SECURITIES AND EXCHANGE
COMMISSION, NIGERIA

The
Nigerian Capital Markets

Preserving our Success and Enabling Our Potential Through Managing Emerging Risks

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1. It gives me great pleasure to present the Keynote address at this year's Standard Chartered Bank Capital Market Forum. I believe our entire market will benefit from the ideas and initiatives that will be discussed here. The Securities and Exchange Commission (SEC) has always supported efforts like this because we recognize the importance of boosting capacity in our capital market.

2. The theme of this event "Managing Risk in a Thriving Sub-Saharan Capital Market" is apt and timely particularly because of the weak global risk outlook and because of our efforts to ensure a risk resilient market. The 2008 crisis which was triggered by the global financial crisis represents bitter lessons of what can happen when insufficient attention is paid to regulation and risk. As a consequence, the goals of SEC's reform agenda have included immunizing our market against external shocks by having a deeper, broader and more institutionalized market.

3. I therefore intend to use this opportunity to talk about the reforms we have been implementing since January of 2010 and the results of those initiatives. Thereafter I will give an overview of emerging risks facing the global securities markets focusing on significant ones facing us and how we can manage or mitigate them.

4. In 2010, we had the very important task and responsibility to lead the market into recovery from the crisis and to build and develop a world-class capital market that can better withstand future crises. Our understanding has always been that the Nigerian economy needs such a world-class capital market that is fair and efficient to fully actualize its potential. Let me now give a summary of some of those major reform initiatives we have implemented and how they are impacting the market.

5. **Strengthening the Bond Market:** In spite of the immense potential of a domestic bond market, our market was largely an equities-dominated market unlike in other parts of the world where bond markets are typically larger than stock markets. For example in the United States of America (USA) the bond market is currently two times larger than the stock market. In the same vein a study by McKinsey & Co revealed that the global bond markets are three times the size of stock markets with the combined global bond markets worth $157 trillion out of the total $212 trillion of capital stock while stocks are worth $54 trillion. We took steps to build a domestic bond

market getting support from a Resident Bond Advisor who was sponsored through the Efficient Securities Markets Institutional Development (ESMID) program, which is hosted by the International Finance Corporation (IFC). We were able to review and streamline the entire bond issuance process including rules on book-building and shelf registration and also pushed for revision of the tax regime to eliminate tax discrimination against those investing in corporate and subnational bonds. As a result, there has been a growing interest in the domestic bond market with State governments raising N421.5 billion and corporate bonds totaling N148.5 billion were raised since 2010.

6. The strong interest in our bond market is not limited to domestic investors, because of the reforms we carried out the domesctic bond market is becoming increasingly more attractive to prestigious international issuers and investors. The IFC, a triple-A rated private sector arm of the World Bank, led the way by issuing its 'Naija Bond' of $50 million and subsequently filed for medium term notes (MTN) of US$1 billion. Another important triple-A rated multilateral institution, the African Development Bank (ADB), has followed suit by filing a US$1.5 billion MTN program. I am delighted to announce that these MTN programs will not be constrained by the previous two-year expiration of shelf programs as the Board of the SEC has approved its elimination allowing shelf programs an unlimited lifespan. These positive developments in the bond market give investors more options apart from equities especially now that the FGN bonds have an extended yield curve of 20 years and have been included in JP Morgan's and Barclay's emerging markets indices.

7. **Introduction of New Products:** Apart from strengthening the bond market, the SEC has created an environment that engenders product innovation to provide even more investment options. Exchange Traded Funds (ETFs), Real Estate Investment Trusts (REITs) and Sukuk have been introduced into our market. All three products can enhance financial inclusion helping increase the level of domestic participation in our market. REITs are particularly important to help Nigeria eliminate the massive housing deficit estimated at about 18 million units while Sukuk will not only attract capital from the Gulf region but will also encourage many Muslims who make up about half of Nigeria's population to invest. Securitization is another product we have made efforts to promote considering the opportunities it offers for infrastructure finance, for the housing market and also for financing business operations and expansion.

