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AN OVERVIEW OF THE NIGERIAN SOVEREIGN INVESTMENT AUTHORITY

By

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Nigeria officially joined the global sovereign wealth fund (SWF) fraternity on May 26, 2011 when Nigeria's President Goodluck Jonathan signed into law the Nigeria Sovereign Investment Authority Act of 2011 ('the Act') as passed earlier that month by the two houses of Nigeria's federal legislative body, the National Assembly. By commencing the initiative, Nigeria finally embraced an initiative that had become widely associated with nations whose economies are mostly, if not solely, dependent on the natural resource extraction sector. Indeed, hitherto Nigeria was one of only three members of the Organization for the Petroleum Exporting Countries (OPEC) that did not have a SWF.[2]

The Act establishes the Nigeria Sovereign Investment Authority ('the Authority') as a vehicle for the actualization of Nigeria's SWF aspirations. Those aspirations may be deciphered from the stated objectives of the Act and also from the functions and powers assigned to the Authority by the Act. The rationale for establishing the Authority may be found in the Commencement section of the Act where it is stated that the mandate of the Authority is necessary "*to prepare for the eventual depletion of Nigeria's bi-carbon resources*".

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[2] See "Nigerian Governors Appeal to Block Sovereign Fund" available at http://www.reuters.com/article/2011/10/24/nigeria-wealthfund-idUSL5E7LO3G820111024

The Act provides that the objects of the Authority are to: build a savings base for the Nigerian people, enhance the development of Nigerian infrastructure, provide stabilization support in times of economic stress, and carry out such other matters as may be related to the above objects.[3]

In order to actualize this triple mandate, the Authority is to establish three separate "ring-fenced' Funds (hereinafter referred to collectively as "the Funds"). These are: "the **Future Generations Fund**" (FGF), a diversified investment portfolio for the benefit of future generations of Nigerian citizens; "the **Nigeria Infrastructure Fund**" (NIF), dedicated to servicing an investment portfolio whose purpose is to assist "*the development of critical infrastructure in Nigeria that will attract and support foreign investment, economic diversification and growth*"; and "**the Stabilization Fund**", a portfolio of investments geared at providing supplemental stabilization funding for the [government of the] Federation of Nigeria in times of need, essentially when other funds set aside for fiscal stabilization purposes are insufficient for that purpose.[4]

Apart from setting up the Funds, the Authority is further entrusted with the operational responsibility of receiving, managing and investing funds on behalf of the Funds[5] and also of reinvesting portions of the profits and proceeds yielded by the primary investments, "*to generate further risk-adjusted returns*".[6]

The Ring-Fenced Funds

The Act specifically describes the Funds as 'ring-fenced'. The Interpretation section of the Act[7] defines "ring-fenced" to mean, "in *the context of each of the Funds, the use of a structure that maintains a separation of the assets and liabilities of one Fund from the assets and liabilities or the other Funds*". This is a rather narrow application of the concept of 'ring-fencing'. A broader application would suggest a categorical declaration that the assets of each of the Funds are insulated not only against encroachment by the other Funds but also against encroachment by the government for use for purposes or in any manner other than in accordance with the provisions of the Act. This broader application of the 'ring-fence' concept, though not captured in the interpretation given to the phrase in the Act is essentially reflected in the strict prescriptions made by the Act on the management of the resources of the Funds including profits from the investments of the Funds.[8]

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3 See Nigeria Sovereign Investment Authority Act of 2011 ('the Act'), s. 3

4 *Id.*, s. 4

5 *Id*., s. 4 (2) (a)

6 *Id*., s. 4 (2) (b)

7 *Id.*, s. 58

8 See *http://www.phrases.org.uk/meanings/302450.html* where it is explained that while literally, 'ring-fences' are used to confine livestock on farms, to prevent them from escaping and to shield them from attacks from threats outside the fence, figuratively, especially in financial engineering, the phrase has been used since the 1980s to denote funds that are set aside for a project and cannot be spent on anything else.

