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The Market Memorandum

The Restoration of the Market:

Fundamental Considerations for Capital Market Reforms in Nigeria

Key Issues for SEC in the Regulation/Supervision of the Market (& NSE)

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The points made here has been articulated with one objective in mind – the need to approach the capital market reform in a wholesale manner *once and for all* – by addressing the foundational issues that we have expediently set aside for far too long, as previous attempts to do so have elicited reactions that make intents and commentaries appear like a turf-war or an expression of dissent.

This ought not to be. For we are often at our best as a people when we choose to engage in healthy debates and this is one we should have.

We are under no illusion that the points and comments made here are by far, the most appropriate or the only course of action open to the market. We however remain convinced that it represents a veritable basis of on the direction our markets should take.

At its very core lies a simple, direct and bold insight into issues that defines our purpose and integrity as a market. This is the guiding philosophy in the choice of topic(s), style of writing and of presentation.

We have taken a long term view of the market and believe that tackling tomorrow's trends rather than today's headlines is the way to go. This must be done after addressing the foundational issues that have held us back for too long.

In the very process of taking an action or invoking the principle of expediency guiding interventions, we often lose sight of reasoning and the need for a destination; for a course of action that stands the test not of just a few weeks, months or years. We ought to be concerned with the vastness of the judgment of history, and the generational impact of our decisions.

We believe that this is the objective of the current reform agenda. This paper therefore sets out our modest contribution to that process.

Thank you.

Yours Faithfully,

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1: License of NSE as an SRO

Two major issues will be addressed here – the linkage of the law and the resolution, ramifications and definition of SRO status.

First the linkage of the law:
A major ingredient missing in the arguments of the Securities & Exchange Commission in the regulation and supervision of the Nigerian Stock Exchange is the issue of 'license' of operations of the NSE.

The existing license of the NSE was obtained under the name 'Lagos Stock Exchange' at independence in September 1960 under the hand of the Central Bank of Nigeria. The name was later changed to The Nigerian Stock Exchange in December 1977 but the certificate still reflects the name: Lagos Stock Exchange.

The rule requiring all licensed operators to display their licenses in the place of business is largely ignored, and rarely ever complied with by the NSE – hence why not much attention was paid to the subject.

Yet, it now becomes more apparent that the regulation and supervision of the NSE must begin with the immediate issuance of an operating license to the NSE by SEC with rules and regulations regarding operations, activities, Board and staff attached therewith.

The Commission ought to have carried out this exercise when it came into existence in 1980 and became a legal entity as per the SEC Decree Number 29 of 1988.

It may be instructive to point out that the Nigerian Stock Exchange was a member of the 12-member Board of SEC alongside the CBN, MoF, Nigerian Enterprises Promotion Board, up until the SEC Decree of 1988) (See SEC website under: Our History - http://www.sec.gov.ng/index.php/content/cID/1/page/2)

"Consequently, the Securities and Exchange Commission Decree No. 71 of 1979 was promulgated, effective retrospectively April 1, 1978, thus establishing the Commission and vesting wider power on it to regulate and develop the Nigerian capital market, in addition to determining the prices of issues and setting the basis of allotment of securities. Unlike its two predecessors, the Commission at this stage was excised from the CBN, although it continued to receive further funding from the apex bank.

It also had an enlarged 12-member board with a CBN representative as its chairman. Other members were drawn from the Ministries of Finance, Trade and Industries, ***The Nigerian Stock Exchange*** *and the Nigerian Enterprises Promotion Board; other members were nominated on basis of personal merit.*

The Commission however took off effectively on January 1 1980 with a staff of 51, (7) of them were on secondment (for a period of three years) from the Central Bank of Nigeria (CBN) while service staff were newly recruited."

It was understood that when SEC into existence under its first Director General, the Late Mr George Akhamiokhor issued directives to all capital market operators to regularize their registrations and licensing with the Commission. Sources say the NSE was issued a similar directive. It is yet to be confirmed if the directive was complied with, resulting in the issuance of an operating license to the NSE as a securities exchange with an SRO status.

If that were to be the correct state, it is necessary for the Commission to issue the Nigerian Stock Exchange a license duly signed by the Director General of the SEC, invite the NSE Council to Abuja to receive the license and invite the media for the coverage, stating that the event was in 'the exercise of its duties as the apex capital market regulator saddled with the licensing of securities exchanges, capital trade points, market operators, etc.'

A similar licensing exercise was performed by the Central Bank of Nigeria at its inception in 1959. All deposit money banks operating in Nigeria prior to the CBN establishment were duly re-licensed by the new financial regulator (First Bank, Union, UBA, NAL Bank, Wema Bank, etc)

Imperatives of NSE licensing:

- The SEC can duly sanction the NSE with less rancour and the mis-conceptions of intent by the public and the NSE itself;
- It simplifies NSE's supervision, similar to that which exists for brokerage firms or commercial banks: simply 'suspend' or 'withdraw' the operating 'license' of the NSE based on violations, proves and fair-hearing thereof of laid out SEC rules and regulations. This approach is the most effective employed by almost all market regulators/supervisors around the world.

