SECURITIES AND EXCHANGE COMMISSION

FROM CRISIS TO A WORLD CLASS MARKET

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1.0 **Introduction:**

1.1 The Nigerian economy is approximately $220bn in size. It is the 2nd largest in Sub Saharan Africa and growing at an average of 4-5% p.a in the last five years. The Economy is overly dependent on oil and to a limited extent on gas. It is the world's 7th largest exporter of oil, the 10th largest oil reserves and produces 6% of the world's cocoa. The Nigerian economy accounts for 41% of West African GDP and 47% of its population. Its financial markets however lag it's economic and resource potential, and therefore need to continue to evolve to position Nigeria to better meet the needs of the average Nigerian and play its role in Africa.

The objective of Nigeria's economic reform agenda must be to achieve a sustainable and accelerated rate of real GDP growth, meet the millennium development goals in this decade, diversify the economy away from excessive dependence on oil & gas, make the country domestically and internationally competitive as a destination for investment flows and lastly, insulate the economy from exogenous shocks.

While, the Nigerian economy has been able to achieve its growth objectives over the last 5 years, peer group oil producers and mineral dependent economies have outperformed Nigeria. Resource potential remains huge but our country faces daunting constraints and challenges. Our Nation clearly has the potential to do much more when compared to its peer nations such as South Africa. While South Africa's GDP of $287.22billion is slightly higher than that of Nigeria, its capital market represented by market capitalization is sixteen times higher than that of Nigeria.

	South Africa	Nigeria
Market cap (US$bn)	794.0	44.3
Fixed Income (US$bn)	169.0	8.3
GDP (US$bn)	276.77	207.12
GDP per capita (units)	5,684.68	1,401.24
Mkt Cap. /GDP	2.87	0.21
Mkt. Cap(bn) per capita	16541.67	295.33
GDP Growth (%)	-1.8	5.6
Reserves ($bn)	38.2	41.0
Current Account Balance (% of GDP)	-4.0%	7.4%
Investment (% of GDP)	20.0%	5.0%
Inflation (%)	6.7%	11.8%
Population (millions)	48.60	147.81

This illustrates the potential that Nigeria has to better leverage its capital market to fuel entrepreneurship, support the real sector and create jobs which bring about the desired multiplier effect for sustainable economic growth. This is why it is extremely important that we create a capital market that is strong, fair, efficient and robust. We must do this continually by raising the standards of our regulatory environment, revitalizing our enforcement programmes, introducing new products, enhancing our processes, widening the investor-base and invigorating investor education. Making significant progress on all these fronts is necessary to build a world class market.

A world class capital market is one where there is investor confidence, adequate product offerings and efficient processes, market integrity, sound regulatory framework, strong and transparent disclosure and accountability regime, good corporate governance, and a fair and efficient market place. This is what will transform our capital markets from crisis to opportunity.

2.0 <u>**The Global Financial Crisis**</u>

The year 2008 was undoubtedly the financial market's *annus horribilis* with such turbulence as had not been witnessed since the stock market crisis of 1929. The causes of the crisis have been very well documented and largely narrowed to the boom in the United States credit market and subsequent housing bubble.

2.1 The cracks in the sub-prime market which came to the fore in 2007 became deeper, taking significant toll on financial institutions and markets, and driving the global economy into a recession. Investors' confidence dipped to its lowest as financial institutions lost confidence in one another and stopped lending to themselves after the collapse of Lehman Brothers in September 2008. As a consequence, the credit market practically froze and business sentiment fell to its lowest in decades. Indeed the collapse of the 158 years old investment bank sent shock and panic across the globe and exposed the seriousness of the crisis and fragility of the international financial market.

2.2 The crisis and its contagion effect raised serious concerns as government after government, unveiled bail out plans for institutions in distress, to stabilize financial markets and prevent economies from sliding into recession. Fears were heightened by the fact that entities which were mostly affected were some of the most respected and important financial institutions. Many of these institutions were highly exposed to other institutions with unimaginable systemic consequences should they fail. The activities of many of them were also global. Thus the risk of failure was not only to national economies but the global economy. Institutions like Fannie Mae and Freddie Mac, AIG, Bear Sterne, Merrill Lynch, Citigroup, HBOS, Dexia, Wachovia, Bradford & Bringley, Fortis and Hypo Real Estate, all announced serious financial difficulties.

