African Private Equity and Venture Capital Association

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LETTER FROM THE CO-CHAIRS

Dear AVCA Members,

We are delighted to share the fourth edition of the AVCA Legal and Regulatory Bulletin. This edition includes expert contributions on topical regulatory, fiscal and market developments impacting the African private equity and venture capital sectors.

In this issue, contributors consider:

- the emerging trends in African private equity;
- the impact of AIFMD on the marketing of African funds;
- private equity regulatory developments in Nigeria and South Africa and their impact;
- how to get governance right;
- the tax footprint of the CEMAC's new current exchange regulation;
- the impact of fintech on Africa's banking sector;
- and liquidity options in permanent capital vehicles.

We are grateful to the contributors for their input and support.

Please send comments, suggestions, and contributions to future editions to avca@avca-africa.org.

Geoffrey Burgess & Cindy Valentine
Co-chairs, AVCA Legal & Regulatory Committee

ABOUT AVCA

The African Private Equity and Venture Capital Association is the pan-African industry body which promotes and enables private investment in Africa.

AVCA plays a significant role as a champion and effective change agent for the industry, educating, equipping and connecting members and stakeholders with independent industry research, best practice training programmes, and exceptional networking opportunities.

With a global and growing member base, AVCA members span private equity and venture capital firms, institutional investors, foundations and endowments, pension funds, international development finance institutions, professional service firms, academia, and other associations.

This diverse membership is united by a common purpose: to be part of the Africa growth story.

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Table of Contents

Private Equity in Africa - Emerging Trends 4
White & Case | Kenneth Barry, Preeti Nana

Recent Regulatory Developments in Nigeria and their impact on PE 7
UUBO | Folake Elias-Adebowale, Faridah Orimobi, Chukwunedum Orabueze, Christopher Oke, Damilola Adedoyin

Federal Competition and Consumer Protection Law – Impact of Private Equity Dealmaking in Nigeria 10
Jackson Etti and Edu | Fola Olusanya

Marketing in Africa - navigating the AIFMD 13
Simmons & Simmons | Charles Vermeylen

Private Equity in Kenya: An Update on the Legal & Regulatory Landscape 16
Anjarwalla & Khanna | Anne Kiunuhe, Daniel Ngumy

South African regulatory reform – what does it mean for Private Equity Fund managers? 19
SAVCA | Shelley Lotz

The 2018 Nigerian Companies Bill – A Mixed Bag for Private Equity Investors 21
G. Elias & Co | Gbolahan Elias, Yemisi Falade

Getting Governance Right 24
Debevoise and Plimpton | Simon Witney, Geoffrey P. Burgess

Tax footprint on the new CEMEC exchange regulation 26
Gide Loyrette Nouel | Magueye Gueye

Fintech as the driver for growth in Africa's banking Sector 28
Olajide Oyewole LLP, DLA Piper Africa member firm in Nigeria | Ogechi Onuoha, Taiwo Peregrino, Ufuoma Isiavwe

Permanent Capital Vehicles - the Liquidity quandry 31
Simmons & Simmons | Cindy Valentine, George Metcalfe

Private Equity in Africa: Emerging Trends

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Private equity in Africa has come a long way since the early 1990s, which saw development financial institutions investing in government-initiated development projects across the continent. The period that followed was characterised by the emergence of a limited number of South African focussed private equity funds, which over the next decade started to invest more widely across the continent. By 1997, there were twelve private equity funds that had collectively raised US$1 billion to invest in Africa.

> Many features typically reserved for private equity transactions in Europe and North America are becoming increasingly prevalent in African private equity.

As we fast forward to 2019, the African private equity ecosystem has significantly matured with over 1022 African private equity deals, with a total value of US$25 billion, being reported between 2013 and 2018, including the first billion dollar sub-Saharan African funds, Helios Investors III and Equatorial Guinea Co-Investment Fund. In terms of sector focus, information technology (19%), consumer discretionary (15%), and consumer staples (13%) accounted for almost half of the total number of private equity deals in 2018, while communication services (which includes deals in telecommunication services) was the largest sector by value. Information technology's share of private equity deal volume has grown significantly in recent years, accounting for 19% of private equity deals in 2018 (compared to only 10% in 2016).

With the new narrative of 'Africa Rising' that pervaded the media from 2000 and in the aftermath of the 2008 economic crisis, private equity funds increasingly turned to emerging markets for levels of growth that were unattainable elsewhere. Although certain countries on the continent have experienced headwinds in recent years (in particular, in 2016 when growth came to a halt in South Africa and Nigeria entered a recession, the two economies being the largest in Africa and accounting for the vast majority of private equity activity in the region), one thing we can be certain of is that African private equity has significantly evolved over time. Many features typically reserved for private equity transactions in Europe and North America are becoming increasingly prevalent in African private equity.

Stronger Exit Opportunities

In the past, a key concern for private equity funds and their Limited Partners regarding African private equity investments was the quality and availability of exit

routes. Illiquid domestic exchanges and political and foreign exchange risk have historically contributed to a limited number of exit paths. However, with the maturation of the African private equity market, the number and scope of exit opportunities have notably improved with AVCA reporting a record number of private equity firms in Africa exiting in 2017 and 2018 (52 and 46 respectively).

Trade sales

Trade sales to strategic investors continue to be a common exit route, constituting over 39% of exits in 2018. This is expected to continue to be the case in the next twelve months. A notable feature of the evolving market, is the increased prevalence of auction sales, such as the sale of Brandcorp in June 2016 by Ethos Private Equity to The Bidvest Group. Given the increased competition for quality African assets in recent years, it is likely that auction processes will become increasingly common.

Secondary transactions

After trade sales, secondary buyouts (sales to other private equity funds and financial buyers), such as the sale by LeapFrog Investments of its stake in Ghana-based pension trustee Petra Trust to pan-African investment firm African Capital Alliance in 2018, account for the next largest proportion of exits, at 37% of deals surveyed in 2018. With strong fundraising by domestic, international Africa-focussed and global funds, we expect that secondary buyouts will continue to be a growing feature in the African private equity market. As the quality of assets and deal sizes gradually increase over time, we would also expect to see more sophisticated secondary transaction structures, such as 'portfolio' deals that package up several assets together to be sold to another fund, or deals which involve the breaking up of larger investments into smaller divisions for sale.

> The challenges posed by the African financing market and the increased complexity of companies' investment needs, means that we also expect to see an increase in the use of tiered capital structures, with a broader range of share classes and debt instruments

IPOs

Although public listings remain one of the most attractive exit routes in the global private equity industry, the converse has historically been true in African private equity. Fragmented regulation, political uncertainty, underdeveloped capital markets and low levels of market capitalisation compared to the developed world, result in low usage of IPOs as a private equity exit route.- only 3% of all 98 private equity exits in Africa during 2017 - 2018 took place through IPOs. Despite the aforegoing, Vivo Energy's IPO on the Premium Segment of the London Stock Exchange in 2018, with a secondary inward listing on the Johannesburg Stock Exchange, and the launch by Jumia (the largest e-commerce operator in Africa) of its IPO on the New York Stock Exchange in 2019 indicate that viable IPO options do exist.

A number of initiatives have been introduced to improve the attractiveness of IPO markets, including: (i) the East Africa Community stock markets integration project, (ii) the introduction of the Growth Enterprise Market Segment by the Nairobi Securities Exchange; and (iii) new mechanisms to trade and settle ordinary shares of London listed or dual-listed Nigerian companies. As such initiatives come to fruition, we expect that exit options on a limited number of exchanges will become more viable.

Increasingly Sophisticated Features and Capital Structures

Equity and debt instruments

The illiquidity of domestic capital markets, as described above, presents challenges for companies seeking funding. The small size and conservative nature of many African banks has resulted in African private equity deals being significantly less leveraged than equivalent deals in the developed world. Accordingly, the primary source of funding in African private equity has historically been equity finance with a simple capital structure.

As the market matures and aims to close the funding gap, mezzanine debt is becoming a key component in the capital structures of African companies, and there are a number of dominant South African funds

in the mezzanine debt market. While specific forms of 'mezzanine debt' in a European context are generally clearly defined, in African countries it refers more broadly to subordinated debt or unsecured senior debt.

A number of private equity funds have raised credit funds specifically targeting these types of investments in Africa. Going forward, we expect to see an increasing number of such funds being established.

The challenges posed by the African financing market and the increased complexity of companies' investment needs, means that we also expect to see an increase in the use of tiered capital structures, with a broader range of share classes and debt instruments, including convertible instruments, loan notes, warrants, high yield instruments, and payment in kind notes.

Warranty and Indemnity Insurance

Private equity has been a driving force in the increased use of warranty and indemnity ("W&I") insurance on global M&A transactions, particularly on the buy-side. Such policies are beneficial for buyers with limited recourse against sellers who have poor covenant strength. It also allows private equity and institutional sellers to achieve a clean break and distribute proceeds to their Limited Partners.

Historically, insurers' have been wary of emerging markets, however, AIG reports that this is a growing area. Before offering W&I insurance, insurers assess the legal, political and regulatory risks in the relevant jurisdiction, and reflect the level of risk through pricing and exclusions. We expect that the trend to take out W&I insurance, and the increased appetite to underwrite W&I policies on African private equity transactions, will continue.

Conclusion

Despite some recent headwinds in certain African regions and sectors, the outlook for private equity investments in the continent is undeniably positive. According to a 2018 AVCA report, 53% of limited partners interviewed indicated that they plan to increase their allocation to private equity in Africa over the next three years, with limited partners, overall, indicating their belief in the long-term attractiveness of Africa; especially, when compared with developed markets.

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Recent Regulatory Developments in Nigeria and their impact on PE

Published reports of concluded deals in Nigeria suggest continuing investor optimism, the sustainability of which will depend on the effectiveness of ongoing efforts to reform and improve the investment climate in Nigeria, particularly from a legal and regulatory perspective.

A recurring theme in 'ease of doing business' rankings and in survey responses from private equity and other dealmakers focused on the Nigerian market, has been that regulatory and compliance issues pose the greatest challenge to deal-making in Nigeria. Ongoing disputes between some of Nigeria's most significant multinational investors and regulatory agencies, 'red tape' bureaucracy, variations in regulatory efficiency, inconsistent enforcement and duplication of compliance requirements are cited as significant deterrents and contributing factors to the reported decline in investment activity.

