

Key Highlights of FRCN's Newly Released National Code of Corporate Governance 2016



INTRODUCTION

The Financial Reporting Council of Nigeria (“**FRCN**”) recently issued the National Code of Corporate Governance 2016 (the “**Code**”). The Code is made pursuant to the powers of the FRCN under Sections 50 and 51 of the Financial Reporting Council of Nigeria Act 2011 (the “**Act**”) and has a commencement date of 17 October 2016.

The Code is essentially a consolidation and refinement of different sectoral codes on corporate governance and has been issued in three parts: the **Code of Corporate Governance for the Private Sector**; the **Code of Governance for Not-for-Profit entities**; and the **Code of Governance for the Public Sector**. The Code of Corporate Governance for the Private Sector (the “**Private Sector Code**”) is mandatory while that for the Not-for-Profit entities will be operated on a “Comply or Justify non-compliance” basis in a manner similar to the United Kingdom’s Corporate Governance Code. On the other hand, the Code of Governance for the Public Sector will not become immediately operative until an executive directive is secured from the Federal Government of Nigeria for that code to take effect.

As compliance with provisions of the Private Sector Code is mandatory, our focus in this news alert will be on the Private Sector Code.

SCOPE OF APPLICATION

The Private Sector Code applies to (i) all public companies (whether listed or not); (ii) all private companies that are holding companies or subsidiaries of public

companies; and (iii) regulated private companies as defined under the Private Sector Code¹.

From the definition of regulated private companies, it would seem that the Private

¹ The Code defines regulated private companies as “private companies that file returns to any regulatory authority other than the Federal Inland Revenue Service (FIRS) and the

Corporate Affairs Commission (CAC), except such companies with not more than eight (8) employees”.

Sector Code has contracted the jurisdictional powers of the FRCN by excluding private companies which file returns with the Federal Inland Revenue Service and the Corporate Affairs Commission **and have eight (8) employees or less**. This is a departure from the scope under the Act which merely excludes private companies that file returns with the Federal Inland Revenue Service and the Corporate Affairs Commission and does not exclude companies merely on the basis on the numerical strength of their employees.

The above notwithstanding, the applicability of the Private Sector Code to **all private companies** is still debatable in light of the Federal High Court of Nigeria's decision in **Eko Hotels Limited v. Financial Reporting Council of Nigeria**² to the effect that "the jurisdictional scope of the Act is limited to public companies and other public entities and does not include private companies". This decision is currently on appeal and as such, the law is not yet settled on whether the fact that an entity files returns with regulatory bodies (other than the CAC and FIRS) should, without more, make such entity liable to registration under the Act and subject to the mandatory requirements of the Private Sector Code.

INNOVATIONS UNDER THE CODE

The Private Sector Code introduces requirements which will foster an improved corporate governance regime if adhered to by the entities that fall within the purview of the code. These requirements apply to directors, auditing, whistle-blowing amongst others.

Directorship

The Private Sector Code requires prospective directors of a company to disclose membership of other boards and serving directors to disclose prospective appointments to other boards. Also, more than two members of a nuclear or extended family are precluded from sitting on the

board of a company at the same time. In addition, the Code provides that the positions of the chairman of the board and chief executive officer shall be separate and held by different individuals. The chairman of the board is also required to be a non-executive director.

These requirements will allow the company to gauge a prospective/serving director's level of commitment to the board as well as determine existence of conflict (if any) and forestall abuse of power by the directors.

Independent Non-Executive Director

The Private Sector Code requires the board of every company to include independent non-executive directors, and provides a non-exhaustive list of factors for measuring independence including; not being a substantial shareholder, not being an employee of the company within the past five (5) years and not serving on the board for more than nine (9) years.

This requirement is aimed at inclusion of unbiased and objective directors on the board for the purpose of checks and balances in the decision making process to sustain investors' trust and confidence in the board.

Conflict of Interest

The Private Sector Code precludes any member of executive management³ of a relevant regulatory institution⁴ who leaves the services of such institution from being appointed as a director or top management staff of a company that has been directly supervised or regulated by the said institution until after three years of disengaging from that institution.

This provision is aimed at preventing conflict/bias on the part of the member of the executive management in dispensing his duties as a director.

Tenure of Office of Directors

The Private Sector Code provides that the tenure of office of the Managing Director/Chief Executive Officer and executive directors shall be not more than

²FHC/L/CS/1430/2012.