It knocks off the oft-perceived overbearing role of a regulator in emerging economies such as Nigeria's.

This supervisory approach has also been effectively employed by the NSE itself as a Self-Regulatory Organisation (SRO). It is therefore surprising that the SEC has been unable to use the same 'highway.'

There are other matters that are related to and arising from the facts stated above – the SEC Act and the ISA Act – whether it ought to be merged or retained as two separate and distinct legislations. This is dealt with in section G below.

There is however a school of thought that insists that 'Exchanges' need not be licensed but registered. They express the viewpoint that what we have currently reflects the state of the law and that we do not require licensing. We differ.

Second, the SRO Status of the NSE – Without Prejudice to Demutualisation Plans:

The Creation of the SEC: Consequent upon the abrogation of the Exchange Control Act 1962 and the Nigerian Enterprises Promotion Decree 1989, the SEC Decree Number 29 of 1988 and later the Investment and Securities Act (ISA) 45 of 1999 and as amended in 2007, created the SEC and codified the existing self-regulatory system for broker-dealers and investor protection in the market.

The NSE as an SRO retained primary authority to regulate its members, but the SEC was given the power to suspend or revoke an exchange's registration if the exchange failed to enforce compliance by its members with the Act (*see point above*). Unlike Nigeria, where the SEC reports to the Minister of Finance, the US SEC reports to the Congress (*this point on benchmark is discussed further under section G, E and F below*).

In the US SEC model, all rules and regulations, sanctions and indeed wide-ranging market reforms agenda are presented to the Congress for legislative oversight vetting. The US SEC therefore has to 'defend' its intents and intended actions at the congress before execution. In 1975, the US Congress amended the

1934 Exchange Act to grant the Commission more authority over the actions of SROs.

The amendments reflected Congressional endorsement of self-regulation, **but with increased government oversight**. For instance, the amendments directed the Commission to review SRO disciplinary proceedings and **required the SEC to approve SRO rules**. Finally, the amendments added **disciplinary actions that the Commission could take against SROs** and gave the Commission **authority to enforce SRO rules when an SRO was unable or unwilling to act or when Commission action was otherwise appropriate**.

With that as background, it is clear that self-regulation has a long history in law and in practice (not just in the US jurisdiction but worldwide). Nonetheless, there are many who question whether self-regulation should continue to exist. We present herewith some of the traditional arguments for and against self-regulation; and the follow-up issues related to our clime and circumstance.

The information on the arguments for and arguments against were informed by the paper presented by Lori Richards, the US SEC personnel that oversaw the activities of brokers/dealers. The paper was written in 2000 and in it she was pro-self regulation. Most significantly, the summations were made before the 2000 U.S. market crash, Enron debacle, the recent U.S market meltdown (which saw the DOW decline from mid 14,000 to 6,600 levels), the Madoff incident and the world financial crisis all of which can be attributed to excesses stemming from self regulation. Instructively, she worked under Bush, and was part of the group that advocated for the repeal of Glass Steagall Act of 1933, which was created after the 1929 market crash. We have only therefore chosen to extract salient points that appear relevant to a general understanding of the key arguments.

A. Arguments for Self-Regulation

One of the primary reasons for adopting the self-regulatory structure was that the SROs were more likely to be able to respond more quickly than a government agency could to new developments in the marketplace.

Employing self-regulation, the logic goes - provides the securities industry with professionals who are more knowledgeable about the intricacies involved in the marketplace and the technical aspects of regulation. This results in a more precise regulatory function.

Involving the industry in the regulatory process may be more effective than direct regulation.

As former SEC Chairman William O. Douglas said, ***"self-discipline is always more welcome than discipline imposed from above."*** He summarized the benefits of self-regulation in an address before the Bond Club of Hartford in 1938 as follows:

"*From the broad public viewpoint, such regulation can be far more effective [than direct regulation]…self-regulation…can be persuasive and subtle in its conditioning influence over business practices and business morality. By and large, government can operate satisfactorily only by proscription. That leaves untouched large areas of conduct and activity; some of it susceptible of government regulation but in fact too minute for satisfactory control; some of it lying beyond the periphery of the law in the realm of ethics and morality. Into these large areas self-government, and self-government alone, can effectively reach. For these reasons, self-regulation is by far the preferable course from all viewpoints.*

The ability of SROs to develop ethical standards that go beyond those which can be imposed by law is an important benefit of self-regulation in the securities industry."