Ownership of the Funds

The Act provides that ownership of the Funds shall be held exclusively by the Nigerian people represented by the governments of Nigeria's federating units.[9] It took further steps to ensure that ownership of the Funds is not diluted by prohibiting the shareholders of the Funds from borrowing against their interests in the Funds, and thus against the assets of the Funds. In this regard, the Act provides that "*the Federal, State, Federal Capital Territory and Local governments of the Federation shall not transfer, redeem, assign, dispose of, sell, mortgage, pledge, or otherwise encumber any interest of any kind in the Authority.*"[10] The prohibition against alienation of interest in the Funds is aimed at upholding the provision on exclusive equity ownership in the Funds by the Nigerian people.

This provision is more important than it may appear at first glance. Nigeria's State governments (and the Federal Government of Nigeria (FGN), to a lesser degree) have a tendency to embark on foreign debt acquisition sprees. If left unchecked, there is no guarantee that they would not seek to leverage their interest in the Funds as premium collateral for such rampant borrowings.

Governance and Management

The Governing Council: The Act establishes a Governing Council for the Authority (the Council) the summary of whose functions is to give advice and counsel to the Executive Management Board.[11] The Council comprises the President of Nigeria (who may e represented by the Vice-President), Governors of Nigeria's 36 States, and eighteen other appointees, including the Attorney-General of the Federation, the Minister of Finance, the Minister in charge of the National Planning Commission, the Governor of the Central Bank of Nigeria, the Chief Economic Adviser to the President, the Chairman of the Revenue Mobilization, Allocation and Fiscal Commission, and representatives of the organized private sector, civil society, professional bodies, Nigerian youths, and the academia, making a total of 55 members.[12] Decisions of the Council are to be made by a simple majority.

The Board of Directors: The Act also establishes a Board of Directors for the Authority (the Board) who shall have primary responsibility for the attainment of the objects of the Authority, the making of the policy and general supervision of the management and affairs of the Authority.[13]

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9 See The Act, *supra*, s. 32 (1)
10 *Id.*, s. 32 (3)
11 *Id*, s. 7
12 *Id*, s. 8
13 *Id*, s. 15

The Board shall consist of nine members including a non-executive Chairman, the Managing Director of the Authority, two Executive Directors and five non-Executive Directors.[14]

Funding Provisions

The Act provides for the sum of USD1billion as take-off capital for the Funds. This initial funding will come from contributions by the four government units on whom the Act confers ownership interest in the Authority, that is, the Federal Government, the State Governments, the Federal Capital Territory, and the Local Government and Area Councils. Each of the units is expected to contribute a percentage of the initial capital that is equal to its percentage share of revenue allocation from the Federation Account.[15]

The use of the word 'contribution' here is rather deceptive. It gives the impression that these government units as shareholders in the Funds have control over the process by which they make their contribution. They do not. Contributions to the fund shall come by way of direct deductions made (by FGN) out the respective allocations due to go the four government units from the Federation Account. We discuss the constitutional implications of this arrangement below.

With a start-up capital of only $1Billion, the Nigerian Funds would at best be minor-league players in the global SWF market. However, the Act provides for further funding that should, if all goes well, ensure the exponential growth of the capital base of the Funds within a very short time frame.

The Authority is to receive further funding in the form of monthly transfers from "**Residual funds**" from the Federation Account above the "**Budgetary Smoothing Amount**".[16] The Act in its interpretation section defines 'Residual Funds' to mean "*revenue received into the Federation Account other than the Projected Federation Hydrocarbon Revenue for the relevant period*", while "Budgetary Smoothing Amount" is defined as "*an amount equal to ten percent of monthly Residual funding up to a cumulative maximum amount at any one time of 2.5 percent of the Projected Federation Hydrocarbon Revenue for the year of such funding*".[17] The simple explanation for this convoluted and unnecessarily technical prescription is that all revenue that accrues to the Federation above the revenue projected to be earned from sale of crude oil at the

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14 *Id*, s. 16(1)

15 The Federation Account is the special account created under Section 162 (1) of the Constitution of the Federal Republic of Nigeria, 1999 into which is paid all revenues collected by the Government, with a few exceptions, and out of which revenue is allocated to the various government units in accordance with a revenue allocation formula determined by the National Assembly.

16 See The Act, *supra*, s. 30.

17 *Id*, s. 58

benchmark price upon which that year's budget is based, less the "Budgetary Smoothing Amount" shall be transferred to the Authority.

