

Objectives

At the end of this chapter, students should be able to:

- Explain the regulation of capital market;
- State reasons for regulation of capital market;
- Mention the types of regulation in the capital market;
- Describe the features of each type of regulation;
- Describe the required attributes of capital market operators.

2.1 Introduction

The capital market is a market where shares and stocks are bought and sold. In this type of market, the services of brokers and jobbers are needed and utilised. There is a guide to the activities of these agents to maintain sanity and orderliness.

Meaning of Regulation of Capital Market

The regulation of capital market is the control of cooperate bodies and individuals, brokers and jobbers activities, and taking care of them; if this is not done, the capital market will collapse.

2.2 Reasons for Regulation of the Capital Market

1. To control the activities of the jobbers and broker.
2. To provide facilities for buyers and sellers of new and old securities like shares, stock and debentures by acting as
as a meeting point to avoid untrustworthy activities.
3. To facilitate the channeling of long-term funds to commerce and industry.
4. To provide investment outlets to individuals and cooperate bodies with surplus investment funds.
5. To provide solid conditions for continued foreign capital investment which will appear very reliable and trustworthy.
6. To facilitate the maintenance of fair prices for securities traded in the capital market.
7. To help government to implement indigenisation programmes.
8. For preparation of requirements for new listing as well as regulating secondarily trading activities by dealers.

2.3 Types of Regulations in the Capital Market

There are regulations in the following areas:

1. Registration of security clearing and settlement agency.
2. Registration of capital market operations.
3. Registration of issuing house.
4. Amends fee for registration.
5. Registration of brokers/dealers.
6. Registration of sub-brokers.
7. Registration of registrars and share transfer agents.
8. Registration of fund/portfolio managers.
9. Underwriting of public issues.

2.4 Description of each of the Features Types of Regulation

This regulation was established by the FG. The ISA registers corporate bodies trading on the capital market as well as regulates and centralises the activities of the capital market. In 1999, the ISA established law ISA No. 45 to amend some of the rule guiding in the operation of the capital market.

Some of these amendments are explained below:

1. **Rule 25:** It changed the registration fee for corporate bodies from 5 million naira to 1 billion naira.
2. **Rule 28:** It abolished the function of middle men, jobbers.
3. **Rule 29:** It changed the registration fee of issuing houses from 150 million naira to 2 billion naira.
4. **Rule 31:** It amended from N70m to N1b.
5. **Rule 32:** The registration fee of stock brokers was changed from N5m to N50m. The registration of an individual as a stock broker was abolished.
6. **Rule 34:** In the registration of registrar and share transfer agent, the registration fee was increased from N50m to N500m.
7. **Rule 37:** Registration of fund/portfolio manager was increased from N20m to N500m.
8. **Rule 75:** The existing provision was amended to read as follow:
All public issues shall be firmly underwritten to the extent provided in Rule 76 below and their investment, which is done in the following ways:
9. **Rule 76:** The amount or percentage of the issue underwritten by any underwriter or syndicate of underwriters shall not be less than 80% of the number of units issued for subscription. Subscription rule(2) is amended by inserting the words by a single underwriter after the word commitment. to read thus;
The level of underwriting commitment by a single underwriter at any time shall not be more than 2½ times the aggregate of the paid up share capital and undistributable reserves.

SEC - Securities and Exchange Commission

This is the apex organ that regulates the capital market in Nigeria and it performs the following functions:

1. Determines the amount, timing and pricing of securities to be sold on exchange.
2. Registers all securities to be traded in the capital market.
3. Performs public enlightenment programmes such as workshops, symposia and seminars to educate the public.
4. Determines the basis of allotment of securities in the public offer.
5. Audits the books of companies and institutions dealing on stock matters.
6. Determines the content of the prospectus and other issuing memoranda.
7. Registers other stock exchange dealers in securities as well as securities to be traded in the market.

