HIGHLIGHTS

TEMPLARS

NIGERIAN CODE OF **CORPORATE GOVERNANCE** **2018**

The Code specifies principles denoting minimum standards to be adopted by companies and adopts an ***"Apply and Explain"*** philosophy in order to be flexible (applicable in diverse circumstances) and scalable (applicable to companies of varying sizes).

BACKGROUND

Until recently, there has been no codified, generally applicable corporate governance regime in Nigeria. However, the void that the absence of a generally applicable national code created was to a certain degree mitigated by a few sector specific corporate governance codes issued by regulators to address the governance challenges in their sectors. Subsequently, in order to consolidate the corporate governance requirements of various sectors and establish a codified corporate governance regime applicable across board, the Financial Reporting Council of Nigeria (“**FRCN**”) released the National Code of Corporate Governance 2016 (the “**NCCG**”). Sadly, whatever governance relief that the emergence of the NCCG brought was short-lived, as it was suspended due to controversies relating to its legality and impact on the ease of doing business drive of the Federal Government of Nigeria (“**FGN**”).

In the events that followed, the FRCN was tasked with the responsibility of engaging stakeholders in order to redevelop a national corporate governance code which will be in consonance with the ease of doing business objective of the FGN and international best practice. The various deliberations resulted in, the approval of the Nigerian Code of Corporate Governance 2018 (the “**Code**”) by the FRCN pursuant to its powers under Sections 11(c) and 51(c)[1] of the Financial Reporting Council of Nigeria Act 2011 (the “**Act**”). The Code was unveiled by the Vice President of the Federal Republic of Nigeria, Prof. Yemi Osinbajo and the Honourable Minister of Trade and Investment, Dr. Okechukwu Enelamah on 15th January 2019. The Code is aimed primarily at institutionalizing corporate governance best practices in Nigerian companies in order to boost the integrity of, and positively redefine public perception of the Nigerian business environment, thereby facilitating increased trade and investment.

The Code specifies principles denoting minimum standards to be adopted by companies and adopts an “***Apply and Explain***” philosophy in order to be flexible (applicable in diverse circumstances) and scalable (applicable to companies of varying sizes). The Code requires companies to apply the principles as best suits the nature of their business as well as size of the company, and explain how the principles were applied (that is, how the specific activities undertaken best accomplishes the purport of the principles specified in the Code).

[1] These sections place a responsibility on the FRCN to ensure good corporate governance practices in the public and private sectors and empowers the FRCN to issue the code of corporate governance and guidelines.

SCOPE OF APPLICATION

The Code does not expressly prescribe its scope of application. As such, an assumption may be made that the absence of a definitive scope suggests that it is intended to apply to all companies in Nigeria. Perhaps with a view to clarifying the position, the Minister of Trade and Investment on 18th February 2019 issued a regulation (effective 15th January 2019) expressly setting out the scope of application of the Code and directing that it shall also apply to "*all regulated private companies being companies that file returns to any regulatory authority other than the Federal Inland Revenue Service (FIRS) and the Corporate Affairs Commission (CAC)*".

Notwithstanding the scope of application of the Code as clarified in the aforesaid regulation, its applicability to 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*". Thus, to the extent that the Code derives its authority from the Act, it should not, based solely on the yet-to-be upturned Eko Hotels decision, be applicable to "unregulated" private companies.

[2] FHC/L/CS/1430/2012.

SALIENT INNOVATIONS UNDER THE CODE

The Code introduces[3] standards which will foster an improved corporate governance regime if adopted by companies. These standards apply to directors, auditing, whistle-blowing amongst others.

Board of Directors

The Board of Directors (the "**Board**") are required to have a charter stipulating their responsibilities. In addition, diversity (including knowledge, skill, experience, age, culture and gender) should be an important consideration in the composition of the Board. Also, prospective directors of a company are required to disclose membership of other boards and serving directors to disclose prospective appointments to other boards. The number of such other directorships and attendant responsibilities should be taken into consideration by the Board, in order to determine whether the director in question can effectively undertake his responsibilities before recommending the director for appointment or continued service as the case may be. Without prejudice to the general intention of this provision (that is, to enable the company gauge a prospective/serving director's level of commitment to the Board, as well as determine existence of conflict (if any)), in light of the fact that there is no yardstick for measuring the ability of a director to effectively perform his/her functions, the application in practice would be subjective, as capacity to multitask (serve on multiple boards) varies from person to person.

