THE LEGAL FRAMEWORK FOR THE ISSUANCE OF COMMERCIAL PAPERS IN NIGERIA

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1. Introduction

Companies looking to raise working or project capital may do so by issuing equity or debt securities. Debt securities are financial instruments which represent that a debt has been issued. Companies sell these debt securities to investors on a promise of repayment at a future date. They may be either short, medium or long term, which reflects the length of the maturity period or period for repayment. Examples of debt securities are bonds, bills notes, papers, etc.

Commercial papers are a popular form of short-term debt security. They are short-term promissory notes, usually unsecured, and a with maturity period of under a year, generally not exceeding 270 days. They are issued by credit worthy companies to meet their short-term obligations. Being short term debt securities, they are regularly traded on the money markets as money market instruments. However, commercial papers are rarely listed and are usually traded at over-the-counter (OTC) markets.

2. Laws and Institutions Governing the Issuance of Commercial Papers in Nigeria

In Nigeria, the issuance of securities is regulated by the Securities and Exchange Commission (**SEC**), the agency established under the Investment and Securities Act (**ISA**) of 2007 for the regulation of investments and securities business in Nigeria.[2] As noted above, commercial papers issued by a company are securities and they are therefore regulated under the ISA by the SEC. However, as we will see in section 3 below, the SEC does not directly regulate the issuance of commercial papers in Nigeria as they are not usually issued directly to the public.

The issuance of commercial papers in Nigeria is also regulated by the Central Bank of Nigeria (**CBN**), as banks are usually a party to commercial paper transactions and the CBN is

[1] Brooks & Knights Legal Consultants (BKLC) is a law firm established in Lagos, Nigeria to provide bespoke legal advisory and policy consulting services to individuals, corporates, government agencies and NGOs.

[2] Section 13, ISA 2007 provides that the Commission (i.e. SEC) shall be the apex regulatory organization for the Nigerian capital market and shall carry out the functions and exercise all the powers prescribed in the section 13 (a) – (dd) of the ISA

the regulator of banking business in Nigeria.[3] In July 2016, the CBN, exercising its powers to regulate banks and commercial papers, issued a circular in July 2016 titled "Letter to all Deposit Money Banks and Discount Houses: Mandatory Registration and Listing of Commercial Papers,"[4] where it approved the quotation rules of FMDQ OTC Securities Exchange[5] (i.e. the FMDQ Rules) and cleared it for the quotation of commercial papers in Nigeria. Through the Circular, the CBN mandated that deposit money banks and discount houses only deal in commercial papers that are registered, quoted on intended for quotation on Authorised Securities Exchanges, whether acting in the capacity of an issuer, guarantor or Issuing, Placing, Paying and Collecting agent (**IPCA**), Collecting and Paying Agent (**CPA**), etc. Thus, issuers who wish to register and quote their commercial papers on the FMDQ platform[6] must comply with the FMDQ Rules.

3. Who Can Issue Commercial Papers in Nigeria?

Given that commercial papers are securities, we must consider whether a private company may issue and offer commercial papers in Nigeria. The ISA requires that only a public company may offer securities to the public. According to section 67 of the ISA, "*no person shall make any invitation to the public to acquire or dispose of any securities of a body corporate... unless the body corporate concerned is a public company or a statutory body or bank established by or pursuant to an Act of the National Assembly and is empowered to accept deposits and savings from the public or issue its own securities (as defined under this Act), promissory notes, bills of exchange and other instruments*..."

However, while commercial papers are securities and would usually be regulated by the SEC, when they are issued over the counter, they are a private placement of securities with potential investors and thus falls outside the scope of this provision. The 9th Edition of the Black's Law Dictionary defines over-the-counter transactions as transactions that are "*not listed or traded on an organized securities exchange; traded between brokers and dealers who negotiate directly*."[7] Private companies can therefore issue commercial papers over the counter to investors, and not be subject to regulation by the SEC. The OTC market is however regulated by the SEC.

