



Amcon And Toxic Assets: Optimizing The Securitization Option

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Introduction

Securitization is the process where illiquid assets or group of assets: receivables, credit card debts, car loans, student loans, home mortgages, commercial mortgages, etc. are pooled together into reference portfolio, assessed by a government approved rating agency to determine their viability and repackaged into interest-bearing securities and issued to the investing public- institutional investors, hedge funds and the general public. The pool assets are usually sliced into tranches- junior, mezzanine and senior-based on the report of the rating agency before they are traded as securities. The return on investment (ROI) on the traded securities is dependent on the performance of the underlying assets. Thus, if the underlying assets perform optimally, then investors will have a positive ROI.

In developed economies, securitization has been long employed to facilitate economic growth and development, significantly in the area of bringing the financial market and the capital market together. Despite its economic advantage, many denigrate the mechanics and operations of the concept which they perceive as the major cause of the 2008 financial credit crunch which ripple effect still lingers. However, several financial institutions (FIs), both in developed countries and emerging markets, still use the concept to raise cash and dispose of assets from their balance sheets.

The concept is equally not a total novelty in the Nigerian economic sector. In fact, the Securities and Exchange Commission (SEC) on April 13, 2015 introduced the **Rule on Securitization (ROS)** to regulate the concept of securitization in Nigeria. **Rule A Para XVII ROS** defined Securitization to mean “an issuance of securities backed by a pool of assets”. Notwithstanding the existence of the ROS, it appears that no FI has taken any step to securitize its debt even when there seems to be agencies that can facilitate the securitization structure. One of such agencies

is the Asset Management Corporation of Nigeria (AMCON).

The Glamour of Securitizing

Securitization began as a way for FIs and corporations to discover an alternative source of funding by moving assets off their balance sheets into the hands of willing investors. This structure reduces the debt burden on FIs arising from incessant and sometimes mismanaged borrowings, and regulatory procedures involved in such borrowings. By securitizing, these corporations “use what they have to get what they want”.

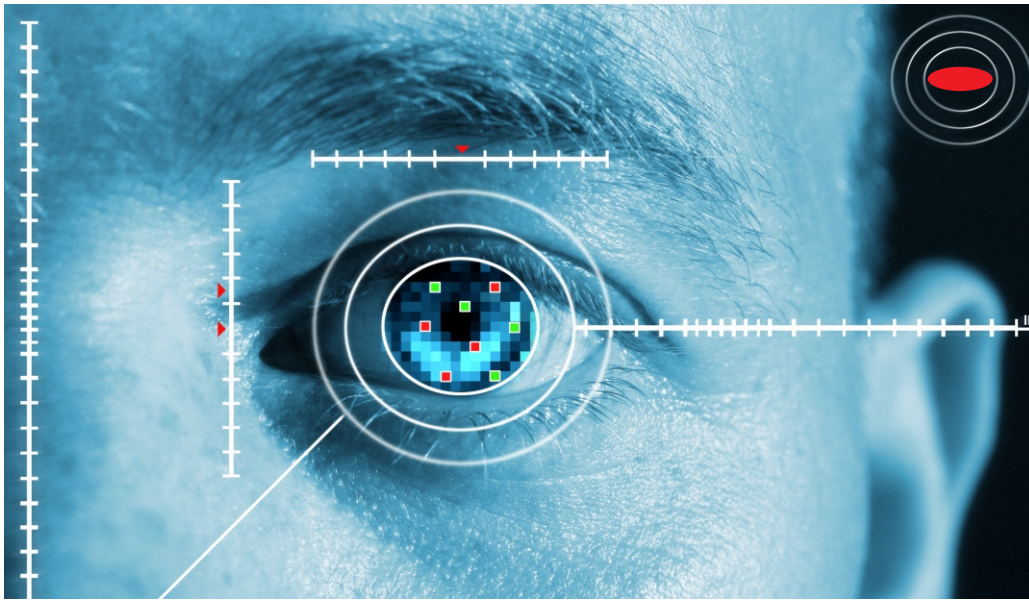
An illustration will help the understanding of this concept. Assuming an FI lends a huge sum of money with its maturity date in 10 years and sometimes in the future (before the 10 years tenure) the FI needs to raise cash; what is obtainable is that the FI would take out a loan or sell bonds thereby imposing additional burden on its balance sheet. With securitization, rather than the loan or note option, the FI could effectively convert a future income stream (the loan with 10 years maturity date) to cash by sourcing for buyers for the already issued loans, converting the loans to tradable securities, repackaging them into tranches and then marketing the loans based on the date of maturity and the interest rate either on a fixed or floating rate.

By securitizing their debts, FIs minimise the problem of credit risks associated with individuals, corporate or government loans. Through this concept, the associated credit risks in the loans granted by FIs are transferred to willing investors thereby freeing up FI balance sheet and making available cash flows for its business operations.