Consequently, it may be helpful for Boards to set parameters such as the number and size of the companies in which the other directorship is held or proposed to be held, in determining capacity to effectively function on the Board.

Chairman, Managing Director and Chief Executive Officer

The Code provides that the positions of the Chairman of the Board and Chief Executive Officer ("**CEO**") should be separate and held by different individuals. The Chairman of the Board is also required to be a Non-Executive Director ("**NED**"). In addition, the Code precludes the Managing Director ("**MD**") and CEO or an Executive Director ("**ED**") of a company from subsequently being appointed as the Chairman of that company, except in exceptional circumstances, in which case a cool-off period of three (3) years is required. There is no prescribed yardstick for determining what will amount to an exceptional circumstance as contemplated under the Code, therefore giving the Board the latitude to qualify any circumstance which they deem fit as such. That said, these provisions are aimed at forestalling abuse of power by the directors.

Independent Non-Executive Director

In order to foster objectivity, the Code requires the Board to comprise of Independent Non-Executive Directors ("**INED**") who will hold office for a maximum of three (3) terms of three (3) years each, and provides a non-exhaustive list of factors for measuring independence including;

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[3] The Code maintains the ideology behind some of the innovations in the suspended NCCG, albeit with slight modifications or additions in some instances.

not holding a shareholding of such value with the propensity to impede independence or more than 0.01% of the paid up capital of the company, not being an employee of the company or group within the past five (5) years, not being a close family member[4] of any advisers, directors, senior employees, consultants, auditors, creditors, suppliers, customers or substantial shareholders and not serving on the board for more than nine (9) years. In addition, a NED is precluded from being re-designated as an INED. Although 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, in order to sustain investors' trust and confidence in the Board, some of the factors for measuring independence could occasion a challenge of implementation/interpretation in practice.

For instance, determination of the value of shareholding which could impede independence is subjective, as this would vary from person to person, likewise, the rationale behind the peg on 0.01% of the paid up capital is unclear, as payment or otherwise for shares does not have any effect on the vested interest of the shareholder, because shares taken up in a company are not required to be paid up immediately[5].

Board Committees

Boards are to establish committees including remuneration, nomination and governance, audit[6], and risk management committees, and delegate some of their functions to these committees in order to guarantee efficiency and effectiveness. The functions of two (2) committees may be fused where suitable. In this vein, the Code recognizes that the functions of the audit and risk management committees are interconnected and thus prescribes that where these functions are vested in separate committees, one or more members of these committees should have dual membership in both committees.

Induction, Continuing Education and Board Evaluation

Boards are required to conduct formal induction exercises for new directors, to sensitize them on the company's operations and business environment, as well as undertake continuing education programs from time to time, in order to update knowledge of the directors and keep them abreast of developments in the relevant sector.

Also an evaluation of the performance of the Board as a whole, individual directors, the Chairman and Board committees should be undertaken annually by the Board and a minimum of every three (3) years by an independent external consultant. This is expected to provide insight into the overall performance of the Board in furtherance of the company's objectives and aid in identifying areas that require modification or improvement as the case may be.

Internal Audit

The Code requires companies to establish an Internal Audit team and process headed by a member of the senior management who is registered with a recognised professional body, in order to guarantee the effectiveness of the governance, risk management and internal control systems. In the event that such team and process is not established, adequate reasons should be included in the annual report of the company elucidating how the Board obtained the requisite assurances.

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[4] A close family members are defined as "***those persons who may be expected to influence, or be influenced by, that person in his dealing with a company***".

[5] Sections 133 and 135 – 138 of the Companies and Allied Matters Act Cap C.20 Laws of the Federation of Nigeria 2004.