³ Executive management is defined as director level and above.

⁴ Sectoral regulators as may be appropriate.

two terms of five years each. The tenure of non-executive directors should not be more than three terms of four years.

Minority Shareholder Protection

In addition to several provisions protecting shareholders rights which are similar to the statutory rights available to minority shareholders under the Companies and Allied Matters Act⁵ (CAMA), the Private Sector Code gives a shareholder or group of shareholders who have a cumulative shareholding interest of not less than one per cent of the share capital of a company the right to contribute to the agenda of the Annual General Meeting by submitting items for inclusion in the agenda.

This provision enables participation of minority shareholders in the decision making process of the company, and inhibits domination by majority shareholders, as matters which are of interest to the minority shareholders can be transacted at AGMs.

External Auditors

The Private Sector Code provides that the tenure of office of auditors of a company shall not exceed ten (10) years continuously and such auditors shall only be considered for reappointment seven (7) years after disengagement. Furthermore, where an auditor's aggregate tenure has already exceeded ten years at the date of commencement of the Private Sector Code, such auditor shall cease to hold office as an auditor at the end of the financial year that the Code comes into effect. In addition, companies are required to request that the audit partners are rotated every five (5) years.

The Private Sector Code also prescribes a list of services which auditors are precluded from offering to companies including actuarial, investment advisory and taxation services.

These provisions would mitigate laxity by auditors in the performance of their functions as a result of overfamiliarity with

the company, its processes and officers and preserve independence of the auditors.

Internal Audit

The Private Sector Code requires every company to establish an Internal Audit Unit (IAU). Amongst other responsibilities, the IAU will report to the Statutory Audit Committee (SAC), SAC and Board Audit Committee (BAC) on the adequacy and effectiveness of management, governance, risk and control policies, deficiencies observed in these policies and management mitigation plans.

This requirement would enable companies identify any governance deficiencies and any potential risk factors prior to an external audit and establish mechanisms to mitigate these factors.

Whistle Blowing

Every company is required to have whistle blowing⁶ policy which will encourage stakeholders to report unethical conduct and violations of any laws or policies to an internal and/or external authority, so that such conduct /violation can be verified, and appropriate sanctions applied to avoid a re-occurrence.

The Private Sector Code provides that the whistle-blowing mechanism shall include a dedicated telephone "hot-line", e-mail address, and other electronic communication methods that could be used (even anonymously) to report illegal or unethical practices. The responsibility of reviewing reported cases and notifying the SAC and BAC of these cases lies with the head of the IAU.

Companies are required to treat all whistle-blowing disclosures (including the identity of the whistle blower) as confidential. In addition, the Private Sector Code affords protection to whistle blowers, by precluding companies from subjecting a whistle blower to any detriment whatsoever on the grounds that he has made a disclosure in accordance with the provisions of the code.

⁵ Cap C20, LFN, 2004

⁶ The Private Sector Code defines a whistle blower as any person(s) including the employees, management, directors, customers, service providers, creditors and other

stakeholder(s) of a company who report any form of unethical behaviour, dishonesty or violation of any law or regulation(s).

Furthermore, an employee who has suffered any detriment⁷ by reason of disclosure made pursuant to the Private Sector Code shall be entitled to compensation and/or reinstatement, whilst in the case of other stakeholders, the whistle-blower shall be adequately compensated.

These provisions will facilitate cooperation of stakeholders with regulatory authorities in curbing corporate excesses and violation of applicable laws within companies, as well as foster international corporate governance best practices by officers and management of Nigerian companies as the awareness of the plausibility of exposure and the attendant repercussion in instances of non-compliance will serve as a deterrent.

ENFORCEMENT & SANCTIONS

The FRCN is responsible for enforcing the provisions of the Private Sector Code. The Code provides that violations of the provisions will result in personal sanctions against the persons directly involved, and sanctions against the companies or firms involved. However, the nature of these sanctions are not provided for by the Code⁸.

