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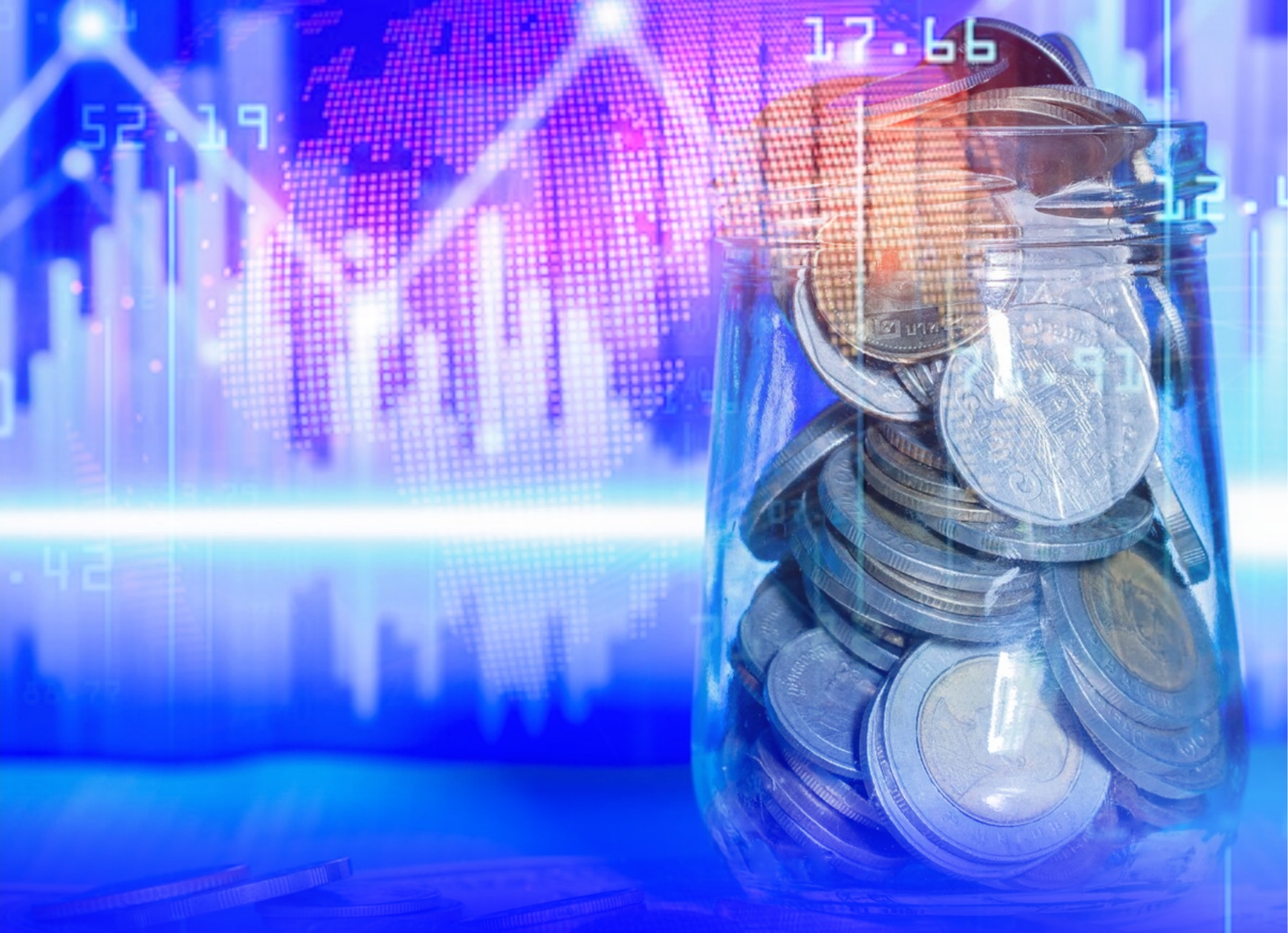

RAISING CAPITAL THROUGH COMMERCIAL PAPER:

