LEGAL REGULATION OF THE CAPITAL MARKET IN NIGERIA: *Analysis and Prospects for Reform*

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DECLARATION

I declare that the work presented in this thesis is my own. Any information originating from other work has been referenced. This work has not been submitted in substantially the same form for the award of a higher degree elsewhere.

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ABBREVIATIONS

APC – Administrative Proceedings Committee

CAMA – Companies and Allied Matters Act 2004

CCB – Code of Conduct Bureau

CFRN – Constitution of the Federal Republic of Nigeria

COMC – Code of Market Conduct

CJA – Criminal Justice Act 1993

DSS – Department of State Security

EFCC – Economic and Financial Crimes Commission

ESMA – European Securities and Markets Authority

FCA – Financial Conduct Authority

FRC – Financial Reporting Council

FSMA – Financial Services and Markets Act 2000

FSCS - Financial Services Compensation Scheme

ICPC – Independent Corrupt Practice Commission

IPF – Investors Protection Fund

ISA – Investment and Securities Act 2007

IST – Investment and Securities Tribunal

MAR – Market Abuse Regulation

NSA – Nigerian Standards on Auditing

NSE – Nigerian Stock Exchange

NYSE – New York Stock Exchange

PRA – Prudential Regulation Authority

SEC – Securities and Exchange Commission

SRO – Self-Regulatory Organisations

ABSTRACT

This thesis focuses on the legal regulations governing the Nigerian capital market. Nigeria is described as one of biggest economies in Africa, endowed with natural and other resources that could be exploited to boost the economy of the country. There is however, a need for infrastructural development and job creation that can stimulate economic growth. The execution of these projects requires the free-flow of capital. The capital market serves various purposes to a country, principal amongst these is that it facilitates the free-flow of short and long term equity and debt capital to corporations and governments that use it to carry out capital-intensive projects that subsequently enhances the economy. In view of this, it is imperative that a capital market is efficient in its structure and operations so as to attract investors. This is tied to the realisation that capital markets thrive on investor confidence.

This thesis, drawing on rules and practices in the United Kingdom, focuses on key problems affecting the Nigerian capital market, including information asymmetry, insider trading and inertia in the enforcement of regulations relating to the capital market. The issues highlighted, though not exhaustive, represent foundational and fundamental challenges with the current system in Nigeria. Using a mix of doctrinal and comparative analysis, the thesis argues that the subsisting regulation of the capital market in Nigeria lacks in many respects requisite legislative and enforcement tools to deal with the problems highlighted. As such, redressing these problems along the lines of the recommendations contained in this thesis would prove to be a crucial step in achieving sustainable financing for corporations in Nigeria as well as a viable Nigerian economy.

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1. The Nigerian Capital Market and Economic Growth

1.1. Introduction

Success in capital accumulation and mobilisation for development varies amongst countries. It is largely dependent on domestic savings and inflows of foreign capital. To avoid economic downturn, countries promote effective resource mobilisation by developing their capital market.

The capital market is considered the bedrock of growth and development of modern national economy because it can attract investors to invest in the economic subsectors. The importance of a capital market cannot be undermined as research has shown that there is a positive relationship between capital accumulation and real economic growth.[1] Economic development is described as the measure of a country's wealth and how it is generated.[2] Large and small companies serve as the primary channel of businesses in a society and in order for them to promote economic growth they require funds to stay afloat. Similarly, governments require funds to carry out capital-intensive projects that will be beneficial to the inhabitants of the country. The capital market serves as a viable mechanism to generate funds for businesses and governments.

A number of factors have been attributed as determinants for capital market success, such as the provision of legal regulations governing the capital market, the

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[1] J. Schumpeter, *Theorie der Wirtschaftlichen Entwicklung, Lepizig: Dunker & Humblo*t, 1912. (In English: O. Redvers, *A theory of economic developmen*t, (Harvard University Press 1934); J.E. Stiglitz, 'Capital market liberalization, economic growth and instability', (2000) 28 World Development, 1077; R. Levine and S. Zervous, 'Stock markets, banks and economic growth', (1988) 88 American Economic Review, 554; L. Alfaro, A. Chanda, S. Kalemli-Ozcan and S. Sayek, 'FDI and economic growth: the role of local financial markets', (2004) 64 Journal of International Economics 107

[2] <http://www.bbc.co.uk/schools/gcsebitesize/geography/development/contrasts_development_rev1.shtml> accessed 12 September 2016.

political framework of the country etc.[3] However, a general consensus that has developed in recent years is the fact that when investors are confident in the capital market there is the propensity for them to invest more in the market.[4] This is because the capital market is a sensitive environment that thrives on investor confidence generated by operational efficiency and the prevailing regulations of its operations.[5] Developing investor confidence is not an easy task; it stems from a continued effort by the operators and regulators of the capital market to ensure that the market is run smoothly by providing adequate and accurate information as well as ensuring that investors will receive returns on their investments.

Several factors have been identified as responsible for investor confidence. Amongst these is the provision of legal rules governing the market, political structure of the country and the endowment in terms of resources of the country etc.[6] This thesis argues that legal regulations are largely accountable for investor confidence. This is borne out of the reasoning that when laws/regulations governing the operations of the market and those protecting investors' interests are in place and efficient, there would be willingness to invest.[7] This willingness is developed by the belief that when investors invest in the capital market they know they are legally protected if anything goes wrong. Furthermore, it is arguable that investors are primarily interested in well-run companies and countries with sound macroeconomic

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[3] R. La Porta, F. Lopez-de-Silanes, A. Shleifer and R. Vishny, 'Law and Finance', (1998) 106 The Journal of Political Economy 1114; M. Roe, 'Legal origins, politics and modern stock markets', (2006) 120 Harvard Law Review 463

[4] K. G. Palepu, P. M. Healy, V. Bernard and E. Peek, *Business analysis and valuation: IFRS Edition*, (Thomson Learning, 2007) 21

[5] A. Aliyu, 'Managing capital markets crimes: the role of Nigeria's Securities and Exchange Commission' (2014) 19 Journal of Humanities and Social Science 56.

[6] R. La Porta, et al (n 3); M. Roe (n 3); M. Pagano and P. Volpin, 'The political economy of finance', (2001) Oxford Review of Economic Policies 506; R. Rajan and L. Zingales, 'The great reversals: The politics of financial development in the 20th century' (2003) Journal of Financial Economics; W. Easterly and R. Levine, 'Tropics, germs and crops: how endowments influence economic development' (2003) 50 Journal of Monetary Economics 7.

[7] R. La Porta, et al (n 3).

policies rather than enforcement regimes. For example, debt investors would rather extend capital to a company they are convinced would repay the capital plus interest rather than solely rely on security.[8] For laws/regulations to efficiently enhance investors' confidence, there are several factors that ought to be available and function effectively. Amongst these are, statutory rules that provide a regulatory framework and encourage/mandate prescribed practices. Concurrently, timely and adequate enforcement mechanisms are important to enhancing investor confidence.[9]

The Nigerian capital market is described to have functioned at its peak until its collapse in 2008.[10] In the last quarter of 2007, the Nigerian capital market was ranked Africa's best performing market.[11] Its all share index value of 100 in 1984 increased to 57,990 at the end of 2007, increasing to 58,580 in first quarter of 2008.[12] It accumulated 12.6 trillion Naira (equivalent of $84 billion) around the first quarter of 2008.[13] At its peak, its total market capitalisation amounted to 21.4 trillion Naira (Equivalent of 150 billion US dollars). The global economic meltdown and other peculiarities eroded the capitalization to about 5.4 trillion Naira ($36 Billion) in the fourth quarter of 2009, which subsequently saw the all share index drop from

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[8] T. N. Parsons, *Lingards bank security documents,* (6th Edition, LNUK 2015)

[9] It is important to note that this thesis does not by any way postulate that the other factors are irrelevant as it explains in the next chapter that a market will inevitably perform better if all three factors are present. This thesis aligns its argument around legal regulation as a result of it being the focal point.

[10] C. U. C. Ikebudu, 'Mismanagement of emerging stock markets; Analysis of the role played by 'Legislative Infidelity' a norm of international Jurisprudence in N8.1 Trillion ($60 Billion) Crash of the Nigerian Stock Market' Theses and Dissertations, Golden Gate University School of Law, 2011, Paper 27, 2.

[11] J. Kew and M. Patterson, Nigeria becomes world's market on bank losses', (*Bloomberg,* 1 April 2009) <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aSechJpKP2yo> accessed 9 December 2014

[12] Punch Editorial Board, 'Preventing another capital market crash', *Punch Newspaper* (Nigeria, 17 October 2013) <http://www.punchng.com/editorial/preventing-another-capital-market-crash> accessed 9 December 2014

[13] O. F. Oladipupo, 'The crash of the Nigerian Capital Market: Explanation beyond the Global meltdown', (2010) 4, International Business Management 37

31.450.78 to 23.206.23.[14] Recent developments within the Nigerian capital market suggest that criminal practices led to its collapse in 2008. Some of the practices included insider trading.[15] In view of this and to avoid further mishaps, it is important that the Nigerian capital market is effectively regulated. Moreover, such regulation could drive economic growth by creating the medium to generate capital for projects that are beneficial to its inhabitants as well as achieving the necessary scale and sophistication to be relevant in the transformation of the economy and achieving national development aspirations.[16]

It is important to note that until recently, the Nigerian economy was Africa's leading economy.[17] However, this is no longer the case with the economy in recession.[18] The reason for the recession is largely attributable to the drop in oil prices that has affected major oil producing countries. The recession has led to decline in the demand for stocks as well as loss of investors' funds of approximately 14 billion Naira.[19] It has also led to a price hike in every sector including the capital market, as stockholders are not willing to sell their stocks at a reduced rate.[20] This thesis argues that if the capital market functioned effectively, there is the likelihood that this recession would have been avoided, as there would be capital available for the exploration of other sectors that will generate some revenue for the country. This

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[14] *ibid*

[15] Thisday Newspaper Editorial Board, 'Preventing insider dealings in a rebounding stock market', *Thisday Newspaper* (Nigeria, 30 April 2013)

[16] SEC Nigeria, 'Nigerian capital market master plan; 10 year plan 2015-2025', Securities and Exchange Commission, 3.2.1

[17] <http://www.bbc.co.uk/news/business-26913497> accessed 16 July, 2016

[18] D. M. Doya, 'S. Africa's economy regains rank as Africa's biggest on rand', [website], August 10, 2016, <http://www.bloomberg.com/news/articles/2016-08-10/south-africa-s-economy-regains-rank-as-africa-s-biggest-on-rand> accessed 24 August 2016
<http://www.bbc.co.uk/news/world-africa-37045276> accessed 24 August 2016

[19] C. Anuforo and C. Obienyi, 'Stockworld: How recession affects capital market activities', *The Sun News* (Nigeria, 31 October 2016) <http://sunnewsonline.com/stockworld-how-recession-affects-capital-market-activities/> accessed 3 April 2017
P. Egwuatu and N. Nnorom, 'Capital market: Investors lose N603.7bn to economic recession', *Vanguard* (Nigeria, 2 January 2017) <http://www.vanguardngr.com/2017/01/capital-market-investors-lose-n603-7-bn-economic-recession/> accessed 3 April 2017

[20] C. Anuforo and C. Obienyi (n 19)

argument is tied to the realisation that the Nigerian economy is largely dependent on the proceeds from the crude oil sector.

Considering this context, this thesis focuses on certain rules and regulations governing the Nigerian capital market. These provisions are compared with similar provisions in the UK, with the objective of identifying problems associated with the Nigerian rules as well as suggesting possible reforms that are aimed at enhancing investor confidence and making the market more efficient. Other than the importance of legal regulations, another factor that is important is the issue of enforcement of these laws. In describing the importance of enforcement. According to John Austin, "…laws without sanctions are mere words".[21] Having laws without adequate enforcement mechanisms makes them ineffective, thus diminishing regulatory compliance

Before delving into the problems associated with the legal provisions governing the Nigerian capital market, the next section briefly highlights what a capital market is, its function and importance and analyses the historical development of the legal structure of the Nigerian capital market.

1.2. Introduction to capital markets

The capital market is a framework of institutions that arrange for the sale and purchase of long-term financial assets, such as shares, government stocks, debentures etc.[22] It is part of the financial system that is primarily involved in raising capital by dealing in shares, bonds and other long term or short-term investments.[23] It serves as a medium through which large and small businesses access equity and debt capital

[21] J. Austin, *The province of jurisprudence determined,* (London, 1832) Lecture 1.
[22] A. Omojola, *Capital market operations*, (Credible associates limited, Nigeria, 2006) 16
[23] F. J Fabozzi, and F. Modigliani, *Capital markets: institutions and instruments*, (4th Edition Pearson International Edition 2009) 10

directly, thus reducing their dependence on bank-based financing.[24] The market serves as the cornerstone of any financial system by providing funds needed for financing not only business and other economic institutions but also the programmes of government as a whole. It grants individuals and institutions the accessibility to corporate bodies and government parastatals that direct their savings towards capital-intensive projects.[25]

The capital market is divided into two sectors, the primary market and secondary market. The former deals with issuing of new stocks and bonds directly from companies to investors, businesses and other institutions.[26] The latter is where investment banks, private investors and other firms resell their equity and debt securities to investors.[27] It is noteworthy that capital market trade is different from regular day-to day trade. Trading in securities comes with the risk of dealing with entities that putative investors have no other means of getting information on other than that provided by the entities themselves. In view of such an arrangement where potential investors are made to rely on disclosure by the company, trust is implicit and very important.

1.2.1. Functions and importance of capital markets

In attaining sustainable growth and development, there must be effective allocation of capital to enable businesses and the economy harness their human material and manage resources for optimal output.[28] When the capital market is thriving in an efficient manner, there is likelihood the economy will grow. If capital resources are

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[24] E. Ferran and L. Chan Ho, *Principles of corporate finance law*, (2nd Edition Oxford University Press, 2014) 59
[25] A. M Chisholm, *An introduction to international capital markets*, (2nd Edition Wiley & Sons Ltd, second edition, 2009) 2
[26] R. Veil, *European capital markets law*, (Hart publishing Ltd 2013) 75
[27] *ibid* 76
[28] E. O. Ogunleye and P. A Adeyemi, 'The impact of stock market development on economic growth in Nigeria', (2015) 6 Journal of Economics and Sustainable Development 21

not provided to economic areas especially industries where demand is growing and which are capable of increasing production and productivity, the rate of expansion of the economy often suffers.[29]

Developed economies explore two channels through which resources are mobilised in the bid to ensure economic growth and development. They are money and capital markets.[30] Developing economies on the other hand tend to place more emphasis on the money market with little consideration for the capital market.[31] This is particularly harmful because when economies develop, more capital is required to meet the rapid expansion and align with global innovations. The capital market in this instance serves as a viable tool to mobilise and allocate savings towards developmental resources that are critical to the growth of the economy.[32] Based on the role of a capital market towards the development of a country's economy, this thesis enlists the following as the functions and importance of the capital market.

First, as highlighted above, a capital market has the ability to spur economic growth.[33] Economic growth hinges on an efficient and effective financial sector that pools domestic savings and mobilises capital for productive projects.[34] When such a system is absent, productive projects that carry developmental agenda will be ignored because they are usually capital intensive.

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[29] T. S. Osinubi, 'Does stock market promote economic growth in Nigeria?' Department of Economics Faculty of Social Sciences, University of Lagos, Nigeria

[30] A. Demirguic-Kunt and R. Levine, 'Stock market, corporate finance and economic growth: An overview' (1996) 10 The World Bank Review 229.
Money market is different from capital market as it is a market where financial instruments with high liquidity and short maturities are traded. Essentially, it is used as a means for borrowing and lending in the short term.

[31] M. O. Nyong, 'Capital market development & long-run economic growth: Theory, evidence and analysis', (1997) First Bank Review 13.

[32] H. I. Alile, 'The Nigerian stock exchange: Historical perspective, operations and contributions to economic development,' (1984) 2 Central Bank of Nigeria Bullion, Silver jubilee 65.

[33] IOSCO, 'Objectives and principles of securities regulation', (2010) OICU-IOSCO

[34] CBL Economic Review, 'Importance of capital market as an instrument of economic development', (2009) CBL Economic Review 2

Second, it connects the monetary sector with the sector for production of goods and services otherwise known as the 'real sector'. This has been considered to facilitate growth in the real sector because it provides sustainable capital by which investors can buy and sell securities efficiently.[35]

Third, it promotes long-term savings that is subsequently channelled to long-term investment.[36] This is achieved by enabling the contractual savings industry such as companies, private pension funds and social pension insurance systems to mobilize long-term savings from small individual households.[37]

Fourth, it promotes infrastructural development by channelling savings into investments through the efficient transfer of funds from individuals, corporations and governments that have excess funds. Infrastructural development is important for sustainable growth and development as it generates competitiveness of domestic industries. With such competition, there is the chance for such industries to compete with their global counterparts, thus steering the momentum towards global integration. Furthermore, infrastructural development can lead to increased domestic productivity and subsequent upsurge in exportation.

Fifth, capital markets promote public-private sector partnerships by encouraging the private sector to participate in productive investments.[38] With the possibility of resources diminishing especially in an economy where the focus is on a primary source, the capital market can assist the public sector in closing the resource gap as well as complement its effort in financing essential socio-economic

[35] A. Omojola, (n 22)
[36] C. A. Yartey, 'The determinants of stock market development in emerging economies: Is South Africa different', (2008) IMF Working Paper 5
[37] D.S. Balami, 'The role of the capital market in the economy', (*Proshare*, 13 August 2015) <https://www.proshareng.com/news/Capital-Market/The-Role-of-the-Capital-Market-in-the-Economy/28259> accessed 4th July 2016. Contractual savings industries are savings institutions that obtain their funds through long-term contractual arrangements and invest these funds on the capital markets. It is inclusive of insurance companies and pension funds.
[38] *ibid*

development through raising long-term project based capital. This might be beneficial for smaller companies that require capital to execute projects, but do not have access to capital market/desired bank finance.

Sixth, an efficient capital market has the potential to attract both foreign direct investors and foreign portfolio investment. This is very important to supplementing domestic savings levels, thus facilitating the inflow of foreign financial resources into the domestic economy.[39]

Nigeria is categorised as a developing country and operates a mono-revenue economy with its primary source of revenue being crude oil.[40] At the point when Nigeria was categorised as the apex economy in Africa, the sectorial contribution are as follows: agriculture 31.20%, crude petroleum and natural gas 28.70%, solid materials 0.20%, manufacturing 2.70%, telecommunication and post 1.80% finance and business services 1.70%, wholesale and retail trade 18.80%, hotel and restaurants 0.40%, construction 1.70%, others 13.00%.[41] As a result of political instability, corruption and poor macroeconomic management, there was a failure to diversify the economy that subsequently led to large reliance on the capital-intensive oil sector.[42] There have been suggestions for the diversification of the economy of the country as a solution to the large reliance on crude oil, which could subsequently lead to economic development.[43] This thesis submits that if the capital market works efficiently, there is the propensity for development in other sectors such as finance, business services,

[39] An efficient capital market is defined as one where the prices fully reflect the available information. This concept serves as the bedrock for this thesis and is discussed further in Chapter Two

[40] U. Nnakenyi, 'Diversifying Nigeria's sources of revenue: An urgent developmental need', iclass Nigeria, [blog], 2nd April, 2015 <http://iclass.ng/blog/index.php?entryid=2203> accessed 1 September 2016

[41] <http://focusafrica.gov.in/sector_profile_nigeria.html> accessed 20 September 2016

[42] *ibid*

[43] O. I. Ifeanyi, A. A. Nwuba, and B. Ndibe, 'Diversification of the economy: A panacea for Nigerian economic development' (2015) 2 International Journal of Multidisciplinary Research and Development, 477

construction etc. because there will be proficient allocation of capital for these sectors that can subsequently lead to development and an improved economy.

The above demonstrates that there are several factors that make the capital market an important branch of the financial system as a whole and it goes further to illustrate the connection between the capital market and economic growth of a country. For a capital market to function effectively, there is the continuous need for regulation and sanctions to avoid fraudulent acts and malpractices. The importance of this cannot be over-emphasised. The next section introduces the legal structure governing the Nigerian capital market and its evolution.

1.2.2. History and evolution of the legal structure of the Nigerian capital market

Nigeria was under British colonial rule until 1960 when it gained independence. Prior to gaining independence, the government sought funds for running the local administration and the primary sources of fund generation were agriculture and mineral mining.[44] These sources were inadequate in meeting growing financial obligations. Consequently, the administration decided to reform the system of revenue mobilisation, taxation and other payments. Additionally, there was the need to raise funds from the public to cover temporary shortfalls in funds availability. This necessitated the establishment of a financial system with infrastructure that would aid its take off pending the development of an organised private sector.[45] Consequently, the government developed the capital market in Nigeria. It is noteworthy there were traces of some less formal market arrangements for the operation of a capital market. Examples include, a 10-year Local Loan Ordinance for the floatation of the first three

[44] E.B Osaze, *Capital markets: African and Global*, (Bookhouse Company Nigeria 2007) 55
[45] *ibid*

hundred thousand-naira government stock with management vested on the accountant general in 1946. Furthermore, in 1957, the General Loan and Stock Act as well as the Local Loan (Registered Stock and Securities) Act were promulgated. Additionally, in 1958, the Central Bank of Nigeria was established. These legislations were aimed at establishing a legal and infrastructural framework for the takeoff of a viable securities market in Nigeria. In 1959, the Central Bank of Nigeria issued the first Nigerian Treasury Bills, which were meant to provide an avenue for the investment of short-term liquid funds in Nigeria and assist in providing the government with funds pending receipt of its own revenues.[46]

1.2.3. Lagos Stock Exchange

The Lagos stock exchange was incorporated on September 15, 1960 as a private limited liability company, limited by guarantee under the provisions of the Lagos Stock Exchange Act 1960. The Act ensured that the stock exchange had monopoly over the business of share dealings in the country, with the aim of ensuring that potential investors were protected by a self-regulatory organisation that proposed standards that would be adhered to by members. Additionally, it conferred the opportunity on the Central Bank to deal directly in securities. It opened up for business with 19 listed securities made up of 3 equities, 6 Federal government bonds and 10 industrial loans.[47]

The Lagos Stock Exchange Act was enacted with the primary aim of placing the stock exchange under some government control. Impliedly, the Lagos stock exchange was only operational in Lagos.[48] By the mid-1970s there was the need for

[46] *ibid*
[47] E.B. Osaze (n 44)
[48] One of the largest city in Nigeria and the African continent. It is regarded as one of the most populous urban agglomerations in the world. It is the major financial center in Africa as well as houses

an efficient financial system for the entire nation, which led to a review of the operations of the Lagos stock exchange. This review documented some problems associated with the market such as the huge amount of currency in circulation that was held outside of the banking system, unsatisfactory demarcation between the operation of commercial banks and the emerging class of merchant banks as well as the extremely shallow depth of the capital market.[49] In response to these problems, the government accepted the principle of decentralisation but opted for a National stock exchange. With the need for further growth of the economy, there was constant demand for more capital and the only way to get this capital was through the establishment of a National stock exchange with its services expanded to individuals and corporations in other part of Nigeria.[50]

1.2.4. The Nigerian Stock Exchange

Subsequent to the above, in 1979, the Lagos Stock Exchange Act was transformed and designed the basis for the creation of the Nigerian Stock Exchange. It was the foundation for trading in long-term securities needed for financing the industrial sector and the economy at large. This expansion established other branches of the stock exchange in Lagos, Kaduna (1978), Port Harcourt (1980), Yola (2002), Onitsha (1990) and Abuja (the current Federal Capital Territory), thus increasing the geographical scope of investment activity in the country.

The Nigerian Stock Exchange (NSE) is currently the center point of the Nigerian capital market with the Securities Exchange Commission (SEC) serving as

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one of the largest and busiest ports on the continent. It was one time the capital of Nigeria and often referred to as the commercial capital of Nigeria.

[49] L. Olawoye, 'Impact of capital market on economic growth of Nigeria', (Lekan Olawoye, 11 December 2011) <http://lekanolawoye.blogspot.co.uk/2011/12/impact-of-capital-market-on-economic.html> accessed 6 July 2016

[50] *ibid*

the apex regulatory body. The stock exchange currently has about 180 listed companies.[51] Most of the listed companies at the exchange have foreign or multi-national affiliations and represent a cross-section of the Nigerian economy, ranging from agriculture and manufacturing to services.[52]

Operations within the market are conducted on two levels, the primary and secondary level. The former is where securities are created. It is the market where firms sell new stocks and bonds for the first time. It is synonymous with initial public offerings (IPOs).[53] The latter is what is referred to as the stock market. This is the market where investors trade amongst themselves. In this market investors trade on previously issued stocks.

1.2.5. Regulation of the Nigerian capital market

At its inception regulation of the capital market was essentially through self-regulation by the NSE and provisions of the Lagos Stock Exchange Act 1960 and in some rare instances through the provisions of the Companies Act 1968. Additionally, the Central Bank of Nigeria also played an informal role in the regulation of the market. The NSE set up the market for trading in securities, management of operation efficiency as well as implemented a listing requirement and other rules that every company or authority wishing to participate in the market either as a trader or issuer of securities must comply with.

In response to the problems identified above the government promulgated the Securities and Exchange Commission Act 1988, which established the Securities and Exchange Commission (SEC) as the apex regulatory organization for the capital

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51 <http://www.nigerianstockexchange.com/Issuers-section/listed-securities/listed-companies> accessed 20 September 2016

52 A. Aliyu (n 5) 57

53 IPOs are when the private company sells stocks to the public for the first time.

market.[54] This was as a result of a recommendation of the Financial System Review Committee (FSRC) that was set up by the Federal Government to review capital market activities and proffer ways of developing the market in order to cope with challenges.[55] The SEC was saddled with the responsibility of developing and regulating the market in order to maintain proper ethical standards and professionalism. Furthermore, the responsibility to review and approve mergers, acquisition and combinations between or amongst companies was placed on the SEC.[56] Additionally, the privatisation and commercialisation Decree No. 25 was promulgated providing for the privatisation of some enterprises in which the Federal Government of Nigeria has equity interest and the commercialisation of Federal Government wholly owned enterprises. This exercise is credited with having attracted more companies to list their shares in the Nigerian Stock Exchange.[57] It should be noted that although the origin of the SEC dates back to 1962, its complete emergence was only actualized in 1980.

In 1999, the Investments and Securities Decree No. 45 became the Investment and Securities Act 1999 (ISA) by virtue of section 315 of the Constitution of the Federal Republic of Nigeria (CFRN) 1999.[58] Subsequently, the ISA 1999 was repealed and replaced by the ISA 2007, which was a product of a long process of

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[54] O. Sunday, E. Ewah, E. Atim, E. Esang and J.U. Bassey, 'Appraisal of capital market efficiency on economic growth in Nigeria' (2009) 4 International Journal of Business and Management 221
[55] Okigbo Committee of 1976
[56] *ibid*
[57] E. B Osaze (n 44)
[58] The CFRN 1999 by virtue of section 1(1) is the supreme law and its provisions have a binding force on the authorities and persons throughout the Federal Republic of Nigeria. Section 315 allows for modifications of an existing law as may be necessary. The principal effect of this is that it becomes an Act of the National Assembly to the extent that it is a law with respect to any matter on which the National Assembly is empowered by the constitution to make laws. Such modification becomes valid if the appropriate authority at any time by order makes such modifications in the text of the existing law as they deem necessary or expedient to bring that law into conformity with the provisions of the constitution.

consultation for the reform and modernisation of the rules governing capital market transactions.[59]

Separately from the provisions of the ISA, there are traces of laws in other legal provisions that have an impact on the capital market. Amongst such are, Central Bank of Nigeria Act 2007 as well as the Banking and other Financial Institutions Act 2004 (BOFIA), which regulates the activities of banks, including their investment in the capital market, as well as their use of the market to raise funds. Additionally, the Federal Ministry of Finance provides supervisory roles by formulating periodical monetary policy guidelines. Recently, the ministry introduced the new whistleblowing scheme aimed at improving public and institutional governance. Whistleblowing is defined as a deliberate non-obligatory act of disclosure that gets into public by a person who has or had privileged access to data or information of an organisation about non-trivial illegality or wrongdoing whether actual, suspected or anticipated which implicates and is under the control of that organisation to an external entity having power to rectify the wrongdoing.[60] Although it is a relatively recent concept, it has led to the recovery of significant sums of money laundered and stolen by politicians.[61] This thesis recommends that this policy be encouraged and promoted in the capital market, as its operation is still considered relatively foreign to Nigerians.[62]

Furthermore, the ISA introduced a fund that is aimed at protecting subscribers against loss and damage arising from the default of issuers and their agents. This fund

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[59] The ISA 2007 is divided into 18 parts dealing with various issues in the capital market.
[60] P. B. Jubb, 'Whistleblowing: A restrictive definition and interpretation', (1994) Journal of Business Ethics 77, 83
[61] Y. Adegoke, 'Nigeria's anti-corruption unit finds $43 million cash in Lagos apartment', (*CNN,* 14 April 2017) <http://edition.cnn.com/2017/04/13/africa/efcc-recovers-funds-nigeria/index.html> accessed 26 June 2017
[62] J. Onyekwere, 'Whistleblowers act is unknown to lawyers, says Akpomudje', *The Guardian* (Nigeria, 24 November 2015) <https://guardian.ng/features/whistleblowers-act-unknown-lawyers-says-akpomudje/> accessed 25 June 2017
SEC Nigeria (n 16) 6.8

is known as the Investors Protection Fund (IPF).[63] It requires a securities exchange or capital trade point to establish and maintain a fund that shall be administered by a Board of Trustees on its behalf. The fund consists of all monies paid to the Board of Trustees by the dealing members of the securities exchange and capital trade point, interest, profits accruing from the fund money recovered by the board and other monies lawfully paid into the fund.[64] These are kept in a separate bank account in Nigeria pending investment or application. The fund is required to be audited with balance sheets kept and is not to fall below the minimum amount approved for a securities exchange or capital trade point.[65] If it does, the Board of Trustees is required to take steps to make up the deficiency. It could do this by directing that an amount equal to the deficiency be transferred from other funds to the investor protection fund or determine the amount to be contributed by each dealing member if there are sufficient funds to be transferred to the fund. Persons that have suffered pecuniary loss can claim compensation from the fund and take appropriate judicial proceedings against the securities exchange or capital trade point to establish the claim. The claimant is usually entitled to the actual pecuniary loss suffered including reasonable costs of disbursements incidental to making and proving his claim less the amount or value of all monies or other benefits received or meant to be received by him from the source other than the fund in reduction of the loss.[66] Furthermore, interest is payable on the amount of compensation at 5% per annum commencing from the date of defalcation.[67] This is commendable, especially in instances where investors' compensation is delayed. Compensation claims are determined by a securities exchange, capital trade point, SEC or the Investment and Securities

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[63] ISA 2007, s.198
[64] Rules and Regulation of the SEC 2013, rule 203 (4)
[65] ISA 2007, s. 205
[66] *ibid*, s.213
[67] *ibid* s.213 (7)

Tribunal (IST). An aggrieved investor is required to make a claim for compensation in the first instance to a securities exchange or capital trade point, which verifies and determines the amount and extent to which the clam will be allowed within 30 days. If verified the aggrieved investor will be paid within 14 days of such verification by the securities exchange or capital trade point. The statutory time limit for verification and bringing the action is commendable if complied with, as they are capable of advancing the legitimate interests of investors. Where the claimant is dissatisfied with the determination made by the securities exchange or capital trade point, the matter is taken to the IST or Administrative Proceedings Committee (APC) of the SEC on the failure of the securities exchange or capital trade point to provide suitable redress.[68]

The statutory minimum that must be paid to the credit of an Investor Protection Fund on the establishment of a securities exchange or capital trade point shall be approved by SEC from time to time.[69] Conversely, the board of trustees shall have the discretion to determine the amount or minimum amounts to be contributed by each dealing member firm to the fund, subject to the approval of the securities exchange or capital trade point. In 2007, the SEC capped the amount recoverable at 200 000 Naira and more recently in 2013 removed the cap to a sum determined by the Board of Trustees.[70] This becomes problematic because, by interpretation, it means if the amount claimed by the investor is less than the limit, the claimant will recover his claims in full, but where it exceeds the limit, the claimant will only be compensated to the extent that his claim falls within the set limit. In the UK, the Financial Services Compensation Scheme (FSCS) provide a maximum compensation for firms in default of £85,000. A similar benchmark in Nigerian law is desirable to check the incidence

[68] *ibid* s.284 (1)(a)(III)
[69] ISA 2007, s.207
[70] E. O. Nwosu and C. Ngozi, 'Legal framework of Nigeria's investors protection fund', (2002-2010) 9 Nigerian Judicial Review 48, 57; Nigerian Stock Exchange Investor Protection Fund Rules 2013, r.4.04

of misappropriation and abuse of the fund as well as under compensation.[71] Although the creation of this fund is a good move in the protection of investors' of interests, this thesis argues that its application is not convincing. The cases of *Boat Nigeria Limited v Nigerian Stock Exchange*[72] and *Ezemgbe v Nigerian Stock Exchange*[73] serve as illustrations of the application of the fund in a manner that is unreasonable and puts the credibility of the fund to question.

The participants of the capital market are the operators who act as intermediaries between the provider of funds and the fund users, amongst which are, the securities exchange, brokers, dealers, issuing houses, jobbers, registrars, trustees, investment advisers, fund/portfolios managers etc. The SEC regulates these participants through the provisions contained in the Rules and Regulations of the SEC.[74] The SEC through its Rules and Regulations as well as the provisions of the ISA 2007, regulates public offerings of securities as well as disclosure of required information to guide investors in making a decision to invest or not.[75]

Section 13 (d) of ISA necessitates the registration of securities of public companies to be offered for subscription or sale to the public.[76] Additionally, registered public companies with securities in the market are required to file with the SEC on a periodic or annual basis and on a specified format, its audited financial

[71] *ibid*
[72] Unreported suit no IST/OA/03/07
[73] Unreported suit No. IST/OA/06/06 decided by the Investments and Securities Tribunal in 13th December 2006; Chapter 5, 5.2.2 for facts of the case.
[74] The SEC is charged with the overall control registration and regulation of investments and securities business in Nigeria as well as regulates the activities of capital market operators with the primary goal of maintaining a functional and sane capital market operations in Nigeria
[75] An investing company is charged with providing a prospectus that contains the financial statement of the issuer and every material information to the public.
[76] Also contained in Rule 106 of the Rules and Regulations of the SEC. It empowers the commission to monitor and regulate the shares of public quoted companies in Nigeria.

statement and other returns as may be prescribed by the commission.[77] The ISA 2007 grants the SEC the power to establish departments. One of such departments is the Administrative Proceedings Committee (APC) that serves as an ad hoc body that is convened to redress any wrongdoings in the securities industry and to impose penalties.[78] There is also the establishment of the Investment and Securities Tribunal (IST), which is a specialized court charged with handling disputes referred to the SEC.[79]

In relation to allotment of shares, issuing companies and issuing houses are responsible for this in accordance with the provisions of the SEC Rules and Regulations and SEC approval of such allotment.[80]

From the above historical outline, it is evident that the Nigerian Capital market has developed at a rather slow and unsteady pace when compared to its international counterparts such as the UK and USA. The market is held out to be small, illiquid and volatile.[81] Regardless of the increment in listed securities, trading activity is still very thin due to the reluctance of institutional and retail investors to trade in the secondary market.[82] Another reason for the apparent reluctance to trade can be largely attributed to the lack of a coherent structure and absence or inadequate structure for protection of investors.[83]

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[77] ISA 2007, s.60-65

[78] *ibid* s.14

[79] *ibid* s. 274 More details on the IST is contained in chapter 5

[80] *ibid* s.88; Companies and Allied Matters Act 2004, s124

[81] A. Babatunde and O. Olaniran, 'The effects of internal and external mechanism on governance and performance of corporate firms in Nigeria' (2009) 7 Corporate Ownership and Control 322

[82] *ibid*

[83] Evidence suggests that there is inadequate protection accorded to shareholders in Nigeria especially of the minority class as well as investors because of the presence of corruption, bribery, poorly functioning markets and lack of infrastructural competence to battle such acts. Furthermore managers and directors have been seen to utilise corporate opportunities and resources for their own personal benefit at the expense of the corporation, its shareholders and investors; B. Ahunwan, 'Corporate governance in Nigeria' (2002) 37 Journal of Business Ethics 274

The SEC was established in 1979, almost 20 years after the NSE was established. Furthermore, the first comprehensive legal document providing rules and regulations for the conduct of operations in the stock exchange are contained in the ISA 1999, thus indicating that the stock exchange ran without a regulatory organ for almost two decades and for another two decades with a regulatory organ weakened by the absence of a comprehensive legal document to assist in the discharge of its regulatory system.[84]

In view of the foregoing, this thesis postulates that, these reasons are largely responsible for the weak and illiquid nature of the market. This is further compounded by growth lapse and lack of adept rules capable of protecting investors. Based on the historical analysis above, one can only imagine the level of unruly acts that must have gone on within this period. Without doubt, this has the likelihood of affecting investor confidence and has the propensity to make them avoid the market all together.

1.3. Scope of thesis

This thesis examines the current legal provisions regulating the Nigerian capital market. It compares these provisions with similar provisions that are used for regulating the UK capital market with the end goal of identifying how to make the Nigerian capital market efficient. It is important to note at this stage that this thesis does not address every legal regulation governing the market. It identifies two major problems associated with the Nigerian capital market and explores prospects for reform of the rules regulating these issues. The aim of this thesis is to contribute to the field that studies the importance of an efficient capital market towards achieving economic development. Primarily, this thesis explores the following:

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[84] A. Sanda, S. A.S. Mikailu and T. Garba, 'Corporate governance mechanisms and firm financial performance in Nigeria' (2005) 149 African Economic Research Consortium 5.

- Theory of an efficient market as well as the factors responsible for building an efficient and strong market
- The impact of information asymmetry on investor confidence
- The importance of regulating disclosure in capital market with its focal point on the legal provisions governing the Nigerian capital market as well as exploring prospects for reforms to meet their foreign counterparts.
- The importance of reputational intermediaries in enhancing investor confidence. Furthermore, it examines the possibility of them being regulated as a guarantee for efficiency.
- The importance of enacting efficient regulations prohibiting insider trading in the Nigerian capital market. Additionally, it compares the substantive legal regulation of insider trading in Nigeria with that of the United Kingdom, with prospect for reform.

