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**SEC NEW RULES ON COLLECTIVE INVESTMENT
SCHEMES – FORGING AHEAD**

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The Securities and Exchange Commission (“SEC”) has recently been on a drive to encourage the creation of collective investment schemes in Nigeria and investments by the public in collective investment schemes. This drive, it seems, is not misplaced. The diversified nature of collective investment schemes has ensured that the many funds set up in Nigeria as collective investment schemes have significantly withstood the effect of the COVID-19 pandemic on the Nigerian economy. Other than equity-based funds which have recorded a decline, the net asset value of most funds has increased over the past three months. According to the data collated by the SEC, as at June 11, 2020, the total net asset value of collective investment schemes in Nigeria was ₦1.258 trillion compared to ₦747.95 billion as at June 14, 2019.

As part of the SEC’s continued interest in the development of collective investment schemes, the SEC released the following clarifications on June 22, 2020 with respect to the Rules Relating to Collective Schemes published by the SEC on December 23, 2019:

- (a) all fund managers of collective investment schemes are required to comply with the provisions of the new rules and file evidence of compliance on or before September 30, 2020;
- (b) the application of the new total expense ratio and incentive fee computation takes effect from the beginning of the third quarter of 2020 i.e. July 2020;
- (c) incentive fees should not be factored into total expense ratio computation and shall be assessable and payable on an annual basis; and
- (d) the Fund Managers Association of Nigeria (FMAN) shall submit acceptable benchmarks for Money Market Funds, Balanced Funds and Ethical Funds at the beginning of each year commencing from the third quarter of 2020.

The above clarifications were published to facilitate effective compliance with the December 23, 2019 Rules on Collective Schemes. To improve the attractiveness of collective investment schemes, the SEC on December 23, 2019 reviewed the offer costs of open-ended funds from 3% to 1% and for close-ended funds from 3% to 1.65%. The operational costs for both open-ended and close-ended funds were also reviewed from 5% to 3.5%.

The clear intention of the SEC in amending the rules applicable to collective schemes is to make these schemes more attractive to the investing public. The new rules are intended to lower the costs for investors and thereby increase the return on investment. Regardless of the haircut the new rules pose for fund managers, there are long-term benefits to fund managers. The rules are designed to increase investor participation in collective investment schemes and the size of the portfolios managed by fund managers.

The most notable changes in the new rules are (i) the clear-cut differences between open-ended and close-ended schemes, (ii) the reduction of the offer costs and ongoing maintenance costs of schemes, (iii) the benchmarking of funds to a clear index, and (iv) the introduction of conflict of interest management procedures for related party transactions that involve fund managers.

We envisage that the new rules will ensure that fund managers are more accountable and thereby improve the performance of collective investment schemes going forward.

We have juxtaposed the rules previously applicable to collective investment schemes with the December 23, 2019 rules below.

| S/N | PREVIOUS RULE | PREVIOUS PROVISION | NEW RULE | NEW PROVISION |
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| 1. | 465(z) and 532(y) | The Fund Manager was restricted from investing the assets of the fund in its own securities or that of the trustees, custodian or other associates of the fund. | 465(2) | This is now permitted if the conditions stipulated in the rules under this subsection are complied with by the Fund Manager- the securities issued by that related party affiliate should not be below investment grade rating A and should yield better returns than prevailing market rates. The consent of the Trustees must also be sought. The rules also state permissible thresholds for such investments. |
| 2. | 450 | Outlined general rules for collective investment schemes | 450 | Now contains more elaborate provisions on collective investment schemes under the following headings: <ul style="list-style-type: none"> - definition of terms; - conflict of interest management and disclosures of conflict of interest transactions to the SEC and the trustee within 24 hours of its occurrence; - content of a trust deed; - requirement of the trustee's consent for certain transactions; - obligations of the board of directors of the fund manager; - filing of quarterly and annual related party transactions reports; and - penalties for contravening the provisions of rule 450. |
| 3. | Not applicable | Not applicable | New rule 450(B) | Rules guiding the offer process for close-ended collective investment schemes vis: <ul style="list-style-type: none"> - filing of the registration statement, executed SEC form 6A, draft prospectus, draft trust deed, draft custody agreement, draft vending agreement, |