WHY CORPORATIONS SHOULD ADOPT A MORE COST-EFFICIENT OPTION

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INTRODUCTION

Businesses seeking to raise capital have a choice between equity or debt financing. Given the increase in inflation and interest rates, it is commercially prudent to adopt short-term debt financing like commercial papers as an easy way to raise cost-efficient capital for a short term, usually less than a year. The money market is becoming a viable option for raising capital. Commercial papers ("CPs") have become an increasingly popular financial instrument in Nigeria's corporate finance landscape. According to the monthly reports of the FMDQ exchange, there has been an increase in commercial paper quotations since the beginning of the year.[1] In this article, we will delve into commercial papers, exploring their advantages over other debt instruments, and examining the legal framework and procedure for their issuance in Nigeria.

COMMERCIAL PAPER OFFERINGS IN NIGERIA IN 2023

The FMDQ Exchange reported a substantial increase in commercial paper quotations, reaching N539.22 billion at Q1 2023. Similarly, firms raised N789 billion in the first half of 2023 through commercial papers, marking an 89% increase on yearly review.[2] Some of the entities that have raised short-term financing through CP in 2023 are MTN Nigeria Communications Plc, which successfully completed the issuance of its Commercial Paper under its upsized N250 billion Commercial Paper Issuance Programme to be applied towards achieving short-term working capital,[3] AFEX Investment limited through its SPV issued a N100 billion three-year Asset-Backed Commer-

[1] FMDQ Newsletter, FMDQ Group (accessed 5th October 2023).
[2] Oladehinde Oladipo, July 11, 2023, Commercial papers up 89% in H1 as firms raise N789bn, Business Day (Accessed 10th November 2023).
[3] MTN issues N100bn commercial papers (punchng.com) (Accessed 6th October 2023)

cial Programme to bridge the financing gap in the agricultural sector. Prima Corporations Limited issued its series 5 N30 billion commercial paper for the issuer's short-term funding requirements. Recently, Chrisland Schools Limited issued N1.2b commercial paper notes under its N8 billion Commercial Paper Issuance Programme, and Saro Africa Funding SPV issued N10 Billion commercial paper notes for series 1 & 2.

UNDERSTANDING COMMERCIAL PAPER

Meaning

Commercial paper refers to a short-term, unsecured money market instrument with a maturity date of up to 270 days.[4] CPs are issued by companies with good credit ratings and proven financial track record. CPs are listed and traded on the FMDQ Exchange platforms. They are commonly issued at a discounted rate and are later redeemed at their face value upon maturity. CPs may be interest bearing CPs or non interest bearing commercial paper (NICP).

Risks

Commercial papers are generally considered low-risk investments due to their short maturity and high credit quality however, there is always the risk of default of the issuer being unable to

[4]Commercial Paper-Corporate Finance Institute https://corporatefinanceinstitute.com/resources/fixed-income/commercial-paper/(accessed 6th October 2023)

meet its payment obligations. Other potential risks include interest rate risk, which arises from fluctuations in market interest rates, and liquidity risk, which entails the challenge of selling CPs before their maturity date. Notwithstanding, CPs still serve as a competitive alternative to other financial instruments and offers attractive returns.

Features

The distinguishing features of CPs are;

a. **Short-Term Maturity:** CPs have relatively short maturities, making them ideal for companies seeking temporary working capital solutions. Maturities typically range from 15 days to 270 days.[5]
b. **Issued at a Discount:** CPs are issued at a discount to their face value, which means that investors purchase them at a lower price and receive the full face value upon maturity. The difference between the purchase price and face value represents the interest or return to the investor. The issuer repays the buyer in the future using liquid cash and no other assets.
c. **Unsecured:** CPs are typically unsecured, meaning they are not backed by collateral. Investors rely on the issuer's creditworthiness to determine their risk, hence the need for a good credit rating.
d. **Liquidity:** CPs are considered highly liquid instruments as they can be easily traded in the secondary market before their maturity date. The liquidity makes them attractive to investors.
e. **High credit quality:** CPs are usually issued by financially stable companies with strong credit ratings.
f. **Non-convertible:** CPs cannot be converted into equity in the issuing company.
g. **Low-interest rate:** Interest rates on commercial paper can be lower than other short-term debt instruments.
h. **Low-cost:** Issuing CP is generally less expensive than issuing bonds or other types of debt securities.
i. **Traded in the money market:** CP is a short-term money market instrument. The money market is a financial market sector where financial instruments with high liquidity and

[5] Rule 3.2(i) FMDQ Rules

short maturities are traded.

