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Nigerian Business Regulatory Review

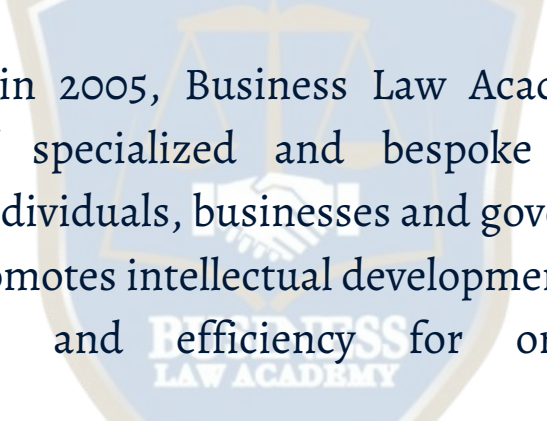
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*NIGERIAN
BUSINESS
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REVIEW*





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Nigeria is dealing with an infrastructure deficit driven by population growth and economic expansion. The 2020 Reviewed National Integrated Infrastructure Master Plan (“NIMP”) calls for spending up to USD150 billion annually to bridge this gap by 2043¹. The private sector, through Infrastructure Funds (“Fund(s)”), is crucial in achieving this goal since the public sector alone cannot provide the entire funding. Currently, there are fewer than ten such Funds, and more are needed. The largest source of funding for these Funds is Nigeria’s pension funds, which hold over USD20 billion in assets², a significant increase from a negative number less than two decades ago. This article will look at the organizational structure of Funds, the Securities and Exchange Commission’s (“SEC”) Rules on Funds in Nigeria, challenges facing Funds in Nigeria as well as viable solutions to maximize the potential of Funds in Nigeria. The regulatory framework is reasonably well-developed, but some further fine-tuning of the rules would be in order.



Structure Options

The cast for the creation of a Fund ordinarily includes the fund originator (typically called a sponsor), fiduciary providers of services to the Fund (such as fund managers, custodians and trustees), the Fund itself (whether it is incorporated or not), the investee entities and other vehicles that will get the Fund monies, and the investors who may include the investing public, high net worth individuals and institutional investors such as pension funds³ (“**Related Parties**”).

A fund manager is distinct from the Fund itself. The SEC has established binding rules regulating fund managers⁴. The decision to organize a Fund, whether as a limited partnership (“**LP**”), collective investment scheme (“**CIS**”) or otherwise, is influenced by considerations including tax efficiency, investors’ liquidity, good governance and applicable pension and securities regulations on fund diversification, financial disclosure and reporting.

(A) CIS

CISs in Nigeria are established as trust; which could

be either a Unit Trust Scheme (“**UTS**”) ⁵ or a Real Estate Investment Trust (“**REIT**”) ⁶, and constituted by a trust deed. When a trust with infrastructure goals offers units to the public, it must adhere to SEC Rules for CISs. Even if a trust doesn’t offer units to the public, it may choose to register with the SEC for credibility or to attract pension fund investments.

According to the SEC Rules, all CISs must be registered with the SEC before conducting business⁷. UTSs and REITs can either be open-ended or closed-ended, with open-ended schemes allowing investors to redeem their units at any time while closed-ended ones do not. Also, close-ended UTSs have more defined rules, although they are less popular due to limited unit redemption options.

(B) LPs

A Fund may be structured as an LP with participation open to only a restricted group of investors. An LP can be registered under the Companies and Allied Matters Act (CAMA) ⁸, under state law, or under the laws of a foreign jurisdiction⁹. Nigerian law permits foreign-LP Funds to invest in Nigeria, but trading in Nigeria requires local incorporation, and offering securities to Nigerians necessitates SEC approval. LPs are limited to twenty partners, with at least one acting as a general

1 Federal Ministry of Finance, Budget and National Planning, Reviewed National Integrated Infrastructure Master Plan (2020).

2 Vanguard, ‘Pension Fund Assets hit N16.76tn’ (August 2023).

3 See the Pension Reform Act 2014 and the Regulations on Investment of Pension Fund Assets 2019 (the “Pensions Regulations”).

