Annual Supervision Fees and Regulatory Fees for Nigerian Funds

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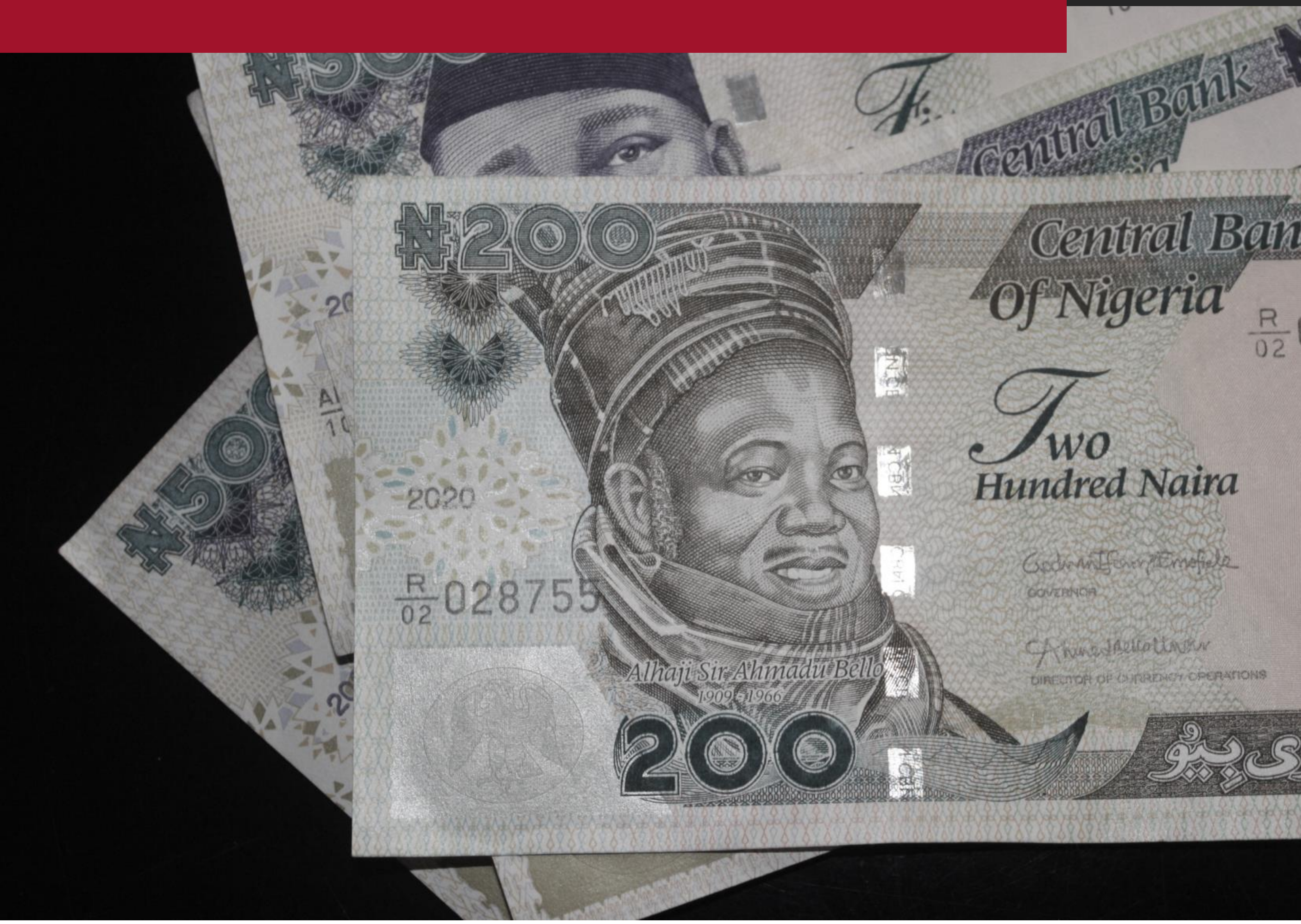

Annual Supervision Fees and Regulatory Fees for Nigerian Funds

Introduction

Nigeria's Securities and Exchange Commission ("**SEC**"), as the primary regulator of collective investment schemes and funds, introduced new fees payable to the SEC by fund/portfolio managers of collective investment schemes ("**CIS**") and funds/portfolios (the "**Supervisory Fees**") by an amendment to the SEC Rules and Regulations 2013 (as amended) (the "**SEC Rules**"). These fees are calculated as a percentage of the net asset value of the CIS or all fund/portfolio under management as applicable. In this article, we examine the components of the Supervisory Fees, who is responsible for paying them and the possible implications of the Supervisory Fees on CISs.

The Supervisory Fees

In January 2021, the SEC introduced the Supervisory Fees. They are:

(a) an annual supervisory fee of 0.005% of the net asset value of the CIS under management (the "**CIS Supervisory Fee**");

(b) an annual regulatory fee of 0.25% of the total asset of all discretionary and non-discretionary funds/portfolios targeted at retail investors under the management of the fund/portfolio manager (the "**Retail Investors Funds Supervisory Fee**"); and

(c) an annual regulatory fee of 0.01% of the total asset of all discretionary and non-discretionary funds/portfolios targeted at qualified investors under the management of the fund/portfolio manager (the "**Qualified Investors Funds Supervisory Fee**").

On December 21, 2021, the SEC further amended the Supervisory Fees as follows:

(a) The CIS Supervisory Fee was increased from 0.005% to 0.2%.

(b) The Retail Investors Fund Supervisory Fee and the Qualified Investors Funds Supervisory Fee would be calculated as a percentage of the total net asset value (and no longer total value).