COMMERCIAL PAPER VS. OTHER DEBT INSTRUMENTS:

a. **Treasury Bills:** Unlike CPs, Treasury bills are government-issued debt securities with maturities ranging from 91 days to one year. Treasury bills are by nature, the most liquid money market securities and are backed by the guarantee of the government of a sovereign nation. The Federal Government of Nigeria, through the Central Bank of Nigeria, issues Nigerian treasury bills periodically to meet the government's short-term funding needs. They are usually issued through a competitive bidding process, following which they would be quoted and traded on relevant platforms on the FMDQ Exchange.[6] In contrast, commercial papers carry default risk, as they are issued by corporations, but they generally offer higher yields when compared to Treasury bills.

b. **Corporate Bonds:** Corporate bonds have longer maturities, often extending up to thirty years. They are typically secured and offer higher interest rates than CPs due to their longer duration and increased credit risk. Also, bonds may be issued upon the terms that in lieu of redemption or repayment, it could be converted into shares in the company at maturity.[7] This is unlike CPs that cannot be converted to equity in the issuing Company.

c. **Bank Loans:** Bank loans and commercial papers are distinct financial instruments used by businesses to secure funding. However, bank loans typically involve private agreements between borrowers and banks allowing for negotiated terms and conditions. They are also backed by assets or other types of collateral with higher interest rates. In contrast, commercial paper, which is a type of unsecured debt, is traded at lower interest and with a shorter tenor usually less than a year. These varying characteristics make commercial papers a more probable short-term financing option.

[6]Treasury Bills , FMDQ Exchange www.fmdqgroup.com (accessed 8th September 2023)
[7]Section 197 of the Companies and Allied Matters Act, 2020

THE LEGAL FRAMEWORK FOR THE ISSUANCE OF COMMERCIAL PAPERS

The issuance and trading of commercial papers in Nigeria are governed by regulatory frameworks and guidelines established by relevant authorities. Currently, the issuance of registered CPs is regulated by the Rules of the FMDQ Exchange and the Central Bank of Nigeria ("CBN") Guidelines.

a) FMDQ Commercial Paper Registrations and Quotation Rules dated October 2023 ("FMDQ Rules"): The FMDQ Rules was developed by the FMDQ Exchange, a securities exchange registered by the Securities and Exchange Commission ("SEC") provide a structure for the issuance of CPs, a platform for the quotation of CPs, promote liquidity, and to enhance transparency. It spells out the guidelines for the issuance of Interest and Non-Interest Commercial Paper on the FMDQ Exchange.

b) CBN Guidelines on the Issuance and Treatment of Bankers Acceptances and Commercial Papers dated 18 November 2009, reissued on 11 September 2019 (CBN Guidelines). The CBN does not directly regulate the issuance of commercial paper but regulates the activities of banks, who are typical parties to the CP. In July 2016, CBN issued a Circular to all Deposit Money Banks and Discount Houses on the Mandatory Registration and Listing of Commercial Papers. The circular mandates deposit money banks and discount houses to only deal in CPs that are registered, quoted or intended for quotation on Authorised Securities Exchanges, whether acting in the capacity of an issuer, guarantor or Issuing, Placing, Paying and Collecting Agent (IPCA), Collecting and Paying Agent (CPA), etc.

REQUIREMENTS FOR THE ISSUANCE OF CPS UNDER THE CBN GUIDELINES AND FMDQ RULES

The requirements can be found under the CBN Guidelines and the FMDQ Rules.