AMCON's Legal Construct

AMCON was established pursuant to the AMCON Act in July 2010 as a key stabilizing and revitalizing tool to reviving the financial system. The ingenious work of AMCON in resolving the problems of Non-Performing Loans (NPLs), pursuant to its mandate of acquiring Eligible Bank Assets (EBA) of Eligible Financial Institutions (EFIs), averted





AMCON and Securitization

The establishment of AMCON and the ROS by SEC are steps in the right direction to kick start and actualize the practice of securitization in Nigeria's Financial Sector (FS). The structure, objectives, functions and powers of AMCON makes it possible for AMCON to securitize its debts. **Section 5(f)(ii), AMCON Act**, which provides that AMCON can take all steps necessary or expedient to protect, enhance or realise the value of EBA including the **securitization or refinancing** of portfolios of EBA, is an indication that AMCON has such power.

To actualise this function, which will be for the overall interest of the FS, AMCON will repackage all the NPLs of the acquired EFIs (the originators) into an asset pool and appoint a duly registered rating agency, pursuant to **Rule A paragraph 5 ROS** to determine the nature of the assets. The agency will measure the likelihood of assets repayment based on a qualitative analysis of the economic, legal, political and financial matters relating to the borrowers, the maturity dates and interest rate.

AMCON will then package the assets and transfer the credit risks of the NPLs by trading them as securities in the capital market to willing investors. The price for the Assets Backed Securities (ABS) or Mortgage Backed Securities (MBS), as the case may be, sold to the public will depend on the security tranche. A risk premium will be applied in the sale of these assets. Thus, a risky asset will be structured to generate high return while a low or no risk asset will generate low return.

AMCON, depending on the refinancing agreement with the EFIs debtors, can sell either an interest or principal yielding asset. To realize investors' value, a servicer, with no link to the originating FI or AMCON will be appointed pursuant to **Rule M**. The servicer will have the mandate of collecting the interest and/or principal amount from the debtors, when due, and disbursing same to investors in the form of dividend. The servicer will also be empowered, pursuant to **Rule N, ROS** to report any defaulting assets to the Trustee- an investor.

By adopting this simple structured finance concept, AMCON would have succeeded in moving all the toxic assets to willing investors and be on the road to recouping the N6.6 trillion spent on NPLs. The amount realised by selling the ABS or MBS to investors will be used to resuscitate more moribund FIs. This concept will not only provide financial assistance to EFIs but will

the collapse of the Nigerian banking sector. To effectively perform its mandate, AMCON is empowered under its Act to issue bonds or other forms of debt instruments as consideration for the acquisition of toxic assets of banks and other FIs. It has the power to borrow or raise money, secure the payments of money via a variety of options, including issuing debentures, debenture stocks, obligations and debt securities of any kind and secure any instrument so issued by trust deed.

It is noteworthy that AMCON's mandate of acquiring EBA of EFIs creates a creditor/shareholder relationship between AMCON and the companies with the NPLs. Thus, AMCON has the power to direct the affairs of the company to ensure its stability. A classic example is the acquisition of Aero Contractors (Aero) from defunct Oceanic bank now Ecobank Nigeria Plc. AMCON by purchasing the EBA of defunct Oceanic Bank acquired about 60% stake in Aero due to Aero's \$200 million indebtedness to Oceanic bank. In directing the affairs of Aero, AMCON on February 5, 2016, pursuant to its powers, changed the company's Board and appointed a manager to oversee its affairs.

From the foregoing, it is apparent that AMCON received enormous powers to ensure stability in FIs and the economy. AMCON therefore seems to have all the instrumentality and backing of the government to bring an end to the NPLs quagmire in FIs.

AMCON is Not Too Big to Fail

The International Monetary Fund (IMF) in 2013 by its Article IV Consultations (No. 13/36 March 28, 2013) commended the efforts of Central Bank of Nigeria (CBN) and AMCON in restoring financial stability after the 2009 bank crisis, but called on the

government to wind down the operations of AMCON so as to prevent what it referred to as "moral hazard and fiscal risks". One of the reasons for IMF's clarion call was due to the N2.37 trillion losses reported by AMCON. Though there were arguments and counter arguments from several quarters on the propriety of IMF's recommendation, the fact remains that AMCON has several debts in its books and may not recover the debts within its 10 years span ending in 2022.

On December 8, 2015, two years after IMF's position, the Managing Director/CEO of AMCON, Mr. Ahmed Kuru, indirectly echoed IMF's concern during a media parley with financial journalists in Lagos. He opposed the idea of AMCON resuming purchase of banks' NPLs. According to him, AMCON is currently focused on recovering the N5.6 trillion debts incurred in the resolution of the 2009 banking crisis. He reiterated that due to the rise in NPLs, another asset management company would have to be established to acquire the rising bad debt in the industry, given the lifespan of AMCON. Mr. Kuru again, in a similar statement, on March 16, 2016 while responding to questions from the House of Representatives' Adhoc Committee on the alleged fraudulent sale of banks stated that the liabilities of the company then stood at about N6.6 trillion. This is about N1.1 trillion higher than its 2015 indebtedness.

