Banking - Nigeria

First technical listing on the London Stock Exchange by a Nigerian bank

Contributed by **Banwo & Ighodalo**

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Introduction

On March 21 2013 Zenith Bank Plc, one of Nigeria's largest banks (in terms of market capitalisation), established its global depository receipts programme by listing 125 million units of global depository receipts on the London Stock Exchange, representing a total of $850 million worth of Zenith ordinary shares. With this listing, Zenith becomes the seventh Nigerian bank to establish a global depository receipts programme and the third to have its global depository receipts listed on the London Stock Exchange. Unlike all of its predecessors, the Zenith global depository receipts programme was a technical listing and thus involved no capital raising.

The absence of capital raising in the establishment of the Zenith global depository receipts programme highlights the increasingly vibrant nature of the Nigerian banking sector, as well as the current attitude of Nigerian corporations to the international capital markets. The Zenith transaction also revealed certain grey areas related to the regulatory framework for global depository receipts programmes and afforded the Nigerian Central Bank the opportunity to make some clarifications.

The consensus among most analysts appears to be that the Nigerian banking crisis has come to an end and that 2013 is likely to see significant growth, particularly among larger banks, which have better asset quality and benefit from lower-cost funding bases. According to a report from rating agency Standard & Poors,(1) a mixture of strong economic growth and political stability should underpin a year of expansion for Nigerian banks. This positive outlook has reawakened the expansionist ambitions of many Nigerian banks and caused several to embark on Eurobonds issuance.

However, integration into the international capital market is partly motivated by factors other than the obvious financial benefits. As Nigerian banks shake off old concerns over capital adequacy, which brought on the banking crisis, and gear up for a renewed round of international expansion, they are also seeking wider recognition and acceptance in international capital and money markets – achieved by their increased presence in the international capital markets.

Although significant progress has been made in the areas of corporate and financial disclosure, particularly with the adoption of international financial reporting standards, Nigerian corporate governance and shareholder activism remain below par in relation to more advanced markets (eg, the United Kingdom and the United States). This situation makes direct listings on international exchanges unattractive, as such listings tend to require that the relevant companies comply with the stringent requirements of more advanced markets. The unattractiveness of direct listings means that Nigerian banks and other corporations often see Eurobonds and global depository receipts as the more favourable option for establishing themselves in the international capital markets. For most of the top-tier banks, which established global depository receipts programmes in 2006 and 2007 following the previous banking consolidation, Eurobond programmes were the only plausible option. For Zenith and other banks, both global depository receipts and Eurobonds were plausible options hence, Zenith chose to adopt a global depository receipts programme.

Background

A global depository receipt is a certificate issued by a depository bank, which purchases shares of a foreign company and deposits such shares on the account against which the global depository receipts are issued. Global depository receipts represent ownership of an underlying number of shares of the shares held by the depository in the foreign company. Under a global depository receipts programme, an identified number of shares are allotted (or transferred) to the depository, which in turn creates and issues 'receipts' (or global depository receipts) to investors, backed by the shares that it holds (each receipt represents a determined number of the shares held by the depository). Global depository receipt prices typically reflect the values of the underlying shares, but the global depository receipts are listed, traded and settled independently of the underlying shares, normally on a different stock exchange. In addition, subject to the specific terms of each programme, global depository receipts are normally exchangeable for the number of shares that they represent.

Global depository receipts programmes normally involve a capital raising such that new unissued shares are allotted to the depository and funds realised from the sale of global depository receipts are passed to the company as consideration for the shares. (2) However, fresh capital may not be raised in every case and a 'zero balance' global depository receipts programme may be established whereby, as opposed to the issuance of new shares, existing shareholders transfer their shares to the depository in exchange for global depository receipts.(3)

Much of the regulatory framework for global depository receipt issuance by Nigerian entities evolved based on the practices adopted during the initial round of global depository receipt issuances in 2006 and 2007. In the first instance, an application is made to the listing authority of the relevant exchange on which the global depository receipts are sought to be listed, the Nigerian Securities and Exchange Commission (SEC) and any industry-specific regulators (ie, the Central Bank in the case of a bank). It is mandatory to notify the exchange on which the issuer's shares are listed. One of the SEC's requirements is that shareholder approval be submitted together with the application to the SEC. On receipt of shareholder and board approvals of the programme, relevant transaction documents (eg, agreements with the depository and custodian of the global depository receipts) and the prospectus to be submitted to the listing authority are finalised and, where applicable, duly executed. The final prospectus is submitted to the listing authority for approval; the approved prospectus is then submitted to the SEC, the Central Bank and other authorities for their records.