[6] Establishment of the audit committee is subject to the provisions of extant laws. This suggests that the requirement is only applicable to public companies in accordance with the provisions of the Companies and Allied Matters Act.

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.

External Auditors

The Code provides that the tenure of office of auditors of a company should not exceed ten (10) years continuously and such auditors may only be considered for reappointment seven (7) years after disengagement. Furthermore, where an auditor's aggregate tenure has already exceeded ten (10) years at the date of commencement of the Code, such auditor is required to cease holding office as an auditor at the next annual general meeting to be held immediately after the Code comes into effect. In addition, companies are required to request that the audit partners are rotated every five (5) years. Also, a cooling off period of a minimum of three (3) years is required between the retirement of a partner from an audit firm and his appointment to the Board of a company which is a client of the audit firm. Likewise, a cooling off period is required before a company engages a member of the audit team as a staff performing financial reporting function.

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.

Whistle Blowing

Boards are required to establish a whistle blowing framework which will encourage stakeholders to report unethical conduct and violations of any laws or policies to an internal and/or external authority, to enable verification of such conduct /violation, and application of appropriate sanctions in order to avoid a reoccurrence. The anonymity of the whistle-blower[7] is sacrosanct, as the Code requires such person's identity to be kept confidential and disclosures emanating therefrom to be treated confidentially. In addition, the Code affords protection to whistle blowers, by placing an obligation on the Board to ensure that a whistle-blower is not subjected to any detriment[8] whatsoever on the grounds that he/she has made a disclosure. A whistle-blower who has suffered any detriment by reason of disclosure made pursuant to the Code is entitled to compensation and/or reinstatement as the case may be. These provisions are expected to 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 companies, as the awareness of the plausibility of exposure and the attendant repercussion in instances of non-compliance will serve as a deterrent.

[7] A whistle-blower is defined as "***any person(s) including the employee, management, Directors, customers, service providers, creditors and other stakeholder(s) of a company who report any form of unethical behaviour or violations of laws and regulations to the appropriate internal authority or regulators***".

[8] Detriment includes "***dismissal, termination, demotion, retirement, redundancy, undue influence, duress, withholding of benefits and/or entitlements, blacklisting, withdrawal of patronage and any other act that has a negative impact on the whistle-blower***".

Ethical Culture and Transparency

The Code prohibits insider[9] trading and requires disclosure of related party[10] transactions. Also, the Code requires a cooling off period of three (3) years prior to the appointment of any person who was previously employed at directorate level or above, in a relevant regulatory institution (that is, an institution that has directly supervised/regulated a company) as a Director or top management staff of a company. These provisions are aimed at guaranteeing sound moral practices and preventing conflict/bias on the part of the member of the executive management in dispensing his duties as a Director.

Boards are required to create an investors' portal which is accessible to the public in downloadable format on the company's website, for publishing of the company's annual reports (for a minimum of five (5) immediately preceding years) and other relevant information about the company.

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[9] An insider is defined as ***(a) "any person who is connected with the company in one or more of the following capacities: (i) a Director of the company or a related company; (ii) an officer of the company or a related company; (iii) an employee of the company or a related company; (iv) any shareholder of the company who owns five percent (5%) or more of any class of securities or any person who is or can be deemed to have any relationship with the company or member; (v) members of the statutory audit committee of a company; and (vi) any person involved in a professional or business relationship who has access to inside information by virtue of his relationship to (i) to (v) above, (b) any of the persons listed in paragraph (a), who by virtue of having been connected with any such person or connected with the company in any other way, possesses unpublished price-sensitive information in relation to the securities of the company".***

[10] A related party/company is defined as ***"a person or company that is related to the company that is preparing its financial statements. A person or a close member of that person's family is related to a reporting company if that person: (i) has control or joint control of the reporting company; (ii) has significant influence over the reporting company; or (iii) is a member of the key management personnel of the reporting company or of a parent of the reporting company".***