2.3 The crisis was so severe that by year end 2008, only two of the five largest US securities firms, Morgan Stanley and Goldman Sachs, were still standing though considerably "bruised". The two firms had sought commercial banking licences, bringing into question the future of investment banking business model.

2.4 Debates were fierce on the failure of financial regulation, and regulatory models. I believe at the end of the day, there was no consensus as to the best financial market regulatory model – single regulatory model exemplified by the UK or the multiple regulatory model represented by the USA. There was however, consensus on the failure of regulation and the global nature of the crisis. Realizing that a concerted global response was critical, the G-20 swiftly provided leadership, holding series of consultations to address the problem. One of the fall out of the global effort was the transformation of the financial stability forum which was borne out of the Asian financial crisis to the Financial Stability Board (FSB) as a strong plank to deal with the problem in collaboration with International Financial Institutions (IFIs) such as the International Monetary Fund (IMF).

2.5 It was inevitable that national governments would examine their regulatory architecture to learn lessons and build pillars to strengthen financial markets. The US Financial Reform Bill and the UK Turner Report are examples of initiatives to strengthen national financial markets. While there were obvious scapegoat and blame games, with financial sector regulators at the receiving end, there were questions about the role of hedge funds, rating agencies, and structured finance products such as CDOs with heightened call for their regulation.

2.6 Expectedly, stock markets took a beating losing considerable value and plunging investors' confidence further. Emerging markets which initially appeared to be insulated found themselves well enmeshed in the crisis. As at end of 2008, most emerging markets were literarily bleeding with unprecedented losses. According to The Economist, China had declined by 64.8% by year end 2008 while Russia lost 66.6%, Greece 66.2%, India 53.0% and Argentina 50.0% (See table I). Nigeria was down by 45.77% in 2008, and in what was clearly the most traumatic period in the history of the capital market. The global stock markets as shown have since rebounded from the position in 2008 as shown in table 1 below.

Table I

Stock Market Performance of Selected Countries

S/N	Country	2008	31/12/2008 to 9/12/2009	31/12/2009 to 21/4/2010
1.	Australia (All Ord)	-44.6%	26.7	2.0
2.	United States (DJIA)	-36%	17.8	6.7
3.	Japan (Nikkei)	-42.9%	12.9	5.2
4.	China (SSEA)	-64.8%	77.7	-7.5
5.	Britain (FTSE 100)	-33.1%	17.4	5.7
6.	Canada (S+PTSX)	-37.6%	26.6	3.3
7.	Austria (ATX)	-61.2%	39.7	10.0
8.	Belgium	-54.4%	29.4	5.9
9.	France (CAC 40)	-44.2%	16.8	1.1
10.	Germany (DAX)	-41.7%	17.4	4.6
11.	Spain (Madrid SE)	-41.6%	23.3	-7.7
12.	Czech Republic (PX)	-52.2%	28.9	15.3
13.	Poland (WIG)	-51.3%	44.2	8.1
14.	Turkey (ISE)	-52.4%	83.1	10.6
15.	Hong Kong (Hang Seng)	-48.5%	51.1	-1.7

16.	Indonesia (JSX)	-51.2%	83.1	14.9
17.	Malaysia (KLSE)	-40.0%	43.2	4.8
18.	Singapore (STI)	-48.6%	58.8	2.4
19.	South Korea (KOSPI)	-41.1%	45.3	3.9
20.	Taiwan (TWI)	-48.1%	69.8	-2.4
21.	Thailand (SET)	-47.9%	54.4	3.2
22.	Brazil (BUSP)	-42.0%	81.1	1.1
23.	Chile (IGPA)	-19.7%	37.9	7.6
24.	Mexico	-24.2	41.5	4.3
25.	South Africa (JSE)	-26.7%	24.3	4.6
26.	Israel (TA-100)	-52.6%	81.9	6.6
27.	Saudi Arabia	-57.4%	24.0	9.9
28	Russia	-66.6%	112.6	7.1
29.	Greece	-66.2	17.9	-11.8
30.	India (BSE)	-53.0%	77.5	-
31.	Argentina	-50.0%	100.3	4.4
32.	Emerging Market (MSCI)	-55.2%	69.8	3.8
33.	World, all (MSCI)	-44.7%	29.1	4.4

Source: *The Economist – January 3, 2009; The Economist – December 12, 2009; The Economist – April 24, 2010*

2.0 Recent Crisis In The Nigerian Capital Market

The Nigerian capital market made a reversal in trend in March 2008, after a strong bull run which witnessed unprecedented growth in the capital market and investor participation.

