UDO UDOMA &
BELO-OSAGIE

Key Structuring Considerations for Foreign Institutions Lending to Nigerian Corporates and Financial Institutions

UDO UDOMA & BELO-OSAGIE

INTRODUCTION

Nigeria has witnessed a significant capital inflow from foreign investors through debt and equity investments over the years. The number of cross-border financing transactions and the value of the loans have skyrocketed significantly. The reason for this is not far-fetched; cross-border financing is one of the many ways in which Nigerian corporates and financial institutions get funding to finance their operations and projects in Nigeria. In the case of financial institutions, sometimes, the proceeds of the foreign loans are used for on-lending to SMEs and women-led businesses and for trade finance. This has been helping to stimulate the growth of the Nigerian economy. The ability of some foreign lenders to provide loans at relatively lower interest rates has also incentivised Nigerian corporates and financial institutions to seek cross-border financing for their projects and business expansion. There are also some foreign lenders looking for investment opportunities to diversify their portfolios and earn higher returns on their investments, which makes them willing to provide financing to Nigerian entities.

Some foreign lenders involved in cross-border financing with Nigerian corporates and financial institutions include international financial institutions, development finance institutions, multi-national banks, export credit agencies and parent companies of Nigerian corporates.

The exposure of foreign lenders to the Nigerian economy through cross-border financing warrants an analysis of the key issues to consider in making decisions regarding providing financing to Nigerian entities. An understanding of efficient structuring options compliant with Nigerian law and regulations is critical in navigating the Nigerian cross-border financing clime.

In this publication, we discuss the legislation and regulatory framework that impact foreign lenders providing financing to Nigerian corporates and financial institutions ("Nigerian Borrowers") on a cross-border basis. It also covers some pragmatic structuring considerations that foreign lenders should take into consideration when entering into cross-border financing with Nigerian Borrowers.

REGULATORY FRAMEWORK AND FOREIGN EXCHANGE CONTROL FOR CROSS-BORDER FINANCING

There is generally no express provision in Nigerian law that governs cross-border financing in Nigeria. As a result, foreign institutions are permitted to provide foreign loans to Nigerian

entities. There are, however, some foreign exchange laws and sector-specific regulations that apply to foreign borrowing by Nigerian Borrowers. For instance, Nigerian financial institutions involved in cross-border financing are required to comply with the Central Bank of Nigeria's ("CBN") regulations and directives in relation to foreign currency borrowings. Other legislation that impact cross-border financing include the Foreign Exchange (Monitoring & Miscellaneous Provisions) Act, 2004 (the "FEMM Act"), which established the foreign exchange market ("FX Market") and the certificate of capital importation ("CCI") regime for foreign loans, the National Economic Intelligence Committee (Establishment, etc.) Act, 2004 (the "NEIC Act"), the CBN Revised Foreign Exchange Manual 2018 (as amended) ("FX Manual") and the circular dated 21st April 2017 issued by the CBN to establish the Investors' & Exporters' FX Window.

Are foreign institutions permitted to lend to Nigerian Borrowers?

Foreign entities are generally permitted to provide loans denominated in foreign currencies to Nigerian Borrowers without any restrictions. The requirement of Nigeria's companies law that foreign companies are not permitted to have a place for business in Nigeria without incorporating as a separate company in the country, does not apply to foreign lenders providing financing to Nigerian entities on a cross-border basis.

Where the loan is not converted into Naira, the lender will not be entitled to a CCI. In this case, if the Nigerian Borrower has access to foreign exchange through other independent sources, it will be permitted to use such funds to repay the foreign loan to the foreign lenders.

Foreign lenders' access to the foreign exchange market for repayment of the loan and payment of interest

The FEMM Act provides that any person may, among other things, provide debt financing to any Nigerian enterprise with foreign currency or capital imported into Nigeria through an Authorised Dealer (that is, a Nigerian bank licensed by the CBN to deal in foreign exchange). Subject to providing the prescribed documentation, upon the importation of foreign currency into Nigeria and conversion into Naira, the foreign lender is entitled to obtain a CCI from the Authorised Dealer within 24 hours of the importation and conversion into Naira. The CCI serves as evidence that capital was brought into Nigeria and indicates the amount of foreign capital brought in, the Naira equivalent, the names of the lender and the borrower, etc. With the CCI, a foreign lender will be permitted to access the FX Market to purchase foreign currency at the official rate to repatriate the principal and interest payments on the loan.