John Dickinson, chairman of a committee on stock exchange regulation during the Roosevelt administration, believed that, ***"if governmental regulation attempts to do too much directly and to control and intervene directly in the first instance over the whole field which it covers, it is in danger of breaking down under its own weight and proving ineffective."***

Finally, it is argued that "employing self-regulation reduces the cost to taxpayers". Under a self-regulatory structure, the industry finances a large part of there own regulation.

B. Arguments against Self-Regulation

Despite those reasonable arguments for self-regulation, it has also been much criticized and argued that regulated entities may believe that self-regulation will be less stringent than direct government regulation.

In fact, the US SEC recognized, in a Special Study of the Securities Markets conducted in 1963 that ***"no business is eager for regulation…and it is only natural to expect less zeal for almost any aspect of the job on the part of a self regulator than may be true of an outsider whose own business is not involved."***

SROs are affiliated with marketplaces and subject to the competitive pressures of attracting and retaining listings and they are also dependent on their members for order flow. In addition, SROs compete against each other in developing new products and trading processes. Therefore, it is said that **SROs may have an incentive to concentrate their efforts primarily on the marketing side of their business as opposed to the regulatory side or that they may be lenient in imposing sanctions against members in order to avoid adverse publicity for the exchange**.

Indeed, in light of these conflicts, many industry participants have suggested that the SRO function be fully separated from its marketplace.

Other suggestions involve creating one overarching SRO for all broker-dealers and markets, or creating a hybrid model, where each market would have an SRO for its floor, but firms with public customers would be overseen by a single SRO. *This idea has been mooted in Nigeria but with serious implications due to our level of practice development and compliance with sound corporate governance principles.*

There are however benefits to these approaches – yet we must accept that these are really difficult issues and not susceptible to easy, obvious answers.

While we do not have a position on which, if any, of these alternatives would work best, we do believe that the goal of any consideration of structural change should be to ensure that self-regulation remains strong and vigilant.

C. SEC Oversight of SROs

This is where the SEC comes in. The SEC's oversight of SROs must seek to protect the self-regulatory process from these types of pitfalls.

As Chairman Levitt explained in a press conference in 1996 announcing the Commission's enforcement action against the NASDAQ stock market: ***"Our securities markets operate under a "self regulatory" system. Markets serve an important public interest, and deserve public oversight; but markets are also innovative and fast moving, and easily stifled by the heavy hand of government. So Congress arrived at a formula in which the industry polices itself, with SEC oversight. This keeps us out of most day-to-day affairs, and allows us to keep our hands off, but our eyes open. And on those rare occasions when self regulation goes off track, the SEC must act in the public interest."***

Former Commission Chairman and later Supreme Court Justice William O. Douglas dramatically described the SEC's oversight role as akin to keeping a *"**shotgun, so to speak, behind the door, loaded, well-oiled, cleaned, and ready for use but with the hope it would never have to be used**."* Douglas' proverbial shotgun in the closet has been fired when necessary.

In just the last decade, the US SEC has brought significant enforcement actions against SROs, **including cases against the NASD and NYSE - the SROs that regulate the USA's two largest markets**. SRO regulatory lapses involved widespread market maker collusion on NASDAQ and a failure by the NYSE to police for widespread illegal trading by its floor brokers.

Our recent experience in Nigeria should find succour in this precedence.

It is very clear that when there are breakdowns in self-policing, the SEC must act, in order to strengthen the self-regulatory framework. The SEC must continue to hold SROs accountable when they fail to exercise vigilant regulation of their members. The market works best when operators are well aware of the reputation risk in being criticized by the SEC – this should incentivise all market participants to the highest standards.

But, does the fact that the SEC's action when viewed against laws of natural justice raises concerns that cloud their action-imperative bode poorly for the future of self-regulation? The jury is still out on this.

D: The Custodian Custode (Who Guards the Guardian?) Question

The key question of 'Who Guards the Guardian' is central to the authority and mandate of the SEC in the discharge of its capital market apex regulator role. There could not be a better case for this than the resolution of its action mantra– "in the public interest."

Historically, the SEC (*and the NSE as explained on page 1 above*) was spurned out of the Central Bank of Nigeria (CBN) and up to a point in the mid 1980's, the NSE was on the Board of the SEC alongside the Nigerian Enterprises Promotion Board and the then Ministry of Finance, Trade and Commerce. The wisdom of the governing authority at that time and even in later years was that the SEC as a regulator of a sub-set of the financial system functions more as a trade and commerce sub-sector coordinator - hence **the decision to take SEC into the supervisory portfolio of the Federal Ministry of Finance**.

In contrast, The United States authority however, recognized and established their SEC as a "**quasi-judicial regulatory**" body. This status recognition was also accorded the Central Bank of Nigeria (CBN) and informs why it reports to the Presidency and the National Assembly and not to the Minister of Finance.