To put this in context, UNCTAD's 2019 World Investment Report recorded a total of USD2 billion in foreign direct investment ("FDI") inflows into Nigeria in 2018 - a decline of 43% from 2017. Recent data from the Nigerian National Bureau of Statistics' July 2019 Capital Importation Report, however, suggests a USD3.26 million or 1.32% difference in FDI inflows into Nigeria between Q1 2019 (for which USD243.36 million has been recorded), as compared with the Q1 2018 figure of USD246.62 million in 2018.

In the wake of its ongoing recovery from recession and less than favourable macroeconomics, however, it is clear that Nigeria's legal and regulatory reform initiatives will need to be strategically and cohesively implemented to enable it to retain its viability as a preferred African investment destination. Key reform initiatives that have recently been undertaken that potentially impact on private equity and other establishment and investment activity in Nigeria, include the Presidential Enabling Business Environment Council ("PEBEC") Initiatives, the Companies and Allied Matters Act (Repeal and Re-Enactment) Bill 2019, the Nigerian Code of Corporate Governance 2018 and the Federal Competition and Consumer Protection Act 2019.

It is clear that Nigeria's legal and regulatory reform initiatives will need to be strategically and cohesively implemented to enable it to retain its viability as a preferred African investment destination

Presidential Enabling Business Environment Council Initiatives

President Buhari established PEBEC in July 2016 to "remove critical bottlenecks and bureaucratic constraints to doing business in Nigeria" and "move Nigeria 20 steps upwards in the World Bank Ease of Doing Business Index''. As at March 2019, PEBEC launched its Fourth 60-day National Action Plan (NAP 4.0) on Ease of Doing Business ("EoDB''). Guided by the World Bank EoDB criteria, NAP 4.0 focuses on addressing challenges faced by SMEs and other businesses in starting a business, getting credit, paying taxes, enforcing contracts and trading within, and across, borders. NAP 4.0 initiatives comprise coordinated inter-ministerial and inter-governmental plans implemented by various ministries, departments and agencies ("MDAs"). NAP 4.0 priorities the enforcement of compliance with Service Level Agreements, the enhancement of the efficiency of small claims courts, the ''visa on arrival'' application processes and, notably, the enactment of the Companies' and Allied Matters Act (Repeal and Re-Enactment) Bill 2019, for achievement by April 2020.

The Companies and Allied Matters Act (Repeal and Re-Enactment) Bill 2018 (''CAMA Bill'')

The CAMA Bill proposes extensive and progressive structuring, governance and operational modernisations that should help to facilitate private equity fund structuring and investments, as it provides for the registration of limited and limited liability partnerships, single member and director companies, electronic general meetings, company rescue procedures, netting provisions for the mitigation of credit risks, and disclosures of persons with significant control for transparency among other innovations. The CAMA Bill was passed by both houses of the Nigerian legislature on January 17, 2019, but President Buhari has not assented to it. There is a risk that, with the new post-election legislature and administration, the CAMA Bill may have lapsed and the opportunity to implement innovations that would facilitate Nigeria's elevation in the EODB rankings may be lost if the Bill is not passed into law.

The Nigerian Code of Corporate Governance, 2018

African private equity pioneer and former Minister for Trade and Investment, Okechukwu Enelamah, issued the Nigerian Code of Corporate Governance, 2018 (the "Code") on 15 January 2019.

The Code applies to all listed and unlisted public companies, private companies that are holding companies of listed companies or other regulated entities, concessioned or private companies and all regulated private companies that are required to include reports of compliance with the Code in annual reports for financial years ending after 1 January 2020, and to adopt an "apply and explain'' approach in so doing.

The Code's innovations aim to institutionalise high degrees of corporate governance in all Nigerian entities, with key focus areas including board and officers, assurance, relationship with shareholders, business conduct and ethics, sustainability and transparency.

While the Code does not prescribe penalties for non-compliance, its monitoring by sectoral regulators and the Financial Reporting Council of Nigeria should help to facilitate the increased adoption of international best practices standards in Nigeria; a welcome development for investors concerned about inadequate and inconsistent corporate governance standards.

The Federal Competition and Consumer Protection Act 2019

The Federal Competition and Consumer Protection Act 2019 ("FCCPA") was enacted in January 2019. The FCCPA establishes the Federal Competition and Consumer Protection Commission ("FCCPC") which is now vested with the power to approve and regulate mergers (including equity and asset investment and acquisition transactions). The Act governs equity and asset transactions, the commercial activities of companies, as well as government entities.

Prior to the passage of the FCCPA, the Nigerian Securities and Exchange Commission ("SEC") was the authority in charge of merger control, and routinely reviewed merger applications in accordance with the now-repealed merger control provisions of the Investments and Securities Act 2007, and the rules and regulations issued by the SEC. The Act also provides for the establishment of a Federal Competition and Consumer Protection Tribunal with powers to adjudicate over matters arising from the operation of the FCCPA, and to oversee forced divestments, among other changes.

The board of the FCCPC, however is yet to be constituted, and commissioners have not been appointed. The FCCPC is yet to issue its own set of rules that will help to address ambiguities and to properly define the powers conferred on the FCCPC and compliance requirements. For the time being, applications for approval of qualifying transactions are being reviewed by a joint desk of the FCCPC and the SEC in accordance with the previous SEC regime, but with the FCCPC remaining at liberty to exercise the wide discretion conferred by its provisions to require additional information and documentation, including in relation to competition and anti-trust issues.

The FCCPA prescribes a 120-business day maximum review period for mergers - From the date on which a complete application is filed with the FCCPC, the initial review period for mergers is fixed by the FCCPA at 60 business days but the FCCPC has the discretion to extend the review period by an additional 60 business days. Section 97(2) of the FCCPA states that if the FCCPC has not issued a decision by the end of the review period, including extensions, the transaction shall be deemed to have been approved. Uncertainty remains around the practical application of these prescribed timelines and other requirements for merger approvals to pending investment and acquisition transactions.

Conclusion

The spate of reforms outlined above do not focus specifically on private equity as a distinct asset class, but as there is a dearth of such laws in Nigeria this is not unusual. It is hoped that the SEC's increasing engagement with the private equity community will facilitate further reviews and reforms of existing laws. The latest statutes, regulations and policies outlined above are not always clear in scope or language, and the process and timing of implementation and rules required to give effect to the prescribed reforms have in some instances not been prescribed. Such factors contribute considerably to the climate of uncertainty reported by investors and dealmakers, who also identify compliance monitoring by a multiplicity of regulators operating independently and incohesively as a continuing challenge for investors doing or continuing to do business in Nigeria.

It is clear that experienced private equity and other investors and institutions continue to invest in Nigeria, adopting available mitigants, including enhanced due diligence, robust contractual structures and protections, warranties, insurance and other measures, to successfully address outlined challenges to doing business here with over 30 deals concluded as at 21 August 2019 across diverse sectors and industries and several others signed and awaiting completion. Nigeria has taken important steps in developing a reform agenda and it is important that, with elections peacefully concluded and investors' continuing optimism exemplified by such market activity, the government's commitment to reforming and improving the investment climate in Nigeria, particularly from a legal and regulatory perspective, remains robust, strategic and cohesively prioritised and implemented.

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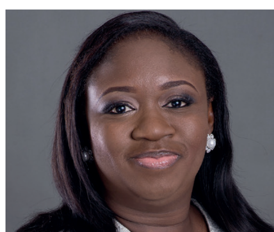

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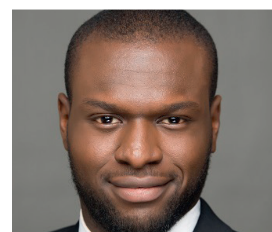

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Federal Competition and Consumer Protection Act 2019 - Impact on Private Equity Deal Making in Nigeria

Introduction

After about 17 years of attempting to introduce competition legislation, Nigeria finally passed the Federal Competition and Consumer Protection Act 2019 ("FCCPA" or the "Act") in the first quarter of 2019. The Act contains comprehensive provisions in relation to competition and has made significant modifications to the merger control regime. Before 2019, in addition to sector regulations, which provided for prior approval of mergers and acquisitions, the regulator responsible for merger control was the Securities and Exchange Commission ("SEC") by virtue of the Investment and Securities Act, 2007 ("ISA"). The SEC at that time acted as regulator for both securities and competition in mergers and acquisition transactions. Indeed, to most stakeholders, the SEC was more of a regulator for the former than the latter. It is against this background that the passing of the FCCPA has introduced a new regime.

The FCCPA will significantly impact private equity in Nigeria. Private Equity continues to be a significant source of deal flow as well as foreign direct investment into Nigeria. Between 2013 and 2018, it is estimated that the value of reported private equity deals was at least USD 7.8 billion, many of which were majority-type deals.

The New Sheriff

The Act establishes the Federal Competition and Consumer Protection Commission ("FCCPC" or "the Commission") with the ultimate responsibility for merger control and indeed, all matters relating to competition in Nigeria. The provisions in the ISA dealing with mergers and acquisitions were repealed. Approval of the FCCPC is now mandatory for all mergers (as defined in the Act). Notification in relation to small mergers is generally excluded, although such notification could be made to the Commission at any time at the discretion of the parties. Mandatory notification of a small merger can however arise if the Commission is of the opinion, within six months of the implementation of the merger, that the deal could substantially prevent or lessen competition.

Notifiable Mergers

The Act introduces some not so obvious changes to the nature of transactions that would constitute a merger. A transaction is notifiable if it falls within the definition of mergers under the FCCPA and, in addition, is above the threshold set by the Commission. A merger is considered to have occurred under the Act where one or more undertakings directly or indirectly acquire or establish direct or indirect control over the whole or part of the business of another undertaking. Whilst the elements of "control" in determining whether a merger has occurred remain the same as they were under the ISA, a merger can now be deemed to have occurred either by acquisition or establishment of control. Under the previous regime, the only "bright line" of control appeared to be 51% or more of acquisition of shares – thus, in spite of being only one of the elements of control, acquisition of majority shares appeared to be the determining factor of a notifiable merger within the applicable threshold.