Requirements under the CBN Guidelines

The CBN Guidelines require an issuer to :

a. Have 3 (three) years of audited financial statements, with the most current not exceeding 18 (eighteen) months from the last financial year-end.
b. Have an approved credit line with a Nigerian bank acting as an Issuing and Paying Agent.[8]
c. Be rated by a credit rating agency registered in Nigeria or any rating agency acceptable to the CBN. The indicative credit rating must have been obtained by the issuer at the time of submission of its information and declarations to a licensed securities depository.

Requirements under the FMDQ Rules

The FMDQ Rules in addition to the requirements prescribed by the CBN further prescribe additional requirements for a commercial paper issuer or promoter, amongst others. The issuer or promoter must:[9]

a. be a company duly incorporated under Applicable Law;[10]
b. by its memorandum and articles of association have the capacity to issue debt securities, borrowing and limits;[11]
c. have a minimum of three (3) years operating track record evidenced by audited financial statements before the date of application for registration of the CP;[12]
d. have shareholders' funds of not less than N500,000,000.00 (five hundred million naira) as evidenced by its latest audited accounts, not being later than 15 (fifteen) months from the date of submission of the application to register the CP programme, and such shareholder's fund shall be maintained at or above that level for the entire period that the commer-

[8]Paragraph 3.0 (b) (i) of the CBN Guidelines
[9]Rule 4 of the FMDQ Rules
[10]Rule 4.2 of the FMDQ Rules
[11]Rule 4.3 of the FMDQ Rules
[12]Rule 4.4 of the FMDQ Rules

cial paper remains on the FMDQ;[13] and

e. where it does not meet the requirements in paragraphs (b) – (d) above, the prospective commercial paper issuance must be backed by a guarantor or a credit enhancement provider that meets those requirements and such other requirements as may be prescribed by FMDQ from time to time.[14]

Commercial paper may be issued directly or through a Special Purpose Vehicle(SPV); where the commercial papers are issued through an SPV, the promoter or sponsor of the SPV will be required to meet the eligibility criteria under the FMDQ Rules.[15] Specifically, where the issuer of a CP is an SPV, established for the purpose of issuing asset or mortgaged backed CPs, the SPV shall be required to have a minimum of three (3) years credit history of the underlying assets, evidence of predictable cash flows of the underlying assets or mortgages and such other provisions as may be prescribed by FMDQ from time to time.

ISSUANCE PROCESS OF A COMMERCIAL PAPER[16]

Parties to a Commercial Paper Issuance

To understand the process, it is necessary to know the parties involved in the issuance of commercial paper in Nigeria.

a. **Issuers:** the issuer is the entity or company requiring financing. The issuer sells the financial paper to the investors to raise funds. CP may be issued through a special purpose vehicle (SPV), in such case, there would be an issuer, which would be the SPV, and a promoter, which is the company sponsoring the SPV.
b. **The issuing and paying agent:** the agent is responsible for handling the administrative aspects of the commercial paper issuance. There are the Issuing and Placing agents **("IPA")**, which are non-bank financial institutions that sponsor the registration and quotation of the CP programme. The IPA is the dealer or arranger of the CP. There is also the Collecting and Paying Agent **("CPA")**, which is a

[13] Rule 4.5 of the FMDQ Rules
[14] Rule 4.6 of the FMDQ Rules
[15] Rule 4.7 of the FMDQ Rules
[16] FMDQ Exchange, https://fmdqgroup.com/exchange/services/fmdq-cp-registration-and-quotation-process/

CBN-licenced bank responsible for the collection and payment of funds on behalf of the issuer or promoter. It is common to have one entity function as an Issuing, Placing, Paying and Collecting Agent **("IPCA")**. The IPCA is a bank that combines the functions of an IPA and a CPA. This entity ensures that the terms of the commercial paper, such as interest payments and maturity, are adhered to. They may also facilitate communication between the issuer and investors.

c. **Credit rating agencies:** they play a crucial role in the commercial paper market by assessing the creditworthiness of the issuer. The rating is an indication of the risk associated with the commercial paper. Higher-rated issuers typically offer lower yields because of their lower perceived risk.

d. **Underwriter or Placement Agent:** This party assists the issuer in placing the commercial paper with investors. The underwriter may guarantee the sale of the commercial paper at a specified price or may purchase the paper from the issuer and resell it to investors.

