

# The Nigerian Stock Exchange (NSE) Rules Governing Transactions with Related Parties or Interested Persons



## What do you need to know?

The NSE issued a new rule governing transaction with related parties or interested persons ("the Rule"). The effective date of this new rule is 1 November 2014 and should be applied prospectively. For example, December year end entities would provide the disclosure requirements to comply with the Rule in their 31 December 2015 Annual reports and financial statements.

The objective of the Rule is to guard against the risk that "Interested Persons" could influence an "Issuer", its subsidiaries or associated companies<sup>1</sup> to enter into transactions that may have adverse impact on the interest of the Issuer or its Securities Holders.

The NSE requires entities within the scope of the Rule to consider:

- the objective of the Rule; and
- the economic and commercial substance of the Interested Person Transaction<sup>2</sup> instead of the legal form.

The diagram below captures in summary the explanation of the terms used in the Rule.

The Rule specifically excludes:

- Issuer whose equity securities are not listed on the stock exchange; and
- A foreign company with secondary listing on the stock exchange.

### Entities at risk

- Issuer on the NSE and their
  - Subsidiaries;
  - Associates:
- Listed Real Estate Investment Trust listed on the NSE;
- Investment Funds listed on the NSE.

### Example of Transactions

- financial assistance;
- purchase, disposal or leasing of assets;
- trading transactions;
- debt, equity, option and derivative transactions;
- investment in joint venture or joint investments.

Interested Persons within the same group as the Issuer (even if they are not listed)

### Example of Interested Persons

- Company:
  - Director, CEO, Controlling shareholder
  - any persons connected to the people listed above;
- Real Estate Investment Trust per Securities Exchange Commission Rules and any person connected to these persons;
- Investment manager, trustee, or controlling unit or its equivalent and any person connected to the above persons.

1. The definition of an Associated Company (see Appendix 1) is not the same as the definition of an associate in IFRS. Entities would therefore need to carefully consider the implication when identifying Interested Persons.

2. Refer to Appendix 1 for definitions of Interested Person Transaction, Interested Person and Issuer.

## What transactions are in the scope of the Rule?

The Rule scopes in the following transactions:

- the provision or receipt of financial assistance; or
- the acquisition, disposal or leasing of assets; or
- the provision or receipt of services; or
- the issuance or subscription of securities; or
- the granting of or being granted options; and
- the establishment of joint ventures or joint investments.

The Rule further indicates that the transactions scoped in include those carried out in the ordinary course of business, and whether or not entered into directly or indirectly through other entities.

The Rule does not state how net tangible assets should be calculated. We however received clarification from the NSE that net tangible asset is defined as total assets minus total liabilities minus non-controlling interest.

## How will the Rule affect your process?

The Rule requires Issuers to notify and discuss transactions with the NSE at an early stage. It would appear that the consultation<sup>3</sup> is required to help Issuers determine if the transaction should be classified as an Interested Person Transaction and the counterparty as Interested Person.

In addition to consulting with the NSE, the Rule requires Interested Person Transaction to be categorised into two broad categories. We have described these categories as Type A and Type B and the key details of these categories are summarised as follows:

### Type A transactions

These are recurrent transactions necessary for the Issuer's day-to-day operations such as the purchase of supplies and materials and transactions that are revenue or trading by nature. General mandate<sup>4</sup> is required for new agreements entered into from 1 November 2014. For existing agreements (Dated - pre 1 November 2014), general mandate should be obtained in the annual general meeting or extra-ordinary meeting.

Further, the Issuer is required to:

- issue a circular to the Securities Holders<sup>5</sup> requesting for a general mandate;
- announce the aggregate value of transactions conducted subsequent to the receipt of the general mandate for the financial period within the timelines required for the announcement of such report;
- disclose the general mandate in the annual report and provide details of the aggregate value of transactions conducted during the year based on the general mandate; and
- request renewal of the general mandate from securities holder on an annual basis.

### Type B transactions

Type B transaction relates to the purchase or sale of assets, undertaking or business. Approval is required for each Type B transaction.

For Type B transactions; the issuer should:

- prepare a scheme of transaction circular for approval by the Securities Exchange Commission;
- request the board to approve and also check that the terms of the sales are not prejudicial to the interest of the issuer and its minority shareholders;
- request for shareholder approval for transactions that meet the threshold (not later than 6 weeks prior to the date of the sale or proposed sale);
- issue and announce the scheme of transaction circular within 28 days even if it relates to the Issuer's subsidiaries and associated companies;
- request audit committee review and approval that the sales are fair and reasonable and do not prejudice the interests of the Issuer and its minority shareholders;
- exclude Interested Person from voting on all resolutions to approve the sales or proposed sales for which the Interested Person would benefit; and
- disclose the Interested Person Transaction in the annual report.

It would appear that in substance, the scheme of transaction circular applicable to Type B and the general mandate circular applicable to Type A share certain key similarities. See Appendix 2 and 3(b) for details required to be included in these documents.