This means that all revenues from other revenue streams besides crude oil export-based revenue will also be applied towards the further funding of the Funds. The implication of this provision is that only revenue earned from crude oil sales at the price at which the Federal budget for the particular year is benchmarked is distributable out of the Federation Account to the federating units of the Nigerian Federation. All other revenues, less specified deductions, shall be transferred to the Authority for investment in the Funds.

Nigeria's 2012 budget adopts an oil price benchmark of $70. According to the Appropriations Bill 2102, excess revenue accruing to the Consolidated Revenue Fund refers to "*Revenues accruing from sales of government crude oil in excess of $70 per barrel, the Petroleum Profit Tax and Royalty on Oil and Gas*."[18]

With Nigeria's premium Bonny light crude oil recently selling for as high as $128 per barrel[19], and with Nigeria's crude oil production having hit a peak of about 2.68 million barrel per day (bpd) as at end of February 2012[20], if crude oil prices maintain their trajectory and Nigeria's crude oil production remains stable, a sizeable amount of revenue would be going into the Federation Account as Residual Funds, and thus accruing to the benefit of the Funds.

The funding provisions for the Funds effectively place them in the class of Natural Resource or Extractive Industry-based SWFs. These are funds "*created with excess budget revenues from exports of oil, gas, copper, diamonds, phosphates, and so on*."[21] This breed of SWFs constitutes the overwhelming majority of SWFs presently in operation.

In the case of Nigeria, the fact that revenues accruing to the Federation Account from other revenue streams are included in the further funding provisions does not alter the identity of the Funds as 'oil funds'. This is because crude oil sales revenue accounts for an overwhelmingly high percentage of Nigeria's earned revenues. The sustained campaign both within and outside Nigeria that eventually led to the establishment of the Funds was inspired by agitation at the perennially imprudent management of crude oil

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18 See Federal Government of Nigeria Appropriations Bill 2012, S.4(2), available at *http://budgetoffice.gov.ng/2012_budget_proposal.html*

19 *See 'Bloomberg African Bonny Light Crude Oil Spot Price' available at http://www.bloomberg.com/quote/AFCRBONL:IND*, accessed on March 13, 2012

20 See 'Nigeria's Crude Production Peaks at about 2.68m bpd', *Vanguard Newspaper*, February 27, 2012 available at *http://www.vanguardngr.com/2012/02/nigerias-crude-production-peaks-at-about-2-68m-bpd/*

21 See Andrew Rozanov, "*Who Holds the Wealth of Nations?*" 15 Cent. Banking J. 52 (2005)

sales revenue by successive Nigerian governments. According to the 2012 budget, the FGN projects a revenue intake of slightly under NGN10 Trillion, out of which about NGN6.5 Trillion (65%) is projected to come from oil and gas, while slightly under NGN3 trillion (or 30%) is expected from such other revenue streams as custom duties, company taxes, personal income taxes, and value-added tax (VAT). This is actually a rather generous nod to the non-oil revenue class. Usually the ratio is closer to 80%-20% in favour of crude oil sales revenue.

What is most striking in the above list of non-oil export-related revenue streams is that there is no mention of non-oil related export. In Nigeria, non-oil export now falls into the category of minor revenue streams known as 'miscellaneous'. This is very sad for a country that was once, before the discovery of oil, globally acknowledged as a prime net exporter of agricultural produce.

The allocation of excess hydro-carbon revenue also suggests the end of the road for Nigeria's famed Excess Crude Account (ECA) which was set up in 2004 by the President Obasanjo administration to ensure prudence in the management of the surplus crude oil revenue that accrued from the upsurge in international oil prices following the US invasion of Iraq. There was general expectation that the Authority would inherit whatever savings that are still left in the ECA. If that had been the case, the Authority would be starting out with an initial capital base far in excess of $1Billion. But the Act neither provides for the transfer of funds from the ECA to the Authority nor even makes any reference to the ECA. This may be because the ECA was not created by legislation but by executive presidential fiat. It would thus have been awkward for the Act to repeal a law that was never enacted. However, the provisions for further funding of the Funds using excess crude revenue beyond the benchmark oil price effectively diverts to the Funds the class of revenues that used to fund the ECA. Being thus starved of funding, the ECA, not having any official status in law is likely to quietly fade away.