The Ministry of Finance is, in a manner of speaking, the Chief Accountant to the Government. Its functions are essentially to coordinate government finances generated from economic, trade and commercial activities within the country.

The nature and mandate of any Securities & Exchange Commission is definitely not of trade and commerce but a mini-judicial body that sets standards of practice, protect investors and operators, regulate semi-autonomous or SROs, ensure an orderly market place, and develops the capital market amongst others. We appear to have a challenge as to which jurisdiction forms our primary best-practice benchmark. While the SEC has at various times made references to the US SEC, the UK's FSA, the Malaysian SEC and the South African JSE – it would appear that we have modeled our SEC after the US model. This point was made very clearly by the Dennis Odife panel report which drew attention to the benchmark. For the purposes of this contribution, we have therefore adopted the US SEC model as a basis for all references to best practice here.

Staying within that line of thought, it would appear that a fundamental issue has been left unaddressed in the structural framework of our capital market – the reporting line and responsibility structure for our apex regulator. Should it report to the MoF or the National Assembly?

In line with the United States best practices therefore, the Nigerian Securities and Exchange Commission should be taken out of the Federal Ministry of Finance into the full oversight of the National Assembly. The National Assembly is the highest electoral body of legislators in Nigeria, the organ constitutionally vested with law-making. The SEC as a law-making and law-enforcing institution should therefore be 'guarded' by the highest law-making body, the National Assembly, and in particular, the Senate (not necessarily the Senate Committee on Capital Market – which simply acts as the eyes and ears of The Senate – and as of today with no clear mandate or core responsibility as regards law making for the capital market).

The leadership question of the SEC, especially the appointment of its Board: Chairman, DG and Commissioners are therefore a matter for the exclusive preserve of the President with the advice and consent of the Senate.

SEC Commissioners should no longer be 'employed' by the Board of the Commission but equally 'appointed' by the President and Senate. The Commissioners of the SEC can therefore carry out their functions with a measure of independence and freedom of expression.

The more contentious issue will be that of the financing of the SEC - this ought to be a matter of appropriation and not a component part of the MoF's annual budget.

The Commission would naturally therefore have to appear before the National Assembly Committee on Appropriations to defend its budgetary proposals and account for its execution at the end of the year.

This process and practice can aid the resolution of issues associated with the appointments of the Chairman and the DG of SEC. Most importantly, the criteria and mandate for this offices will have been clearly spelt out in the SEC Act – a matter we will come back to later after quickly addressing the subject of coordinated regulation in a dynamic market place.

E: Coordinated Financial Services Regulation

The Lamido Sanusi-led Central Bank of Nigeria (CBN) has in the past one year highlighted the urgent need for coordinated or 'consolidated regulation', said to be largely lacking in the post-bank consolidation years, resulting in the largely unregulated market place that led to the current crisis in the banking sector and indeed the entire financial system.

Lamido Sanusi has also revealed that the so-called Financial Services Regulatory Coordinating Committee comprising of the CBN, SEC, NAICOM, PENCOM, the NSE and the Ministry of Finance has **failed to meet for almost two years**. The FSRCC was set up during the Professor Charles Soludo era by the CBN at the onset of the bank consolidation programme. The main idea was to allow all the regulatory agencies work together for the common good of the financial system.

The MoF and the CBN had sits at the head of the table of the FSRCC meetings. It was believed and still believed that the Central Bank is the Chief financial markets regulator. This is a matter for deeper reflection on.

While the CBN is the banker of 'last resort' and the designer and implementer of monetary policies, the supervision and regulation of the broader financial system **MUST** lie with the Securities & Exchange Commission (SEC). The scope of the oversight responsibilities of the SEC is enormous and bares this out. It is worth outlining here these responsibilities in brief:

Structure of the Capital Market:

- Securities Exchanges/Capital Trade Points, etc
- Market Operators (Brokerage firms, Issuing Houses, Registrars, Solicitors, Reporting Accountants/Auditors, Investment Banks, Custodians, etc)
- Clearing and Settlement institutions (e.g. the CSCS)
- Rating agencies
- Government Institutions (DMO, BPE, Corporate Affairs Commission, FIRS, etc)
- Quoted Companies
- Fund Managers
- Collective Investment Schemes
- Pension Fund Administrators
- Trustees
- Insurance firms
- State Governments using the debt capital market

The SEC is correctly therefore, the apex financial markets regulator, comprising all the commercial banks under the supervision of the CBN, the insurance firms under NAICOM and the pension fund managers under the PENCOM.

The securities market extends far and beyond - more intriguing and intricate, its activities go to the heart of the nation's economy and beyond. It's the engine of any economy. To underscore the importance of the securities market, the Nigerian Stock Exchange was set up just a year after the CBN in 1959.