4 See ss. 91-95, ss. 450-453, and ss. 494- 500 SEC Consolidated Rules and Regulations (2013); SEC Amendment to Rules on Collective Investment Schemes under the SEC New Rules and Sundry Amendments (December 23, 2019) (the “SEC Rules”).

5 Ss. 152 and 315 of ISA defines a Unit Trust as “any arrangement made for the purpose, or having the effect, of providing facilities for the participation of the public as beneficiaries under a trust in profits or income arising from acquisition, holding, management or disposal of securities or any other property”



partner¹⁰ who is responsible for executive functions and full liability for partnership debts, while other partners are limited partners without executive functions and liability limited to their contributed capital.¹¹

Tax Structure

For trusts and LPs without legal personality, the Fund pays no income or capital gains tax on money going into the Fund by way of income or capital gains. Income and capital gains tax arise only on distributions out of Funds to trust beneficiaries¹² and limited partners respectively. For Funds constituted as LPs that have juristic personality, the law is unclear and as yet untested. The better view is that income and capital gains tax arise both when money goes into the Fund and when money goes out of the Fund as distributions to the beneficiaries or LPs.

Liquidity

In strict law, both trusts and LPs can be structured to allow ready redemption by investors, with the fund manager to pay the investors either out of cash in hand, borrowing afresh, selling assets or by issuing further units to new investors. In practice, ready redemption is rarely an option. This is because the Fund will ordinarily have distributed most of its cash, and most of the underlying Fund assets will not be so liquid as to be readily sellable either in part or as a whole.

It is not surprising that by the terms of the constitutive documents, redemption is typically allowed at best only periodically, and then only subject to maximum limits and a need to give ample prior notice. Units in a trust or LP cannot readily be constituted as tradeable securities on a stock exchange. This is because by trading, more than fifty unitholders may occur and the law is to the effect that, absent a clear statutory exemption, a Fund with more than fifty members must be otherwise organized.

Governance

By law, a SEC-registered Fund, organised as trust or not, must have a custodian, a manager, a registrar, trustees, annual audited accounts, investor meetings, quarterly reporting to the SEC, periodic valuation, and an

investment committee.¹³ For Funds that are not registered with SEC, these several features are optional in strict law but widely adopted in practice. In practice, regardless of the organisational structure, it is also usual to have an advisory committee comprised of independent, credible and knowledgeable experts.

Pension Fund Regulations

Pension funds are permitted to invest only in SEC-registered Funds¹⁴ and are subject to additional requirements such as the Fund having a minimum value of ₦5 billion and at least 60% of the Fund invested in projects within Nigeria. A single pension fund cannot invest more than 10% (for Fund I investments) or 5% (for Fund II investments) of the assets of the pension fund in any one Fund.

SEC Rules on Infrastructure Funds

On May 12, 2014, SEC first issued its Rules on Infrastructure Funds (the "Rules").¹⁵ By the Rules, a fund manager must have a minimum of two experts in infrastructure work and has been active in infrastructure financing work for not less than five years. A Fund may have a minimum tenor of seven years, or interval schemes (with a five-year lock-in and intervals not exceeding one month).¹⁶

After being fully paid for, Fund units can be listed on securities markets.¹⁷ Even Funds organized as private equity LPs may, but need not, be listed on a securities exchange.¹⁸ Furthermore, publicly-traded Funds must disclose an anticipated timing for the listing of units in them and may buy back up to 20% of the initial units sold.¹⁹ Funds must also disclose to potential investors their indicative portfolio composition as well as the minimum amount of units that an investor can subscribe to.

The Rules specify limits on how Fund assets are to be allocated. A Fund must:

- a. invest at least 90% of its assets in securities or debt instrument²⁰ of Eligible Entities;²¹
- b. invest up to 70% of its net assets in the securities or assets of any single Eligible Entity.

⁶ A trust made for the sole purpose of acquiring intermediate or long-term interests in real estate or property development. See s. 193 of ISA.

⁷ S. 160 of ISA and Rule 459 SEC Rules.