3. Based on clarification obtained from the NSE, consultation is required for all Interested Person Transaction.

4. Entities may choose to seek approval from securities holders for each individual transaction that meets the 5% quantitative threshold instead of a general mandate.

5. The use of securities holder instead of shareholders is due to the different type of entities covered within the rule.

## What does Transaction Value mean?

The Rule defines transaction value as the amount at risk to the Issuer and provides some examples (see Appendix 3(b) for details). In addition, the Rule prescribes the following threshold for Interested Person Transaction that require Securities Holder approval:

- 5% of the Issuer or its group's latest audited net tangible assets; or
- 5% of the Issuer or its group's latest audited net tangible assets, when aggregated with other transactions entered into with the same interested person during the same financial year. However this excludes transactions previously approved by Securities Holders; or
- 5% of the issued share capital.

## Does the Rule require an independent opinion?

The NSE requires that circulars (i.e. circular for general mandate and scheme of transaction circular) must include the following:

- an independent financial adviser's<sup>6</sup> opinion (acceptable to the exchange) on whether the methods or procedures applied in determining the transaction price are on normal commercial terms and do not prejudice the interest of the Issuer and its minority securities shareholders;
- an opinion from the audit committee if they have a different view from the independent financial adviser;
- when a general mandate is up for renewal, an independent financial adviser opinion is not required if the audit committee specifically confirms that:
  - the methods or procedures for determining the transaction prices have not changed since the last securities holder approval; and
  - the methods or procedures are sufficient to ensure that the transactions are carried out on normal commercial terms and are not prejudicial to the interests of the issuer and its minority shareholders.

## What are the requirements for newly listed entities?

The Rule provides a practical expedience for newly listed entities that issue a prospectus containing information similar to those in the general mandate.

The prospectus document should satisfy the requirement of the Rule for shareholders' approval until the earlier of:

- first annual general meeting of the Issuer following listing; or
- first annual anniversary of the listing date.

## What are the disclosure requirements in the annual report?

The annual report contains both the financial statements and other information.

Entities affected by this rule will need to consider where the information will be reflected in the annual report. For instance the information could be included either:

- in the Director's report; or
- other information section.

The requirements of the Rule are different in a number of respects from the requirements of IAS 24 *Related Party Disclosures* which are disclosed in the financial statements. For instance, the definition of Interested Person and Interested Person Transaction are not exactly the same as the definition of related party and related party transactions under IAS 24 *Related Party Disclosures* in IFRS.

As such, compliance with IAS 24 is not sufficient to cover the requirements of the Rule.

## Are there any waivers from complying with the terms of the Rule?

No waiver is provided from complying with the terms of the Rule.

6. An independent financial adviser should be duly registered with Securities Exchange Commission as an issuing house or investment adviser.

# Appendix

## Appendix 1: Description of terms

Terms of the Rule	Definitions extracted from the Rule
Issuer	Entity listed on the stock exchange.
Associated Company	An investee company that is not a subsidiary and in respect of which; <ul style="list-style-type: none"> <li>the investor's interest in the voting power of the investee is substantial</li> <li>the investor has the power to exercise significant influence over the financial and operating policies of the investee; and</li> <li>the investor intends to retain its interest as a long term investment.</li> </ul>
Interested Person	Interested person means: <ul style="list-style-type: none"> <li>(a) In the case of a company: <ul style="list-style-type: none"> <li>(i) a director, chief executive officer, or controlling shareholder of the Issuer; or</li> <li>(ii) any person connected<sup>7</sup> to such director, chief executive officer, or controlling shareholder.</li> </ul> </li> <li>(b) In the case of a Real Estate Investment Trust (REIT), the meaning ascribed to it in the Securities and Exchange Commission's Rules and Regulations.</li> <li>(c) In the case of an investment fund which is not a REIT: <ul style="list-style-type: none"> <li>(i) a director, chief executive officer or controlling shareholder of the investment manager(s) (or any equivalent) of the investment fund;</li> <li>(ii) the investment manager(s) (or any equivalent), the trustee or controlling unit holder of the investment fund; or</li> <li>(iii) any associate of any of the persons or entities in (i) or (ii) above.</li> </ul> </li> </ul>
Interested Person Transaction	Interested person transaction means a transaction between an entity at risk and an interested person.
Entity at Risk	Entity at risk means: <ul style="list-style-type: none"> <li>(a) the Issuer; or</li> <li>(b) a subsidiary of the Issuer that is not listed on the Exchange; or</li> <li>(c) an associated company of the Issuer that is not listed on The Exchange provided that the listed group, or the listed group and its interested person(s), has control<sup>8</sup> over the associated company.</li> </ul>
IFRS	International Financial Reporting Standards
Financial Assistance	Financial assistance includes: <ul style="list-style-type: none"> <li>(a) the lending or borrowing of money, guaranteeing or providing security for a debt incurred or the indemnifying of a guarantor for guaranteeing or providing security; or</li> <li>(b) the forgiving of a debt, the releasing of or neglect in enforcing a financial obligation of another, or assumption of the financial obligations of another.</li> </ul>

7. Based on clarification received from the NSE "connected persons" have similar meaning as related parties in terms of IAS 24 (see Appendix 4).