2.5 Objectives Of Statutory Regulations

Part of the functions of statutory regulations is to protect investors and their investment; this is done in the following ways:

1. By banning the activities of the middlemen (jobbers and brokers).
2. Provision of secure investment outlet for investors.
3. By ensuring that properly registered bodies operate in the capital market.
4. By providing favorable time for their investment.

2.6 Developing the Market Tools of Regulation

1. **Registration:** This involves payment of a stated amount to the registration agency to legally become a member of the capital market/operator. This means that only qualified, reliable and competent operators operate in the capital market.
2. **Surveillance and Monitoring:** This ensures that violation of rules and regulations are promptly detected and dealt with to avoid further occurrences.
3. **Investigation:** This ensures that all offending acts and allegations in the capital market are properly looked into with the aim of penalising the culprits and forestalling future occurrences.
4. **Enforcement:** This ensures that all rules and regulation are strictly applied in the capital market.
5. **Rule-making:** This ensures that strict guidelines and regulations are put in place for market operators to follow and penalties are specified for the offenders.

Self-regulation Stock Exchange

The Nigerian Regulation Stock Exchange: The operations of the stock exchange are carried out by the Director-General and her team of executives (Heads of Department) and Branch Directors. There are seven major departmental heads who report to the Director-General. The departments are:

1. **Administration and Management Services:** It handles personnel management, finances and accounts and provides administrative services to the exchange.

2. **Legal and Compliance:** It is responsible for the legal services as well as compliance of the dealing members to the rules and the regulations of the exchange.
3. **Research and Information Technology:** It is responsible for the production and publication of the stock market daily official list (SEDOL), computation of the stock market price index, research monitoring and documentation of transactions or deals struck on the trading floor.
4. **Corporate Affairs Department:** This acts as the liaison between the exchange, the press, the public and other corporate bodies.
5. **Quotation and Listing Department:** This is responsible for the analysis and scrutiny of application from companies seeking quotations on the exchange and ensures that quoted companies comply with the disclosure requirement and adhere to the accepted accounting standards in preparing their annual accounts.
6. **Emerging Market / Special Projects Department:** It is in charge of all aspects of promotion, quotation and dealings in the securities of the companies quoted on the SSM and TSM of the exchange.
7. **Strategy and Derivatives Department:** This is responsible for new product development (Futures options swaps FOS.) as well as strategy formulation.

2.7 Functions of the Nigerian Stock Exchange

1. It provides facilities for trading to buyers and sellers of new and existing securities e.g. shares, stock and debentures by acting as a meeting point.
2. It facilitates the channeling of long-term funds to commerce and industry.
3. Provides investment outlets to individuals and corporate bodies with surplus investible funds.
4. Provides opportunities for continued attraction of foreign capital into Nigeria for development purposes.
5. Facilitates the maintenance of fair prices for securities traded in the capital market.
6. It helps the government to implement its indigenization programme.
7. Prescription of requirements for new listing as well as regulating secondary trading activities by dealers.
8. Provision of business and economic information through the daily official list on securities and performance of participants in the capital market.

Commodity Exchange

This is a type of market located in Abuja where commodities like cocoa, palm oil, groundnut, rice etc are bought and sold. The commodity market is guided by rules and regulations for the smooth running of the market.

2.8 First-tier Market

This is the segment that deals with companies, which meet all the NSE listing requirements. The shares of these companies are standardized and already made. They are known as the blue-chip companies.

Rules for Listing of First-tier Securities

1. The company must be a limited liability company or plc registered under the Provisions of Companies and Allied Matters Act, 1990.
2. It must submit its five years financial trading record to the NSE.
3. Company must be audited. The audited account must not be less than nine months prior to the date of its submission;
4. Amount of the money that can be raised is unlimited depending on the borrowing power of the directors/ company.
5. Annual quotation fees are based on capitalisation.
6. At least 25% nominal value of share capital must be offered to the public.
7. Number of shareholders must not be less than 300.
8. After listing, the company must submit quarterly, half yearly and annual accounts.
9. Securities must be fully paid-up at the time of allotment.
10. Unallotted securities must be sold on the NSEs trading floor.
11. There is provision for mergers, acquisitions, unit trust or mutual funds.