8. Venture Capital (VC) and Private Equity (PE) form another important asset class due to the impact they can have on economic growth, innovation and job-creation. To encourage the growth of the PE/VC industry in Nigeria we introduced new rules on private equity while lending support to the Ministry of Industry, Trade and Investment who recently inaugurated an Industry Committee to make recommendations on the best ways to develop the PE and VC in Nigeria. We understand the important role capital markets play in spurring the developing of private equity by offering sufficient depth and liquidity to provide exit channels which is why we continue efforts to deepen and broaden our market.

9. **New Listing Rules to Deepen the Equities Market:** There are currently 196 listed equities on the mainboard of the Nigerian Stock exchange giving investors a very limited number of options in their portfolio composition especially because Banking and Construction sector companies dominate. The current composition of the listed equities does not reflect the Gross Domestic Product (GDP) of Nigeria since important sectors making up our GDP such as Agriculture, Oil & Gas and Telecommunication are not proportionally represented. Apart from advocating the listing of leading companies in these sectors to broaden investors' options, we have been proactive in approving new listing rules that tackle the peculiar concerns of the companies to attract more listings especially from upstream oil & gas companies as well as the big telecommunications firms. Small and Medium Enterprises (SMEs) who are in need of raising capital as well as companies with good feasibility studies can also access the market through the Alternative Securities Market (ASeM) which has special listing requirements tailored to the nature of such businesses. We believe this is an important platform to prepare SMEs to become bigger players on the mainboard in the future especially by strengthening their internal systems and the by subjecting them to higher standards of corporate governance.

10. **Rules on Securities Lending and Short Selling and Introduction of Market Making:** A key challenge facing our market is liquidity, illiquid markets are unable to perform the important price discovery and capital allocation functions of a market efficiently. To help boost liquidity and enhance confidence in the market, we introduced rules guiding securities lending and consequently permitted short selling to herald the introduction of market making which is already increasing liquidity in the market. Short selling is important not just for its impact on liquidity but also from a risk management perspective; it helps brokers and other investors to hedge their positions.

11. **Approval of Alternative Trading Platforms:** Since 1960, the NSE has been the sole regulated, organized market for the trading of securities in Nigeria yet the stocks listed on the exchange do not adequately reflect the Nigerian economy. Now we have two alternative platforms that will enable organized, transparent and well regulated trading of securities over-the-counter (OTC); first the NASD platform sponsored by the National Association of Securities Dealers which has already started operations and then the Financial Markets Dealers (FMDQ) platform which will facilitate the OTC trading of bonds. Both are under the SEC's regulatory oversight and will significantly enhance price discovery and liquidity. Both platforms will expand the regulatory perimeter by bring OTC trading under the SEC's oversight.

12. **Adherence to Principles of Securities Regulation:** The SEC, being one of the leading members of the International Organization of Securities Commissions (IOSCO)[1] has employed international best practice in performing its regulatory functions. Therefore, the reform agenda we have been implementing is anchored on the 38 principles of securities regulation which are based upon three objectives: the protection of investors; ensuring markets are fair, efficient and transparent; and reducing systemic risk. We have implemented those principles by introducing rules covering the roles of market intermediaries including minimum entry requirements, segregation and protection of client assets (mandating asset managers to concentrate on their main role while client assets are held by custodians such as Standard Chartered) as well as the adoption of risk-based supervision.

13. **Robust Enforcement Regime:** The SEC's innovative quasi-judicial Administrative Proceedings Committee (APC) is an important organ for dispute resolution in our market. This informed our decision to revamp the body to now include a retired Chief Judge, an academician and a global capital markets experts in addition to the Director General of the SEC and other SEC Board members. We have leveraged cooperation with other government agencies to make our enforcement actions tougher and swifter. As you know, we have partnered with the Nigeria Police to establish a Police Desk at our head offices and also with the Attorney General of Federation who has dedicated staff to handle capital market related cases.

