
Overview of the Recent Amendments to the Nigerian Securities and Exchange Rules

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Background

The recent financial crisis revealed several inadequacies in the laws regulating global capital markets, leading to reviews of structures and processes governing capital market operations in several countries including the United States and United Kingdom. Nigeria has not been left out in the race to review laws regulating capital market operations. In 2008, the Nigerian Securities and Exchange Commission (SEC) constituted some industry-wide committees with the objective of repositioning the market for greater efficiency and international competitiveness. One of such committees was the "**Dotun Sulaiman Committee**" on the review of Nigerian capital market structure and processes. The Committee made its recommendations in March 2009. The recommendations were subsequently codified in the March 2010 amendment to the 2007 SEC Rules and Regulations. It is however believed that SEC had commenced implementation of accepted recommendations prior to codification. This Newsletter is the first of a two part series. It examines some of the notable amendments and introductions to the Rules.

Appointment of Capital Market Operators

A new Rule 15(A) gives SEC the power to approve the appointment of Executive Directors of Market Operators prior to their appointment in such positions. The Investment and Securities Act (ISA) 2007 defined Capital Market Operators as persons (individuals or corporate) duly registered by SEC to perform specific functions in the capital market. No other definition is given elsewhere. It would appear however that the players in the



Nigerian capital market are operators who act as intermediaries between Funds and Fund users. They include Securities Exchanges, Brokers/Dealers, Issuing Houses, Registrars and Investment Advisors. Going by the new Rules, these operators would first have to obtain SEC's approval before appointing their Executive Directors. It is doubtful whether SEC would need to ratify any appointments made before the Rules came into effect or check their activities after appointment.

In addition to the above, a new Rule 15(A) (ii) requires Directors of Market Operators to have the same minimum qualification required from Sponsored Individuals in Rule 16 of the 2007 Rules. The 2007 Rules defined Sponsored Individuals as principal officers and/or professionals held out by the applicant companies as experts and on whose advice or actions investors are expected to rely. It is however not clear whether the directors referred to in sub-rule (ii) of Rule 15(A) are the same as the Executive Directors in sub-rule (i) of the same Rules. Where the intention was to refer to Executive directors, it is not clear why the Rule would require such directors to have the same qualification and invariably the same standard of care as other principal officers and professionals of capital market operators. In company law, Executive Directors have higher standard of care.

Bonus Issues

SEC modified the rules on registration of securities in Rule 40 of the 2007 Rules. A new Rule 40(D) was created. Rule 40(D) (1) however defines "Bonus" as the proportionate issuance of new shares to existing shareholders of a company, at no cost to the shareholders by the capitalization of accumulated reserves from the profits earned in previous years. It seems that the definition could have

appropriately covered "Bonus Issue" and not "Bonus".

Only public companies are allowed to make applications for registration under this Rule. A new Rule 40(3) waives the requirement for companies to produce registration documents including certificates of incorporation and increases in share capital or any other document specified in the 2007 Rules, provided that such companies give undertakings confirming that there are no changes in the documents previously filed with SEC.

Public Offers and Listing by Introduction

a) Initial Public Offer (IPO)

A new Rule 50 was created by the Rules. The Rule requires as conditions for companies to issue IPOs for pure equity, convertible or listing by introduction:

- i) a three year financial track record;
- ii) a track record of distributable profits excluding extra-ordinary profits for at least two out of the immediately preceding three years; and
- iii) a positive shareholders fund.

A new Rule 50(3) requires sworn declaration of full disclosure of all material facts in the offer document from issuers. The declaration has to be signed by the Chief Executive Officer, Company Secretary and Chief Financial Officer of such an issuer.



b) Subsequent Public Offer

A new rule 50(A) allows subsequent offers to be approved only on satisfactory account of utilization of the proceeds of previous issues. The test to be applied in determining what constitutes satisfactory utilization of the proceeds of previous issue however remains unclear.

c) Pre-Offer Waiting Period

A new Rule 59(c) requires companies to allow at least one week period of interval after the execution of offer documents before the opening of offer.

d) Extension of Offers

While Rule 60(b) of the 2007 Rules made provisions for extension of offer periods on the occurrence of any of the events in (b) (i) – (iv) such as political, religious or social crisis; labor unrest or riots; a minimum of 3 public holidays within an offer period; or natural disasters such as earthquakes, fire breakouts etc, a new Rule 60(d) has now specified the basis for granting such an extension. It provides that an extension would be granted only if the issuer's latest audited accounts will remain valid all through the extension period.

The Rule further makes the extended date of an offer the reference date for computation of any penalties for late submission of an allotment proposal.