With the definition of mergers explicitly expanded to include establishment of control, all the other elements

of control now constitute a "bright line". Many private equity transactions in Nigeria are developmental growth capital in which case, the private equity fund ordinarily acquires significant minority interests. Given the explicit provisions relating to the establishment of control for purposes of determining a notifiable merger, typical provisions in minority share acquisitions, for example those that mandate appointing half or more of the board of directors or requiring consent or veto for strategic decisions in such transactions, may constitute a basis for notification. The FCCPC is yet to issue any new rules, regulations or guidance (the rules under the SEC rules and regulations by virtue of a Joint Advisory by FCCPC and SEC are still applicable and limited to only acquisition of shares) but may follow the jurisprudence in South Africa, given the similarities in merger control provisions.

Foreign to Foreign Transactions

The most significant impact of the new merger control regime on the Nigerian private equity industry, is perhaps the jurisdiction of the FCCPC over undertakings and commercial activities having an effect in Nigeria. Consequently, acquisition of shares or assets outside Nigeria which results in a change in control of part, or the whole of a Nigerian business is caught by the FCCPA. It was becoming common place for a holding company of an investee company to be set up in Mauritius or other tax-friendly location into which the investment by the private equity fund is made. This arrangement provided several benefits including alignment of the investor and promoters as well as facilitation of exits by the private equity investors. Historically, under this arrangement, an investment into and exit out of the foreign holding company would not be affected by the local laws of the investee company. This would however no longer be the case, as the approval of the FCCPC would be required if the investment or exit falls within a notifiable merger.

Extended Regulatory Approval Process

Depending on the industry in which the investment is to be made and whether the entity is a private or public company, regulatory approval for a PE transaction which is notifiable will involve between one and three approval processes.

If the notifiable merger is in an unregulated private company, it is only the approval of the FCCPC that is required. The FCCPA provides for specified timelines for the review of a merger application – 60 business days, extendable where the Commission requires more time for consideration, up to a maximum of 120 business days.

A private equity investment into a public company will require the approval of both the FCCPC and SEC, whilst a transaction involving a regulated public company will now require the approval of the FCCPC and the Sector Regulator.

Mergers involving public companies in a regulated industry will now require the approval of the FCCPC, SEC and the Sector Regulator.

Interim arrangements were put in place by the FCCPC in March 2019 to the effect that, until further notice, all merger and acquisition notifications will be reviewed under the existing SEC Rules and Regulations on Mergers and Acquisitions by both FCCPC and SEC. The Joint Advisory/Guidance while acknowledging the powers of SEC to determine the fairness of transactions involving public companies, indicated that decisions will be communicated by the FCCPC.

The Act confers concurrent jurisdiction on the FCCPC and Sector Regulators, in relation to competition. Both the FCCPC and the Sector Regulator is enjoined to enter into agreements to harmonise and co-ordinate their concurrent jurisdiction. As at the date of this article, there are no harmonisation/co-ordination agreements in place, but the regulators are statutorily required to have them in place by February 2020.

Increased Disclosure

Typically, public notifications of private equity deals (except for transactions involving public companies) are made only after the transaction has been concluded and all conditions precedent satisfied and even then, are based on the communications policy of the respective private equity firms. This practice held true under the previous regime, as parties to an acquisition were only required to publish the fact of the acquisition after the transaction had been concluded. The FCCPC is required to publish not only the notice of its decisions (in this case in two national newspapers) but must also publish the notification of the application, five days after receipt.

Furthermore, although the prevailing SEC Rules and Regulations are still applicable by virtue of the Joint Advisory/Guidance, in a recent foreign–to-foreign transaction approval, the FCCPC required information in relation to turnover, contact details of top five customers and largest aggregate purchases in value for each identified product or service.

Consolidation Play

Stakeholders in the Nigerian private equity industry have acknowledged that the bulk of the potential transactions fall within the range of USD25-50 million. Bigger private equity firms with larger ticket sizes have begun to consider a consolidation play as an approach to reaching the preferred transaction size. They previously only had to contend with the Sector Regulator, several of which had no competition provisions. With the FCCPA, it is to be expected that such transactions will involve more scrutiny and a private equity firm is now obliged to show that such

transactions do not substantially prevent or lessen competition or result in any technological efficiency or pro-competitive gain with every additional bolt-on acquisition.

Due Diligence

Additional aspects of review are now required to be included in conducting due diligence on prospective investee companies. The FCCPA prohibits agreements and arrangements that have an actual or likely effect of preventing, restricting or distorting competition, except those authorised by the Commission. As this is the first time Nigeria has had a comprehensive competition law - telecommunications, aviation, power and broadcasting sectors have some competition provisions (with telecommunications being the most active industry in terms of competition) – all agreements, arrangements and practices must now be considered in line with the FCCPA, particularly provisions on restrictive agreements. The provisions of the FCCPA are prescriptive in nature with attendant criminal liability on both the company and directors. Contravention of the FCCPA provisions in respect of restrictive agreements renders the non-compliant agreements/arrangements not only void but also unlawful. Furthermore, on conviction the offending company is liable to a fine of 10% of the previous year's turnover, whilst directors are each liable to a fine of circa USD 15,000 and/or a term of five years imprisonment.

Introduction of Gun-Jumping Provisions

The FCCPA provides clear and specific provisions as to the impact of non-compliance with the mandatory nature of the merger control provisions. This was not the case under the previous regime. Any action taken further to a merger without FCCPC approval is rendered void and parties involved in such actions are liable to a fine of 10% of the previous year's turnover. It is not unusual for a prospective investee company to undergo restructuring or re-organisation in order to facilitate the receipt of the private equity investments.

With the explicit provision of the Act, two approaches are available to undertaking private equity transactions involving pre-deal restructuring (i) inclusion of the restructuring as part of the transaction as is usually the case; and (ii) disjoin the restructuring activity from the private equity transaction. The downside of the first option is that the restructuring would only be undertaken upon receipt of FCCPC approval, however, the parties would have certainty. In the second option, the restructuring will be undertaken prior to executing the transactional documents. Whilst the private equity firm will get comfort that the restructuring is effected to its satisfaction, there would be the risk of the absence of definitive agreements to bind the prospective investee company and its promoters.

Conclusion

The Commission is presently trying to put rules, regulations and guidelines in place to give effect to the provisions of the Act. At a recent event titled "The Changing Landscape – Federal Competition and Consumer Protection Act" organised by Jackson, Etti & Edu, the Director-General of the FCCPC indicated that the Commission will be taking a "prioritisation approach" towards the provision of the subsidiary legislations, which would mirror national economic priorities.

Stakeholders in the Nigerian private equity industry should take advantage of the nascent regime to contribute to the shaping of the rules, in order to further facilitate private equity deal-making in the country without taking out the essence of the provisions of the FCCPC.

Given the fact that most private equity investments are financial in nature with limited or no overlaps or relationship within the private equity firm's portfolio, a fast track procedure (maximum of two-three weeks) for merger approval should be put in place by the FCCPC. This approach should also be applicable to holding company restructuring. It is also hoped that the FCCPC would take a pragmatic approach to market definition, vertical relationships, as well as spill-over effects of private equity consortia in considering notifications involving private equity firms.

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Marketing in Africa – navigating the AIFMD

Marketing by private equity GPs to investors has become significantly more complex over the last few years, with the tightening up of regulations and the advent of the Alternative Investment Fund Managers Directive ("AIFMD") which governs marketing to European investors. European based Development Finance Institutions ("DFIs") continue to be a key source of capital for Africa focused fund managers and understanding the impact of the AIFMD on structuring and marketing is therefore of utmost importance.

Fortress Europe

The European Parliament has recently adopted new rules on the cross-border distribution of collective investment funds that will amend the AIFMD. Although the new rules will have limited impact on African and other non-European managers and do not enter force until 2021, the current direction of travel is, if anything, likely to make it harder to market into the EU. Fully authorised European fund managers benefit from a marketing "passport", which offers a consistent, streamlined process enabling marketing to European investors. There is no immediate sign the passport will be extended to third country (i.e. non-European) managers, who must continue to navigate the patchwork of national private placement rules under Article 42 of the AIFMD.

Marketing to European investors by third country fund managers

For many third country fund managers, having a fully authorised European management entity is not an option – the cost of having a place of business in Europe and becoming fully authorised to take advantage of the European passport (which allows marketing to all applicable European jurisdictions) is significant. Larger global emerging markets managers may well consider utilising this option, however smaller managers may opt to market as a Small (sub-threshold) Manager (please see further detail below), or opt to market under Article 42 of the AIFMD. Article 42 allows third country fund managers to market to European investors based on the National Private Placement ("NPPRs") in each country in which they wish to market. If the manager is allowed to market under Article 42, then it must market according to the specific NPPR of that country (which differs from country to country). This can be an expensive and time consuming process – whereas, for example, the UK requires a notification and allows pre-marketing, other jurisdictions don't allow pre-marketing and may require a 3 month approval process. However, in order to ascertain whether a manager can in fact market under Article 42, the article needs to be examined in more detail. It prescribes that:

1. the manager must comply with certain disclosure and reporting requirements;
2. the fund must not be established in a country designated as "non-cooperative" by the Financial Action Taskforce; and
3. MoUs must be in place between the regulator in each EU state where the fund is marketed and the regulators in the countries where fund and the manager are established.

The first requirement above is generally well-known, and there are various providers, including law firms,

which can help smaller managers comply (see "The Lightbulb Moment" below). However, the second two requirements may disproportionately affect African managers.

The FATF precondition

The Financial Action Taskforce (or Groupe d'action financière) is a G7 initiative to develop policies to combat money-laundering. Botswana, Ethiopia, Ghana and Tunisia are currently considered by the group to "have strategic AML/CFT deficiencies" and accordingly the second requirement of Article 42 is likely to be problematic for funds established in those countries.

MoU precondition

Article 42 states that MoUs must be in place between the regulator in each EU state where the fund is marketed and the regulators in the countries where fund and the manager are established. The European Securities and Markets Authority ("ESMA") maintains a list of the various agreements in place. Of course, a fund will often be established in a different jurisdiction from the manager, and it is important to check both those jurisdictions against the relevant target EU country.

