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DEVELOPMENT FINANCE INSTITUTIONS (DFI) LENDING IN NIGERIA:

WHAT EVERY BORROWER MUSTKNOW BEFORE SIGNING

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INTRODUCTION

Lending from development finance institutions such as the International Finance Corporation, African Development Bank, Proparco, and German Development Finance Institution, DEG, and other multilateral and bilateral development finance institutions is becoming more accessible to Nigerian businesses across sectors. There may be longer tenors, attractive pricing, or even a strategic partnership that adds credibility and capital.

However, borrowers should be aware that DFI loans are not commercial bank loans. They come with conditions, obligations and consequences that many Nigerian borrowers are not prepared for when they enter the facility agreement.

In this article, we identify the five most critical areas where DFI lending most often cause problems for Nigerian borrowers and what every borrower should know before signing.

1. ENVIRONMENTAL AND SOCIAL COMPLIANCE

Every major development finance institution lends under an Environmental and Social (E &S) framework - IFC Performance standards are the most common and most widely used directly (for IFC loans) or by reference (for many bilateral DFIs and funds that use IFC Standards as their benchmark). Respecting the applicable E & S framework is an obligation that goes beyond drawdown alone - it is an ongoing obligation throughout the life of the facility.

Specific E & S obligations that Nigerian borrowers most commonly fail to meet are: preparation and maintenance of an Environmental and Social Management System (ESMS) meeting the relevant performance standard; community and stakeholder engagement in accordance with DFI requirements; and reporting of adverse E1and1S incidents to the lender within specified timeframes.

Breach of E & S covenants is a default under most DFI facility agreements and DFI lenders have accelerated loans on E & S grounds. This is not a theoretical risk. By signing DFI facility agreements without understanding the E & S obligations, they are taking on a material default risk that is unrelated to their financial performance.

2. REPORTING OBLIGATIONS

Many times, DFI facility agreements place reporting obligations that are far more stringent than equivalent provisions in Nigerian commercial bank facilities. The typical requirements for borrowers are: an annual audited financial statement prepared under specific accounting standards (usually IFRS); quarterly management accounts are included within specified periods of each quarter; annual E & S compliance reports based on the applicable performance standard, verified by an independent E & S consultant; annual conformity certificates from the directors of the borrower show compliance with all financial and non-financial covenants. Events of default, material adverse change, or material litigation shall be made promptly known.

This creates a significant management burden that is often not realised until the first annual report cycle when the borrower is already in breach of its reporting obligations. More management time, external audit costs, and consultant costs related to DFI reporting should be budgeted by Nigerian businesses using the facility for the first time.

3. RESTRICTIONS ON DIVIDENDS AND RELATED-PARTY TRANSACTIONS

Restrictions on dividends and related-party transactions are typically contained in financial covenants in the loan facility agreements. Those restrictions protect the lender and they prevent value being stripped from the borrower in ways that impair its ability to service its debt obligations but they also have big commercial implications for borrowers and their shareholders.

These are some of the restrictions that Nigerian borrowers should pay attention to: dividend lock-up provisions - which may stop dividend payments entirely or limit them to a percentage of distributable profits; related-party transaction restrictions - typically, DFI approval is required for all transactions between the borrower and its affiliates that exceed a certain threshold; restrictive capital expenditure rules that may prevent the borrower from making new investments without lender consent; and they place restrictions on debt incurrence that prevent the borrower from taking on additional financial indebtedness above some level.

If Nigerian business owners are accustomed to the leniency of commercial bank lending - where covenant packages are light and compliance is less stringent - they should model the impact on their business before signing the facility agreement.

A pricing-sensitive DFI loan that limits the borrower's operational and financial flexibility in ways that are inconsistent with its business model is not a good deal.

4. CHANGE-OF-CONTROL PROVISIONS

Most DFI facility agreements contain change-of-control provisions that define “default” as any change in the borrower's ownership or control or at least as an obligation to prepay the facility. This is because the DFI made a lending decision on the basis of its assessment of the management, ownership, and governance of that borrower and any material change in any of those factors changes the basis for the lending decision.

A change-of-control provision in an existing DFI facility may create a serious commercial constraint for Nigerian businesses looking for new investors, planning a management restructuring, or anticipating a corporate reorganisation. New strategic shareholders being taken into consideration, new private equity investors, or even an internal restructuring of the borrower's holding structure could be changes of control under the facility agreement provided that the founders remain in operational control.

In advance of signing a DFI facility agreement, borrowers should identify all transactions, restructurings, or ownership changes expected during the loan period and get DFI consent (or a waiver) before signing rather than finding out about the conflict later on in the process. Generally speaking, DFI lenders will accept planned

ownership changes if they are disclosed upfront but will not accept a change of control once it has taken place.

5. GOVERNING LAW

In general terms, DFI facility agreements are governed by English law and all disputes are resolved by international arbitration- in the case of investment disputes usually through the International Chamber of Commerce (ICC), the London Court of International Arbitration (LCIA), or the International Centre for Settlement of Investment Disputes (ICSID). In doing so, Nigerian borrowers agree to sue the DFI in an international forum, under foreign law and at a cost that reflects international arbitration economics.

This is not necessarily problematic - commercial law is complex and well developed and international arbitration is neutral and enforceable. Still, Nigerian borrowers need to know what they are agreeing to. So, the management burden of an international arbitration - time, cost, and specialist legal advice in the relevant jurisdiction is very high in comparison to the equivalent burden of a Nigerian court proceeding or a Lagos-based arbitration.

Also, borrowers should consider whether the governing law and arbitration provision are consistent with the rest of the facility agreement. Any facility agreement governed by English law, but with security arrangements governed by Nigerian law, requires close coordination between English law advisers and Nigerian law advisers and gaps in that coordination can cause enforceability problems at the point of enforcement action

CONCLUSION

For Nigerian businesses, access to capital, credibility with development finance institutions, and long-term partnerships are huge opportunities that development finance institutions can offer. However, the obligations that come with that capital are real and demanding. Only Nigerian businesses that understand those obligations before they sign and structure their operations and management systems accordingly can make DFI lending work. But those who discover those obligations once they sign are those who struggle with covenant compliance, reporting requirements, and commercial restrictions when they need them most.

Please note that the contents of this article are for general guidance on the Subject Matter. It is NOT legal advice. For further information or to see our other service offerings, please visit www.goldsmithsllp.com or contact:

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