STATUS OF THE PRIVATE SECTOR CODE VIS-À-VIS OTHER EXISTING CODES OF CORPORATE GOVERNANCE

Prior to the commencement of the Private Sector Code, different industries or sectors in the Nigeria had bespoke codes of corporate governance (including the overarching Code of Corporate Governance for Public Companies issued by the Securities and Exchange Commission (“SEC”)). In issuing the Private Sector Code, the steering committee did consider such existing codes and similar directives with a view to harmonising the codes and avoiding conflicts

and overlaps with the Private Sector Code. In particular, the committee considered the Code of Corporate Governance for Banks in Nigeria Post-Consolidation 2006; the Code of Corporate Governance for Licensed Pensions Operators 2008; the Code of Corporate Governance for Insurance Industry in Nigeria 2009; the SEC Code of Corporate Governance in Nigeria 2011 and the Central Bank of Nigeria Code of Corporate Governance for Banks and Discount Houses 2014. The outcome was a harmonization and unification of the various codes with a directive that the Private Sector Code will, with effect from 17 October, 2016, supersede any other corporate governance code in force in Nigeria before that date, and that in the case of a conflict between the provisions of the Private Sector Code and any sectoral code or supplement thereto, the provisions of the Private Sector Code shall to the extent of those inconsistencies prevail.

For the avoidance of doubt, the issuance of the Private Sector Code does not prevent or otherwise circumscribe the powers of the various sector regulators to issue new codes of corporate governance or to supplement their existing codes. The Private Sector Code recognises that such regulators remain empowered to issue corporate governance guidelines on specific matters except that such guidelines must be consistent with the Private Sector Code or be void.⁹

In sum, stakeholders in the private sector are now required to look to and observe the requirements of the Private Sector Code only subject to any supplementary (and non-conflicting) corporate governance guidelines that may be issued from time to time by various regulators.

⁷ Detriment includes dismissal, termination, demotion, retirement, redundancy, undue influence, duress, withholding of benefits and/or entitlements and any other act that has a negative impact on the whistle-blower.

⁸ It is possible that even in the absence of an express penalty or sanction in the Code, the FRCN can look to the Act to find the appropriate sanction. The Code might be silent but the FRCN can rely on its general statutory powers to sanction defaulters on the ground of non-compliance with directives, orders and codes of the FRCN.

⁹ There is the outstanding question of whether the FRCN is empowered to confer a preemptory status on the Private Sector Code such that all codes of corporate governance made by other regulators that are statutorily empowered to issue such codes must kowtow to the FRCN's Private Sector Code. The answer to that question is, unfortunately, outside the scope of this newsletter.

OVERLAP AND CONFLICT WITH EXISTING LEGISLATION

Some provisions of the Private Sector Code conflict with provisions of CAMA which is the primary legislation regulating the administration of companies in Nigeria. Two areas in which these conflict occurs are with respect to:

Directors Remuneration

The Private Sector Code requires the board of every company to establish a remuneration committee which shall be responsible for recommending the remuneration of both executive and non-executive directors to the board, amongst other function. This is contrary to the CAMA which gives the company in general meeting the power to determine the remuneration of the directors.

This provision also appears inimical to the principles of corporate governance, given that the members of the board would be in a position to recommend their remuneration, and further contradicts another provision of the Private Sector Code to the effect that **“a director shall not be present during the time any matter in which he has an interest is being discussed or decided”**.

Voting by the Board

In addition, the Private Sector Code provides that **“Where a majority of independent non-executive directors’ dissent on an issue decided by the board, such decision can only be valid where at least 75% of the full board (without reference to quorum) vote in favour of such decision”**

This provision conflicts with the CAMA which expressly provides that questions arising at any meeting shall be decided by a majority of votes, and where there is an equality of

votes, the chairman shall have a second or casting vote.

CONCLUSION

The emergence of a unified code of corporate governance is no doubt long awaited, particularly by shareholders and other investors who require greater accountability and transparency from their boards. However, a major drawback of the Code is the fact that some of its provisions conflict with the CAMA. The nature of corporate governance codes across various jurisdictions is generally supplementary and should not conflict with extant company legislation.

Also, the requirement of mandatory compliance by private companies does not seem realistic in view of the fact that a lot of the provisions will be onerous on a significant number of Nigerian companies that come within the definition of regulated private companies. Such companies should have the liberty to apply the code to their corporate and governance structures or implement the general objectives of corporate governance in a manner suitable for the size, nature and structure of their businesses rather than being forced to comply with a “one size fits all” set of corporate governance rules. As with codes of corporate governance across the world, the aim of the Private Sector Code should be to provide general guidelines of best practice as opposed to a rules-based approach which rigidly defines exact provisions that must be adhered to.

Notwithstanding its shortcomings, the Private Sector Code has some laudable provisions which will no doubt strengthen governance and ensure accountability, corporate neutrality and sustainability and improved risk management by the companies to which it applies.