The following shows a selection of relevant countries (with "x" indicating the absence of the relevant MoU):

	Egypt	Morocco	Mauritius	South Africa	Tanzania
AMF (France)			X		X
BaFin (Germany)	X	X	X	X	X
CMVM (Portugal)	X				
CNMV (Spain)			X		
Consob (Italy)			X		X
CNB (Czech Republic)					X
Finanssivalvonta (Finland)		X	X		X
Finanzmarktaufsicht (Austria)	X	X	X	X	X
FSMA (Belgium)	X	X			X
AVP (Slovenia)	X	X	X	X	X
CFSSA (Croatia)	X	X	X	X	X

For example, this means a Mauritius PE fund sponsored by an Egyptian manager could not be marketed in France, Germany, Spain, Italy, Finland, Austria, Slovenia, Croatia, Portugal or Belgium. The existence of the right MoU certainly cannot be taken for granted and it is fundamental to ensure that this is considered when the jurisdictions of the fund and the manager are being determined.

Small (sub-threshold) Managers

One aspect of AIFMD which has been implemented differently across various states is the "small manager" regime. AIFMD has an exception in respect of managers managing (directly or indirectly) funds which, in aggregate, have assets not exceeding either €100m or €500m. The €100m limit will apply in all cases, save where the AIFM manages funds which:

(i) are not leveraged; and

(ii) (in summary) do not allow redemptions for investors within 5 years of their admission.

For these purposes, "leverage" would not include drawdown bridging facilities provided the facility is at all times covered by undrawn commitments (this is on the basis that such borrowings are excluded from the calculation methodology for "leverage" in the AIFMD, though not expressly carved out from the definition of that term).

For marketing into the UK, the small AIFM exemption is helpful, as it would allow an African manager managing African funds below the threshold to register as a "small third country AIFM" and so to escape the alternative of having to market under Article 42 regime which would otherwise apply. However, EU states have latitude as to whether the regime applies in their country, and many,

such as the Netherlands, do not make a distinction for these small managers. Accordingly this exemption is of limited value as a result of divergent implementation of the AIFMD across Member States (a theme which is common to many of the frustrations which non-European managers experience when marketing into Europe).

The Lightbulb Moment

Assuming the FATF and co-operation agreement preconditions are both met, non-EU managers will look to ensure compliance with the rest of Article 42. Unfortunately the notion that 'only Article 42 applies', whilst literally true, is not the whole story. Article 42 has the effect of 'switching on' various other parts of AIFMD so that those also become applicable to non-EU managers. In this context, the following other Articles are relevant:

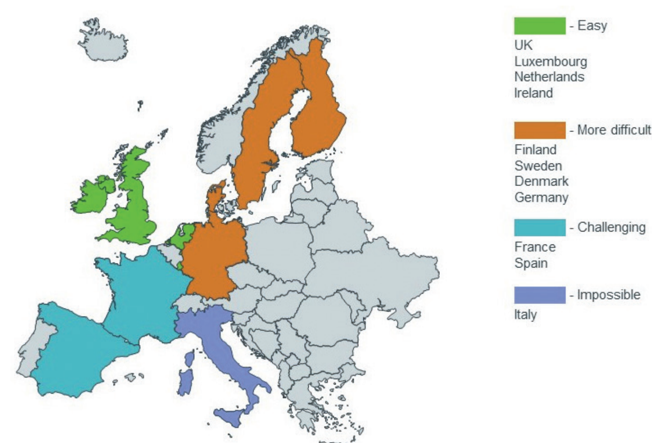
- **Article 22:** The fund's annual report must contain certain prescribed content. This includes some detail about remuneration paid to staff (including any carried interest). Accordingly it is sometimes controversial with, for instance, US managers but perhaps less so with African managers more used to DFI-imposed transparency requirements;
- **Article 23:** Certain prescribed disclosures must be made prior to an investor's admission. In practice, these disclosures are included as a matter of course in the offering documents of well-advised African managers so this is generally not a difficult ask;
- **Article 24:** There are some ongoing reporting obligations. This is similar to the Form PF process, and managers will generally require the assistance of compliance consultants. Note that a slimmed down version of these reports is also generally required from those "small managers" described above; and
- **Articles 26-30:** These are known as the 'asset-stripping' provisions and the onerous ones are generally applicable to funds gaining control over EU companies, which is likely not the case for a typical African fund.

Gold-plating

Aside from the points above (including the 'switch-on' of certain other parts of AIFMD), Article 42 reminds us that "Member States may impose stricter rules."

France, for example, is challenging because of the requirements to appoint a French centralising agent and to comply with the vast majority of AIFMD. In Spain, the local regulator there may reject applications on grounds such as prudential reasons. Moreover, a Spanish entity must be appointed to intermediate the payment of the marketing application fee (and note that fees vary greatly between EU countries).

The following 'heatmap' gives a quick overview as to the relative overall difficulty of marketing.



Clearly, African fund managers have to contend with significant divergence across the EU. We would suggest that, when African managers are considering their choice of legal counsel, cross-border marketing expertise should figure prominently in order to guide your structuring decisions and navigate the marketing landscape.

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Private Equity in Kenya: An Update on the Legal & Regulatory Landscape

The real GDP of Kenya grew approximately 5.9% in 2018, up from 4.9% in 2017, thanks to favourable weather conditions, greater political stability and increased investor confidence. The economy is predicted to experience steady growth in 2019 and 2020 by approximately 6.0% each year, illustrating that the 'Africa Rising' narrative still applies to the country today. This is underpinned by the Kenya Vision 2030, the long-term development blue print for the country launched in 2008, the aim of which is to create "a globally competitive and prosperous country…" and the Big 4 Agenda – an economic plan introduced in 2017 by President Kenyatta that envisages accelerating economic growth to at least 7% a year. The Big 4 Agenda focusses on four pillars: expansion of the manufacturing sector, affordable housing, affordable healthcare and food security. These in turn are expected to shape the focus areas for investment by both government and the private sector.

The positive growth in the economy was reflected in the level of M&A activity in the last financial year. All mergers taking place in Kenya and resulting in a change of control require a mandatory notification to the antitrust regulator – the Competition Authority of Kenya ("CAK"). There were approximately 150 transactions that were notified to the CAK in the financial year July 2017/June 2018, with a significant number of these being private equity-led. It is predicted that the number and value of investments will increase in 2019. The outlook for Kenya is therefore promising and investors remain attracted to the investment prospects that the country has to offer.

The regulatory and business landscape in Kenya is constantly evolving with continuous reform activity taking place in order to spearhead the Kenya Vision 2030 and bolster the Big 4 economic plan. According to the World Bank's Ease of Doing Business 2019 report, Kenya moved up 19 places in the world rankings, from 80 to 61. The digitisation of Government-to-Citizen services and payments and the shift away from manual processes has been instrumental in tackling inefficiencies in government service delivery and doing business in Kenya. The Business Registration Services and e-Citizen Platform has streamlined government services and public accessibility and facilitates person-to-government

> The digitisation of Government-to-Citizen services and payments and the shift away from manual processes has been instrumental in tackling inefficiencies in government service delivery and doing business in Kenya.

and business-to-government payments. Public sector digitisation now touches every part of the Kenyan economy, enabling investors to do business in Kenya legitimately without the bureaucratic bottlenecks that previously existed.

Notwithstanding this move in the right direction, the country's success is stifled by other challenges that are a cause for concern to investors - Kenya has ranked in the bottom quartile of Transparency International's Corruption Perception Index and is poorly ranked in the Economic Freedom Index, which suggests that there are still regulatory and legal hurdles and a "cost" that comes with doing business in the country.

In Kenya, unlike the European Union, there is no overarching private equity legislation and whilst there are a large number of funds operating in or investing in the country only a handful of these are set up as onshore funds in Kenya. Most funds with a focus on East Africa tend to be domiciled offshore, with Mauritius being a key jurisdiction for a fund's domicile due to an established track record, investor safeguards, deal structuring and tax flexibility. The long-awaited Mauritius-Kenya Double Taxation Agreement (the "DTA") was also seen as an added benefit to promote foreign direct investments. The DTA was, however, dealt an unprecedented blow as a result of a March 2019 High Court ruling that nullified it due to a procedural defect. However, this defect is curable by the publication of a fresh Legal Notice which can then be tabled in Parliament. It is not yet clear if the Kenyan Government will lodge an appeal against the High Court decision or publish a fresh Legal Notice.

Nevertheless, reforms continue to be felt. From a regulatory perspective, the 2015 Companies Act and the 2015 Insolvency Act were welcome changes to historical and outdated legislation, bringing Kenyan company law in line with modern international business practices and are principally based on their UK equivalents. Significant legal developments have also sought to streamline processes and reduce the number of licences required to do business in Kenya. Parliament has also, in recent years, passed legislation relating to anti–bribery and corruption along with corporate governance codes issued by different industry regulators to align and implement best international practices in the country.

Competition law continues to play a significant role in the timing and cost of investments in Kenya or investments which have a Kenyan element. There are currently two operational competition law regimes that may impact a Kenyan investment, (i) Kenya's domestic competition law and (ii) private equity COMESA competition law. In addition, the East African Community ("EAC") competition regime may soon become applicable once the EAC Competition Authority is operationalised. Presently, parties must make a dual notification of a merger if they meet the relevant criteria requiring an approval from the Competition Authority of Kenya and the COMESA Competition Commission. A third notification may soon be required where the merging parties qualify under EAC competition law. The aim of the COMESA competition regime and the EAC competition regime is to be a "one-stop shop" for regional competition law, but this is yet to be achieved. The overlapping and multiplicity of competition regimes and the lack of coordination and harmonisation between the competition authorities increases the cost and burden on investors.

Significant legal developments have also sought to streamline processes and reduce the number of licences required to do business in Kenya

When it comes to private equity, competition law does not take into consideration that the structure of private equity funds and the way investments are made into portfolio companies are distinct from traditional mergers and acquisitions. A broad definition of "change of control" is provided for in competition legislation that takes into account not only a vanilla acquisition of majority of the shares in an undertaking, but also an acquisition of a minority stake with rights that enable the acquirer to 'materially and decisively influence' the business of the undertaking. This, coupled with the fact that at present there are no financial or market-share thresholds in Kenya's competition laws, means that nearly every transaction undertaken by a private equity fund mandatorily requires approval from the Competition Authority. It is irrelevant, from a competition law perspective, that the investments were made out of separate funds as they would all be treated as a common entity under common control.