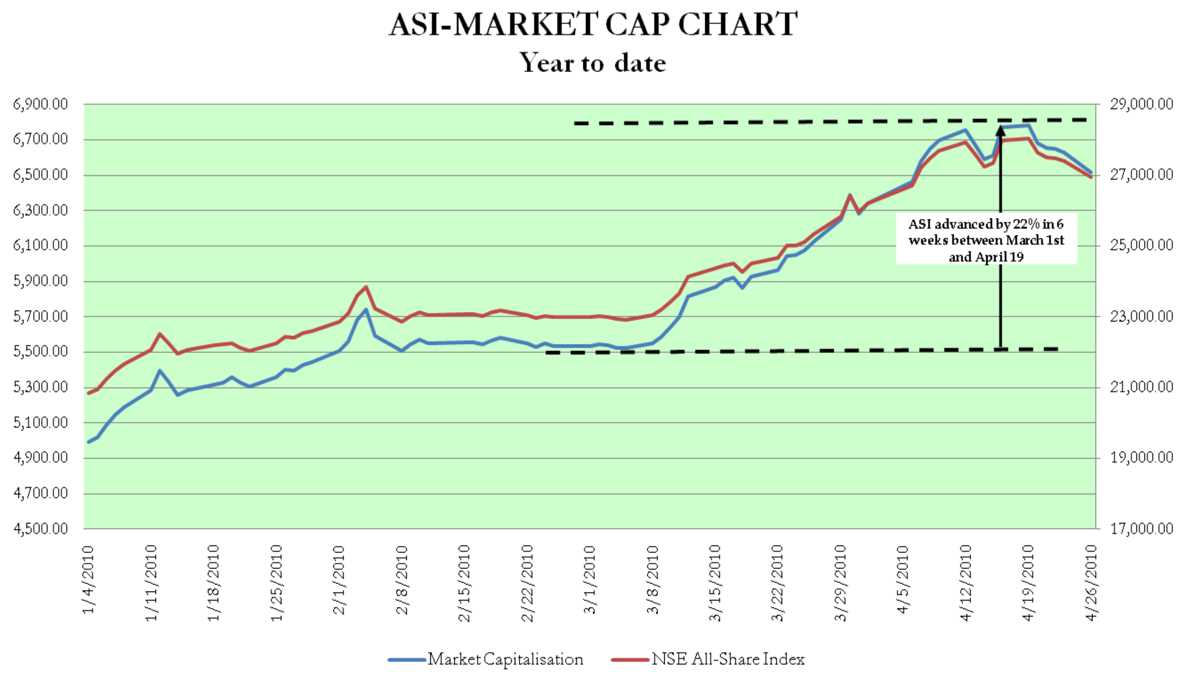
	2008	2009	% change
NSE All-Share Index	31,450.78	20,827.17	(33.8)
Total Turnover Volume (shares)	193.14	102.85	(46.75)
Total Turnover Value (N'trn)	2.4	0.69	(71.43)
Average Daily Volume (units)	775.65	414.73	(46.53)
Average Daily Turnover (N'bn)	9.55	2.76	(71.1)
New Issues Approved (N'trn)	2.6	0.28	(89.3)
Number of Listed Companies	213	216	1.41
Number of Listed Securities	299	266	

New issues reached a record ₦1.3 trillion in 2007 as against ₦278.6 billion a year earlier and ₦405.8 billion in 2005. Issuers took advantage of the strong investor appetite for equities, which were popularized mainly by the banking consolidation exercise. Besides banks, an impressive number of real sector entities rode on this sentiment to raise funds.

Equity market capitalization also witnessed phenomenal growth, from ₦2.5 trillion in 2005 to ₦10.3 trillion at year end 2007. At the height of the bull run in early March

2008, equity market capitalization hit ₦12.64 trillion while the Nigerian Stock Exchange All Share Index (ASI) which rose by 37.8% in 2006 and 1.01% in 2005 gained a record 74.73% in 2007. Between 31st December 2007 and the peak of the bull run in early March 2008, the market gained 14.45%.

2.1 By year end 2008, the NSE All Share Index which gained 74.73% the previous year, had declined by 45.8% while equity market capitalization shed 32.4% from ₦10.3 trillion at year- end 2008 to ₦6.96 trillion at the close of 2008. To an investor community which was unaccustomed to big and prolonged market slides, panic and fear drove confidence to its lowest despite assurances and stabilization measures by financial market regulators.