In Iraq, the Baghdad Stock Exchange, though manually operated was re-opened immediately after an Interim Government was set up by the United States. The

Afghan government of President Hamid Karzai about three years ago raised millions of dollars in the global debt capital market based on guarantees received from the occupying army – the US. The capital market has also been the backbone of other mid-Eastern economies: Pakistan, India and the UAE. In East Africa, the administration of President Paul Kagame in 2008 recognised the imperatives of a stock exchange, hence the establishment of the Rwandan Stock Exchange and the take-off listing of government bonds. In Kenya, the Nairobi Stock Exchange operated for several years at inception solely on government development bonds.

F: SEC Funding & Commission Charges on Secondary Market Activities

Discussions surrounding the funding of the Securities & Exchange Commission (SEC) and any new funding arrangement(s) should address the issue of the fee earned on transactions in the secondary market.

There exists practice ethics issue related thereto or arising from the current practice as we have it. ***Specifically,*** the commission on daily transactions (*formerly 1% and recently reduced to 0.25%*) is collected by the SEC from the NSE.

To allow for independence, integrity and an unfettered role as regards transactions in the market it regulates, it is essential to distinguish the SEC as a distinct party separate from beneficiaries, especially given the high incidence of criminal and near-criminal practices in our market. How do we mean?

Historically, the commission on transaction that the SEC collects (1%) was 'engineered' by the Nigerian Stock Exchange (NSE) in the late 1990s following the lacklustre funding status of the new agency (SEC) in 1988. This 1% commission, charged by the apex regulator, was its main lifeline for several years.

Looking beyond the cash flow however, it is important to point out that this source of funding (via the NSE) was a critical component of the leverage used to subject the SEC to the dictates of the Stock Exchange.

Equally beyond the 'apron strings' nature of the 'incestuous relationship' it connotes – that of a regulator getting a 'piece of the action'; is the serious ethical dilemma it places the SEC – in the conduct of its oversight function. Does it look the other way to improve its funding and benefit from its work in growing the market – or does it stands up to its oversight responsibilities and puts itself in a position where it does not only bark, but able to bite hard.

If for instance, and using the recent examples of price manipulation and insider trading that has taken place and for which SEC has formally charged some firms while investigating others - how does the SEC and market operators interpret the decisions of the commission or the IST, having already collected a portion of the shares transaction value under dispute?

Does the SEC still treat the sums received as revenue in its books, does it refund it in the case of willful theft or illegal sales of investor shares; or does it treat it as proceeds of ill-gotten wealth and return to enforcement agencies or reclassify in its books as investor protection fund?

There needs to be some clarity on the subject of commissions from secondary market activities. It is akin to collecting a percentage of fixed deposits from bank customers at its base interpretation. It simply leaves a bad taste in the mouth.

For the benefit of the new and independent SEC, this commission collection issue must be addressed – indeed dropped/scrapped. Only fees earned through M&A's, floatation of mutual funds, IPO's, new products, annual registrations and renewals should augment SEC's adequate funding via the National Assembly.

If the SEC must lead an ethical organisation, it must eliminate the incentives to look the other way, one which appears inherent in its current structural set-up.

G: SEC Decree 1988 vs. ISA (1999 & 2007)

There is a fundamental issue central to the arguments of the SEC as the apex regulator of the financial markets, in the exercise of its powers, which has largely been ignored or brushed over.

According to the SEC's website referred to above, "Nine years after the establishment of the Securities and Exchange Commission, the enabling law, Decree No. 7 of 1979 was re-enacted as SEC Decree No. 29 of 1988 with additional provisions to address observed lapses in the previous arrangement and to enable the Commission pursue its functions more effectively.

To further enhance the Commission's pursuit of its objects of investor protection and capital market was carried out in 1996 by a 7-man panel headed by Chief Dennis Odife. Based on the panel's recommendations, a new Act Known as "The Investment and Securities Act No. 45 of 1999" was promulgated on May 26, 1999. The Act repealed the SEC Act of 1998. The new Act is expected to promote a more efficient and virile capital market, pivotal to meeting the nation's economic and developmental aspirations in this new millennium."

It can be seen from the above that today, there is no clearly defined Law that sets up or established the Securities and Exchange Commission (SEC) ***as different from the Laws guiding Investment and Securities market in Nigeria***. Simply put: a single document (ISA of 2007) represents the authority of SEC's legal existence as well as a document to be used by the SEC itself as a market regulator.

This is not what obtains in the benchmarked US SEC jurisdiction and indeed in our local environment for which we will provide a few examples here to shed light on the way forward.

(1) The CBN Example – CBN ACT vs. BoFIA:

The mandate of the Central Bank of Nigeria (CBN) is derived from the 1958 Act of Parliament, as amended in 1991, 1993, 1997, 1998, 1999 and 2007.

