sup>15</sup> Ibid

<sup>16</sup> S.39(1) of the Act

<sup>17</sup> S.41(1) of the Act



commodity cycle of oil on Nigeria. The Stabilization Fund is to be invested prudently and in a way that supports the objective of the Fund to be made available to stabilize federation revenues.<sup>18</sup> The NSIA may invest in or sell all such assets, and use such derivative instruments for the purposes of hedging or efficient asset management, as may serve such objective.<sup>19</sup>

### **External Asset Managers**

Perhaps, the most important provision of the Act which reveals the Government's commitment to the success of the NSIA is the provision which permits appointment of external asset managers on the basis of comprehensive assessment criteria, policies and procedures as the NSIA may develop from time to time. By virtue of their extensive research capabilities and experience, external asset managers should ensure prudent investment and asset management which will lead to the success of the SWF.

### **International Regulation of SWFs**

As noted above, the Act mandates the NSIA to implement best practices with respect to management independence and accountability, corporate governance, transparency and reporting in regard to the Santiago Principles. Thus, giving an indication that plans may be underway for the Nigerian SWF to join the International Forum of Sovereign Wealth Funds (IFSFW),

established by IWG in 2009. Issues of regulation and transparency of SWFs have always been areas of major concern for SWFs.

The IWG, recognizing that SWF investments are beneficial and critical to international markets, sought to ensure that SWF arrangements are properly set and investments are made on economic and financial basis when it developed the Santiago Principles, a set of Generally Accepted Principles and Practices (GAPP) for SWFs.<sup>20</sup>

**GAPP 1 Principle** proposes that the legal framework for SWF be sound and support its effective operation and the achievement of its stated objective.

**GAAP 2 Principle** requires that the policy purpose of the SWF should be clearly defined and publicly disclosed.

**GAAP 3 Principle** provides that where the SWF's activities have significant direct domestic macroeconomic implications, those activities should be closely coordinated with the domestic fiscal and monetary authorities, so as to ensure consistency with the overall macroeconomic policies.

**GAAP 4 Principle** requires clear and public disclosure of policies, rules, procedures or arrangements in relation to SWF's general approach to funding, withdrawal, and spending operations.

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<sup>18</sup> S.47 of the Act

<sup>19</sup> S.47(1) of the Act

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<sup>20</sup> Santiago Principles October 2008, *ibid.*



**GAAP 5 Principle** requires timely report of relevant statistical data.

**GAAP 6 Principle** proposes clear division of roles and responsibilities under the SWF's governance framework to facilitate accountability and operational independence.

**GAAP 7 Principle** advocates for countries to set the objectives of SWF, appoint members of the governing body and exercise oversight functions.

**GAAP 8 Principle** makes a case for clear mandate and adequate authority and competency of governing bodies.

**GAAP 9 Principle** recommends that the SWF's strategies be implemented in an independent manner.

**GAAP 10 Principle** recommends that the accountability framework for SWF's operations be defined in a legislation, charter or other constitutive document, or management agreement.

**GAAP 11 Principle** recommends timely preparation of annual reports and accompanying financial statements in accordance with international or national accounting standards.

**GAAP 12 Principle** recommends annual audit of SWF's financial statements.

**GAAP 13 Principle** recommends clearly defined professional and ethical standards for members of the SWF's governing body, management and staff.

**GAAP 14 Principle** recommends that the SWF's operational dealings with third parties should be based on economic and financial grounds with defined rules and procedures.

**GAAP 15 Principle** recommends that SWF's activities in host countries should be conducted in compliance with applicable regulatory and disclosure requirements of the host country.

**GAAP 16 Principle** recommends public disclosure of SWF's relevant financial information to demonstrate its economic and financial orientation, so as to contribute to stability in international financial markets and enhance trust in recipient countries.

**GAAP 18 Principle** recommends that the SWF's investment policy should be clear and consistent with its defined objectives, risk tolerance, and investment strategy, and based on sound portfolio management principles.

**GAAP 19 Principle** recommends that the SWF's investment decisions should aim to maximize risk-adjusted financial returns in a manner consistent with its investment policy, and based on economic and financial grounds.