The findings and recommendations of this thesis will serve several purposes. Firstly, it will add to the sparse literature in relation to the importance of legal regulation of the Nigerian capital market. Secondly, it may educate the Nigerian government and lawmakers on the importance attached to enacting efficient rules to govern the capital market based on its importance as a thriving tool for economic development. This will be particularly useful as the Nigerian economy is currently in recession and no longer holds the position of Africa's largest economy. Additionally and as mentioned above, it will highlight how an efficient capital market in Nigeria can serve as a viable mechanism to generate capital needed to explore other areas in the search for diversification of the revenue of the economy. Furthermore, it can be used as a resource for the Nigerian government when enacting legal provisions governing the capital market. This thesis also seeks to identify the weak nature of the enforcement of these laws regulating the capital market in Nigeria.

In order to achieve the aims of this thesis, the primary research question to be addressed is:

> "***To what extent are the legal frameworks and enforcement procedures of the Nigerian capital markets effective as compared to those in the United Kingdom?'***.

In determining the efficiency of a capital market, one important factor that is taken into consideration is the provision of reliable information. The information disclosed to investors is an important factor utilised by investors when deciding on whether to invest. This to a large extent determines how efficient a market is. It has been said that the legal framework for an efficient capital market essentially mandates disclosure.[85] To achieve this, there is the need for rules mandating companies listed in the market to supply legally adequate information to investors.[86]

The issue of regulation is taken seriously in the UK and other developed countries. In recent times there have been sufficient literature on the impact adequate legal regulations will have on a capital market.[87] To demonstrate the importance of legal regulation of capital markets, following the global financial crisis that highlighted the weakness in global governance especially in relation to the international architecture, the European Commission mandated a group of high-level financial experts to study, evaluate and assess the European financial situation. They

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[85] R. Veil, (n 26) 210.

[86] *ibid*

[87] R. La Porta et al (n 3); R. Levine, 'Stock markets, economic development and capital liberalization' (1997) 3 Investment Company Institute; R. Levine, 'Law, finance and economic growth' (1999) 8 Journal of Financial Intermediation 32; D. Mansoor and M. Atkin,'Stock markets in developing countries: key Issues and a Research Agenda' (1990) The World Bank Working Paper WPS515 Washington D.C.

were tasked with making recommendations that are aimed at improving and reforming the system. One of their recommendations was the need to develop the legal and technical rules to ensure fast and effective mechanism for strong co-operation and above all, consistent regulation to avoid the previous lengthy process of addressing issues to the European Court of Justice.[88]

1.4. Structure of thesis

This thesis is composed of six chapters aimed at answering the research question and the structure of the remaining chapters are highlighted in turn.

Chapter two defines what an efficient capital market is. It explores different theories on the efficiency of a capital market by Eugene Fama. The work of Fama is explored because it is recognised as the leading empirical work on the efficient markets theory and its proponents have influenced public policy around the world.[89] Furthermore, it analyses three reasons that have been attributable to some countries having stronger capital markets than others. The reasons analysed are 'Law and Finance, 'Politics and Finance, and 'Endowment and Finance'.

Chapter three discusses the problem of information asymmetry. It highlights the effects it can have on capital markets as well as explores ways that it can be curtailed through disclosure and the presence of reputational intermediaries. It discusses the importance of regulating these concepts legally in a bid to achieving an efficient market. It compares the regulation of disclosure in Nigeria with that of the UK as well as enforcement mechanisms of the said regulation. Furthermore, it

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[88] N. Kost De Severes, 'The new European financial markets legal framework: a real improvement? An analysis of financial law and governance in European capital markets from a micro and macro-economic perspective' (2011) 7 Capital Markets Law Journal 31

[89] R. Sinquefield, 'Eugene Fama's efficient market is a sound guiding principle for investors and policymakers', (*Forbes,* 17 October 2013) <https://www.forbes.com/sites/rexsinquefield/2013/10/17/eugene-famas-efficient-market-is-a-sound-guiding-principle-for-investors-and-policymakers/#ac2889f680c9> accessed 16 May 2017.

explores ways in which disclosure can be managed i.e. through the use of reputational intermediaries and how they can be regulated with the aim of achieving excellence in the capital market.

Chapter four examines the problem of insider trading/dealing. It highlights the likely effects of the offence on the market and identifies the reasons attributable for traces of it in the Nigerian capital market. Furthermore, it compares the legal provisions prohibiting insider trading in Nigeria with that of the UK and recognizes that some of the legal provisions governing the Nigerian capital market are not capable of dissuading market participants and corporations from engaging in the act. It highlights the importance of these regulations and identifies prospects for reform of the provisions. Additionally, it compares enforcement of these laws in Nigeria with enforcement of laws regulating the act in the UK.

Chapter five identifies some further issues relating to legal regulation of the Nigerian capital market. It explores the importance of the rule of law, efficient rules, awareness, enforcement mechanisms and the operation of corporate governance as important catalysts in developing efficient capital markets.

Chapter six concludes this thesis by giving a summary of the issues identified and highlights the importance of adopting the recommendations of this thesis in the bid to make the Nigerian capital market more efficient.

1.5. Research Method

This thesis applies both '*doctrinal'* and '*comparative* analysis in achieving the aim of the thesis. It is important to highlight that this thesis employs a mix of inter-disciplinary research due to the reliance of economics/sociology literature in propelling its arguments.

1.5.1. Doctrinal Methodology

Doctrinal analysis is applied in this thesis because it is regarded as the traditional methodology used for research in law.[90] It basically concerns the formulation of legal doctrines through the analysis of legal rules.[91] It has been defined as research aimed at solving uncertainties and gaps in existing law by analysing and giving systematic exposition of principles, rules, and concepts governing a particular field or institution.[92] It usually has three main goals, which are to describe, prescribe and justify.[93] This basically connotes describing the current legal regulation and identifying possible loopholes, prescribing prospects for reform or amendment and justifying the reasoning for the prescription with cogent and applicable explanations.

The key steps for doctrinal research can be grouped into four stages. Firstly, analysing legal issues in order to identify the issue or issues that need further research. Secondly, determining the relevant law that is applicable to the issue or issues. Thirdly, the facts in terms of law are analysed with an aim to fuse the issues with the applicable rules. Finally, having conducted the analysis, the research comes up with a probable conclusion based on the facts established and the law considered.[94] In applying this methodology to this thesis, it is rightly identified that in running the capital market in Nigeria, there are some regulatory issues associated with the market that tends to be affecting the reputation of the market as a viable place to invest. This is evident from the fact that investors allegedly avoid the Nigerian capital market as it

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[90] A. K. Singhal and I. Malik, 'Doctrinal and socio-legal methods of research: merits and demerits' (2012) 2 Educational Research Journal 252.

[91] P. Chynoweth, *Legal research*, in A. Knight and L. Ruddock, *Advanced research methods in the built environment,* (Wiley-Blackwell 2008) 29

[92] J. M. Smits, 'What is legal doctrine? On the aims and methods of legal-dogmatic research', Maastricht European Private Law Institute, Working paper, No.2015/06, p.5 Available at <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2644088> accessed, 8 August 2016

[93] *ibid* p.8

[94] *ibid*

is held out to be illiquid and weak.[95] This thesis highlights the legal regulations charged with making the market a viable place for investment and asserts that the legal regulations are either not sufficient or are not being applied in the right way. This is as a result of the regulations not being available or not being sufficient. It makes some recommendations on how to make these legal regulations function more efficiently based on comparison with similar provisions in the UK.

1.5.2. Comparative Analysis

This thesis also utilises comparative analysis by comparing the legal provisions regulating highlighted issues in the Nigerian capital market with similar provisions contained in the UK. Comparative analysis is described as the investigation of rules and procedures not of one system in isolation but in harness with the examination of the equivalent rules and procedures in at least one other system.[96] It is the study of the similarities and differences between the laws of two or more countries or between two or more legal systems. The aim of most comparative studies is to imply some form of comparative law by making some part of the domestic law more coherent by external comparison. When attempting to improve a legal system, it is important to analyse the other side of the border especially if the area aimed at been improved is already thriving in the other country. However, importing solutions from other countries may not necessarily work all the time because of a difference in context.

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[95] A. Aliyu, (n 5) 56

[96] A. Watson, *Legal transplants: An approach to comparative law*, (2nd Edition University of Georgia press 1993) 2

Comparative legal research has gained considerable popularity recently because it has profited from the efforts to harmonize the law of the member states of the EU.[97] It can be carried out in three ways

i) Descriptive comparative law

ii) Comparative history of law

iii) Comparative legislation or comparative jurisprudence.[98]

This thesis applies the third category, comparative legislation, which represents the effort to define the common basis on which present national doctrines of law are designed to attach themselves as a result of both the development of the study of law as a social science and of the legal consciousness.

Although this method has been utilised often in recent times, it is important to note that there have been some identifiable disadvantages accorded to this mode of research. Firstly, it is seen as superficial as it is hard enough to know in detail one branch of the law of one system, as well as the history of that branch and its relationship with that of another system.[99] Secondly, there is the possibility of getting the foreign law being used wrongly.[100] Error of law has been held out to be more common in comparative law than in any other branch of legal study mainly because the understanding of the foreign law depends on the writings of others including other comparatists.[101] It has been held that too often, little knowledge is derived from too few original sources and too frequently linguistic deficiencies interpose a formidable barrier between the scholar and his subject.[102] Thirdly, the systems chosen for study

[97] M.V. Hoecke and M. Harrington, 'Legal cultures, legal paradigms and legal doctrine: Towards a new model for comparative law' (1998) 47 International and comparative law quarterly
[98] A. Watson (n 96) 3
[99] *ibid*
[100] H. C. Gutteridge, *Comparative law*, (2nd Edition, Cambridge University press 1946) 15
[101] A. Watson, (n 96) 11
[102] *ibid*

may have no proper relationship, thus making the conclusions insignificant. Additionally, systems may be examined at different points in their evolution[103]

This thesis applies the comparative analysis method because firstly, both countries are common law countries and possess similar companies act. Historically, Nigerian laws particularly the legal rules governing economic organisation have been adopted from the UK both in its systemic and single-rule variations. In particular, the first Company Law in Nigeria was the Companies Ordinance of 1912, which was a local enactment of the Companies (Consolidation) Act 1908 of England, and the current Companies and Allied Markets Act is largely modelled on the U.K Companies Act 1985.[104]

In view of the above, this thesis submits that the application of comparative analysis in this thesis is beneficial in numerous ways that are identified in turn. Firstly, by comparing the laws in Nigeria and the UK, it serves as an instrument of learning as the information of the laws in the UK can lead to better understanding and possibly the need to implement the same in the Nigerian capital market. It serves as a way in which the laws regulating the Nigerian capital market can be enhanced by application of the relevant sections compared with that of the UK. This can serve as a way to improve the legal system. Furthermore, this thesis highlights some loopholes in the legal regulations of the Nigerian capital market. These problems have been experienced by the UK at some point and they have updated their legal regulations to cater for these issues whilst the Nigerian legal regulations are mostly unchanged. It is important to note that there are already traces of legal regulations similar to those in the UK regulating the Nigerian capital market. However, these laws have not evolved

[103] *ibid* 11
[104] A. Guobadia, 'Protecting minority and public interest in Nigeria company law: The corporate affairs commission as a corporations Ombudsman' (2000) 1 International Company Law Annual 80

with current trends to meet the prevailing issues concerned with adept regulation and efficient enforcement.

In the next section, the doctrine of '*Legal transplants'* is discussed. It is important to highlight this theory because this thesis puts forward several recommendations based on how these issues have been tackled in the UK, with a view of adopting same in Nigeria.

1.6. Legal transplants

A legal transplant involves moving a rule or a system of law from one country to another.[105] It is an artefact of globalisation, in that legal knowledge transcends borders and enables lawmakers, regulators, judges and lawyers to discover and import legal solutions for local problems in the global market of legal ideas.[106] The core purpose of legal transplants is to enable countries to compare their laws with those in other countries. The country seeking to 'transplant' laws may have a particular area that it hopes to improve.

Comparison has been described as an instrument used to falsify or verify the relationship between two phenomena.[107] Different countries in their search for best practices have utilised this method by comparing their laws with similar laws in other countries with a view to importing some of the rules from the other country especially if it has worked well. For example, in the search to counteract congestion in inner cities, countries draft relevant rules in consideration of the London congestion

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[105] A. Watson (n 96) 21

[106] M. A. Waters, 'The future of transnational judicial dialogue' (2010) 104 American Society of International Legal Procedures 465

[107] H. Xanthaki,'Legal transplants in legislation: defusing the trap' (2008) 57 International Comparative Law Quarterly 659

regulations; utilising results produced by the application of the congestion zones in London.[108]

Legal transplants are commonplace.[109] It was used to shape several European countries in the late 18th and 19th century.[110] It is diffusionism based (i.e. a means to spread the legal provisions) and is the most common source of legal developments. The history of a legal system is largely filled with legal materials from other legal systems and of assimilation of materials from outside of the law.[111] Such legal transplants range from the wholesale adoption of an entire system of laws to copying of a single rule.[112] The current trend of legal globalisation creates fertile grounds for transplants from legal systems not only within the region or country of reception but also further afield.[113]

As identified in this chapter Nigeria is currently in economic recession.[114] Studying the legal regulations of the capital market in Nigeria is beneficial at this stage because if the stock market operates efficiently there is the possibility of generating capital that can be used to explore other areas in an attempt to diversify the economy. Additionally, if demand for law is high, there will be high voluntary compliance and such countries invest in the legal institutions necessary to uphold any legal order.

Some writers may argue that the rules utilised in the United Kingdom for regulating their capital market may not necessarily work in Nigeria. This thesis argues that this is unlikely to be a problem as the reception of a transplanted law is possible

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[108] *ibid*
[109] *ibid*
[110] D. Berkowitz, K. Pistor and J. F Richard, 'The transplant effect' (2002) 51 American Journal of Comparative Law 170
[111] R. H. Lowie, *Primitive society*, (New York 1920) 441
[112] H. Kanda and C. J. Milhaupt, 'Re-examining legal transplants: The directors fiduciary duty in Japanese corporate law' (2003) 51 American Journal of Comparative Law 887
[113] *ibid*
[114] <http://www.bbc.co.uk/news/business-37228741> accessed 2 September 2016

and still easy even though the receiving society is much less advanced materially and culturally.[115] Nigeria as a country is classified as a developing country, compared to the UK that is already developed. Furthermore, common law migrated quite naturally into Nigeria because it was a British colony.[116] It is important to note that the Nigerian judicial system has its blueprint from the UK. Moreover, lawmakers in developing countries are always keen to improve the potential of their countries to attract capital due to intensified international competition.[117] In view of this, they tend to compare their provisions with other countries provisions with a view to improve theirs to attain international standards.

In view of the foregoing, this thesis submits that the suggestions and recommendations highlighted in this thesis will function well in the regulation of the Nigerian capital market as evidence indicates that transplantation of legal codes into Nigeria began as far back as the nineteenth century.[118] The legal rules governing economic organisation is a primary example of the transplant phenomenon both in its systemic and single-rule variations. It has been identified in this chapter that Nigerian company laws regulations have largely been based on UK company laws. There are also traces of Nigeria borrowing laws that have been successful in other countries, for instance the Australian mode of industrial arbitration.[119] Moreover, the transplanting of legal rules have been held to be socially easy regardless of any opposition there might be either from the bar or the legislature as they move easily and are accepted into the system without so much difficulty.[120] However, the process of transplanting

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[115] A. Watson (n 96) 99
[116] D. Nelken and J. Feest, *Adapting legal culture*, (Hart Publishing 2001) 94
[117] D. Campbell and M. Siems, 'Convergence, legal origins for transplants in comparative corporate law: A case based and quantitative analysis' (2015) 63 American Journal of Comparative Law 114
[118] T. O. Elias, *The Nigerian legal system*, (Oxford University Press 1963) 3, 39, 58, 113
[119] P. O. Omaji, 'Legal transplantation: A case study of the migration of the Australian collective labor law to Nigeria' (1993) 34 Law context, A Socio-legal Journal 38
[120] T. O. Elias (n 118) 98

regulations might face some challenges as Nigeria has been described to exude attributes of an ineffective legal system because the transplant of UK corporate laws have not been efficacious.[121] The reasons allied to the foregoing include the ineffectiveness of the judiciary, operation of corruption and lack of enforcement of these laws.[122]

The suggestions advanced in this thesis will be beneficial, as these laws will help create some firmness in the regulation of the Nigerian capital market. At this stage in Nigeria, an efficient capital market will be beneficial to the country as it has the propensity to spur economic growth. This is borne out of the argument that economic performance and inefficient governance in Nigeria has been attributable to weak laws and legal institutions.[123]

Although evidence indicates traces of transplanted regulations governing the capital market in Nigeria, there is also evidence that indicates dearth of management of the economy in Nigeria, which basically postulates that these laws have been ineffective or not applied properly.[124] This is unfortunate because Nigerian corporate governance law is regarded as one of the most sophisticated in the African region. However, paradoxically, there are still reports of corporate fraud, shareholders rights being disparaged, and the judiciary being ineffective in tackling these dangerous developments.[125]

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[121] J. A. Arewa, 'Evolution of the Nigerian legal order: implication for effectiveness, economic growth and sustainable development' (2012) 1 NIALS Journal of Law and Public Policy 3-5
[122] These issues are discussed further in Chapters 3, 4, and 5
[123] J. A. Arewa (n 121) 2
[124] *ibid*
[125] P.E.G. Angaye, 'Corporate governance in infancy and growth: An interview-based study of the development of governance and corporate regulation in Nigeria', in S. Uddin, *Corporate governance in less developed and emerging economies*, (Bingley Emerald group publishing limited 2008) 359

In order to succeed, a legal transplant must be accepted to the general and legal culture in which it is inserted.[126] For the law to be effective, it must be meaningful in the context in which it is to be applied so citizens have incentive to use the law and to demand institutions that work to enforce and develop the law.[127] When countries are faced with drafting instructions for new legislation, they turn to countries with a similar legal system, language and legal tradition that are familiar to theirs because of the need to harmonise the chosen solutions with international practice.[128]

It has been argued that there is the likelihood for countries that transplant laws to suffer from what is referred to as the 'transplant effect'.[129] Furthermore, there is also the argument that countries that have developed their own laws have a comparative advantage to countries that have transplanted because internal development can take advantage of new solutions as economic agents develop in response to new challenges for existing constraints.[130] This thesis refutes these arguments and argues that this is not applicable to Nigeria because internal development has not being practised in the country. Most of the legal regulations are transplanted and amended to suit its applicability in the country. Additionally, this thesis provides that the suggested rules will work efficiently in the Nigerian Legal System when it applies to the capital market because there are already traces of rules governing the Nigerian capital market that are similar to those contained in the UK. Moreover it has been held that transplant of laws may be more receptive and grow if

[126] L. F. Del Duca and A. A. Levasseur, 'Impact of legal culture and legal transplants on the evolution of the U.S legal system' (2010) 58 American Journal of Comparative Law 1
[127] H. Kanda and C.J. Milhaupt, (n 112) 890
[128] JHM van Erp, 'The use of comparative law in the legislative process', in Netherlands reports to the 15th International congress of comparative law, (Bristol, 1998), 36
[129] This effect postulates the likely mismatch between pre-existing conditions, institutions and transplanted law that has the likely effect of weakening the effectiveness of the imported legal order.
[130] D. Berkowitz et al (n 110) 170

it has familiarity with the legal system that it uses as a model for borrowing.[131] This would be evident in Nigeria as the legal system has its blueprint from the UK due to colonial ties with the country. There is also the argument that the fact that countries share a common root is no guarantee of a successful transplant. For example most European countries have their legal systems developed on the basis of the Roman Law; however, they have developed distinct legal systems in subsequent years.[132] This thesis argues that this will not be applicable to Nigeria and the UK because, other than the fact that they have common roots from the past, there are laws from the UK that are embedded into the Nigerian corporate legal and judicial sphere. These laws were transplanted from the UK to Nigeria. Their perceived ineffectiveness is tied to the fact that the laws have not evolved or have not been updated as practiced in the UK.

1.7. Conclusion

This thesis addresses the regulation of <u>two</u> primary issues affecting the Nigerian capital market. They are *information asymmetry* and *insider trading*. It is important to note that these two issues by no means cover all the problems associated with the market. But these two problems are major issues that prevent the capital market from attaining its full potential. Their importance is further accentuated by the fact that investor confidence is currently low due to the twin factors of the 2008 market crash and lack of investor protection regulations.

[131] *ibid* 180
[132] *ibid*

2. THEORIES OF AN EFFICIENT CAPITAL MARKET

2.1. Introduction

Economic development is imperative for the continued survival of a country. In an attempt to ascertain what determines economic growth, several theories have been put forward and one of them postulates that a country with an efficient capital market is likely to have a developed economy.[1] An argument for this notion is that a country with an efficient capital market possesses the pre-requisite capital for major projects if efficiently allocated, which in turn has the likelihood to enhance development in a country.[2] Investors are inclined to invest when they are confident in the market structure by virtue of being provided with accurate information as well as being guaranteed to a reasonable extent that they will receive returns for their investments in form of dividends or interests and will not be expropriated of their investments.[3] Establishing an efficient capital market rests on a complex network of legal regulations and market institutions that create an avenue for investors to receive adequate and correct information about the value of a company's business.

This chapter identifies and discusses the different theories of an efficient market. Furthermore, it examines other reasons/theories that have been put forward as to why some countries have stronger capital markets than others. The theories

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[1] L. Burn and E. Greene, 'What are capital markets and what are they for? (2016) 11 Capital Markets Law Journal 343

[2] R. Ngugu, D. Amanja and I, Maan, Capital market, financial deepening and economic growth in Kenya', (2009) Research Paper, Centre for the study of African Economies, Oxford University1-3
Centre for capital markets competitiveness, 'Strengthening US capital markets: A challenge for all Americans', (2008) US Chamber of commerce,
<http://www.capitalmarketssummit.com/files/2010/11/2008_Report.pdf?ce474b> accessed 20 August 2016

[3] B. S. Black, 'The legal and institutional preconditions for strong securities markets' (2001) 48 UCLA Law Review 781.

analysed are '*law and finance theory*', '*politics and finance theory*', and '*endowment and finance*'.

2.2. Efficient Capital Market Theory

As early as the 1960s economists had begun empirical research on what constitutes an efficient capital market. One of the first people to come up with the theory as to the efficiency of a market was Paul Samuelson in 1965.[4] However, in 1970 Eugene Fama in his seminal article defined an efficient capital market as one where prices always "fully reflect" available information.[5] He stated that an efficient capital market was "one where the necessary information is available to all market participants with no transaction cost". He stated further that all participants of the market agree on the implication of current information for the current price and distribution of future prices of each security.[6] Hypothetically speaking, an efficient market is one in which a trader cannot improve his overall chances of speculative gain by obtaining information about companies whose securities are in the market and evaluating that information intelligently in determining which stocks to buy and sell.[7] This theory implies that security prices adjust rapidly to new information in an unbiased manner and prices change randomly.[8] The notion of price changing in a random manner postulates that if every other thing is equal with the flow of information unimpeded

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[4] P. Samuelson, 'Proof that properly anticipated prices fluctuate randomly' (1965) Industrial Management Review 6.2

[5] E. Fama, 'Efficient Capital Markets: A review of theory and empirical work', (1970) 25 Journal of Finance 383

[6] *ibid* 387

[7] D. R. Fischel, 'Efficient capital market theory, the market for corporate control and the regulation of cash tender offers', (1978) 57 Texas Law Review 4

[8] B. Lev, *Financial statement analysis: A new approach*, (Englewood cliffs, NJ: Prentice Hall Inc, 1974)

and immediately reflected in stock prices, then tomorrow's price change will reflect only tomorrow's news and will be independent of price changes today.[9]

Efficiency of a market is a result of competitive efforts of securities analysts and investors who strive to earn superior returns by identifying misplaced securities that are either over valued or undervalued.[10] This theory has gained significant cognizance and is regarded as the blueprint for an efficient capital market.[11] A likely explanation for the continuous recognition of this theory is the fact that information is of paramount importance to investors when deciding to invest.[12] If the information depicts reliability, there is the propensity for investors to invest. Additionally, a market that shows change in circumstances for stocks will attract more investors because it can be argued that nothing is hidden from investors.

The importance of this theory is fundamental to this thesis as it explores the proponents that are a crucial element to the proper functioning of the Nigerian capital market. Additionally, this is central to eradicating information of asymmetry and the prohibition of insider trading.[13] In establishing this theory, Fama proposed three tiers of market efficiency; weak form efficiency, semi-strong form efficiency and strong form efficiency. These are now considered in turn.

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[9] B. Malkiel, 'Efficient market hypothesis and its critics' (2003) 17 Journal of Economic Perspective 59
[10] D.R. Fischel, (n 7) 4
[11] *ibid*
[12] P.M. Healy, K.G Palepu, 'Information asymmetry, corporate disclosure and the capital markets: a review of the empirical disclosure literature' (2001) 31 Journal of Accounting and Economics 406
[13] These issues are discussed in Chapter 3 and 4 respectively.

2.2.1. The Weak Form of Market Efficiency

This connotes a market where little or no information is available or reflected on security prices. In this form, prices cannot be predicted by an analysis of past prices.[14] It suggests that the movement in share price on any one particular day is not correlated with the share price the next day hence, making it impossible to predict new share price movements from old share price movements.[15] The consequence of this is that investors cannot earn abnormal returns.[16]

This theory was developed from the 'random walk' theory, which suggests that the past movement or trend of a stock price or market cannot be used to predict its future movements (i.e. the prices develop randomly and are not deducible from past prices).[17] It indicates impossibility of outperforming the market without assuming additional risks. Critics of the random walk theory argue the possibility of outperforming the market by carefully selecting entry and exit points for equity investments.[18] The economies that fall under this tier are characterized by unavailability of up-to-date information and inability to follow rapid and/or consistent change of share prices. The test to determine the weak form of market efficiency is the examination of the interrelationship between current and past stock prices.[19]

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[14] R. Pike and B. Neale, *Corporate finance and investment: Decisions and strategies,* (5th Edition, Pearson Education 2006) 36

[15] P. Barnes, *Stock market efficiency, insider dealing and market abuse*, (Gower & Ashgate 2009) 46

[16] Abnormal returns are generated by a given security or portfolio over a period of time that is different from the expected rate of return. It is a summary of how the actual returns differ from the predicted returns.

[17] B. Malkiel, *A random walk down Wall Street: The time tested strategy for successful investing,* (W. W. Norton & Company Inc. 2007) 24

[18] S. R. Vishwanath and C. Krishnamarti, *Investment management: a modern guide to security analysis and stock selection,* (Springer 2009) 502

[19] V. K. Gimba, 'Testing the weak form efficiency market hypothesis; evidence from Nigerian Stock Market' (2010) 3 Central Bank of Nigeria Journal of Applied Statistics 122.

Research indicates that the Nigerian capital market is efficient in the weak form.[20] Prices in the capital market are fixed daily based on the demand and supply mechanism as well as on performance information documented either in periodic reports or brief by the managing director of a company to the dealing members of the Nigerian Stock Exchange.[21] Prices in the secondary market are determined by considering quantitative and qualitative characteristics. The former entails studying the fundamentals of a company by analysing its earnings record, earning projections, asset structure, dividend record, growth records, cash flows etc. The latter involves judgment on the future projection of the company, judgment on equality of management, quality of the products of the company, monetary and fiscal policies of government etc.[22]

Regardless of the above methods of price determination, the market is considered weak because companies still complain about their shares being undervalued. The principal reason for this is that technical analysis or other forms of security analysis based on historical prices appear to be valueless in the Nigerian capital market. This is further accentuated by the fact that stockbrokers are not sufficiently familiar with companies' operations to enable them put a fair price on the company's shares.[23] Other factors considered include inadequate information flow in the stock market, inefficient communication system, inadequate understanding of

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[20] G. C. Okpara, 'Analysis of weak-form efficiency on the Nigerian Stock Market: Further evidence from the GARCH model', (2010) 4 The International Journal of Applied Economics and Finance 62
R. Olowe, 'Weak form efficiency in the Nigerian stock market: Further evidence' (1999) 11 African Development Review 64
O. F. Ayadi, 'The Nigerian capital market and the random walk hypothesis' (1990) Unpublished MSc dissertation, University of Lagos
J. M. Samuels and N. Yacot, 'Stock exchanges in developing countries' (1981) 4 Savings and Developments
[21] R. Olowe (n 20) 54
M. Ajao, 'Testing the weak form of efficient market hypothesis in Nigerian capital market', (2012) 1, Accounting and Finance Research 169
[22] R. Olowe (n 20) 54
[23] *ibid*

financial information by Nigerian investors, low level of automation in the country and interference by the regulatory authorities in the determination of secondary market prices.[24] Furthermore, prior to public offers and announcements in the Nigerian capital market, there is usually an erratic price movement that often has minimal effect on pricing but creates the possibility of price volatility.[25] This is because prior to the information being made public through an official announcement, it had already arrived in the market, thus creating the possibility for overestimated prices of stock.[26] Further reasons for classifying the Nigerian capital as weak includes the fact that the SEC adopts a lacklustre attitude towards abnormal financial activities and does not monitor the market closely to enable it grow and achieve optimal maturity as well as the inadequacy in risk management and market discipline that results in greed and bad choices.[27] A consequence of these factors is the inefficiency of the market that paves way for individuals to reap abnormal returns.[28] These reasons are partly responsible for lack of depth in the market, because investors will not be encouraged to invest in a market characterised with inadequate and inaccurate information, which essentially are characteristics of a market categorized in the weak form.

[24] *ibid*
[25] W. Bewaji, *Insider Trading in developing Jurisdictions: Achieving an effective regulatory regime*, (Routledge 2012) 203
[26] *ibid*
[27] V. K. Gimba, (n 19) 125
[28] J. N. Mojekwu, and S. Ogege, 'Econometric investigation of the random walk hypothesis in the Nigerian stock market' (2013) 1 Journal of Emerging Issues in Economics, Finance and Banking 394

2.2.2. The Semi- Strong Form of Market Efficiency

In this form, share prices adjust to publicly available information rapidly in an unbiased fashion, thus no excess returns can be earned by trading on that information.[29] In this form neither fundamental analysis nor technical analysis will be reliable to produce excess returns.[30] Further, as current market prices reflect all publicly available information, no one can consistently outperform the stock market to earn abnormal returns. It recognizes that insiders could outperform the stock market because of their possession of private information.

The test for the semi-strong form has been described as event studies, where the reaction to announcement of a new piece of information both during the days prior to and after the event is analysed. [31] An adjustment to previously unknown news that ought to be reasonable in size and instantaneous is also analysed.[32] If there are any such adjustments, it would suggest that investors had interpreted the information in a biased fashion and hence in an inefficient manner.[33] These tests concentrate on the ability of the market to anticipate stock price changes before new information is formally announced.[34]

A tough question that resurfaced in the years following Fama's theory is the meaning of publicly available information. When is information publicly available? Which information is public?[35] It has been stated that for the efficient capital market hypothesis put forward by Fama to be plausible, it has to provide clear explanation of

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[29] M. C. Jensen, 'Some anomalous evidence regarding market efficiency' (1978) 6 Journal of Financial Economics 99

[30] L. H Dymond, *A recent history of recognised economic thought: Contributions of the Nobel Laureates to economic science,* (Lulu Publishing, 2015) 584

[31] P. Barnes (n 15), 46

[32] J. N. Kallianiotis, *International financial transaction and exchange rates: trade, investments, and parties*, (Palgrave Macmillan 2013) 74

[33] G. Chege, 'Efficient market theory and tests', Godfrey Chege, The Accountant [web blog], <http://godfreychege.blogspot.co.uk/2014/01/efficient-market-theory-and-tests.html> accessed 3 May 2015

[34] *ibid*

[35] W. F. Sharpe, 'Efficient Capital Markets; Discussion' (1970) 25 Journal of Finance 419

what is meant by publicly available information.[36] Some scholars define publicly available information as information available to an investor at zero cost.[37] This thesis concurs with this definition and adds that such information in addition to being available at zero cost should be easily accessible by prospective investors for it to be categorised as public information. Furthermore, making such information available on accessible platforms such as the internet and other databases will be beneficial to support this theory. Public information includes inter alia, past prices, data reported in a company's financial statement (such as income statements, filing before the SEC, annual reports etc.) earnings, dividends announcements, announced merger plans, financial situation of a company's competitors, expectations regarding macroeconomics etc. However, it is important to note that public information need not be only of a financial nature.[38]

The rationale behind this theory is that all things being equal, investors should not be able to profit consistently by trading on publicly available information. However, the identification of publicly available information is not precise and information in a capital market is not labelled to indicate the shares it affects or does not affect.

2.2.3. The Strong-Form Market Efficiency

This theory provides that all relevant information (i.e. information that will enable an investor make a decision if to invest) whether publicly or privately held are made available to investors.[39] This model of the efficiency theory postulates that profits

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[36] M. C. Jensen, (n 29) 97

[37] R. Ball, What do we know about Stock market efficiency' in R. M. C. Guimaraes, B. G. Kingsman and S. J. Taylor, *A reappraisal of the efficiency of financial markets,* (1989, Springer-Verlag) 28

[38] J. Clarke, T. Jandik, and G, Mandelker, The efficient markets hypothesis, in R. Arffa, *Expert financial planning; advice from industry leaders*, (Wiley & Sons 2001)

[39] P. Barnes (n 15) 47

exceeding normal returns cannot be made regardless of the amount of information that investors have access to. It is the most compelling form of the efficiency theory but it suffers one substantial setback, the emergence of insider trading.[40] Large markets are efficient in the weak and semi-strong form, but not the strong form due to the secrecy of insiders, who are privy to information that can modify prices. When such information is kept from the investing public or utilised before it is scheduled for public consumption, the strong form efficiency becomes unattainable.[41] This theory posits that any barrier preventing private information from becoming public information or the operation of insider trading makes this theory unattainable.

To affirm this theory, the market needs to exist where investors cannot consistently earn excess returns over a period of time. Academics have not been able to carry out test for this form as performed in other forms because of the secrecy of inside traders.[42] This tier of the theory has largely been developed by observing market reactions prior to the announcement of an important piece of news that insider dealing has occurred on such a large scale as to alter the prices of shares.

2.3. Criticism of the Efficient Market Theories

The efficient capital market theory is considered a maintained hypothesis.[43] Decades after its emergence there have been different theoretical and empirical works with findings that contradict the efficient market theory entirely or which sought to show that its case has not been proven. Different arguments against the theory have emerged to which this thesis now examines.

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[40] Chapter 4 for the discussion on insider trading
[41] M. Lamo De Espinosa Abarca' The need for substantive regulation on investor protection and corporate governance in Europe: Does Europe need Sarbanes-Oxley?' (2004) 19 Journal of International Banking Law and Regulation 14
[42] P. Barnes (n 15) 47
[43] S. P. Kothari, 'Capital markets research on accounting' (2001) 31 Journal of Accounting and Economics 105, 110

First, it was argued that the theory assumes that all market participants have the same expectations about future securities markets, i.e. they arrive at a rational expectation forecast thus making it impractical because trade in securities implies the existence of different expectations and, as such, the essence of trade would be defeated if participants had similar expectations.[44]

Second, although share prices adjust to new information, it is not as instantaneous as put forward in the hypothesis.[45] Price convergence to value has been described as a much slower process.[46] Furthermore, the manner in which news is interpreted is not addressed in the theory. Although there is the possibility of equal access to information by virtue of modern technology, interpreting the information may be a challenge. Not every investor understands the information given to him or her and the effect of the inability of average retail investors to utilise information disclosed has been well documented.[47] This argument implies that interpreting information may take some time and generate costs. Retail investors that are not financially knowledgeable may employ skilled personnel to explain the content of the information to them and the time used for interpreting information is vital when defining the various stages of efficiency.[48]

Third, although the theory indicates that it will be self-defeating to make excessive profits out of public information in an efficient market, it however does not cover why profit as such is not a sustainable phenomenon.[49] Entrepreneurial profit is described as the eagerness of buyers to outbid others who are equally anxious to

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[44] F. Shostak, 'In defense of fundamental analysis: A critique of efficient market hypothesis' (1997) 10 The Review of Austrian Economics 29

[45] J. Clarke et al (n 38) 135

[46] R. Frankel and C. M. C. Lee,' Accounting Valuation, Market Expectation and Cross-Sectional Stock Returns' (1998) 25 Journal of Accounting and Economics 315

[47] G. S Willemears, *The EU issuer-disclosure regime: Objectives and proposals for reform,* (Wolters Kluwer, 2011)

[48] H. Hans-Herman, 'On certainty and uncertainty, or: How rational can our expectations be? (1997) 10 Review of Austrian Economics 52

[49] J. Clarke et al (n 38) 139

acquire shares in limited supply.[50] It has been argued that planning and research cannot guarantee profits as profits emerge when an entrepreneur discovers that the prices of certain factors are undervalued relatively to a potential value of the products and if such an entrepreneur acts on this, he is likely to make profits.[51]

Fourth, the emergence of behavioural finance has also been used to criticise the theory. Behavioural finance studies the effect of psychological, social, cognitive and emotional factors affecting the economic decisions of individuals and the consequence for market prices, returns and resource allocation.[52] The focal point is on why market participants make irrational systematic errors contrary to the rational assumption of market participants. Such errors are said to affect prices and returns as well as create market inefficiencies.[53]Academics discovered some behaviour that cannot be explained by the efficient market theory. Whilst the theory presented what an ideal situation should be, the real world proved to be a different scenario in contrast to the theory. Furthermore, behavioural finance introduced the emergence of anomalies in securities market by proposing psychology-based theories to explain the said anomalies. These anomalies are empirical results that seem to be inconsistent with maintained theories of asset-pricing behaviour.[54] They indicate either market inefficiency or inadequacies in the underlying asset-pricing model.[55]

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[50] L. Von Mises, *Human Action*, (Chicago Contemporary Books 1963) 300
[51] *ibid*
[52] C. M. Pereira, 'Reviewing the literature on behavioural economics', (2016) 11 Capital Markets Law Journal 414
[53] T. W. Lin, 'A behavioural framework for securities risk' (2011) Seattle University Law Review 338
[54] G.W. Schwert, 'Anomalies and market efficiency', (2002) 1 Handbook of the Economics of Finance 3
[55] R. Klein and V. Bawa,' The effect of limited information and estimation risk on optimal portfolio diversification', (1977) 12 Journal of Financial Economics 102; M. R. Reinganum, 'The anomalous stock market behaviour of small firms in January', (1983) Journal of Financial Economics 96; M. J. Fields, 'Stock prices: A problem in verification', (1931) 4 Journal of Business 415-418

Criticism of the efficient capital markets hypothesis indicate the possibility of determining the prices of securities in a market thereby refuting the proposition that in an efficient capital market prices are decided randomly. Whilst there is some substance in these criticisms, this thesis argues that they have not completely discredited the provisions of the efficient capital markets hypothesis. If the capital market thrives on investor confidence that is generated by information disseminated to investors, then the propositions of the efficient capital market theory have a solid standing. The idea of an efficient market has been misunderstood and interpreted to mean that prices are always perfect. This notion is not possible, as room should be provided for mistakes to be made in the market.[56] Moreover, humans/investors are typically responsive to incentive risks. Like with every other thing, errors are inevitable in dealings, hence, this thesis concedes to the argument that markets can be efficient regardless of the fact that the market sometimes makes errors in valuation, that the participants are irrational or even if the prices exhibit greater volatility then can apparently be explained by fundamentals such as earnings.[57]

Anomalies and statistically predictable patterns that are significant in stock returns are asserted to have been uncovered.[58] However, these patterns have been considered not to be robust and dependable in different sample periods.[59] Furthermore, some of the patterns based on fundamental valuation measures of individual stocks may simply reflect better proxies for measuring risk.[60] The anomalies found in conventional theories appear to contradict each other in some instances. Behavioural finance appears to be a collection of anomalies that can be

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[56] B. Malkiel, (n 9)
[57] *ibid*
[58] *ibid*
[59] *ibid*
[60] *ibid*

explained by market efficiency. However, evidence from these anomalies does not suggest the abandonment of the efficient market theory.[61]

Although the provisions of the efficient market theory are not free from criticisms, this thesis argues that it addresses to a considerable extent what determines the efficiency of a capital market. Furthermore, evidence from the categorisation acknowledges that it is almost impossible for a market to be efficient in the '*strong form*'. This is a result of the process it takes information to be made available as well as the auspices of insider trading

In addition to the theory, this thesis recommends that it is important that adequate protection is accorded to investors by way of rules and regulations that are also used to monitor the market. From the definition of an efficient capital market, when a market is efficient, there is the likelihood that there will be investors, which in turn creates the likelihood for unforeseen errors due to the nature of capital market operations. In such an instance, investors will be keen to invest in a market that accords them protection in the event of any mishaps. Although this is not completely absent because of the proponents of the theory of law and finance, this thesis submits its inclusion makes the theory complete.