ENFORCEMENT & SANCTIONS

The FRCN is responsible for monitoring implementation of the Code, albeit through sector specific regulators and registered exchanges. However, the Code does not prescribe penalties for non-compliance, possibly due to the intention for the Code to be voluntary which occasioned the "**Apply and Explain**" philosophy of the Code. Whist the lack of sanctions would initially appear to be valid in light of the voluntary nature of the Code, it is our view that this could potentially inhibit implementation of the Code given the rationale behind the philosophy, since there are no consequences for non-compliance. For clarity, the Code requires adoption of the prescribed standards or like standards capable of achieving the overarching objectives of the various standards in the Code. Thus, in the absence of some measure of sanction as an incentive for compliance, there is likely to be a lesser degree of compliance with the Code than anticipated.

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

Prior to the commencement of the Code, different sectors in Nigeria had bespoke codes of corporate governance (including the Code of Corporate Governance for Public Companies 2011 issued by the Securities and Exchange Commission ("**SEC**"). Whilst the Code specifically recognised the prior existence of the following codes of corporate governance: Code of Corporate Governance for the Telecommunication Industry 2016 issued by the Nigerian Communications Commission; Code of Corporate Governance for Banks and Discount Houses in Nigeria 2014 issued by the Central Bank of Nigeria; Code of Corporate Governance for Public Companies in Nigeria 2011 issued by the SEC; Code of Good Corporate Governance for the Insurance Industry in Nigeria 2009 issued by the National Insurance Commission; and Code of Corporate Governance for Licensed Pension Fund Operators 2008 issued by the National Pension Commission, the Code does not make provision for which code will prevail in the event of a conflict between the Code and any of these sector specific codes or the means of addressing any such conflict. Nonetheless, it would appear that such provision may not be necessary given the voluntary nature of the Code. Therefore, where there is a conflict between the Code and a sector specific Code with mandatory character, it is presumable that the sector specific code will prevail. That said, such interpretation/implementation necessitated by the omission in the Code potentially derogates from the overarching objective of the Code.

OVERLAP AND CONFLICT WITH EXISTING LEGISLATION

Some provisions of the Code conflict with provisions of Companies and Allied Matters Act (the "**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 Code requires Boards to establish a remuneration committee which will be responsible for recommending the remuneration policy and structure for all directors, amongst other functions. It precludes the MD/CEO and ED's from being members of such committee and being involved in the determination of their remuneration. Thus, the committee will be constituted solely of NEDS. Furthermore, it provides that the remuneration for NEDS should be fixed by the Board and approved by the shareholders in a general meeting. Cumulatively, these are contrary to the CAMA which gives the shareholders in a general meeting the power to determine the remuneration of the directors. These provisions also appear inimical to the principles of corporate governance, given that the members of the Board (the NEDS) would be in a position to recommend their remuneration, and further contradicts another provision of the 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***".

Meetings of the Board

Boards are required to meet a minimum of once in every quarter, that is, at least four (4) times in a year. This infringes on the liberty enjoyed by the Board under the CAMA to convene their meetings at their discretion. For clarity, the CAMA provides that the Board is at liberty to ***"…meet and regulate their meetings as they think fit***". There is also the question as to whether the Board of any private company to which the Code applies can still take decisions by passing written resolutions (as contemplated by section 263(8) of CAMA) in lieu of convening physical meetings since the Code requires that not less than four meetings should be convened in a given year.

CONCLUSION

The emergence of a generally applicable 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 law.

Despite the seemingly blurry lines between the intention for the Code to be voluntary and the rationale behind the "**Apply and Explain**" philosophy of the Code, it appears from the Code that the philosophy is more sacrosanct than the intention, as the Code places an obligation on Boards to ensure corporate governance evaluations are undertaken annually and a minimum of every three (3) years by an independent external consultant. Furthermore, a summary of the report of such evaluation is required to be included in the company's annual report and published on the investors' portal on the company's website.

Notwithstanding its shortcomings, the Code has some laudable provisions which no doubt have the potential of strengthening governance and improving risk management by companies which adopt and apply its prescribed standards.

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