A CCI can also be issued for foreign loans brought into Nigeria in the form of equipment, plant, or machinery. In that case, the importation documents must not be more than 6 (six) months old.

Where parties structure a cross-border financing transaction in a way that transaction fees (such as commitment fees, agency fees, arrangement fees etc.) payable by the Nigerian Borrower to the finance parties are deducted at source before the inflow of the loan into Nigeria, a CCI will only reflect the actual amount brought into Nigeria. A CCI will not be issued for any amount brought (or is not brought) into Nigeria and converted into Naira. In this case, at the time of repayment, the foreign lender will only be able to repatriate the amount of the loan indicated on the CCI and interest thereon through the FX Market.

Although the CCI guarantees the unconditional transferability of the proceeds from the investment that it relates to, it does not guarantee liquidity. A Nigerian Borrower and foreign investor will only be able to access funds for repatriation if there is sufficient liquidity in the FX Market. Furthermore, where a loan is not converted into Naira in order for a CCI to be obtained, neither the investor nor the borrower will be permitted to access the official market for repatriation. If the Nigerian Borrower, however, has access to foreign exchange through other independent sources, it will be permitted to use such funds to repay the foreign loan and interest to the foreign lenders.

Mitigating FX risks in foreign loans to Nigerian entities

The best mitigating factor is to grant such foreign currency loans to Nigerian companies that generate foreign exchange from their operations. Those companies are, however, not common in Nigeria. As a result, depending on the commercial agreement of the parties, various options could be considered to mitigate foreign exchange liquidity risks. The structuring options include structuring the financing (i) as a convertible loan, (ii) in a way that an offshore affiliate of the Nigerian Borrower will be the borrower of record (notwithstanding that the proceeds of the loan will be used to finance the project of the Nigerian entity) with the primary obligation to repay the loan, (iii) in such a way that, as a security package, the offshore affiliate/subsidiary of the Nigerian Borrower is required to guarantee repayment of the loan and interests in the event of the inability of the Nigerian Borrower to repay the loan and make interest payment. Any of the structures to be adopted would depend on the commercial agreement of the parties and will be documented as such.

TAX AND STRUCTURING

Stamping

The Stamp Duties Act 2004 (as amended) requires stamp duty to be paid, at the rates specified in the Act, on instruments executed in Nigeria "or relating, wheresoever executed, to any property situate or to any matter or thing done or to be done in Nigeria", failing which payment, such instruments shall not be admissible in evidence in any civil proceedings in Nigeria and non-stamping could also constitute an offence. As a result, any agreement for the provision of foreign loans to Nigerian Borrowers is subject to stamp duty in Nigeria within 30 (thirty) days of a copy or original of the agreement being executed or received in Nigeria. The applicable stamp duty rate could be nominal or ad valorem, depending on the transaction, document, and the parties. The final determination of the stamp duty rate will only be obtained from the tax authority on the relevant assessment date.

Where the agreement is executed and kept outside Nigeria, the obligation to stamp the document and pay stamp duty will not arise until within 30 (thirty) days from the date that the original or a copy of the document is first received in Nigeria. Until that time, no penalty for non-stamping or late stamping of the agreement will arise.

Withholding Tax

Interest payments to foreign lenders from Nigerian Borrowers are subject to withholding tax in Nigeria. The generally applicable rate is 10%. This could be reduced to 7.5% if the lender is resident in a country with which Nigeria has a double taxation agreement that such a reduced rate applies. Certain exemptions would apply if the loan is structured to meet certain prescribed terms. The tax, when withheld and remitted to the tax authority, will be the final tax due on that interest income in the hands of the foreign lender in Nigeria.

Finance parties may, however, structure the terms of the foreign loan to have, among other things: (i) a tenor of 2 (two) to (seven) years; and (ii) a grace period (including moratorium) of between 12 (twelve) months and 2 (two) years on the repayment of principal and payment of interest. The tax exemptions are provided under the Companies Income Tax Act 2004 (as amended) to include a tax exemption of (a) 70% where the repayment period of the loan is above 7 (seven) years (with a grace period of not less than 2 (two) years); (b) 40% where the repayment period of the loan is between 5 (five) to 7(seven) years (with a grace period of not less than 18 (eighteen) months); and (c) 10% where the repayment period is between 2 (two) to 4 (four) years (with a grace period of not less than 12 (twelve) months).