2.4. Further reasons for Strong Capital Markets

This thesis has aligned its argument to the consensus that a propelling factor for economic development is the strength of the financial system that serves as the lifeblood of the economy. It coordinates and allocates capital to building the necessary infrastructures needed in a country. It also represents the economic strength and development of a country because of opportunities created for investment. Stock

[61] E. Fama, 'Market efficiency, long-term returns and behavioural finance', (1998) 49 Journal of Financial Economics 304.

markets must function effectively to achieve its goals, as no work ethic will be sufficient for misallocation of capital.[62] If these assertions are true, then it would be beneficial to understand how to engineer economic growth or at least how to provide the necessary tools that will lead to economic growth.[63] Other than the efficient market theories highlighted above, several theories have emerged as to what leads to the development of a strong capital market. Amongst these theories are the '*law and finance theory*', '*politics and finance theory*', and the '*endowment and finance theory*' etc. Each theory has propelled reasons why it is to be considered the most important factor to develop a strong capital market. This section analyses these theories by evaluating the arguments put forward for the superiority of one theory over the other.

2.4.1. Law and Finance.

The Law and Finance theory postulates that the laws provided by a country for the protection of investors is the reason some countries have bigger capital markets than others.[64] It examines the difference between laws governing security markets in common law jurisdictions and civil law jurisdictions.[65] This theory analyses the quality of shareholder and creditor rights and postulates that common law countries provide shareholders and creditors with the strongest protection, whilst French civil law countries provide the weakest, with German civil law countries falling in between. It also analyses enforcement of these rights and hypothesise that Scandinavian and German civil law countries provide the highest enforcement procedures and mechanisms, with common law countries next and French civil law

[62] F. Mishkin, 'Is financial globalization beneficial'? (2007) 39 Journal of Money, Credit and Banking 267
[63] *ibid*
[64] R. La Porta, F. Lopez-de-Silanes, A. Shleifer, R. Vishny, 'Law and Finance', (1998) 106 The Journal of Political Economy 1114.
[65] *ibid*

countries providing the least. The findings of the research, which is propelled by the work of La Porta and others, are broken down into three categories (shareholder rights and protection, creditor rights and enforcement) that are discussed in turn below.

2.4.2. Shareholder rights and protection

First, they consider laws in countries that allow voting by proxy, which will be mailed and counted. They find that it is permitted in 39% of common law countries, 5% of French civil law and absent in both German civil law and Scandinavian countries.[66]

Second, they consider rights attached to shares by examining the one-share, one-vote.[67] Their findings suggest that one-share, one-vote is mandated in 17% of common law countries, 29% French civil law countries with low and high voting shares, as well as founders' shares with extremely high voting rights.[68] 33% in German civil law countries practice it but absent in Scandinavian countries.

Third, they considered laws requiring shareholders to deposit their shares with the company or financial intermediaries prior to shareholders meeting. This is used to block outsider capital that can exert influence over the corporate governance of the company.[69] Prior to shareholder meeting, shares are not blocked in common law and Scandinavian countries. It is blocked in German civil law countries and 29% of French civil law countries.[70]

Fourth, they considered the laws provided by countries to protect minority shareholders against perceived oppression by directors. Laws protecting minority

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[66] R. La Porta et al (n 64) 1127

[67] S. Grossman and O. Hart, 'One-share-one-vote and the market for corporate control', (1988) 20 Journal of Financial Economics 192

[68] R. La Porta et al (n 64) 1127; Presumably these classes of shares are issued to limit the power of shareholders in interfering in the running of the company.

[69] R. M. Baker, *Corporate governance, competition and political parties: explaining corporate governance change in Europe*, (Oxford University Press 2010)

[70] R. La Porta et al (n 64) 1127

shareholders such as right to repurchase shares, challenge the decision of directors etc. are provided in 94% of common law, 29% of French civil law, with half of the German civil law countries having these mechanisms and no Scandinavian country possessing these laws.[71]

Fifth, they analysed the provision of cumulative voting where each share entitles a shareholder to as many votes as there are directors to be elected.[72] This gives minority shareholders the ability to elect some board members even if the majority shareholders are opposed to it by merging their votes for a select member or director.[73] Their findings indicate that common law countries rarely permit cumulative voting, whilst 19% and 17% of French and German civil law countries permit it, however, it never happens in Scandinavian countries.[74]

Sixth, they considered the doctrine of shareholders pre-emptive rights to buy new stock of share as protection from dilution.[75] This principle was developed in the case of *Gray v Portland Bank*.[76] Their findings indicate that this is embedded in 44% of common law countries, 62% of French civil law countries, 75% of Scandinavian countries and 33% of German civil law countries.

Seventh, they analysed the required share capital needed to call an extra ordinary shareholders meeting.[77] The higher the percentage of share capital required, the tougher it is for minority shareholders to conduct such a meeting to challenge management of a company. 9% is required in common law countries, 5% in German

[71] *ibid*
[72] D. Larcker and B. Tayan, *Corporate governance matters: a closer look at organizational choices and their consequences,* (2nd edition Pearson Education 2016) 65
[73] S. Bhagat and J. Brickley, 'Cumulative voting: the value of minority shareholder voting rights', (1984) 27 Journal of Law and Economics 339
[74] R. La Porta et al (n 64) 1127
[75] Dilution in this instance refers to the reduction in the ownership percentage of a share of stock caused by the issuance of new shares; H. Drinker, 'The pre-emptive right of shareholders to subscribe to new shares', (1930) 43 Harvard Law Review 586
[76] 3 Mass. 364 (Mass.1807)
[77] This meeting is usually called when there are serious issues to be determined.

civil law countries, 15% and 10% respectively in French civil law and Scandinavian countries.[78]

Lastly, they considered the right to mandatory dividend. This rule necessitates the need for companies to pay out a certain fraction of their declared earnings as dividends. It is considered a restrictive measure used to prevent shareholders from diverting corporate assets.[79] However, it is not free from criticism, as it has been held to reduce internal funds available for firms to invest possibly leading to the loss of valuable projects.[80] It is practiced in 11% of French civil law countries, 5% of Scandinavian countries and absent in both common law origin and German civil law countries.[81]

2.4.3. Creditor rights

Other than shareholder rights, La Porta and others also considered the issues below pertaining to creditor rights.[82] This is done with its focal point on when the company goes into insolvency. Insolvency was utilised because by definition, the company would typically have insufficient assets to meet all its liabilities.

First, they investigated the reorganisation process when a company goes bankrupt. This involves the restatement of assets and liabilities as well as holding talks with creditors in order to make arrangements for repayments.[83] When a company

[78] R. La Porta et al (n 64) 1128
[79] T. C. Martins and W. Novaes, 'Mandatory dividend rules: do they make it harder for firms to invest?' (2012) 18 Journal of Corporate Finance 953
[80] R. La Porta et al (n 64) 1134
[81] *ibid*
[82] Creditor rights are the procedural provisions designed to protect the ability of creditors to collect money that they are owed by a company. These provisions vary from one jurisdiction to another.
[83] It is utilised as an attempt to extend the life of a company facing bankruptcy through special arrangements and restructuring to minimize the possibility of past situations reoccurring.

is functional they have two types of creditors, senior secured creditors[84] and junior unsecured creditors.[85] During bankruptcy, the former generally takes priority when repayment is being carried out. Furthermore, there is usually an automatic stay on the assets thereby preventing secured creditors from getting possession of loan collateral.[86] This is considered a form of protection for unsecured creditors, managers and it prevents the company from automatic liquidation. Their findings postulate that incidence of automatic no stay of assets is evident in 72% of common law countries, 26% of French civil law countries, 67% German civil law and 26% of Scandinavian countries.[87]

Second, in an ideal arrangement, when a company is insolvent, secured creditors are given priority because the money they lend to the company is collateralised. This is not guaranteed in some countries, where secured creditors are placed behind government and workers who possess priority over them when it comes to paying off debts.[88] Their findings postulate that secured creditors are paid first in 89% of common law countries, 65% of French civil law countries, whilst German civil law and Scandinavian countries ensure that secured creditors are paid first.

Third, during bankruptcy, there is the tendency for managers to unilaterally file for reorganisation without the consent of the creditors. This grants substantial power to the management of the company, and can subsequently lead to delay in creditors getting their money back. Although it is arguable that in some instances this may not necessarily be a bad thing as there are sometimes urgent actions that need to

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[84] Senior secured creditors are creditors or lenders that take collateral for the extension of credit, loan or bond issuance. They have senior protection in bankruptcy because they have specific assets that collateralize their loans.
[85] Junior unsecured creditors do not have the benefit of any security interests in the assets of the debtor.
[86] Insolvency Act 1986, Sch B1, para 43. *Re Atlantic Computer Systems plc (No 1)* [1990] EWCA Civ 20
[87] R. La Porta et al (n 64) 1135
[88] *ibid*

be taken to prevent further loss of assets. Their findings postulate that managers are precluded from arranging reorganisation in 72% of common law countries, 42% of French civil law countries, 32% of German civil law countries and 75% of Scandinavian countries.

Fourth, during reorganisation, some countries allow management to remain pending the resolution of the reorganisation procedure, whilst some countries replace management by appointing a neutral party usually by the Court or by the creditors. Their result postulate that management is not allowed to remain in 78% of common law countries, 26% of French civil law countries, 33% of German civil law countries and 45% of Scandinavian countries.

Finally, they utilized the existence of a legal reserve requirement as a remedial creditor right. This requirement necessitates the need for firms to maintain a certain level of capital to avoid automatic liquidation. Their findings postulate that this is hardly ever used in common law countries except in Thailand.[89] A legal reserve requirement is available in 21% of French civil law countries, 41% of German civil law countries and 15% of Scandinavian countries having the same requirement.

2.4.4. Enforcement of legal regulations

They also assessed the provisions for enforcement of creditor rights through the competence of judicial systems, rule of law, corruption, risk of expropriation, and likelihood of repudiation of contracts by Government. These proxies have been identified to affect national growth rates.[90] Their findings postulate that Scandinavian countries accord the best law enforcement and German civil law countries closely

[89] This could be attributed to the protection accorded to investors.
[90] S. Knack and P. Keefer, 'Institution and economic performance: cross country tests using alternative institutional measures', (1995) 7 Journal of Economics and Politics 211

follow them. Common law countries are behind the leaders but ahead of French civil law countries.[91]

They also analyse basic accounting standards and they find that 74% of Scandinavian countries, 69% of common law countries, 62% and 51% of German and French civil law countries respectively have high accounting standard

Finally, they analysed ownership concentration in countries because when there is poor investor protection, ownership concentration becomes a substitute for legal protection. They postulate that there is concentrated ownership in 54% of French civil law countries, 43% of common law countries, 34% and 46% in German civil law countries and Scandinavian countries respectively.

2.4.5. Law and Finance in Nigeria

Aspects of the law and finance theory exist in Nigeria. In relation to shareholder rights and protection, proxy voting is practised in Nigeria.[92] However, the practice has been described as controlled by directors who become default donees of members' voting rights.[93] This thesis commends the provision of proxy voting, as the shareholders, though not present, would still be in control of their votes. However, it is important to note that such a voting system could be improved through electronic modes of communication because Nigeria currently lacks an effective postal system.

Section 116 of the CAMA provides for one-share-one-vote and prohibits the issuance of non-voting and weighted shares by providing that any share of a company that is presumed to carry more than one vote or does not carry any vote at a general meeting is deemed to carry one vote only. There are no provisions within the Nigerian

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[91] R. La Porta et al (n 64) 1141
[92] CAMA 2004, s. 230
[93] O. Akinpelu, *Corporate governance framework in Nigeria. An international review,* (iUniverse Inc, Bloomington, 2011) 236

corporate regulatory regime that requires shareholders to deposit their shares before the annual general meeting. This is in line with the provision of Article 63 of The Treaty on the Functioning of the European Union (TFEU) that prohibits restriction of free movement of capital between member states and member states and between member states and third countries.[94] In the case of *Commission v UK (BAA)* it was held that acquisition of shares carrying more than 15% of votes is a restriction on the free movement of capital between member states.[95]

Section 300 of the CAMA provides protection for minority shareholders against illegal and oppressive conduct using injunctions, declarations, personal and representative actions as well as derivative actions. In relation to derivative actions, this thesis in chapter 4 highlights the fact that the application of the rules regulating derivative actions may not be practical and the penalty for failure to comply with an order of court may be insufficient.[96]

Section 117 of the CAMA prescribes, by implication, that existing shareholders have pre-emptive rights to subscribe to new shares upon issuance by the company and this is to be contained in the articles of association of a company. This mitigates dilution of their interest. In relation to cumulative voting, section 226 (1) of the CAMA holds that when a member is entitled to more than one vote, s/he need not cast them all the same way, thus creating the possibility to cast all votes towards a director.

Members holding not less than one tenth of the paid of capital of the company may requisition an extra ordinary general meeting.[97] It is arguable that in comparison

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[94] Consolidated Version of the Treaty on the Functioning of the European Union [2007] C 326/01
[95] [2003] ECR I-4641 (BAA); See also *Commission v Portugal* [2002] ECR I- 4731 and *Commission v France* [2002] ECR I-4781
[96] 4.5 below.
[97] CAMA 2004, s. 215 (2)

to the UK requirement of 5% paid up capital, the Nigerian requirement is copious.[98] Additionally, section 380 of the CAMA provides for payment of dividends if the company can pay its debt when due.

In relation to creditor rights, there are no provisions for automatic stay on assets, as a receiving order[99] cannot be made against a company incorporated under the CAMA.[100] The absence of this provision has been criticised and described to have the propensity to make it impossible to achieve reorganisation in Nigeria as investors can grab the company's assets pending the obtainment of a moratorium because of delay or impossibility of getting the requirements.[101]

When a company becomes insolvent, the CAMA prescribes that secured creditors with fixed charges are paid first, followed by secured creditors with floating charges and then unsecured creditors.[102] Section 410 of the CAMA makes it possible for the directors of a company to petition for winding up, however, the courts and sometimes creditors appoint a liquidator.[103]

In relation to enforcement, this thesis highlights the fact that the enforcement of regulations in the Nigerian judicial system is not sufficient as meagre sums are usually awarded as fines with custodial sentences hardly ever used.[104]

Ownership structure in Nigeria is concentrated which gives an insight as to why minority shareholders are oppressed. Although countries such as Germany and Japan possess a concentrated ownership structure, the situation is different in Nigeria. The dispersed minority shareholders are unsophisticated with little knowledge of or

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[98] Companies Act 2007, s. 303 (2)
[99] A court order authorising an official receiver to act in case of bankruptcy
[100] Bankruptcy Act, 2004, s. 108 (Nigeria)
[101] C. W. Iheme, *Towards reforming the legal framework for secured transactions in Nigeria,* (Springer, 2016) 255
[102] CAMA 2004, s. 494
[103] *ibid* s. 422, 473
[104] Chapter 5, 5.2.2

concern about the internal management of their corporations and few options are available to redress problems when it arises.[105] The consequence of this is the ability of majority shareholders with few or no hindrances expropriating the benefits of control without regard to the interest of minority shareholders

Nigeria is categorised as an English common law country and operates the system where judges exert flexibility in their decisions. However, the proposed effect that this ought to have on the capital market as proposed by law and finance theory is not evident in the Nigerian capital market, as the market is categorised as weak. This is borne out the operation of corrupt practices, inefficient legal regulation and partly because not until recently, the country is known to operate a cash-based economy with over 90% of funds in circulation as opposed to a credit/cashless society.[106] Furthermore, research carried out on African countries indicates that law mechanisms shows broad support for financial development.[107] These findings show only partial support for consensus that English common law countries provide better conditions for financial developments.[108]

2.4.6. Criticism of the Law and Finance Theory

Academics have questioned the accuracy of the Anti-Directors Rights Index (ADRI) utilised in developing the law and finance theory.[109] It was held that ADRI result of 33 of the sample countries used by La Porta ought to be corrected because they are not

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[105] B. Ahunwan, 'Corporate governance in Nigeria' (2002) 37 Journal of Business Ethics 275
[106] C. K. Ayo, 'The prospects of e-commerce implementation in Nigeria', (2006) 11 Journal of Internet Banking and Commerce
[107] S. A. Asongu, 'Law and finance in Africa', (2011) African Governance and Development Institute Working Paper 11/009
[108] *ibid*
[109] M. Giannetti and Y. Koskinen, 'Investor protection, equity returns and financial globalization', (2010) 45 Journal of Finance and Quantitative Analysis; H. Spamann, 'Law and finance revisited', (2008) John M. Olin Center for Law, Economics and Business

distributed with significant differences between common and civil law countries.[110] As a result of this, the idea that the ADRI values were predetermined by legal origin was rejected.[111] In rejecting the result of legal origins, some shareholder protection variable such as the one share-one vote and mandatory dividend were analysed and it was argued that the results do not correlate with the ADRI, as data utilised was inconsistent between countries.[112]

Furthermore, the legal origins theory has been described as limited because a majority of the indices used only provide a cross-sectional view that described the law as it stood roughly in the second half of the 1990s.[113] It is argued that, although the common law systems had stronger shareholder protection between 1995-2005, the civil law systems were catching up with the common law counterparts as the civil system was increasing the level of shareholder protection at a fast rate. Although it should be noted that this was considerably insufficient as the common law possessed the initial advantage.[114] In testing the link for an indication of stock market development by virtue of shareholder protection, there is apparently no link both in common law and civil law systems.[115]

Further criticism of the law and finance theory was generated by the notion that institutions that monitor market activities matter for economic performance. "Institution" in this context is defined as rules of the game where the purpose or function is to minimise transaction costs associated with market activity.[116] Additionally, shared beliefs that impart stability and order as well as agents'

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[110] H. Spamman (n 109) 3
[111] *ibid*
[112] *ibid*
[113] J Amour, S Deakin, P Sarkar, M Siems, and A Singh, 'Shareholder protection and Stock market development: An Empirical test of the legal origins hypothesis', (2009) 6 Journal of Empirical Legal Studies 350
[114] *ibid*
[115] *ibid*
[116] D, North, *Institutions, institutional change and economic performance*, (Cambridge University Press 1990)

interactions have also been classified amongst institutions that spur economic performance.[117] It is also argued that it is wrong to assume that those in power will act in the interest of the public when enacting and enforcing rules as the state is usually composed of agents and coalitions that are pursuing their own interests. [118]

In addressing these criticisms, La Porta et al asserted that there has been no substantial rejection of the importance of legal origins in shaping outcomes. The most cogent version of the critique acknowledged the importance of legal origins and the quality of the judiciary as an effect of financial development.[119] Furthermore, they argued that the existence of approval and disclosure procedures such as fiduciary duty discourages them in common law countries. In contrast, evidence suggests that the bright line rules of civil law allow corporate insiders to structure legal transactions that expropriate outside investors.[120] In relation to the argument that common law judicial decision making powers has the likelihood of leading to unlikely judgments, evidence was presented that shows that flexibility leads to financial development. It has been held that national legal rules protecting investors improve the ability of firms to develop company specific corporate governance mechanisms.[121] They stated further that their findings do not indicate that politics is unimportant for either legal rules or economic outcomes, and that politics may provide the impetus for countries to revise their laws and regulations. However, the thrust of the legal origins theory is that such

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[117] M, Aoki, *Towards a comparative institutional analysis*, (Stanford University Press 2001)
[118] B. Ahlering, and S. Deakin, 'Labour regulation, corporate governance and legal origin: A case of institutional complementarity?' (2005) Centre for Business Research, University of Cambridge, Working Paper No.312 3
[119] R. La -Porta, F. Lopez-De-Silanes and A. Shleifer, 'The economic consequences of legal origins', (2008) Journal of Economic Literature 298.
[120] S. Djankov, C. McLeish and A. Shleifer, 'Private credit in 129 countries', (2007) 84 Journal of Financial Economics 301, 312
[121] R. La-Porta et al (n 64)

in response to political demands countries will design reforms consistently with legal traditions.

Developing a financial market rests on a number of factors. Investors would be more inclined to invest in a system governed by rules and regulations that provide some protection if issues arise and to a considerable extent, guarantees some rewards back either in form of dividends, etc. This may not be attainable if the market is tainted with corrupt practices or mismanagement. The findings of La Porta et al are well grounded, and this thesis synchronises with most of its findings vis-a-vis investor protection, but notes that this may not generally be applicable to the Nigerian setting, given that there are other factors that have to be taken into consideration and not just provision of laws alone. The next section addresses the theory of politics and finance, which is another reason attributable for the strength of a capital market.

2.4.7. Politics and Finance

The politics and finance theory connotes that economic function propels stock market through demands by large enterprises for capital that must be gathered from many sources. This process is held to only work when policymakers or private players build institutions that support stock markets and have sufficient political support that does not attack finance.[122] Their function includes amongst others, protecting the private market, enacting rules and regulations that prohibit certain acts whilst conducting business in the market.[123] In most instances they prescribe applicable penalties when the rules are not observed. Penalties include, suspension of trading license, fines and

[122] M. Roe, 'Legal origins, politics and modern stock markets', (2006) 120 Harvard Law Review 463

[123] B. R. Weingast, 'The economic role of political institutions: market-preserving federalism and economic development', (1995) 11 Journal of Law, Economics and Organization 24

expulsion from the market etc. The importance of these institutions cannot be overstated as their operation and presence in a market have the likelihood of generating some confidence in the investing public.[124] Government's role in the capital market is not limited to providing institutions. It imposes disclosure rules to ensure that firms in their quest for wealth do not exploit uninformed consumers.[125] They also interpret the rules since the judiciary is an arm of Government

In most of the rapidly growing economies, the government has taken an active role in creating financial institutions, regulating them and in directing credit. These features aid in stabilising the economy and sustaining the solvency of financial institutions in ways that enhance growth prospects. However, it should be noted that limitations on market are greater in developing countries and as such it is recommended that government policies that are attentive to these limitations should be pursued.[126] There has been the call for the diversion of thoughts of academics and policymakers towards the mechanism required to engineer economic growth as against focusing on the tools of traditional common law.[127] It is stated that this will likely lead to the discovery of other tools that can propel economic growth that does not have any connection with the tools of common law.

Historical sources suggest that the emergence of the London and Amsterdam financial markets can be ascribed to the rise of large trading monopolies with close links to the governments, which are described as the factors responsible for the financial innovations that led to the emergence of trading in shares as well as

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[124] M. Roe (n 122) 481

[125] J. Stiglitz, 'The role of the state in financial markets', (1993) World Bank annual conference on development economics 20

[126] *ibid*

[127] F. Mishkin, 'Is financial globalization beneficial?' (2007) 39 Journal of Money, Credit and Banking 272

strengthening investor's property rights.[128] The theory of politics playing a central role in market development is not peculiar to London and Amsterdam alone, as the theory has played a critical role in the emergence of various financial systems worldwide.

2.4.8. Arguments for the Politics and Finance theory

There have been various arguments supporting this theory, some of which are highlighted in turn.

First, it was argued that the property protection efficacy attributed to the common law depends on the willingness of the legislature to accommodate it because if the legislature does not, the efficacy will collapse under political pressure.[129] Modern states are described to regulate the economy more than legal origin because legislature and its regulatory creations are central in defining economic rights.[130]

Second, the law and finance theory is stated to be useful only in the right context, which is after polity that supports capital market is established.[131] In view of this, it is argued that building legal structures in the midst of a hostile polity would waste resources and risk disappointment.[132]

Third, it is argued that although common law judges are accorded some flexibility in reaching decisions, there are no substantial changes and even if it does it is described not to be so serious as to make much financial difference.[133] It was argued further that if the law and finance theory is accepted, the other tools needed to provide

[128] S. Andrianova, P. Demeteriades and C. Xu, 'Political economy origins of financial markets in Europe and Asia', (2011) 39 World Development 695

[129] R. Rajan and L. Zingales, 'The great reversals: the politics of financial development in the 20th century', (2003) 69 Journal of Financial Economics 18

[130] N. Douglass, *Institutions, Institutional Change and Economic Performance*, (Cambridge University Press 1991) 107

[131] *ibid*

[132] *ibid*

[133] M. Roe (n 122)

a strong financial market that is not associated with the common law would be missed.[134]

Fourth, irrespective of common's law fiduciary duty requirement, the importance of institutions provided by the government cannot be discredited as the fiduciary function has been shifted to the Securities and Exchange Commission (SEC). Furthermore, it has been argued that regulators now do much of the work that can be done by judges of common law in relation to fiduciary duties.[135] Taking an example from the USA, American common law judges were once described as unwilling to protect minority stockholders.[136] It is argued that the threats of the SEC and not common law ensured the courts toughened up on insider trading that was permitted in most states with common law origin in the early 20th century.[137]

Fifth, it has been argued that civil nations can also develop institutions to protect minority stockholders the way common law countries are presumed to, thus making it wrong to conclude that the common law has an inherent structural advantage over the civil law in building financial markets.[138] This highlights the importance of institutions such as the SEC, which is established by polity.[139]

The law and finance theory has been described as an extension of the politics and finance theory as law is the practical application of politics in society and the development of its control within the financial system demands a separate study from

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[134] *ibid*
[135] *ibid* 516
[136] W. Cary, 'Federalism and corporate law: reflections upon Delaware', (1974) Yale Law Journal 663, 670, 681-684; *Goodwin v Agassiz*, 283 Mass. 358, 186 N.E. 659 (1933)
[137] R. Gibson and B. Black, *The Law and Finance of Corporate Acquisitions*, (2nd Edition, University Case book studies 1995)
[138] L. Bebchuk, 'A rent-protection theory of corporate ownership and control', (1999) 260 Harvard Law School Journal 55
[139] M. Roe (n 122) 473

the politics and finance theory.[140] This description is better explained by the views of legal positivists that assert, "law is the command of the uncommanded commander".[141] It has been argued that legal origin does not stop a nation from developing the institutions that capital markets need and if a nation does not develop these institutions, there is usually something else at play but not legal origin.[142] Furthermore, although common law fiduciary duties are described essential for developing stock markets, they may be ill suited for developing nations, because simple rules would be easier to enforce than complex fiduciary standards.[143]

In recent years the importance of politics to the financial system has been demonstrated through schemes enacted by some countries in the wake of several financial scandals in some countries.[144] These schemes were aimed at enhancing transparency via regular accounting with the sole purpose of enhancing investor confidence. They contain rules for self-regulation through a code of conduct together with a 'comply or explain' rule, although, others require substantive rules to be in place. For example, the enactment of the Sarbanes-Oxley Act 2002 in the USA was aimed at enhancing disclosure rules.[145] It increased sanctions and penalties for falsified disclosure.[146] Other countries have also provided rules of conduct in the belief that market efficiency will cause the quality of a company's disclosure to affect the price of its stock. Examples of these "rules" include the UK's Cadbury report 1992, Higgs report on corporate governance 2003, Spain's Aldama report 2003,

[140] J. Anderson, 'Capital Markets: Monetary and Fiscal Policy Determinants', (2004) Creighton University 7
[141] R. Lansing, 'A definition of sovereignty' (1913) 10, American Political Science Association, 61
[142] M. Roe (n 122) 464
[143] R. Posner, 'Creating a legal framework for economic development', (1998) 13 World Bank Reserve Observer 5
[144] E.g. Enron
[145] Sarbanes-Oxley Act, 15 U.S.C.A (2002), s.302, 409
[146] *ibid* s. 802

European Union Winter report 2017, France's Vienot Report 1995, The Nigerian Money Laundering (Prohibition) Act 2011 etc.

In fortifying the importance of politics to the market the concept of '*natural state*' and '*open access state*' was also analysed. The natural state is described as characterised with limitation of access to economical innovations and provides order through the political system that generates rents that are used to stabilise the political system and limit violence in the pursuit of social stability.[147] Developing countries are categorized under the natural state.[148] An example of a country in natural state was Mexico in the 18th century where the wealthy elite created legal and political barriers to entry in the banking industry. The financial system was the political machine for the ruling class and when institutional innovations were built their use was reserved for the enterprises of the few well-connected financiers.[149]

The open access states are characterised with free and open access to economic and political organisations with a sustainable rate of economic growth and development. Evidence suggests that only a dozen of the contemporary countries are open states with examples such as the United States of America, the major EU Countries and Japan.[150]

Capital markets of developing countries have less market capitalisation because of the political constraints placed on financial intermediaries who pave the

[147] D. North, J. Wallis and B. Weingast, *Violence and social orders: A conceptual Framework for interpreting recorded human history*, (Cambridge University Press 2009)
[148] *ibid*
[149] H. Stephen, 'Industrial concentration and the capital markets: A Comparative study of Brazil, Mexico and the United States', (1991) 51 Journal of Economic History 564
[150] S. Andrianova (n 128)

way for poorly defined property rights and government regulatory policies.[151] To stop this, the government in power must be desirous of enhancing the economy rather than catering for greedy needs. In this regard a case can be established for the Nigerian capital market because it is evident that the government though desirous of implementing institutions that will be beneficial to the growth of the market, they have arguably not been efficient in this regard due to auspices of corrupt practices evident both in the government and the institutions. There are allegations of financial impropriety levelled against individuals in charge of institutions connected to the capital market.[152] Furthermore, in some instances, the substantive provisions of these institutions need to be updated to match international best practices. This could be unachievable when the individuals chairing the capital markets committee in the Nigerian Senate and Federal House of Representatives do not possess the required knowledge in these areas.[153] This becomes problematic, as they do not appreciate the need to provide the institutions that will take the market to the next level. Additionally, these individuals fail to attend trainings that will keep them abreast of occurrences in the ever-evolving financial industry but the keep the funds allocated for themselves.[154] This arguably is liable for the lack of implementation of cogent rules for the capital market.

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[151] J. Anderson (n 140)

[152] Editorial Team, 'The Nigerian Stock exchange spent millions on a yacht and Rolex watches for some reason', *Business Insider* (Nigeria, 8 May 2012) <http://www.businessinsider.com/the-nigerian-stock-exchange-spent-millions-on-a-yacht-and-rolex-watches-for-some-reason-2012-5?IR=T> accessed 28 January 2015

[153] Chapter 4, 4.3.2

[154] C. Ndujihe, 'SEC: Public hearing turns bizarre for Hembe, Azubogu', *Vanguard Newspaper* (Nigeria, 25 May 2012). A video of the hearing can be accessed at https://www.youtube.com/watch?v=WfIVO9A7_U8> accessed 20 January 2017

The politics and finance theory has been criticised by some academics. According to North:

> "*Throughout most of history and in much of the present world, institutions have not provided credible commitment necessary for the development of low cost transacting in capital and other markets. There is therefore, little evidence to support the view (apparently implicitly held by many economists doctoring the ailing economies of central and eastern Europe) that the necessary institutions will be the automatic outcome of getting the prices right through elimination of price and exchange controls*".[155]

The arguments propelling the importance of politics to the development of capital markets has sufficient credibility because, regardless of the provisions of the law governing market dealings, these laws have to be enacted by polity. Institutions enacted by polity such as the SEC provide rules that specify norms and practices of market participants. In view of the foregoing, this thesis submits that the government has a large role to play in the running of the markets and its presence cannot be dispensed with.

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[155] D. North, 'Institutions and credible commitments', (1993) Journal of Institutional and Theoretical Economics 14

2.4.9. Endowment and finance

The endowment hypothesis holds that environment directly influences the quality of law, labour and production.[156] It is argued that sufficient endowments and natural resources lead to productivity, thus generating the need to develop industries to facilitate production, which has the likelihood to generate investment opportunities.[157] Additionally, it has been argued that environment shapes economic development directly by influencing the inputs directed towards production.[158]

The endowment theory proposes that the location of a country is essential to its economic development.[159] It is argued that merchants examine the environment (climate and terrain) of a state to determine the possibility of trade in a particular region.[160] Tropical environments are characterised with poor crop yield, weakening diseases and endowments that cannot effectively employ productive technologies developed in temperate zones.[161] A landlocked country is not open to trade, which limits its access to large economic markets as well as its ability to exploit economies, consequently lowering its productivity and leading to lack of investment opportunities.[162]

States located in environments not conducive for development of industries are likely to experience stagnated economic growth. Research indicates that tropical countries have a lower GDP because research and development in these countries are

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[156] H. Mansfield and N. Tarcov, *Niccolo' Machiavelli: Discourses on livy,* (The University of Chicago Press 1996); C. Montestquieu, *The spirit of laws,* (Book XX1, 1748)
[157] W. Easterly and R. Levine, 'Tropics, germs and crops: how endowments influence economic development', (2003) 50 Journal of Monetary Economics 7
[158] *ibid*
[159] H. Mansfield and N Tarcov (n 156)
[160] C. Montestquieu (n 156)
[161] D. Kamarck, A. Kraay, P. Zoido- Lobaton, *The tropics and economic developments*, (John Hopkins University press 1976)
J. Diamond, *Guns, gerns and steel: the fates of human societies* (New York, 1997)
[162] J. Sachs and A. Warner, 'Natural resource abundance and economic growth', (1995) NBER Working Paper 5398

considerably less because of minimal western investment.[163] Countries with temperatures and humidity that are consistently high year-round, encounter difficulty when trying to motivate workers because the climate is not as conducive as a more temperate climate. Furthermore, countries close to centres of development and trade will have a better market to trade goods in and will be open to foreign investment.[164] Landlocked countries may be disadvantaged because their immediate trade is with countries they are surrounded by thus limiting trade prospects with a small number of investors as well as reducing the flow of capital.[165]

The suggested way to fix this problem is by rectifying the geography towards globalisation paying attention to development of international transportation, global governance as well as research and development.[166]

'The Institutional Endowment Theory' was developed by this theory and postulates that the endowment theory is based on <u>three</u> building blocks.

First, different colonisation strategies are accountable for the type of institutions developed in countries. For example, European powers created institutions to promote economic welfare referred to as 'settlers' colonies'. The other type is 'the extractive states' that had little or no interest in the establishment of institutions to protect private property and check the power of the state.[167] The colonisation process of Nigeria places it in the category of extractive states.[168] This can arguably be considered accountable for the economy's stagnation as it is argued that Africa's

[163] T. Gylfason and G. Zoega, ' Natural resources and economic growth: The role of investment', (2001), Working paper, University of Iceland
[164] H. Ricardo, 'Prisoners of geography', (2001) Foreign Policy 45
[165] *ibid*
[166] *ibid*
[167] D. Acemoglu, J. Simon and R. James,' The colonial origins of comparative development; an empirical investigation' (2009) 91 The American Economic Review 1369
[168] G. Austin, 'African economic development and colonial legacies', (2010) 1 International Development Policy

relative poverty is primarily the result of the form taken by European colonialism.[169] Europeans were settling for extraction rather than settling themselves and introducing the kind of institutions that was responsible and economic growth in colonies of the European settlement in North America and Australia.[170]

Second, the feasibility of settlement influenced the colonisation strategy. Areas with diseases favourable to colonialists where deemed the settlers colony and had institutions that will promote long-run economic development enacted, whilst those with unfavourable disease environment formed the extractive states with minimal or no attention to such institutions.[171]

Third, the institutions established to aid in economic development persist till date.[172] The reason for their presence till date has to do with the emergence of the place. For instance, when authoritarian institutions are extracting resources from a colony and it gains independence, the rulers tend to use these institutions to their own advantage and profit. Examples given in this regard are Sierra Leone, Senegal and Congo.[173]

Endowments have been an important element in developing economic institutions, which includes capital markets throughout the colonial and modern times.[174] The colonisation of European powers in the 16th century favoured both the rich and the poor. Developing countries have grown wealthy, while certain developed

169 *ibid*
170 *ibid*
171 T. Beck, A. Demirguc-Kunt and R. Levine, 'Law and finance: Why does legal origin matter? (2003) 31 Journal of Comparative Economics 654
172 E. Stanley and K. Sokoloff, *Factor endowments, institutions and differential paths of growth among new world economies*, in S.H. Haber, *How Latin America fell behind*, (Stanford University Press 1997) 273
173 H. Ricardo (164)
174 S. Engerman and K. L, Sokoloff, 'Factor endowments, institutions and differential paths of growth among new world economies: A view from economic historians of the United States' in S. Haber, *How Latin America fell behind: Essays on the economic histories of Brazil and Mexico, 1800-1914,* (Stanford University Press, 1997)

countries have become poor because the developing countries were established in a way to cater for economic growth, while the established institutions within the developed countries were left unmolested.[175]

Nigeria is richly endowed with different resources such as gas, tin, iron ore, coal, limestone, niobium, zinc, arable land etc.[176] However, irrespective of these resources, research indicates that most of the country's wealth is largely dependent on crude oil with the country still importing different commodities that can be produced in the country.[177] These other sectors are not sufficiently explored because of the presumption of lack of capital. In recent times there has been the call for diversification of the economy and development of the other sectors.[178] Following the proponents of this theory, the Nigerian capital market can attain its full potential because of the presence of these resources if adequately managed. If properly explored, this thesis submits that it can lead to substantial development of the economy through the creation of sufficient industries. This will subsequently lead to exportation of produced and services.