Proceeds of Issue

a) Interest Yielding Account

While Rule 64(1) of the 2007 placed the burden of depositing

proceeds of an issue exclusively on the relevant issuing house or lead issuing house, a new Rule 64(1) has now revised that provision. The new Rule places the burden on both the issuing house and the receiving banker.

It appears therefore that by this Rule SEC would have the power to proceed against Receiving Bankers for failure to deposit issue proceeds in separate interest yielding accounts. It could invoke any of the sanctions stipulated in Schedule VII Rule 11 against the relevant bank. It is not clear however whether SEC would have **jurisdiction** over such banks enough to maintain such claims or sanctions.

b) Absorption of Oversubscription

The old Rule 64(4) (a)(iii) was equally amended. First the word "utilized" was changed to "absorbed". Secondly, while the 2007 Rules required the issuer to utilize only 25% of any surplus money realized from an issue, the new Rule requires the issuer to absorb any sum not exceeding 15% of the offer sum as surplus money.

c) Interest on Return Monies

Rule 64(4) of the 2007 Rules made provisions for surplus monies to be returned to affected subscribers within 5 working days of approval of allotment proposal. This Rule has now been extended in the 2010 Amendment. Presently, where such monies are



not returned within the stipulated period, the issuer would be liable to pay interest to unsuccessful applicants at a rate not below CBN Approved Monetary Policy Rate plus five percent (CBN MPR + 5%).

Allotment

a) Basis for Allotment

There has also been an amendment to Rule 69(2) of the 2007 Rules which required that preference be given, in the event of over-subscription, to small investors who had applied for the specified minimum subscription level. The new Rule 69(2) now requires that a minimum modified pro-rating approach be adopted. This means that all subscribers in an allotment shall receive minimum subscription units as specified in the offer document. Any residual balance would then be pro-rated in equal proportion to the amount each subscriber has applied for.

There is also a new requirement for reduction of the minimum allotment to subscribers where the minimum subscription cannot accommodate all subscribers.

b) Under-subscription

While Rule 70(6) (ii) of the 2007 Rules made 25% the lowest threshold for issues that are not underwritten to remain under-subscribed or 50% where they are offered through the capital trade point, the 2010 amendment put the threshold at 50%. It requires issuers of issues that are not underwritten to terminate them where

they are under-subscribed by up to 50%.

c) Cost of Issue

The total cost of issue in Rule 73 is now reduced from 7% to 4.3% of the gross total proceeds. The new Rule excludes underwriting fees from such cost.

d) Underwriting of Public Issues

While Rule 75 of the 2007 Rules made it mandatory for all public issues to be underwritten, the 2010 amendment now leaves the decision whether or not to underwrite issues at the issuer's discretion.

The issuer is also allowed to exercise such discretion where rights issues are involved. A new Rule 75(A) however makes the exercise of this discretion subject to the prior consent of issuer's shareholders.

Know Your Customer

The 2010 Amendment creates a new Rule 100(6) (B). The Rule specifies the type of transactions that would amount to suspicious transactions for which a report is required to be made to the Economic and Financial Crimes Commission. They include:

- a) transactions with unusual frequency;
- b) frequent deposit of cash with an operator in sums marginally below the threshold specified by law;
- c) transactions by or on behalf of clients without evidence of ownership or capacity to own such funds;



- d) transactions involving under aged persons, and clients with irregular signatures and/or regular change of address;
- e) transactions inexplicable in commercial terms and deviating from conventional business norms, practices and habitual patterns;
- f) transactions that obscure the real identity of the parties involved; and
- g) inter-member transfer of specific stock from a client to another stock broking firm for sale without any previous buying instruction from clients etc.

The list does not appear to be exhaustive. Capital market operators may therefore be exposed to sanctions for other reporting requirements not specified.

Acquisition of Own Shares

The Amendment sought to amend a Rule 109(B) (vi) of the 2007 Rules. It specified that companies can only acquire their own shares out of the profits otherwise available for dividend or from fresh issues specifically made for that purpose. The Rule requires entries complying with the requirements to be shown in the company's latest audited account which shall not be more than 9 months old. However, there is no Rule 109(B) (vi) in the 2007 Rules. It is therefore not clear what provision the Rule sought to amend.