The decree of 1991, now an Act of the National Assembly of the Federal Republic of Nigeria provides for the continuance of the CBN with a Board of Directors consisting of the Governor, four deputy governors and five non-executive directors. The Act charges the Bank with the overall control and administration of the monetary and financial sector policies of the Federal Government.

The statutory mandates of the CBN are as follows:

1. To issue legal tender currency

2. To maintain external reserves
3. To safeguard the international value of the legal tender currency
4. To promote monetary stability and a sound financial system in Nigeria
5. To act as banker and financial adviser to the Federal Government.

The Monetary Policy in Nigeria is best understood from the stance of the mandate set for the Bank, which include:

- Maintenance of Nigeria's external reserves to safeguard the international value of the legal currency.
- Promotion and maintenance of monetary stability and a sound and efficient financial system in Nigeria.
- Acting as banker and financial adviser to the Federal Government; and
- Acting as lender of last resort to banks.

Consequently, the Bank is charged with the responsibility of administering the Banks and Other Financial Institutions (BOFI) Act (1991) as amended, with the sole aim of ensuring high standards of banking practice and financial stability through its surveillance activities, as well as the promotion of an efficient payment system.

CASE NOTE: Please note that **there is a very clear distinction between the CBN ACT of 1958** (as amended several times) a document (ACT of Parliament) that sets up the Central Bank of Nigeria and outlines its Board composition, tenure, etc as well as core mandate as distinctively different from ANOTHER legal document (also an ACT of Parliament) **the Banks and Other Financial Institutions Act (BoFIA) of 1991** that charged the CBN with ensuring high standards of banking practice and financial stability through surveillance and efficient promotion of the payment system.

Over the years, especially since our move towards democratic governance in 1999, the Central Bank of Nigeria (CBN) has pushed for wider powers of autonomy and/independence of its authority in the pursuit of the responsibilities under BOFIA via the National Assembly.

Hence the CBN Act has been reviewed twice (1999 and 2007) while another review is being vigorously pursued under the present Lamido Sanusi's administration in line with the current realities and future outlook (to streamline its powers and operational mandate). The separation of the two legal documents has simplified the regulation and supervision of banking and other financial institutions in Nigeria namely:

- The **CBN ACT** takes care of the legal existence of the CBN in terms of the appointment of the Governor, the Deputy Governors and the Directors, its reporting authority namely the Presidency, its funding sources and the core mandates;
- The **BoFIA** takes care of the administrative procedures of supervising the banking system and provide the mechanism of how the CBN achieves its core mandates under the CBN ACT. Simply stated: the BoFIA is the Law that outlines banking practices, stipulates supervision and discipline of deposit money banks and provides the processes of an efficient banking system. The CBN also uses it to supervise and guide the relationship between the commercial banks and the depositors, creditors, etc. BoFIA is therefore the 'Rule Book' of banking in Nigeria and NOT the CBN ACT.

While the CBN ACT was designed by the initial promoters of the Central Bank just before independence, the BoFIA was a product of 'circumstance' in 1991. It was promulgated under the military administration of President Ibrahim Babangida as a tool of supervising the banking sector. Known then as BoFID it was later passed through the National Assembly in 1999 to become BoFIA. The CBN has since relied on BoFIA in the exercise of its core mandates.

(2) The US SEC Example:

According to www.wikipedia.org, "the US SEC was established by the United States Congress in 1934 as an independent, quasi-judicial regulatory agency during the Great Depression that followed the Crash of 1929. The main reason for the creation of the SEC was to regulate the stock market and prevent corporate abuses relating to the offering and sale of securities and corporate reporting. The SEC was given the power to license and regulate stock exchanges, the companies whose securities traded on them, and the brokers and dealers who conducted the trading."

"Currently, the SEC is responsible for administering seven major laws that govern the securities industry. They are: the Securities Act of 1933, the Securities Exchange Act of 1934, the Trust Indenture Act of 1939, the Investment Company Act of 1940, the Investment Advisers Act of 1940, the Sarbanes-Oxley Act of 2002 and most recently, the Credit Rating Agency Reform Act of 2006."

"The enforcement authority given by Congress allows the SEC to bring civil enforcement actions against individuals or companies alleged to have committed accounting fraud, provided false information, or engaged in insider trading or other violations of the securities law. The SEC also works with criminal law enforcement agencies to prosecute individuals and companies alike for offenses which include a criminal violation."

There is therefore an urgent need for the separation of the SEC ACT and the Investment and Securities Act ***just as was done*** with the CBN ACT and the BoFIA. Today, the SEC operates through an omnibus document.