2.9 Emerging Market (Second-tier Securities Market (SSM))

The second-tier securities market came into existence in 1985. It was established by the Central Bank of Nigeria for the purpose of serving the needs of small and medium-scale firms which require long-term financing but are unable to meet the stringent requirements for listing in the Nigeria Stock Exchange via the first-tier market.

Its operation is similar to the Nigeria Stock Exchange in terms of buying and selling of shares through the agents such as stock brokers, merchant and commercial banks. The above requirements are not exhaustive and the Council of the Exchange may alter them from time to time. For the emerging market formerly known as the 'Second-tier Securities Market', the requirements have been relaxed with respect to the following six essential matters while all other requirements remain unchanged.

Rules for listing in the emerging (Second-tier Securities)

1. The firm must submit its three years audited financial trading records to the NSE, instead of five years, although the date of the last of such statements must not exceed nine months.
2. The listing fee for the emerging market company is a flat rate of N30, 000 per annum, as well as per offer.
3. Only 10% of the nominal value of the issued shares of the company is to be offered to the public.
4. The minimum number of the shareholders here is 100 as against 300.
5. For interim results, the company needs to submit half-year accounts only, in addition to the annual account.
6. Securities must be fully paid-up at the time of allotment.

2.10 Third-tier Securities Market

Listing requirement are the same with the emerging market but only differ on the listing fees that is nil for the third-tier. Percentage of shares sold is 10%.

2.11 Stages in Public Quotation

1. Consultation/Discussion Stage: A company wishing to raise funds and is considering the stock market option may approach its local banker or an issuing house. Alternatively, an issuing house may approach a company with a proposal for recapitalisation through the stock market. If the initiative is from an issuing house, the benefits of public quotation will be explained to the company. The issuing house will also explain the procedure, length of time and the associated cost of issue. If there is any need for the restructuring of the company, this will also be discussed at this stage. The need to audit the accounts of the company will also be considered.

2. Decision-making/Mandate Stage: After discussion with the proposed issuing house, the management or board or owners will get together to decide to go public. This meeting could be held alone or with the financial advisers. The memorandum and articles of association will be suitable, amended by passing the necessary resolutions to facilitate this. A decision will be taken on the nature of public offer to be made.

- i. Public issue for subscription
- ii. Hybrid public issue/debt
- iii. Preference shares
- iv. The volume and value of securities to be listed

A mandate letter will then be issued to the stockbroker/issuing house to take the issue to the market.

3. Documentation/Packaging Process: The stockbrokers/issuing house will meet with the issuer to suggest and appoint other parties to the issue. After all the appointments have been made, a meeting of all parties is convened. At this meeting, functions are allocated to everybody and a time-table of issue is also drawn-up. Costs and fees are agreed and all parties finalise and get the application ready.

4. NSE Quotation Approval/SEC Registration Stage: The stockbroker submits the application fees for registration to the NSE with a covering letter and the NSE application fees for registration and queuing for the next quotation committee meeting, which is usually held every last Thursday of the month. The stockbroker continues to liaise with the NSE for date of presentation to the committee and for further clarifications from the quotations department. The stockbroker will continue his liaison with the quotations department to know the date of the quotation committee meeting in order to inform the issuer. The following officers/parties must be present: the CEO, the Company Secretary, the Head of Finance, Trustees (in case of debentures), the CEO of the Issuing House, the Registrar, the Chairman and other board members and management staff (optional).

5. Completion Board Meeting Stage: All parties the issue will meet (at the Completion Board Meeting) to issue and sign the offer documents having obtained a Certificate of Exemption from the Nigeria Stock Exchange approving the publication of abridged versions of the detailed offer documents. The directors of the issuing company will also attend the meeting to sign the documents holding themselves individually and severally liable for all information contained in the prospectus and other offer documents. If the issue is underwritten, the underwritten proceeds are paid.