[1] The SEC sits on the Board of IOSCO and chairs its Africa Middle-East Regional Committee (AMERC)

14. **Building Strong Institutions:** For our market to be resilient, it is important to have strong, highly professionalized institutions participating in it. You are all familiar with the steps we have taken to strengthen the Central Securities Clearing System (CSCS) and the NSE. We are pleased with the ICT transformation being implemented in both institutions, especially the roll-out of the NSE's X-GEN trading platform. Our broker-dealers, custodians, trustees and other market operators need to be strong, independent bodies with sound internal practices. For example a broker needs to have clearly delineated front, middle and back offices in addition to a minimum technology standard. Clearly the current minimum capital requirement of N70 million can no longer guarantee that broking firms have all these in place. We have therefore worked with the market community to come up with new minimum capital requirements for all capital market functions which were recently approved by the Board of the SEC.

15. **Expanding Domestic Participation:** A strong, virile market must have significant domestic participation which is why the SEC has championed various market development activities aimed at increasing the number of local investors in our market, especially through collective investment schemes (CIS). Consequently, we have supported the Fund Managers' Association of Nigeria (FMAN) to develop a strategy document that aims to achieve a multi-trillion naira CIS industry in Nigeria by 2018, bringing in about 4.5 million new unit holders. We believe these lofty goals are achievable and will help to institutionalize our fund management industry while protecting investors as they rely on professional management of their investments under the SEC's regulatory oversight. It is not just the retail domestic investors that we are targeting but equally the domestic institutional investors such as the Pension Fund Administrators (PFAs), Insurance companies and the Nigeria Sovereign Investment Authority (NSIA) who all have large pools of investible funds.

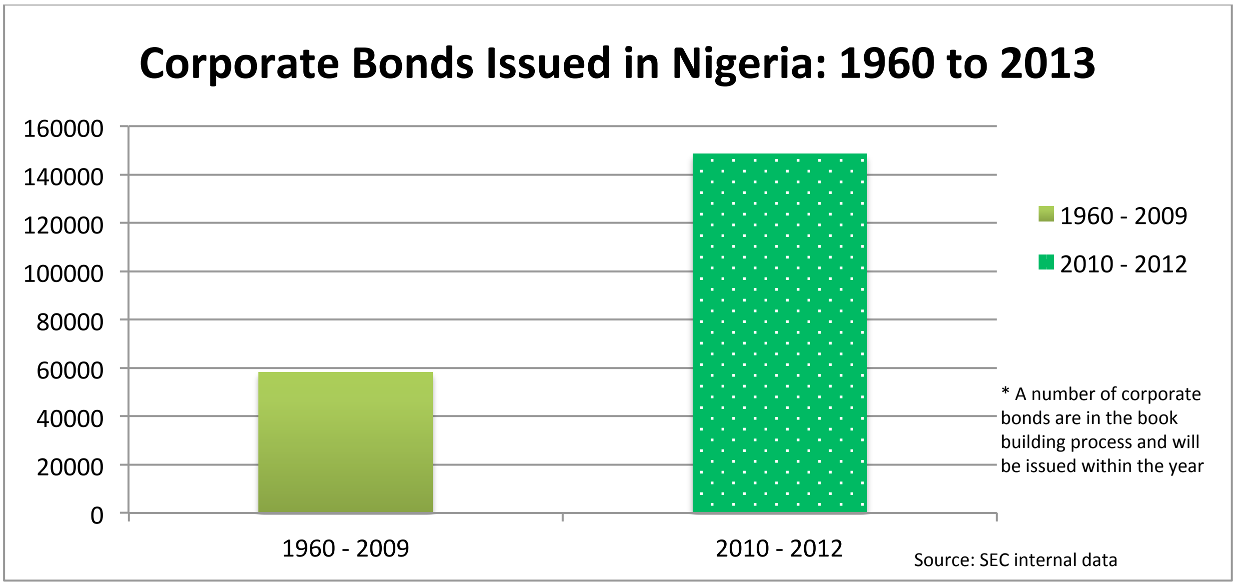
16. **Robust Investor Protection:** As earlier noted investor protection is one of the key objectives of securities regulation and is also an important aspect of the SEC's mandate. We have promoted investor education as the first line of defense for investors but have gone a step further to be among a handful of countries in the world with an investor protection fund in addition to the NSE's investor protection fund which focuses on malfeasance by broker/dealers. The National Investor Protection Fund (NIPF), a company limited by guarantee with seed capital of N5 billion will

compensate losses incurred by investors due to malfeasance by capital market operators other than broker/dealers.