New SEC ACT – Some suggestions:

- Should remove the oversight of SEC from the Ministry of Finance to the National Assembly for a proper and necessary realignment with best practice and the democratic dictates we all subscribe to;
- The funding of SEC should come directly from the National Assembly as a direct charge;
- Reform agenda plans spear-headed by the SEC will NOT become operable unless it was approved by the Senate (not the Senate Committee on Capital Market) (e.g. the Dotun Sulaiman Report of 2008, etc);
- The positions of SEC Chairman (non-executive), Director General and the Commissioners should be nominated by the President of the Federal Republic of Nigeria on the advice and consent of the Senate;
- The President should have no powers to fire the SEC Commissioners and the circumstances of such removal should be clearly stated in the SEC ACT which would guide the national assembly;
- Political affiliations should be expunged from the criteria for the Commissioners of the SEC, and included in the SEC Act;
- Corporate governance issues for SEC: conflict of interest, declaration of interests in quoted and unquoted companies, code of corporate governance should be a matter for the SEC Act.

The Amended INVESTMENT AND SECURITIES ACT – A Suggestion:

- An amendment of the existing one (2007 edition) to outline specific market issues, tailored towards the BoFIA; and
- Provisions to address the fall-outs from the recent problems faced in exercising its powers are addressed.

H: NSE on SEC Board? Who Dunnit?

Reflecting on this past decision, what informed the decision to allow a representative of the Nigerian Stock Exchange sit on the Board of the SEC?

The history of both SEC and the NSE has been more of an 'incestuous relationship' to the detriment of the capital market. The NSE through its very powerful founders and the Council and top Management have exercised market domination, given the peculiar historical emergence, maybe rightly so. But human history has shown that 'absolute power corrupts absolutely.'

Now that the SEC rightfully seeks to assert its rightful role as the apex responsibility institution for the capital market; it must, however, be seen to address this in a very careful and less damaging manner as it concerns the eventual market perception. A brutal show of force as witnessed on August 05, 2010 would appear ill-informed – especially the use of security agencies to 'seize control' of the exchange. This appears more of an admittance of the failure of regulation and discipline in the market.

Let the truth be told, the NSE had become an overbearing institution and a law unto itself for almost 50 years - yet this was made possible because of the active and inactive connivance (or aiding and abetting) of the rank and file within the past and present SEC?

Putting a stop to such an insidious and incestuous relationship therefore, must go beyond the personalities of the current actors that dominate the headlines.

I. Our Position

Frankly speaking, and based on our experience in the last three years, it would appear that self regulation did not work because of human greed left to flourish because of an absence of a regulator alive to its responsibilities.

It would appear that, if you allow market participants to regulate themselves, you will have issues like what happened in the U.S. in 2007/2008 that brought down Lehman Brothers & several banks, almost brought down Citibank, Bank of America, AIG, and Goldman Sachs, if it weren't for the US government financial interventions. Ditto our situation in Nigeria with the R8 and other financial services institutions.

The problem with self regulation is that investors and governments in the final analysis end up bailing these institutions out with public funds. Taking a look at what happened here in Nigeria - N600 billion and counting had to be expended to plug the gap created by organisations that simply outsmarted the regulatory regime in place then.

Basically, market participants in Nigeria were allowed to self-regulate. Self regulation allowed them to basically play Russian roulette with investors' funds because of no government or institutional (i.e., SEC nor NSE) oversight. **That laxity was very costly to Nigerian investors.** It must never happen again.

In the end, the government and tax payers picked up the tab. Most of the market participants who were in on the deals and knew what was happening took their funds and ran, while average Nigerians lost billions.

Today the average Nigerian or American investor has 'temporarily' lost confidence in the stock market because they now believe that the odds are stacked against them especially in a market were institutional investors are allowed to manipulate stock prices because of a lack of stringent oversight.

Human greed needs oversight - and that is why the U.S. government recently passed the Wall Street reform, which although is intended to prevent these market participants (especially banks) from taking unnecessary risks with depositors funds, is seen by most people as not being very stringent enough.

According to the Wall Street journal today, *"In looking at Lehman's demise last week, the **Financial Crisis Inquiry Commission** produced testimony and documents that suggest the firm's short-term funding was a serious problem well before its Sept. 15 2008 crash. The new Lehman material is a brutal reminder of the flightiness of short-term debt. **And it begs the question: Why didn't Dodd-Frank do more to limit banks' use of things like repo markets, in which banks take out short-term collateralized loans**?*

*It was in the repo market that Lehman experienced stress from early 2008. J.P. Morgan Chase, which plays a central role in the "triparty" repo market, decided to introduce a reform in early 2008 aimed at making the market safer. The firm decided that borrowers would have to start providing collateral that slightly exceeded the intraday amounts it had advanced them. This extra collateral is called margin. When discussing the change, a Lehman executive called it "a problem," in a February 2008 email contained in FCIC documents.**While the repo market is smaller and stronger today**, and Lehman had unique weaknesses, the details emerging from the crisis show the risks created by heavy reliance on short-term debt to juice returns. To help save other banks, the government had to introduce a debt guarantee program at the end of 2008.*

***Yet Dodd-Frank is weak on this issue**. It says regulators can demand limitations on a financial firm's short-term debt but doesn't specify ceilings. **Instead of setting up ways to impose haircuts on a bank's secured creditors if necessary in a wind-down, which would inject more market discipline, the legislation merely sets up a study on this subject**. What is more, it establishes procedures for the government to widely guarantee bank debt again. If the financial crisis were written up as a Victorian novel, overuse of short-term debt would be the problem no one wants to properly discuss. But the ugly details of the Lehman debacle are making it harder and harder to avoid."*

Can we ever get to such a level where we have laws that are stringent enough?