The final source of capital for the Funds is the profits and proceeds from the investments made by the Authority. As we have seen, one of the functions of the Authority is to reinvest the profits and proceeds of its investments to generate further risk-adjusted returns.[22] The profits when so re-invested will beef up the capital base of the Funds. All profits and proceeds from the investments of the Funds for the first five years are required to be so re-invested. It is only after five years that the Board may by a unanimous vote agree to declare a distribution of the profits from the investments, provided, inter alia, that: each of the Funds has made a net profit for each of the five years preceding the year of the proposed distribution of profits, including the particular year in question;[23] the profits to be so distributed shall not be more than 60% of the

[22] See The Act, *supra*, s. 4(2)(b)
[23] *Id.*, s. 34

profits of the Authority at the time of the distribution; and the Council approves the payment of distributions declared by the Board.[24]

It is quite obvious from the foregoing provisions that the purpose of the Act is to discourage distribution of profits and encourage their re-investment until the Funds are on a very sound footing.

Allocation of Funds to the Funds

The Act empowers the Board to determine the formula for allocation of funds to the Funds, provided that each of the three Funds shall be allocated a minimum of 20% of the capital of the Funds derived from both the initial start-up capital and from subsequent funding provisions.[25] The Act does not say what is to be done with the unallocated balance of the Funds. It is assumed that the balance is to be used to meet what the Act refers to elsewhere as "*the Authority's anticipated operational needs as set out in its business and investment plans*".[26]

Regulatory Prescriptions

There is considerable uncertainty on the issue of regulatory oversight of the Authority. The general understanding is that the Board is answerable to the Council. But the Council does not shape policy for the Authority. The Act confers on the Board the power to both design and implement the policy and set the investment agenda for the Authority. The Council is merely entrusted with the responsibility to provide advice and counsel to the Board. In performing its functions, such as there are, the Council is explicitly enjoined to observe and respect the independence of the Board. But it is not clear what actions of the Council would amount to interference with the independence of the Board. The Board is required to submit a report annually to the Council but it is not at all clear what the Council will do with the report or what actions it will take if it is dissatisfied with the report submitted by the Board.

To further underscore the independence of the Board the Act provides that "*the Council may not by resolution or otherwise require the directors to take or to refrain from taking any specified action*".[27]

The Act gives a commendable nod to the Santiago Principles by specifically enjoining the Authority to "*implement best practices with respect to management independence and accountability, corporate governance, transparency and reporting on performance*".[28]

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[24] *Id*., s. 35(1)
[25] *Id.*, s. 31
[26] *Id.*, s. 34(b)
[27] *Id*.,, s. 25
[28] *Id.*, s. 4(2)(d)

However, because of the political dynamics surrounding the Funds, despite this high-minded declaration, there is reason to doubt the Authority's ability to attain the ideal of management independence.

One of the more interesting aspects of the reporting and regulation provisions in the Act is the role of the National Economic Council (NEC). Without categorically conferring regulatory powers on the NEC, the Act insinuates the body into certain crucial positions that more or less equip it with effective regulatory powers over the Authority. For instance, the Act suggests that the initial capital for the Funds to be contributed by the shareholders was determined by the NEC[29]; mandates the Authority to submit its annual report to the NEC, amongst other recipients[30]; stipulates that the Minister of Finance while advising the President in the appointment of the non-elected appointees in the Council[31] and the members of the Board of Directors[32], shall consult with the NEC; requires that the Minister of Finance, while advising the Board in appointing custodians to manage the assets of the Authority, shall consult with the NEC;[33] and confers on the NEC the power to make the final decision whether the Authority may invest funds of the NIF in 'Development Projects'.[34]

The NEC is a Federal Executive body established by the Constitution with the duty "*to advise the President concerning the economic affairs of the Federation, and in particular on measures necessary for the economic planning efforts or economic programmes of the various governments of the Federation*".[35] The membership of the NEC comprises the Vice-President of the Federation, all the State Governors and the Governor of the Central Bank of Nigeria.[36]

What makes the NEC's role in the activities of the Authority rather interesting is the fact that all the members of the NEC are members of the Council (excepting only the Vice-President who is not a member of the Council, but may under the Act sit in place of the President as Chairman of the Council). Thus, while the Council has a fairly insignificant regulatory role to play, the real powers in the Council, the President (through the Vice President, the State Governors and the CBN Governor have a more impactful role to play in their separate capacity as members of the NEC.