The burning questions on the minds of many considering this enormous debt remain - how AMCON can successfully actualize its mandate in this era of dwindling oil price and economic downturn without being overburdened by the debts in its books? How can AMCON expunge the debts which are growing exponentially, from its books? How can it realise the debts of the EFIs from recalcitrant debtors? Who or what can save AMCON from its financial state?

also foster job creation in the economy. The recent economic downturn has caused these EFIs with several NPLs in their books- which AMCON has vowed not to acquire- to retrench their staff leading to job losses for Nigerians. This concept will be a redeeming force to an impending doom in our financial system.

Despite the attractiveness of this form of structured finance, one source of worry lingers; how will AMCON ensure the debtors of the EFIs redeem their debts for the ultimate benefit of the investors? What is the assurance that AMCON will not balk and abandon investors to their fate once the credit risks are transferred? Due to these concerns, risk averse investors (which constitute majority of the investing public) may be very wary of such uncertain investment.

To avoid this situation and create investor's confidence, the regulatory authorities (SEC and CBN) should mandatorily require AMCON and the EFIs (originators) to maintain a five percent (5%) minimum equity interest/stake in the riskiest tranche of assets pool. This approach will incentivize them to ensure debtors' fulfilment of their loan obligations. Also, appointing a securitization Trustee (ST), from amongst the investors, to act as a watchdog on AMCON and the EFIs, will facilitate a seamless operation of the concept. The ST will ensure that the debts are performing and in the event of default or drop in assets value, demand for a credit enhancement, pursuant to **Rules A and F, ROS**, from the EFI and/or AMCON. If the debtor fails to comply then the ST will notify AMCON of such default: remove the asset from the pool, dispose of the collateral, and distribute the proceeds to the investors. The ST will also be empowered to personally move against the debtor.

Conclusion

The beauty of this concept notwithstanding, some may argue and rightly so that AMCON is not contemplated as a participant under ROS being neither a public limited company nor a Trustee and has no SPV attached to it pursuant to **Rule C, ROS**. However, it is arguable that government agencies like AMCON are accommodated in **Rule C Para 1(b)** which stipulates that *an SPV can be any other legal entity which the Commission may by regulation permit to be used for a securitization transaction*. Pursuant to this rule, it seems that SEC intends that a government agency like AMCON can act as an SPV once such agency is permitted and authorized by SEC.

Even if SEC contends that AMCON is not contemplated under the rule, it is my view that rules are made for men and not men for rules. When SEC made the ROS, it probably did not envisage the current economic realities of AMCON. The present situation of AMCON constitutes a good reason for the amendment of ROS to include a government agency like AMCON- which possesses the requisite legal construct of an SPV- to securitize its debts. AMCON is currently battling with financial instability and the only way to save it from the "*devil and deep blue sea*" situation is for SEC to amend the ROS to allow AMCON securitize its debts. This will create a new investment avenue for investors, both domestic and foreign, increase liquidity in the economy and ultimately, prevent economic apocalypse in the FS.

If SEC decides that AMCON cannot perform the functions of an SPV under the ROS and it cannot be accommodated by the amendment of the ROS, then it behoves on AMCON to establish an SPV pursuant to its incidental powers under **Section 5(g), AMCON Act**. Relying on its incidental powers- *of performing such other activities and carrying out such other functions which in the opinion of the Board are necessary, incidental or conducive to the attainment of the objectives of the Corporation* - the established SPV will subsume and securitize the N6.6 trillion AMCON debts (toxic assets/NPLs) and securitize them. Without amending its Act, the SPV will perform similar functions as AMCON but, rather than acquire EBA of EFIs, it will buyout the EBAs/NPLs from AMCON. AMCON may however, in order to create a tidy mechanics, amend its Act to clearly provide for the functions and duties of the SPV. The amendment will emphasize that the SPV is a separate entity from AMCON and pursuant to ROS, does not have any direct link with AMCON, the EFIs (originators) or any of its affiliates. This "simple" concept will free AMCON from the clutching cold hands of NPLs.

The concept of securitization has helped salvage several economies and will definitely aid the Nigerian economy in this era of economic downturn. The ROS should be amended to recognise AMCON as an SPV participant. This concept could be a veritable option to help AMCON and FIs escape the present economic conundrum by permitting them to "*use what they have to get what they want*". Writing off debts from books is not the answer as that will reduce cash flow. The concept should begin with AMCON but it definitely should not end with it, FIs should be allowed to turn anticipated cash flows to cash at hand.

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