

## **DRAFT... Private Placement Rule, 307 (A) \_\_\_ for Bonds**

**NOTES:** This has NOT been fully vetted; a global comparison for Private Placements is being developed as well to be reviewed by the SEC.

This DRAFT is exposed for comments by market operators. Comments may be sent to Mary Uduk, Director, SIS Department, SEC at [muduk@sec.gov.ng](mailto:muduk@sec.gov.ng)

### **Background**

1. Consideration must be given for the Nigerian environment, more specifically to the regulatory environment, focusing on what the SEC and PenCom expect regarding Private Placements (PP) of bonds.
  1. The SEC already has a Private Placement Rules 89-97, which mostly relate to shares
    - i. THESE RULES 89-97 SHOULD STATE “FOR EQUITIES ONLY”**
  2. The SEC has Rules 306 and 307 which regulate securities issued by States and local governments
  3. The SEC in March 2010, adopted Rule 307 (A) which regulates issuances of Corporate Bonds
    - i. This Rule allows issuance through public offering or private placement
  4. PenCom recently revised its Investment Rules for Pension Funds
    - i. PenCom Rule 3.2 allows Pension Fund Administrators (PFAs) to invest in Corporate Bonds through public offering or private placement approved by the SEC
    - ii. PenCom does not allow PFAs to invest in private placements of equities
2. Both the SEC and PenCom, in the current environment, are restrictive as to what their regulated entities are allowed to do or not do. In this regard, despite what the regulators say, they are both *merit-based* rather than *disclosure-based* regulators. That is, they set the rules and expect all entities to be in compliance with those rules, rather than letting the regulated entities disclose all salient features, and letting the clients or investors decide to participate or not.
3. Universally speaking, PPs are intended for investment by qualified investors, and do not require a full prospectus or even approvals by the regulators; regulators assume that these qualified investors are sophisticated enough to perform their own due diligence into the worthiness of the investments. However, this is not the case in Nigeria.
4. It is hoped and envisioned that the regulators will move toward a disclosure-based regulatory framework sometime in the near future. Until that time, however, the regulatory framework in Nigeria will be relatively merit-based and restrictive.
5. Keeping the above in mind, there will be a new SEC Rule drafted which relates to the issuance of Private Placements for Bonds; it shall be incorporated in SEC Rule 307 (A).

6. The elements of the Private Placement Bond Rule (within 307.A) will include:

### **Draft Rule 307 (A) \_\_. Private Placement of Bonds**

#### **Rule \_\_. Definitions**

(1) No public company shall offer securities by way of private placement without the prior approval of the Commission.

a. Approval shall be at the level of the Executive Commissioner, Operations; in her/his absence, by another Commissioner.

(2) **“Private placement”** shall mean the issue of securities not involving public offering.

#### **Rule \_\_. Conditions for approval of offer**

Private placement of bonds by public companies shall be subject to the following conditions:

(1) The company shall describe the intended use of proceeds.

(2) The securities shall not be offered to more than 50 bond holders, all of whom are Qualified Investors.

a. The issuer shall compile a list of the bond holders with contact details and send to the SEC.

b. When there is a transfer/trade of bonds, the name and contact details of the new bond holder shall be sent to the SEC.

i. NOTE: It is anticipated that the bond holders will have to either (1) complete a simple questionnaire or attestation regarding their qualifications as a QI and submit that to the SEC; or (2) notify the SEC as well as the issuer that the bond holder is a QI

(3) The minimum application amount in a Bond Private Placement shall be no less than (e.g., ₦20,000,000) per bond.

(4) The offer shall be for a period as proposed by the issuer and approved by the Commission but not exceeding ten (10) working days: Provided that the Commission may extend the period under special circumstances.

(5) No advertising or general solicitations of the private placement shall occur.

#### **Rule \_\_. Access to information, etc.**

1) Access to information shall be only by reason of the offeree’s position to the issuer.

2) Each offeree shall have access to the same kind of information included in a placement memorandum or any offering document.

3) The offeree shall have the opportunity to question the issuer about the terms and conditions of the offering, and to obtain any additional facts necessary to verify the information given. At a reasonable time prior to the sale of securities, the issuer

shall furnish to the offeree, the same kind of information included in a placement memorandum to the extent necessary for proper understanding of the issuer, its business and the securities being offered.