The organisation of the society provides a better explanation for economic growth because of the incentives that the institutions offer to obtain investments.[179] To measure economic growth what must be analysed is the institutional quality, enduring

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[175] D. Acemoglu, J. Simon and, R. James, 'Reversal of fortune; geography and institutions in the making of modern world income distribution', (2002) 1171 The Quarterly Journal of Economics 243

[176] <http://www.opec.org/opec_web/en/about_us/167.htm> accessed 3 July 2017

[177] O. Gabriel, 'Nigerians: Time to decide what not to import', *Vanguard* (Nigeria, 13 July 2015) < http://www.vanguardngr.com/2015/07/nigerians-time-now-to-decide-what-not-to-import/> accessed 3 July 2017

[178] U. Nnakenyi, 'Diversifying Nigeria's sources of revenue: An urgent developmental need', iclass Nigeria, [blog], 2 April, 2015 <http://iclass.ng/blog/index.php?entryid=2203> accessed 1 September 2016

[179] D. Acemoglu, S. Johnson and J. Robinson, 'Institutions as the fundamental cause of long-run growth', in Aghion and Durlauf, *Handbook on economic growth,* (Amsterdam: North Holland 2005) 390

quality of institutional and colonisation strategy of the European settlers.[180] Countries endowed with natural resources possess one of the perquisites to engage in trade. If well managed, they can export some of these products thus increasing the GDP. This has the potential to equate the rate of import.[181] Furthermore, if well managed, there will be advent of companies being developed to cater for these endowments that can subsequently generate investments because it becomes competitive which has the likelihood of leading expansion and comparison with their international counterparts.

2.5. Conclusion.

This thesis acknowledges the various arguments that have emerged for the development of a strong and efficient capital market. However, this thesis asserts that in determining the strength of the capital market, no single theory can be solely attributable to the success and subsequent strength of the market as all three theories discussed above have a part to play when developing a strong and efficient capital market. Whilst the provisions of law are very important for investor protection, the laws have to be enacted by legislators. Furthermore, when government enacts laws, they still need the institutions that will facilitate the operation of the law. Furthermore, the endowment and finance theory have highlighted the importance of the location of a country as well as the natural resources of the country in determining economic growth. A country that has no natural resources will have no industries developed neither would there be foreign investors. In view of this, this thesis submits that with all three working concurrently, there is the possibility to establish a strong capital market.

[180] H. Ricardo (164)
[181] *ibid*

Relating these theories to Nigeria, this thesis submits that the emergence of political factors in building the capital market is of paramount importance. This is because the laws governing the market and attempting to protect investors are not particularly credible as established by this thesis in the subsequent chapters. The importance of this cannot be undermined because if there are credible rules, investors will invest. In several instances, legal practitioners and other experts have approached the Senate and the Federal House of Representatives with likely solutions to the problems faced by the capital markets and also with a view to making the market more efficient.

The importance of politics can also serve as a catalyst for jurists to act well. Nigeria is rated one of the most corrupt countries in the world. If the government is desirous of stopping corruption in the capital markets, it will implement rules that will compel jurists to carry out their functions efficiently and effectively. Indeed government has to implement laws that provide good remuneration as well as grants some incentives to judges. This would likely help them resist temptations to be corrupt. Furthermore, severe penalties should be enacted against judges that collect bribes or act in an unprofessional manner. The power of the government is also extended to creating and empowering of efficient institutions that monitor, enact rules and enforce necessary actions in the market. The importance of these institutions cannot be undermined as they usually aid in the smooth running of a securities market. Example of such an institution is the SEC.

In view of these, this thesis posits that if the Federal Government of Nigeria enacts credible laws as well as establishes and empower credible institutions, there is the likelihood of the securities market growing. However, this is not the case at the moment because the polity of the Nigerian government does not exactly support the capital market. This is not borne out the fact that they do not want the capital market to be developed or intend to hinder economic development, but because the persons in charge of securities market committee both at upper house of the National Assembly (Senate) and lower house of the National Assembly (Federal House of Representatives) are not aware of the importance of the enacting credible laws as well as creating and establishing credible institutions in for the market.[182] This thesis submits that for a capital market to efficiently grow, it is of paramount importance that these theories work together i.e. supporting polity that encourages the securities market growth which would lead to the enactment of credible rules that can be utilised in protecting investors and also setting a standard of operation of such markets.

[182] Chapter 4

3. Information Asymmetry and Disclosure

3.1. Introduction

Investing in business could be an arduous affair for investors. This is partly because entrepreneurs have superior information of the business and sometimes overstate their value, thus placing the onus of extracting relevant and reliable information on their putative investors. [1] Furthermore, entrepreneurs sometimes expropriate the investments of investors in a manner investors are not aware of.[2]

Companies seek investors' funds through various marketing strategies, whilst investors request for information about the issuers and securities to serve as a guide when deciding to invest.[3] Information is of sacrosanct importance in capital market transactions as buyer behaviour is largely dependent on the information available before and after purchase. In meeting the needs of the investors, companies provide them with the offer prospectus and documents that ought to enable an investor make an informed assessment of the securities.[4] Information sought varies but generically includes information about a company, what they do, what they require the funds of the investor for, the fiscal health of the company, how and when prospective investors would receive dividends. Providing information to investors is crucial, but of more importance is the provision of credible information. It is hackneyed that some companies provide falsified, misleading, misstatements or omit important information which would portray the company as performing well by relevant indices in an

[1] Information or 'lemons' problem arises from information differences and conflicting incentives between entrepreneurs and savers. It was stated that this alone could lead to a breakdown in the functioning of the capital market; G.A. Akerlof, 'The market for lemons: quality and uncertainty and the market mechanism', (1970) 84 Quarterly Journal of Economics.

[2] P. M. Healy, and K. G. Palepu, 'Information asymmetry, corporate disclosure and the capital markets; A review of the empirical disclosure literature', (2001) 31 Journal of Accounting and Economics 407

[3] R. Romano, 'Empowering investors; A market approach to securities regulation', (1998) 107 Yale Law Journal 2359, 2374

[4] D. French, S. Mayson and C. Ryan, *Company law,* (33rd Edition, Oxford University Press 2016) 202 Prospectus Directive (Directive 2003/71/EC) article 5; ISA 2007, s. 71; Rules and Regulations of the SEC 2013, rule.279; Prospectus Rules, r. 1.2

attempt to attract potential investors.[5] Accordingly, investors commit themselves to companies they assume they have sufficient knowledge of based on the information provided. When investors become aware that the information provided to them is incorrect there is going to be lack of trust in the system; thus generating the possibility of instituting legal actions against such companies for misrepresentation as witnessed in cases like *Hedley Byrne v Heller & Partners Ltd*.[6]

This chapter focuses on the challenge of information asymmetry and how it makes a market less favourable for investment. Furthermore, the concept of disclosure is analysed with emphasis on how it is regulated in Nigeria compared to the UK in a bid to promote credible dissemination of information to investors. The final part of this chapter highlights the operation of reputational intermediaries otherwise known as gatekeepers or watchdogs and how they assist in reducing information asymmetry

3.2. Information Asymmetry

Information asymmetry in the capital market is described as when corporations listed in the capital market have more information about their financial status and relevant information about their business than they disclose to prospective investors.[7] It serves as a barrier between issuers of common shares and public investors.[8] The seminal work of George Akerlof introduced this problem.[9] He utilised the market for used cars as an example of the problem of quality certainty. He describes how interaction between quality heterogeneity and asymmetric information can lead to the

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[5] N. C. Shil, B. Das and A. K. Pramanik, 'Harmonization of accounting standards through internationalisation', (2009) 2 International Business Research 195
[6] [1964] AC 465
[7] R. Veil, *European capital markets law,* (Hart Publishing Ltd 2012) 211
[8] B. Black, 'The legal and institutional preconditions for strong securities markets'. (2001) 48 UCLA Law Review 786
[9] G.A. Akerlof, 'The market for lemons: quality and uncertainty and the market mechanism', (1970) 84 Quarterly Journal of Economics.

disappearance of a market where guarantees are indefinite.[10] In recent years, information asymmetry has gained awareness because countries are desirous of their financial markets attaining efficiency and the effects it has on a capital market is not desirable. Some of these effects are identified below.

First, investors could offer less for shares than the original asking price because they believe the market is tainted with falsified disclosures, thus, generating a negative effect on corporations that want to list in the market for the first time and corporations that have not falsified information.[11]

Secondly, it reduces the confidence investors have in the market when they become conscious of the likelihood of receiving falsified information, thus making them seek for the required information from sources that can be costly and sometimes incorrect.[12]

Thirdly, it leads to the co-existence of high and low quality goods and services in the market, which places the strenuous task on buyers to determine the quality of goods and services offered to them.[13]

Fourthly, it hinders the possibility of achieving an efficient market described by Fama's theory, as the information given does not reflect all the available information.[14]

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[10] *ibid*

[11] P. M. Healy, and K. G. Palepu (n 2) 424

[12] P. R. Nayar, ' Information asymmetries: a source of competitive advantage for diversified service firms', (1990) 11 Strategic Management Journal 514

[13] G. J. Stigler, 'The economy of information', (1961) 69 Journal of Political Economy 213

[14] E. Fama, 'Efficient capital markets: A review of theory and empirical work', (1970) 25 Journal of Finance, 383. For a discussion on this theory see chapter 2 above.

Nigeria's capital market can arguably be classified as a market suffering from information asymmetry. Research indicates that information asymmetry, amongst other factors is a prominent challenge faced by individual investors in the Nigerian capital market.[15] It has been argued that one of the reasons the Nigerian economy has not developed as much as the market is because of what is referred to as development trap occasioned by prevalent insider trading, asymmetric information amongst other anomalies.[16] Investors facing transparency challenges are not confident in the Nigerian capital market because of the belief that they are disadvantaged in the market owing to inadequate and unevenly distributed information between investors, subsequently leading to few insiders having access to material facts.[17] This has been described as one of the reasons for illiquidity in the market.[18]

The advent of delayed disclosures, misstatements, and fraudulent disclosures have affected the Nigerian capital market as the market is described as one where investors do not trust the system to trade.[19] The rampancy of information asymmetry in the market is attributable to the deficiency of market compliance, which is exacerbated by the lack of automated processes.[20] Furthermore, research indicates that a reason for the volatility of the market is attributable to the advent of information

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[15] N. R. Ikeobi, 'Challenges faced by individual investors in the Nigerian capital market', (2015) 7 European Journal of Business and Management 36

[16] A. Mayowa, 'Testing the weak form market efficiency in Nigerian capital market', (2012) Accounting, Finance and Research 169

[17] A. O. Umoren, 'Accounting disclosures and corporate attributes: A story of listed Nigerian companies', (2009, Unpublished PhD Thesis Covenant University Nigeria) 6

[18] I. O. Dada, *The Nigerian capital market: developments, issues and policies*, (Spectrum Books Limited 2003) 23

[19] P. Egwuatu, 'Retail investors have not sufficiently returned to the stock market', *Vanguard Newspaper* (Nigeria, 9th March 2015). Available at <http://www.vanguardngr.com/2015/03/retail-investors-have-not-sufficiently-returned-to-stock-market-afolayan/> accessed 14 July 2015
Editorial team, 'Senate moves to boost capital market', *The Tide Newspaper* (Nigeria 10th March 17) <http://www.thetidenewsonline.com/2017/03/10/ex-niob-chief-wants-fg-to-subsidise-cement-cost-2/>

[20] M. Eboh, 'Market collapse: Onyema indicts past Nigerian stock exchange management and regulators', *Vanguard* (Nigeria, 9 March 2012) <http://www.vanguardngr.com/2012/03/market-collapse-onyema-indicts-past-nse-mgt-regulators > accessed 14 July 2015

asymmetry that subsequently prevents investors from investing.[21] It is arguable that there is the propensity for investors to avoid a market that is tainted with practices such as information asymmetry. This is borne out of the fact that they would not want to lose their money invested and the possibility of this happening is increased when the information disclosed is incorrect or falsified.

This thesis argues that information asymmetry is largely attributable for the alleged sparse concentration of investors in the Nigerian capital market and it was suggested that the way to avoid the continued operation of information asymmetry is for the SEC to develop adequate policies to prevent manipulation of information as they have significant effect on the market dynamics that can result in the nation's macroeconomics stability.[22] Information asymmetry is practiced in two principal ways identified in the next section.

3.3. Types of Information Asymmetry

Information asymmetry can occur in one of two ways, *adverse selection*, and *moral hazard*.

3.3.1. Adverse Selection

Adverse selection occurs when entrepreneurs do not share information they know to prospective investors leading to the supply of low quality securities.[23] A market exhibits adverse selection when there is the inability of buyers to distinguish among products of different quality. Informed market participants make decisions that harm uninformed parties, thus exposing the market to the possibility of failure because insiders have more knowledge than outsiders about their own behaviour in conducting

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[21] M. Anifowose, 'Information asymmetric information on the stock return volatility in Nigerian capital market', (2012) 14, Accounting Frontier, 47
[22] *ibid*
[23] H. Braido, C. Da Costa, and B. Dahlby, 'Adverse selection and risk aversion in capital markets', (2011) 67 FinazArchiv, Public Finance Analysis 311

the firm's affairs.[24] It can also occur where the buyer is unable to observe the seller's characteristics or the contingencies under which the seller operates.

Entrepreneurs are alleged to omit important information to prospective investors in a bid to maximise earnings.[25] Furthermore, when an entrepreneur is risk neutral, projects with negative expected returns are financed because he has some control over which projects are handed priority.[26] This is considered a notable effect of market imperfection and a major source of investment reduction when investors become aware of this process of adverse selection.[27]

It has been argued that perpetual adverse selection in a market can lead to excessive investment because the risks involved in trading are omitted thus leading investors to flood the market because of the belief that the investment is viable.[28] This thesis argues that this postulation has the likelihood of achieving a contrary effect i.e. the market being sparsely populated. Investors that are risk averse as well as understand the chance of information being omitted will avoid the market due to the fear of the unknown thereby limiting the amount of investors in the market.[29] The reluctance to invest is further intensified by virtue of fact that the goods in questions are not tangible, hence extinguishing the possibility of it being returned, inspected or exchanged.

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[24] J. M Mendoza, 'The untapped potential of alternative markets', (2011) 6 Capital Markets Law Journal 383
[25] D. De Meza and D. Webb, 'Risk, adverse selection and capital market failure', (1990) 100 Economic Journal 206
[26] D. De Meza and D. Webb, 'Too much investment: a problem of asymmetric information', (1987) 102 Quarterly Journal of Economics 281
[27] J. E. Stiglitz, A. Weiss, 'Credit rationing in markets with imperfect information', (1981) 71 American Economic Review 399
[28] R. Broadway and M. Keen, 'Financing and taxing new firms under asymmetric information', (2006) 62 Public Finance Analysis 471
[29] D. De Meza and D. Webb (n 25) 214

3.3.2. Moral Hazard

Moral hazard refers to a situation where a party is prepared to take more risk because he does not feel the consequences of his actions.[30] It is the willingness of individuals or organisations to engage in riskier behaviour than they otherwise would because of a tacit assumption that someone else would bear part or all of the costs and consequences of the risk.[31] It can be likened to insurance transactions where an insured party is willing to take certain risks because he knows that he does not bear the costs in the event of any loss.

In capital markets, it is a situation where a party to a transaction takes more risks than he usually does because he is aware that he is insulated from risk and has more information about the transaction than the party who intends to fund the transaction.[32] Sometimes companies take advantage of the fact that they are insulated from loss because the money they use for their businesses belongs to investors, thus generating the avenue to carry out risky business that may not necessarily be in the interests of the investor. This is further accentuated by the doctrine of separate legal entity established in *Salomon v Salomon & Co Ltd*.[33] Judges are often reluctant to hold directors personally liable because to do so undermines the doctrine of separate legal entity and unduly interfere with directors' commercial judgment.[34] Furthermore, investor's contracts are usually with the company and not the director. The issue of moral hazard has gained momentous awareness lately and there has been the call for its curtailment because, in the event of any unforeseen circumstances, private

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[30] A. Chisholm, *An introduction to international capital markets: products, strategies and participants,* (2nd Edition John Wiley & Sons 2009) 20

[31] New Palgrave, *A Dictionary of Economics*, (1987) 3 547

[32] S. B. Kamin, 'Identifying the role of moral hazard in international financial markets', (2002) 7 International Finance Discussion Papers 27

[33] [1897] AC 22

[34] H. Anderson, 'Directors' personal liability to creditors: theory v tradition', (2003) 12 Deakin Law Review 1

creditors bear the loss and more of the burden of resolving emerging market crises by rolling over, rescheduling and reducing the value of their credits.[35] The state also bears a share of this burden as it may be forced to engage in bailouts or quantitative easing schemes in order to provide cheap credit.

Moral hazard is not a desirable feature of markets as it has the propensity to reduce average returns on human capital investment because profitable investments cross-subsidise the unprofitable investments in such circumstance.[36] Furthermore, when a market is tainted with moral hazard, the principal-agent relationship is introduced. This occurs where one person (agent) is able to make decisions on behalf of another person or entity (principal).[37] The problem occurs when the agent acts in his own best interest rather than those of the principal. Owners of corporations sometimes select managers to run the business and in such a relationship there is the possibility of the interests of the principal and agent not being mutually aligned. The principal may seek to maximise their wealth via the sale of shares, whilst the manager may be working at his own best interest, e.g., seeking higher salary or attempting to improve his resume'. Managers oversee project evaluation process, and with the knowledge of the fact that owners are aiming at profit, managers can take extra risks to facilitate securing such desired profits.[38] In some instances, they may make bad decisions that lead to a loss. Furthermore because there are limited penalties for selecting such risky projects, there is the propensity to engage in such risks. It is however important to note that in public companies with widely dispersed

[35] S. B Kamin (n 32) 27

[36] B. Jacobs, and S. Van Winjnbergen, 'Capital market failure, adverse selection and equity financing of higher education', (2006) 63 Public Finance Analysis 3

[37] S. J. Grossman and O. D. Hart, 'A analysis of the principal-agent problem', (1983) 51 Econometrica 8

[38] T. Silver, 'Moral hazard a bump in the contract road', <http://www.investopedia.com/articles/financial-theory/09/moral-hazard-conflict.asp> accessed 18 July 2015

shareholding, there is a measure of alignment between managers and owners' interests due to share compensation schemes for employees and directors. This may reduce the moral hazard problem.

It should be noted that the problem of moral hazard does not necessarily amount to fraud. Moral hazard does not necessarily involve illegal behaviour in most cases; it is the overzealous effort of managers to make excess profit for the company. An example of where fraud can be said to be involved is where owners or staff take excessive risks and corporate assets with prior knowledge that there would be compensation to the investor in case of bankruptcy.

Information is most desired by prospective investors when they intend to invest in the capital market and as such the problem of information asymmetry should not be ignored. A market aspiring to compete with its international counterparts or develop in order to spur economic growth should not have such issues in its operations. This thesis proposes that the best way to curtail this problem is with adequate legal regulation, establishment and encouragement of norms and practices that would promote adequate disclosure as well as adequate enforcement mechanisms. The next section identifies and analyses the theory of disclosure in capital markets. It highlights the regulation of disclosure in Nigeria in comparison with the UK with the aim to identifying any loopholes and proffering suggestions prospects for reforms.

3.4. Disclosure

Disclosure involves the publication of any economic information relating to a business enterprise, quantitative or otherwise, which facilitates the making of investment decisions.[39] Ideally, it promotes delivery of accurate information in a timely manner about products traded in the capital market.[40] It is also used to increase transparency by providing useful information to both internal and external users of financial reports whilst making business and economic decisions.[41] The information, other than aiding the prospective investor to decide if to invest or not also assists the investor in evaluating the likely problems associated with a proposed investment.[42]

Generally, disclosure involves exposing intricate details of a company's operation, production and other important information relating to the company. Companies sometimes abstain from disclosure because the information disclosed could be used by competitors that are interested in the same line of business. However, this is not a good reason for non-disclosure. Disclosure is the price that companies pay for playing at the competitive and high-end of the market. In view of the foregoing arguments, it is important to highlight that disclosure does not guarantee that people will invest. This defeats the purpose for disclosure if the information can be utilised to the disadvantage of the company disclosing. This raises two important questions, why disclose, and how much should a company disclose?

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[39] F. D. S Choi, 'Financial disclosure and entry to the European capital market', (1973) 11 Journal of Accounting Research 169

[40] J. Sarra, 'Disclosure as a public policy instrument in global capital markets', (2007) 42 Texas International Law Journal 875

[41] S. Brown-Hruska and S. Satwah, 'Seeking transparency in a perfect storm', (2009) 4 Capital Markets Law Journal 135

[42] C. Bradley, 'Information society challenges to financial regulation', (2006) 37 Toledo Law Review 307, 315

One of the reasons that companies disclose information to investors is to facilitate and build confidence of investors in the products so they can invest. Disclosure could also serve as an element to reduce the cost of capital as companies with obscure information often have a high cost of capital or have to provide security for loans. Furthermore, companies disclose information by virtue of the provisions of law necessitating it as an obligation to trade in the market. This concept is known as mandatory disclosure, which is discussed in this chapter.[43] The disclosure philosophy has been described as the most ubiquitous investor protection mechanism that has innumerable advantages.[44] Some of these advantages are highlighted below.

First, it serves as protection for investors as they are presented with adequate information of the deals presented to them as well as gives an insight to the business of the company. Investor protection is of paramount importance to a market and is regarded as the cornerstone of securities regulation.[45] It is a feature of deep and vibrant securities market and also acts as an important component for the successful operation of securities market.[46] It plays an indispensable role in bolstering investor confidence and retention. Disclosed information serves as a catalyst when prospective investors are deciding whether to invest. In serving its protective function, it can be used as evidence in a law court in the event of the disclosed information not matching what happens or where it appears there has been some falsification.

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[43] Section 3.5 of this Chapter

[44] J. K. Gakeri, 'Calibrating regulatory disclosure in Kenya's securities markets; Challenges and opportunities for investors', (2014) 4 International Journal of Humanities and Social Science 135

[45] Y. Yadav, 'Beyond efficiency in securities regulation', (2014) Vanderbilt Law and Economics Research Paper 15 Available at SSRN:< http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2400527> accessed 4 April 2015; Z. Goshen and G. Parchomovsky, 'The essentials of securities regulation', (2006) 55 Duke Law Journal 711

[46] A. Guzman and S. J. Choi, 'Portable reciprocity: rethinking the international reach of securities regulation', (1998) 71 South California Law Review 903, 941; Joel Seligman, 'The historical need for a mandatory corporate disclosure system', (1983) 9 Journal of Corporation Law 10

Second, it has a prophylactic effect by deterring corporate insiders from engaging in fraudulent, corrupt behaviour or mismanagement.[47] Furthermore, it reduces the agency problem because managers are denied access to exploit internally produced information on intangible unknown to other investors as the information is required to be disclosed.[48] It levels the playing field amongst investors thus making it harder and costlier to be privately informed as there is availability of information in the public domain. This reduces the possibility of trading with a better-informed counter party and reduces the uncertainty about a firm's value, which is generated by informational advantage that an informed trader might have. Competent disclosure of intangibles has the propensity to increase demand for securities of a company.[49]

Third, because of improved transparency there is efficient allocation of resources. Reduced cost of capital has the likelihood to generate the real worth of securities because investors develop confidence in the securities market, consequently increasing liquidity for the shares of a firm.[50]

Fourth, it leads to market efficiency and promotes corporate governance by providing investors with sufficient access to a firm, thus improving the market's understanding of the firm's value creating process and activities as well as the economic risks attached to the firms' shares.[51]

[47] C. Bradley (n 42) 309

[48] Z. Mousavi and N. Takhtaei, ' The impact of intellectual capital disclosure on capital markets: An overview', (2012) Business Intelligence Journal 268; P. G. Mahoney, 'Mandatory disclosure as a solution to agency problem', (1995) Chicago Law Review 1047

[49] D. Diamond and R. Verrecchia , 'Disclosure, liquidity and the cost of equity capital', (1991) Journal of Finance 1325

[50] M. Managena, R. Pike, and Li Jing,' Intellectual capital disclosure practices and effects on the cost of equity: UK evidence', (2010) Institute of Chartered Accountants of Scotland; M. B. Fox et al, 'Law, share price Accuracy and Economic Performance: The New Evidence', (2003) 102 Michigan Law Review 331, 335; D. J. Schuttle, 'The debatable case for securities disclosure regulation', (1998) 13 Journal of Corporate Law 535, 539

[51] J. E. Grojer, and U. Johanson, 'Voluntary guidelines on the disclosure of intangibles: a bridge over troubled water', Paper presented at the international symposium measuring and reporting intellectual capital: experiences, issues and prospects. Amsterdam

In a bid to reduce information asymmetry, countries have adopted laws mandating disclosure hence compelling companies to disclose information favourable or otherwise that would assist an investor when making an investment decision. This has been described as a commitment device that is considered important when trading in capital markets.[52] Without any form of commitment, firms have the likelihood to withhold or manipulate information presented to investors. The laws mandating disclosure vary from country to country and are usually supported with appropriate sanctions if the substantive rules are not observed.

3.5. Mandatory disclosure

Mandatory disclosure is the compulsory provision of information by companies to prospective investors.[53] It is usually mandated by provisions of law or regulatory bodies and assists the decision process of investors when considering the securities offered by issuers.[54] Countries mandate disclosure as a condition to operating in the market in attempting to make the market efficient and transparent. This is regarded as a simple way to regulate complex markets as well as promote investor autonomy.[55] It is important to note that this issue concerns to a greater extent, average retail investors rather than institutional investors.

As identified above, companies sometimes reveal only favourable information to investors whilst encouraging them to invest. Mandatory disclosure reduces this problem by acting as a communication tool between the discloser and the recipient as

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[52] M. D. Guttentag, 'An argument for imposing disclosure requirements on public companies', (2004) 32 Florida State University Law Review 123

[53] K. Lannoo, 'The emerging framework of disclosure in the EU', (2003) 2 Journal of Corporate Law Studies 329

[54] *ibid*

[55] J.E. Grojer, and U. Johanson (n 51)

I. H-Y Chiu, 'Delegated regulatory administration in mandatory disclosure: Some observations from EU securities regulation', (2006) 40 The International Lawyer 737, 742 well as compels delivery of both positive and negative information of a company. It also serves as a solution to information asymmetry and a mechanism used to boost investor confidence. However, it has also been described as a mixture of material assumptions that are usually difficult to comprehend.[56] This description is tied to the fact that not all investors are familiar with the information disclosed thereby making comprehension of the terms expressed in disclosure documents difficult. Again, it is important to highlight that this issue concerns, to a greater extent, average retail investors rather than institutional investors. Furthermore, disclosure of overly sophisticated material to retail investors could act as a barrier to investment because they incur costs in seeking financial advice on the material that is not easily comprehendible. This arguably could defeat the purpose of disclosure. In an attempt to salvage this problem, it has been recommended that the information disclosed be sufficiently clear because prospective investors apply this information in making investment decisions.[57] When the information contained in prospectus is delivered in a manner that is easy to comprehend, investors will be more inclined to accept and believe the contents of these documents. However, it is important to note that although most initial public offerings (IPOs) are targeted at institutional investors,[58] it is important that prospectuses (offer documents) are delivered in a clear manner in the interest of retail investors.

Mandatory disclosure is not cost free as issuers incur transaction costs whilst complying with disclosure.[59] Data gathered by the European Securities and Markets Authority (ESMA) indicated that the costs of drawing up a prospectus can sometimes

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[56] S. Brown-Hruska and S. Satwah, (n 41) 151
[57] *ibid* 135
[58] <http://www.ocadogroup.com/news-and-media/news-centre/2010/2010-07-06.aspx> accessed 10 March 2017
[59] F. H. Easter and D. Fischel, 'Mandatory disclosure and the Protection of Investors', (1984) 70 Virginia Law Review 669, 707-709

amount to over 10 per cent of the amounts raised in a small capital raising exercise, and of this, preparing the operating and financial review as well as the historical financial information can each cost in excess of 100,000 Euros.[60] Costs incurred includes, assembling, analysing and summarising the information. Experts are employed to conduct these tasks because of the nature of due diligence involved in it thereby increasing the costs.[61] Additionally, cost is also incurred when disseminating this information to a wide spectrum of investors. This unarguably has an impact on the price at which securities are offered as well as a bearing on the realisations form a capital offering because a high transaction cost may ultimately defeat the economic rationale of the offering.

In view of the aforementioned, an important question that has emerged is if a price should be put for information disclosed? This question emerged by virtue of the fact that disclosure grants competitors an insight to the intricacies of the business with no guarantee of investment. Competitors can use such information to evaluate their chances of success in similar product developments and might even obviate their having to expend resources on product developments.[62] It has been argued that if mandatory disclosure benefits competitors with no benefit for the company disclosing, the purpose would be unrewarding.[63] There have been suggestions that companies should charge for the information they provide to investors.[64] Charges are considered a compelling and reliable factor to providing accurate disclosure than the

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[60] ESMA, 'Technical advice on possible delegated acts concerning the prospectus directive as amended by Directive 2010/73/EU', (ESMA/2011/323) Para 229
[61] S. M. Philips and R. Zecher, *The SEC and public interest*, (MIT press 1981)
[62] J. R. Macey, 'Efficient capital markets, corporate disclosure and Enron', (2004) 89 Cornell Law Review 413
[63] W. H. Beaver, 'The nature of mandated disclosure' in Richard A. Posner and K. Scott, *Economics of Corporation Law and Securities Regulation,* (Boston, MA: Little, Brown & company, 1980) 320
[64] S. M. Philips and R. Zecher (n 61)

external sources the investors will attempt to get the information from.[65] Whilst this enhances the possibility of minimising the cost accrued by companies as well as placing value on information provided in the minds of the investors, this thesis argues that putting a cost on disclosure is not ideal in a developing country like Nigeria. The reason for this is that, due to the prevalence of corruption in Nigeria, there is the belief that market practices are not forthright. This arguably has contributed to scarcity of investors in the system. If prospective investors are therefore asked to pay for information when they want to invest, there is the likelihood that they will avoid the altogether. Furthermore, assuming there are charges for disclosure, this thesis imagines that such charges will not be substantial, therefore competitors that are desirous of getting such information will pay for the prospectus and still not invest.

Mandatory disclosure has gained significant cognisance in recent years and different writers have written in support of it. It is depicted to be the right mechanism with the propensity to alleviate managers' incentives to suppress valuable information that is unfavourable.[66] However, some writers are opined that disclosure should not be made mandatory for different reasons identified below.

3.5.1. Criticism of Mandatory Disclosure

First, as identified above, corporations spend money in making information available and in some cases they acquire costs without any returns as well as expose the intricacies of their business.

Second, it has been described as a phenomenon that has not been confirmed as theoretical and empirical studies provide no more than a weak support for mandatory

[65] *ibid*
[66] J. C. Coffee Jr, 'Market failure and the case for a mandatory disclosure', (1984) 70 Virginia Law Review 722

disclosure.[67] Research indicates that disclosure of certain information such as audited balance sheets, profit and loss statements, and proxy information prior to shareholder meetings and details on insider transactions resulted in significant positive abnormal returns to shareholders in the range of sixteen to eighteen per cent.[68] In view of this, it has been stated that although the idea of mandatory disclosure provides truthful information and reduces the firm's incentives to committing fraud or giving misstatements, it should not be made mandatory by law.[69]

Third, it has been argued that there is no need for mandatory disclosure as firms voluntarily disclose their private information as a signal of their products quality.[70] Firms will voluntarily disclose information so as not to be confused by customers with firms having lower quality products. Firms with high quality products have the likelihood of committing to a disclosure regime that credibly commits firms to full public disclosure. In the same vein, firms with product quality a notch below that of the high quality firms will voluntarily commit to a full disclosure regime so as not to be confused with firms with even lower quality.[71]

Whilst the arguments are well founded in part, this thesis argues that they are not sufficient to call for the elimination of a mandatory disclosure regime and enlists the following as likely advantages of mandatory disclosure.

First, mandatory disclosure limits the ability of a firm to remain silent. In developing this argument, the anti-fraud rule in the market is analysed along with the doctrine of mandatory disclosure and it was stated that in a world with an anti-fraud

[67] W. H. Beaver (n 63) 316

[68] J. R. Macey (n 62) 411. Abnormal returns are returns generated by a security or portfolio over a period of time that is different from the expected rate of return

[69] *ibid*

[70] S. Grossman and O. Hart, 'Disclosure laws and take over bids', (1980) 35 Journal of Finance 323, 327

[71] A. Ferell, 'The case for mandatory disclosure in securities regulation around the world', (2004) 492 Harvard Law and Economics 9

rule but no mandatory disclosure system, firms would remain silent with impunity.[72] The distinction between failure to inform and misrepresentation is not particularly clear as the former may be considered implied representation that nothing has changed, thus the unlikelihood of there being an element of fraud. Furthermore, it can be argued that it improves anti-fraud laws as a rule against only fraud leads to the discovery of only little information about securities.[73]

Second, mandatory disclosure can serve as a cost reduction mechanism. Information provided by corporate issuers may not be optimally verified thus leading to search for information from non-issuer sources, which can be expensive. Mandatory disclosure subsidises search costs to secure both greater quantity of information and a better testing of its accuracy.[74]

Third, a substantial basis exists for believing that greater inefficiency would exist without mandatory disclosure because investors pursuing trading gains will incur excess social costs. Furthermore, even in an efficient market, there remains information that the rational investor needs to optimise his securities portfolio and such information is best provided by mandatory disclosure.[75]

Fourth, mandatory disclosure can serve as an efficient mechanism to reduce the blame placed on credit rating agencies when there is a financial crisis. Credit rating agencies were held largely accountable for the financial crisis of 2008 as it was argued that investors placed too much faith in the rating agencies, which were held to

[72] F. H. Easterbrook and D. R. Fischel, 'Mandatory discussion and the protection of investors', (1984) 70 Virginia Law Review 680
[73] *ibid*
[74]J. C. Coffee Jr (n 66) 717
[75] *ibid*

have failed in getting in right.[76] Credit rating agencies also played a significant role in the European sovereign debt crisis in 2009.[77]

Although mandatory disclosure is not a flawless securities regulatory mechanism, it is increasingly becoming the preferred regulatory approach amongst a set of imperfect alternatives.[78] It is presumed that the most obvious and straightforward way to achieve an efficient capital market is through the commitment of firms to the rules, especially in a country with weak legal infrastructure. It is important to note that there is no evidence indicating that firms in countries with weak legal infrastructure can in fact bind themselves by mandatory disclosure provisions or not to engage in opportunistic midstream switching through purely contractual devices such as supermajority voting rules in the firm's charter.[79] However, it would be injurious to a capital market if it were totally absent because there is the possibility of investors seeking for the information by other means that are not reliable. The effect of this is the collection of duplicated, wrong and falsified information.[80]

In sub-Saharan African countries where financial illiteracy is pervasive, there is the absence of the required mandatory disclosure infrastructure in comparison with countries where there is sufficient literacy. These infrastructures include, a receptive public, information analysts, financial journalists and market intermediaries that help synthesise and simplify the information for investors.[81] This, arguably, can be

[76] E. Benmelech, 'The credit rating crisis' (2009) 24 NBER Macroeconomics Annual; Section 3.9.2 of this thesis for discussion on the operations of credit rating agencies in capital markets.
[77] M. Gartner, B. Griesbach, F, Jung, 'PIGS or Lambs? The European sovereign debt crisis and the role of rating agencies', (2011) 17 International Advances in Economic Research 3
[78] S. Brown-Hruska and S. Satwah (n 41) 138
[79] R. Romano, 'The need for competition in international securities regulation', (2001) 258 John M. Olin Center for Studies in Law, Economics and Public Policy 4; E. Rock, 'Securities regulation as a lobster trap: a credible commitment theory of mandatory disclosure', (2002) 23 Cardozo Law Review 675
[80] J. R. Macey (n 62) 411
[81] S. Brown-Hruska and S. Satwah (n 41) 137

considered accountable for the lack of development of capital markets in these countries. Regardless of the absence of these infrastructures, this thesis underlines the importance of enacting and enforcing laws that mandate disclosure as it would deter fraudulent activities as well as compel corporations to disclose accurate information.

Countries have implemented different regulatory schemes in enforcing laws that mandate disclosure. They are empowered by legal provisions that investors can utilise in establishing liability against companies. The laws and regulations are imposed on a range of people involved in producing offer document such as issuers, directors etc.[82] Regulations are supported by sanctions such as suspension, or expulsion from the markets if not upheld. However, for completeness and prevention of issuers avoiding the market altogether, it is important that the severity of these sanctions be balanced to avoid undue restriction on issuers conduct, as excessive regulation and sanctions can result in less informative and untimely disclosure.[83] Stringent or lax enforcement can have a damaging effect on the capital market. Therefore, it is imperative that a balance is struck between investor protection, freedom of issuers and the ability of management to make decisions.[84] The next section highlights how mandatory disclosure is regulated in Nigeria in comparison with the UK.

