

Bond Training Work Shop for Accountants and Insurance Companies

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THE WORLD BANK



Presentation to Accountants and Insurance Companies

- Tax Waiver Status
 - Background; Benefits; Bottom Line
- Use/Importance of Bonds in Nigeria
 - For Issuers; For Investors; Bottom Line
- Importance of Disclosure
 - What is Disclosure; ACT-Up Principle; IOSCO and SEC Initial Requirements; Ad Hoc, Continuing Requirements; Bottom Line
- Relevance of Bonds for Insurance Companies

Tax Waiver Status

Background:

- Signed by President Jonathan in March 2010
 - To date, however, this Tax Waiver has not been published in the Gazette
- FIRS is granting waivers to all that apply
- The Tax Waiver is for Corporate and sub-national...or State issuers, as well as for Supra-Nationals, like the IFC
- Also benefits for investors

Tax Waiver Status

Background (continued):

- Subjects taxation of these bonds, for the issuer and for the investor, on equal tax status as that for FGNs
- Tax waiver granted for min. period 10 yrs
- To include (in addition to the exemptions for bonds previously granted under the Companies Income Tax Act) taxes under (1) the Personal Income Tax Act, (2) Value Added Tax, and (3) the Capital Gains Tax Act.

Tax Waiver Status

Benefits to include:

- Reduction in stamp duties for the re-issuance of previously executed debentures to 20 per cent of the stamp duty payable on a new debenture of the same value;
- Sub-nationals and corporate entities can now access long term capital by issuing bonds at a relatively cheaper cost than they would have if there had been no tax exemptions;
- A level playing field is created for all bonds regardless of the issuer;

Tax Waiver Status

Benefits (continued):

- Multilaterals such as the World Bank, International Finance Corporation and the African Development bank among several others can issue bonds which will be exempt from Nigerian taxes. The effect of this would serve to encourage multinationals to participate in the development of the Nigerian domestic bond market, while the perception of Nigeria in the international financial markets will be improved;

Tax Waiver Status

Benefits (continued)

- The tax exemptions will increase the range of securities/ options available to investors, encourage the development of new products and attract foreign investors to the domestic capital market;
- Issuers would have an opportunity to raise more stable capital from a large investor base at a relatively lower cost;
- Help to improve the capital market and also help even out the imbalance between interests in equity versus debt securities; and
- Expected help to increase the GDP of Nigeria through increased issuances.

Tax Waiver Status

Bottom Line:

- The implementation of a Tax Waiver is sought after in every market, either developed or developing.
- Companies as well as sub-nationals need a competitive advantage, or at least to have an equal footing, as compared to the Government bonds.
- The risk may be higher with corporates and sub-nationals, but the rewards (i.e., coupon or interest payment) are higher, so there is greater potential reward on the higher-risk investments.
- This Tax Waiver is an important step forward for issuers and investors alike, and I personally, congratulate the President in his endorsement of such.

Use/Importance of Bonds in Nigeria

For Issuers:

- 3 choices for raising capital:
 - Bank Loans
 - Issue Shares
 - Issue Bonds...similar to a bank loan, which is an I.O.U. of a company or a sub-national to return principal at a pre-determined date in the future, meanwhile having an obligation to pay interim interest payments to the investors.
- Bonds are debt securities, and therefore do not dilute ownership but merely obligates the issuer to pay both interest (unless the bond issued is a 'zero-coupon' bond, which pays no interest during the life of the bond, is issued at a discount, and at maturity, pays the 'par' amount to the investor) and principal at pre-determined intervals through maturity.

Use/Importance of Bonds in Nigeria

For Issuers (continued):

The **intended use of proceeds** is important for the SEC and investors to know as a viable reason for issuing a bond and must be stated in the prospectus. A corporation, for example, might decide on issuing a bond to build a manufacturing plant in another state, thus expanding business opportunities. A State may issue a bond to build or improve the road network throughout the State.

Use/Importance of Bonds in Nigeria

For Issuers (continued):

Reasons for bond issuance in Nigeria, either by small, medium, or very large companies, could include:

- Obtain beneficial short or long-term debt financing at attractive rates and as alternatives to issuing shares or obtaining bank loans
- To gain debt financing, which does not dilute shareholder ownership
- Help the economy of Nigeria by seeking financing away from bank financing
- Help kick-start the non-government bond market of Nigeria, being a leader for other issuers to follow
- To provide additional (types of) assets for Nigerian Pension Funds and Insurance Companies to invest in
- To gain greater exposure/improve public relations for a company; bonds can be traded or quoted on the Exchange

Use/Importance of Bonds in Nigeria

For Investors:

- The company's or State's ability to pay the interest and eventually the principal
 - The higher the (perceived) risk of the company of being able to pay the interest or principal, the higher the coupon or interest payments that the company must pay
 - As general Nigerian interest rates move higher, the market price of the existing bond moves lower; therefore interest rates and bond prices move in opposite directions.

