

**BANKS TAKING SECURITY OVER SHARES –
A REVIEW OF THE CONSENT REQUIREMENTS UNDER THE
BANKS AND OTHER FINANCIAL INSTITUTIONS ACT, 2020**

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Introduction

Section 20 of the Banks and Other Financial Institutions Act (BOFIA), 2020 provides two ways banks may acquire or hold shares in other entities. It provides that banks may hold shares in small and medium scale enterprises for business purposes, and banks may also hold shares acquired in satisfaction of a debt.

This article focuses on restrictions surrounding the holding of shares acquired in satisfaction of a debt and examines how the restrictions interact with the provisions on banks holding shares for business purposes.

Creating security over shares

Shares are financial assets that indicate the owner's equity interest in a company. In secured lending, lenders typically take security over shares as part of the security package over various assets of the obligors [1] to secure loans made to the borrower. Some key reasons lenders take security over the shares of a company are to ensure that there would be no change of control of the borrower or its guarantors without the lenders' consent, and to ensure that the lenders will be able to take control of the borrower or its guarantors, and or sell the business as a going concern during enforcement.

Security interest over shares may be created by way of mortgage, charge or pledge. In a legal mortgage, the shareholder transfers the legal title [2] in the shares to the mortgagee on the condition that it would be re-transferred upon discharge of the secured obligations. Equitable mortgage transfers equitable interest [3]

to the mortgagee and may be created through a deposit of share certificate with the mortgagee and the necessary documentation. A charge creates a security interest over the shares in favour of the chargee [4] A pledge requires the delivery of possession of the asset to the creditor (pledgee) [5]

Lenders usually aim to capture 100% of all classes of shares in an obligor (after a comprehensive corporate due diligence); the preferable mode of creating security over shares is a commercial decision for lenders. The nature of security needed from the obligors and the lender's approach to taking security over the obligors assets influences lenders' commercial decision. Typically, parties' understanding in a secured finance transaction is that the lender would release the security created over the obligor's assets upon the borrower fulfilling its payment obligations under the loan contract.

[1]Obligors means the borrower and guarantors.

[2]The lender would be registered as a shareholder in the company's register of members.

[3]Equitable mortgage may be created where the formalities to create a legal mortgage are not completed.

[4]Where the charged shares are transferred upon enforcement, then the transferee would be registered as a shareholder in the company's register of members.

[5] Security over bearer shares may be created by way of pledge.

Enforcement of security over shares

Upon the occurrence of an event of default under a facility, the lender may decide to take enforcement steps as specified in the transaction documents. The enforcement options available to a lender depends on the type of security created over the borrower's shares, the terms of the security documents, and the applicable laws. The enforcement options available include the appointment of a receiver, sale of the shares, and taking possession of the shares. Banks may secure debts on any real or other property of obligors, and in default of repayment, BOFIA [6] recognizes that banks may acquire such property and exercise any power of sale under any instrument or law.

However, specific regulatory requirements under BOFIA [7] significantly alters the ability of banks to take security over shares. One of the new provisions introduced under the 2020 BOFIA provides that where a bank seeks to hold shares acquired in the course of the satisfaction of any debt owed to it, the bank is required to obtain the prior written approval of the Central Bank of Nigeria (CBN),

[6] Section 19 (9) BOFIA, 2020
[7] Section 20 (2)
[8] Section 19(8) of BOFIA, 2020

provided the shares acquired are not those of the bank's subsidiary, holding company, associate or other related party. Essentially, the provision of section 20(2) implies that the CBN's consent would be required at the point of enforcement of security created over shares.

The rationale for this new provision appears to be the fact that the enforcement of security over shares by acquiring and holding shares of a borrower, may lead to banks engaging in non-banking activities.

This position is premised on the fact that over the years, CBN has restricted banks from engaging in non-banking activities. Also, banks are restricted from engaging in wholesale or retail trade, including import or export trade, without the prior approval of the CBN [8]

Therefore, it is not farfetched that the restrictions on enforcement of security over shares by banks may be a fallout of CBN's regulatory concerns and the need for banks to maintain their core business and avoid contingencies that may dilute their capital adequacy ratio or compromise their financial stability.

Considerations for banks in holding or acquiring shares

Notwithstanding the provisions restricting banks from engaging in non-banking activities [9] banks are permitted [10] to acquire or hold part of the share capital of any agricultural, industrial, private equity or venture capital company subject to the approval of the CBN and meeting specific threshold provisions. These thresholds include that the shareholding of a bank, in such activities:

- shall not be more than 10% of the bank's shareholders' funds unimpaired by losses and shall not exceed 20% of the paid-up share capital of the company or such other percentage prescribed by CBN [11]
- the aggregate value of equity participation of the bank in all enterprises shall not at any time exceed 20% of its shareholder's funds unimpaired by losses or such other percentage prescribed by CBN [12]

Banks may also hold or acquire the share capital of any other business, subject to the approval of the CBN [13]

However, some uncertainties in the BOFIA provisions raises the following questions for considerations:

- Where a bank wishes to hold shares acquired in satisfaction of a debt and applies to the CBN for written approval, the BOFIA is not clear on the items that the CBN will consider in granting or denying such a request. Would the approval of the CBN be guided by the limitations on shareholding specified under Section 20(1)(a) to (e) [14]?
- Where a bank seeks to hold 100% shares of a borrower/obligor acquired in the course of satisfaction of a debt, would that result in a breach of the threshold requirements?
- Where a bank creates security over the shares of a borrower/obligor by way of mortgage, would consent of the CBN be required before the creation of the security (as a matter of prudence) or at the enforcement stage?

It is interesting to note that noncompliance penalties accompany the obligations created under Section 20(1) and (2) of the BOFIA. The defaulting bank will be liable to a penalty of not less than N5,000,000 and an additional penalty of N100,000 for each day that the contravention continues.

[9] See Section 19(8) of BOFIA, 2020
[10] See Section 20(1)(a) to (e) of BOFIA 2020
[11] Section 20(1)(c) of BOFIA 2020
[12] Section 20(1)(d) of BOFIA 2020
[13] Section 20(5) of BOFIA, 2020
[14] Of BOFIA, 2020

Conclusion

The banking sector is highly regulated, with banks discouraged from providing unsecured credit facilities exceeding specified amounts [15] to the borrowing public. The creation of security over the assets of the borrower/obligor is consequently an essential consideration in achieving the financial stability of the banking sector.

It may therefore be necessary for the CBN to provide guidelines on how certain provisions of Section 20 of BOFIA will be implemented. It is essential that issues surrounding the creation and enforcement of security are clearly addressed to ensure that the law meets its purpose, and banks do not inadvertently breach the law and become liable to penalties.

[1] See Section 19(3) of BOFIA 2020

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