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| | | | | <p>sworn undertaking to file periodic reports and returns with the SEC, board resolution of the fund manager, rating report (where applicable), evidence of appointment of a sharia adviser (for sharia compliant funds), evidence of payment of the SEC fees and any other relevant document;</p> <ul style="list-style-type: none"> - filing of the executed offer documents; - restriction on affiliates or companies related to the fund manager from acting as lead issuing houses; - 28 working days offer period for close ended schemes subject to an extension by the SEC; - rules on the administration of the proceeds of the issue; - submission of the allotment period within two weeks after the close of the offer period and rules on the content of the allotment proposal; - the summary report on the completion of the offer; - the discretion of the fund manager to offer the close-ended fund by way of a shelf registration; - abortion of a close-ended fund offer; - publication of the allotment; - cost of the offer (1.65% of the offer size with professional parties' fees not exceeding 1.30% together and the issuing house individually not exceeding 0.50%); - underwriting of the offer; - the content of the vending agreement; - quality and completeness of the offer documents; and - disclosure of procedures for conflict of interest resolution in the offer documents. |
| 4. | Not applicable | Not applicable | New rule 450(C) | <p>Rules guiding the offer process for open-ended collective investment schemes vis:</p> <ul style="list-style-type: none"> - filing of the registration statement along with the executed SEC Form 6A, the draft prospectus, draft trust deed, draft custody agreement, sworn undertaking to file periodic returns and reports with |

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| | | | | <p>the SEC, evidence of payment of SEC fees, rating report (where applicable), board resolution of the fund manager, evidence of appointment of a sharia adviser (for sharia compliant funds) and any other relevant document;</p> <ul style="list-style-type: none"> - filing of executed scheme documents after the approval of the offer; - the scheme launch; - scheme post registration report 90 days post-registration; - abortion of the scheme launch; - cost of the offer (1% of the initial registration size or amount raised with professional parties' fees not exceeding 0.80%); - quality and completeness of the offer documents; and - disclosure of conflict of interest management procedure in the offer documents. |
| 5. | 451(i) | States the allowable fees and expenses of a collective investment scheme | 451(l) | Marketing/distribution fees are now allowable expenses. |
| 6. | 452 | Guidelines for the advertisement of a scheme | 452 | The provisions regarding advertisement of a scheme are more. Also, the rule now prohibits misleading advertisements and defines the 'misleading'. |
| 7. | 463(e), (p) and (z)(ii) | Contents of a prospectus | 463(e) and (z) | The rule now requires close-ended funds to state the opening and closing dates of the offer and open-ended schemes to state the commencement date. Sub-rule (p) on the 3-year forecast of the income of the fund has been deleted. |
| 8. | 465(k) | Limited the incentive fee not more than 30% of total returns in excess of 10% of the scheme's net asset value per annum. | 465(k) | The new provision simply states that the trust deed should contain a statement as to the incentive fee to be charged. |

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| 9. | Not applicable | Not applicable | New rule 465(ff) | <p>This provision requires schemes to be benchmarked to an appropriate index.</p> <p>It also requires the fund manager’s incentive fee to be chargeable only where the fund has outperformed its benchmarked index. When the fund has outperformed the index, the incentive fee may only be chargeable on the annualized returns above the benchmark and up to 20% of the excess returns.</p> <p>The provision also requires the following:</p> <ul style="list-style-type: none"> - the benchmark shall be reflective of the nature of the fund and its underlying instruments; - only actively funds may charge an incentive fee; - where a fund underperforms its benchmark, the management fee shall decrease by the same percentage by which the fund underperformed; and - the fund’s performance must have reached a high-water mark. <p>The rule is also applicable to open-ended investment companies, real estate schemes and other relevant schemes.</p> |
| 10. | 465(l) | Restriction of the fund manager’s management fee to 5% of the net asset value of the fund. | 465(l) | <p>The new rule states that the total annual expenses of a fund shall not exceed 3.5% of the net asset value of the fund. The management fee but not the incentive fee is also categorized as one of the expenses of the fund.</p> <p>This rule is applicable to both open-ended and close-ended schemes.</p> |
| 11. | Not applicable | Not applicable | New rule | <p>This rule requires the names assigned to schemes to be reflective of the asset allocation and/or investment objective of that fund.</p> <p>In furtherance of this requirement, it goes further to define the criteria for naming funds. They are:</p> <ul style="list-style-type: none"> - equity fund: a fund with a minimum allocation of assets into equities listed on an exchange; - money market fund: fund with the primary objective of capital preservation |