A recent challenge faced by investors has been the interest rate caps on bank lending in Kenya, at 4% above the Central Bank of Kenya rate. The interest rate cap is seen to have had a significant impact on the country's economic growth and a damaging effect on the financial services sector. On the one hand, it has made the financial services sector less attractive as a target investment for private equity investors as the banking sector has experienced diminished returns; however on the other hand banks have been more conservative in their lending and businesses have had

to look for alternative sources of financing, including private equity as a substitute. In March 2019, the High Court of Kenya declared the section of the Banking Act that introduced interest rate caps as unconstitutional and required the law to be amended within twelve months and so it is hoped this will change in the future.

From a tax perspective, Kenya remains attractive within Africa for private equity investments due to its favourable tax regime. Capital Gains Tax ("CGT"), often one of the principal concerns for private equity investors on exit, was reintroduced in Kenya in 2015 at 5% which is very low compared to other jurisdictions. The CGT rate is currently 30% for corporations in Rwanda, Tanzania, and Uganda. In addition, Kenyan legislation does not provide for taxation of CGT on the indirect transfer of assets where the underlying asset is held in Kenya, unlike Uganda, Tanzania and even Ethiopia, which seek to tax offshore indirect transfers of a local asset.

However, the Finance Bill 2019 (as published in June 2019) has proposed to increase CGT from 5% to 12.5%. The Bill also proposes to exempt CGT arising from an internal restructuring within a group which does not involve the transfer of property to a third party or which does not involve a change in beneficial ownership. This exemption is welcomed and is likely to see the conclusion of many corporate restructuring transactions in Kenya. As at the date of this article, the Bill is yet to come into force and hence these new provisions may potentially be subject to varying interpretations as to what relates to an internal group restructuring to qualify for CGT exemption. It is also the case that Parliament in the course of debate on the Finance Bill has recommended that the current rate of 5% be retained.

Although there are still hurdles for private equity investment in Kenya, there are significant reforms experienced in the recent past and promising changes ahead. Kenya remains an attractive investment destination and in a Limited Partner Survey conducted by the African Venture Capital Association, Kenya was selected by the second-highest proportion of limited partners as an attractive country for private equity investment in Africa over the next three years. It is hoped that, as the number of private equity transactions grow, legal and structural reforms will continue to be put in place in order to make the country even more conducive to private sector investments.

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South African regulatory reform – what does it mean for Private Equity Fund managers?

Following the Global Financial Crisis in 2008, regulation was largely criticised for failing to protect customers, prompting regulators throughout the world to undertake a review of financial regulation. Following the lead of a number of developed countries, the South African government published a paper, called "A safer financial sector to serve South Africa better" introducing the concept of a new regulatory framework, the Twin Peaks Model, for financial institutions in 2011. Due to the significant reforms proposed, the regulatory framework took a number of years of deliberation before the first enabling act, namely the Financial Sector Regulation Act ("FSR Act"), was signed into law on 21 August 2017. It came into effect on 1 April 2018. The FSR Act creates the legislative framework for the reforms and was the first piece of legislation to be signed into law commencing the process to overhaul the existing South African regulatory framework to the proposed Twin Peaks Model.

The purpose of this legislative overhaul is ultimately to create a safer financial services sector in South Africa. It is believed that this could be achieved by, amongst others, consolidating and harmonising a fragmented set of regulations governing the sector, into a more uniform set of regulations, split between prudential regulations and conduct regulations, which would apply to all financial institutions.

In order to implement, oversee and enforce the above, the FSR Act established two new regulatory bodies, namely the Prudential Authority ("PA") and the Financial Sector Conduct Authority ("FSCA") (previously the Financial Services Board). The PA and the FSCA came into existence on 1 April 2018. They were tasked with promoting and enhancing the safety and soundness of regulated financial institutions and protecting financial customers through supervising market conduct (including but not limited to what is commonly referred to as the "treating customers fairly" or TCF principles) respectively.

> This legislation represents a fundamental shift in the way that financial services firms will be regulated, changing to an activity and principles based, outcomes-focused and risk-based approach.

The first draft of a new piece of conduct legislation, dealing solely with the market conduct of financial institutions was published for public comment at the end of 2018. The Conduct of Financial Institutions Bill ("COFI bill") creates the legal framework in respect of the conduct of financial institutions, and will, upon coming into effect, repeal the conduct requirements from all other primary legislation that currently deals

with the market conduct of financial institutions. The purpose of such repeal and subsequent regulation in terms of the COFI bill, is due to the fact that financial sector laws deal differently with market conduct requirement in terms of that law. The prescribed conduct requirements of a bank under the Banks Act, for example currently differs from the conduct requirements imposed on an insurer in terms of the Long-term Insurance or Short-term Insurance Act, notwithstanding the fact that both the bank and the insurer sells a financial product to a client. This is an example of where entities (and the conduct of such entities) are being regulated based on an institutional form (i.e. as a bank or an insurer) and not based on an activity (i.e. selling a financial product) which such entity performs. The legislative reform thus aims to harmonise the legislation and treatment of all financial services firms doing similar types of activities, irrespective of whether they are a bank, asset manager, insurer, private equity or venture capital firm.

This legislation represents a fundamental shift in the way that financial services firms will be regulated, changing to an activity and principles based, outcomes-focused and risk-based approach.

1. Principles based

The drafting of principles in the regulation, enable the policing of the spirit as well as the letter of the legislation. The COFI bill sets out principles that should be complied with rather than strict rules, although the drafters set out in the explanatory memorandum that a certain number of rules will still remain to protect highly vulnerable consumers.

2. Activity based

Regulation of the activity that a financial services provider performs rather than their institutional definition or form with the aim of creating a more level playing field for all companies operating in the sector. The effect of an activity based model of regulation is that companies will now be regulated on what you do rather than who you are.

3. Outcomes focused

The regulators are of the view that management is best placed to determine controls, processes and policies that should be in place to achieve desired outcomes. The new regulatory approach will enable the monitoring of desired outcomes being achieved and ensure preventative action is taken. The regulation focuses on whether institutions are conducting themselves in a manner that delivers the regulators' desired outcomes.

4. Risk based and proportionate

This is closely related to outcomes focused approach and enables the regulators to identify the greatest conduct risk areas and use its proportionate regulatory capacity to address these risks.

The COFI bill, once enacted, is expected to have a significant impact on the private equity and venture capital industry. For the first time in South African financial regulation, the legislation included a definition of an 'alternative asset'. Although the COFI bill is not yet finalised, it clearly indicates the regulators intention in relation to all alternative assets. The explanatory policy paper accompanying the COFI bill, clarifies that both pooled funds currently regulated under the Collective Investments Schemes Control Act ("CISCA") and private equity funds and real estate trusts will be licenced under the COFI bill.

As with most first drafts of new legislation, there are still a number of items that require clarification. In terms of the private equity and venture capital industry, this includes which entity / entities will require a licence, as multiple entities within a traditional private equity en Commandite partnership could meet the licencing requirements (based on the activities they perform). The draft does not specify how foreign fund managers will be regulated where they manage South African institutional money, or how or if, an investment holding company will be included in the regulation. SAVCA continues to engage with the policy makers on a number of industry specific issues, and we hope that a number of these items will be considered and clarified in the second draft of the COFI bill.

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The 2018 Nigerian Companies Bill - A Mixed Bag for Private Equity Investors

Some aspects of the Companies and Allied Matters Act (Repeal and Re-enactment) Bill 2018 (the "Bill") significantly impact private equity investors and their advisers. Some of the aspects are welcome, while others are missed opportunities for reform.

The Bill was passed by the Senate on May 15, 2018 and the House of Representatives on January 17, 2019. It was supposedly transmitted to the President for his assent prior to March 2019, however, the Bill is apparently once more before the House of Representatives and recently had another first reading on July 23, 2019. This means that the Bill has not yet become law and recommendations can still be made to the National Assembly to refine it.

The Bill is intended to replace the Companies and Allied Matters Act (1990) ("CAMA"). It introduces several proposed important reforms, which are highlighted in more detail below. Unfortunately, the Bill fails to fix some aspects of company law that often challenge players in the private equity sub-sector. Among these are the survival of old rules relating to the redemption of preference shares and the prohibition of share warrants and non-voting shares. Hopefully these concerns will be remedied in the course of the Bill going through the Nigerian National Assembly again.

New (and welcome) Developments

There are several helpful new developments under the Bill, including that a private company can now have only one shareholder; a company can now give financial assistance to an investor as long its solvency will not be threatened; a company can now acquire its own shares; the "one share, one vote" rule is no longer to apply to preference shares; limited partnerships can now be organised under Federal law; and large companies can now be merged by court order even where none of the merging companies is a shareholder of the other.

> There are several helpful new developments under the Bill, including that a private company can now have only one shareholder

Single Shareholder Private Companies. Under CAMA a company incorporated in Nigeria must have at least two shareholders. In contrast, the Bill allows a private company to have only one shareholder. This will be convenient for private equity investors that choose not to invest directly in Nigerian companies but rather in a parent company in a tax-advantaged jurisdiction with that parent company investing in a Nigerian company. As the law currently stands, the parent company cannot own the Nigerian company 100%. There must be at least one other shareholder. The Bill allows the parent company to own the Nigerian company 100%.

Financial Assistance. Under CAMA, financial assistance rendered by a company to a shareholder or potential shareholder seeking to acquire shares in the company is expressly prohibited. This restriction poses a challenge on share acquisitions especially with regard to the investee company providing indemnities to potential private equity investors as an incentive or pre-condition for their investing in the company. The Bill now allows private companies to provide financial assistance subject to (i) the net assets of the company not being reduced below 50% and, where so reduced, the assistance should be provided out of distributable profits, (ii) approval of the company by a special resolution, and (iii) the directors of the company making a statutory declaration of solvency.

Acquisition by a Company of its own Shares. CAMA restricts the ability of a company to acquire its own shares to rare situations such as the redemption of preference shares, settling a debt, and the elimination of fractional shares. This restricts the exit options of private equity investors in Nigerian companies - an investor exiting by selling its shares to the company is prohibited except in exceptional circumstances. The Bill has changed that. It now allows a limited liability company to acquire their shares subject to (i) the articles of association of the company permitting such acquisition, (ii) a special resolution of the company approving the acquisition, (iii) the shares being fully paid up, (iv) publication in two national newspapers, (v) a declaration of solvency by the directors of the company, (vi) the payment being made from distributable profits, and (vii) the company not holding more than 15% of its issued shares as treasury shares (that is, shares that the company has acquired from its shareholders).