**GAAP 20 Principle** discourages SWFs from taking advantage of privileged information or inappropriate influence by the broader government in competing with private entities.

**GAAP 21 Principle** recommends that SWFs exercise ownership rights in a manner that is consistent with their investment policies and



protects the financial value of their investment.

**GAAP 22 Principle** expects SWFs to have a framework that identifies, assesses, and manages the risks of their operations.

**GAAP 23 Principle** requires SWF's report of its assets and investment performance to its national government.

**GAAP 24 Principle** recommends regular review of level of implementation of GAAP in SWFs.

The OECD also made similar recommendations on transparency and accountability in its 2008 Guidelines for Recipient Country Investment Policies relating to National Security.<sup>21</sup>

### **The Norwegian Practice**

While before now, Nigeria's Excess Crude Account which was established in 2004 had an asset of \$.5Billion, Norway, with a Government Pension Fund currently has the biggest SWF in the World.<sup>22</sup>

The Government Pension Fund-Global (GPF), an offshoot of the former Petroleum Fund, established in 1990 is a pool of the surplus wealth produced by the Norwegian

petroleum income.<sup>23</sup> The GPF has been said to be among the most transparent of the SWFs in its holdings & investments.<sup>24</sup>

The strategy of the GPF is based on the objective of high return subject to moderate risk in order to contribute to safeguarding the basis of future welfare, including national pensions. The fund invests globally in a large number of financial instruments, including fixed income and equities. It also focuses on stocks and bonds, and has achieved broad diversification which has been the reason for its good investment returns with moderate financial risk.<sup>25</sup>

The Norwegian Ministry of Finance has reviewed the GPF in line with the Santiago principles.<sup>26</sup> The GPF utilizes external asset managers, such as Norges Bank Investment Management (NBIM), who are required to comply with ethical guidelines based on sector and company behavior.<sup>27</sup> The companies that the GPF invests in are closely monitored by a Council of Ethics, who may make recommendations for withdrawal of funds where the companies' operations are in conflict with the guidelines. The guidelines also prohibit investment where there is a risk that a company is involved in activities that can

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<sup>21</sup> Available at <http://www.oecd.org/dataoecd/0/23/41456730.pdf>, last assessed 28<sup>th</sup> June 2011.

<sup>22</sup> Norway's sovereign wealth fund biggest in the world – report available at <http://www.interaksson.com/article/5504/norways-sovereign-wealth-fund-biggest-in-the-world---report>, last assessed 28<sup>th</sup> June 2011.

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<sup>23</sup> Sovereign wealth fund Institute - Norway Government Pension Fund Global available at <http://www.swfinstitute.org/swfs/norway-government-pension-fund-global/>, last assessed 28<sup>th</sup> June 2011.

<sup>24</sup> Ibid

<sup>25</sup> Santiago Principles October 2008, *ibid*.

<sup>26</sup> The Norwegian Government Pension Fund Norway's adherence with the Santiago principles: available at [http://www.regjeringen.no/Upload/FIN/brosjyre/2011/GapSurvey\\_Norway](http://www.regjeringen.no/Upload/FIN/brosjyre/2011/GapSurvey_Norway), last assessed 28<sup>th</sup> June 2011.

<sup>27</sup> Ibid



contribute to violation of human rights, corruption, environmental damage or other particularly serious violations of fundamental ethical norms.<sup>28</sup>

## **Conclusion**

While the recent Nigerian legislation contains extensive provisions in line with GAAP above, a lot still remains to be achieved in the area of transparency and accountability as well as proper reporting mechanisms. It is hoped that extensive compliance will be achieved in subsequent Regulations, Guidelines and Procedures to be implemented by the NSIA.

The use of external asset managers in NSIA's investments is strongly encouraged in view of the level of expertise these external managers possess.

The NSIA would do well to adopt best practices from existing SWFs, such as the Norwegian SWF's practice explained above as well as the Chinese SWF practice, to mention a few. This should help domestically in improving the management of Nigeria's public finances and supporting growth, as well as in placing the country in a strong financial position internationally.

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<sup>28</sup> Ibid



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