As part of the process, the underwriters and the issuer agree on the price of the global depository receipts. In the Zenith transaction, the price was determined by the bank (working with its financial advisers) using the last trading price of the shares on the Nigerian Stock Exchange just before the UK Listing Authority's final approval was obtained. The global depository receipts are subsequently allocated to the investors using the agreed ratio and at the agreed price, and are admitted to listing and trading on the relevant exchange on obtaining the relevant approval.

Certificate of capital importation

A major area of uncertainty that previously existed with regard to global depository receipts programmes in Nigeria was the issue of how these programmes interact with the repatriation of capital rules. Under Nigerian foreign exchange rules, foreign investors in Nigerian companies are guaranteed access to the official foreign exchange market for funds for repatriation of dividends and capital, subject to the condition that the original investment is made through an 'authorised dealer'(4) and a certificate of capital importation is issued in relation to such investments in the name of the particular investor. The concern was that if investors in a global depository receipts programme had failed to obtain certificates of capital importation in respect of such investments, they could face challenges regarding repatriation following conversion of their global depository receipts into shares. In order to address this concern, in 2007 the Central Bank issued a circular which provided for the issuance of a 'master certificate of capital importation' in respect of a global depository receipts programme, which would be marked down every time that shares were withdrawn from the programme, with sub-certificates issued in respect of the withdrawn shares. A subsequent 2010 Central Bank circular also provided for the mark-up of certificates of capital importation where shares were re-converted into global depository receipts.

The Zenith transaction highlighted a grey area in the regulatory framework with respect to certificates of capital importation. As previous global depository receipts programmes had involved capital raisings, previous Central Bank circulars had focused on the marking up/marking down of certificates of capital importation issued in respect of the inflows from the capital raising. It was thus necessary to confirm that the Central Bank would permit the creation of a master certificate of capital importation through the accumulation of such certificates of participating international investors. Specific confirmation of this point had to be sought from the Central Bank as part of the transaction process. Eventually, confirmation was obtained and the transaction proceeded successfully to financial close. It is expected that in the near future the Central Bank will issue a formal circular confirming this position and further enhance the legal framework for global depository receipts transactions.

Capital gains tax

Other aspects of the regulatory framework for global depository receipts in Nigeria could benefit from clarification. Under the existing capital gains tax regime, any gain realised on the disposal of shares is exempt from capital gains tax. However, there is no specific indication as to whether this exemption extends to global depository receipts. Thus, there is uncertainty as to whether gains realised on the disposal of global depository receipts are subject to capital gains tax in Nigeria.

Comment

In view of the growing trend of Nigerian banks and other corporations seeking to enter and participate in the international capital markets, a clear, concise and duly harmonised regulatory framework is urgently required. Much of this framework is already in place in separate bits of regulation and individual approval letters. However, all of these must be consolidated and the rough edges must be smoothed out. The Central Bank and other regulatory agencies (eg, the SEC) have thus far been responsive to the needs of the market, tweaking regulatory requirements to accommodate transaction complexities where necessary, while still ensuring compliance with mandatory statutory requirements. Therefore, it is expected that the regulatory framework for global depository receipts and other sophisticated financial instruments will continue to develop as the market grows.

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Endnotes

(1) "The Nigerian Banking Sector Outlook 2013: At The Start Of A New Cycle".

(2) Before the Zenith transaction, all of the global depository receipts issuances in Nigeria had involved a capital raising.

(3) This is how the Zenith transaction was structured.

(4) A commercial bank licensed to deal in foreign exchange.