Use/Importance of Bonds in Nigeria

For Investors (continued)

- In Nigeria, the SEC requires all publicly traded bonds, i.e., traded or listed on the Stock Exchange or in the Over the Counter market, to have an ‘investment grade’ credit rating, meaning that a credit rating agency has rated the bond at a level of “BBB” or better, which in turn means that there is good likelihood that the issuer will pay interest and principal on a timely basis throughout the existing life of the bond.
- The PenCom has also required that for bonds to be purchased in Pension Fund portfolios, that the bond has two credit ratings of investment grade or higher.

Use/Importance of Bonds in Nigeria

For Investors (continued):

Benefits of investing in bonds include:

- Yields
- Flexibility
- Dependable Income
 - e.g., for insurance companies, with known liabilities 5-7 years out, they can purchase 5-7 year-maturing bonds to meet these liabilities
- Safety and Reliability
- Diversification

Use/Importance of Bonds in Nigeria

Bottom Line:

- Non-government bonds have a tremendous potential in Nigeria...for issuers and for investors.
- As all securities, there are risks associated with bonds, including risk of default.
- However, with effective due diligence, issuers should be able to benefit by issuing bonds in the capital market and investors should benefit gaining a dependable income stream and flexibility to meet financial goals and investment objectives.

Importance of Disclosure

What is Disclosure

- Disclosure by issuing companies (States) is required by regulators...and by investors
- Disclosure provides a modicum of transparency regarding the issuer and its issuances...equities and/or bonds
- The capital markets thrives on information being transmitted to investors and regulators alike, whereby investors make investment decisions: to sell; to buy; or to hold
- It is most important for issuers to disclose market-affecting information, whether by regulation or voluntarily, on the “ACT-UP” principle

Importance of Disclosure

ACT-UP:

Accurately

Completely

Timely

Up-to-Date

Information not reported, disclosed, and disseminated on an ACT-UP basis is doing a disservice to investors...it's the investors in the bonds or equities who drive the market, whether they are institutional or retail; domestic or foreign.

Importance of Disclosure

IOSCO and the SEC:

- IOSCO, the International Organization of Securities Commissions, as well as SEC Nigeria have prescribed disclosure requirements for companies applying for and issuing securities.
- The SEC is also developing a template (a type of check list) of the Bond Prospectus for issuers to use upon application; the SEC has already adopted a template for the Pricing Supplement for Shelf Offerings.

Importance of Disclosure

Ad Hoc, Continuing Disclosure:

The SEC is contemplating adopting requirements for continuing issuer disclosure for the following events on an ad hoc basis, i.e., when they occur; disclosure would be required within two business days of occurrence:

- Principal and interest payment delinquencies (issuer is therefore in 'default');
- Nonpayment-related defaults;
- Unscheduled draws on debt service reserves and/or credit enhancements reflecting financial difficulties;
- Substitution of credit or liquidity providers, or their failure to perform;
- Adverse tax opinions or events affecting the tax-exempt status of the Bonds;

Importance of Disclosure

Ad hoc, continuing disclosure (continued)

- 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
- Modifications to rights of bondholders;
- Bond calls;
- Defeasances (i.e., debt negation without repayment; setting aside of assets for repayment of a debt without actual retirement of the debt);
- Release, substitution, or sale of property securing repayment of the Bonds; and
- Rating changes.

Importance of Disclosure

Other recommended items for Ad Hoc Disclosure:

As suggested by one of the major active stakeholders in the Nigerian market, additional disclosure and requirements of the prospectus should be made by the issuer incorporating:

- (1) a Negative Pledge Covenant (i.e., a clause stating that the company will not pledge any of its assets, if doing so gives the lenders less security, or preventing the company from issuing senior debt subsequent to the issuance of this bond), 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.

Importance of Disclosure

Bottom Line:

In other words, if there is a risk that the bond holders will be negatively impacted by actions of the issuing company or others, these bond holders as well as the SEC should be immediately informed by the issuer.

Relevance of Bonds for Insurance Companies

- Insurance Companies are fairly unique in their potential relationship with bonds:
 - Invest in Bonds;
 - Issue Bonds; and uniquely
 - Insure Bonds for credit enhancement on issue
- In the USA for example, “monoline” insurance companies perform this insurance function for bonds...for a fee of course (+/- 1% of issue amount)
 - **Bond insurance** is a service whereby issuers of a bond can pay a premium to an insurance company, who will provide interest and capital repayments as specified in the bond in the event of the failure of the issuer to do so, i.e., default by issuer

A new business line for Nigerian insurance companies?