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29 *Id*., s. 29
30 *Id.*, s. 37(1)
31 *Id*., s. 8(3)
32 *Id*., s. 16(2)
33 *Id.*, s. 6(4)
34 *Id.*, s. 41(5) & (7)
35 See The Constitution of the Federal Republic of Nigeria, 1999, Third Schedule, Part I, s. 19
36 *Id*, s. 18

Investment Philosophy

It is also not yet known what shape the Authority's investment philosophy will take, or in what sectors of the economy and which regions of the world it will choose to invest. The Act requires the Authority to develop every year a 'rolling five-year investment plan' for each of the NIF and the FGF.[37] One wonders the rationale for developing a new five-year plan every year!

There is no requirement for a rolling five-year plan in respect of the Stabilization Fund. However, one provision of the Act in respect of the Stabilization Fund provides a basis for prediction as to the direction the investments of the funds assigned to that particular Fund may take.

In a provision captioned "Stabilization Availability Trigger' the Act provides that

> **"***The Minister [of Finance] may, at the end of any financial quarter, request, and the Authority shall upon such request pay from the Stabilization Fund, an amount equal to the difference, if negative, between the actual quarterly Federation Account revenues generated through the sale of Benchmark Hydrocarbons and the Projected Federation 'Hydrocarbon Revenues for such quarter, provided that such amount will only be drawn after the depletion of the Budgetary Smoothing Amount*."[38]

Thus, the Minister of Finance may at the end of any financial quarter and without any prior notice request the Authority to release funds from the Stabilization Fund for the purpose of budgetary stabilization. It necessarily follows that for the Authority to be able to answer the Minister's desperate call whenever it comes, it must operate an investment philosophy that tilts heavily in favor of liquid public instruments and de-emphasizes investments in assets that cannot be liquidated at a moment's notice. This would rule out investments in infrastructure, real estate and private equities, amongst others. Thus, while the Authority may deploy the funds of the NIF "*to acquire strategic stakes in international companies active in the [infrastructural] sector*",[39] the funds of the Stabilization Fund would not be ideal for such investments.

The Constitutionality Question

The big elephant in the room as far as the future of the Funds is concerned is the continuing doubt as to the constitutionality of the initiative as presently designed. It is doubtful that the action of the FGN in unilaterally mandating the diversion of part of the revenue accruing to the other federating units to fund the Funds will pass the constitutionality test.

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[37] See The Act, *supra*, s. 39 & s. 41 respectively
[38] *Id.*, s. 48
[39] *Id*, s. 41 (3)

The State Governors initially sought to block the inauguration of the Funds on the ground that the Act infringed on constitutionally guaranteed State rights, and threatened to mount a legal challenge against the operationalization of the Act. The FGN countered with the claim that it had consulted with the Governors prior to the enactment of the Act and that the Governors had consented to the substance of the bill that it subsequently submitted to the National Assembly. The Governors retorted that what they had approved was not what was eventually enacted.

However public opinion was decidedly against the governors and in favor of an initiative that was seen as an attempt to sanitize the usually messy management of Nigeria's crude oil revenue. The general opinion was that the Governors had consented to the initiative so as not to alienate the public at a time they were preparing for general elections, but once the elections were over and they had secured their re-election they suddenly realized that the Act infringed on the constitutional right of States. The combined weight of public opinion and reassurances from the FGN persuaded the State Governors to withdraw their opposition and allow the inauguration of the Authority to proceed.