⁸ Companies and Allied Matters Act, 2020 (as amended).

⁹ LPs are often registered in jurisdictions such as Mauritius, the British Virgin Islands, Jersey and the Cayman Islands.

¹⁰ The general partner will be the fund manager or a wholly owned subsidiary of the fund manager incorporated with no assets and carrying on no business other than acting as general partner of the limited partnership.

¹¹ S. 795 CAMA and s. 44(2) of the Partnership Law of Lagos State. Limited partners are the investors in the Fund. For efficient management, they are often represented by the trustees who receive subscriptions from investors and in turn invest in the LPs.

¹² S. 17(5) of CITA



c. invest not more than 30%²² of its net assets in debt instruments in Eligible Entities that are unrated or graded below investment grade.

d. restrict its investments in any unlisted or listed security issued by way of private placement by the Fund's Related Parties. Where a listed security exceeds 25% of the Fund's net assets, it must be subject to the approval of the trustees and full disclosures to investors.²³

Fund assets are to be valued by the fund manager in good faith, using valuation methods based on trustee-approved principles.²⁴ The valuation process and methodology²⁵ must be documented, with supporting data retained for at least seven years after the offer ends.

Management fees payable to a fund manager²⁶ for a year cannot exceed 2% of the assets under management in that year.

However, where the Fund meets whatever hurdle rate may be specified in its constitutional documents, performance fees, carried interest, or incentive fees may be eligible in an amount not exceeding 20% of the profits above the hurdle rate.²⁷

Where a Fund has eligible Sovereign Wealth Fund and/or Multilateral Development Finance Organization Limited Partner investors, the fund manager must always own a minimum investment of 1% of the Fund. Where it lacks these, but the fund manager has a minimum 'BBB' Investment Manager rating from at least two SEC-recognized rating agencies, the fund manager must always own a minimum of 3% of the Fund²⁸. These requirements apply whatever the organizational structure of the investment vehicle may be.



G. Elias is a leading Nigerian business law firm founded nearly thirty years ago. We have always had an international outlook. If we may say so, we have a reputation for, and an outstanding record of, carrying out critical, innovative, and complex work to the highest standards. We have advised on many significant developments in Nigerian business law. Our practice areas are mergers, acquisitions, strategic investments, re-organizations, foreign investment, compliance, lendings, derivatives, insolvency, capital markets, litigation, arbitration, "white collar" defence and investigations, tax, intellectual property, competition, data protection, and employment law. We are a member of Multilaw, a leading global alliance of independent law firms.



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¹³ See the Investment and Securities Act (ISA) and the SEC Rules

¹⁴ Reg 4.7 (iii) of the Pensions Regulations permits the investment of pension fund assets in infrastructure funds registered with SEC.

¹⁵ SEC, Rules on Infrastructure Funds, Collective Investment Schemes and Sundry Amendments, May 12, 2014. The Rules were further amended in 2017 by the SEC's New Rules and Amendments as at June 2017. The Rules define "Infrastructure Fund" as a specialized fund or scheme that invests primarily (at least 90% of net assets) in securities, loans or securitized debts instruments of infrastructure companies, infrastructure capital companies, infrastructure projects, special purpose vehicles which are created for the purpose of facilitating investment in infrastructure and other permissible assets ("Eligible Entities").

¹⁶ An Interval Scheme is a collective investment scheme that is close ended but is made open-ended for an interval period within which redemptions may be made and new subscriptions received. An Interval Period is the period/interval of one month within which a Fund is open for purposes of redemptions and new subscriptions. An interval period may occur more than once in the life of an interval scheme.

¹⁷ In Nigeria, the securities markets include, the Nigerian Exchange Limited and the FMDQ Securities Limited.

¹⁸ Rule 4(2), the Rules. See also Section 5.2.11 of the 2019 Pension Regulations on requirements of Private Equity Funds.

¹⁹ Rule 4(3), the Rules.

²⁰ A Fund may invest in equities, convertible instruments, money market instruments, structured loans, and bank deposits for liquidity purposes.



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