

Capital Markets

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Securities and Exchange Commission Issues New Rules

Introduction

On April 28, 2010, the Securities and Exchange Commission (**SEC**) took another step towards the bridging of some of the gaping gaps that currently exist in securities regulation in Nigeria, through the issuance of new SEC rules (the **New Rules**). The New Rules, which have taken immediate effect, contain 23 new rules and eight amendments (to existing ones), cover a wide range of issues, including executive appointments by market operators, underwriting of public offers, issuance of corporate bonds, money market funds, mergers and acquisitions, anti-trust break-up, reporting obligations, and proceedings before the Administrative Proceedings Committee (APC).

This note will discuss the key changes that have been introduced to securities regulation in Nigeria through the New Rules.

Securities Offering

One of the areas where significant changes have been made is that of public offering of securities. The SEC has (through the New Rules) taken a number of steps to maintain the integrity of public offerings.

For instance, the SEC has introduced three new requirements to be satisfied by companies that are either approaching the market for the first time, or seeking to be listed by introduction. Accordingly, an applicant company will be required to demonstrate to the SEC that it (a) has a three (3) year financial track record, (b) has been distributing profits (excluding extraordinary profit) for at least two of the preceding three years, and (c) has positive shareholders' funds.

Also, the requirement of mandatory underwriting of public offers of shares (and bonds by States and Local Governments) which had hitherto been abused, has now been expunged from the rules, with the underwriting of offers now at the discretion of the issuer.

CORE PROVISIONS

- “ New Requirements for Securities Offering
- “ Post Merger Inspection
- “ Procedural Clarification on Anti-Trust Break Up
- New Rules on Corporate Bonds
- “ Extensive Regulation on Money Market funds
- “ Financial Reporting & Risk Management
- “ Amendment of Rules governing APC proceedings

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However, under the New Rules, the threshold for the categorization of an offer as 'being undersubscribed' (thereby requiring an abortion of the issue) has been increased from 25% to 50%.

Unlike in the past, where companies did not have to account for proceeds of previous public offerings, it has now been made a condition for subsequent public offers, for companies to satisfactorily account for the utilization of the previous issue proceeds. This requirement also applies to private placement and Global Depository Receipt (GDR) issues.

Another innovation that has been introduced by the New Rules in relation to public offers is the mandatory one week *pre-waiting offer period*, which is defined to mean the period from the date of the execution of the offer document to the date the offer opens. The legislative intent behind the introduction of this new waiting period, is however unclear.

In an apparent move to deal with some of the mischief of the recent past, the New Rules (a) require that Securities are to be listed within 30 days after allotment clearance, (b) impose an interest rate of CBN MPR + 5% on unreturned monies, and (c) prohibit issuers from advertising private placement in any form, violation of which makes the private placement liable to suspension, and any capital market operator that advised on the transaction, liable to sanctioning.

It is also noteworthy that the maximum cost of public offers (excluding underwriting fees,) has now been reduced under the New Rules from 7% to 4.3% of the gross proceeds.

Mergers

In relation to Mergers & Acquisitions (**M&A**), one of the key changes that has been made is the expansion of the universe of entities that are subject to SEC merger regulation, to include partnerships and government agencies. In addition to the foregoing, the New Rules have also introduced the concept of *Post Merger Inspection*. To this end, the SEC is required to conduct a post-merger inspection, three months after the approval of the merger, to ascertain the level of compliance with the provisions of the scheme documents.

Pre-Offer Waiting Period

New in relation to Rules on public offers is the mandatory one week *pre-waiting offer period*, which is defined to mean the period from the date of the execution of offer document to the date the offer opens

Post Merger Inspection

SEC is now required to conduct a post-merger inspection three months after the approval of the merger to ascertain the level of compliance with the provisions of the scheme documents

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Furthermore, the New Rules provide for new thresholds (in terms of combined assets/turnover) for the categorization of mergers; a threshold of less than N250,000,000 for small mergers, N250,000,000 – N5,000,000,000 for intermediate mergers, and above N5,000,000,000 for large mergers. In calculating the thresholds, the New Rules provide that the *annual turnover* is to be calculated in accordance with *SAS 30*, and the *asset value* is to be calculated on a gross assets basis (as reported in the audited accounts of the company for the last financial year).