6 Distribution/Marketing Stage: The Issuing House distributes forms to all receiving agents. The required number (50 copies of the abridged version and 25 copies of its hardcover) is submitted to the NSE for distribution to branches and council members. The application list opens on the selected date and closes after 4 to 6 weeks. If an extension to the application closure date is required, the stockbroker must get the written approval of the Exchange. Any variation in the offer documents (including prospectus and other documents) must also be supported with a written approval of the Exchange. A similar approval must also be sought and obtained from SEC by the Issuing House.

7. Range Analysis/ Allotment Stage: If the issue is oversubscribed, the Registrar prepares a range of analysis on how the securities should be allotted. After the range is agreed upon, allotment is done and the pattern used is sent to SEC for confirmation. A copy of the allotment pattern is also sent to the NSE for confirmation. Monies in respect of unsuccessful/rejected application are returned. Applications may be rejected because of incidences of multiple applications or the applications were not under seal (in the case of companies). If the issue is under-subscribed, every subscriber is allotted in full and the balance of the security is warehoused if there is no standby underwriting. If the issue subscription is under 25%, the issue is aborted and the proceeds returned to subscribers. At the conclusion of allotment, allottees are sent share certificates. Payment of proceeds are made to the issuer along with commission to receiving agents (stockbrokers and banks).

8. General Undertaking Stage/Declaration of Compliance: At this stage, the company prepares and delivers to the exchange, on its letter head paper:

- i. General Undertaking (as set out in Appendix III of all the rules governing listing)
- ii. A Declaration of Compliance (Appendix IV)

The Company Secretary and Director must sign the above statements. Additionally, the General Undertaking must be under company seal. At this point, the company also requests for a listing date.

9. Listing Stage: On the date a company is to be listed, it is mandatory for the stockbroker to the issue, the company's CEO, Company Secretary, Finance Director and Registrar of the company to come to the Exchange for briefing at

9.30 a.m. They are informed of the importance of complying with the post-listing requirements, submitting timely reports to the Exchange and getting approval before publishing any reports, notices or circulars. The chairman of the Board of Directors and the other members of the management team may also attend the briefing and /or listing sessions, but it is not mandatory for them. The quotations department will arrange for the team to have copies of the Daily Official

List for that day and to attend and observe the day's trading on the floor. Thereafter, the company will be listed on the Daily Official List.

2.12 Benefits of Public Quotation

- 1. Marketing of the Shares:** Listing on the Nigeria Stock Exchange by the firms increases marketability of the shares. The company's shares can be traded and valued easily and can also be used as collateral for banks loans. This greatly increases the potential of the business and personal benefits to its owners.
- 2. Continuity:** The survival and the continuity of a company listed on the exchange is guaranteed after death of its founders.
- 3. Public Confidence:** A company quoted on the Exchange enjoys greater confidence both from its investors and the banks. Bank managers find it easier to offer credit to a quoted company than to an unquoted one.
- 4. Sharing Risks and Retaining Control:** The opportunity for existing shareholders to share part of their investment risks while still retaining control of the company.
- 5. Expansion and Modernisation:** Proceeds from the issue can be used for expansion and modernization of the company.
- 6. Enhanced Status and Credit Facilities:** A company's status is enhanced when it is listed on the Exchange. The new status leads to confidence in the company by suppliers of credit.

2.13 Summary

In this chapter, students have learnt that:

- The regulation of the capital market is to control the entry of corporate bodies and individuals as well as brokers and jobbers activities.
- There are different types of regulations in the capital market e.g. registration of securities clearing and settlement agency, registration of issuing house, registration of brokers etc.
- The Investment and Securities Agency (ISA) was established by the federal government to register corporate bodies trading in the capital market
- The Investment and Securities Agency (ISA) has made a lot of amendments to the ISA Law No 45.
- The Securities and Exchange Commission (SEC) is the apex organ that regulates the capital market in Nigeria and performs many functions.

2.14 Revision Questions

1. Explain the term .Regulation..
2. Itemise two (2) types of regulations.
3. Examine the ways by which SEC regulates the capital market.
4. State two objectives of Statutory Regulation.
5. Mention four tools of Regulation.