Weighted Voting Preference Shares. The Bill, unlike CAMA, allows a preference share to carry more than one vote where the terms of issue so prescribe. With the introduction of preference shares having more than one vote, each private equity investor may have weighted shares that make it easier for them to exercise control over the companies and thereby protect their investment more securely and conveniently.

Limited Partnerships. The Bill allows not more than 20 persons to register a limited partnership with general partner(s) and limited partners, with the limited partnership having juristic personality separate from that of its partners. This allows private equity investors to explore setting up funds in Nigeria by way of limited partnerships that are "pass through" vehicles. The partnership will not be liable to pay income tax, only the partners themselves will pay income tax. Prior to the Bill being law, limited partnerships could only be formed under state law, and few states have a limited partnership law (Nigeria is a Federation with 36 States.) There are lawyers who would argue that the benefits of limited liability partnerships do not apply beyond the boundaries of the state under which the partnership is formed. Allowing partnerships under Federal law addresses this challenge.

> Mergers by court orders are now permissible without regard to either any existing relationship between the merging companies or their size

Mergers of Unrelated Large Companies. As the law currently stands, large unrelated companies cannot be merged by court orders transferring liabilities from one of them to the other. Mergers by court orders are permissible only where one of the companies is a shareholder of the other, or each of the combined revenues or assets of the company is less than the equivalent of roughly USD1.5million. This has been a major inconvenience where the private equity investment contemplates a merger either as an instrument of growth during the life of the investment or as an exit tool. The Bill has changed the law here. Mergers by court orders are now permissible without regard to either any existing relationship between the merging companies or their size.

Room for Further Reform

The Bill is welcome, but it does not go far enough. Ideally, it should also allow for the easier redemption of preference shares, the issuing of warrants and the denomination of share capital in hard currencies.

Redeeming Preference Shares. The law in issue here prevents the redemption of redeemable shares out of capital (rather than out of profits or the proceeds of a fresh issue of shares). The Bill leaves this rule intact. It therefore limits the possibility of paying off private equity investors using the assets of the investee company even where that would not make the target either crippled or insolvent. Much time and effort is frequently spent by lawyers and other advisers in trying to explain to foreign private equity firms the scope and limits of the rules, to structure and design around the rules and in seeking alternative exit options. In our experience, the outcomes of such efforts are not always either elegant or fully convincing as a matter of law.

The law has its roots in nineteenth century English law, but the United Kingdom and the Commonwealth have largely moved away from this. The laws in the

United States of America have never contemplated this to any meaningful extent. Modern emphases are on (i) the realities of companies having sufficient net assets and solvency, and (ii) financial statements not being misleading, not on conceptual purity that annoys and can trap investors but lack practical significance. The real-world evidence from these other jurisdictions is a strong indicator that Nigeria should also follow suit.

Further, it is not clear why controls such as ensuring that the net assets of a company are not reduced below 50% that apply to financial assistance in the Bill (see above) are not applicable here too. As long as such controls are in place, it is unclear why preference shares should not be redeemable from the net assets of the company.

Other Prohibitions Relating to Shares. Among the peculiarities of Nigerian law are that it prohibits the issue of warrants (as distinct from options). The law is also unclear on whether or not the capital of a company may be denominated in a currency that is not Nigerian. It is unfortunate that these rules limit the options available to foreign private equity firms and tend to discourage them from investing in Nigeria. Nigerian companies need increased access to money from such firms and elsewhere. It is also unfortunate that the Bill does not categorically sweep away the rules against issuing warrants, and does not make it clear that the capital of a company can be denominated in foreign currency.

The rules here have not always been part of our law. In the pre-1990 era prior to the law currently in force, our law allowed warrants, and nothing in it prohibited the denomination of a company's shares in foreign currency. Indeed, in those days many companies incorporated under UK law and with capital denominated in Pounds Sterling carried on business in Nigeria without fraud, chaos, inefficiency or incongruity.

Where the majority of shareholder capital of a company flows in from Europe and its revenues are from exports, there is a compelling case to have its capital denominated in Euros. Denominating the capital of a company in foreign currency would certainly not mean that Nigerian Currency (Naira) would not be legal tender for the purpose of its debtors paying off their debts to it.

Conclusion

The reconsideration of the Bill by the 9th Nigerian National Assembly is a welcome development that we expect will address most of the reforms pointed out above.

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Getting Governance Right

L&R

Most private equity firms, in particular those investing in emerging markets, know that good governance helps to protect against downside risks. In fact, putting in place appropriate procedures to mitigate the risk of legal and regulatory infringements is at the heart of the investment and stewardship process. But governance – if done well – can also help firms to deliver the upside potential of a business. A well-designed decision-making process can avoid strategic errors, help a company to spot emerging opportunities and deliver a plan to exploit them. Sometimes, that aspect of the governance process could benefit from greater attention.

In Africa, as in other emerging markets, the importance of good governance cannot be overstated. In many markets, powerful merchant families and wealthy individuals dominate business at many levels, management teams and boards often lack true independence, and financial controls can be often weak, as highlighted by the Financial Times article Abraaj Woes Put Gulf's Corporate Governance under Spotlight. While the recent high-profile collapse of Abraaj may be exceptional in many respects, emerging market investors are now increasingly focused on both fund and portfolio company level governance.

However, many of the best African GPs realize that corporate governance improvements are not just about risk prevention, but rather provide an opportunity to deliver value creation. Global best practices can be particularly effective in Africa. AVCA's 2018 Africa Sustainability Study demonstrated that corporate governance improvements have been linked to value creation for 85% of PE-backed portfolio companies.

Defining the roles of the various participants in the governance process is an important starting point, and there is no "one-size-fits-all" model

Defining the roles of the various participants in the governance process is an important starting point, and there is no "one-size-fits-all" model. For example, the investors will often reserve some important rights to themselves and some common understanding of these potential conflicts and a procedure for resolving them is helpful (especially if there are multiple investors who may have differing interests and expectations). Where there is common ground – for example, with respect to exit timelines – it is helpful to memorialise that and consider building in contractual mechanisms to force or incentivise the parties to stick to their initial understandings. It is also helpful for all parties to understand where and by whom investor-level decisions are taken: are powers exercised around the boardroom table by a nominated director, or by an investment committee of the general partner? If the former, a process for dealing with the director's potential conflicts of interest is needed, because

the director is likely simultaneously to owe duties to the company and the investor. If the latter, it can be frustrating if decision-making processes are slow and unnecessarily cumbersome, so designing one that is responsive to the needs of the portfolio is critical.

Then, of course, there is the board itself, which ought to be at the heart of a well-functioning governance system. Defining the board's responsibilities is key. Clear terms of reference, objectives set by reference to the due diligence findings and the company's business plan, and a well-defined demarcation between the respective responsibilities of the board and the management team are all helpful to establish clear lines of accountability and to avoid conflicts and misunderstandings later.

It is important to get the right people on the board, matching the skill sets to the board's specific objectives. Most private equity investors prefer relatively small boards – five to eight people, with at least two non-executives – but there is no universal rule. Where there are multiple rounds of finance, even relatively small investors may insist on having board seats, making the board much bigger and, sometimes, unwieldy. In those cases, delicate discussions may be needed to persuade some early investors, who may no longer be playing an effective part in the company's further development, to step down. Replacing their board seat with high-quality reporting and dialogue may be one option that actually suits both parties better.

An outside Chair can add significant value to a business, and not only by ensuring that board discussions are relevant, focussed and well-informed – although that is, of course, a critical role. Many investors also look for external Chairs who can add value in other ways, including through their situational experience or sectoral knowledge, their networks, and their ability to coach (or, if needed, deputise for) the CEO.

Internal controls and company policies are essential governance tools, but they must be used intelligently and pro-actively. There is no point in establishing a policy that is not reviewed and policed. The board must own responsibility for monitoring all relevant risks, and maintaining a risk register is usually helpful. The board should regularly review policies and procedures and ensure that a sufficiently senior and competent person regularly reports to the board on material concerns, using pre-defined consistent KPIs. The board should be satisfied that compliance audits and effective training are actually taking place, and that effective whistleblowing procedures will alert relevant people to breaches.

Stakeholder management is an increasingly important part of the board's role, a responsibility that must start with the board defining who the company's key stakeholders are. There will be some obvious ones, including employees, customers and suppliers. But the board should think more broadly and consider whether, for example, regulators and local communities are also important enough to be included in the list. If the interests of these groups are not taken into account when the board takes a decision, could that damage the company's interests?

Finally, the board should accept that it has a lead role in setting the company's culture and ethical standards: often referred to as "tone at the top". The board needs to understand the culture and have some ways to police it, even if it is not able to do that on a day-to-day basis. No doubt that will involve non-executive directors in spending more time on the ground but, if every contact with the business is filtered by senior management, there is a risk that the board will not be able to hold that management team properly to account.

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Tax Footprint of the new CEMAC Exchange Regulation

The new regulation governing exchange regulation in the Central African Economic and Monetary Community (CEMAC) entered into force on 1 March 2019. While this new regulation is primarily marked by the willingness of the regional monetary authorities to replenish the foreign exchange reserves of the Central Bank of Central African States (BEAC), it has a certain originality which is reflected in the consideration of fiscal issues.

It is interesting to reflect on how the new exchange rate regulations have been influenced by provisions against tax evasion, in particular those governing transactions between entities within the same group. The authors of the new exchange regulations noted that cases of CEMAC residents holding foreign currency abroad, often in violation of exchange regulations, could be combined or facilitated by breaches of tax legislation.

Indeed, with the development of the foreign currency holding situation abroad, CEMAC zone States are increasingly exposed to the risk that resident companies, often subsidiaries of international groups, may abuse these accounts in the context of tax arrangements resulting in indirect transfers of profits abroad. These bank accounts can be used to accumulate funds outside the scope of BEAC's supervision or hardly verifiable by the tax administrations of the CEMAC countries.

As a reminder, indirect transfers of profits abroad often take place in the context of transfer pricing matters. The concept of transfer pricing refers to prices between entities of the same group but established in different countries. Transfer prices cover all types of transactions that may give rise to the payment of a price: sales, services, interest loans, capital investments, corporate restructuring, etc.

The Arm's Length Principle

The tax framework for transfer price is designed to prevent indirect transfers of profits by ensuring that transactions between entities of the same group comply with the arm's length principle, namely that intra-group prices must be the same as those that would have been charged between two independent entities in the context of a commercial relationship in similar economic circumstances.