e. **Central securities Depository ("CSD"):** this is a specialist financial institution, which holds commercial papers either in certificated or uncertificated form so that ownership can be easily transferred through a book entry rather than the transfer of physical certificates. The depository acts as the registrar and the custodian of the commercial papers. Its essence is for the dematerialization of commercial paper. An issuer may choose to register with the FMDQ Depository or any licensed securities depository like the Central Securities Clearing System Plc (CSCS).

f. **Solicitor:** Prior to the issuance, the solicitor engages in a comprehensive legal due diligence process to identify and proactively address potential legal challenges that may emerge in the pre-issue phase. This involves a meticulous examination of constitutive documents to ensure that the articles of association and shareholders' agreement permit the issuance of

CPs and NICPs. They play a pivotal role in securing relevant corporate authorization for the issuance, such as board approval and member resolutions if required.

They also ensure that the company complies with securities laws and regulations to protect investors and maintain the integrity of the financial markets, like the CBN Guidelines and FMDQ Rules. Solicitors also draft and review various legal documents associated with commercial papers. In addition, solicitors provide advice on the optimal capital structure for the company and how the issuance of CPs fits into the overall financial and business strategy. Solicitors act as a liaison between the company and regulatory authorities to address any queries or concerns that may arise during the pre-issue process.

g. **Dealer or Broker:** Dealers or brokers may facilitate the buying and selling of commercial paper in the secondary market. They act as intermediaries between issuers and investors, helping to enhance the liquidity of the commercial paper market.

h. **Investors:** these are individuals or entities that purchase commercial paper. They provide the funds required by the issuer in exchange for the CP. Investors may include institutional investors such as fund/asset managers, banks, private equity funds and hedge funds, investment/unit trusts, staff schemes, insurance companies, multilateral and bilateral institutions seeking short-term low-risk investments.[17]

Process of Issuance of Commercial Paper

Generally, the issuance process of CP is similar to the bond market. The issuance

[17] Paragraph 3.9 of the FMDQ Rules

process is a structured process and entails the following:

a. To commence the process, the Issuer, acting through the Sponsor, applies to FMDQ along with the necessary documentation for evaluation in line with the FMDQ Rules.[18]

b. Following the document submission, the FMDQ Board Listings and Markets Committee (the Committee) shall thoroughly assess the Issuer and the proposed CP Programme. This assessment is based on predefined eligibility, suitability, sustainability, disclosure requirements, compliance with Exchange Rules, and other relevant regulatory frameworks applicable to the Issuer.

c. Upon meeting the Exchange's requirements, the Sponsor notifies FMDQ Exchange of the CP sought to be issued under the Programme no later than twenty-four (24) hours before the opening of the offer. This notification shall include the details of the amount on offer, minimum level of subscription (if applicable), offer open/close dates and issue date.

d. Once the CP is admitted, the CP will be quoted on the FMDQ Exchange Daily Quotation List and the FMDQ Exchange's website. It will also be deposited at the relevant depository.

e. The company is then open at this stage to receiving offers from investors. The company would also simultaneously initiate the book-building process and investor engagement. The book-building process involves assessing the demand for commercial paper at various interest rates. Once completed, the issuer closes the offer period.

f. The final leg of the CP issuance journey encompasses the transfer of funds from investors to the issuer. Simultaneously, the commercial paper is credited to the investors' accounts with the depository, ensuring electronic ownership.[19] Confirmation of settlement is communicated to both issuers and investors, and relevant reports are submitted to regulatory authorities, signifying the completion of the issuance cycle.