17. **Global Best Practice in Financial Disclosure and Corporate Governance:** All public companies in Nigeria were mandated under a federal government policy to migrate to the International Financial Reporting Standards (IFRS) with effect from 1st January 2012. The SEC, as the apex regulator of the capital market provided support for the transition by listed companies. The disclosure requirements within IFRS are in line with global best practice. We introduced a new code of corporate governance in 2011 which mandates companies to state their level of compliance with the code. These, along with IFRS, provide an unprecedented disclosure regime which will certainly give investors more comfort to invest in Nigeria.

18. **Risk-Based Supervision and Rules on Margin Lending:** Prior to the crisis that began in 2008, there were no clear rules on margin lending and we know that contributed to aggravating the crisis as many banks and brokers were exposed to nonperforming margin loans. To forestall reoccurrence, we have introduced rules on margin lending that, among other pertinent elements, excludes banking stocks. We have moved away from the compliance approach to a risk-based approach in our inspections which helps identify risks in the business activities of operators and determine if mitigants are in place. Our Anti-Money Laundering/Counter Terrorism Financing (AML/CFT) regime has also been strengthened winning commendations from Financial Action Task Force (FATF).

19. In addition to the highlights provided above, let me briefly outline the results achieved so far with the reform agenda. As already noted, the bond market has been rejuvenated with strong interest from domestic and international issuers taking current debt market capitalization to about N4.35 trillion. We are particularly pleased with the growth of corporate bonds, the value of bonds issued by corporates between 2010 and 2013 is more than two and half times all the bonds issued by corporations from 1960 to 2009 in nominal terms.



Equities market capitalization has risen from N4.98 trillion in January 2010 to N11.76 trillion as at 4 October 2013, a more than two-fold increase. For collective investment schemes, funds under management continue to grow, albeit slowly. More important is the visible impact of SEC's support for the fund management industry in terms of a robust regulatory framework, expertise and the variety of funds that include ethical and umbrella funds.

KEY EMERGING RISKS?

20. Securities markets regulators across the world take the issue of risk management and mitigation very seriously meeting twice annually under the auspices of IOSCO to discuss emerging risks facing our markets. Some of the risks regulators are concerned about include continued bank sector dominance, capital adequacy risks, regulatory gaps, new products/technology risks, prudential risks, concentration risks, systemic stress from Europe, liquidity risk due to equities market fragmentation, market risk due to concerns over the US political gridlock, contagion risk, risk within the derivatives markets, risk associated with high frequency trading, tapering as well as the eventual reversal of near zero interest rates. I will only focus on those risks that I consider of most significance to our market.

21. **Vulnerabilities of the World Economy:** Growth outlook always influences investor behavior which is why vulnerabilities of the global economy should be a cause for concern. Global growth gives a divergent picture, or what the IMF calls "3-speed mode"; emerging markets growing rapidly,