The Supervisory Fees are due on or before January 31 every year. Failure to pay the Supervisory Fees attracts a penalty of ₦100,000 and a further sum of ₦5,000 for every day of default.

Who Should Pay the Supervisory Fees?

The Supervisory Fees are payable by CIS fund managers (the "**CIS Fund Managers**") and the fund/portfolio managers of all discretionary and non-discretionary funds and portfolios whether targeted at retail investors or qualified investors (the "**Fund Managers**"). Although, not expressly stated, we expect that Supervisory Fees will apply to only Fund Managers and/or funds/portfolios under the regulatory supervision of the SEC.

For the purposes of calculating the Retail Investors Fund Supervisory fee and the Qualified Investors Funds Supervisory Fee, the total net value of assets of CISs would be excluded in determining the total net assets value of all discretionary and non-discretionary funds/portfolios under the management of the relevant fund/portfolio manager. Although not expressly stated in the SEC Rules, we expect that the CIS Supervisory Fee will be calculated and paid per CIS under the management of a CIS Fund Manager rather than calculated collectively for all of the CIS funds being managed by the CIS Fund Manager.

From the language of the SEC Rules, we expect that Fund Managers will pass on the cost of the Supervisory Fees to the investors as a part of the annual expense for managing the assets. This is because the Supervisory Fees are expressed as a percentage of the net asset values of CISs and funds/portfolios being managed by the Fund Managers. If the Supervisory Fees were expressed as a percentage of the management and/or performance fees of the Fund Managers, for example, then it would be absurd for the Fund Managers to pass on these costs to the investors. We understand that for CISs, for instance, Fund Managers consider that the Supervisory Fees must fall within the expense ratio limit of 3.5% of the Asset Under Management ("**AUM**") which accrue on a daily basis prior to the daily valuation of the fund. SEC Rules provide that the total annual expenses of a fund shall not exceed 3.5% of the net asset value of the fund. If the CIS Supervisory Fees will be passed on as an expense, then a CIS Fund Manager must be careful that all expenses in any given year (including the Supervisory Fees) do not exceed the limit imposed by the SEC Rules.

Implications?

First, the introduction of the Supervisory Fees betrays some incoherence in the Nigerian regulation. The amendments to the companies' income tax regime in the Finance Act, 2019 and, more recently, the Finance Act, 2021 exempts the dividends distributed by unit trusts and dividends received by real estate investment schemes on behalf of their shareholders as profits exempted from taxation. The inference here is that there is some design to make CISs more attractive to investors. However, the Supervisory Fees may deaden the brilliance of these tax incentives if the cost of the Supervisory Fees will be ultimately shifted to the investors (as annual expenses). It would appear that what the government did not take in taxes, it has decided to take by way of the Supervisory Fees.

Second, the Supervisory Fees beg the question, what is different about the supervision of the SEC such that it has necessitated the introduction of the Supervisory Fees? Or, is it the case that the number of funds have increased over the years such that the SEC introduced the Supervisory Fees to enable it keep up with its regulatory functions? In any event, should the SEC be paid by investors for playing its supervisory role in the first place, considering that investors will pay income and capital gains taxes (as applicable) on investment returns?

Third, if the successful outing to retail investors with the last MTN shares offering is any indication, retail investors in the Nigerian capital market have a healthy appetite for high returns. There are several money market and fixed income funds which enables retails investors to participate in Nigeria's debt capital markets, including the recently launched fixed income fund by Cordros Asset Management Limited. Because Nigeria's capital markets have not grown to the depths and breadths of participation desired, retail investments are concentrated on CIS-type investment products. Additional costs of investments in the form of SEC's Supervisory Fee presents a risk, however little, of dampening the appetites of retail investors – considering that CISs provides only minimal returns which will be further reduced by additional expense.

The SEC does not distinguish between funds that are doing well and those that are struggling. Should there not be an exemption for Fund Managers managing funds that have experienced losses or were established less than a year before January 31 of any year? The aforementioned categories of funds/CISs should definitely be exempted. The SEC could consider (A) stipulating a minimum amount payable by funds with a net asset value below a particular threshold if its approach is for no Fund Manager to be exempted and (B) introducing variable rates, as opposed to a fixed rate, to be applied depending on the amount of the net asset value (similar to the tax band applicable for the payment of personal income tax). These are options to be considered after the basis for the Supervisory Fee is well articulated.

Conclusion

The Supervisory Fees come across as a revenue generating scheme – which is still rough around the edges. To smoothen out these rough edges, we suggest that:

1. the introduction of the Supervisory Fees be reconsidered, as it detracts from the recent incentives introduced by the Finance Act 2021, which appear to suggest an intention to make CISs more attractive to investors;

2. the SEC should clarify if the Supervisory Fees should be calculated for each CIS under the management of a CIS Fund Manager or calculated collectively for all of the CIS funds being managed by the CIS Fund Manager;

3. there is a risk, however little, that the Supervisory Fees could increase the cost of running the funds (especially funds targeted at retail investors), and consequently make them less attractive to retail investors; and

4. the SEC should distinguish among profitable funds, struggling funds and loss-making funds for the purposes of imposing the Supervisory Fees.

Authors

Ayodele Ashiata Kadiri
SENIOR ASSOCIATE
ayodele.kadiri@gelias.com

Samuel Dunmade
ASSOCIATE
samuel.dunmade@gelias.com

LOCATIONS

LAGOS OFFICE
6 Broad Street
Lagos, Nigeria

T: +234 (1) 460 7890
E: gelias@gelias.com

ABUJA OFFICE
2nd Floor, Abia House,
Plot 979, First Avenue,
Central Business District
F.C.T, Abuja.
T: +234 (1) 888 8881

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