The new CEMAC exchange regulation was designed to address this issue. Article 71 of the new regulation therefore provides that any import of services shall take the form of a contract under which a non-resident undertakes to provide a resident with a service or technical assistance, or in particular to grant him the right to use a sign, a brand or a trademark. There is also an obligation to declare to the BEAC all expenditure on the import of services, it being specified that expenditure equal to or greater than CFA Francs 5 million shall also be domiciled with a CEMAC credit institution.

In addition, Article 73 of the new regulation lays down an obligation to respect the arm's length principle for all technical assistance or imports of intra-group services, as well as for any financial contribution by resident companies to the management and research-development costs incurred by their parent companies or shareholders. In this respect, Article 74 points that imports of services are carried out under

the responsibility of the (resident) entity concerned and shall consist of effective supplies of services in accordance to the real needs of the resident entities and paid at their fair price. The BEAC may reject any approval request for payment in foreign currency where the underlying transaction does not comply with this arm's length principle.

In addition, failure by the economic agent to comply with the arm's length principle in the case of imports of intra-group services shall be punishable by a fine of 10% of the amount of the import service concerned. It should also be noted that failure by the economic agent to domicile imports of goods or services within a local bank shall be punishable by a fine of 10% of the amount of the transaction and failure to effectively import services shall be punishable by a fine of 100% of the amount in question.

What about Sanctions?

It is worth pointing out that in trying to venture into the maze of international taxation, the drafters of the new exchange regulations have probably forgotten that in tax law, the devil is in the detail. Thus, Articles 73 and 74 of the new exchange regulation only apply to import services with regard to the obligation to respect the arm's length principle. Imports of goods or lending transaction are not covered by these provisions, whereas the arm's length principle referred to in relation to the transfer price applies to both intangible and tangible transactions.

While the inclusion of tax issues in foreign exchange regulation can be welcomed as a contribution to combating indirect profit transfers, their effectiveness remains questionable.

With the current provisions of Articles 73 and 74 referred to above, it must be pointed out that the new exchange regulations do not authorise the CEMAC monetary authorities to sanction non-compliance with the arm's length principle and the ineffectiveness of the imports in the context of transactions with foreign entities relating to goods or loans.

The principle of strict interpretation of punitive laws should lead to the limitation of the application of fines for non-compliance with the arm's length principle and for the ineffectiveness of the importation of services to transactions involving services only. It is therefore uncertain whether BEAC will be able to extend these fines beyond service transactions as part of its power of interpretation.

Moreover, the fact that the tax legislation of the CEMAC Member States already sanction indirect transfers of profits raises questions about the application of the sanctions provided for in the new exchange regulation for the same facts. It will be interesting to see how the CEMAC Community judges will decide on this accumulation of sanctions, in particular with regard to the principle non-consecutive sentences.

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Fintech as the Driver for Growth in Africa's Banking Sector

Access to financial services is a widely acknowledged tool for promoting credit creation and enhancing capital accumulation, and thereby increasing the levels of investment and economic activity. According to the 2017 Global Findex Database[1], about 1.7 billion adults remain unbanked, and nearly half of those live in just seven developing economies, of which Nigeria is one[2]. In 2014, it was reported that Sub-Saharan Africa, with about 350 million unbanked adults, accounts for 17 percent of the global unbanked population[3].

Most people and small businesses in Africa are financially excluded, as they do no not fully participate in formal financial systems. Many transact exclusively in cash and do not have access to credit beyond their personal networks and informal lenders. Those with basic financial accounts often lack access to a broad range of financial products. As a result, there is a potential loss of deposits or savings for individuals and loss of investible funds for businesses.

A heavy reliance on cash creates significant costs for financial institutions, and reduces the number of customers that they can effectively and profitably serve. It also makes it difficult for financial service providers to gather the necessary information required to assess the creditworthiness of potential borrowers, thereby creating room for fraud. Further, reliance on cash reduces government tax revenue and creates a leaky pipeline for expenditure[4].

Fintech offers a transformational solution for Africa's banking sector. The unique environment for financial services in the continent presents a fertile ground for innovative Fintech players to capitalise on the opportunities to disrupt or leapfrog established business models, in order to make financial services more affordable, accessible and profitable.

Fintech: Benefits and Opportunities

Research[5] has shown that the shift from cash payments to digital payments will not only increase the number of people who own and use bank accounts, but also improve efficiency by increasing the speed of payments and reducing the cost of disbursing and receiving them. FinTech can be used to enhance the security of payments and increase transparency, and thus reduce associated crime and corruption. The Bank Verification Number was implemented by the Central Bank of Nigeria to increase security and protect bank customers from illegal transactions.

By providing access to a diverse range of financial products and services such as credit facilities for individuals and businesses, fintech can boost aggregate

1 World Bank Group, The Global Findex Database 2017, pages 35-36.

2 Ibid., page 37: More than 60 million Nigerians are without bank accounts.

3 Asli Demirguc-Kunt, Leora Klapper, Dorothe Singer and Peter Van Oudheusden, The Global Findex Database 2014: Measuring Financial Inclusion Around the World, World Bank, 2015.

4 See Kenneth S. Rogoff, The Curse of Cash, Princeton University Press, 2016.

5 Better Than Cash Alliance, Responsible Digital Payments Guidelines, 2016; Asli Demirguc-Kunt, Leora Klapper and Dorothe Singer, Financial Inclusion and Inclusive Growth: A Review of Recent Empirical Evidence, World Bank, 2017.

expenditure, thereby improving gross domestic product levels. Provision of financial services through the use of technology also benefits the government by providing a platform to facilitate an increase in aggregate expenditure, which subsequently generates higher tax revenue from an increase in the volume of financial transactions[6].

Additionally, financial innovation through technology can have long-term positive effects for banking performance. A recent study[7] examining the impact of the adoption of SWIFT, a network-based technological infrastructure and set of standards for worldwide interbank telecommunication, on bank performance showed that it has large effects on long-term profitability, and a significant improvement on banking performance.

Digital Trends in Africa's Banking Sector

The widespread use of mobile phones and the internet has given rise to a new generation of financial services in Africa. The younger element of the population has rapidly adopted the use of mobile financial wallets, with partnerships between telecommunications companies and banks set to encourage and increase the use of mobile payments. Relatively simple, text-based mobile phones have powered the spread of mobile money accounts, and smartphone technology is increasingly being used to make transactions through financial institution accounts.

The Kenyan fintech sector has been dubbed one of the fastest growing on the continent, with technology increasingly defining the day-to-day running of businesses in the country. Kenya has adopted digital platform banking models whereby service providers create an ecosystem of diverse and multiple industry players in their core business, opening new growth paths. For instance, KCB Bank empowers its customers by connecting them to credible home investors and giving them the opportunity to own homes at a lesser cost.

Similarly, Equity Bank Kenya has launched Equitel, a user-friendly platform that lets customers manage their money and communicate with more freedom, choice and control. Equitel's Eazzy Loan allows users to acquire loans through their mobile phones, monitor their loan balance and make repayments through the same channel. The main advantage of this platform is that the loan is deposited directly to customers' mobile phones, and they are not required to visit the physical branch or subject themselves to any form of physical assessment.

Nigeria as a Case Study

Nigeria's banking ecosystem has moved to retail banking and the use of e-banking channels, which has led to improvements in financial inclusion. According to the 2017 annual report of the Central Bank of Nigeria ("CBN")[8], the total value of electronic payment transactions recorded in 2017 rose by 32.5 percent to NGN83.1 trillion, from NGN62.7 trillion in 2016. Nigerian banks are starting to adopt more dynamic operating approaches, and to introduce financial products that are in sync with the emerging digital trends. For instance, Zenith Bank launched Scan to Pay, an app that can be used by both customers and non-customers to make online and in-store payments in seconds through quick response code scanning on any internet-enabled phone. The banks and telecommunications companies have also introduced unstructured supplementary service data codes, by which normal banking transactions can be carried out on mobile phones.

Nigeria Inter-Bank Settlement System ("NIBSS") is jointly owned by all licensed banks in Nigeria, including the CBN. NIBSS operates as a shared service infrastructure for handling inter-bank payments, in order to remove potential bottlenecks. It also operates the Nigeria Automated Clearing System, which facilitates the electronic clearing of cheques and other paper-based instruments, electronic funds transfer, automated direct credits and automated direct debits. Further, NIBSS has launched the mCash payment system to facilitate low-value retail payments and grow e-payments by providing accessible electronic channels to a wider range of users, and extending e-payment benefits to payers and merchants at the bottom of the pyramid, where cash payments have been predominant.

Another trend fast becoming a reality in Africa is the use of Artificial Intelligence ("AI"). To increase levels of customer acquisition and retention, AI can be used in delivering intelligence about customer behaviours and preferences that will help in the development of personalised responses, insights and product types. AI will affect the way banks conduct financial due diligence, especially with respect to fraud detection, risk management and credit allocation. The Union Bank of Nigeria announced in 2018 the deployment of robotic process automation technology in its operations. This uses software tools developed to simplify and improve the efficiency of business process delivery.

6 J. Manyika, S. Lund, M. Singer, O. White, C. Berry, Digital Finance For All: Powering Inclusive Growth in Emerging Economies, McKinsey Global Institute, 2016.

7 Susan V. Scott, John Van Reenen, Markos Zachariadis, "The long-term effect of digital innovation on bank performance: An empirical study of SWIFT adoption in financial services," Research Policy, volume 46, issue 5, 2017, pages 984-1004.

8 Draft Central Bank of Nigeria Annual Report 2017.

Regulatory Developments in Nigeria

In a bid to promote mobile money payments in Nigeria, the CBN, in August 2011, granted licenses to 14 mobile money payment providers. The CBN has demonstrated an aggressive approach toward promoting fintech in Nigeria, and introduced several regulations and guidelines in this regard.

The Nigerian Communication Commission ("NCC") plays an important role in the promotion of fintech. Payment services involving telecommunications infrastructure are regulated under the NCC Licence Framework for Value Added Service ("VAS"). Under this framework, mobile payment service providers must obtain a five-year renewable license from the NCC under the category of VAS of a commercial nature. The NCC License Framework imposes certain requirements on VAS licensees, including:

- advertising restrictions;
- prohibition of spam, unwanted messages and hidden charges;
- storage obligations; and
- provision of flexibility to consumers for opting in and out of their services.