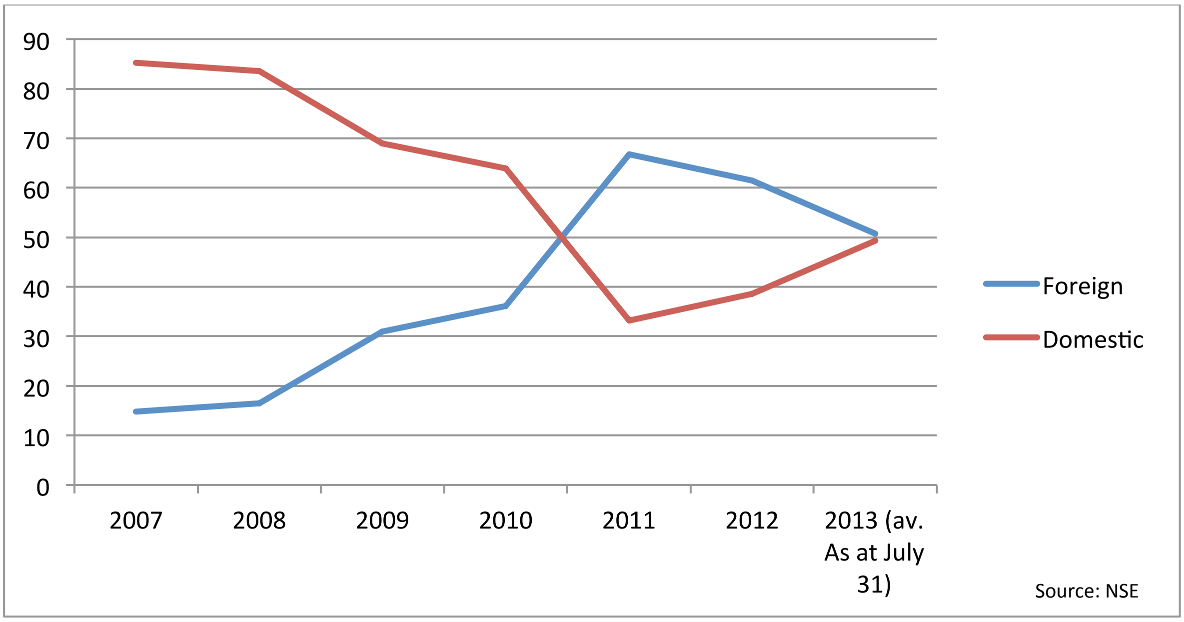
the United States growth steadily picking up and Europe still struggling. Generally, the growth seems fragile considering the fact those major emerging markets which served as growth drivers for years are showing signs of a slowdown.

22. **Eventual Reversal of Zero Interest Rate Policy and Tapering:** Interest rates have remained near zero in the developed markets. This has led to falling yields and in response investors from those countries are looking elsewhere for more attractive yield. Quantitative Easing (QE), the $85 billion monthly bond buying program of the US Federal Reserve (Fed), has also led to massive financial inflows into emerging markets such as ours. Over the last four years about $3.9 trillion has flowed into various emerging markets as a result of the expansionary monetary policies in developed economies. The risk here is in the eventual reversal of these policies, any suggestion of a tightening stance by a major central bank may lead to outflows that could hurt many emerging markets. This is exactly how the crisis we suffered in 2008 was triggered as foreign portfolio managers pulled out their funds leading to free fall of stock prices. In fact Mr. Ben Bernanke's announcement about the eventual discontinuation of the monthly bond buying gave us a glimpse of what to expect when tapering commences.