Corporate Bonds

Some amendments were equally recorded with respect to corporate bonds.

a) Required Documents and Information

The Amendment sought to create provisions on corporate bond issues under Part K of the Rules. Part K of the 2007 Rules contained provisions on bond issues by states, local governments and other government agencies. The new rule however amends the provisions to include issuance by public companies, foreign public companies and supranational bodies in a newly created Rule 307(A). The Rule further lists the type of documents required for approval under the rule in Rule 307(A) (1)(a)-(p) such as a completed Form SEC 6, filing and registration fees, two copies of resolutions authorizing the bond issue, two copies of the issuer's memorandum and articles of association certified by the CAC, issuer's certificate of incorporation certified by the Company Secretary, issuer's latest audited accounts for the preceding three years which must not be more than nine months old, Accountant's report, consent letters of the parties to the offer, draft vending agreement between the issuer and issuing house, draft underwriting agreement, report from registered rating agencies, letter of clearance from relevant regulatory body, two copies of the draft trust deed, draft offer document, issuer's declaration of compliance and such other information which SEC may require from time to time.

The nature of registration required from the rating agencies or the place of registration is unclear. However, it



appears from Rule 307(A) (2)(a)(ii) that rating agencies are required to be registered with SEC.

b) Conditions for Approval

Rule 307(A) (2) of the 2010 Amendment specifies the conditions for approval of corporate and supranational bond issues. Issuers are required to satisfy the following conditions:

- a) Be eligible for such debt issuance. For this purpose the Rule stipulates that every public company, foreign public company and supranational body is eligible for approval. The Rule further requires that for eligibility every issue must be rated by a rating agency duly registered with SEC and disclosed in the offer document. Furthermore, the Rule requires an annual review of rating throughout the tenor of the bond with the reviews published in at least two national newspapers. In addition, the rating for public offers must not be below an investment grade.
- b) Rule 307(A) (2)(d) covers the requirement for disclosure and creation of charge. The Rule requires the issuer to ensure that the assets on which a debenture is secured are adequate. The issuer is required to make this declaration along with the ranking of the charge(s) in the offer documents. The issuer is also required to specifically set

out the risks associated with any residual charge or subordinated obligation.

c) Registration Fee

The primary market registration fee contained in Schedule 1, Part C, 4(i) of the 2007 Rules is reduced from 0.5% to 0.15%.

Money Market Fund (MMF)

a) Definition

The Rule creates a new provision on MMF in Rule 249. Rule 249(A) (1) defines MMF as a Collective Investment Scheme (CIS) authorized by SEC and having as its primary objective, the provision to investors/participants in the scheme of steady streams of income derived from investments in high quality money market instruments with financial instruments rated by rating agencies as specified from time to time by SEC. By this definition MMF is made a type of CIS in Nigeria. For SEC to authorize such schemes however, the investments must be in high quality money market instruments with financial instruments which must be rated by rating agencies that are registered with SEC.

Rule 249(2) (i) specifically restricts the use of the term "MMF" only to schemes that fit the description. The definition would not apply to schemes with diversified portfolio even where parts of the portfolio are invested in money market instruments.



Rule 249(2) (ii) of the 2010 Rules requires that the term "Money Market" be dropped from Schemes that do not meet the criteria laid down in the definition in Rule 249(1) or can be upgraded to meet the criteria, thus conferring a retrospective effect on schemes that were established prior to the Rules.

b) Approved/Permissible Instruments

Rule 249(3) specifies the nature of investments that can be made with deposited property of a registered and approved MMF. These include high quality money market instrument, unsubordinated short term debt securities; deposits with eligible financial institutions; and other instruments which CBN may approve provided that the instrument or issuer's credit rating is not below the investment grade approved by SEC.

The Rule however did not define the nature of institutions that would qualify as "eligible financial institutions". It also failed to specify the investment grade limit SEC is required to approve.

c) Government Securities

A new Rule 249(A) (8) makes it mandatory for MMFs to invest a minimum of 25% of their assets in short term securities issued or guaranteed by the Nigerian Government.

d) Annual Rating

In addition to the rating requirement, Rule 249(A) (14) of the Amendment requires registered rating agencies to carry out annual reviews throughout the life of the Fund.

e) Annual Supervision Fee

Schedule 1, Part C, items 5, 6 and 7 of the 2007 Rules which empowered SEC to charge 0.25% of the annual gross income of CISs, Venture Capital Fund and Real Estate Investment Trust Fund as annual supervision fee has now been deleted by the 2010 Amendment.

Mergers, Takeovers and Acquisitions

a) Scope of Regulation of Mergers, Takeovers and Acquisitions

The 2010 Amendment made innovative provisions one of which is the extension of the provisions on mergers, takeovers and acquisitions to Partnerships in Rule 227.