8. In terms of IFRS 10 you can only control a subsidiary. For associates, the threshold is significant influence.

# Appendix

## Appendix 2: Scheme of Transaction Circular

A Circular containing the Scheme of Transaction in respect of a related party transaction shall be issued by the Issuer within twenty eight days of its approval by Securities and Exchange Commission and shall include:

1. details of the interested party transacting with the Issuer, and the nature of that party's interest in the transaction.
2. details of the transaction including relevant terms of the transaction, and the bases on which the terms were arrived at.
3. the rationale for, and benefit to, the entity at risk.
4. an opinion in a separate letter from an independent financial adviser who is acceptable to the Exchange stating whether the transaction:
  - (i) is executed on normal commercial terms, and
  - (ii) is not prejudicial to the interests of the Issuer and its minority shareholders.
- (b) an opinion<sup>9</sup> from the audit committee shall be required for the following transactions:
  - (i) the issue of shares or the issue of other securities of a class that is already listed, for cash.
  - (ii) purchase or sale of any real property where:
    - the consideration for the purchase or sale is in cash;
    - an independent professional valuation has been obtained for the purpose of the purchase or sale of such property; and
    - the valuation of such property is disclosed in the circular.
5. an opinion from the audit committee, if it takes a different view from the independent financial adviser.
6. all other information known to the Issuer or any of its directors, that is material to security holders in deciding whether it is in the interest of the Issuer to approve the transaction. Such information shall include the true potential costs and detriments of, or resulting from the transaction, including opportunity costs, taxation consequences, and benefits forgone by the entity at risk.

9. The opinion should indicate if the audit committee reviewed and approve the transaction and the terms of the transaction are fair and reasonable and are not prejudicial to the interests of the Issuer and minority shareholders



# Appendix

## Appendix 3:

### a) Circular issued for General Mandate

A circular to shareholders seeking a general mandate shall include:

- (i) the class of interested persons with which the entity at risk will be transacting;
- (ii) the nature of the transactions contemplated under the mandate;
- (iii) the rationale for, and benefit to, the entity at risk;
- (iv) the methods or procedures for determining transaction prices;
- (v) the independent financial adviser's opinion on whether the methods or procedures in (iv) are sufficient to ensure that the transactions shall be carried out on normal commercial terms and shall not be prejudicial to the interests of the Issuer and its minority securities holders;
- (vi) an opinion from the audit committee if it takes a different view from the independent financial adviser;
- (vii) a statement from the Issuer that it shall obtain a fresh mandate from shareholders if the methods or procedures in (iv) become inappropriate; and
- (viii) a statement that the interested person shall abstain, and has undertaken to ensure that its associates shall abstain, from voting on the resolution approving the transaction.

### b) Examples of Transaction Values

The value of a transaction is the 'amount at risk' to the Issuer. This is illustrated by the following examples:

- (i) In the case of a partly-owned subsidiary or associated company, the value of the transaction is the Issuer's effective interest in that transaction;
- (ii) In the case of a joint venture, the value of the transaction includes the equity participation, shareholders' loans and guarantees given by the entity at risk; and
- (iii) In the case of borrowing of funds from an interested person, the value of the transaction is the interest payable on the borrowing. In the case of lending of funds to an interested person, the value of the transaction is the interest receivable on the loan and the value<sup>10</sup> of the loan.

The following terms are used in this Standard with the meanings specified:

A related party is a person or entity that is related to the entity that is preparing its financial statements (in this Standard referred to as the 'reporting entity').

<sup>10</sup>. Value means the carrying amount of the loan

# Appendix

## Appendix 4: Relevant IFRS Pronouncements IAS 24:9

- (a) A person or a close member of that person's family is related to a reporting entity if that person:
- i. has control or joint control of the reporting entity;
  - ii. has significant influence over the reporting entity; or
  - iii. is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.
- (b) An entity is related to a reporting entity if any of the following conditions applies:
- i. The entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).
  - ii. One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).
  - iii. Both entities are joint ventures of the same third party.
  - iv. One entity is a joint venture of a third entity and the other entity is an associate of the third entity.
  - v. The entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity.
  - vi. The entity is controlled or jointly controlled by a person identified in (a).
  - vii. A person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

A related party transaction is a transfer of resources, services or obligations between a reporting entity and a related party, regardless of whether a price is charged.

Close members of the family of a person are those family members who may be expected to influence, or be influenced by, that person in their dealings with the entity and include:

- (a) that person's children and spouse or domestic partner;
- (b) children of that person's spouse or domestic partner; and
- (c) dependants of that person or that person's spouse or domestic partner.

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