2.2 There was no doubt that investors sentiments were boosted by rising equity prices, which in many cases could not be supported by fundamentals. Sentiments were also bolstered by corporate earnings and dividends particularly by banks, some of which we now know did not reflect the true state of the entities. Competition by banks in the quest to be perceived as the industry leader led to various unhealthy practices. Additionally, credit was freely available to anyone who cared to borrow to buy shares. With the euphoria of a rising market, more investors, in particular, retail investors with little understanding of the risk of the market, were attracted into purchasing both registered and unregistered securities and got locked in as the bear market emerged.

The market has gained about 30% this year from a loss of similar percentage in the preceding period last year. The improvement has been driven by a number of factors including the anticipation of the establishment of the Asset Management Corporation, various regulatory actions and reforms which are improving financial disclosure, transparency and governance of financial institutions and listed companies and drop in rates which are encouraging portfolio shift. The SEC welcomes these developments which have provided some succor to an obviously traumatized investor community and restates its commitment to work relentlessly towards restoring investors' confidence and the full recovery of the Nigerian capital market.

Building a World Class Capital Market

3.0 Restoring Investor Confidence

The greatest asset of any capital market and indeed financial market is its investors. It is investors, whether retail or institutional who provide the savings which are needed for productive investment. Therefore if investors lose confidence in the capital market, the ability of the market to mobilize and channel long term funds which are very vital for economic development ,will be marred. In point of fact, a market would lose its essence without the confidence of investors. To build a world class market therefore, the SEC would focus considerably on investor protection and the restoration and sustenance of investors' confidence in the market. No doubt, investors will feel protected and confident to participate when a market is perceived as fair, efficient and transparent with a strong enforcement regime. The SEC is committed to building a market which displays such internationally recognized characteristics.

4.0 Deepening and Broadening Capital Markets

Our objective is to build an efficient and low cost market which will be the preference for capital sourcing by corporates and governments. We have started improving our processes and introducing international best practices in the offering of securities. Today, offerings are largely through book building and bonds are largely through shelf registration while the requirements for bonds have been simplified in line with international best practice. The Commission believes that a virile bond market holds one of the keys to the development of the nation's infrastructure and therefore will commit resources to developing the sector. As part of this effort, the Commission through the World Bank ESMID programme now has a Bond Resident Adviser. With the concerted efforts by stakeholders and the recent tax waivers on bonds, I see an active corporate and sub national bond market which may ultimately become larger than the equity market as in many market. An active bond market would not only encourage the floatation of infrastructure bonds, it would encourage the flotation of more bond funds which should increase asset classes in the market. Besides, an active bond market would also provide corporates with alternative funding instrument to equities

<u>Building a Sound Regulatory Environment</u>

5.0 **<u>Restoring Market Integrity</u>**

It is often said that in crises are opportunities. This, to me, is true of the Nigerian capital market as the recent crisis provides the perfect opportunity to assess and strengthen our regulatory environment. A sound regulatory environment requires a strong enforcement framework which should aim at deterring securities law violations. We shall build capacity in people and technology to enable us deal with infractions much more efficiently. We shall also place strong responsibilities on Self Regulatory Organizations (SROs) in monitoring brokers-dealers and enforcing their rules. In this regard, the capacity of the SROs and trade groups shall be enhanced to complement the monitoring and enforcement activities of the SEC. Indeed, the SEC is engaging the Nigerian Stock Exchange to be more responsive to broker dealer monitoring. A Committee of both institutions is working out the modalities for this.

This brings me to the issue of capital for intermediaries. The key objective of the Commission in this matter is to build strong and sound institutions. You will agree that we cannot afford to have weak institutions if we desire to be a world class market. Capital is very important for business, whether start-up or continued operations. Regulatory capital requirements would be based on the activities and risk exposures of intermediaries. This however, does not mean that there would be no minimum capital for each line of business in the capital market.

5.1 While penalties for violating securities law should be commensurate with the offences, they must be stiff enough to discourage violations. When sanctions are a 'slap on the wrist', they become incentive to violate. Our enforcement regime would also be that which attracts the confidence of participants in its process and outcome.

5.2 You will agree with me that the work of the criminal law enforcement agencies is extremely important in the investigation and prosecution of criminal cases. Successful prosecution of such cases will undoubtedly, serve as deterrence and reduce criminal practices in the market. The Commission is therefore strengthening relationship with these institutions. We believe that closer collaboration will improve understanding and capacity of law enforcement agencies to expeditiously handle capital market matters and strengthen the Commission's zero tolerance policy on infractions.