**Rule \_\_. Filing requirements**

- (1) The issuer shall within 10 working days of the close of offer, file a report on the offer with the Commission.
- (2) The report shall contain the following information:
  - a. Names, addresses, email, and telephone numbers of the purchasers;
  - b. Amount purchased by each offeree and the mode of payment;
  - c. Declaration of the offeree as Qualified Investor;
  - d. Total amount raised ;
  - e. Applicants subscribing for 5% and above of the PP:
  - f. Bank statement evidencing payment of subscription:
- (3) The report shall be signed by person(s) duly authorised to do so by the issuer.

**Rule \_\_. Private Placement Memorandum**

**NOTES:** (1) The draft provisions below relating to the “Private Placement Memorandum” and “Continuous Disclosure Requirements” in **BOLD** are proposed as lesser requirements to be for smaller issues (e.g., up to ₦100,000,000) with a restricted number (e.g., 5) of QI bond holders...to encourage SMEs to issue and therefore access the capital markets.

(2) If the company is already listed, consideration should be given to lessen these disclosure requirements so as NOT to duplicate what has already been filed and that can be accessed. If already on file, information should be accessible, on web sites in particular. If information on file is outdated or not complete or accurate, then updates only need to be filed, disseminated, and accessible.

(3) The following Disclosure Requirements, in the Private Placement Memo and for Continuing Disclosure...can be placed in a Template, to be completed by the Issuer and/or Financial Advisor

**Where a private placement is proposed in line with this regulation, the issuer shall file two hard copies and/or one soft copy of the placement memorandum containing, amongst other things, the following.**

The draft provisions relating to the “Private Placement Memorandum” and “Continuous Disclosure Requirements” below in **BOLD** are proposed to be for smaller issues only (e.g., up to ₦100,000,000) with a restricted number (e.g., 5) of QI bond holders.

- (1) Summary of the offer, including trust indenture and other contractual agreements and covenants**
- a) Principal amount:**
  - b) Denomination:**
  - c) Issue Price/interest rate:**
  - d) Tenor/Maturity Date:**
  - e) Coupon:**
  - f) Class:**
  - g) Subordination or other limitations on rights (e.g., negative pledge), describe:**
  - h) Redemption provisions (mandatory or optional), describe:**
  - i) Options, put/call, if any, describe:**
  - j) Conversion provisions, if any, describe:**
  - k) Restrictive (or protective) covenants<sup>1</sup>, describe:**
  - l) Events of default, describe:**
  - m) Meetings of bondholders, describe:**
- (2) A description of the securities, including:**
- a) Security/collateral/guarantees/insurance, if secured**
  - b) Liens**
  - c) Payment dates of principal and interest; tenor**
  - d) Method of offering**
  - e) Modification of Terms**
  - f) Paying Agent /Registrar of Securities**
  - g) Representation of Debt Security Holders (Through Trustees or Any Other Representative of the Debt Security Holders)**
  - h) Credit Rating(s), if any, and Credit Rating Agencies providing Ratings**
  - i) Tax status**
- (3) A description of the risks of the securities, among others:**
- a) Default**
  - b) Consequences of a Failure to Make Payments**
- (4) Use of proceeds**
- a) Project:**
  - b) Amount:**
  - c) Percentage:**

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<sup>1</sup> Restrictive (or Protective) Covenants protect the interests of bondholders by restricting the activities of the issuer in certain situations. These limitations include:

- Debt limits—restrictions on taking on more debt;
- Dividend payments—limitations on payment of dividends or retiring equity;
- Limitation on liens or negative pledge (the issuer will not pledge assets to another lender, creating a class of creditor that ranks above the bondholders in the hierarchy of creditors);
- Limitation on asset dispositions;
- Limitations on merger, consolidation or sale; and/or
- Limitations on transactions with affiliates.

