INSIGHTS INTO THE PROPOSED REGULATORY FRAMEWORK FOR PRIVATE EQUITY FUNDS IN NIGERIA

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Introduction

In the dynamic landscape of private equity, regulatory frameworks serve as the bedrock for investor confidence, market integrity, and sustainable growth. In recognition of the importance of robust regulations, the government body established as the principal regulator of the capital markets in Nigeria, the Securities and Exchange Commission (the "SEC"), issued an exposure draft of new and sundry amendments to the SEC rules and regulations of 2013 (as amended) (the "SEC Rules") on 8 December 2023, including proposed amendments to the rules on private equity funds (the "Proposed Rules"). The SEC Rules make provision for the regulation of private equity funds in Nigeria with a minimum commitment of N1billion investors' funds . Save for the amendments to the registration fee for private equity funds and the provision of Form SEC QR8 in respect of filing quarterly return for private equity funds pursuant to the new rules and amendments to the SEC Rules issued by the SEC on 23 December 2019, no amendment or new provision has been issued or proposed in respect of private equity funds by the SEC until the Proposed Rules.

The Proposed Rules represent a significant evolution in regulatory thinking, aiming to modernize and enhance the regulatory framework to better serve the needs of market participants, in keeping with international best practice. This article briefly analyses the contents of the Proposed Rules, assessing their potential impact and benefits for the private equity landscape in Nigeria.

Overview of the Proposed Amendments

1. Definition Refinement

Under the SEC Rules, the definition of private equity funds primarily focuses on investments in private equity/unlisted companies without specific criteria for investment strategy or horizon . The Proposed Rules introduce criteria related to investment strategy and defined investment horizon, enhancing clarity and aligning regulatory expectations with industry practices.

It is apparent that the SEC aims to provide clarity regarding the operational objectives and scope of private equity funds, thereby facilitating better understanding among stakeholders and regulatory authorities. By explicitly outlining the investment strategy and horizon, the amendment enhances transparency and regulatory oversight within the Nigerian private equity landscape.

2. Threshold Adjustment

Another key amendment under the Proposed Rules is the adjustment of thresholds for regulatory oversight. Under the SEC Rules, all private equity funds with a minimum commitment of N1 billion (One Billion Naira) investors' funds are subject to regulatory oversight . The Private Equity and Venture Capital Association of Nigeria (PEVCA) expressed its opinion regarding what it considered a narrow definition of what constitutes a private equity fund. In response to PEVCA's observation, the SEC provided under the Proposed Rules that private equity funds below a target fund size of N5 billion (Five Billion Naira) are exempt from registration but are required to file governing documents for regulatory review. This adjustment strikes a balance between regulatory oversight and the diverse needs of smaller funds, thereby encouraging market participation while maintaining investor protection standards. The Proposed Rules exempt private equity funds below a target fund size of N5 billion (Five Billion Naira) from registration but requires them to file governing documents for regulatory review, balancing oversight with market participation. By adjusting thresholds and introducing exemptions for smaller funds, the amendments would significantly improve market participation from a broader range of investors and fund managers, thereby promoting inclusivity and diversity within the private equity ecosystem.

3. Investment Restrictions

The proposed amendments introduce investment restrictions, such as limiting single investments to not more than 30% of the fund's assets and mandating a minimum investment of 3% in pension fund assets. These restrictions aim to promote diversification, risk management, and alignment with investor interests, thereby enhancing the resilience of private equity investments in Africa and mitigating risks associated with concentrated exposures. Under the SEC Rules, investment restrictions are limited to not investing more than 30% of the fund's assets in a single investment.

The Proposed Rules introduce additional restrictions, such as mandating a minimum investment in pension fund assets and limiting total management fees and expenses, promoting diversification and investor protection.

4. Enhanced Reporting Requirements

In addition to refining the definition and thresholds, the proposed amendments enhance reporting requirements for private equity fund managers. Under the SEC Rules, reporting requirements focus on quarterly and annual returns to the regulatory authority.

The Proposed Rules enhance reporting requirements, ensuring regular disclosure of fund performance, investment activities, and fee structures to empower investors and facilitate regulatory oversight. These enhanced reporting requirements ensure regular disclosure of fund performance, investment activities, and fee structures. By providing greater transparency, these amendments empower investors to make informed decisions and facilitate regulatory oversight, ultimately contributing to market integrity and investor confidence. The proposed standardization of valuation methodologies and alignment of regulatory frameworks with international best practices would significantly enhance the attractiveness of Nigerian private equity investments to global investors.

5. Valuation Methodology Standardization

A notable change is the standardization of valuation methodologies based on principles approved by the fund's advisory board. While under the SEC Rules, valuation was based on fair value regime with limited standardization, the Proposed Rules standardize valuation methodologies based on principles approved by the fund's advisory board, enhancing consistency, reliability, and accountability. This departure from the fair value regime enhances consistency, reliability, and accountability in valuing fund assets, thereby aligning with international best practices and investor expectations. Standardized valuation methodologies also promote comparability across funds and facilitate investor due diligence.

6. Conflict of Interest Provisions

Lastly, the proposed amendments introduce robust conflict of interest provisions, requiring disclosure of potential conflicts and establishing policies to manage and mitigate such conflicts. While the provisions regarding conflict-of-interest disclosure and management in the SEC Rules are limited , the Proposed Rules introduces robust conflict of interest provisions, requiring disclosure and management of potential conflicts, strengthening governance and market integrity. These provisions enhance governance, integrity, and trust in fund management practices, safeguarding investor interests and promoting market confidence.

Implication for Private Equity in Nigeria

The proposed amendments hold significant implications for stakeholders kindly in the Nigerian private equity ecosystem. Fund managers, investors, and regulatory authorities must adapt to the evolving regulatory landscape, ensuring compliance, transparency, and accountability. Moreover, these amendments are poised to enhance the attractiveness of Nigerian private equity investments, fostering increased capital inflows, market development, and economic growth across the continent. By promoting diversification, risk management, and accountability, the Proposed Rules contribute to the resilience and sustainability of private equity investments, thereby fostering economic growth, job creation, and innovation in Nigeria.

Conclusion

The Proposed Rules are a welcome development and represent a significant step towards fostering regulatory clarity, transparency, and investor protection within the Nigerian private equity landscape. Through a comparative analysis with the existing rules and an assessment of their potential impact and benefits, it is evident that the Proposed Rules hold the potential to drive positive change, stimulate market growth, and enhance the overall integrity of the private equity ecosystem in Nigeria. By refining regulatory frameworks, aligning with industry best practices, and addressing emerging challenges, the Proposed Rules pave the way for a more resilient, inclusive, and sustainable investment environment in Nigeria. As stakeholders collaborate to implement these reforms, Nigeria's private equity is poised for continued growth, innovation, and socioeconomic impact.

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