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| | | | | <p>and steady streams of income from federal government of Nigeria money market instruments and highly rated instruments from financial and non-financial institutions;</p> <ul style="list-style-type: none"> - ethical fund: a fund with ethical investment objectives or other moral/ethical-based investment strategies; - faith-based fund: a fund with investment objectives and/or strategies based on religious principles; - fixed income fund or bond fund: a fund with 70% minimum allocation to bonds or other debt instruments with a term to maturity of not less than 365 days; and - balanced fund: a fund with an asset allocation of a minimum of 40% and maximum of 60% to equities, a minimum of 40% and a maximum of 60% to fixed income and money market instruments, and a minimum of 20% to fixed income securities at all times. |
| 12. | Not applicable | Not existing in the former rules | | <p>The new rules state restrictions that would now apply to investments made by schemes.</p> <ul style="list-style-type: none"> - Equity securities issued by a single company shall not exceed 5% or in the case of a company with a market capitalization of N50 billion or more, 10% of a fund's net asset value. An equity fund is however excepted from the restriction. - Other than treasury bills, money market instruments issued by any single issuer shall not constitute more than 20% of a fund's net asset value. - Other than federal government bonds, bonds issued by any single issuer or a group shall not constitute more than 30% of a fund's net asset value. - Fixed deposits with a single institution shall not constitute more than 20% of a fund's net asset value. - Other than feeder funds and fund of funds, units of any collective investment |

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| | | | | <p>scheme shall not constitute more than 20% of a fund’s net asset value.</p> <ul style="list-style-type: none"> - Equity investments by a fund shall not exceed 10% of the securities of a single issuer. <p>These restrictions do not affect the applicability of the investment restrictions in unlisted securities.</p> |
| 13. | 494(3) | The rules on investing in unlisted companies have been deleted. | 494(3) | The new rules states that a fund manager shall only invest in the unlisted securities of a public company that is traded on a registered over-the counter market. |
| 14. | 501 | Definition of ‘Umbrella Funds’ and “Sub-Fund of Funds” | 501 | “Umbrella fund” alternatively referred to as “fund of funds” is now defined as a mutual fund that invests primarily in other funds. “Sub-fund of funds” is now replaced with “sub-fund” and defined as a fund or group of funds under an umbrella fund. |
| 15. | Not applicable | Not applicable | New rule (B) | The new rule provides the registration requirements for umbrella funds. |
| 16. | 502(4) and 503(2) | The previous rule provided that the management fee charged to a fund of funds, master and feeder fund levels shall be commensurate to the degree of investment strategies employed by the Fund Manager to achieve the stated objective and shall not be more than 3% of the net asset value of that fund of funds per annum. | 502(4) and 503(2) | The new rule provides that the management fee charged to a fund of funds, master fund and feeder fund levels shall be commensurate to the degree of investment strategies employed by the fund manager to achieve the stated objective and shall not be more than 1.5% of the net asset value of that fund of funds per annum. |
| 17. | 504 (2) | A feeder fund manager was required to appoint a custodian/trustee for the fund. | Not applicable | The requirement has been deleted. |

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| 18. | Not applicable | Not applicable | New rule | The total expense ratio of a real estate investment company shall not exceed 3.5% of its net asset value. |
| 19. | 532 (j) | All fund expenses, including the annual management fee shall not exceed 5% of net asset value of the fund | 532 (j) | All REIT expenses, including the annual management fee, shall not exceed 3.5% of net asset value of the REIT |

In addition to the foregoing specific changes, the fees payable for the registration of schemes and the applicable registration forms have also been revised by the SEC.

This publication does not constitute legal advice and does not create a client-attorney relationship. For assistance with any legal issues that may arise on collective investment schemes and the Nigerian capital markets in general please contact capitalmarkets@gelias.com; yemisi.falade@gelias.com or amarachi.oji@gelias.com.

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