Foreign lenders may also negotiate and require the incorporation of a tax gross-up provision in the finance documents. This will require the Nigerian Borrower to increase the amount of the interest to an amount which, after deducting the withholding tax, will leave an amount equal to the interest amount which would have been due if no deduction of withholding tax had been made. This is standard practice in cross-border financing transactions, and it is recognised and enforceable in Nigeria.

Double tax treaty and multilateral agencies tax benefits

Nigeria has effective double taxation agreements with some countries that grant partial tax exemption on interest payments to foreign lenders incorporated in the country with which Nigeria has signed a double taxation agreement. Nigeria currently has double tax treaties with Canada, China, the Czech Republic, France, the Netherlands, Pakistan, the Philippines, Romania, Singapore, Slovakia, South Africa, Spain, Sweden, and the United Kingdom. Where the foreign lender is a government or a government agency of a country with a double taxation agreement with Nigeria, the interest payments by a Nigerian Borrower to such a foreign lender may be exempted from tax in Nigeria under the relevant double tax agreement if the loan is not granted on commercial bases. If the foreign lender is resident in South Africa, China, Singapore, Sweden and Spain, the applicable withholding tax rate on interest payments by the Nigerian Borrower will be reduced from 10% to 7.5%.

In addition, several development finance institutions are conferred with certain immunities and tax exemptions on loans to Nigerian Borrowers. This will apply if Nigeria is a signatory party to the relevant instrument of establishment. This is by virtue of the Diplomatic Immunities and Privileges Act, 2004, which provides for immunities and tax exemptions applicable to some specified persons and institutions. The law also empowers the Minister of Finance to, by an order published in the Federal Gazette, exempt an international organisation from payment of any public tax, duty, rate, levy, stamp duties or fee applicable in Nigeria, or chargeable under any other instrument to which any of the specified organisation or person is a party. These exemptions are required to be given effect to by an order published in the Federal Gazette in Nigeria. Accordingly, where a foreign lender is a development finance institution, such a foreign lender will benefit from the tax exemptions in the law once the relevant Order is issued and published in the gazette.

SECURITY ISSUES IN SECURED FOREIGN FINANCING

Nigerian Borrowers are permitted to create various security interests for the benefit of lenders. The nature of assets and commercial terms would determine the nature of security to be provided, the issues to be addressed and the costs to perfect the security.

UDO UDOMA & BELO-OSAGIE

Security Package

Foreign lenders often require Nigerian Borrowers to provide fully perfected security over their assets for foreign loans. The usual security interests include fixed and floating charges, legal or equitable mortgages and assignment by way of security. The security package could comprise various types of assets of the borrower, including a third party's assets. It is always essential for foreign lenders to understand the scope of the security package and the mechanics of perfecting security interests in Nigeria. This is because the security package may result in significant transaction costs, such as stamp duty at the rate of 0.375% of the secured sum, registration fee at Nigeria's corporate registry at 0.35% of the secured sum, and registration at the National Collateral Registry at the sum of NGN 1,000 (one thousand Naira) (where applicable). Where there is security interest over land/buildings, leases, aircraft or ships, such security interest will need to be registered at the relevant registry following obtaining the relevant consent and payment of the applicable fees. Some of such fees could be significant, up to 4% of the secured sum in some cases, depending on the relevant registry.

Regarding stamp duty, finance parties sometimes agree to structure the security in a manner that the lenders are only secured in respect of an agreed percentage of the loan and perfect the security for that lower amount. This will be with a provision for upstamping and registration for a higher sum in the event of an occurrence of specified upstamping events.