In Nigeria, the FMDQ OTC Securities Exchange is an over-the-counter market place for trading in securities. Issuing commercial papers on the FMDQ platform is not an issue to the public but a private placement by dealers to buyers. It is a

3 Section 33(1)(b) of the CBN Act 2007 states that the CBN "may issue guidelines to any person and any institutions under its supervision." Based on the provisions of the Banking and Other Financial Institutions Act, banks are statutorily under the supervision of the CBN as no bank in Nigeria is permitted to operate a banking a banking business unless it is so authorized by the CBN. See Section 3, Banking and Other Financial Institutions Act (BOFIA), Cap B3 Laws of the Federation of Nigeria (LFN) 2004.

4 CBN Circular BSD/DIR/GEN/LAB/09/035 dated July 2016 and titled "Letter to all Deposit Money Banks and Discount Houses: Mandatory Registration and Listing of Commercial Papers."

5 The most recent FMDQ Rules are the FMDQ Commercial Paper Registration and Quotation Rules issued in August 2019.

6 The FMDQ Platform is defined under the FMDQ Rules as the FMDQ-organised marketplace for registration, listing, quotation, order execution, trade reporting, *inter alia* of securities and other products traded or tradable within the FMDQ markets.

7 *Black's Law Dictionary* 1214 (9th ed. 2009).

bilateral exchange and does not constitute an issue to the public. Private placements are not regulated by the SEC or the ISA. Therefore, a private company can issue commercial papers on the FMDQ platform.[8]

4. Structure of a Commercial Paper Issuance

Parties

The major parties to a commercial paper programme issuance are: the issuer, the promoter (where applicable), the Issuing and Placing Agent (**IPA**), the Collecting and Paying Agent (**CPA**) (which when combined with the responsibilities of an IPA becomes an Issuing, Placing, Paying, and Collecting Agent (**IPCA**)), the licensed securities depository (called the Central Securities Depository or **CSD** under the FMDQ Rules), the Credit Rating Agency, and the commercial paper investors. Other parties include a guarantor and an underwriter, where applicable, solicitors and an auditor.

The issuer is the entity issuing the commercial papers. Where the commercial papers are issued through a special purpose vehicle (**SPV**), the promoter is the entity incorporating the SPV for the purposes of the issuance and holds a significant ownership and control of the SPV, i.e. it is the SPV's parent company. For the purposes of the FMDQ Rules, the promoter is the party with the primary disclosure requirements under a commercial paper issuance.

The IPA is a non-bank financial institution sponsoring the registration and quotation of the commercial paper programme, the issue of commercial papers on the FMDQ platform, and the placement of the commercial papers with investors at the primary issuance. The IPA is also known as the arranger or dealer of the commercial papers. The FMDQ Rules require that an IPA be an FMDQ licensed Registration Member[9] (Quotations).

An IPCA is a CBN-licensed bank sponsoring the registration and quotation of commercial paper programmes and issues on the FMDQ platform and act as CPAs for the purposes of collecting and paying funds from/ to investors on behalf of the issuer or promoter. The IPCA merges the functions of the IPA/ dealer with that of the CPA. Only a CBN-licensed bank can perform the functions of an IPCA as only a bank can perform the functions of a CPA. The FMDQ Rules also require that an IPCA be an FMDQ licensed Registration Member (Quotations).

The Licensed Securities Depository is a specialist financial institution, licensed by the SEC, which holds commercial papers either in certificated or uncertificated (dematerialized) form so that ownership can be easily transferred through a book entry rather than the transfer of physical certificates. The depository acts as the registrar and the custodian of the commercial papers. In Nigeria, the most popular licensed securities depository is the Central Securities Clearing System Plc (**CSCS**). FMDQ recently launched the FMDQ Depository as a securities depository.[10]

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8 SEC Nigeria, Modes of Public Offering, available at https://sec.gov.ng/modes-of-public-offering/

9 The FMDQ Rules define a Registration Member (Quotations) as a member of FMDQ that is licensed to sponsor an issuer or promoter of CPs for registration or quotation on FMDQ.