[18] The Approved Documentation as contained in Appendix 1 to the FMDQ Rules
[19] Introduction to Commercial Papers II – Key Stakeholders and Issuance Process, FMDQ-Newsletter-Edition-100-February-2023.pdf- FMDQ Newsletter | FMDQ Group (accessed 6th October 2023)
[20] Paragraph 4.2 of the CBN Guidelines

Relevant Documentation

The required documentation for the issuance of a CP include;

a. CP raising mandate
b. A board resolution authorizing the Company to borrow
c. An Issuing, Placing and Paying Agency Agreement
d. Commercial Paper Note
e. Bank Guarantee, where applicable
f. Investment Instruction/Investment Mandate
g. Investment Advice
h. Custodial Agreement
i. Information memorandum on the issuer in the case of clean Cps
j. The latest rating report from the credit rating agency either domestic or international acceptable by CBN
k. Backstop loan request for guaranteed Cps[20]

SUBSCRIPTION TO CPS QUOTED ON FMDQ EXCHANGE

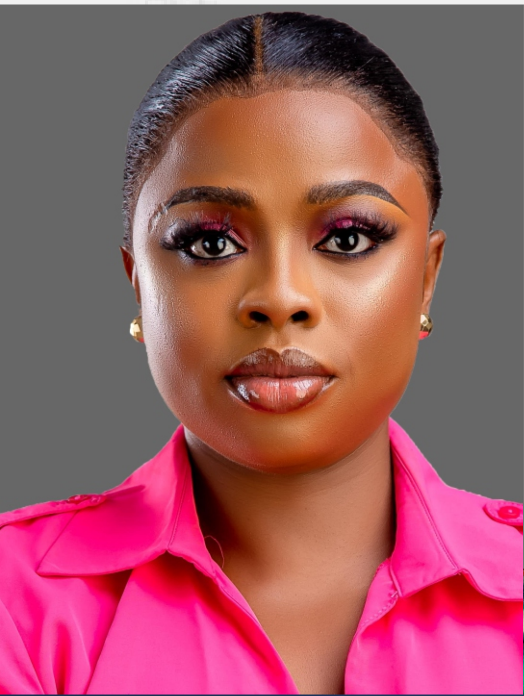
Once a CP is approved and listed on the FMDQ Exchange Daily Quotation List and the FMDQ Exchange's website it is open to subscription. Therefore, individuals who intend to subscribe to a CP may do so directly from the FMDQ market, or through the secondary markets to identify and facilitate the purchase. There is therefore a duty on the investor to carry out their due diligence to ensure the CP is fit for their investing purpose.

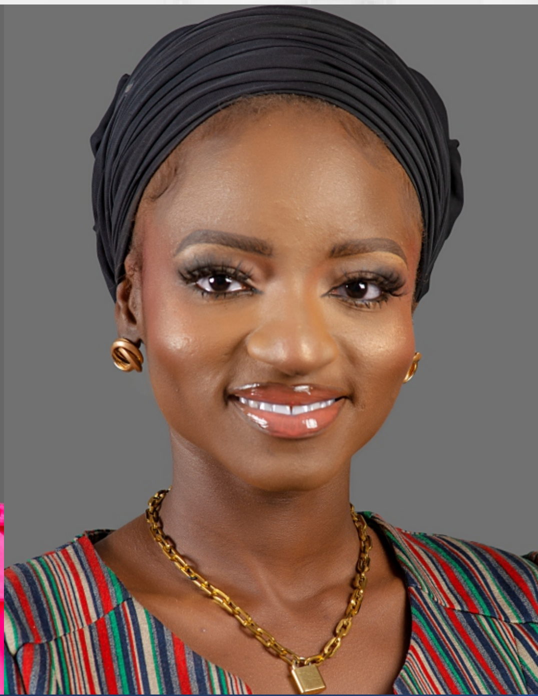
CONCLUSION

Commercial papers have emerged as a vital source of short-term financing for businesses in Nigeria, offering a win-win solution for both issuers and investors. Their flexibility, short maturities, and relatively high returns make them a popular choice in the corporate finance landscape. However, potential investors should exercise caution and perform thorough due diligence, given the inherent credit risks associated with commercial papers. Nigeria's regulatory bodies have established a legal framework that promotes transparency and investor protection in the CP market, further bolstering its growth and stability.

PLEASE NOTE THAT THIS ARTICLE IS FOR INFORMATION PURPOSES ONLY AND DOES NOT CONSTITUTE LEGAL ADVICE

MEET THE AUTHORS





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Do you need to get in touch with us, to know more on how we can help you and your business?
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