We do not believe so and that is why we need to appreciate and recognise the **"limits of regulation, the blurred lines of over-regulation and the need to employ common sense"** in the way we go about our much needed capital market reform.

2: Enforcement by 'Rules & Regulations' NOT Laws

Experienced regulators around the world, especially in developed markets have developed a robust regime of rules and regulations as a more efficient and effective weapon of oversight rather than relying on the dictates of the Law guiding the markets.

For one, Laws are a potent tool, subject to 360 degrees of interpretations by both the Bar and the Bench. Laws are easily subjected to suspension through injunctions, etc. Hence, **regulators develop rules, regulations and conventions to achieve oversight functions** in a highly dynamic and fast-paced environment such as the financial markets.

A very good example of institutions that have employed the use of rules and conventions to achieve efficient 'policing' is the United Nations Organisation (the **UN**). Set up initially in 1938 as the League of Nations and later re-branded as the UNO at the end of the Second World War in 1945, the UN has employed the use of RESOLUTIONS of either the Security Council or the General Assembly to deal with North/South Korea, Iraq/Kuwait, Libya/UK/USA, Russia/Afghanistan, etc. *The Charter of the UN is hardly in reference at any point in the exercise of its mandate as the world's number one policeman.*

The SEC should therefore develop a set of rules and regulations guiding the operations of securities exchanges. Below are suggested rules of engagements:

- Minimum capital base (in Naira) for obtaining an operating license of a stock exchange, capital trade points, etc
- Minimum legal registrations with both SEC and the CAC
- Minimum requirements (educational/professional, etc) for the principal promoters (executives and non-executives) of a stock exchange
- The right of SEC to screen executives of stock exchanges before employment
- Minimum requirements for the Board of Directors of a stock exchange
- Rules relating to erosion of minimum regulatory capital (e.g. 20% of total assets, etc)
- Rules relating to suspension or withdrawal of a stock exchange operating license (maybe as applicable to stockbrokers under NSE Rules)
- Rules on fair hearing of a stock exchange by the SEC before sanctions
- Rules on sanctions of executive and non-executive officers of a stock exchange (e.g. the case of Erastus Akingbola order of removal to NSE by SEC in 2009)
- Rules relating to corporate governance for Directors and Officers of NSE (e.g. conflict of interest – Transcorp/NDI, dual directorship, NO directorship on board of quoted companies for minimum of 2/3 years after leaving NSE, No directorship on board of any quoted company minimum of 3 years before appointment to NSE Board of directors or as a top management officer (CEO or EDs), etc

Despite the above and in line with international best practices, **the SEC will have to tow a more fluid approach to setting of Rules and Regulations for stock exchanges in the following areas under a demutualised environment, avoiding under interference:**

- Licensing fees charged stockbrokers;
- Annual floor—based charges (per trading booth or seat);
- How dividends are declared, etc.;
- Fees payable to executive and non-executive directors;
- Staff salaries and emoluments; and
- Staff and directors bonuses, allowances, etc.

3: Deregulate Securities Exchanges, NOW!

The most potent of weapon that the SEC can employ in breaking the monopoly and over-bearing status of the NSE (*in the absence of the non-resolution of the structural provisions in point 1(2) above*) is to actively encourage and ADVERTISE in the media, applications for any group of investors or individual organizations to set up securities exchanges trading in (stocks/shares, financial instruments only, commodities, etc).

The SEC should encourage institutions such as Zenith, UBA, First Bank, Access, BGL and GTB to own trading floors for trading stocks/shares, money market, fixed income, etc such as Merrill Lynch, Goldman Sachs, Barclays, etc. The above-listed institutions are financial supermarkets with subsidiaries in custodian, capital markets operations.

The regulation/supervision of the securities exchanges thus becomes easier. The SEC would call for meetings of securities exchanges at will, just like the Central Bank does to all deposit money banks, issue guidelines and instructions and everybody will have to fall in line. If any SRO fails to show up or misbehave, SEC can whip such a body into line.

The above can however only be done where regulators have a well structured and technologically relevant system to ensure that it remains in control of all that transpires in the market.

Thank you.

Lagos, September 6, 2010

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