10 Iheanyi Nwachukwu, *FMDQ Depository Goes Live*, Business Day Newspaper September 23, 2019,

The credit rating agency issues a credit rating on the issuer and the issue for the purpose of the registration and quotation of the commercial papers. The credit rating agency must be registered and recognised by the SEC to qualify the commercial paper programme for registration.

The commercial paper investors are the parties that purchase the commercial papers. The FMDQ Rules provide for and define Eligible Investors and Qualified Institutional Investors. Qualified Institutional Investors include banks, fund managers, pension fund administrators, insurance companies, investment/unit trusts, multilateral and bilateral institutions, registered private equity funds, registered hedge funds, market makers, staff schemes, trustees/custodians, stockbroking firms and any other category of investors as may be determined by the SEC from time to time. Eligible investors are investors that are not qualified institutional investors as defined by the FMDQ Rules, who have executed a declaration attesting to their eligibility in the manner prescribed in the FMDQ Rules.

Requirements for the Issuance of Commercial Papers under the CBN Guidelines and the FMDQ Rules

The CBN Guidelines require that, to qualify as a financing vehicle, a commercial paper issuer must:

(a). have 3 (three) years audited financial statements, with the most current not exceeding 18 (eighteen) months from the last financial year end; and

(b). have an approved credit line with a Nigerian bank acting as an Issuing and Paying Agent, i.e. an IPCA,[11] where the bank guarantees the issue.[12]

The CBN Guidelines also require that the commercial paper issuer and the specific commercial paper issue be rated by a rating agency acceptable to the CBN. An indicative rating must have been obtained by the issuer at the time it is submitting its information and declarations to a licensed Securities Depository.[13] The issuer or the issue shall have a minimum of investment grade credit rating (BBB- or similar rating).[14]

Finally, the CBN Guidelines require that guaranteed commercial papers extended to a single obligor by a bank shall not exceed 30% of a bank's shareholders' funds unimpaired by losses; and a bank's aggregate guaranteed commercial papers shall not be more than 150% of shareholders' funds unimpaired by losses.[15]

The FMDQ Rules recognise that commercial papers may be issued directly or through an SPV; however, where the commercial papers are issued through an SPV, the promoter or sponsor of the SPV will be required to meet the eligibility criteria under the FMDQ Rules.[16]

The FMDQ Rules further prescribe additional requirements for a commercial paper issuer or promoter, amongst others:[17]

available at https://businessday.ng/exclusives/article/fmdq-depository-goes-live/

11 This is different from the Issuing and Placing Agent under the FMDQ Rules but is similar to the IPCA under the FMDQ Rules.

12 Paragraph 3.0(b)(i) of the CBN Guidelines.

13 Paragraph 5.1 of the CBN Guidelines.

14 Paragraph 5.2 of the CBN Guidelines.

15 Paragraph 8.0 of the CBN Guidelines.

16 Paragraph 4.1 of the FMDQ Rules.

17 Paragraph 4 of the FMDQ Rules.

(a). it must be duly incorporated under Applicable Law;[18]

(b). it must have been incorporated for a period of not less than 5 years and must have been in operation for not less than 3 years prior to the date of application for registration of the programme;

(c). it must have shareholders' funds (unimpaired by losses) not less than NGN500 million as evidenced by its latest audited accounts, not being later than 12 (twelve) months from the date of submission of the application to register the programme, and shall be maintained at or above that level for the entire period that the commercial paper remains on the FMDQ Exchange; and

(d). where it does not meet the requirements in paragraphs (b) – (c) above, the prospective commercial paper issuance must be backed by a guarantor or a credit enhancement provider that meets those requirements and such other requirements as may be prescribed by FMDQ from time to time;[19]

The FMDQ Rules also provide for similar credit rating requirements as provided in the CBN Guidelines and stated above.[20]