3.6. Regulating Mandatory Disclosure in Nigeria

The Nigeria-UK Capital Markets Projects in its inaugural reports identified the need to strengthen the integrity of the market by improving information disclosure, reduction of potential for manipulation, promotion of transparency and good

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[82] J. Khoo, 'Civil liability for misstatements in offer document; striking the right balance', (2010) 6 Brigham Young University International Law and Management Review 51

[83] *ibid*

[84] *ibid* 91

governance to improve standards and investors' confidence.[85] Furthermore, it is documented in the Nigerian Capital Market Master Plan that efforts will be directed towards ensuring that credible financial disclosure by adopting specific initiatives such as enforcing the International Financial Reporting Standards (IFRS) standards with full compliance by all capital market participants as well as enhancing and enforcing shareholder value disclosure for public listed companies.[86]

The provisions of the Rules and Regulations of the SEC 2013 and the provisions of the Investment and Securities Act 2007 (ISA) regulate disclosure in the Nigerian capital market. The substantive provisions of both regulatory instruments are highlighted in the next section. Additionally, the Code of Corporate Governance 2003 in Nigeria also contains provisions that regulate disclosure such as the requirement for an audit committee of public listed companies whose principal function is to ensure compliance with the legal and regulatory requirement of the company's financial statements.[87]

3.6.1. Provisions of the Rules and Regulations of the Securities Exchange Commission (Nigeria) 2013, mandating disclosure

Mandatory disclosure is effected by providing prospectus to prospective investors. A prospectus is a formal legal document that provides details about an investment that is offered for sale to the public.[88] It ought to contain the relevant fact/s investors require to make investment decisions. Prior to the issuance of a prospectus for subscription of

[85] Editorial team, 'Nigeria-UK capital markets project report calls for improved integrity, disclosure', *Thisday Newspaper*, (Nigeria, 29th July 2015) <http://www.thisdaylive.com/articles/nigeria-uk-capital-markets-project-report-calls-for-improved-integrity-disclosure/215958/> accessed 20 August 2015
[86] SEC Nigeria, 'Nigerian Capital Market Master Plan; 10 year plan 2015-2025', Securities and Exchange Commission 7.4 < http://sec.gov.ng/nigerian-capital-market-masterplan/> accessed 7 August 2017
[87] Code of Corporate Governance, 2003, r. 30; Chapter 5, 5.4
[88] D. French et al (n 4) 202

securities of companies, government and its agencies in the Nigerian capital market, they are to be registered with the SEC.[89] The requirements for registration are contained in s. 279 (2) (a) – (m) of the Rules and Regulations of the SEC. Prospectuses are to be filed either electronically or in printed form.[90] The information to be contained in a prospectus is listed in s.288 (1) of the Rules and Regulations of the SEC. Amongst the contents of a prospectus is a property schedule listing landed properties and buildings the issuer possesses. It discloses issues such as tenure of lease, usage of the property and any relevant information.[91] Furthermore, the prospectus is required to comprise information about any liability, claims, pending litigation, unclaimed and unpaid dividends, and debtors.[92] Additionally, it contains a caveat on risk factor that shall be contained and highlighted in the bold letter.[93]

The prospectus is not required to contain only favourable information about the business, as there is the requirement for it to contain likely risks associated with the business such as sectorial risks, political risks, currency risks, and environmental risks etc. It should also contain measures that will be used to address and/or mitigate risk factors.[94] The issuer makes a sworn declaration that it has fully disclosed all material facts in the offer documents that is signed by the chief executive officer, company secretary and the chief financial officer of the issuer.[95] When approved and duly signed by directors of the issuer and other parties to a public offer the prospectus together with offer documents shall be forwarded to the SEC for registration within 48 hours of signing the prospectus.[96] An issuing house is required to file the

[89] Rules and Regulations of Securities Exchange Commission, 2013, s.279 (1)
[90] *ibid*, 285 (1)
[91] *ibid*, 288 (15)
[92] *ibid*, 288 (16)
[93] *ibid*, 288 (2)
[94] *ibid*, 288 (3)
[95] *ibid*, 80 (3)
[96] *ibid* 279 (6)

registration statement for offer of securities and prior to approval no securities shall be sold or offered for sale, as it is unlawful for any person to sell, make an offer for sale, or buy securities before the registration statement is filed or after it has been filed but not approved by the commission.[97] The penalty for not adhering to this rule is a fine of five thousand Naira (equivalent of £9) for every day the default persists.

Registered securities have a life span of six months and if they are not offered for sale within six months after registration, they have to be revalidated by the Commission when they intend to make an offer.[98] This is done to cater for any changes that may have occurred within the time span for registration.

In a bid to promote transparency of the dealings of the company, corporations are mandated to provide details of remuneration whether in cash or otherwise of each director.[99] Information and details of amounts or benefits paid or intended to be paid or given to any promoter within the two years preceding the date of the prospectus shall be provided. Furthermore, any interest of a director either direct or indirect is required to be disclosed. [100] If directors sell their shares in the company or purchase shares in the company they are mandated to notify the SEC not later than 48 hours after such activity.[101] The issuer, issuing house and reporting accountants (where relevant) shall report to the commission immediately the occurrence of any event after the submission of the prospectus which is likely to alter the contents of information in the offer documents or render the information in the prospectus misleading.[102]

[97]*ibid* 280 (1); r 282
[98] *ibid* 279 (7)
[99] *ibid* 288 (16) (2)
[100] *ibid* 288 (10)
[101] *ibid* 401 (a)
[102] *ibid,* 288 (22)

3.6.2. Provisions of the Investments and Securities Act 2007 mandating disclosure

In a similar way, but with less detailed provisions, the ISA 2007 also mandates disclosure in the Nigerian capital market. It provides that no person shall issue any form of application to deposit money for the purpose of subscribing to purchasing or in any way acquiring securities of a public company unless the form is issued with a prospectus.[103] Contravention of this rule is deemed as an offence punishable with an imposed fine of 100 thousand Naira (equivalent of £200) on conviction.[104] The Act requires prospectus to be registered with the SEC.[105] The process of registration is not specified by the Act. However, it is provided that it shall be sent to the commission with every named director or his agent authorised in writing and having endorsed on it or attached any consent to the issuance of the prospectus.[106] Approval by the SEC is important as no person is permitted to issue, circulate, publish, disseminate or distribute any notice, circular for advertisement to the public for offer for subscription to securities.[107] The SEC only registers a prospectus that is dated, signed and has documents attached (if any).[108]

Every prospectus indicates if a copy has been delivered for registration as well as specifies any document required to be endorsed on or attached to the copy so delivered.[109] The date contained in a prospectus is taken as the date of publication unless there is proof discrediting this.[110] If a prospectus contains a statement made by

[103] ISA, 2007, s.71 (1)
[104] *ibid,* 71 (4)
[105] *ibid,* 80 (1)
[106] *ibid*
[107] *ibid,* 75
[108] *ibid,* 80 (4)
[109] *ibid,* 80 (3)
[110] *ibid*

an expert, it cannot be issued unless the expert has given his written consent before delivery of the prospectus and has not withdrawn his consent.[111] The life span of a prospectus is six months. On the expiry of the sixth month no person shall make an invitation to the public to acquire or dispose of any securities of a public company.[112]

3.6.3. Mandatory disclosure in the United Kingdom

In the United Kingdom, they employ a mix of public and private enforcement strategies are employed to underpin the regulatory framework governing public issuance of securities and the admission of securities to trading in an organized market.[113]

The European Securities and Markets Authority (ESMA), Prospectus Directive, Prospectus Regulation, Companies Act 2006, and the Financial Services and Markets Act 2000 (FSMA) regulate mandatory disclosure. Together they provide rules guiding companies when disclosing information in the securities market. The disclosure regime proposed by the Prospectus Directive and the Prospectus Regulation is considered a forum for maximum harmonisation.[114] The aim of harmonising these rules is for the standardisation of prospectus information, with the objective of developing standard information that should be contained in a prospectus, thus making it easier for investors to compare and evaluate strengths and weakness of different investment opportunities.[115] The implication of harmonisation is that national authorities cannot adopt general rules requiring a prospectus to contain items of

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[111] *ibid,* 77 (1)
[112] *ibid,* 78 (1) (a)
[113] E. Ferran and L. C. Ho, *Principles of Corporate Finance Law*, (2nd Edition, Oxford University Press 2014) 388
[114] *ibid,* 378
[115] *ibid,* 380

information that are not included in relevant schedules and building blocks contained in the Prospectus Regulation 2017 (EU/2017/1129).[116]

The standardisation objective is applied in the ESMA, which maintains recommendations for consistent implementation of prospectus requirements and it provides that those responsible for drawing up a prospectus must take into account the ESMA recommendations as part of determining the approval process.[117] The Financial Conduct Authority (FCA) approves prospectus.

In the United Kingdom a mandatory prospectus for securities may be drawn up in a single or tripartite document.[118] A single mandatory prospectus contains all the relevant information in one concise document. A tripartite prospectus comprises of three documents, a registration document containing information relating to the issuer, a securities note that contains details of the securities to be offered or admitted, and a summary note. A summary note is compulsory regardless of whether the prospectus is drafted as a single or tripartite document.[119] It is a key source of information for retail investors that should be drafted in a concise and non-technical language with an appropriate structure that conveys key information relevant to securities contained in the prospectus and when read with the rest of the prospectus should aid prospective investors in making the decision to invest or not.[120]

The Prospectus Regulation 2017 prescribes detailed information that should be incorporated in a prospectus and how they are presented.[121] A prospectus is to contain necessary information that will enable an investor make an informed assessment of:[122]

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[116] *ibid*
[117] ESMA, Update of the CESR recommendations on the consistent implementation of commission regulation (EC) No 809/2004 implementing the prospectus directive (ESMA/2013/319)
[118] E. Ferran and L. C. Ho (n 113) 376
[119] Financial Services and Markets Act 2000 (FSMA), s87a (5)
[120] FSMA, s87a (6), (9) and (10); Prospectus Regulation 2017, Article 10 (1)
[121] Prospectus Regulation 2017, Article 6 (1)

a) The assets and liabilities, financial position, profit and losses and prospects of the issuer of the transferrable securities of any guarantor and
b) The rights attached to the transferrable securities.[123]

The general obligation to disclose is not restricted to information known by persons responsible for the prospectus. It extends to information obtainable when the necessary enquiries are made.[124] Information contained in one or more previously or simultaneously published documents that have been filed with the competent authority or which have been provided to that authority in accordance with regulatory requirements can be referenced.[125] Information that is usually referenced includes, annual accounts and reports.[126]

The contents of the prospectus are linked with the nature of issuer and the securities to be offered and the prospectus regulation draws a distinction between wholesale and retail investors with the former benefitting from a less onerous disclosure regime.[127] Furthermore, there is the requirement for on-going disclosure, which requires particular types of information to be publicised whenever they occur.[128] This ensures that the markets are updated with new developments and ensures efficient price formation as well as limits the possibility of insider trading because new developments become public knowledge thus limiting the opportunity for insiders to use private information for their own benefit. However, issuers can delay the public disclosure of inside information so as not to prejudice its legitimate

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122 Commission Regulation (EC) 809/2004 of April 29 2004, which implemented Directive (EC) 2003/71 of the European Parliament and of the Council as regards information contained in prospectuses as well as the format.
123 FSMA s.87A (2)
124 *ibid,* s. 80 (3) (b)
125 Prospectus Regulation 2017, Article 19
126 *ibid*
127 I. G. MacNeil, *An introduction to the law on financial investment,* (2nd Edition, Hart Publishing 2012) 296
128 *ibid,* 299, Market Abuse Regulation 2014, article 17

interest. For this to be viable, the issuer has to ensure that such omission will not mislead the public as well as ensure that the information be kept confidential.[129]

The ESMA maintains a questions and answers document on prospectuses.[130] This document is regularly updated to answer questions posed by the public and competent authorities in relation to the practical application of the prospectus directive. Its purpose is to promote supervisory approaches and practices.[131] This section is important because financial information is technical and complex and it seldom inspires investors because of information contained therein.[132] Furthermore, businesses are becoming more complex with several entities, making it difficult to describe what they do in writing. In view of this it is imperative that the necessary information be presented in a format that is comprehensible and easy to analyse.[133] Furthermore, the Prospectus Directive proposes that the language used in prospectus must be one accepted by its home state regulator as well as be made available in languages that are acceptable to the competent authorities in each of the host states or at the issuers choice of language that is customary in the sphere of international finance.[134]

A prospectus that does not include the final offer price or the amount of transferrable securities must be filed with the FCA as soon as practicable.[135] Additionally, after the approval of a prospectus and prior to the closure of the offer or admission to trading, if a new significant factor or a material mistake or inaccuracy arises, there is a directive-derived requirement for a supplementary prospectus.[136]

[129] MAD 2014, article 17 (5)
[130] ESMA/2013/1537 (October 2013 update)
[131] E. Ferran and L. C. Ho (n 113) 380
[132] S. Brown-Hruska and S. Satwah, (n 41) 136
[133] FSMA s.87A (3)
[134] Prospectus Regulation 2017, Article 27 (2)
[135] FSMA, s87Q
[136] FSMA s87G; Prospectus Regulation 2017, Article 23 (1)

Significant factor in this instance includes any factor considered to be important in making an informed assessment of the kind mentioned in the general duty of disclosure.[137] A supplementary prospectus provides sufficient information to correct any mistake or inaccuracy that gave rise to the need for it.[138] It should be noted that where the relevant transaction involves both an offer and admission to trading in a regulated market, the relevant period that a supplementary prospectus may be required ends with the later on the closure of the offer when trading of the securities on a regulated market begins.[139] These documents are submitted to the Financial Conduct Authority when listing in the capital market and they are valid for twelve months. This system aids in making the process of issuance more efficient and the first major United Kingdom securities offering to adopt this model was the flotation of Standard Life plc in July 2006.[140]

A prospectus is approved by a competent authority of the issuer's home state and then made available to the public before an offer of securities to the public or a request for admission of securities to trading on a regulated market.[141] An approved prospectus is deemed to have a community scope, which entails that it is valid for public offers or the admission of securities to trading on a regulated market in any number of states within the EU.[142] A prospectus is considered available to the public when presented in electronic form either on the corporation's website, website of financial intermediaries or on the website of the market where they are to trade.[143] Where a prospectus is published by one of the electronic methods, a paper copy must

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[137] FSMA, s87G (4)
[138] *ibid* s87G (6)
[139] *ibid* s87G (3A)
[140] E. Ferran, 'Cross border offers of securities in the EU: The standard life flotation' (2007) 4 European Company and Financial Law Review, 2006
[141] Prospectus Regulation 2017, Article 20 (1); FSMA, s85
[142] *ibid* Article 24 (1)
[143] *ibid,* Article 21(2) (a)-(c)

be delivered free of charge to those investors who request it.[144] Published prospectus shall be available in electronic form for at least 10 years after publication in the websites listed above.[145]

3.7. Enforcing Rules of Disclosure

Countries use different approach in enforcing rules of disclosure. Securities legislation grants investors the right to sue under tort law or law of contract if they invest on the basis of falsified information.[146] The investor is to establish that the issuer failed to reveal specific information mandated by law as against proving the issuers negligence.

3.7.1. Enforcement in Nigeria

In Nigeria, civil or criminal penalties are used to enforce the provisions of mandatory disclosure. Where a person is invited to subscribe for shares in a company and he relies on the information on a prospectus and eventually suffers loss, they are entitled to compensation.[147] Compensatory actions can be instituted against directors, persons who consented to be named and are named in the prospectus as directors and employees of the company who participated in or facilitated the production of the prospectus and the issuing house and its principal officers.[148] The regulations exclude liability for directors in certain instances; directors that withdraw their consent as directors before the issuance of the prospectus,[149] directors that are unaware of the

[144] *ibid,* Article 21(11)
[145] *ibid,* Article 21(7)
[146] S Djankov, EL Glaeser, R La Porta, F Lopez de Silanes and A Sheifer, 'The new comparative economics', (2003) 31 Journal of Comparative Economics 595
[147] Rules and Regulations of the SEC, r.292 (1); ISA2007, s. 85 (1)
[148] *ibid* 292 (2) and ISA 2007, s. 85 (2)
[149] ISA 2007, s. 85 (4) (a)

issuance of the prospectus or done without their knowledge,[150] and directors that notify in writing that a prospectus issued or about to be issued contains an untrue statement.[151] The regulations also exclude liability against experts that give their opinion on certain issues contained in the prospectus.[152] Where a prospectus includes an untrue statement or misstatement, any director or officer who authorised the prospectus can be held criminally liable and convicted to imprisonment for a term not exceeding three years or a fine of not less than 1 billion Naira or both. If summarily convicted, he shall be liable to a fine of not less than 1 billion Naira or imprisonment for a term not exceeding three months or both. He can avoid such terms if he proves that the misstatement or untrue statement was immaterial or that he had reasonable grounds to believe and did up to the time of the issuance of the prospectus believe that the statement was true.[153]

3.7.2. Enforcement in the United Kingdom

In the United Kingdom, civil and criminal sanctions are applied when enforcing rules of disclosure. For civil actions, there is the option of rescission of contract or compensation claims.

3.7.3. Rescission of contracts

Rescission involves unwinding the contract and placing parties back into their pre-contractual position.[154] An investor that acquires securities on the belief of information provided by or on behalf of the other party that later turns out to have been false or misleading can seek for rescission of the contract by which he acquired

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[150] Immediately such director becomes aware of this, he must give a reasonable public notice that it was issued without his consent. ISA 2007, s 85 (4) (b)
[151] ISA 2007, s. 85 (4) (c)
[152] *ibid,* s. 85 (4) (5)
[153] *ibid,* 293 (1) ISA 2007, s. 86
[154] E. McKendrick, *Contract law,* (11th Edition, Palgrave 2015) 236

the securities.[155] In instituting such action, the claimant must be within the class of persons to whom the false statement was addressed.[156] When shares are offered to the public generally, this requirement should be easily satisfied since everyone is within the category of addressee. Furthermore, the statement complained must be a statement of fact and not law; intention or opinion and must have also come from the company, either directly or indirectly.[157] Silence is not actionable as a general rule. However, a claim may lie if the effect of an omission is to render what is said false or misleading.[158]

It is important to distinguish rescission from repudiation of contract because these two terms are usually confused for each other and sometimes used as synonyms. Repudiation also known as anticipatory breach refers to refusal of a party to perform an obligation owed to the other party. It does not challenge the existence or validity of the contract *ab initio,* rather it challenges the continued existence or performance of obligations under the contract. In securities market transactions, when the investor has paid for the securities, there are no further foreseeable obligations on his part. In view of this, repudiation will not be ideal when seeking to enforce the disclosure regime because other than there being no further obligations on the part of the investor, it means there is still an enforceable contract. However, this thesis argues that there is nothing stopping parliament or a regulator from compelling performance of an obligation to disclose after breach of disclosure rules. This would be beneficial if it is to serve as a remedy for investors, however, the timing must be right.

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[155] E. Ferran and L. C. Ho (n 113) 370

[156] *AL Nakib Investments (Jersey) v Longcroft* [1990] 1 WLR 1390

[157] Companies can hardly distance themselves from statement even though the statement was issued on its behalf, or when it is a work of specialists who contributed to the compilation of the prospectus.

[158] *R v Kylsant* [1932] 1 KB 442

A party seeking to rescind the contract must act promptly after the discovery of the fraud or misrepresentation. The case of *Sharpley v South and East Coast Rly*[159] established the importance acting promptly because if an investor performs an act that amounts to ownership after learning of an entitlement to reject, the right to rescind will be barred.[160]

It is important to note that rescission cannot be sought against a company that has gone into liquidation because individual creditor actions are barred due to the principle of collectivity that operates in insolvency. However, the courts may give permission for such actions.[161] This bar is applicable even while the company is in solvent liquidation.[162] If the case is successful, the investor must notify the company that the shares are retracted and take steps to have his name removed from the register or any other actions practicable. If the company disputes this, the company may apply to the court for rectification.[163]

3.7.4. Compensation Claims

An investor who has acquired shares on the basis of a false prospectus may seek financial compensation in addition to or instead of rescission. If there is a contractual relationship between the maker of the statements and the person seeking compensation, the innocent party may be able to seek compensation under the Misrepresentation Act 1967 and may additionally have a claim for breach of contract.[164] Section 90 of the FSMA 2000 provides the medium to statutorily claim for compensation exclusively in regards to prospectuses and listing particulars and lists

[159] (1876) 2 Ch D 663 at 685
[160] Attempting to sell shares, attending company meetings, signing proxies, paying calls, or accepting dividends have all been reasons for barring the right to action for rescission.
[161] Insolvency Act 1986, s 130 (3)
[162] *Re Hull and County Bank, Burgess case* (1880) 15 Ch D 507
[163] *Re Derham and Allen Ltd* [1946] 1 Ch 31 at 36
[164] E. Ferran and L. C. Ho (n 113) 392

persons capable of instituting such claims.[165] Furthermore, failure to publish a required supplementary prospectus establishes the possibility of instituting an action for compensation by virtue of Section 90 (4).

Persons that can be sued in this regard are listed by the Prospectus Rules to include, the issuer, directors of the corporation, persons that are liable for the prospectus etc.[166] An issuer and its directors are not responsible if the issuer has not made or authorised the offer or request for admission to trading in relation to which the prospectus was published.[167] Furthermore, a director is not responsible for a prospectus if it is published without his knowledge or consent. For such a director to avoid liability, he must, as soon practicable give reasonable public notice that it was published without his knowledge or consent.[168] In the same vein, an offeror whom is not the issuer is not responsible for a prospectus where the issuer is responsible for it or the prospectus was drawn up primarily by or on behalf of the issuer, and the offeror is making the offer in association with the issuer.[169] Furthermore, a person can be liable for only a part of a prospectus by indicating the parts of the prospectus he is accepting liability only to the extent specified if it is included in the form and context to which the person has agreed.[170]

In establishing a claim for compensation, the burden is on the investor to prove a causal link between the inaccurate prospectus and the loss he suffered i.e. prove that he suffered loss as a consequence of wrong information he relied on to acquire shares.[171] However, if the investor knew he was presented with false

[165] Persons who have acquired securities based on the prospectus with omission or untrue statements, persons that have suffered loss based on the untrue or misleading statements or omitted statement.
[166] United Kingdom Listing Authority Prospectus Rules, Rule 5.5.3
[167] *ibid,* 5.5.5
[168] *ibid,* 5.5.6
[169] *ibid,* 5.5.7 This approach is supported in the ESMA/2013/1537, Q47
[170] *ibid,* 5.5.8
[171] E. Ferran and L. C. Ho (n 113) 400

information his right to be compensated becomes lessened.[172] Nonetheless, the investor is not mandated to verify the accuracy of the information as well as prove that the person responsible knew of the incorrect nature of the information contained therein.[173] However, he is to prove that the maker of the statement failed to act with sufficient care when instituting an action under section 90 of FSMA. For deceit claims the claimant shall prove that the maker of the statement knew it was false, did not have an honest belief in its truth or was reckless as to its veracity.[174]

3.7.5. Criminal liability for defective prospectuses

Sections 89-92 of the Financial Services Act 2012 makes it possible to institute criminal proceedings when a prospectus contains false information or conceals material facts. These sections make it is an offence to knowingly or recklessly make a statement that is false or misleading in a material respect or dishonestly conceal material facts in a prospectus.[175] If they do this recklessly or with the intention to induce another person to enter into a relevant agreement, then criminal actions can be instituted.[176] Furthermore, it is prohibited to intentionally create misleading impressions as to the market price or value of investments in order to induce an investment decision.[177] Anyone found guilty of these offences is liable to a maximum penalty of seven years imprisonment plus a fine.[178] In *R v Feld,* the Court of Appeal upheld a six-year sentence against a director for offences relating to a rights issue prospectus under a statutory predecessor offence. In upholding the sentence, the court highlighted the vital importance of maintaining the confidence of the city and

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[172] *ibid,* 401
[173] *Aaron's Reefs Ltd v Twiss* [1896] AC 273
[174] *Derry v Peek* (1889) 14 App Cas 337,
[175] Financial Services Act 2012, s 89
[176] *ibid*
[177] *ibid,* s 90
[178] *ibid,* s 92

financial institutions in the veracity of information contained in prospectuses and similar documents.[179]

Criminal actions can also be instituted under the provisions of the Fraud Act 2006. Failure to disclose information or by abuse of position is held to be a statutory criminal offence.[180] In such instance, the act must have been done dishonestly with the intention of making a gain or causing a loss or risk of loss to another. The loss does not have to take place. Pursuing such a claim is rare because of the high standard of proof required in criminal law i.e. proof beyond reasonable doubt.

The foregoing sections have highlighted the importance of regulating disclosure in capital markets. The regulatory provisions of Nigeria and the UK exhibit some similarities such as operating two or more regimes in regulating mandatory disclosure as well as the substantive rules governing the act contained in the rules. However, there are few exceptions. For example, some rules contained in the UK, are absent in the regulations in the Nigerian regulations. Furthermore, the laws mandating disclosure for corporations listed in the Nigerian capital market have been empirically researched and findings indicate that the Nigerian corporate reporting practices are weak.[181] In 2004, the World Bank stated that Nigerian financial reporting practices are deficient in terms of listed companies.[182] In the UK, the report of the Financial Reporting Council in 2015 indicates that a good level of corporate reporting is practiced by larger public corporations especially those in the FTSE 3500, with

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[179] *R v Feld* (Case No. 97/3093/X5), unreported, (1998) CCA

[180] E. Ferran and L. C. Ho (n 113) 404

[181] R. Wallace, 'Corporate financial reporting in Nigeria', (1988) 72 Accounting and Business Research, 352; E. N. M. Okike, 'Extension of information in accounting reports: An investigation', (2000) 3 Nigerian Financial Review 3; G. Ofoegbu and E. Okoye, 'The relevance of accounting and auditing standards in corporate financial reporting in Nigeria: Emphasis on compliance', (2006) 39 The Nigerian Accountant 2

[182] <https://www.worldbank.org/ifa/rosc_aa_nga.pdf> accessed 16 June 2015

boards responding well to new strategic report requirements. There are also examples of good reporting by smaller companies and AIM quoted companies but there are traces of errors in how they apply the IFRS.[183] Furthermore, in 2016, a survey of 224 stakeholders on behalf of the Financial Reporting Council indicate that corporate reporting is generally good, with 90% of the directors and auditors as well as 73% of investors expressing high confidence in the quality of corporate reporting.[184] This thesis proposes the need to correct such assertions because the effects are detrimental to the capital market, as there is the likelihood both local and foreign investors will avoid the market if it is categorised as such. In the interest of growth, sustainability and economic development, disclosure should be made mandatory and adequately regulated. It should be encouraged as a norm guiding operators of the securities market in Nigeria. This will reduce occurrences of market abuse in the market as well as propel the market to be efficient.

In view of this, this thesis argues that the laws already established in Nigeria though commendable, have some loopholes that may be exploited, and discourage investors from investing in the market. The reasons for this argument are highlighted below.

First, there are some important issues contained in one of the rules that are absent in the other. For example, the SEC Rules and Regulations make provisions for the declaration of director earnings whilst this provision is absent in the ISA. Such information can be used to establish liability against directors. Although the rules utilised in the UK share similar attributes, i.e. some laws are contained in one

[183] Financial Reporting Council, 'Corporate reporting review: Annual report 2015', (2015) Financial Reporting Council, 3. Also available at <https://www.frc.org.uk/Our-Work/Publications/Corporate-Reporting-Review/Corporate-Reporting-Review-Annual-Report-2015.pdf > accessed 24 May 2017

[184] Financial Reporting Council, 'Annual review of corporate reporting 2015/2016', (2016) Financial Reporting Council, 4 Also available at<https://www.frc.org.uk/Our-Work/Publications/FRC-Board/Annual-Review-of-Corporate-Reporting-2015-16.pdf> accessed 24 May 2017)

provision and are absent in another this thesis submits that such practice in Nigeria may not be ideal. Nigeria is a developing country where there is some level of financial regulation ignorance. This coupled with the fact that there are no reported cases of these regulations being applied, highlights inertia in terms of enforcement, which can partly be attributed to lack of knowledge of these rules. This thesis proposes further harmonisation of both regulatory acts by providing a more detailed requirement for mandatory disclosure in both acts. In the alternative, this thesis proposes the streamlining of these regulations to be contained in one regulatory regime as against two. The ISA is an Act of the legislature that regulates capital market operations. It is arguable that the SEC Rules and Regulations are subject to it because generally an act of legislature supersedes the procedural rules of an executive organ. This makes it impractical that the rules contained in the SEC Rules and Regulations are not conspicuously available in the ISA. In view of this, this thesis proposes that both regulatory regimes should contain provisions for mandatory disclosure or in the alternative, reference where the provision is contained in the other regime.

Second, neither the provisions of the SEC Rules and Regulations nor the ISA prescribe the extent to which disclosure is to be carried out. In comparing this to the UK, the FSMA provides that disclosure is not restricted to individual knowledge. It should be extended to things that would be known when searches are conducted diligently. Following the regulatory provisions in Nigeria, there is the possibility corporations will not search for information, as they are not mandated to by any regulation. This thesis recommends that the provision of the FSMA highlighted above be adopted into the SEC Rules and Regulations as well as the ISA. This will help in ascertaining what ought to have been disclosed by corporations in a court of law should the need arise where there is insufficient disclosure. Although it is arguable that the provision of section 73 of the ISA caters for this, this thesis argues that the substantive provision of section 73 does not prescribe the extent to which information should be disclosed, it only provides a possible defence that can be employed by directors and persons in charge of a prospectus.[185]

Third, the Nigerian regulatory regime is arguably more lenient in terms of enforcement than the UK. Persons that provide misstatements are liable to seven years imprisonment, whilst in Nigeria an individual who performs a similar offence is liable to three years imprisonment. Whilst this thesis commends the effort to have these rules in place, enforcing these laws should be given utmost importance. There are no recorded cases of any individual going to jail for provision of misstatement in disclosure. This leads to two assumptions, which are: the rules are good enough and individuals adhere to them or they have not been utilised. This thesis aligns it argument with the latter, as evidence from the Nigerian Stock Exchange/ SEC website show a list of companies that have either been suspended or had their license revoked by virtue of not providing quarterly reports or annual reports and no reports of indicating that there is no application of these rules that incarcerates individuals that have committed the offence. This coupled with the fact that Nigeria is known as a corrupt country makes this thesis align its argument that corporations listed in the stock exchange do not disclose honestly. In view of this, this thesis proposes that an austere approach towards such acts of malpractice in the market should be adequately penalised. Penalties such as imprisonment and seizure of assets that can be used for compensation for investors who have suffered loss should be applied. This has the possibility to bring some sterility to the market when applied appropriately. In relation

[185] ISA, 2007, s. 73

to fines, the SEC Rules and Regulations and ISA make provision for fines not less than 1 billion Naira (equivalent of approximately £2 million). This sum is unrealistic and potentially unenforceable. Whilst it is important to have rules governing the capital market, it is important to set realistic and enforceable rules. This thesis postulates that this is likely the reason there are no reported cases of individuals or corporations paying any such fines. Furthermore, the Nigerian penal system is known to award little to nothing as fines.[186] In view of this, this thesis proposes more realistic sums to be imposed as fines, by the Courts.

The foregoing suggests that there is the possibility for corporations not to adhere to adequate disclosure when listing in the Nigerian capital market. The criticisms underlined above, if addressed have the propensity to curtail wrong practices if properly implemented. Although these issues appear minimal, this thesis submits that for completeness it is important they be incorporated into the rules regulating mandatory disclosure in the capital market as it may cause more harm if they are absent.

Although mandatory disclosure has been criticised its importance cannot be undermined, neither can the effect it has on the confidence of investors be emasculated. This thesis suggests that regardless of the criticisms, it would be harmful if it were absent in a capital market or not amply obeyed. It is arguable that there are some benefits being enjoyed by mandating disclosure as reports indicate that corporations are obeying the rules because of the stringent practices employed by the Nigerian Stock Exchange. In 2011, the stock exchanged reported to have suspended

[186] E. N. M Okike, 'Corporate governance in Nigeria: the status quo', (2007) 15 Corporate Governance: An International Review 173, 190

48 firms listed for failure to publish annual reports on time. Furthermore, in 2012, it penalized 72 firms for not meeting the reporting requirement. This is held out to have led to greater compliance of disclosure in the market.[187] This is a welcome development and should be practiced more often with more stringent reparations for erring participants of the market, as there are still reports of corporations not observing mandatory disclosure in the market. In view of the foregoing, this thesis proposes the enactment of credible regulations and ample enforcement in a bid to ensure that corporations adhere to the rules. The next section discusses another form of disclosure utilised in capital markets known as voluntary disclosure.

3.7.6. **Voluntary disclosure**

Voluntary disclosure is the provision of information beyond requirements by a company's management such as the generally accepted principles and SEC rules. It is the provision of extra information that will be relevant to the decision making for investors. The information disclosed is determined by the firm's corporate governance structure and ownership.[188] The discretion exercised by privately informed managers or firms in disclosing information is beneficial because, rational market participants would otherwise interpret non-disclosure as unfavourable news and consequently discount the value of the firm's assets.[189] Studies have examined the economic consequences of voluntary disclosure and a common consensus is that it affects the market in several ways identified below.

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[187] Oxford Business Group, 'The report: Nigeria 2013', (2013) Oxford Business Group 87

[188] S. T. Chen, 'Ownership structure, board structure and the level of information disclosure: views of corporate governance', (2015) 4 Review of Contemporary Business Research 18

[189] J. Francis, D. Nanda and P. Olsson, 'Voluntary disclosure, earnings quality and cost of capital', (2008) 46 Journal of Accounting and Research 56

First, it increases the confidence of investors in the market by reducing information asymmetry amongst informed and uniformed investors.[190] This confidence emanates from the belief that stock market transactions occur at a fair price due to companies voluntarily providing information that they are not mandated to provide by law.

Second, it has the likelihood of generating more liquidity for a firm's securities.[191] Managers believe that voluntarily communicating information increases the overall liquidity of a company's stock.[192] Furthermore, it levels the playing field and reduces the amount of price protection that less informed traders apply when purchasing shares.[193]

Third, it reduces a firm's cost of capital by mitigating adverse selection problem in the capital markets. The lemons problem in capital markets creates the incentive for managers to voluntarily disclose to reduce the cost of capital.[194] When disclosure is imperfect, investors bear risk of forecasting the future payoffs from their investment and if the risk is non-diversifiable investors will demand an incremental return for bearing the information risk. Consequently, firms with high level of disclosure and low information risk having lower cost of capital than firms with low disclosure levels and high information risk have.[195] This reduces the information asymmetry between firms and investors thus enabling greater liquidity.[196] That said,

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[190] A. Kandelousi, M. Alifiah and A. Karimiyan, 'Investigation of the association between disclosure and asymmetric information', (2016) 7 Journal of Business Studies Quarterly 40
[191] P. M. Healy and K. G. Palepu (n 2) 429
[192] C. Leuz and P. Wysocki, 'Capital markets: effects of corporate disclosure and disclosure regulation', (2006) 2, Research study: Evolving Investor Protection 202
[193] *ibid* 203
[194] P. M. Healy and K. G. Palepu (n 2) 429
[195] C. B. Barry and S. J. Brown, 'Differential information and the small firm effect', (1984) 13 Journal of Financial Economics 291
[196] D. Diamond and R. Verrechia, 'Disclosure, liquidity and the cost of capital', (1991) 46 Journal of Finance 2189

evidence supporting this notion is contradictory because of difference in size of companies, presence of intermediaries etc.[197]

The effects of voluntarily disclosing information are considered profitable to a corporation and the capital market. In view of the foregoing, a question that comes to mind is, why reveal information not mandated by law to disclose? This is crucial considering the likelihood that the intricacies of the company might be exposed. The next section highlights some reasons management of a company voluntarily discloses information.

3.7.7. Reasons managers voluntarily disclose information to prospective shareholders

In an efficient capital market, managers have superior information about their firm's expected future performance than outside investors. If auditing and accounting regulations work perfectly, managers' accounting decisions and disclosures would communicate changes in their firms business economics to outside investors.[198] Managers' incentives for voluntarily disclosing information are identified below.

First, shareholders hold managers accountable for stock performance because the managers oversee the running of the company. Furthermore, poor stock price performance is associated with CEO turnover.[199] Dissident shareholders who wage a proxy fight for board representation frequently cite poor earnings performance as justification for proposed management changes.[200] Therefore managers use voluntary disclosure to reduce the likelihood of undervaluation and to explain why there is a

[197] A. Kandelousi (n 190)
[198] P. M. Healy and K. G. Palepu (n 2) 420
[199] W. J. Watts and K. Wruck, 'Stock prices and top-management changes', (1988) 20 Journal of Financial Economics 463
[200] L. DeAngelo, 'Managerial competition, information costs and corporate governance: The use of accounting performance, measures in proxy contests,' (1988) 10 Journal of Accounting and Economics 16

poor performance earnings.[201] Furthermore, they apply voluntary disclosure as a means of developing investor confidence with the view to raise capital for the company. This coupled with some compensation schemes granted to managers such as stock grant options[202] and stock appreciation rights[203] provide a likely explanation as to why managers voluntarily disclose information.

Second, restrictions on insider trading provide managers with incentives to make voluntary disclosure to correct any perceived undervaluation prior to the expiration of stock option awards.[204] In the same vein, if a manager is interested in trading in their stocks, they have the likelihood to voluntarily disclose private information to meet the restrictions imposed by insider trading.

Third, managers employ voluntary disclosure to avoid litigation by shareholders. Managers in firms with bad earnings have an incentive to pre-disclose information to reduce the cost of litigation. This hypothesis presumes that in the absence of litigation managers have a reason to disclose good and bad news symmetrically as the Courts rationally focus on whether there was delay in the announcement of bad news.[205] Research has also indicated that a firm's decision to disclose information to investors is influenced by concern that such disclosures can damage their competitive position in product markets.[206]

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[201] P. M. Healy and K. G. Palepu (n 2) 421

[202] Stock Options Grants give the employee the right to purchase a certain number of shares of the company's stock at a predetermined price. The idea behind it is to give the employees incentive to align their interests with that of stockholders.

[203] Stock appreciation rights (SARs) is a method a company utilises to give employee a bonus if the company has had a good financial performance. They receive the bonus either in cash or stock

[204] P. M. Healy and K. G. Palepu (n 2) 422

[205] D. Skinner, 'Why firms voluntarily disclose bad news', (1994) 32 Journal of Accounting Research 40.

[206] P. M. Healy and K. G. Palepu (n 2) 424

Research on the effects of voluntary disclosure in Nigeria indicates that bigger firms tend to make voluntary disclosure compared to smaller firms.[207] The study also found that better performing firms provide more corporate disclosure when measuring firm performance such as earning per share and dividend.[208] It has been recommended that companies should engage in voluntary disclosure of information that is industry specific and useful to prospective investors.[209] Furthermore, authorities charged with the responsibilities of regulating the information disclosed in financial reports and prospectus should review their disclosure requirement and incorporate voluntary disclosure items into them with the view of increasing transparency.[210]

Adequate and efficient disclosure boosts the confidence of investors in a capital market and decreases liability on companies because investors are presented with further information to guide them when making the decision to invest. This thesis submits that the concept, if properly explored and regulated has the propensity to encourage prospective investors to invest their money in such markets.

The Nigeria UK capital markets projects in its report of March 2015 highlighted the need for transparency and eradication of manipulation in the capital market.[211] A stringent disclosure regime was suggested as an improvement in an attempt to deter insider trading, information asymmetry and improve transparency in the capital market.[212] The urgent call for transparency cannot be undermined, as there are unquantifiable benefits a capital market will gain by operating a transparent

[207] I. Adelopo, 'Voluntary disclosure practices amongst listed companies in Nigeria', (2011) 27 Advances in International Accounting 344
[208] *ibid*
[209] E. Unuagboi and D. Oziegba, 'Financial reporting and voluntary disclosure in Nigeria quoted companies', (2016) 1 Igbinedion University Journal of Accounting 53
[210] *ibid*
[211] S. Kiyingi and E. Uwais, 'Nigerian capital markets: legal and regulatory review and recommendations', (2015) A collaborative report of: the Nigerian capital markets solicitors and Law Society of England and Wales 10
[212] *ibid*

market. Amongst these include, enhancement of investor confidence, which subsequently leads to a robust capital market. With a robust capital market, there will be sufficient capital to engage in projects that will aid in economic development.