5.3 An important component of the zero tolerant policy is the naming and shaming of market violators. This is perhaps one of the most effective means of ensuring market discipline as it rubs on the reputation of the violator which can be very costly indeed. We are determined to name and shame and employ any sanction we consider appropriate, to render securities law violations unattractive and unprofitable. Clearly, when violations are seen as unattractive and unprofitable, there would be less violations and increased investor and issuer confidence in the integrity of the market. I believe that there is no market without infractions but it should be an exception and not the norm while effective mechanism should be in place to deal with it decisively. These, we are firmly committed to.

5.4 Investigation will remain a core component of the enforcement regime. However, it is being overhauled for greater efficiency, effectiveness and result. We believe that effective training of our investigation staff, employment of specialists and appropriate tools would be vital in the envisaged improvement in investigation and complaint management.

5.5 The SROs must be alive to their responsibilities in dealing with complaints affecting broker dealers. In other jurisdiction, such complaints are primarily handled by them which free the statutory regulator to deal with other important market issues. As part of the market reform, the SEC will develop a framework for SROs to deal with such complaints under its oversight with sanctions for failure to effectively discharge these responsibilities.

6.0 **Leveraging on Technology**

It is absolutely impossible to effectively monitor an increasingly sophisticated and dynamic market without the application of technology. The Commission therefore intends to leverage on technology to police activities in the market. Such application of technology would improve the capacity of the Commission to detect insider dealings, market manipulation and other forms of abuses which were said to have been prevalent during the Bull Run. We also hope to leverage on technology to improve the examination of market intermediaries and SROs. We are making progress in the introduction of electronic filing of offer documents and periodic returns. This is one of the priorities of the Commission given its potential benefits to the efficiency of the capital market. As an interim measure to full electronic filing which is being assiduously pursued, dedicated e-mail addresses have been created to enable on-line filing, processing and posting of deficiencies and feed backs.

6.1 The market needs to migrate from a certificate based system to full dematerialization in order to improve market efficiency and eliminate the problems associated with the current system. The process for achieving is currently on.

7.0 **<u>Strengthening disclosure and transparency</u>**

The integrity of any market can be partly measured by the level of information disclosure, transparency and quality of governance of institutions. The mere provision of information to the public is not the key issue. What is absolutely important is the integrity, completeness and timeliness of information. The Commission is making reasonable strides in ensuring that public companies release periodic information on a timely basis. Our goal however is to achieve full compliance by sanctioning non-compliance, which going forward, may include trading suspension.

7.1 To become a world class market, we need to adopt International Financial Reporting Standards (IFRS) which have become the best practice in financial reporting. I am pleased to state that there is now a consensus among stakeholders to adopt IFRS. As a consequence, a road map committee of which the SEC and NASB are major participants was constituted and is working extensively to facilitate migration. As Nigerian entities continue to seek listings and raise capital in the international markets, a shift to IFRS is inevitable and would raise the profile of the Nigerian capital market.

Promoting Good Corporate Governance

7.2 Strong and sound institutions cannot be built without good corporate governance practices. Recent experiences in the country buttresses this point. Promoting good corporate governance practices in public companies and intermediary firms would therefore be a priority of the Commission. Nigeria cannot afford to be weak on corporate governance as this would not only affect the quality and integrity of our institutions and market, but international perception and capital flows into the country. Therefore, one of the strategies in building a world class market is to promote good corporate governance practices in public companies and intermediary firms. The SEC will continue to issue corporate governance codes, monitor compliance very closely, take necessary regulatory actions on poor governance practices and educate directors and corporate managers on the consequences of poor governance of their companies. The SEC may also encourage the development of corporate governance index as exist in Malaysia and Brazil to promote good governance.

8.0 Governance and Infrastructure of Securities Exchanges

You will again agree that securities exchanges are extremely important to the development of capital markets. They are private institutions whose functions are important to capital formation, wealth creation and economic development. It is therefore not surprising that governments and the public usually develop considerable interest in their activities and stability. While they are well recognized as wealth creating institutions, poor governance of exchanges can undermine integrity and destroy wealth. A poorly governed exchange is a good "candidate" for abusive practices. Obviously, to build a world class market, the governance of the exchanges in the country has to be over-hauled and trading infrastructure upgraded to meet the challenges of an increasingly dynamic, sophisticated and growing market. The current platforms are incapable of meeting these challenges as recent happenings have shown. Consultation with the Nigerian Stock Exchange indicates that efforts are being made to acquire a more efficient trading platform. The SEC is interested in this, given its importance to market integrity and development and will make relevant input and monitor developments.