Relevant Agreements to be executed

The relationship between the issuer and the other parties are generally governed by the following agreements:

(a). the Agency Agreements executed between the issuer and the agents (IPA and CPA or the IPCA), which highlights each party's duties and obligations. The FMDQ Commercial Paper Registration and Quotation Template Guide (**FMDQ Template Guide**) provides an indicative template of the general contents of the agency agreement and includes extensive duties and obligations of the issuer and the IPA/ IPCA, among other things;

(b). the Deed of Covenant including the commercial paper Note, which is a deed poll executed in favour of the holders of the commercial papers (Noteholders), providing for the rights of the Noteholders and the terms and conditions of the issue/ Note;

(c). the commercial paper raising mandate, which is the engagement letter between the IPA or IPCA and the issuer containing the terms upon which the IPA/ IPCA will act as dealer and arranger on the commercial paper programme issuance;[21]

18 Applicable Law is defined under the FMDQ Rules as any law, statute, code, ordinance, decree, rule or regulation (including rules and regulations of self-regulatory organisations) that may relate to activities within the FMDQ markets (as may be revised, updated and/or amended from time to time).

19 Paragraph 4.6 of the FMDQ Rules.

20 Paragraph 3.8 of the FMDQ Rules.

21 Provided for under the CBN Guidelines.

(d). the Custodial Agreement, which is executed between the issuer and the custodian/ registrar of the issue;[22]

(e). a deed of Guarantee, where commercial paper is guaranteed, along with a backstop loan where the commercial paper is guaranteed by a bank. Under the CBN Guidelines, where a bank invests in a commercial paper by disbursing its own funds, the transaction shall be reported on balance sheet and treated as a loan; however, if the bank merely guarantees the commercial paper, it shall be shown off-balance sheet as a contingent liability; and

(f). an underwriting agreement, which is an agreement to buy all or part of a new issue of commercial papers to be offered/held for sale with a view to resell and not as a form of investment.[23] Under the FMDQ Rules, an underwriting agreement may be firm (where the entire issue is sold to the underwriter, who then attempts to resell the securities. Here, the issuer/ promoter receives the agreed amount and all the risks associated with selling the securities are transferred to the underwriters) or standby (where the underwriter is legally bound to take and pay up to the underwritten percentage only if the issue is not fully subscribed).[24] An underwriting agreement is relevant with regard to the requirement for minimum subscription level under the FMDQ Rules and CBN Guidelines.[25] Where a commercial paper issue is not underwritten, and it is undersubscribed and cannot meet the minimum subscription level, the issue may be aborted and any consideration received in connection with the issue must be immediately returned to the subscribers. Underwritten commercial papers are exempted from the minimum subscription level requirement and any subscription shortfall shall be taken up by the underwriter.

Other Considerations Relevant to the Structure

The FMDQ Rules recognise the registration of a commercial paper Programme, which registration shall be valid for a 3 (three) year period and may only be extended in accordance with the FMDQ Rules.[26] Each commercial paper issuance may only be issued for a tenor of between 15 – 270 days,[27] where a bank is involved in the commercial paper issuance or for a tenor of 30 – 270 days[28] the commercial paper is only regulated by the FMDQ. CBN also expressly prohibits the capitalization of upfront

22 *id.*
23 Definition section of the FMDQ Rules.
24 *id.*
25 Paragraph 9.2 and 9.3 of the CBN Guidelines and paragraph 3.3 of the FMDQ Rules.
26 Paragraph 3.2 of the FMDQ Guidelines.
27 Paragraph 6.2 of the CBN Guidelines.
28 Paragraph 3.2 of the FMDQ Rules.

interest or discounts on maturing commercial papers into a rollover.[29]

The FMDQ Rules[30] allow for a commercial paper to be interest bearing or discounted to face value. The CBN Guidelines expressly recognise commercial papers with upfront interest or that are issued with a discount to the face value of the commercial paper note.[31]