Mandatory disclosure is an important concept in a capital market that should be encouraged and enforced in countries with financial illiteracy and countries that are prone to fraudulent issuers. In the same vein, voluntary disclosure should also be encouraged, promoted and adopted as a norm, but should not be relied on as the sole means of disclosure accorded in a capital market especially in countries where financial illiteracy and corruption is pervasive.

One major issue with disclosure emanates from the fact that there is no guarantee that the information disclosed is accurate. In view of this, there has been the need to adopt what is known as reputational intermediaries or watch dogs of the capital market to attest to the validity of information that is disclosed to prospective investors. The next section analyses the role of reputational intermediaries and the possibility of regulation.

3.8. Reputational intermediaries

Reputational intermediaries also called 'gatekeepers', or 'watchdogs' are professional agents that monitor management and alert shareholders to opportunistic behaviour by their managers.[213] They are referred to as independent watchdogs of the capital market. They screen out flaws, identify defects and verify compliance with standards or procedures relating to investments. In a bid to reduce information asymmetry, they

[213] J. C. Coffee Jr, *Gatekeepers: 'The Professions and Corporate Governance*, (OUP 2006) 9

act as an assurance instrument for investors by confirming that a company has complied with the relevant procedures prescribed by law and has not falsified information to investors. They are positioned to prevent wrongdoing by withholding necessary cooperation of consent.[214] For example, an investment-banking firm can refuse to underwrite the issuer's securities if it finds that the issuer's disclosures are deficient.[215]

They work with reputational capital, which is the quantitative measure of an entity's reputational value in a community or a market place.[216] They get reputational capital when they repeatedly carry out duties of vouching for the correctness or otherwise of a company's disclosure. Entry into the field of gatekeeping is usually restricted and protected because new entrants possess no reputational capital to work with. Furthermore, reputational capital can be lost if an intermediary has condoned some form of wrongdoing, thus generating the perception that intermediaries will be loyal to investors because of the likelihood of losing reputational capital. They lend or pledge reputational capital to the corporation thus enabling investors or the market to rely on the corporation's own disclosure or assurance where they otherwise might not.[217] The next section identifies some reputational intermediaries, their functions, and possible regulation towards achieving an efficient capital market.

3.8.1. **Auditors**

An audit is a systemic process of objectively gathering and evaluating evidence relating to assertions about economic actions and events that an organisation making

[214] R. Kraakman,'Gatekeepers: The Anatomy of a third-party enforcement strategy', (1986) 2 Journal of Law and Economics 53
[215] J. C. Coffee Jr (n 213)
[216] J. Klewes and R. Wreschniok, *Reputation capital: building and maintaining trust in the 21st century*, (Springer Link 2009) 3
[217] J. C. Coffee Jr (n 213) 2

the assertion has been engaged. It is used to ascertain the degree of correspondence between these assertions and the established criteria.[218] Auditors conduct audits to verify the accuracy of financial records and accounting practices of a business or government.[219] They check and verify financial statements as well as ascertain the correctness or lack thereof of the amounts contained in statement, liability and ownership of assets as well as check if the financial statement is in conformity with accounting standards.[220] In their capacity as intermediaries, they ensure that organisations provide accurate financial records and statements. They perform systematic and independent examination of data, statements, records, operations and performance for a stated purpose. It should be noted that an auditor's task does not include deciphering if a company is doing well or substantiating the risks associated with the business or the likelihood of success.[221] They are to report misstatement contained in financial statement disclosed by the companies as well as express any complaints.

There are <u>two</u> types of auditors, internal auditors and external auditors. Internal auditors are usually employees of the companies they audit. They work in close range with the companies and are apprised of the intricate details of the running of the company.[222] They promote disclosure and ensure that financial statements disclosed contains required information.[223] External auditors are independent auditors

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[218] B. Porter, J. Simon and D. Hartherly, *Principles of external auditing,* (2nd Edition John Wiley & Sons Ltd 2003) 3
[219] G. Cosserat, *Modern Auditing,* (2nd Edition John Wiley & Sons Ltd 2004) 46
[220] The role and function of external auditors. The institute of chartered accountants in Australia, p.3
[221] J. L. Kroeker (Chief Accountant U.S. Securities and Exchange Commission), 'Testimony concerning the role of the accounting profession in preventing another financial crisis'. Before the subcommittee on Securities, Insurance and Investment of the Senate Committee on Banking, Housing and Urban Affairs, April 6, 2011
[222] A. Schneider, 'Modeling external auditors: evaluations of internal auditing', (1984) 22 Journal of Accounting Research 65
[223] IIA Position Paper, 'The role of internal auditing in enterprise-wide risk management', (2009) Institute of Internal Auditors

employed by companies or investors to audit the account of a company. They sometimes work directly or in conjunction with governmental agencies.[224]

Verification by auditors can be used to enhance investor confidence when deciding whether to invest.[225] However, this thesis argues that because it has been suggested that the verification given by auditors does not insure or guarantee the accuracy of financial statements, there is the likelihood of them performing their tasks in a mediocre manner because they know liability will not be on them.

This thesis proposes that auditors should be held accountable, partly liable and should be able to be sued by investors if disclosure is incorrect, especially in instances where they could have detected such malpractices if they had performed their duties diligently. This is borne out of the thought that auditing financial statements is a sensitive task that should be conducted with the highest level of caution. This proposition does take into account the likelihood of mistake and deceit by companies been audited. In view of that, this thesis proposes that before liability can be established against an auditor/auditing firm, it should be proven that such misstatement or falsified information was one that an auditor ought to identify if he carried out his job diligently.

Whilst this proposition above has the propensity to generate an upright attitude by auditors towards their duties, it is crucial to maintain a balance when imposing such rules to avoid auditors neglecting or evading jobs. For instance, it was argued that because of the fear of possible litigation auditors resist responsibility for

[224] D. Larcker and B. Tayan, *Corporate governance matters,* (Pearson 2016) 301
[225] P. N. Onulaka, 'Effect of audit expectation gap in Nigerian capital market', (2014) 4 International Journal of Accounting and Financial Reporting 304

assessing the appropriateness of chosen accounting conventions, insisting that management has this responsibility.[226]

A major concern in relation to the characteristics of auditors as gatekeepers is the issue of the independence and objectivity, which are qualities expected of an auditor. Other characteristics include detection of error, carrying out tests, giving opinions on the materiality of financial statements, reporting of material error and fraud. In view of these and based on the sensitive nature of their job, it is imperative that auditors are efficiently regulated to enable them operate within the ambit of the law.

The collapse and eventual restructuring of some institutions within Nigeria and outside the country (e.g. Enron and WorldCom in the USA, Cadbury, Intercontinental Bank, Oceanic Bank, Fidelity Bank in Nigeria) and the subsequent implications of reporting by auditors have placed the profession under close scrutiny.[227] Investors in Nigeria have lost several billions of dollars through the collusion of accountants and external auditors with company management and directors to falsify and deliberately overstate company's accounts.[228]

It has been suggested that contrary to the claim of protecting the public interest accountants and auditors may be partly responsible for the closure of some of these corporations in Nigeria even though the statutory provisions and acts relating to companies and professional bodies place the responsibility on accountants and auditors to detect and report cases of suspected fraud and accounting malpractices.[229]

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[226] L. A. Cunningham, 'Book Review of Gatekeepers: The Professions and Corporate Governance by John C. Coffee, Jr', The British Accounting Review 40 (2008) page 88.
[227] S. B. Adeyemi, 'An empirical investigation of the audit expectation gap in Nigeria', (2011) 5, African Journal of Business Management 7964
[228] O. M. Bakre, 'The unethical practices of accountants and auditors and the compromising stance of professional bodies in the corporate world: Evidence from corporate Nigeria', (2007) 31, Accounting Forum 277
[229] *ibid*

Moreover, it is important to highlight the effect of the presumed failure of auditors in carrying out their duties efficiently and diligently, e.g. the closure of some of these corporations led to unemployment in the Nigerian economy and poverty of millions of Nigerians.[230]

Auditors in Nigeria are considered the reason some corporate malpractices are evident in the system. For instance, it is asserted that they fail to alert regulators when they discover fraudulent or other questionable activities in company's book. They are said to sometimes prepare three different accounts for the same organisation (one for the shareholders, one for management and one for tax authority).[231] This kind of practice is held to be widespread in corporate Nigeria. In 2006 the firm of Akintola Williams & Deloitte was accused of collaborating with board of directors of Afribank Nigeria to falsify the business account for March 2006. Following this suspicion of malpractice in the system that was not investigated or sanctioned, the firm was accused of collaborating with the members of the board of Cadbury Nigeria PLC to deliberately overstate the company's account by between 13 billion Naira and 15 billion Naira six months later.[232] There are other instances of unreported unethical conducts by auditing firms in Nigeria. In view of the foregoing there is the need for efficacious regulation of auditors in other to achieve best corporate practices.

In Nigeria, auditors are regulated by the Nigerian Standards on Auditing (NSA), which prescribes that all audit carried out should be in compliance with the International Standard on Auditing (ISA).[233] Furthermore, the Companies and Allied Matters (CAMA) mandates all financial statements of listed companies in Nigeria to

[230] *ibid*
[231] S. B Adeyemi, 'Minimisation of financial crime: The role of accountant', (2004) 1, Student Accountant Journal 7
[232] O. M. Bakre (n 228) 279
[233] <http://icanig.org/ican/documents/NSAs.pdf > accessed 14 September 2016

be audited by qualified auditors.[234] Additionally, the SEC also requires public companies with securities to file its audited financial statement and other returns that may be prescribed with the commission on periodic or annual bases.[235] In a bid to attain heights that are comparable to its international counterparts, the Nigerian government in 2010 adopted the International Financial Reporting Standards (IFRS) with the aim of it being fully operational and applicable to audits carried out in Nigeria in 2014.[236]

The UK is not immune from unethical practices by auditors as it has been documented that banks sometimes request accounting firms to visit their clients with the purpose of writing and reporting on the viability of their business operations. The accountants and auditors are tasked to provide pessimistic picture of the business with the aim of being appointed as receivers based on the recommendations from these accountants and auditors.[237] Furthermore, evidence indicates that auditors that were implicated in audit failures and referred to professional bodies were sometimes not investigated.[238]

In the UK, the requirements for statutory audits are set out by the Statutory Audit Directive (2006/43/EC), adopted by the European Union and transposed into UK law by the Companies Act 2006 (s.475). This directive grants powers to entities known as Recognized Supervisory Bodies (RSBs) to register and supervise auditors. They are subject to an independent oversight and are regulated by the Financial Reporting Council (FRC). The FRC is the independent regulator responsible for

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[234] CAMA 2004, s. 357

[235] Rules and Regulations of the SEC

[236] A. Madawaki, 'Adoption of international financial reporting standards in developing countries: A case for Nigeria', (2012) 7, International Journal of Business Management 152

[237] J. Cousins, A. Mitchell, P. Sikka, C. Cooper and P. Arnold, '*Insolvency abuse: Regulating the insolvency industry*', (Association for Accountancy and Business Affairs, 2000) 3

[238] P. Sikka and H, Willmot, 'Illuminating the state-profession relationship: Accountants acting as department of trade and industry investigator', (1995) 6, Critical Perspectives on Accounting 341

promoting high quality corporate governance and reporting. It does this by setting codes and standards as well as oversees regulatory activities of the professional accountancy bodies.[239] The enforcement committee or tribunal effects enforcement by deliberating if an auditor has complied with the regulatory framework of auditing. It imposes a sanction on the auditor if the auditor has not complied with the regulatory framework. Sanctions include suspension, withdrawal of registration and regulatory penalty of a fine that is determined by the enforcement tribunal or committee. In Nigeria, auditors can be held liable for negligence.[240] Furthermore, the ISA[241] provides for the imposition of a fine of 100 thousand Naira and subsequent 50 thousand Naira on a daily basis against an auditor for not filing annual report and periodic report with the SEC or failing to issue a statement as to the existence, adequacy and effectiveness or otherwise of the internal control system.[242] Additionally, in a bid to ensure that the financial statements produced by auditors is efficient, there is the provision that any officer of a company that knowingly or recklessly provide false statements to auditors will be held liable. In such an instance, s. 369 of CAMA provides that such person may be liable to a year imprisonment or a fine of N500 or both.

If both the Nigerian and UK provisions are compared, one thing is evident, the deficiency in Nigerian regulatory provisions on auditors. The provisions in Nigeria do not explicitly define what behaviour constitutes negligence in comparison to the provision in the FRC in the UK. However, they can be held liable under the common

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239 <http://www.icaew.com/en/about-icaew/what-is-chartered-accountancy/regulation-of-the-accountancy-profession> accessed 14 September 2016
240 CAMA, 2004, s 368
241 ISA, 2007 s.65 (2)
242 System of internal controls is a system a public company is required to establish to control its financial reporting in a bid to preserve the integrity of a company's financial control and reporting. CAMA s. 61

law for tortious professional negligence or negligent misstatements.[243] This arguably is insufficient as auditors can feign ignorance of acts that they are prohibited from doing. Furthermore, in relation to penalties, the Nigerian provisions of penalty of 100 thousand Naira and subsequent 50 thousand Naira for each day is not substantial enough to make auditors abstain from wrong acts whilst carrying out their duties. This thesis proposes a firmer approach with substantial sums as penalties. There has been the recommendation of a more rigorous approach towards quality control measures by individual auditing firms and quality monitoring teams of the professional accounting bodies in Nigeria.[244] Furthermore, there has been the recommendation for stiffer penalties for erring auditors as practiced in other climes. Taking an example from the UK, although it is stated that the enforcement committee or tribunal determines the amount of the fine, the precedent set is commendable and a similar standard should be adopted in Nigeria. For instance, in 2014, Ernst & Young and Mazars LLP were fined 52, 000 and 10,400 pounds respectively for not complying with the regulatory framework for auditing its audit of an entity's 2013 financial statement.[245]

The regulation of auditors is very important because of the sensitive nature of the job they perform. This thesis recommends a stricter approach towards auditing firms and auditors that do not perform their duties diligently and a stricter liability if by virtue of their verification, an individual invests in the market and subsequently suffers a loss. This has the likelihood to generate some diligence whilst performing their duties.

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[243] Y. A. Ojo, 'Firm sues bank over alleged negligent misstatement', *The Guardian* (Nigeria, 31 March 2015)
[244] S. C. Okaro and G. O. Okafor, 'Drivers of audit failure in Nigeria: Evidence from Cadbury Nigeria PLC.' (2013) 4 Journal of Finance and Accounting 17
[245] <https://www.frc.org.uk/Our-Work/Audit/Audit-Quality-Review/Auditor-Regulatory-Sanctions-Procedure/Auditor-Regulatory-Sanctions.aspx> accessed 3 September 2016

3.8.2. Credit Rating Agencies

Credit rating agencies issue ratings about the creditworthiness of debt securities such as government and corporate bonds.[246] They are used to assess the risk of a borrower's default and its financial loss, in the sale of financial products.[247] In essence, they provide standardised assessments of the future probability that a debtor will default on the liabilities owed to creditors.[248] They play a very important role in the running of securities market by assigning ratings to securities, trading companies and governments.[249] These ratings are a combination of purported science based on mathematical modelling of the entities financial performance or economy in the case of governments based on assessments of the prospects for that entity's business or economy or its place in the global economy generally.[250] They function in a ***'Two-way'*** or ***'Three-way'*** manner. In the two-way manner they rate financial products and present them to investors. The need for accuracy and independence is important because, investor's confidence escalates if the information provided by the agency is credible thus leading them to invest. In the three-way manner they present individual ratings to financial product issuers whom furnish them to investors using the associated credit ratings as a form of certification.[251] Ratings are offered on variety of issues such as issuers, debt, instrument, credit risk of assets. They also rate general corporate debt or the credit risk of assets within a pooled security.[252] Furthermore, they provide continuous assessments of securities they have already rated by

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[246] M. Goergen, *International corporate governance,* (Pearson 2012) 196
[247] T. Edmonds, 'Credit rating agencies regulation', (2016) House of Commons Library, Briefing paper 3
[248] H. McVea, 'Credit rating agencies, the subprime mortgage debacle and global governance: The EU strikes back', (2010) 59 International and Comparative Law Quarterly 701, 704
[249] E. M Ekins, M. A. Calabria, C. O. Brown, 'Regulation, market structure and the role of the credit rating agencies', (2011) APSA 2011 Meeting Paper http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1902320> accessed 20 June 2014
[250] A. Hudson, *The law of finance*, (2nd Edition Sweet & Maxwell 2013) 1025
[251] T. Edmonds (n 247) 4
[252] The former connotes where there is the overall financial health of a company is analysed whilst the latter would include mortgage backed up security

upgrading, downgrading, confirming a rating or placing the securities in an early warning watch list.[253]

As reputational intermediaries, they reduce information costs as well as increase the pool of potential borrowers and promote liquid markets.[254] They are expected to act independently whilst carrying out their duties so as to reach their ratings without favour or bias.[255] In this regard, an argument about the independence of credit rating agencies is likely to be spawned because the companies they rate sometimes remunerate them. Their assessments are theoretically provided to investors through independent evaluation and assessment of the debt securities and provision of a succinct risk assessment in the form of credit worthy gradations for financial products. Gradations range from AAA to C.[256] These gradations assess risks associated with holding specific debt or debt-like securities.[257]

They are sometimes used for contractual purpose, which is aimed primarily at regulatory compliance. In some countries, such as the United States of America, credit rating agencies have a regulatory licence that empowers them to endorse a debt instrument that is eligible by law for particular types of investments. Such licenses help insulate fiduciary liability when making investment.[258]

Credit rating agencies have been criticized on different issues. Chief amongst these issues is the fact that there is a shadow of doubt cast over the ability of these 'gatekeepers; to provide reliable signals that investors can utilise to make informed decisions because they are held to provide little informational value especially for

[253] H. McVea (n 248) 705
[254] T. Edmonds (n 247) 5
[255] E. M. Ekins (n 249)
[256] T. Edmonds (n 247). AAA represent the best ratings with C, been the lowest ratings. There are other ratings such as AA, A, BAA, BA, B, CAA, and CA.
[257] H. McVea (248) 704
[258] F. Partnoy, 'The siskel and ebert of financial markets? Two thumbs down for credit rating agencies' (1999) 77 Washington University Law Quarterly 681

more complex asset backed securities.[259] Furthermore, there is the issue of conflict of interest that may arise when both the issuer and the rating agencies have an economic interest in ensuring the success of the issue.[260] The issuer would want to ensure the sale of securities and the rating agency is desirous of being paid and securing lucrative future business from the issue.[261] This becomes acute when the rating agency's analyst proffer suggestions with regard to the structure of financial instrument in order to get good ratings, thus making the process of ratings more of a negotiation rather than one of commercial judgment.[262]

The global market for credit rating agencies is believed to be oligopolistic. The effect of this is sparse concentration of credit rating agencies in the market, thus generating the possibility to make excessive profits. Furthermore, it creates the susceptibility to exude over confidence as well a lackadaisical attitude whilst giving ratings because there is little or no competition. Additionally, with the reputation such agencies already possess in the market, it would be a difficult task breaking grounds due to lack of experience and reputation. For example, in Nigeria, there are a handful of recognised credit rating agencies amongst which are, Augusto & co (a subsidiary of Africa's global rating agency), Pharez ratings and Brickfield Road Associates. Standard & Poor is reported to have a local office.[263] This is largely accountable to the fact that there are not a lot of rateable instruments as well the fact that the culture of credit rating in Nigeria is still underdeveloped.[264] This thesis proposes the need for more players in the market, as it has the likelihood of generating some competition in the performance of their duties. Furthermore, by virtue of the sensitive nature of their

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[259] H. McVea (n 248) 712
[260] *ibid*
[261] *ibid*
[262] *ibid*
[263] V. Shobo, 'Credit ratings: opportunities and challenges', (African Bond Market Conference, Nairobi Kenya, November 2011)
[264] *ibid*

tasks, this thesis argues that there is the paramount need for regulation of credit rating agencies in a bid to get them to perform efficiently.

In the UK, credit rating agencies are regulated by the provisions of the ESMA that is implemented in the UK provisions of The Credit Rating Agencies Regulation 2010. In Nigeria, the SEC regulates them. The provisions contained in the Rules and Regulations of the SEC in Nigeria are not sufficient to tackle wrong behaviours by credit rating agencies or their employees towards investors. The rules do not regulate rating agencies conduct of their duties as it only lists procedure and accompanying document for registering with the SEC as well as the functions.[265] Paradoxically, the provisions of the Credit Ratings Agencies Regulation 2010 indicates the possibility of imposing financial penalties on a credit rating agency that has contravened a requirement imposed by the EC regulation.[266] Furthermore, upon imposing a penalty, the authority must publish a statement that it has imposed the penalty on that person or agency.[267]

This thesis argues that regulation of credit rating agencies in Nigeria is grossly deficient, as it does not cater for situations where such agency may carry out its duty in a wrong manner or where they perform fraudulent acts. The UK provision on the other hand makes provision for this through the imposition of fines and publishing that such a fine was imposed. This thesis recommends that the SEC rules and regulations and the ISA grant strict liability for erring credit rating agencies. This thesis recommends both criminal and civil sanctions for the agencies that give falsified or incorrect ratings that leads investors to invest and then experience loss of

[265] Rules and Regulations of the SEC 2013, r. 114
[266] Credit Rating Agencies Regulation 2010 s.21
[267] *ibid*

money. This is a viable means to ensure that credit rating agencies operating in Nigeria carry out their duties diligently and honestly.

It is important to highlight that credit rating agencies were held partially liable for the financial crisis of 2008. However, the regulatory approach was updated in 2010 by the virtue of the provisions of the ESMA and Regulation (EC) No 1060/2009 that was subsequently incorporated into the Credit Ratings Agencies Regulation 2010. These addressed a number of issues concerning credit rating agencies. Issues such as conflict of interest was catered for in the EC regulation that prescribed that rating agencies or analysts that participated in a credit rating or anyone that has approved a credit rating directly or indirectly or has any financial instruments of the rated entity or any related third party or has any direct or indirect ownership interest in that entity was prohibited from issuing a credit rating.[268] It is also important to highlight that there have been adoption of non-legislative voluntary action in regulating credit rating agencies, e.g. IOSCO's *Code of conduct fundamental for credit rating agencies* that was published in 2004 to promote investor protection by safeguarding the integrity of the rating process.[269] This thesis asserts that the regulatory provisions contained therein are sufficient to tackle any form of perceived impropriety.

Another issue that is of primary concern is the fact that the same corporations that they provide these ratings for remunerate credit rating agencies. This problem is highlighted as a major issue that generates conflict of interest. This becomes problematic especially in a country as corrupt as Nigeria.[270] This thesis argues that this system is not ideal in a country as corrupt as Nigeria as it gives rise for corporations to bribe or attempt to bribe for favourable ratings for their instruments.

[268] Regulation (EC) No 1060/2009 Annex I, B (3)(a). Other issues catered for includes transparency, accompanying disclosures, independence, registration etc.
[269] <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD180.pdf>
[270] Chapter 4

This practice has been criticised and there have been suggestions that they should revert to the old system of the credit rating agencies serving as agents for the investors. This thesis argues that this has the propensity to generate honest ratings from the agencies. Although this would place the cost burden on investors, this thesis argues that in a country where corruption is considered as a viable enterprise, it is a better alternative to avoid instances of corporations paying for ratings that can turn to be misleading to investors.

In view of the above, there is the issue of sophistication of ratings provided. This applies more to retail investors. A question that may arise in view of this is should ratings provided to retail investors be different from the ratings provided to institutional investors? This thesis argues that the ratings credit rating agencies should adopt a system that entails easy comprehension of information to avoid incurring further costs of trying to decipher the content of the ratings.

3.8.3. Lawyers

Not all gatekeepers provide verification or approval with the required standards for transactions, some gatekeepers perform advisory role with respect to structural and regulatory issues, and they are tagged as gatekeepers because they advise clients to avoid illegal conduct as well as analyse the documents provided to investors to ensure its conformity with the requirements of the law. Lawyers fall in this category. They play a more behind the scene role as gatekeepers.[271] These roles have been compared either as a total commitment model or a gatekeeper.[272]

The emergence of lawyers as intermediaries can arguably be viewed as an attempt to solve the inherent agency problems. Agents of companies seeking some

[271] S. Bainbridge, *Corporate governance after the financial crisis*, (Oxford University Press 2012)
[272] P.G. Haskell, *Why lawyers behave as they do*, (Westview press 1998) 86

capital are usually short-term players that insinuate favourable statements in order to get the required capital, thus generating suspicion of their claims.[273] Using a lawyer to verify the competence and completeness of the information provided can solve this problem. Furthermore, by carrying out verification repeatedly, a lawyer is likely to acquire relevant skills that will aid him in detecting fraudulent documents or misstatements.

Lawyers also serve as coordinators by ensuring that companies disclose the required information they often conduct the legal due diligence on a company's affairs before a public offering/capital restructuring. In performing this role, it is arguable that because their future and further engagement hinges on them performing diligently, they will act right. Furthermore, if the company they represent gets into trouble, there is the possibility that they will be held partially liable if there is sufficient evidence to prove that they aided in committing fraudulent acts or acted negligently.

The role of lawyers as gatekeepers has been scrutinised in the past, as arguments have spawned up as to the acceptance of the role of the corporate attorney as a gatekeeper, some of which are highlighted below.

First, critics argue that if lawyers are gatekeepers, their loyalty can be compromised due to a conflict in their responsibilities as they sometimes serve as advocate, transaction engineer and disclosure supervisor.[274] The foregoing argument is stated to already have traces of gatekeeper duties.[275] Furthermore, lawyers are potentially not willing to risk their reputation because if they file a falsified document

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[273] M. Bradley, I. De La Salvetierra and M. Gulati, 'Lawyers: Gatekeepers of the Sovereign Debt Market?' (2013) 38 International Review of Law and Economics 15

[274] J. Fisch and K. Rosen, 'Is there a role for lawyers in preventing future Enrons?" (2003) 48 Villanova Law Review 1117

[275] J. C. Coffee, Jr, 'The attorney as gatekeeper: An agenda for the SEC', (2003) Columbia Law and Economic Working Paper No.22 117.

they are likely to be charged with "aiding and abetting" if they were reasonably expected to know the document was falsified.[276] Additionally, they are aware of their primary duty to uphold the law in all their dealings. These coupled with the doctrine of noisy withdrawal ensures that lawyers act appropriately as intermediaries.[277] Moreover, the same argument could be made for gatekeepers like auditors.

Second, all the other gatekeepers have a public body that regulates their activities as well as draw up a code of conduct that they are to adhere to. For example, in the United States of America, auditors are regulated by the Public Company Accounting Oversight Board (PCAOB), security analysts are subject to regulation by the National Association of Securities Dealers '(NASD) and the New York Stock Exchange (NYSE). Because lawyers do not have a regulatory body critics have used this as a possible influence for lawyers to act unprofessionally.[278] This argument barely stands as most countries have bar associations that sanction erring lawyers. Furthermore, in Nigeria, there is another body known as the Capital Market Solicitors Association, which is charged with promoting best practices amongst lawyers operating in the capital market in any capacity.[279] It is however, important to note that it is not particularly clear if they are empowered to caution erring practitioners. In view of some of these criticisms identified above, there have been recommendations of certain requirements and obligations that should be adhered by lawyers in order to make them effective gatekeepers. These requirements and obligations are identified below.

i) Due diligence obligation

[276] *ibid*
[277] Noisy Withdrawal is the public withdrawal of legal representation in which the lawyer having knowledge of the client's existing or potential improprieties such as a serious breach of securities law, disavows work done for the client and notifies the proper authorities of his/her withdrawal
[278] S. M. Bainbridge (n 271) 18
[279] <https://www.proshareng.com/news/Capital%20Market/Capital-Market-Solicitors-Association-holds-2012-members-forum/16283> accessed 13 May 2016

ii) Independence requirement

iii) Attorney certification requirement.[280]

3.9. Due Diligence Obligation

It is argued that the first step in this regard will be mandating the practice of due diligence by lawyers in preparation of disclosure documents.[281] There has also been the call for the SEC to necessitate the investigation as to the accuracy of statements made in documents prepared by lawyers.[282] This requirement is evident in legal practice in Nigeria as lawyers sign documents that they have performed due diligence on. This is contained in rule 180 (2) of the Rules and Regulations of the SEC. This arguably instils some responsibility on the lawyer to perform his job with utmost care. This thesis argues that for such provision to work, there is the need to have adequate penalties for lawyers that do not carry out their fiduciary duties efficiently or lawyers that aid in fraudulent dealings. This suggestion also takes into account the possibility of hindrances a lawyer may encounter when carrying out such investigative function e.g. clients concealing information from the lawyer. In view of this, it is important that such laws expressly define the parameters within which a lawyer is to operate before liability is placed on the lawyer. Furthermore, whilst it is arguable that proving this may be problematic, the fear of being involved in such case has the likelihood to make a lawyer act diligently so as not to lose reputational capital.

[280] A. A. Sommer, 'The emerging responsibilities of the securities law, address to the banking', (1974) Corporation and Business Law Section 617-619 <https://www.sec.gov/news/speech/1974/012474sommer.pdf > accessed 4 August 2015

[281] S. M. Bainbridge (n 271) 27

[282] *ibid,* 28

3.9.1. Independence

Lawyers have been described as increasingly intertwined with their clients.[283] A law firm that holds in its portfolio a certain percentage of the client's equity is likely to be a poor, or biased monitor.[284] Lawyers intertwined with clients may falsify information or provide inflated figures during disclosure when wooing investors. In view of this, there is the suggestion that a rule should establish the level of independence a firm should have in relation to its clients, and such rule should define when the attorney is not sufficiently independent of the client to perform sensitive tasks.[285] It has also been suggested that the SEC of a country should define the limits to which a lawyer is to function as a gatekeeper. This thesis posits that this alone will not prevent lawyers from functioning poorly as intermediaries as it is going to be a strenuous/impossible task monitoring every lawyer that is functioning as a gatekeeper. In view of this, thesis proposes that, in addition to such laws, there should be adequate and prompt enforcement mechanisms that will instil some caution on lawyers when practicing as intermediaries. This thesis recommends that in other to avoid the issue of conflict within lawyers, a system should be adopted by law firms that entails that in relation to disclosure obligations i.e. prospectus, only counsel that is not under a retainership or has not carried out any work (other than one-off capital market/disclosure work) should be instructed by the prospective issuer. This inevitably will prevent the likely conflict that may arise when a counsel that is primarily involved in capital market cases within the firm is briefed.

[283] *ibid,* 29
[284] *ibid*
[285] *ibid*

3.9.2. Attorney Certification

Lawyers serve as watchdogs that analyse documents with no certification. Implementing a law that requires a lawyer to certify documents he analysed as well as placing liability on him for certifying a faulty document will aid in boosting the efficiency of lawyers in their role as gatekeepers. A typical question that will arise in view of this proposition is what documents should the lawyer be reasonably be asked to certify? It has been suggested that in preparing the disclosure document or filing with the SEC, it should be certified by the lawyer that he believes the statements made in the document or report to be true and correct in all material respects and that he is not aware of any additional information whose disclosure is necessary in order to make the statements made, in light of the circumstances under which they were made not misleading.[286] This coupled with the suggestion of due diligence which requires lawyers to certify that after making such inquiry the attorney reasonably believes that adequate disclosure has been made would guarantee reliance and credibility of their role as gatekeepers. This thesis proposes that for this to work, strict liability should be placed on lawyers that affirm falsified disclosures. However, limits on such laws should be placed, i.e. the lawyer should not be asked to certify the accuracy and completeness of all information disclosed in SEC filings seen as he did not audit its client. Furthermore, the documents a lawyer should be required to certify should be limited to such he would reasonably understand and be able to detect if any information is falsified or omitted.

The Nigerian Bar Association has implemented the compulsory affixing of stamp and seal by duly qualified lawyers in documents they file.[287] Although this is a recent concept aimed at swooping out quacks from the profession, this thesis proposes

[286] *ibid* 31
[287] Rules of Professional Conduct for Legal Practitioners (Nigeria) 2007, r 10

that it should be promoted to include documents related to the securities market. A law aimed at mandating stamping and sealing of documents by lawyers in the performance of their duties, as gatekeepers will be beneficial to the capital market.

In concluding this section, this thesis postulates that a lawyer as a gatekeeper should be guided by two primary standards, which are, his impartiality in his dealings as well as his ability to advance the client's lawful objectives and interests. The emergence of gatekeepers has condensed the problem of information asymmetry and insider dealing to a considerable extent. Investors are likely to invest when there are people/organisations that vouch for the credibility of information presented to them when deciding to invest. However, there has been some criticism about the role they play ranging from conflict of interest, provision of favourable recommendations to companies that have employed them, lack of regulation of gatekeepers' etc. These criticisms suggest the possibility of information asymmetry regaining prominence, which is a problem for investors. In view of this, there have been recommendations for second-tier reputational intermediaries that are meant to vouch for the verification provided by reputational intermediaries.

3.10. Second Tier Reputational Intermediaries

Second tier reputational intermediaries vouch for first-tier intermediaries (gatekeepers).[288] Voluntary self-regulatory organisations (SROs) play this role efficiently. Self-Regulatory organisations exercise some degree of regulatory authority over an industry or profession. This could be applied in addition to some form of government regulation or it could fill the vacuum of an absence of government oversight and regulation. The regulatory authority of an SRO is not

[288] B. S.Black, 'The legal and institutional preconditions for strong securities markets', (2001) 48 UCLA Law Review 788

necessarily derived from government as they set standard rules that participants are bound by, and a failure to meet the target standard can lead to suspension or expulsion by these SROs. This has the likely effect of preventing investors from seeking consultation from such gatekeeper.

There has been the call for the implementation of mandatory self-regulatory organisations.[289] This has been considered a possible permanent solution to the issues associated with gatekeepers. For example, in the United States, investment bankers must belong to either the New York Stock Exchange or the National Association of Securities Dealers, and a member who is evicted by one is unlikely to be accepted by the other.[290] There has also been the suggestion of provision of licenses by mandatory SROs. Minimum standards should be set to receive such license.[291] This can promote credibility amongst gatekeepers if there are sanctions for participants that do not adhere to the set standards. Sanctions such as fine, suspension and revocation of license can help in guaranteeing the credibility of these gatekeepers.

Regardless of these SROs aiming at instilling some sanity in the gatekeepers, desperate gatekeepers seeking favourable accreditation can compromise them. In view of this, it was suggested that low quality intermediaries could form a lax SRO to vouch for their quality and thus allowing investors figuring out if the SRO itself is a bogus intermediary.[292]

The above have the likelihood to reduce unruly practices by gatekeepers. This thesis proposes the need for SRO's in Nigeria to ensure credibility of gatekeepers. The Nigerian stock exchange is an SRO that is aimed to protect and maintain the confidence of investors and to preserve the integrity of the market. This is

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[289] *ibid*
[290] *ibid*
[291] *ibid* 789
[292] *ibid*

commendable; however, this thesis proposes the need for every gatekeeping profession to have their individual SRO that will provide accreditation for its members. Such a body should be empowered to sanction any member that acts in contravention of the general need to enhance investor confidence in the capital market. Such sanctions should be publicised in a bid to reduce their reputational capital. This thesis submits that this has the likelihood to make such gatekeepers sit up and carry out their functions diligently as well as ensures that investors do not utilise their services when they have been sanctioned.

3.11. Conclusion

Information asymmetry is a problem that should not be apparent in capital markets, particularly in markets situated in developing countries. The importance of disseminating accurate information to investors cannot be overemphasised. This is based on the peculiar nature of capital market transactions. A market known to possess corporations that provide accurate information is likely to have more investors willing to invest.

The importance of credible rules governing disclosure is an important factor for the growth of a capital market as well as important in attaining the efficient status. Furthermore, it is equally important to have adequate and timeous enforcement mechanisms aimed at enforcing these laws if corporations do not adhere to the provisions. This coupled with adequate reparations that are properly enforced will boost investor confidence in the system. Although these recommendations are not free from criticism, this thesis submits that it would be more harmful if they were absent in a capital market and as such recommends that developing countries that are aiming to make their capital market efficient adopt it.

4. Insider Trading in the Nigerian Capital Market

4.1. Introduction

'Insider trading' or 'insider dealing', phrases used interchangeably in this chapter, is the use of inside information that is price sensitive and has not been made available to the public about a company or securities in order to make a profit or avoid loss through trading activity.[1] It usually involves an insider (director, employee or professional advisor) or someone connected to such persons trading on information obtained in the course of employment or in the course of their professional relationship with a company and which information is not available to the broader market.[2] It also includes instances where one party provides the inside information (commonly referred to as tipping) to another party/parties who trades on the basis of the inside information.[3] It is not confined to companies' shares alone as it can also occur in the market for government securities.[4] It is a manifestation of inefficient markets and a corporate governance problem.[5] The illegality of this act is based on the fact that when transactions are to be executed in a financial market, there is the estimation of prices on the value of securities on the assumption that the special details known to the insider do not exist.[6] In other words, investors trade on the assumption that they have been provided with complete information relating to the security they intend to invest in.

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[1] J. Armour et al, *Principles of financial regulation,* (Oxford University Press 2016) 182
[2] L. Bromberg, G. Gilligan and I. Ramsay, 'The extent and intensity of insider trading enforcement: an international comparison', (2016) 17 Journal of Corporate Law Studies 74
[3] *ibid*
[4] A. A. Oluwabiyi, 'A comparative appraisal of the problem of insider trading, mergers and acquisitions', (2014) 2 Frontiers of Legal Research 2
[5] K. Alexander, 'UK Insider dealing and Market abuse: Strengthening regulatory law to combat market misconduct' in S. Bainbridge (ed) *Research Handbook on Insider Trading*, (Edward Elgar Publishing Ltd 2013) 407
[6] R. Pennington, *Company Law*, (8th Edition, Butterworths 2001) 463

Insider trading is rampant in Nigeria and was identified as one of the reasons for the Nigerian market crash in 2008.[7] Attempting to unravel the extent to which insider trading occurs in the Nigerian capital market is a daunting task and this is partly attributable to the deficiency of evidence in support of such allegations. This is further compounded by the fact that insiders conceal the act, trade through friends, relatives, and fictitious names to avoid detection. This chapter analyses the current legal regulation of insider trading in Nigeria in comparison regulation in the UK. It identifies the likely loopholes and highlights some recommendations on how to efficiently regulate the act. Before analysing the substantive rules, some of the effects of insider trading are highlighted in the next section.