However, despite the capitulation of the State Governors, the initiative remains constitutionally suspect. The Act does indeed contain provisions that reinforce the narrative that Nigeria practices neither true federalism nor true democracy. With or without the acquiescence of the State Governors, it was presumptuous of the FGN to enact legislation that disposes of revenue due to the other federating units. This is a violation of the Constitutional provision that all revenues lodged in the Federation Account (which is the special account created by the Constitution for the lodgment of all revenues accruing to the Federation[40]) must be shared between the Federal Government, the States and the Local governments in accordance with a revenue allocation formula to be determined by the National Assembly[41]; and that all revenue going to the States collectively as a result of the revenue allocation process must subsequently be distributed amongst the States in accordance with a formula to be determined by the National Assembly.[42]

Some analysts have contended that the power given by the Constitution to the National Assembly to determine the formulae by which revenues standing to the credit of the Federation shall be distributed between the Federal Government and the other federating units, and revenues standing to the credit of the States shall be distributed amongst the States somehow justifies the National Assembly enacting legislation that withholds portions of the revenues due to the States and the local governments and transferring same to the Authority. I am not persuaded by this argument.

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40 See The Constitution, *supra,* s. 162(1)
41 *Id*., s. 162 (3)
42 *Id.*, s. 162(4)

The constitutional right of the federating units to receipt of revenue accruing to them from the Federation Account is one of the key pillars of the Nigerian federal system and gives practical expression to the doctrine of 'fiscal federalism'. The implication of this constitutional provision is that each tier of government has the right to spend its own share of the revenue as it pleases within the ambits of the Constitution.[43]

Similarly, it was presumptuous of the State Governors to have given their consent to such legislation by the FGN, either initially or subsequently after expressing their opposition thereto, without the authorization of their Houses of Assembly, the legislative arm of the State governments. This is a contravention of the provisions of the Constitution to the effect that all revenues accruing to a State shall be paid into a Consolidated Revenue Fund for the State[44], that no money paid into the Consolidated Revenue Fund shall be expended other than in accordance with prescriptions by the Constitution or as authorized by an Appropriations Law or other Law passed by the State House of Assembly,[45] and generally that "*no moneys shall be withdrawn from the Consolidated Revenue Fund of the State or any other fund of the State except in the manner prescribed by the House of Assembly*".[46]

There can be no doubt that before a State Governor can agree to an arrangement that turns over revenues due to the State to some other authority for use or management, a law authorizing such an arrangement must be enacted by the State House of Assembly. Alternatively, the State Governor will have to submit the proposal for such revenue withdrawal for approval every year as part of the annual appropriations bill (budget). No Governor has the right to agree to an arrangement that diverts revenue accruable to the State to some purpose neither approved by the House of Assembly nor placed under the control or management of the State.

The Act makes a belated acknowledgment of the importance of the State Houses of Assembly by listing them amongst recipients to whom the Authority must submit an annual report at the end of every financial year.[47]

In view of the above-identified possible constitutional infractions, it is not at all clear that a legal challenge on the constitutionality or otherwise of the Act, especially its funding provisions, will not succeed.

Conclusion

The Authority has been inaugurated and is currently going through the preliminary processes preparatory to commencement of operations. But as we have seen above,

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43 See CBN, "Reserve Management", available at *http://www.cbn.gov.ng/Intops/ReserveMgmt.asp*
44 See The Constitution, *supra*, s**.** 120(1)
45 *Id*., s. 120(2)
46 *Id*., s. 120(4)
47 See The Act, *supra*, s. 37 (1)

many questions remain unanswered as regards the legal and political dynamics that will impact on the operations and the future of the Funds.

To some extent the Funds bridge the gap between two competing viewpoints on the utilization of surplus revenue accruing to Nigeria from perennial price surges in the international crude oil market. When the ECA was set up in 2004 by the Obasanjo administration, supporters of the ECA, including the International Monetary Fund (IMF), justified the initiative on the ground that it was wiser to save such extra-budgetary revenues for future use as a budget stabilization mechanism in the event of oil prices falling below budgetary projections. Opponents of the ECA contended that it was foolhardy for a developing country with very poor critical infrastructure to adopt such an aggressive revenue savings policy to the detriment of national development.

From the stated objectives of the Act and the mandate of the Authority, it is clear that the Act intends for the Funds to address the concerns of both camps by incorporating both savings and stabilization-targeted components on the one hand and an infrastructure development component on the other hand. It remains to be seen how successful the Authority will be in achieving this balancing act.