The scope of the Rules on mergers, takeovers and acquisitions in Rule 228 was equally extended to include mergers, takeovers, acquisitions or business transactions undertaken by Nigerian Federal Government Agencies, pursuant to the statutory powers conferred on them. The Rule however makes the exercise of this power subject to SEC's approval.

b) Exemptions

Rule 230(ii) of the 2007 Rules has been replaced. The new rule removes the reporting requirement from merging



entities in small mergers prior to conclusion of a merger. The new rule now allows such small entities to inform SEC at the conclusion of the merger.

c) Draft Scheme of Arrangement

Rule 231(2) of the 2007 Rules which required merging companies to file Draft Scheme of Arrangements with SEC has now been repealed. Companies are no longer required to file such documents.

d) Post Approval Requirement

New provisions have been added to Rule 234 of the 2007 Rules such as the requirement for post merger inspections. SEC is now required to carry out post merger inspections three months after a merger to ascertain entities' level of compliance as set out in the Scheme.

e) Restraint of Competition

Rule 229(2) of the 2007 Rules prohibited the approval of mergers, takeovers and acquisitions which restrain competition or create monopoly in relevant industry or enterprise. A new Rule 229(2) (c) has now been added. The Rule now allows transactions that would likely restrain competition where one of the parties to the merger is able to show that it is on the brink of failure.

f) Power to Order Break up of a Company

A new Rule 234(c) has been made. The Rule gives SEC the power to order the breakup of a company where it perceives that the continued existence of the company as a single entity

would restrain competition or create monopoly within the industry.

SEC is required to communicate the basis of its observation to affected entities before exercising the powers conferred on it. Such entities are given 30 days from receipt of notification to respond. Senior officers of affected entities are also given the opportunity to defend their position after the initial response. SEC is then required to make a final decision which shall be communicated to the entity. There is a further requirement for court sanction of SEC's decision on the issue.

The Rule however failed to specify the nature of decision required to be communicated to court. It is therefore not clear whether SEC is required to communicate every decision on the issue. It does appear however that communication to Court for sanction is only required where SEC decides to proceed with the breakup despite representation from affected entities.

A new Rule 234(c) (3) lists the nature of practices which SEC shall consider as capable of restraining competition or creating monopoly such as:

- 1) where companies enter into agreements with the intention of preventing, restricting or distorting competition in the market. Such agreements would be faulted even where the intention to create such monopolies is not evident. The agreements include:



- i) those that directly or indirectly fix the sale or purchase price of goods and services within the market;
 - ii) those that limit or control production, markets, technical development, or investment;
 - iii) those that share markets or sources of supply;
 - iv) those that apply dissimilar conditions to equivalent transactions with other trading parties, which would have the effect of placing such parties in competitive disadvantage; and
 - v) those that make conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.
- 2) A second practice prohibited by the Rules is one that allows companies or business enterprises to abuse the dominant positions they previously achieved in the Nigerian market. This is irrespective of how the dominant position was achieved, especially where the practice would have the effect of:
- i) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
 - ii) limiting productions, markets and technical developments to the prejudice of consumers;
 - iii) applying dissimilar conditions to equivalent transactions with other trading parties thereby placing them at a competitive disadvantage; and
 - iv) making the conclusion of contracts subject to acceptance by other parties of supplementary obligations, which by their nature or according to commercial usage, have no connection with the subject of the contracts.

Calculation of Companies Assets and Annual Turnover

A new Schedule X has been added to the Rules. The Schedule makes it mandatory for companies to apply the standards laid down in the Nigerian Statement of Accounting Standards (SAS) 30 in calculating their annual turnover and value of assets. The Schedule makes the SAS application subject only to the method of calculation set out in the Schedule.

Conclusion

There is no doubt that the amendments contain innovative provisions within the Nigerian capital market. The Director-general of SEC recently pointed out that even though the amendments and introductions were recently codified, about 95% of the rule-based recommendations of the **"Dotun Sulaiman Committee"** have since been implemented. This means that though a recent introduction, the market has since been exposed to the Rules. It is necessary therefore for market participants to be aware of the changes introduced by the Amendment and the challenges resulting from it. The fact that SEC has already commenced implementation makes this all the more necessary.



Rule implementation remains a major area of concern in the Nigerian capital market. It is hoped that though some of the uncertainties explained above exist, a more effective and efficient implementation would curtail participant's level of exposure.

This document serves merely as a note on the recent amendments to SEC Rules and Regulations and is not intended to serve as a legal advice to any person or group of persons whether natural or corporate regarding the issues discussed herein. All persons desirous of legal advice should therefore contact a solicitor. Aina Blankson LP shall not be liable for any breach or loss resulting from reliance on any part of this newsletter.

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