Security over land

In relation to security over the real estate, the Land Use Act 2004 vests all the lands within the territory of a State in the Governor of that State to be held in trust and administered for the use and common benefit of all Nigerian citizens. Based on this provision, Nigerian courts have held that foreign entities cannot hold an interest in land in Nigeria. This means foreign lenders cannot be legal mortgagees over land in Nigeria. Foreign lenders can, however, be beneficiaries of a security interest over real estate in Nigeria, provided that the entity holding the legal title to the security is a Nigerian entity. In this regard, a structuring option to navigate this restriction is that, where a security package includes land, foreign lenders would appoint a Nigerian entity to act as a security trustee to hold the security interest over the land for the benefit of the lenders.

Security in respect of insurance policies

The CBN restricts the assignment of insurance policies to non-Nigerian entities. In addition, the National Insurance Commission also restricts the assignment of reinsurance policies to non-Nigerian entities. This means that where a security package includes insurance policies, such policies cannot be assigned by way of security to non-Nigerian entities. The restriction

does not, however, extend to issuance proceeds. A way around these restrictions is for foreign lenders to appoint a Nigerian entity as a security trustee to hold security interests over insurance and reinsurance policies. In the alternative, instead of the insurance policies, the proceeds derivable from such insurance policies can be assigned to non-Nigerian entities.

Fraudulent Preference and Financial Assistance

The Companies and Allied Matters Act 2020 renders invalid acts by a company within a three-month period before either the commencement of winding-up proceedings against the company or the passing of a resolution for the voluntary winding-up of the company where such acts have the effect of giving a person, being one of the company's creditors or a surety or guarantor undue advantage. Such acts will be deemed fraudulent preference of the company's creditors and therefore invalid. In addition, Nigerian companies and their subsidiaries are prohibited from giving financial assistance, directly or indirectly, to any person, to acquire the shares of that company or to reduce or discharge any liability incurred in relation to the acquisition of shares in that company. This restriction has limited exceptions, such as financial assistance that is incidental to a larger purpose of the company or financial assistance approved through a whitewash procedure. This issue of financial assistance is usually a key consideration in share acquisition deals.

FOREIGN LOANS TO BANKS IN NIGERIA

The CBN issues prudential and hedging requirements for Nigerian banks to implement in their foreign currency borrowings from time to time. In that regard, the CBN requires each Nigerian bank to ensure that its foreign currency borrowings does not exceed 125% of shareholders' funds (unimpaired by losses) and to institute specific risk mitigation strategies regarding foreign currency exposures. The CBN prescribed risk mitigation strategies include, among others, the requirement that borrowings must be subordinated debts with prepayments allowable only at the instance of the bank and subject to the prior approval of the CBN. There are also various structuring considerations around prepayments, repayments and event of default that foreign lenders often explore to mitigate the impact of the CBN's requirements regarding foreign loans to Nigerian banks.

Lastly, where a Nigerian bank is obtaining a foreign loan for on-lending to other Nigerian corporates, the CBN requires that the details of such on-lending facilities should be submitted to it. The CBN states, among other things, that Nigerian banks are not required to notify the CBN before entering into negotiations with foreign lending institutions, but that it is expected that banks will submit the details of the arrangement, such as the terms and conditions of the loan, including the tenor, moratorium (if any), interest rates applicable and other relevant information to the Banking Supervision Department of the CBN before signing

the agreements and drawdown. Compliance with this requirement is usually included as a condition precedent to disbursement in foreign loan agreements.

CONCLUSION

Globalisation and technological innovations are driving an increasingly interconnected global economy. This has led to the increased movement of foreign capital across borders and the availability of financing opportunities in different parts of the world. Consequently, foreign lenders are continuously seeking business opportunities in emerging markets and developing economies such as Nigeria to increase earnings. Offshore development finance institutions are also seeking institutions in developing countries to provide financing for projects that will support economic growth, fight poverty, create employment opportunities, support women-led businesses, and support the growth of small and medium enterprises. Nigeria is one of such economies. As a result, it is essential for foreign lenders to have an understanding of the key issues in financing transactions and taking security over assets in Nigeria. This will help foreign lenders make more informed decisions when entering into loan arrangements with Nigerian corporates and financial institutions.

This update has been provided by Yinka Edu, Joseph Eimunjeze, Victor Samuel and Itoro Uwemedimo Etim of the Banking & Finance team at Udo Udoma & Belo-Osagie. For more information about our Banking & Finance practice group offerings, please visit our website at www.uubo.org or email us at uubo@uubo.org.