Apart from the foregoing, the New Rules also provide for the detailed documentation requirement and the approval stages in an M&A process, including merger notification, clearance of scheme documents, formal approval and post approval requirements.

Antitrust Break-Up

On anti-trust, the New Rules have thrown more light on what the SEC will consider, and the procedure it will follow, in ordering the break-up of a company that is engaged in business practices that substantially prevents or reduces competition.

Apart from the procedural clarification, the New Rules have classified anti-competition business practices into two broad heads that is, entering into agreement with companies whose sole object is to restrain competition, and, the abuse of dominant positions by dominant players.

Corporate Bonds

The New Rules have introduced a robust regime for the issuance of corporate bonds in Nigeria, which had previously been issued based on the rules and regulations formulated for the issuance of equity securities.

Apart from the requirement for listing the documentation, and the conditions for approval of a bond, the New Rules also extend the category of entities that may issue corporate bonds (by public offering) in Nigeria to include foreign

Antitrust

New Rules have also classified anti-competition business practices into two broad heads, that is, entering into agreement with companies which sole object is to restrain competition, and abuse of dominant position.

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companies and supranational bodies.

However, the legal efficacy of this provision is doubtful as the expansion seems to be in direct conflict with the provisions of Section 67 of the Investment Securities Act (ISA) (being the parent legislation of the SEC Rules) which provides that only statutory bodies and public companies (incorporated in Nigeria) can issue bonds to the public in Nigeria.

Money Market Fund

Another innovation under the New Rules is the extensive regulation of Money Market Funds, which have been defined as *collective investment schemes having as their primary objective, investment in high quality money market instruments with rated financial institutions*. The New Rules regulate the nature of instruments that each fund may invest in, maturity of the fund's portfolio, allocation of the fund's assets, as well as dividend distribution.

Financial Reporting & Risk Management

In an apparent bid to ensure adequate financial disclosure by public companies, the New Rules have imposed additional reporting and compliance requirements for public companies in Nigeria. To this end, all public companies are required to file with the SEC (and in the prescribed format), their (a) earnings forecast, at least 20 days prior to the commencement of a quarter, (b) quarterly report, within 30 days from the end of a quarter, (c) half yearly returns within 30 days from the end of the end year period, and (d) annual report, not later than 90 days after.

Further, public companies are now required to actively pursue risk management. In this regard, a public company is required to disclose strategies for dealing with the risks the company is exposed to, disclose unmitigated risk on corporate responsibility and include risk management as part of its accounting policies.

Legal Efficacy of New Rules on Corporate Bonds

On the authority of **Osadebey v A.G. Bendel State [1991] 1 NWLR (Part 169) 525 S.C**, the Supreme Court has held that any part of a subsidiary legislation which seeks to extend the application of the parent legislation is a nullity. However, an argument can be made that expansion can be anchored on **Section 313 (h) ISA** which provides that the SEC may by rule making, restrict or expand the scope of application of any provision of the ISA. It however remains to be seen whether such an argument will find favour with the courts.

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APC Proceedings

The New Rules have also made certain amendments to the rules governing the Administrative Proceeding Committee (**APC**) proceedings.

Under the New Rules, an investigation process is now interposed between when a complaint is made and when the matter is brought before the committee. In this regard, complainants are required to first forward their complaints to the SEC for investigation rather than filing their briefs directly before the APC. And it is only if the appropriate department within the SEC considers the complaint meritorious (upon the conclusion of its investigation) that the matter will be referred to the APC.

Further, under the New Rules, the APC is entitled to hear and determine matters in the absence of parties, provided the parties were served with hearing notices. However, the absent party may be granted a re-hearing upon application for same, within one month.

Apart from the foregoing, the New Rules have made some procedural changes to the proceedings before the APC, e.g. as regards witness evidence, documentary evidence and compelling of witnesses.

Bonus Issue

In relation to bonus issues, the New Rules now require public companies to issue bonus shares to their shareholders within a limited time frame. In the case of dematerialized shares, the bonus shares are required to be credited into the securities account of the shareholders within 5 days of approval of the bonus by the SEC, and in the case of certificated shares, to be dispatched within one month of the approval of the bonus issue by the SEC. This new Rule 40(D) also provides extensively for the registration requirements of bonus issues.

Conclusion

Clearly, the New Rules represent a step in the right direction in the quest to restore investor confidence in the Nigerian Capital Market, but the question is whether the rules are a day late, and a Naira short?

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