4.2. Effects of Insider trading

The impact of insider trading on capital market is quite obvious and the clout of negativity surrounding it cannot be down played. This arguably would be so because of the consequential impression it places on the market and investors. Some of these effects are highlighted below

First, it reduces the trust investors have in the markets, thereby diminishing investors' confidence to invest in such a market. This unarguably is detrimental as the importance of investor confidence has being highlighted in the preceding chapters of this thesis.[8] Company officials betray the trust of investors when they engage in insider trading because in good and austere economic climates, investors' funds are used to keep a company afloat while investors receive the increased value of their

[7] O. F. Oladipupo, 'The crash of the Nigerian Capital Market: Explanation beyond the Global meltdown', (2010) 4 International Business Management 37 <http://www.medwelljournals.com/fulltext/?doi=ibm.2010.35.40> accessed 8 February 2015.
[8] Chapter 3, 3.5

shares and dividends if the company succeeds.[9] In such an arrangement, trust is implicit as companies inform prospective investors of their intentions for the requested capital by disclosure. A consequence of a breakdown in trust is diminished investor confidence, which has also been identified by different academics as detrimental to running an efficient securities market.[10] Furthermore, due to the nature of capital market trade, it is implicit that all investors have a level playing field in terms of the timing of relevant information.

Secondly, because of diminished confidence, investors avoid the market, subsequently leading to less liquidity.[11] The liquidity of a market is an important feature of a capital market used to measure institutional efficiency.[12] If depleted it can lead to the crash of a market and financial institutions i.e. capital in the form of cash flow as opposed to lack of capital in the sense of legal rules.[13] Insider trading affects market liquidity both in price and quantity.[14]

Third, insiders have an incentive to choose riskier projects whilst utilising investors' funds and they do this knowing that there is a possibility of lower returns that will not be beneficial to the investor.[15] They embark on these projects without the informed consent of investors. If such investment is successful, they capture a portion

[9] H. L. Wilgus. 'Purchase of shares of corporation by a director from a shareholder', (1910) 8 Michigan Law Review 272
[10] V. Brudney, 'Insiders, outsiders and informational advantages under the Federal securities laws', (1978) 93 Harvard Law Review 343-346; J. Thompson, 'A global comparison of insider trading regulation', (2013) 3 Journal of Accounting and Finance 2
[11] E. Gailard, *Insider trading: The laws of Europe, The United States and Japan*, (Kluwer 1992) 6
[12] R. Veil (ed), *European capital markets law,* (Hart Publishing 2013) 213
[13] D. Fischel and D. Carlton, 'The Regulation of Insider Trading', (1982) University of Chicago Law School, Journal Articles 879
[14] L. Cheng, M. Firth, T. Y. Leung and O. Rui, 'The Effects of Insider Trading on Liquidity', (2006) School of Accounting and Finance: The Hong Kong Polytechnic University 481
[15] L. A. Bebchuk and C. Fershtam, 'The Effects of Insider Trading on Insiders' choice among risky investment projects', (1991) National Bureau of Economic Research, Technical Working Paper, No.96 4. Riskier investment in this context would entail investment that returns are not guaranteed

of the gains and if it does not go as planned the shareholders bear the loss.[16] Although it has been suggested that trading on riskier projects can generate more liquidity for the market by stimulating competition,[17] this thesis argues that trading on riskier projects can also have an adverse effect on investors' interest. However, it is important to note that capital ought to be used for survival and growth of a company. During the growth phase, the company would often require investments in uncharted areas and investors, particularly equity investors cannot expect to enjoy the benefits of the subsequent growth without bearing the burden. Furthermore, in a bid to increase the confidence of investors or establishing business relationship, it is imperative that all information relating to the investment be made available to investors. This is not achievable if insiders conceal information from investors and utilise their investments for risky projects.

Fourth, a major consequence of insider trading is delay in disclosure.[18] Although this has been described as having the potential to be beneficial in some situations, this thesis argues that delay in disclosure may discourage investors from the market.[19] An investor apprised with securities market operations will be discouraged from investing when there is delay in disclosing information he needs to make an investment decision.

Fifth, insider trading obstructs the efficiency of a capital market. An efficient capital market has been described as a market that prices fully reflect the available

[16] F. H. Easterbrook, 'Insider trading, secret agents, evidentiary privileges, and the production of information', (1981) The Supreme Court Review 309, 332

[17] Z. Goshen and G. Parchomovsky, 'On insider trading, markets, and negative property rights in information', (2000) 6 Fordham Law and Economics Research Paper 21

[18] R. A. Schotland, 'Unsafe at any price: A reply to Manne, Insider trading and the stock market', (1967) 53 Virginia Law Review 1448

[19] H. Manne, 'Insider trading and the law professors', (1970) 23 Vanderbilt Law Review 547, 552

information.[20] If information is withheld or utilised in trade for the individual benefits of company officials, it makes the idea of an efficient market unattainable.[21]

Academics have researched the Nigerian capital market and have arrived at different results in terms of the market's efficiency.[22] Whilst some find the market efficient on a weak level, others find that the market is efficient on a semi-strong level.[23] A unanimous consensus in these studies is that there are traces of insider trading in the Nigerian capital market. Moreover, it has been documented that prices in the Nigerian capital market do not reflect the available information as it sometimes takes several weeks before the information reflects on the price of securities and in some instances, the likely impact of the company's profitability on share prices take up to ten weeks before it becomes public information.[24]

Based on the effects of insider trading, it is important to identify the reasons for insider trading practices in the Nigerian capital market and ways the act can be curtailed effectively. This thesis identifies three major reasons accountable for widespread insider trading in the Nigerian capital market; corruption, lack of knowledge of the act as well as its consequences and, poorly drafted rules with inadequate enforcement of rules. It should be noted that other reasons may also contribute to the operation of insider trading in the Nigerian Capital Market but these three reasons essentially stand at the root on which other problems are developed.

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[20] E. Fama, 'Efficient capital markets: A review of theory and empirical work', (1969) 25 Journal of Finance 383. Discussed in detail in Chapter 2, 2.1-2.1.3

[21] N. Jain and L. J. Mirman, 'Effects of Insider trading under different market structures', (2002) 42 Quarterly Review of Economics and Finance 21

[22] O. J. Ojeyinka, Efficient market hypothesis and the Nigerian stock market: A review of theory and empirical work', (1995, unpublished); R. A. Olowe, 'Stock splits and the efficiency of the Nigerian stock market', (1998) 1 African Review of Money, Finance and Banking 97; S. B. Oludoyi, 'Capital market efficiency and the effects of earnings announcement on share prices in Nigeria', (1999, unpublished); O. J Adelegan, 'Capital market efficiency and the effects of dividend announcements on share prices in Nigeria', (2003) African Development Bank Review 218

[23] Chapter 2 above for the Efficiency theory

[24] Oludoyi (n 22) This should not be the case as earnings announcement ought to be public information

These problems coupled with poor investigation, prosecution and conviction of insiders provide a substantial explanation for the existence of insider trading in the Nigerian capital market. Although some attempts such as enactment of laws prohibiting the act have been put in motion to control and eradicate insider trading in the Nigerian Capital market, these efforts have so far proven to be futile. These reasons highlighted are discussed in turn.

4.2.1. Corruption

Corruption in its entirety is ubiquitous in complex societies and can be traced back to biblical Israel, Rome, and ancient Greece.[25] It is not peculiar to any continent because it is an endemic phenomenon that is experienced in both developed and emerging economies.[26] It is said to flourish in countries with systems where decision making is unaccountable, access to decision makers is restricted and where pay is generally low.[27] Both developing and emerging economies have incidence of corrupt practices in their business sector.

In the Nigerian capital market, corruption is considered a viable enterprise and practiced in different ways.[28] It is practiced both at the top and lower levels. For instance, a former Director-General of the Nigerian Stock Exchange gives a good illustration of corrupt activities in the capital market. She held this position between 2000 and 2010, and was alleged to have perpetuated some corrupt dealings in her time as the boss of the Stock Exchange before her subsequent dismissal. Under her watch,

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[25] V. E. Dike, 'Managing the challenges of corruption Nigeria', (2003) Centre for Social, Justice and Human Rights 2

[26] I. Carr, The UK Bribery Act: business integrity and whistleblowers', (2012) 4 Financial Fraud Law Report 361

[27] Editorial Team, Corruption and bribery: trade and investments impacts', <http://www.controlbae.org.uk/background/investment_impacts.php> accessed 11 February 2015

[28] I. K. Nageri, I.S. Nageri and A. Amin, 'The joint impact of stock market and corruption on economic growth and development in Nigeria: Evidence from cointegration and VECM analysis', (2015) 10 Serbian Journal of Management 189

the stock exchange was said to have purchased 165 Rolex watches for employees of the stock exchange who have served for a long time. However, only 73 watches were presented to recipients and as of now there has been no account for the remaining 92, which amounts to about 99,500,000 Naira (£398,000). Furthermore, the stock exchange was said to have bought a yacht worth 37 million Naira ($235,300,000) with no recipient till date. Although the SEC attempted to investigate the alleged fraud behind the crisis, it was unable to publish its findings because the then Director General got a court injunction restraining the SEC from publishing the report and stopping further investigation.[29]

Corruption in Nigeria has been evident for some time now, even before 1999 when democratic governance was restored. In 1998, transparency international corruption perception index (CPI) survey of 85 countries ranked Nigeria as 81.[30] In 2001, the CPI survey of 91 countries portrayed the image of Nigeria going further south as it was ranked 90 out of 91 countries studied. With such figures, it is apparent that the problem of corruption has settled in Nigeria and its effects are felt in every parastatal or sector of the country including the capital market. In 2014, the Transparency International Corruption Perception index ranked Nigeria 136 out of 175. The government's response to this was that they were winning the war against corruption.[31] More recently, in 2016, the country is still ranked at 136 out of 176 countries.[32] The country is still devoid of a system to trace, eradicate or control

[29] Editorial Team, 'The Nigerian Stock exchange spent millions on a yacht and Rolex watches for some reason', *Business Insider* (Nigeria, 8th May 2012) <http://www.businessinsider.com/the-nigerian-stock-exchange-spent-millions-on-a-yacht-and-rolex-watches-for-some-reason-2012-5?IR=T> accessed 28 January 2015

[30] S. M. Lipset and G. S. Lenz, *Corruption, culture and markets in culture matters*, (New York Basic Books 2000) 112

[31] K. Olaniyan, 'How corrupt is Nigeria?' *Vanguard* (Nigeria, 17 December 2014) <http://www.vanguardngr.com/2014/12/corrupt-nigeria/> accessed 16 February 2015

[32] www.transparency.org

corruption witnessed in most of the parastatals, including the capital market.[33] Corruption affects the performance of the capital market by increasing volatility in the political and economic environment, which further affects the GDP growth through lesser foreign direct investments.[34] Views from international organisations on the correlation between corruption and investment suggest that this is incontrovertible. For example, the World Bank identified corruption as one of the biggest impediments to investment opportunities.[35] Similarly, the IMF also suggested that corruption reduces investment by around 5% and that an increase by one point in the corruption index can result in a reduction of foreign investment as much as 8%.[36]

The reasons participants of the capital market in Nigeria engage in corrupt practices are borne out of several cultural beliefs and odd societal structure. Some of these issues are identified below.

First, participants of the Nigerian capital market engage in corrupt practices because they see it as an avenue to make quick money and create a luxurious way of life. Many people living in Nigeria believe that indulging in corrupt practices is inevitable because morality is relaxed and people struggle for survival without any assistance from the government. Furthermore, there is the belief that material possessions of an individual substantiate his success. Merton affirmed the connection between cultural beliefs and corruption by indicating that there are several elements of social and cultural structures, but of crucial importance are culturally defined goals,

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[33] *ibid*
[34] I. Saka, 'Insider dealing: The problematic corporate crime <https://unilorin.edu.ng/publications/ismaelsi/INSIDER%20DEALING.pdf > accessed 8 February 2015
[35] The World Bank, 'Anticorruption in transition: A contribution to the policy debate', (2000) <http://siteresources.worldbank.org/INTWBIGOVANTCOR/Resources/contribution.pdf> accessed 11 February 2015
[36] C. Schiller, 'Improving governance and fighting corruption: An IMF Perspective', (2000) IMF Fiscal Affairs department 31st March 2000.

purposes and interests.[37] He stated that these things are the things worth striving for and that whilst some of these culturally defined goals, purposes and interests are directly related to the biological drives of man, some are not determined by them.[38] This thesis argues that whilst businesses see nothing wrong in corrupt practices that result in greater profits for their companies there is a wide consensus that corruption has a negative economic impact on society.[39]

Second, corrupt practices are sometimes regarded as reward for work because of the poor remuneration system in Nigeria. Workers are not sufficiently remunerated for work done as well as not remunerated promptly.[40] Consequently, individuals develop methods to cater for their livelihood and daily needs. This is further accentuated by the limitation of economic opportunities in Nigeria. The problem is convoluted because the society is achievement oriented and one where economic success is regarded an important goal with limited access to opportunities thus paving the way for corrupt practices.[41]

Third, the Judiciary and law enforcement agencies such as the police have a lukewarm and inept attitude towards corrupt practices. When persons are charged with corrupt offences in Nigeria the law enforcement agencies are in most cases beneficiaries of bribes thus leading to neglect, eventual quashing, or lackadaisical trial of cases. The situation is worsened if the individual charged or being investigated of an offence is influential by virtue of a position he holds or has held. Law enforcement

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[37] R. K. Merton, 'Social structure and anomie', (1938) 3, American Sociological Review 672
[38] *ibid*
[39] I. Carr and O. Outhwaite, 'Controlling corruption through corporate social responsibility and corporate governance: theory and practice', (2015) 2 Journal of Corporate Law Studies 299, 300
[40] Late remuneration is a constant practice in Nigeria generally, with emphasis on government parastatals. In some instances, workers don't get paid for as long as three months. Furthermore, law enforcement agencies are not adequately remunerated.
[41] S. M. Lipset and G. S. Lenz (n 30) 118

agencies face the possibility of losing their job if they carry out investigations or charge such individuals to court. An inevitable consequence of this is the widespread entanglement of corruption eating deeply into the system. An individual faced with the temptation to commit an offence will indulge in the act knowing that he can bribe his way out of it.

Recently, the Federal Government of Nigeria's Department of State Security ('DSS') raided the homes of senior Judges (Justices of the Federal High Court and a Justice of the Supreme Court).[42] In this operation, the DSS are alleged to have recovered sums of money that exceed the salary and allowances of these said Justices. Upon being questioned, the accused Judges had no viable explanation as to how they had these funds (both in foreign currencies and local currency). Rather, they classified it a witch-hunt by the government. Furthermore, upon being arraigned, additional evidence indicated that one of the Judges' sons had been a beneficiary of a bribe from a senior lawyer in the form of a BMW car.[43] There are many more instances of such practices in Nigeria and this thesis submits that such acts of corruption are partly responsible for the Judiciary not handling cases of market abuse (in this instance insider trading if there are such cases being tried) expeditiously and honestly.

Corruption hinders effectiveness and stifles competitiveness in a capital market. This can be a major hurdle in the growth of the economy as well as impact fair business competitiveness adversely.[44] A country with a capital market where corruption is practiced develops a reputation that affects companies emerging from

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[42] <http://www.bbc.co.uk/news/world-africa-37603857> accessed 20 January 2017

[43] B. C. Onochie and O. Richards, 'We sold N8M vehicle to Justice Ademola's son, witness testifies', *Guardian Newspaper* (Nigeria, 17th January 2017) <https://guardian.ng/news/we-sold-n8m-vehicle-to-justice-ademolas-son-witness-testifies/> accessed 20th January 2017

[44] S. Bhalla, 'Survey on bribery and corruption: Impact on economy and business environment', (2011) KPMG Journal 5

such economy when they enter the international markets. Furthermore, it reduces the inflow of foreign direct investment because they are perceived as corrupt based on the market they are emerging from.[45] Consequently, there is difficulty in establishing some sort of relationship with partner companies who see the companies emerging from that economy as untrustworthy business partners.

This thesis proposes the need for an efficient structure that will tackle the incidence of corruption. If tackled effectively there is the likelihood of cleansing the market, thus reducing insider trading.

It is worth noting that different bodies have been set up to tackle corruption in Nigeria. Such bodies include the Code of Conduct Bureau (CCB), Public Complaints Commission, Economic and Financial Crimes Commission (EFCC) and Independent Corrupt Practices Commission (ICPC). Furthermore, in 2013, the EFCC signed an MOU with the Nigerian stock exchange to tackle stock market fraud and other corrupt practices in the stock exchange with insider trading identified as one of the offences that the collaboration should address.[46] Although these bodies have been established, it is arguable that their effectiveness is moving at slow pace particularly when it relates to the Nigerian capital market. However, there are a few cases that have been prosecuted by these bodies in the financial sector, e.g. *EFCC v Cecilia Ibru*[47] where the accused was arraigned on a 25-count charge of corrupt practices in office amongst which was the fact that she granted a credit facility in the sum of 20 million US Dollars to a company which was above her credit approval limit. She was also

[45] I. Carr and R. Jago, 'Petty corruption, development and information technology as an antidote', (2014) 103 The Round Table 465, 472
[46] News Administration, 'EFCC signs MOU with Nigerian stock exchange to tackle fraud', The Street Journal, 04 October 2013, <http://thestreetjournal.org/2013/10/efcc-signs-mou-with-nse-to-tackle-stock-market-fraud/> accessed on 2nd February 2015.
[47] FHC/L/297c/2009

accused of granting a credit facility in the sum of 2 billion Naira to another company without adequate security as laid down by regulations.[48] She was subsequently convicted and sentenced to six months' imprisonment. She also forfeited properties and assets values at 191 billion Naira.[49] Another case worth noting is the case of *FRN v Lucky Igbinedion*[50] where a former governor of Edo state in Nigeria was arraigned with a 147 count charge on fraudulent embezzlement, stealing and use of several corporate companies as conduit pipes to siphon several billions of naira. He pled guilty to all counts and was subsequently convicted and fined with 3.5 million Naira.[51] It is important to note that both cases were concluded by a plea bargain that facilitated shorter sentences and reduced fines when compared with the gravity of the offence committed. This has been described a mockery on the Nigerian criminal law system.[52]

Another way in which corruption can be reduced is through the operation of the recent whistle-blowing scheme.[53] The adoption of this scheme has led to recovery of a substantial amount of stolen monies.[54] This thesis recommends the implementation of this scheme in the Nigerian capital market as it can serve to deter corporate executives and capital market operators from engaging in corrupt practices. This recommendation is made because corporate executives that engage in corrupt practices usually utilise the help of individuals in the lower cadre of the ladder. In view of this, there is the propensity for such individuals to report such unethical practices when they are aware that they would receive a fraction of the money

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[48] I. O. Babatunde and A. O. Filani, 'The economic and financial crimes commission and its role in curbing corruption in Nigeria: Evaluating the success story so far', (2016) 2 International Journal of Law 17

[49] *ibid*

[50] Unreported suit No. FHC/EN/CR/10/2008

[51] n 48 p.16

[52] *ibid*

[53] Chapter 1, 1.2.5

[54] S. Daniel, 'Whistleblower: FG nets N 73 billion in 4 months'. *Vanguard* (Nigeria, 16 April 2016) http://www.vanguardngr.com/2017/04/whistleblower-fg-nets-n73-billion-4-months/ accessed 5 July 2017

recovered as practiced in Nigeria.[55] This thesis argues that the possibility of being found out can instil some caution and diligence on corporate executives to avoid participating in corrupt practices. A prime example of the operation of the whistleblowing policy is evident in the Enron when Sherron Wetkins blew the whistle when she saw some discrepancies in the accounts of the company.[56]

Curbing corrupt practices in the Nigerian capital market will increase the interest of investors in the capital market. As Bod Dewar a former British High Commissioner to Nigeria stated, "…building the confidence of investors is paramount to deepening the capital market and this can only be achieved by the execution of good corporate governance and ridding the market of corruption".[57]

4.2.2. Lack of knowledge of the Act as well as its consequences

Other than the problem of corruption, there is prevalent ignorance of market abuse in Nigeria, particularly insider trading. The level of ignorance is pervasive. It extends to market participants, investors, stockbrokers etc. The level of ignorance is also displayed by members of the Nigerian legislature charged with enacting rules that are aimed at regulating market malpractices. For instance, the legislators of the lower house of Nigeria's bicameral National Assembly empowered to enact rules tackling corrupt practices such as insider trading are not particularly knowledgeable in this

[55] S. Tukur, 'How Nigerians can make money, be protected in new whistle blowing policy: Finance Minister', *Premium Times* (Nigeria, 21 December 2016) <http://www.premiumtimesng.com/news/headlines/218643-nigerians-can-make-money-protected-new-whistle-blowing-policy-finance-minister.html> accessed 5 July 2017

[56] J. D. Glater, Added value; A whistle blowers' all too familiar story', *The New York Times* (New York, 23 March 2003) <http://www.nytimes.com/2003/03/23/business/added-value-a-whistle-blower-s-all-too-familiar-story.html?rref=collection%2Ftimestopic%2FWatkins%2C%20Sherron%20S.&action=click&contentCollection=timestopics&region=stream&module=stream_unit&version=latest&contentPlacement=7&pgtype=collection> accessed 5 July 2017

[57] E. Ajefa, 'British Envoy tasks SEC on corruption in capital market', *The Nigerian Voice* (Nigeria, 2 September 2010) <http://www.thenigerianvoice.com/news/33495/1/british-envoy-tasks-sec-on-corruption-in-capital-m.html> accessed 23 January 2015

area based on their academic background and previous employments.[58] The Nigerian House of Representatives committee on capital market is chaired by a member who has a degree in economics and worked as a realtor in real estate practice for seventeen years prior to becoming a legislator and possesses no previous experience in dealings that have to do with the securities market. This committee is co-chaired by a member who has a similar background, economics with no reference to what job he has engaged in the past. The situation is not different in the Senate as a member whose first degree is in political science chairs the committee and co-chaired by a member whose first degree is in management and his masters and PhD both in Christian leadership, chairs the capital market committee.[59] If a person with no experience supervises such a sensitive position, it is arguable that the laws that will be enacted would lack credibility and substance. Unfortunately, in Nigeria, it would seem that placement in committees is based on political consideration rather than qualification, specialisation and relevant experience.

Although this practice is not without its merits as it provides equal opportunity for everyone to attain significant positions, this thesis argues that because of the important role a capital market plays in the economy and due to the complex nature of its operation, persons with adequate knowledge and expertise should supervise such sensitive positions and the appointment of floor members can be preserved for individuals who do not necessarily have to be experts in the capital markets.[60]

[58] Although academic background does not necessarily guarantee knowledge, experience can guarantee some knowledge that can be employed when enacting laws aimed at tackling the problems associated with the market. Furthermore, Wunmi Bewaji in his book carried out interviews where he stated that of all the legislators he interviewed, not one of them could define insider trading. W. Bewaji. *Insider Trading in developing Jurisdictions: Achieving an effective regulatory regime*, (Routledge 2012)

[59] These committees are empowered to address problems associated with the capital market and how it can be developed.

[60] As observed by Wunmi Bewaji in his book the politicking that goes on between the Nigerian National Assembly means committee heads and members are not necessarily picked based on their academic background or expertise but rather such positions are usually reserved for members of the

Alternatively, this thesis recommends the appointment of specialists in the field to the committee to evaluate problems associated with capital markets and suggest ways efficient laws can be enacted to curb such problems. Additionally, there should be continuous training for individuals in such committees in a bid to increase their knowledge as well as make them apprised of recent developments in capital markets around the world. However, this thesis recommends that the government should monitor such training and ensure that such individuals register for trainings attended. This recommendation emanates from the fact that there is evidence to indicate that a member of the Federal House of Representative in Nigeria was sent for conference in Dominica Republic and it is alleged that he did not attend the conference/training, but rather kept the money for himself.[61]

Stockbrokers in the Nigerian capital market are described as having little or no knowledge of insider trading in Nigeria.[62] Stockbrokers occupy a strategic position in the market and are empowered to monitor the market as well as report any irregularity in the market including suspicion of insider trading to the relevant authorities. This cannot be achieved if they possess little or no knowledge of how an offence such as insider trading occurs. Furthermore, the fact that insider trading is often a surreptitious affair necessitates the need for adequately skilled personnel to detect it.[63] Research carried out based on interview of stockbrokers in Nigeria indicated that over 80% of the stockbrokers had no knowledge of insider trading, with 10% being able to

ruling party and also in some instances, such positions are reserved for a particular state. He also rightly observed the fact that in some instances people who have minimal experience or are minimally educated in a particular region are assigned to head committees whilst the persons with adequate knowledge or expertise serve as floor members.

[61] C. Ndujihe, 'SEC: Public hearing turns bizarre for Hembe, Azubogu', *Vanguard Newspaper* (Nigeria, 25 May 2012). A video of the hearing can be accessed at <https://www.youtube.com/watch?v=WfIVO9A7_U8> accessed 20 January 2017

[62] W. Bewaji (n 58) 151

[63] *ibid*

recognise it after being guided as to what it entails.[64] Furthermore, the research indicated that journalists working in the financial sector regarded stockbrokers as mere traders who do not possess the necessary skills to be considered a stockbroker.[65]

Lawyers are active participants in the conduct of legal proceedings on insider trading in addition their gatekeeping duties as identified in chapter 3 of this thesis. However, research has indicated that lawyers in Nigeria are not particularly knowledgeable in this area of practice because there is minimum specialisation in this area.[66] Moreover, prosecuting criminal acts such as insider trading is not considered lucrative in comparison to the other areas of practice that are likely to generate more remuneration in Nigeria.[67] It should be noted that this lack of specialisation starts from the root of the chain because, no law faculty in all the Nigerian universities has insider trading incorporated into its syllabus.[68] Furthermore, the Nigerian Law School has no reference of insider trading in its syllabus since the removal of the provisions of insider trading from the Company and Allied Matters Act of 2004.[69] This statute is used for company law tutorials in the Nigerian Law School and the absence of insider trading provisions in it means a lawyer may have no knowledge of insider trading regulation.[70] Whilst this thesis acknowledges that the above assertion is not peculiar to Nigerian Universities, it proposes the insertion of the topic into the syllabus for law schools to enable students that are subsequently employed by corporate firms involved in capital market matters to be aware of the Act.

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[64] *ibid*
[65] *ibid*
[66] *ibid*
[67] F. F. Adegbie and A. S. Fakile, 'Economic and financial crime in Nigeria: Forensic accounting as antidote', (2012) 6 British Journal of Arts and Social Sciences 39
[68] It is important to note that insider trading is not a component of LLB degrees across the world. However, this thesis recommends its incorporation for the benefit of individuals that intend to go into corporate practice so as to have a knack of it before being presented with practical situations
[69] Companies and Allied Matters Act 1990, s. 614-624 contained the relevant provisions criminalizing insider dealing was repealed and subsequently incorporated in the Investment and Securities Act
[70] W. Bewaji (n 58) 148

Nigerian journalists have knowledge of insider trading and the danger it poses to the securities market.[71] However, having the knowledge does not mean they are audacious to investigate an incident of insider trading or publish it. This is because of the fear of losing their jobs and lack of integrity of the media.

The issue of awareness is further complicated by the fact that players in the Nigerian capital market are described to have adopted a less pejorative name to classify insider trading as 'market liaison'.[72] The effect of this is the continuity of insider trading with the belief that they are engaging in market liaison and in some instances, these insiders do not know the effect of their conduct on the market or economy whilst the unassuming investors are not aware of their rights to make a complaint to the appropriate authorities. Furthermore, the regulators are hardly certain about what is happening, given the lack of knowledge of the act, and a consequence of this is the prevalence of insider dealing, weak oversight, no enforcement and zero prosecution.

4.2.3. Legal framework

Whilst there are some differences in the jurisdictional approach in regulating insider trading, most jurisdictions have criminalised insider trading.[73] Most countries have enacted rules that prohibit the operation of insider trading in their capital market. It is important to note that this alone is not enough to prevent insiders from performing the act, as there is the need for effective enforcement by the regulators and the courts.[74]

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[71] *ibid*
[72] *ibid*
[73] L. Bromberg et al (n 2) 74
[74] V. Lei and Ramsay, 'Insider trading enforcement in Australia', (2014) 8 Law and Financial Markets Review 214

The offence of insider trading was first recognised as a statutory offence in Nigeria in 1990 by virtue of its incorporation into the Companies and Allied Matters Act ('CAMA') 1990. However, the provisions contained in CAMA were not effective for the purpose of regulating insider trading. Evidence suggests that almost ten years after its inception there was no reported prosecution or investigation of insider trading.[75] Consequently, the provisions regulating insider dealing under CAMA were repealed and replaced with the provision in the Investment and Securities Act (ISA) 1999. The ISA 2007 was enacted to repeal the ISA 1999 because of its perceived ineffectiveness, inadequate capacity to monitor required market standards compliance, ambiguities in some of its provisions, weak enforcement, administrative sanctions and lack of civil penalties.[76] The statutory provisions currently regulating insider trading in Nigeria are the ISA 2007 and the Securities and Exchange Commission Rules and Regulations 2013. The sections covering insider trading under both statues took precedence from the Company and Securities (Insider Dealing) Act 1985 of the United Kingdom, Criminal Justice Act 1993 of the United Kingdom and Rule 10 and 10b of the United States of America Securities Exchange Act of 1933 and 1934. Unfortunately, similar to its predecessors, these rules have not been successfully utilised, as there is only one reported successful conviction of insider dealing in Nigeria.[77] This has various implications on the market but most importantly is the fact that Nigerian capital market operators are known for notorious misrepresentations, manipulation of security prices, stealing of customers' funds or

[75] A. Garba, 'Impediments to effective enforcement of insider trading regulations in Nigeria', (2013) 3 International Journal of Management 15

[76] N. Dimgba, 'Regulation of competition through merger control: case under the Investment and Securities Act 2007', (Nigerian Bar Association, Section on Business Law Conference, Abuja, April 2009)

[77] Sir Kingsley Ikpe the Chief Executive officer of Thomas King Securities Limited was sentenced to 151 years in prison for insider dealing in 2005. Available at < http://www.proshareng.com/news/197> accessed 14 February 2015

securities, violation of broker-dealer responsibility, violation of responsibility to treat customers fairly, insider trading and selling of unregistered securities.[78]

Based on the foregoing it is arguable that the laws regulating the act are insufficient or have not been adequately enforced. To attain successful regulation of insider trading, the elements of the offence should be coherently defined for ease when attempting to establish liability against offenders. The next sections identify the relevant parts defining the act and its elements with a view to identifying any loopholes contained therein in comparison to similar provisions in the UK.

4.2.4. **Insider trading**

Section 111 of the ISA prohibits a person who is an insider of a company from buying, selling or dealing with securities of a company which are offered for public sale or subscription if he has information that is unpublished and is price sensitive to those securities. Section 111 (2) (a) prohibits a person from trading on information obtained directly or indirectly from another person connected with a particular company or was at the time within the six months preceding the obtaining of the information. Furthermore, he is aware or expected to know that the person he obtained the information from holds the information by virtue of being a member of the company and that the holder is not expected to disclose such information except for the proper performance of the functions attached to that position. Additionally, the interpretation given in section 315 of the ISA gives a clearer insight as to what individuals are precluded from doing with information that they obtained directly or indirectly from an insider. Similarly, rule 269 (2) of the Rules and Regulations of the SEC defines insider trading as occurring when a person or group of persons who are

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[78] Punch Editorial Board 'Preventing another capital market crash' *The Punch* (Nigeria 17 October 2013) <http://www.punchng.com/editorial/preventing-another-capital-market-crash> accessed 9 December 2014.

in possession of some confidential price sensitive information not generally available to the public utilises such information to buy or sell commodities for their own account or makes such information available to a third party who either knowingly or unknowingly uses it to avoid loss for his benefit.

It is arguable that these definitions are not thorough and can be considered broad. This thesis recommends the simplification of the definitions rather than having them littered through the act for ease of establishing liability and identifying exactly what the act prohibits. Taking an example from the UK, section 52 of the Criminal Justice Act (UK) 1993 (CJA) gives a thorough definition of what insider trading entails. It defines the act clearly as well as identifies ways that insider dealing can be practiced. The relevant sections of defining insider trading are highlighted below.

> "*(1) An individual who has information as an insider is guilty of insider dealing if, in the circumstances mentioned in subsection (3), he deals in securities that are price-affected securities in relation to the information.*
>
> *(2) An individual who has information, as an insider is also guilty of insider dealing if—*
>
> *(a) He encourages another person to deal in securities that are (whether or not that other knows it) price-affected securities in relation to the information, knowing or having reasonable cause to believe that the dealing would take place in the circumstances mentioned in subsection (3); or*
>
> *(b) He discloses the information, otherwise than in the proper performance of the functions of his employment, office or profession, to another person.*
>
> *(3) The circumstances referred to above are that the acquisition or disposal in*

question occurs on a regulated market, or that the person dealing relies on a professional intermediary or is himself acting as a professional intermediary".

The definition provided in the CJA is coherent and less likely to be problematic when attempting to establish liability for insider dealing. Other than identifying the offence being carried out, it also makes it illegal for an insider to provide information that he is privileged to by virtue of his position. Additionally, an insider will be held liable if he encourages someone else to trade on information he has provided. However, it is worth highlighting that the provision of Section 52(b) has the likelihood of facing some problems in an instance where the information is disclosed unknowingly. Proving disbursement of information knowingly beyond reasonable doubt is likely to be difficult as anyone charged has the likelihood of asserting lack of knowledge of the information been disbursed.[79] Furthermore, the definition of insider dealing in the CJA postulates that criminal liability for each offence may only be attached to an individual. The word 'individual' is defined to exclude corporations.[80] Directors sometimes partake in insider dealing for the benefit of the company, and this thesis argues that the appropriate liability established should be extended to such a company that is a beneficiary of the act. Furthermore, this thesis argues that the fact that the director maybe considered to have done so without the company's knowledge should not be used as a defence. In *Moore Stephens v Stone Rolls Ltd (in liq),* it was held that where a fraudulent act was done for the benefit of the company, the company is presumed to be aware of the fraud and primarily liable for it.[81] Furthermore, this thesis argues that in some instances, the director's action may prejudice the company thus

[79] W. Bewaji (n 58)
[80] K. Alexander (n 5) 414
[81] [2009] UKHL 39

making the company the victim to the fraud. In such instance this thesis suggests that the above assertion should not be applicable. This thesis argues that this has the propensity to make companies more cautious and employ adequate mechanisms to prevent their directors from engaging in insider trading. Also, a company is held to have a separate legal personality by the principle developed in *Salomon v Salomon & Co Ltd* and as such, it is arguable that a company is capable of dealing in securities.[82] This thesis submits that not explicitly identifying the possibility of establishing liability against a company is likely to be problematic as insiders can disguise their transactions in the name of the company with the aim of evading liability. This thesis proposes the need for the possibility to hold companies liable through fines as well as the possibility of holding directors jointly liable with the company because they are involved in the day-to-day running of the company. Such approach could generate a sense of caution by companies in a bid to discourage their directors from engaging in insider trading.

The situation is not different in Nigeria as there are no provisions to establish liability against a company. However, it is important to note that, there are provisions for penalties accorded to companies in the ISA as will be identified in the later part of this chapter. This serves as a contradiction as it is pointless having penalties for an offence that is not statutorily defined.

Whilst the definition given in the CJA is not free from loopholes, it is clearer and in conformity to the EC directive on market abuse in the UK and its effects are evident as there are reports of prosecution and investigation of insider dealing in the UK. The amount of prosecution and investigations carried out by the Financial

[82] [1897] AC 22; M. A. Pickering, 'The company as a separate legal entity', (1968) 31 The Modern Law Review, 418; E.C. Mujih, 'Piercing the corporate veil: where is the reverse gear?, (2017) 133 The Law Quarterly Review 322

Conduct Authority (FCA) and its predecessor Financial Service Authority (FSA) is impressive when compared to Nigeria. There were no fewer than 27 convictions for insider trading between 2009-2015 with a number of ongoing investigations.[83]

4.2.5. The Definition of 'Insider'

An insider is anyone engaged in insider trading and consequently prosecuted for the behaviour.[84] Insiders can be classified into two categories, primary and secondary insiders. A primary insider is usually an individual that possesses key information relating to production and stock performance by being a member of the administrative, management or supervisory body of the company.[85] It also includes persons or entities that beneficially own more than 10% of a company's voting shares.[86] Examples of primary insiders include directors, and managers of a corporation. They partake in insider trading when they utilise their informational advantage for trade purpose to transfer wealth from outsiders for their personal gain or for that of the company in a capricious manner.[87]

Primary insiders by their position in the corporation owe a fiduciary duty to have regard for the interests of the company and its members, e.g. directors. Non-directors owe other duties such as duty of care and duty to exercise reasonable skill. The fiduciary duty theory is a common-law theory that originated in England and Wales and is implied when employees accept appointment in their capacity.[88] This theory postulates that the director by virtue of the position he occupies is to act loyal

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[83] J. Dunkley, 'Disgraced former hedge fund manager Julian Rifat jailed for insider trading', The Independent, 20th March 2015. <http://www.independent.co.uk/news/business/news/disgraced-former-hedge-fund-manager-julian-rifat-jailed-for-insider-trading-10121481.html> accessed 12 April 2015
[84] I. Seredynska, *Insider dealing and criminal law: Dangerous Liaisons*, (Springer 2012) 20
[85] K. L. Hopt, 'The European insider dealing directive', (1990) 27 Common Market Law Review 52
[86] IOSCO, 'Insider trading: How jurisdictions regulate it', (2003) Reports of the Emerging Markets Committee of the IOSCO
[87] Pennington, (n 6) 335
[88] *ibid*

to the company and not utilise the fiduciary position in way that is adverse to the interests of the persons for whom the fiduciary is acting[89] Furthermore, when a person is in a fiduciary position, they are not to make a private profit through the position. Any profit made should rightfully go to the person on whose behalf they are working.[90] The House of Lords (as it then was) held that by virtue of the fiduciary duty, if a director possesses or is apprised to confidential information because of his position, it is unlawful for him to trade on it for his private profit. Further, if he did so, the company could recover the profits even though it itself had suffered no loss.[91]

A more recent assessment of insider trading emanated from the United States of America, known as the '*misappropriation theory*'. This theory provides that information is a type of property belonging to the corporation and if disclosed to a third party by someone apprised of this information because of his position in the corporation, this can be categorised as a form of theft.[92] Furthermore, anyone that trades on such information in a stock market is guilty of insider trading.[93] This notion was developed in *United States v Chiarella* and subsequently applied in *SEC v Materia*.[94] Applying this principle in the UK, the Serious Fraud Office (SFO) in 2004 secured convictions of Richard Spearman, Catherine Spearman, Michael Smith and Norman Payne for insider dealing based on the information passed to them by Norman Payne whilst carrying out his duty as a proof reader at a firm of commercial printers where he saw drafts of prospectuses and offer documents prior to the

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[89] D. French, S. Mayson and C. Ryan, *Company law,* (33rd Edition, Oxford University Press 2016) 478 Companies Act 2006, s. 172; *Arklow Investments Ltd v Maclean* [2000] 1 WLR 594

[90] H. Alexander, *Insider dealing and money laundering in the EU: Law and regulation*, (Ashgate Publishing Limited 2007) 15.

