



CENTRAL BANK OF NIGERIA

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CIRCULAR TO ALL MERCHANT BANKS GUIDELINES ON OPERATION OF GROUP STRUCTURE BY MERCHANT BANKS IN NIGERIA

Following the introduction of the revised banking model in 2010, which made provision for a re-emergence of merchant banking activities in Nigeria, the CBN licensed a number of merchant banks. The activities of merchant banks were stated in: The CBN Regulation tagged *CBN Scope, Conditions and Minimum Standards for Merchant Banking No 2, 2010*. Permissible activities under the guidelines include assets management and capital market activities.

However, efforts by the newly licensed merchant banks to carry on capital market and asset management activities were constrained by provision of Section 188 of Investment & Securities Act, (ISA) 2007 and Pension Commission rules, which require merchant banks to incorporate a separate legal entity to carry out such activities. These developments hindered effective operation of merchant banking business in Nigeria.

To address this challenge and elevate merchant banks to the right position to play active role in the capital and pension sub-sectors of the economy, the CBN hereby amends the provision of Section 5 (1) (e) of Regulation 3 to allow merchant banks own subsidiaries for the sole purpose of capital market and asset management activities. In addition, the CBN has attached herewith, Guidelines on Operation of Group Structure by merchant banks that own such downstream. This amendment, which takes immediate effect, is expected to strengthen the operations of merchant banking in Nigeria.

Please, note that no merchant bank is allowed to use its depositors' funds for the incorporation of a capital market or asset management subsidiary. Furthermore, merchant banks shall not use depositors' funds for any trading activity through the subsidiaries, except when carrying out express instruction from clients.

Yours faithfully,

A handwritten signature in blue ink, appearing to read 'Osaretin Oyewumi'.

OSARETIN OYEWUMI

For: **DIRECTOR, FINANCIAL POLICY AND REGULATION DEPARTMENT**



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NIGERIA**

BY

**CENTRAL BANK OF NIGERIA
ABUJA**

AUGUST 2015

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1.0 INTRODUCTION

The CBN's *Scope, Conditions and Minimum Standards for Merchant Banks Regulation No. 02 of 2010*, permits merchant banks to provide specialized services such as issuing house activities, underwriting, asset management, proprietary trading in debts and equities as well as custodial services. Available information to the CBN indicates that efforts by the merchant banks to carry on these activities have been constrained by the provisions of Section 188 of the Investment and Securities Act (ISA), 2007, and SEC Rules, which require such activities to be undertaken by separate entities incorporated specifically for the purpose.

To address this challenge, Section 5 (1) of the CBN Regulation 3 on the *Scope of Banking Activities and Ancillary Matters No. 3 of 2010*, is hereby amended to include Sub-section (1) (e) to read, thus: "Such a related enterprise is a subsidiary set up by a merchant bank for the purpose of carrying on capital market and asset management activities".

This amendment takes immediate effect, and is expected to place merchant banks in the position to leverage on the opportunities inherent in the capital market to mobilize long-term funds for economic development.

2.0 CONDITIONALITIES

The following conditions shall apply to banks carrying on merchant banking activities through subsidiaries:

2.1 LENDING

All lending activities between a merchant bank and its subsidiary shall be conducted on acceptable commercial terms, at arm's length and in a transparent manner. In addition, the following shall apply:

- i. Any lending between a merchant bank and its subsidiary shall attract 100 per cent Risk Weight (if fully secured) but where such is not secured, the lending shall be a deduction from the capital of the parent company in the computation of its capital adequacy ratio.
- ii. The parent merchant bank shall not take a loan or any credit facility on the security of the capital of its subsidiaries.
- iii. Any loan by a subsidiary to the parent (merchant bank) shall be regarded as a return of capital and shall accordingly be deducted from the capital of the bank in computing its capital adequacy or other prudential ratios.

- iv. No merchant bank shall hold contingent liabilities in respect of its subsidiary which exceed 20 per cent of the bank's shareholders' funds unimpaired by losses.
- v. Where the subsidiary of a merchant bank sponsors, manages, advises, organizes or floats an instrument or investment fund, the parent company shall not be eligible to subscribe to, extend any credit in whichever form or purchase any asset from such fund.
- vi. No transaction, class of transaction, or an activity by a merchant bank shall be deemed to be permitted, if it would:
 - a. Result in material conflict of interest between the bank and its clients, customers, or counterparties;
 - b. Give rise to material exposure by the bank to "high-risk assets" or "high-risk strategies";
 - c. Constitute a threat to the safety and soundness of the bank; or
 - d. Pose a threat to financial stability.

2.2 INVESTMENT

All investment-related activities between a merchant bank and its subsidiary shall be guided as follows:

- i. No merchant bank shall acquire or hold equity capital of any undertaking, except pursuant to:
 - a. Sections 21(1) and 22(1)(c) of Banks and Other Financial Institutions Act ; or
 - b. Section 5 of the Regulation on the Scope of Banking Activities & Ancillary Matters, No. 3 of 2010, as amended.
- ii. No subsidiary of a merchant bank shall acquire or hold shares in the merchant bank or in other subsidiaries of the merchant bank.
- iii. No subsidiary or associate of a merchant bank shall acquire controlling interest in any other undertaking, except with the prior approval of the CBN.
- iv. Notwithstanding the provisions of Section 2.2(iii) above, any subsidiary acting as a nominee may acquire or hold shares of any undertaking on behalf of its clients.

2.3 INTRA-GROUP TRANSACTIONS

All intra-group transactions between a merchant bank and its subsidiary shall be guided as follows:

- i. All transactions or business relationship between a merchant bank and any of its subsidiaries shall be conducted at arm's length;

- ii. Where shared services are provided within a merchant banking group, such shall be done at arm's length.
- iii. Transactions in respect of shared services, and the basis for allocating the cost thereof, shall obtain the consent of Board of Directors of the subsidiary.
- iv. There shall exist a signed Service Level Agreement between the merchant bank and its subsidiaries in respect of shared services.
- v. The following broad services may be provided by a merchant banking group, subject to CBN prior approval:
 - Human Resources policy;
 - Risk Management policy;
 - Internal Control policy;
 - Compliance policy; and
 - Any other services as may be approved by the CBN from time to time.

2.4 GENERAL PROHIBITION

No subsidiary of a merchant bank shall carry on any business that the parent is not permitted to undertake under the CBN extant regulations.

3.0 OVERSIGHT

The oversight function of merchant banks on their subsidiaries shall be based on activities of the subsidiaries and the complexities of such activities. In this regard, merchant banks are expected to engage relevant, knowledgeable and experienced staff for the envisaged activities of subsidiaries.

4.0 REPORTING

Merchant banks shall forward to the Director of Banking Supervision on a quarterly basis forward, activity reports on subsidiaries, including the management accounts of such subsidiaries. This shall comprise, among others, statement of profit or loss and comprehensive income and the statement of financial position. Where any of the above statements contains a schedule or breakdown, such shall, equally, be provided.