**d) Duration:**

- (5) A description of the issuer to include:
- a) Profile of the Executive Management & key employees of the Issuer
  - b) Description of issuer's business and industry specific information
  - c) Major contracts
  - d) Any legal or regulatory enforcement actions relating to the issuer
- (6) Statutory/General information stating date of incorporation, registration number and share capital history of the company, the principal shareholders, directors' interests, subsidiaries and associated companies, extracts from the Articles of Association, claims and litigations, material contracts, consents, documents available for inspection, underwriting (where applicable) and any other material information.
- (7) **Financial summary for three years (or less if the company is less than three years old).**
- a) Annual Information Filing: financial and operational information.
  - b) Annual Audited Financial Statements (Audits).
  - c) Notice of Failure of any person required to provide the Annual Information Filing.
- (8) Directors of the Issuer/Parties to the offer.
- a) Issuer:
  - b) Lead Issuing House/Joint Issuing Houses:
  - c) Trustees:
  - d) Solicitor to the Issue/Trustees
  - e) Solicitor to the Issuer:
  - f) Auditor to the Issuer:
  - g) Reporting Accountants (where applicable):
  - h) Stockbrokers (where applicable):
  - i) Registrars/paying agent:
  - j) Underwriter(s), if applicable:
  - k) Receiving Bank(s):
  - l) Rating Agency(ies)
- (9) **Chairman's letter.**
- (10) **Placement period.**
- (11) **Application form.**
- (12) **Declaration of QIB**

Copies of other documents, including the trust indenture, significant contracts and corporate authorization described in the memorandum, are available from the trustee upon request of a bondholder.

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**Notes:**

1. The SEC has dropped the mandatory requirements for (1) Credit Ratings and for (2) resolution by the AGM for the Private Placement (non-convertible) bond issuance.
2. There will be full disclosure (with PenCom and SEC desirous of such, to help satisfy PenCom to allow Private Placement investments purchased with assets from pension funds) within the PP Memorandum as well as continuing disclosures of material information.

**Rule \_\_. Continuous Disclosure Requirements.** Besides the annual audited financial information, continuous disclosure elements should include the following, where the issuer shall send to all bond holders and to the SEC, within three (3) business days of occurrence:

- i. **Principal and interest payment delinquencies;**
- ii. Nonpayment-related defaults;
- iii. **Unscheduled draws on debt service reserves and/or credit enhancements reflecting financial difficulties;**
- iv. Substitution of credit or liquidity providers, or their failure to perform;
- v. Adverse tax opinions or events affecting the tax-exempt status of the Bonds;
- vi. **Change in control of issuer**, e.g., issuer is acquired by or merges with another company; if there is a change in the trust deed
- vii. **Modifications to rights of bondholders;**
- viii. Bond calls;
- ix. **Defeasances** (i.e., debt negation without repayment; setting aside of assets for repayment of a debt without actual retirement of the debt);
- x. **Release, substitution, or sale of property securing repayment of the Bonds** (this includes the issuer (1) incorporating a Negative Pledge Covenant and (2) an Anti-Asset Stripping Covenant restricting the disposal of more than 20% of group assets within any rolling 12-month period, unless the proceeds are either (i) re-invested in new operating assets of a similar nature or (ii) applied to pay down debt that is senior to the bonds or (iii) used to offer the bonds back at par.); and
- xi. Rating update which involves a downgrade of the existing rating.

**NOTES for Consideration:**

1. What is the advantage for an issuer to issue a Private Placement rather than conduct a public offering?? Good question. Not exactly cost efficient over a public offering, but then again, not all issuers will be large companies able to gain access to funding through public offerings. If SMEs want to issue a Private

Placement, this may still be realistic vs. a public offering, and where they can gain medium-term to long-term funding as well and still save costs and expenses as compared to bank loans, which may or may not be available.

- **Strong consideration should be given by the SEC toward encouraging SMEs to apply for a private placement of bonds, in that funding should be longer term and at cheaper rates than comparable bank loans. Therefore, given a lower threshold, SMEs should be able to issue a private placement at a low cost. For example, consideration might be given to lesser disclosure requirements if the private placement was:**
  - i. **₱100,000,000 or less, AND**
  - ii. **5 or fewer (QI) bond holders**

The rationalization of above is that in practicality, those qualified investors of SME private placements are friends, relatives, and/or customers of the SME, therefore know the management and operations of the company.

The draft provisions relating to the “Private Placement Memorandum” and “Continuous Disclosure Requirements” above in **BOLD** are proposed to be for smaller issues (e.g., up to ₱100,000,000) with a restricted number (e.g., 5) of QI bond holders.

2. In US private placements, the private placement memorandum or offering circular generally contains the same level of information as a prospectus for registered, public offering securities. Consideration may be given to have the above requirements for initial and ongoing disclosures the same for Public Offerings of Bonds.
3. The above requirements may be placed onto a “Template”, to fill in the blanks and to add relevant detail info. Please refer to Pricing Supplement Template and the Draft Bond Prospectus Template.