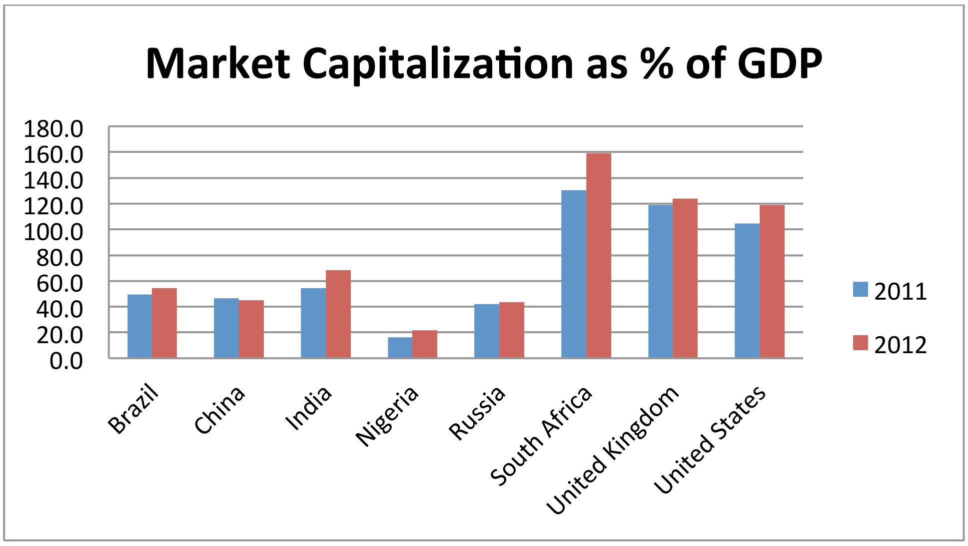
23. As you know the Fed's announcement led to a bearish run that saw the NSE's capitalization decline from the all-time-high of N12.85 trillion to a low of N11.40 trillion, a loss of N1.45 trillion all within the same month of June 2013. Nigeria was not alone in reaction to the announcement. Within the first six weeks of Mr. Bernanke's announcement, the Indian rupee plunged by over 14% eliciting fears of run on the currency while emerging market equities witnessed steep declines.

24. The risk from 'hot money' flows is real and can be anticipated. Two ways to manage that risk is to continue efforts aimed at broadening and deepening the market so that the inflows do not cause asset bubbles. Efforts that we have already outlined will enable our market possess multi-product offerings as well as instruments that enable brokers and investors to hedge their positions. Another way to help Nigeria survive massive outflows is to build a large domestic investor base, an effort which the SEC is championing. Domestic investors have been gradually returning to the market since 2011, their rate of participation has increased from a low of 20% to 50% currently.

Contribution to trading volumes: Domestic v. Retail Investors



25. **Concentration Risk**: Internally, our market remains highly concentrated. Banks make up 28.4% of total equities capitalization while the two largest companies, Dangote Cement and Nigerian Breweries constitute almost 40% of the NSE's equities capitalization. This is why we are pushing for more listing of other companies from various sectors to even up the proportions and reduce the dominance of a few sectors. Listing upstream oil & gas companies alone will not only deepen the market but also neutralize the concentration. When Ghana Stock Exchange listed its first upstream oil company, stock market capitalization more than doubled on the first day of listing, imagine the impact it could have on the NSE if two or three of the major upstream players come to the market. Nigeria's current market capitalization as a percentage of GDP is only 21.4% compared to 159.3% in South Africa, 120% in the U.S., 121% in the U.K., 68.6% in India and 54.6% in Brazil.



Source: World Bank Database

26. **Operational Risk:** As I earlier stated, market operators must continually look at their internal processes and resources to identify areas of risk. Capacity deficit is among our key areas of weakness. We believe raising the minimum capital requirement will contribute to addressing this challenge. We continue to advocate strong internal control mechanisms and strict adherence to best corporate governance practices. These are not only useful for the firm but will ultimately help the market manage risk from a micro-prudential standpoint.

27. I will conclude by taking a quick look at the macro economy and sharing a few thoughts on safeguard that have been put in place to guard against vulnerabilities to external shocks. Nigeria's GDP growth remains robust at about 6.5% while inflation has been contained in the single-digits, debt-to-GDP level remains low and foreign exchange rates are largely stable. To sustain macroeconomic stability government has built buffers through prudent management of the country's reserves, inclusion of a stabilization fund within the sovereign wealth fund and important initiatives to move the economy away from over-reliance on oil and focusing on job-generating sectors such as Agriculture and Manufacturing.

28. Regulators of the Nigerian financial system recognize the value of coordination in achieving financial system stability which impacts the entire economy and all work together within that framework to pursue goals of macro-prudential regulation. Within the perimeter of securities markets, we are conscious of the critical role strong capital markets play in ensuring financial system stability. We are therefore committed to building a world-class capital market that broadens economic access for the citizens of Nigeria through wealth creation and distribution for the ultimate achievement of Nigeria's socioeconomic development ambitions.

Thank you for your kind attention.