8.1 The governance of the Exchange should be such that prevents the occurrence of conflict of interest, enshrines accountability, transparency and professionalism and commands public trust. An exchange must be seen to enforce its own rules and where it fails to do so, be sanctioned by the statutory regulator. This is the best practice which the SEC has committed to enforce.

9.0 **<u>Demutualization of the Exchange</u>**

Globalization and advances in information technology have since the 1990s, significantly increased completion among stock exchanges. This competition has pressured many to adopt business models which have markedly improved the efficiency of the trading and settlement infrastructure and reduced transaction costs. Competition has also increased transparency and ushered remote trading and virtual exchanges symbolized by such heavily technology based facilities as the Electronic Communications Networks (ECNs) and the Alternative Trading Systems (ATSs). To improve efficiency and attractiveness in the face of strong global competition, exchanges have also had to build alliances and/or consolidate within and across borders as well as demutualize. In point of fact, many exchanges became candidates of mergers/ acquisitions post demutualization.

9.1 Demutualization has provided exchanges access to capital which as mutual organizations, they were incapable of raising. Such access has enabled them meet their needs and stay competitive. Mutual exchanges principally depend on contributions from members and listing fees from quoted entities to fund their requirements. Certainly, there is an extent to which levies can be imposed on members or fees can be increased on listings. Demutualization therefore, opens access of exchanges to more capital to meet the challenges of contemporary markets without necessarily placing additional financial burden on participants.

9.2 Demutualization has also been driven by the desire to strengthen governance as shareholders' activism can be an effective means of improving transparency, accountability and management performance. Mutual organizations operate like clubs and tend to be more inclined to addressing members' interest than the interest of other stakeholders. The mix of shareholders and members which demutualization often brings neutralizes the dominance of the latter. Besides, with improved management structure and financial muscle, demutualized exchanges appear to be better positioned to innovate, embrace market changes and meet customers' demands.

9.3 The demutualization of the Nigerian Stock Exchange as well as the Abuja Securities and Commodities Exchange would be an important step in the overall reform and transformation of the Nigerian market into a world class market. However, as we have stated earlier, the SEC has a major role to play in this transition.

10.0 **Alternative Trading Market**

The Commission has received applications for the introduction of Over-the-Counter-Markets in the country which should play an important role in attracting new companies to the capital market and provide alternative platform for trading in bonds. The Nigerian Stock Exchange has also filed for approval for an Alternative Investment Market (AIMs). The SEC supports both initiatives which could potentially deepen the capital market.

11.0 **Investor Education:**

Given that our primary mandate is to protect investors, we are broadening our investor education and public enlightenment programmes. This is particularly important as we must strengthen investors' understanding of their rights and the risks associated with investing in the market. Consequently we are committing resources to scale up the education of investors not only on the benefits and risks of owning shares in companies but also on their rights and the protection afforded them by our regulatory framework. To do this, the SEC will further leverage our Zonal offices and use the print and electronic media to enlighten the public. We will also target unreached segments of the market. A better understanding of the capital market by people can potentially lead to an increase in awareness on the issues and the elimination of sharp practices and ultimately increase the investor-base.

12.0 Conclusion

In conclusion, if we are successful in restoring investor confidence and market integrity, enhancing our disclosure regime and corporate governance, and increasing our product offerings, notably establishing a world class bond market, and a fair and efficient market place my vision of our capital markets is one that

- Becomes a catalyst for growth and a fulcrum for the financial hub of West Africa
- Enables Nigeria achieve an investment grade rating
- A consistent increase in capital flows
- A sharp increase in national savings and capital formation

While in the short term the challenges are daunting, I have no doubt that we will have established a world class capital market that will fuel sustainable economic and social progress, if we are successful.

In their August 2007 edition, The Economist had this to say; "Nigeria – There must be few other countries on earth with such a glaring mismatch between their actual state and their extraordinary potential". I hope that their views will change as we build a capital market that will become a benchmark market for Africa and the world.

Let me end by expressing my profound gratitude to the Nigerian Economic Summit Group (NESG) for giving us the opportunity to present our strategy for building a world class capital market.

Thank you.