Both the CBN Guidelines[32] and the FMDQ Rules[33] mandate that commercial papers only be redeemable at maturity and expressly prohibit the pre-liquidation of commercial papers. The CBN Guidelines allow for commercial papers to be issued in physical or dematerialized form but it encourages issuers and investors to issue and hold their commercial papers in dematerialized form.[34] The FMDQ Rules only allow commercial papers to be issued and held in dematerialized form, with an FMDQ recognised CSD.[35]

Both the CBN Guidelines[36] and the FMDQ Rules[37] provide that commercial papers be issued for a minimal value of NGN100 million and in multiples of NGN50 million thereafter. FMDQ recognises the registration of a commercial paper programme in a foreign currency or in multiple currencies, provided that such foreign/ multicurrency commercial paper programme shall be supported by the issuer or promoter's foreign currency rating(s) provided by a CRA registered or recognised by the SEC.[38]

5. Necessary Documentation

The CBN Guidelines provide that the standard documentation requirements for the issuance of a commercial paper shall include:[39]

(a). the commercial paper raising mandate;

(b). the issuer and promoter's board resolution to borrow;

(c). the Agency Agreement;

(d). the commercial paper Note;

(e). bank guarantee, where applicable;

(f). investment instruction/ investment mandate;

(g). investment advice;

(h). custodial agreement;

(i). information memorandum on the issuer or promoter;

(j). the latest credit report from the rating agency; and

(k). a backstop loan request for guaranteed commercial papers.

The FMDQ Rules provide for the following documentation and disclosures from the issuer and promoter in connection with the registration of commercial paper programme on its platform:[40]

(a). FMDQ Application Form;

29 Paragraph 6.2(c) of the CBN Guidelines
30 Paragraph 3.1(iii) of the FMDQ Rules.
31 Paragraph 6.2 of the CBN Guidelines.
32 Paragraph 20.0(b) of the CBN Guidelines.
33 Paragraph 3.1(iv) of the FMDQ Rules.
34 Paragraph 11.1 of the CBN Guidelines.
35 Paragraph 3.1(ii) of the FMDQ Rules.
36 Paragraph 7.2.1 of the CBN Guidelines.
37 Paragraph 3.1(ix) of the FMDQ Rules.
38 Paragraph 3.1(vii) of the FMDQ Rules.
39 Paragraph 4.2 of the CBN Guidelines.
40 Paragraph 5 of the FMDQ Rules.

(b). memorandum and articles of association or other relevant constitutional document;

(c). certificate of incorporation or its equivalent;

(d). particulars of directors and shareholders;

(e). 3 (three) years audited financial statements, with the most recent not exceeding 12 (twelve) months from the date of submission of the application for registration;

(f). most recent unaudited interim reports and accounts;

(g). external auditor's comfort letter on the issuer/ promoter;

(h). corporate profile of the issuer/ promoter;

(i). documentation providing information and details of any charges/ encumbrances on cash flows;

(j). comprehensive schedule of current debt profile;

(k). details of any litigations/ claims certified by the external solicitor;

(l). evidence that the commercial paper issuance does not exceed the limit of its borrowing powers;

(m). for non-bank corporate issuers or promoters, a bank reference on the issuer or promoter and a credit information report on the issuer or promoter obtained by a CBN-licensed credit bureau; and

(n). evidence of payment of application fee.

In addition to the provisions of the CBN Guidelines on required documentation for a commercial paper issuance, the FMDQ requires the following:[41]

(a). details of repayment sources/ funding plan for the issue;

(b). a general undertaking in the form provided in the FMDQ Template Guide;

(c). a declaration of compliance by the issuer or promoter in the form provided in the FMDQ Template Guide;

(d). the solicitor's opinion on the issue; and

(e). evidence of payment of all relevant fees.

6. Conclusion

Corporations seeking to raise short-term working capital may look to the commercial paper space as a viable market for this purpose.

41 Paragraph 5.3 of the FMDQ Rules.