Investment Opportunities in Nigeria

As fintech startups continue to underpin consumers' daily transactions, they have attracted a high caliber of global and local investors. In 2018, it was estimated that investors pumped US$73.7 million into Nigerian startups, with fintechs receiving about 75 percent of these investments. Similarly, in 2017, an estimated US$800 million was injected into the African economy through investments in fintech companies.

The top areas for investors looking to participate in the sector include payment services/solutions, investment, savings and credit provision platforms, the first being the lead area for investors. Notable fintech service providers in Nigeria includes Flutterwave, PiggybankNG, Paystack, WalletNG, Cellulant, Crowdy Funds, and I-Invest. Traditional financial institutions also provide these services through their mobile banking apps.

Challenges and Recommendations

Provision of fintech solutions comes with challenges. A major one is the lack of technological infrastructure in Africa – for example, unreliable mobile networks. Another is the lack of trust from stakeholders in both Africa's financial institutions and the products that they offer.

The McKinsey Global Institute has identified three building blocks required for powering the inclusive growth of fintech in emerging economies. These are a widespread digital infrastructure, a dynamic financial services market and digital finance products that meet the needs of individuals and businesses in ways that are superior to the informal tools available to them currently.

Physical infrastructure (such as reliable electricity and mobile networks) and financial infrastructure (that includes both an adequate payments system and a physical network to deliver payments to all corners of an economy) are key to promoting fintech. Once the digital infrastructure is in place, it needs to be supported by an enabling business environment, which requires putting in place consumer protection rules to safeguard fraud and abuse. Jurisdictions like Kenya and Nigeria have enacted consumer protection laws to protect consumer rights, but it is paramount that these laws are effectively implemented. The environment must also have a competitive market structure and financial markets that are open to foreign investments. Further, the digital financial products being offered must have a true advantage over the existing alternatives in terms of cost and utility.

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Permanent Capital Vehicles: Dealing with the Liquidity Quandary

Although not a new concept, permanent capital vehicles (PCVs) remain a relatively underused vehicle for private equity funds in emerging markets. Investor demand for conventional structures, where commitments are invested and proceeds distributed within a defined period of time (ordinarily invested over 5 years and a 10-12 year fund life), remains strong. However, interest in PCVs has increased significantly in recent years in the African market in certain sectors, in particular in sectors such as real estate and infrastructure or other income producing assets which suit a longer term hold.

What structure is used is very much dependent on the nature of the underlying investments, the type of investors and the exit plan. Drivers for setting up an evergreen vehicle include the ability to:

- implement longer strategies and 'ride-out' short and medium-term market volatility;
- continue fund raising without the need to structure and raise successor funds;
- keep a steady capital base to invest without needing to return it back to investors;
- offer investors variations on the conventional 2 and 20 fee model which can be better suited to longer term investments; and
- utilise alternative exit strategies such as listings and redemptions.

The key concern around the use of evergreen funds is certainty of liquidity. Absent any fixed termination date, investors need to ensure that they will be able to exit at a suitable point in time. Put more simply – investors need liquidity.

We have seen a variety of innovative approaches taken to address the issue of liquidity, which we discuss briefly here.

Liquidity Basics – A Brief Reminder

Primary liquidity through redemption of interests involves investors realising their investment by redeeming their interest in a fund by way of buyback, which is may be financed by the manager in a number of ways, including taking in new subscriptions, realising underlying investments, borrowing from a third party, or a combination of the above. The manager uses the cash proceeds to fund the redemptions (or at least maintain the fund's NAV).

Primary liquidity is therefore challenging as redemptions raise certain issues and need to be thought through carefully before being considered. Selling underlying fund assets to raise funds for redemptions is problematic as the underlying assets are usually not readily disposable – it may take an extended period of time to find the best buyer or exit option. In addition, tension can arise when deciding which assets are to be disposed of – selling the 'best' or 'easiest-to-sell' assets could be prejudicial to investors remaining in the fund and this conflict of interest must be well managed Some mangers keep a small pool of liquid investments for this purpose.

Borrowing by the fund exposes non-redeeming investors to greater leverage risks. Moreover, borrowing in private equity funds is usually very tightly controlled, and normally only bridge finance or relatively small working capital facilities are permitted. Incoming investors often prefer their commitments to

be put in new investments, rather than buying into an existing, static portfolio and watching their cash walk out the door with a redeeming investor.

In order to protect the fund and investors, investors' ability to redeem, if it exists, is often limited by gates (i.e. restrictions on amounts which may be redeemed at a given time, and the frequency at which investors can redeem), lengthy notice periods, payment deferrals, and suspension powers in case of market stress or runs, all of which reflect the inherent illiquidity of private equity assets. More widely, managers suffering erosion of the asset base have less capital to put to work in investments, and for less time, making hurdle rates and performance fees more difficult to attain.

Secondary liquidity involves investors selling their interests, either to another investor in the fund or a third party. Sales to third parties can be achieved in several ways, for example (i) through the private secondaries market, (ii) listing the fund on a public securities exchange or (iii) 'tokenising' the fund interests. However, like the primary liquidity options, secondaries also have their shortcomings in that:

- the secondaries market, whilst long established, does not function particularly efficiently for market participants looking for a quick exit. The process can be slow and cumbersome, often fails to provide selling investors a 'clean break' and is, ultimately, dependent on a manager being willing to take credit risk (and other risks) on a new investor;
- listing a fund is notoriously expensive, so it is normally only a viable option for larger funds. It will also need to be part of the investment proposal from the fund's launch. Also, disclosure and transparency rules can hinder a private equity or venture capital manager in conducting business; and
- tokenising a fund, by initial coin offering or otherwise, is a new process – effectively a hybrid of the private secondaries market and the public securities market. Banks, fund service providers and, importantly, investors are generally cautious about dealing with fund interests (or tokens) on a digital currency/blockchain platform. Regulators are also catching up with this new technology, which creates considerable uncertainty for managers operating in an unpredictable regulatory environment.

Hybrids

As neither primary nor secondary liquidity alone offers a clear, workable solution to investors' needs for a reliable exit option, a variety of approaches are being taken in PCV structures to offer investors liquidity. Some are relatively simple, some are more complicated, and often involve a combination of liquidity options.

> In emerging markets, notably Africa, there is a significant trend towards an ultimate objective of listing as a natural exit. Investors, however, still require certainty of exit

In emerging markets, notably Africa, there is a significant trend towards an ultimate objective of listing as a natural exit. Investors, however, still require certainty of exit. Accordingly, although a PCV may be evergreen, if its investment mandate is to exit by listing then investors will likely require that the manager must seek to achieve an initial public offering (IPO) once the fund's NAV has reached a certain (pre-determined) point , or if that NAV is not reached by a certain point in time, when a fixed time period has passed. If an IPO is not achieved within the time/ value constraints, investors will likely require the fund to be wound down.

Listing the shares in this way gives investors some comfort that they should, if the fund is successful, be able to sell some or all their shares in the fund on the open market. If unsuccessful, they will have whatever capital is available, returned to them. Equally, on an IPO, investors can keep their investment, or even increase their stake by buying shares from investors who are selling shares. This is a simpler option than re-upping into a successor fund of a conventional fixed term real estate or private equity fund.

We have also seen funds use a combination of liquidity solutions operating in tandem, in hybrid vehicles. Such structures aim to occupy the space between pure open and closed ended structures, through methods such as redemption windows, continuation votes or liquidity events.

An example of this is providing investors with the ability to approve a listing after a certain time period (i.e. there is a lock up), or inserting a requirement that a listing is completed within a certain time period (other than obtaining of a certain NAV as explained above)' Like the example mentioned above, this gives investors a secondary liquidity option, allowing them to realise their investment at that point by selling their shares on the open market (to the extent that, in practice, there is a ready market). It also gives investors

control to approve a listing in their discretion at the time, rather than being bound by pre-set conditions put in place during the initial fund-raising which may no longer be in their best interests. In addition, after the lock-up, where there is no listing, investors can redeem their shares year on year up to a certain limit, giving investors a second (albeit partial) exit option, using a primary liquidity mechanism. Although not providing 'immediate' liquidity as might be seen in a conventional hedge fund, given that shares in listed funds often trade at a discount to NAV, having the choice to redeem some shares at a price equal to NAV (less costs) is clearly desirable for investors. Also, limiting redemptions in this way allows the manager to manage any asset sales sensibly, lessening the need for any asset fire-sales or cherry-picking, or suspension of redemptions, as well as use income generated from underlying assets that would otherwise be distributable.

We have also seen several long-term funds structured with no fixed term, but which have a continuation vote after an initial period of ten or twelve years, allowing the fund to continue for a further ten or twelve years thereafter. Other funds, for example in the infrastructure space, hold continuation votes more frequently (every three or five years) after the fund has been running for ten or twelve years. Either way, this approach gives investors greater control over their exit and allows them to judge the prevailing market conditions and fund performance to date at the relevant time.

Alternatively, some long-term funds have been structured to continue automatically if certain fund performance thresholds have been reached, failing that an investor vote will be determinative. Other funds simply have no fixed term, and all that is offered by way of secondary liquidity is an obligation on the manager to use reasonable endeavours to assist investors with finding buyers for their interests. However, such terms have often been less popular with investors, who are then subject to wider market liquidity forces, confidence in the valuation of the interests being sold and, ultimately, manager engagement.

Market Trends

The increasing use of PCVs and hybrids in emerging markets, notably Africa, suggests a growing sophistication of managers and investors operating in that space. Although conventional private equity fixed term funds are likely to remain predominant, a PCV provides a sensible alternative.

Liquidity is a key issue and managers need not be tied to any single approach to providing it. However, it is the case that PCVs which offer a clear exit option for investors are more likely to appeal to a wider group of investors. PCVs with less focus on investor exit may only attract capital from investors which are willing (and able) to lock up capital for the long-term. As such, funds using a combination of liquidity solutions which operate in tandem can be a workable solution, as they can cater for a wider range of investor exit requirements.

Ultimately, whatever the manager or investor base, and however liquidity is offered, liquidity is a fundamental investor concern with PCVs (including hybrids) and careful thought should be given from the outset as to the best solution for both the manager and investors.

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