[91] *Regal (Hastings) Ltd v Gulliver* [1942] All ER 378

[92] D. M. Nagy, 'Reframing the misappropriation theory of insider trading liability: a post O'Hagan suggestion', (1998) 59 Ohio State Law Journal 1223

[93] A person commits fraud in connection with a securities transaction where he misappropriates confidential information for securities and trading purposes in breach of a duty owed to a source of the information.

[94] *United States v Chiarella* (1980) 664 F 2d 12; *SEC v Materia*, (1984) 745 F.2d 197

announcement of bids in the London Stock Exchange. Michael Smith and Catherine Spearman pled guilty and were both sentenced to 18 months in prison, Norman Payne got 21 months. Richard Spearman pled not guilty and was sentenced to 30 months in prison and ordered to pay £169, 000 by way of confiscation.[95]

The second category of insider is the secondary insider, who trades on information received from a primary insider.[96] For example, where a corporate insider tips a friend about non-public information that is likely to influence the company's share price and the friend in turn trades with this information. The person who provides the information is known as the 'tipper' and the trader who trades on this information is known as the 'tippee'.[97] Secondary insiders include lawyers, investment bankers and others who receive confidential information from a corporation while providing services to the corporation.[98] They are held liable for insider violation if the information they come across is disbursed to non-insiders either knowingly or otherwise since they acquire the fiduciary duties of a true insider. Furthermore, people that receive information from secondary insiders are liable if they had reason to believe that the source of the information had acted in breach of his fiduciary duty.[99] The source shall also be liable for his part in disclosing of confidential information and the liability will be more onerous where he benefitted from such disclosure.[100]

Section 111 (2) (a) of the ISA identifies an insider as a person that has information that he knowingly obtains from another person who is connected to a

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[95] P. Barnes, *Stock market efficiency, insider dealing and market abuse*, (Ashgate Publishing 2010) 155
[96] I. Seredynska, (n 84) 22
[97] *ibid*
[98] Collectively referred to as constructive insiders.
[99] *Dirks v SEC* 463 U.S 646 (1983)
[100] *ibid*

company or was at any time within six months before the information is connected to the company. Rule 400 (3) of the Rules and Regulations of the SEC defines an insider as anyone who is connected with the company in the preceding six months in their capacity as director, officer of the company or a related company, employee of the company or related company, anyone involved in professional or business relation with the company, members of the audit committee and are in possession of unpublished price sensitive information of the securities of the company because of the position they occupy or once occupied.[101]

Based on the foregoing discussions on the capacity in which an individual may be categorised as an insider, it is evident that the provisions identified above do not cater for this coherently. The ISA by its definition of the act identifies an insider but does not give a clear indication of the capacity an individual should occupy to be tagged as an insider. The attempt in section 111 (2) (a) does not cater for this either, and it is arguable that section 111 (2) (a) (i) identifies secondary insiders, this thesis argues that it does so vaguely. Rule 400 of the Rules and Regulations of the SEC gives a clearer definition of both primary insider and secondary insider. This thesis recommends the coherent definition of the various capacities an insider may occupy in the ISA because it serves as the principal regulator of the capital market and will make it easier to establish liability against alleged offenders.

In the United Kingdom, section 57 of the CJA 1993 gives a detailed description of an insider by identifying a primary insider through his position in the corporation as well as a secondary insider by virtue his getting information from a primary insider. The provision postulates that such a person would be guilty of insider

[101] Rules and Regulations of SEC Nigeria 2013, Rule 400 (3)

trading if and only he is aware of the fact that it is inside information.[102] This definition is arguably apt but leads to the possible argument in relation to proving the state of mind, i.e. proving the alleged offender knew that the information was inside information. This thesis proposes that in satisfying the element of awareness, it should be screened through a reasonable/objective test in a bid to achieve best results.

4.2.6. Inside Information

Inside information is information that is not been made public or has not been made public, is of a precise nature and is likely to have a significant effect on the price of the securities it concerns.[103] Examples of inside information include details on an upcoming merger, changes in performance of a company or the expectation of the performance of the business or changes in the share capital. Different elements have to be proven to show that the information is inside information. These are discussed in turn.

'Non-public or unpublished information' in its simplest form means information that has not been made available to members of the public or the market. It is important to highlight that not all non-published information is regarded as inside information. For information to be classified as inside information, it must indicate the direction or movement in the price that would or might occur if the information was made public.[104]

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[102] CJA 1993, s 57(1)(a)

[103] Securities and Future Commission, 'Guidelines on disclosure of inside information,' (2012) Securities and Future Commission 3 <http://www.sfc.hk/web/EN/assets/components/codes/files-current/web/guidelines/guidelines-on-disclosure-of-inside-information/Guidelines%20on%20Disclosure%20of%20Inside%20Information.pdf> accessed 5 July 2017

[104] *Hannam v Financial Conduct Authority* [2014] Lloyd's Rep F.C. 704

'Precise' means exact, clear and correct.[105] Information is precise if its contents can lead a conclusion to be drawn on the possible effect/s of certain circumstances or event/s on the price of qualifying investments or related investments. It is the role of a competent authority or a court to define the extent of precision required because proving that information was not precise enough to constitute inside information can be used as a defence by an alleged offender. Information would be deemed precise even if it were a fragment of a process. In the case of *Geltl v Daimler*, the European Court of Justice (ECJ) held that an intermediate step in a protracted process intended to generate a future event might be regarded as precise information.[106] An example of such instance is when a company is negotiating. Every intermediate step towards achieving the targeted aim will be regarded as precise information. However, a future event can only be considered inside information if there is a realistic prospect it will occur and that an anticipated high impact of the future event on the issuer cannot compensate for a low likelihood that the future event will occur.[107]

'Significant effect on price' This is an important feature of inside information, as information would only be classified as inside information if it has the prospect of affecting the price of securities.[108] It is not a question of law to determine if information is likely to have an effect on price of securities as each case is decided on its own peculiarity.[109] It has been suggested that when determining if information would have a significant effect on price, the value of the information should be

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[105] Longman Dictionary of Contemporary English, (Pearson Education, 2009) 1361
[106] ECJ Case C-19/11, 28 June 2012.
[107] H. Krause and M. Brellocks, 'Insider Trading and the disclosure of inside information after *Geltl v Daimler*: A comparative analysis of the ECJ decision in the *Geltl v Daimler* case with a view to the future European Market Abuse Regulation', (2013) 8 Capital Markets Law Journal 299
[108] D. French et al, (n 89) 353
[109] S. Griffin, *Company law: fundamental principles*, (4th Edition, Pearson Longman 2006) 200

evaluated in a hypothetical way and all possible scenarios taken into account and the actual results should be considered only to the extent that they were predicted.[110]

Section 112 of the ISA defines inside information as information held by a public officer or former public officer by his position or former position as a public officer, or is knowingly obtained by a person (directly or indirectly) from a public officer or former public officer who he knows or has reasonable cause to believe held the information by virtue of any such position. It identifies the elements of inside information by providing that the person holding it knows it is unpublished, price sensitive, and is in relation to securities of a particular company.[111] Furthermore, section 315 of the ISA caters for the need for information to be precise.

The UK CJA 1993 defines inside information as information relating to particular securities or to a particular issuer of securities or to particular issuers of securities and not to securities generally or to issuers of securities generally.[112] It identifies the elements required to classify information as inside information.[113] Furthermore, section 56 (1) (d) highlights the need for information to have significant effect on the market price of the particular security or securities if the information is made public.[114] These provisions make it easier to know what inside information entails and as such will be easier to establish liability. Prior to the enactment of the CJA, it was held that information must be capable of being pointed at, identified and expressed unequivocally.[115] Desperate defendants exploited this to avoid liability as it implied that rumors or speculative gossip could not be regarded as inside information.

[110] H. Alexander (n 90) 18
[111] ISA 2007, s. 112 (1) (c)
[112] CJA 1993, s.56
[113] *ibid*
[114] K. Wetherspoon, 'Insider dealing- The new law: Part V of the Criminal Justice Act 1993', (1994) The Modern Law Review 421
[115] *Ryan v Triguboof* [1976], 1 NSWLR 88, 588

This was corrected by the CJA that recognised the relevance of inference. Section 58 (2) (d) prescribes that any information not made public is inside information if used for trade on securities. Section 58 provides a detailed but not exhaustive guidance on how and when information is to be treated as having been made public. Section 58(3) identifies different circumstances that information may be considered public. Examples given includes, information that can only be acquired through due diligence or expertise, information communicated to a section of the public and not the public at large, communicated on payment of a fee etc.[116]

Regulation of insider trading as evident in the CJA are arguably sufficient and less likely to be problematic when establishing liability when compared to the ISA and Rules and Regulations of the SEC. Based on the aforementioned, it is arguable that whilst the regulations are partially sufficient, they can be simplified and well put together as against being littered through the act. Furthermore, there are some issues missing in the Nigerian regulatory regime such as establishing liability for insider trading against a company, indicating the capacity that an individual should occupy to be deemed a primary insider as well as granting a coherent definition of secondary insiders. This thesis argues that these issues appear minimal but will be beneficial if corrected in the fight against the act in the Nigerian capital market as well as for completeness.

4.2.7. **Penalties**

There are custodial and non-custodial sentences available to offenders that engage in insider trading. In recent times, there has been an upsurge in both custodial and non-custodial sentences accorded to individuals that participate in insider trading in the

[116] CJA 1993, s.58 (3)

UK. The same cannot be stated for Nigeria as identified above. The need for adequate penalties for alleged offenders of insiders is very important as it cultivates a conscious effort in individuals to abstain from engaging in insider trading. This thesis argues that with adequate penalties there is the likelihood that the act will be reduced to a considerable extent in Nigeria.

The ISA prescribes a fine of not less than 500 thousand Naira or double any amount of profit derived by him or loss averted by such insider whilst carrying out the act.[117] For corporate bodies, they are to be fined 1 million Naira or twice the amount of profit realised or loss averted.[118] Furthermore, in relation to custodial sentence, an insider is liable for a term of imprisonment not exceeding 7 years.[119] These provisions are arguably tailored around the provisions contained in the CJA and should be sufficient in tackling the problem, however, the thesis submits that these penalties will only be effective if adequately enforced. Evidence indicates that since the enactment of the Act-prohibiting insider trading there has been only one reported case of insider trading.[120] Enforcement of the regulatory provisions of insider trading is of paramount importance because it is insignificant if laws are enacted and not enforced properly and adequately, especially when evidence indicates that the problem the act is aiming at regulating is been practiced in the capital market.[121]

This chapter identified the fact that Nigeria is considered one of the most corrupt countries in the world. Issues such as lack of enforcement of legal regulations are largely responsible for the widespread corruption. With a corrupt judiciary, there

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[117] ISA 2007, s (115)(a)(i)
[118] *ibid* s (115)(b)
[119] *ibid* s (115)(a)(ii)
[120] Sir Kingsley Ikpe the Chief Executive officer of Thomas King Securities Limited was sentenced to 151 years in prison for insider dealing in 2005. Available at < http://www.proshareng.com/news/197> accessed 14 February 2015
[121] A. Garba (n 75) 17

is the likelihood that corporate executives will bribe their way out of charges of inside trading. This problem is further complicated by the fact that, the regulatory provisions are sometimes not appropriate for controlling the act. Consequently, there are little or no cases of insider trading in the courts as litigants consider this a futile endeavor.

4.3. Arguments for Insider trading

Some academics have proposed the decriminalisation of insider trading on the basis that it is a victimless act and that no form of crime is committed whilst engaging in the act.[122] It has been argued that if injustice results when one individual takes the property of someone else without the persons consent and the government prevents such acts, then the government should refrain from interfering with non-fraudulent transactions.[123] Furthermore, since no one's right is being violated and no unjust act is done, insider trading should be legalised.[124] Additionally, there is also the challenge of meeting the burden of proof of the offence when attempting to establish liability. This thesis submits that legalising insider trading will diminish the confidence of investors because of the belief that they are being exploited. Furthermore, when insider trading occurs directors act in contravention of their duty to act in the best interest of the company with regards to the interest of the shareholders. Moreover, other than harming investors, it has the likelihood to harm the corporation as executives sometimes use this information for their personal benefit. This is confirmed by the misappropriation theory that connotes that the information executives use to trade for their personal benefit is property of the company.[125] Furthermore, it has the propensity to harm the company if there is erosion in the value of the company, high cost of

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[122] R. McGee and W. Block, 'Information privilege, opportunity and insider trading', (1989) 10 Northern Illinois Law Review 3; L. Harris, '*Trading and exchange*, (Oxford Press, 2003) 591-597

[123] R. McGee and W. Block (n 122)

[124] *ibid*

[125] 4.4.2 for the discussion on misappropriation theory

equity as well as lack of access to capital because of the effects of the act.

To further strengthen the case against criminalisation of insider trading, it has been likened to the operation of business. It was stated that it would be unfair if traders were mandated to make the entire intricacies of their business known.[126] Additionally, it has been argued that most outsiders who bought from or sold to insiders would have traded regardless and possibly at a worse price.[127] This thesis submits that because of the complexities involved in capital market operations and the fact that investors are dealing with intangible goods, it is imperative that investors are collectively notified of information that will instigate investors to participate in the market. Trust is implicit in these sorts of transactions and if an investor becomes aware that the company is hiding information or that individuals operating the company are using information for their monetary advantage and/or that of a company, s/he would be less interested in investing. Furthermore, it is important that investors make informed independent decisions based on the information that is disclosed to them. This also has the effect of protecting the company if an investor seeks legal redress in the event of something going wrong. In such instance, the company will aver that they complied with disclosure obligations and, as such, made no efforts to convince the investor into investing.

Another reason that has emanated for the de-criminalisation of the act is the fact that the evidential burden of proof is high in criminal trials. In view of this, there has been the call for civil remedies to tackle the act. Some countries have adopted this as an alternative to criminal trials for the act and this is discussed in the next section.

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[126] L. Harris, (n 122) 593
[127] H. G. Manne, *Insider trading and the stock market*, (The Free Press, New York, 1966) 111

4.4. Civil Actions

Establishing criminal liability for insider trading entails proving the *actus reus* and the *mens rea* beyond reasonable doubt.[128] The onus of proof is on the prosecution. Proving the *actus reus* is less likely to be problematic as it entails proving that there was trade in securities with privileged information. However, proving the *mens rea* that the alleged offender knew the information was not available to the public and is price sensitive is likely to be difficult as an individual charged would assert lack of knowledge except he is willing to admit.[129] This problem generates a setback in the pursuit of insiders. Furthermore, in Nigeria, criminal prosecution is sanctioned on the attorney general of the Federation (Minister of Justice) and attorney general of the individual states. These offices are more interested in defending the Country or State rather than prosecuting cases of financial crimes. The problem is further convoluted by the fact that there is no specialised unit charged with investigating or prosecuting crimes emanating from the financial markets. Although there is the Economic and Financial Crimes Commission (EFCC) empowered to investigate and prosecute economic and financial crimes. The EFCC seems not to have been involved in prosecuting offences generated from the capital market. They are more inclined to prosecute cases of money laundering and corruption. In 2013, the EFCC signed an MOU with the Nigerian stock exchange to guard against infractions on extant rules by players in the capital market.[130] This was considered a welcome development. However, this thesis submits that the pace at which they are working is very slow. Since the MOU was signed in 2013, there have been only two reported cases that

[128] C.O. Okonkwo and M.E. Naish, *Criminal law in Nigeria*, (2nd Edition Sweet and Maxwell 1980) 97
[129] L.C.B. Gower, *Review of Investor Protection,* (Cmd 9125, 1984) para 634
[130] News Admin, 'EFCC sings MoU with NSE to tackle stock market fraud', (2013) The Street Journal <http://thestreetjournal.org/2013/10/efcc-signs-mou-with-nse-to-tackle-stock-market-fraud/> accessed 20 January 2017

have explored the collaborative effort of the EFCC and NSE's MOU.[131] More recently, the EFCC also signed a MOU with the SEC.[132]

The UK at some point experienced the problem of proving the *mens rea* in insider dealing cases. Prosecution of insider dealing was considered infrequent and often unsuccessful as they were typically no more than one or two successful prosecutions a year, and in some years there may be none at all.[133] Because of the technicality involved in proving the *mens rea*, authorities sought after other offences such as conspiracy to defraud and offences contained in the Theft Act in order to avoid the complications of proving the specialised crime of insider dealing and this led to minimal results being achieved under the provisions of the CJA part V. In addressing these concerns there was consultation with the financial industry that led to the provision of a guide to market operations. This guide was known as the Code of Market Conduct (COMC). Reference was made to the standard of the *mens rea* required to prove insider dealing in the original guide provided. Although no reference was made to *'mens rea'* in the statutory definition, the essence of it been contained in the guide was to establish a behaviour that is likely to be regarded as falling below the expected standard of a person in that position (the regular user test).[134]

Consequent to the above, there was the enactment of the Financial Services and Markets Act 2000 (FSMA) by the UK Parliament. The provisions of the FSMA

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[131] S. Opara, 'NSE, EFCC stop N20m capital market fraud', *Punch Newspaper* (Nigeria, 9th December 2016) <http://punchng.com/nse-efcc-stop-n20m-capital-market-fraud/> accessed 20 January 2017 <http://www.nigerianstockexchange.com/dealing-members-site/Notices/The%20Collaboration%20between%20NSE%20and%20EFCC%20Continues%20to%20Yield%20Fruit.pdf> accessed 20 January 2017

[132] G. Egene, 'SEC, EFCC to collaborate on capital market infractions', *Thisday Newspaper* (Nigeria, 27 December 2016)

[133] S. Griffin (n 109) 203

[134] A. Alcock, 'Five years of market abuse', (2007) 28 The Company Lawyer 2

created the opportunity to establish a single regulator charged with complete overhaul and consolidation of the UK Financial Services Law as well as provide the regulator with enhanced regulatory powers. This regulator was known as the Financial Services Authority (FSA).[135] The FSA was empowered to punish and regulate market participants whose conduct fell below acceptable standards but does not necessarily rise to the level of a criminal offence. It was empowered with a variety of rulemaking and investigatory powers as well as with the responsibilities to prosecute offenders for insider trading, enforce the provisions of the FSMA through several sanctions such as injunctions, fines, restitution order, publicly reprimand or fine a company or any of its directors. This was considered a stepping-stone in the fight to regulate insider dealing as it created an avenue to enforce regulatory and administrative proceedings in which unlimited civil penalties could be imposed on the basis of a lower evidentiary standard.[136] It is worth noting that prior to the enactment of the FSMA, there were traces of civil liability for breach by directors and officers who benefitted from inside information or who illicitly disclosed privileged information although limited by virtue of the decision in *Percival v Wright* where it was stated that the duties of a director are owed to the company and not to individual shareholders.[137]

The emergence of the FSMA made it possible to institute civil suits and proving such actions on a civil standard of proof, which is on a balance of probabilities. However, it should be noted that the fact a procedure is referred to, as civil procedure does not necessarily make it one for the purposes of Articles 6 and 7

[135] A quasi-judicial body responsible for the regulation of the financial services industry in the United Kingdom.
[136] K. Alexander, 'Market structures and market abuse' in G. Caprio, *Handbook on Safeguarding Global Financial Stability*, (1st Edition Academic Press 2013) 379
[137] [1902] 2 Ch 401

of the European Convention on Human Rights (ECHR).[138] This was the issue in *R (Fleurose) v Securities and Futures Authority Ltd*,[139] where it was held that on the basis of the decision in *Wickramsinghe v UK,*[140] market abuse proceedings should be categorised as civil, however, for the purpose of the ECHR such cases should be treated as criminal. Moreover, English law postulates that where civil cases imply criminal or quasi-criminal behaviour, the standard of proof ought to be affected. In *Hornal v Neuberger Products Ltd,* Lord Denning stated that in situations where the standard of proof is in dispute, the more serious the allegation, the higher the degree of probability required because it is less likely that the offence happened. This is also referred to as the sliding scale principle.[141] The Financial Services and Markets Tribunal (FSMT) adopted this model in *Mohammed Ariff v FSA*. The applicant was on trial for dealing based on inside information and on the basis that the allegation made against the applicant was a serious one attracting potentially serious penalties.[142] Furthermore, the House of Lords in *Re a Solicitor*[143] provided that when applying the Denning sliding scale, the more serious the allegation, the less likely the event occurred and hence the evidence ought to be stronger. This was subsequently adopted by the FSMT in cases such as *Davidson & Tatham v FSA*[144] and *Parker v FSA*.[145] The FSMT in these cases stated that in serious cases as these, the civil standard of proof would most likely provide similar result with the criminal standard of proof.

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[138] Article 6 and 7 of the European Convention on Human Rights covering the right to a fair trial and the right of no one been held guilty of any criminal offence on account of any act or omission that did not constitute a criminal offence respectively

[139] [2001] IRLR 1033; Affirmed on slightly different grounds in [2002] IRLR 297

[140] [1987] 1 EHRR 6

[141] *Hornal v Neuberger Products Limited* [1956] 1 QB 247

[142] <http://www.tribunals.gov.uk/financeandtax/Documents/decisions/FSMTribunal/012.pdf> accessed 14 January 2015

[143] [1993] QB 69

[144] (2006) FSMT Case 031

[145] (2007) FSMT Case 037

The substantive provisions that create the possibility of instituting civil suits for insider trading are contained in Part VIII of the FSMA 2000 and the Market Abuse Regulation 2016.[146] This does not repeal or alter in a major way (except for the lower evidentiary requirement) the criminal provisions for regulating insider trading as contained in the CJA 1993, rather it supplements it. It contains some commendable innovations such as identifying another class of insiders who are individuals in possession of information as a result of their criminal activities or persons who obtained information in other means which he knows or ought to know is inside information.[147] Section 118(c) (5)(a) provides that in relation to precision requirement, the information might not be wholly accurate but must indicate circumstances or events that actually existed or had occurred or which might be reasonably expected to occur when viewed objectively. In relation to future events, the test required was if there was a realistic prospect that the event would occur. This was demonstrated in *Hannam v Financial Conduct Authority* where it was held that the accuracy of information is not a necessity as inaccurate information might be sufficiently precise to amount to inside information. It stipulated further that in assessing precision as demonstrated in Section 118 (c) (6) of the FSMA 2000 caters for the need for information to have significant effect on the price of securities.[148]

The reputation of the UK's capital market as a leading financial center hinges on the openness, competitiveness as well as it being free of market abuse and malpractices.[149] The enactment of the FSMA can be described as enhancing the prospects of achieving this purpose this. As identified above, the FSMA created the Financial Services Authority (FSA). Its creation consolidated the nine regulatory

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[146] FSMA 2000
[147] *ibid* s (118) (b) (d & e)
[148] [2014] UKUT (TCC)
[149] A. Alcock (n 134)

bodies that were charged with regulating the market.[150] The emergence of the FSA was admired by a host of other countries, and some went as far as adopting their own model.[151] The consolidation was deemed necessary and was regarded as the formation of an integrated system with overall consistency and quality supervision.[152] With its creation, the UK financial markets flourished and attracted a significant share of global financial transaction and in the mid-2000s it was widely thought that the UK's approach to financial regulation was giving the London financial markets an international competitive edge.[153]

The FSA was dissolved in April 2013 due to its perceived failure in the market crisis of 2007-2008. The system was considered costly, inefficient and confusing, as well as not delivering the standard of supervision and investor protection that was expected.[154] Upon its dissolution, its power was split between the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA). The FCA regulates financial firms providing services to consumers and is charged with maintaining the integrity of the UK financial markets whilst the PRA is responsible for the prudential regulation and supervision of banks, building societies, credit unions, insurers and

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[150] C. Briault, 'The Rationale for a single National Financial Services Regulator', (1999) Financial Services Authority, Occasional Papers in Financial Regulation 6.
The nine bodies comprised off: Securities and Investment board, Personal Investment Authority, Investment Management regulatory organization, Securities and Future Authority, Supervision and Surveillance division of the Bank of England, Building Societies Commission, The Insurance Directorate of the department of Trade and Industry, Friends Societies Commission, Registrar of the Friends Society.

[151] E. Wymeersh, 'The Structure of Financial Supervision in Europe: About Single, Twin Peaks, and multiple financial Supervisors', (2007) 8 Europe Business Organization Law Review 50-52
Example of Countries to adopt the model include; Germany that consolidated its financial regulatory body into one in 2002 and led to the emergence of the Federal Financial Supervisory Authority (Bundesaufsichfsamt fur system), Ireland renamed its bodies to one leading to the emergence of Central Bank and Financial Services Authority.

[152] M. Cihak and R. Podpiera, 'Integrated financial supervision; which model?' (2008) 19 North American Journal of Economics and Finance 135, 141

[153] I. Begg, 'Regulation and supervision of financial intermediaries in the EU; The aftermath of the financial crisis', (2009) 47 Journal of Common Market Studies 1117

[154] E. Ferran, 'The breakup of the Financial Services Authority', (2011) 31 Oxford Journal of Legal Studies 456, 462

major investments firms. It sets standards and supervises financial institutions at the level of the individual firm. In promoting safety and soundness, the PRA focuses primarily on the harm that firms can cause the stability of the UK financial system, they do this by ensuring the provision of a stable financial system, which is considered a precondition for a healthy and successful economy.[155] The FCA is charged with the responsibility of consumer protection in financial services, and the regulation of conduct of business, including the conduct of firms supervised by the PRA and market regulation, including the listing of securities.[156] Their duties include, establishing rules to prevent the outbreak of insider trading as well as handle cases involving insider trading and general market abuse.

Other than the FSMA, there was the enactment of the EU Market Abuse Regulation 2016 (MAR 2016) that strengthens the FSMA. The MAR 2016 aims to increase market integrity and investor protection as well as propel the securities market as a viable place to raise capital. It came into effect in July 2016. It bears similarities with the FSMA but has some substantial difference that expands the scope of market abuse regime. Article 8 (1) of MAR defines insider dealing as well as identifies who an insider is. Article 8 (2) identifies secondary insiders. Article 14 prohibits insider dealing by primarily engaging in the act, recommending someone to engage in the act, or inducing someone to engage in the act. Furthermore, article 10 introduces a new offence known as unlawful disclosure of inside information. It is described as a situation where a person possesses inside information and discloses that information to someone else, except when made in the normal exercise of

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[155] *ibid*
[156] *ibid*

employment, profession or duty.[157] Article 11 (4) posits that disclosure of inside information made in the course of 'market sounding'[158] shall be deemed to be the normal exercise of a person's employment, profession or duty. However for this not to be considered a normal exercise, the participant must make a written record of the inclusion of the information with reasons as well as obtain consent to disseminate the information.[159] Article 17 mandates issuers to inform the public as soon as possible of inside information that concerns the issuer. They are mandated to ensure that the information is disseminated in a manner that enables fast access, complete, correct and timely assessment of the information by the public.[160] In a commendable manner, article 18 of the MAR 2016 prescribes that a list of all the persons that have access to inside information and those working for them under a contract of employment or otherwise performing tasks through which they have access to inside information be drawn up. The list includes but is not limited to advisers, accountants, credit rating agencies etc. This thesis asserts that this is a good innovation when attempting to establish liability as there is typically a list containing individuals that had access to the inside information that was used for investment, thus narrowing down the number of individuals that need to be investigated.

The *mens rea* problem for insider trading offences is not absent in Nigeria and can arguably be considered accountable for lack of prosecution of insider trading in Nigeria. There are no express provisions in the Nigerian regulatory framework that provides civil remedies for insider trading. Section 116 of the ISA has some traces of providing a civil remedy for insider trading. The relevant parts are highlighted below.

[157] Market Abuse Regulation 2016, article 10 (1)

[158] Market sounding is the communication of prior to the announcement of a transaction in order to gauge the interests of potential investors in a possible transaction and the conditions relating to it such as potential size or pricing to one or more potential investors; MAR 2016 Article 11

[159] MAR 2016, article 11 (4)

[160] MAR 2016 article 17 (1)

116 (1)‘*A person who is liable under this part of the act shall pay compensation at the order of the commission or the tribunal, as the case may be, any aggrieved person, in a transaction for the purchase or sale of securities entered into with the first mentioned person or with a person acting for or on his behalf, suffers a loss by reason of the difference between the price at which the securities would have likely been dealt in such transaction at the time the first mentioned transaction took place if the transaction had not occurred.*’

(2) ‘The amount of compensation for which a person is liable under subsection (1) of this section is the amount of the loss sustained by the person claiming the compensation or any other amount as may be determined by the commission or the Tribunal.’[161]

This thesis submits that this provision is deficient and not capable of completely regulating insider trading with civil standards for reasons highlighted below.

First, it only provides the remedy of compensation, which limits its scope, as this is not the only civil remedy that can be used to regulate the act. Executives, corporations are likely to engage in insider dealing if they know that compensation is all they will liable to pay. Furthermore, because the Nigerian judicial system is known for granting relatively meagre sums as compensation and fines, it is important that other forms of civil remedies be made available or else the provision will be futile. This thesis recommends the greater use of suspension and expulsion from the market as further penalties that can be imposed on individuals that engage in insider trading

[161] ISA 2007, s (116)

Second, it does not create an avenue for victims of insider trading to institute private civil actions before a regular court of competent jurisdiction as the Investment and Securities Tribunal (IST) is charged with trying cases for insider trading.[162] This is further complicated by the fact that section 284 of the ISA lists out the possible cases the IST is empowered to adjudicate over and it does not cater for disputes or question of law between corporations or between investors and corporations, thus implying that it is impossible to seek civil remedies against corporations or directors that have participated in insider dealing.

Third, the provision of section 116 ISA operates contrary to the provision of section 251(e) of the Constitution of the Federal Republic of Nigeria 1999 (CFRN). The substantive provision of section 251(e) bestows jurisdiction on the Federal High Court of Nigeria to try civil cases arising from the operations of CAMA or any enactment replacing the act or regulating companies incorporated under CAMA.[163] Regulation of insider trading was initially contained in the CAMA.[164] When it was repealed, the regulatory provisions were incorporated into the ISA. In view of this, it is arguable that the provision of section 116 is in contravention of section 251(e) of the CFRN. The CFRN is the supreme statute and its provisions override any other statute enacted.[165] This unarguably generates some difficulties, as litigants may be confused as to where to institute civil actions.

The foregoing makes it arguable that the regulatory provisions in Nigeria are not efficient to tackle the problem of insider trading. This is supported by the fact that since the enactment, there has been only one recorded case of insider trading in the

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162 A. Garba, (n 75) 17
163 CFRN 1999, s (251)(1)(e)
164 CAMA 1990, s. 614-624 contained the relevant provisions criminalizing insider dealing was repealed and subsequently incorporated in the Investment and Securities Act
165 CFRN 1999 s. 1 (3)

Nigerian capital market. The UK provisions are more likely to prevent the act from eating deep into the system by adequately identifying the elements of the offence, providing and enforcing penance as well as creating a viable alternative of civil remedies if the burden of proving beyond reasonable doubt is problematic. The next section comprises of recommendations on how the act of insider dealing can be effectively and efficiently regulated in the Nigerian capital market.

4.5. Recommendations for regulating insider trading in Nigerian Capital Market

This section highlights some recommendations on how to effectively regulate insider trading in the Nigerian capital market.

First, mandatory disclosure should be adequately regulated and the substantive rules governing disclosure should be expeditiously enforced. This thesis in chapter 3 highlighted the importance of laws regulating disclosure with the aim of attaining Fama's theory of an efficient capital market. In the United Kingdom, mandatory disclosure has been used to control insider trading to a reasonable extent and enforcement of this regulation is extended to family members of insiders.[166] It is tagged the oldest anti-insider dealing technique and was introduced on the recommendation of the Cohen committee of 1945 which mandated disclosure by companies to investors.[167]

Mandatory disclosure instils caution on insiders, as they know that this is required by law and as such must be complied with. Furthermore, and importantly, this thesis proposes that disclosure should not be limited to the company alone but inclusive of company directors and officers as contained in the Rules and Regulations

[166] L. Bromberg et al (n 2) 5
[167] Report of the Committee on Company Amendment, CM 6659, 1945

of the SEC rule 401. However, this thesis proposes the need for such provision to be contained in the ISA. Such a provision creates the possibility of tracking director's earnings and shareholdings, thus making it easier to detect when they have any unusual dealings. This recommendation considers the possibility of directors trading through associates and recommends the adaptation of the rule that extends liability for insider trading to the known associates and family members of the director as practiced in the UK under the CJA, FSMA and MAR. Additionally, insiders and corporations that do not conform to the laws of mandatory disclosure should have adequate penalties levelled against them. It goes without saying that having the provisions is not enough as there is the need for adequate and expeditious enforcement of these penalties. For example, the US Securities Exchange Act 1934 compels companies to disclose the required information or abstain from trading.[168] This thesis recommends the adoption of this model because it has the likelihood of generating efficient pricing of securities as all traders have equal access and same quality signals of information.[169]

Second, there is the urgent need to reform some of the substantive rules regulating insider trading to convey coherent rules as well as provide adequate enforcement. This chapter identified several loopholes and terminologies that can be exploited by insiders when actions are brought against them in order to evade liability.[170] The importance of reforming/updating these rules cannot be taken for granted if the Nigerian capital market is desirous of being at par with its international counterparts, attaining a strategic position in Africa as well as enhancing the

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[168] Securities Exchange Act, 1934, s10b-5.
[169] A.S. Kyle, 'Market structure, information, future markets and price formation' in G.G. Storey, A. Scmitz and A.H Sarris *International agricultural trade: Advanced readings in price formation, market structure and price instability*, (Boulder & Cauldron: Westview press, 1984) 45
[170] Amongst these terminologies are insider, inside information, a coherent definition of Insider trading as identified in 4.4.1-4.4.3

economy. In attaining this, this thesis recommends that certain provisions be made coherent and free from loopholes that can be exploited by desperate individuals. This has the likelihood to spark improvement in tackling and investigating the act as well as develops the knowledge on individuals who are unaware of the fact that the act is wrong.

Third, it is crucial that an adequate enforcement mechanism be implemented because it will be futile having rules that are not enforced.[171] The current penalties contained in the ISA are arguably sufficient, nevertheless, enforcement is a major problem identified in this chapter. Aggravating the problem further is the fact that influential persons will be able to evade these penalties because of the corrupt nature of the country. Furthermore, the role of law enforcement agencies and the courts in the fight against insider trading cannot be taken for granted. Efficient investigation and expeditious application of penalties against offenders have the propensity to reduce the occurrence of the act. This thesis proposes a more adept approach in upholding the regulations whilst ignoring corrupt practices, such as granting favourable judgments and rulings to influential persons. The lackadaisical approach by the judiciary is a major factor that has hindered the growth of the market. It has also diminished the reputation of market and has discouraged institutional, retail and international investors from the market. Taking an example from the United States of America, Sam Waksal was found guilty of insider trading and sentenced to prison for 7 years and 3 months as well as ordered to pay $ 4.3 million in fines and back taxes.[172] Another case worth noting is the Martha Stewart case where she was implicated in the Imclone scandal and was indicted on conspiracy charges. She was found guilty and

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[171] L.C.B. Gower, *Principles of modern company law*', (7th Edition, London: Sweet & Maxwell 2003)
[172] Sam Waksal is the founder and CEO of the biopharmaceutical company ImClone Systems and Kadmon Pharmaceuticals.

sentenced to serve a five-month term in a US Federal correctional facility and two-year period of supervised release to include five months of electronic monitoring.[173]

Furthermore, in other to effectively enforce the rules regulating the capital market, there is the need for copious investigations.[174] A setback in the provisions of the ISA is the absence of providing an efficient system of investigation. It has been suggested that this defect might be due to the fact that the same defect existed in the UK Company Securities (Insider Dealing) Act 1985, which is the statute from which the ISA was culled up.[175] It is worth nothing that this defect in the UK legislation was sorted by provisions of the repealed Financial Services Act 2010 and incorporated in provision 3 and 4 of the Enforcement Guide, Financial Conduct Authority, which empowers them to investigate and prosecute insider dealing as defined in the CJA 1993.

The SEC in Nigeria is empowered by Section 45(1) of the ISA to conduct routine and special inspection as well as carry out investigation of capital market operators. This provision is limited to capital market operations by virtue of this provision highlighted below.

> '*This part of the Act applies to any capital market operator who is involved in the administration, management or custody of funds for or on behalf of client including the management and operation of a collective investment scheme or the soliciting of investment in a collective investment scheme.*'[176]

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[173] Martha Stewart is a popular American business woman and television personality
[174] A. Garba, (n 75) 19
[175] *ibid*
[176] ISA 2007, s.45 (9)

This thesis argues that this limited provision does not empower the SEC to conduct investigations required for the prosecution of insider trading. There is the suggestion to empower the SEC to appoint specialist investigators that will inquire into any alleged infringement of the ISA generally and any suspected case of insider trading.[177] This thesis proposes the need for investigation to be conducted into the affairs of corporations and directors that can link them to insider trading if they had engaged in the act. In attaining this, the proposed MOU signed between the SEC/Nigerian Stock Exchange and the EFCC will serve as a viable mechanism to pursue this.

Furthermore, it is important to implement procedures that can be used by market participants to ensure that insider trading is not practiced in their establishment. Taking an example from the MAR, article 16 (1) stipulates that market operators, investment firms that are operating in a trading venue shall establish and maintain effective arrangements and systems as well as procedure aimed at preventing and detecting insider dealing. In applying such a principle to Nigeria, this thesis proposes the need to promote the operation of corporate governance in the market through the development and efficient regulation of audit committees.[178]

Fourth, it is suggested that there is a need to implement a variant of the short-swing rule as provided in section 16(b) of the US Securities Exchange Act 1934. This rule precludes insiders from making short sales within a six-month period.[179] It prevents insiders whom are privileged to material company information from taking advantage of information for making short-term profits. It provides that insiders are

[177] A. Garba, (n 75) 19
[178] This issue is discussed in Chapter 5, 5.5
[179] L. Anthony, 'Section 16(b) Insider reporting and liability for short swing trading', (2014) White Paper 2 <http://www.legalandcompliance.com/wp-content/uploads/2014/07/LC-White-Paper-070114.pdf> accessed 21 January 2016

required to surrender to the company all profits if a transaction as such happens within six months.[180] This rule follows section 16(a), which provides that every director or officer of the company with registered equity security as well as every beneficial holder of 10% of every class of registered equity security to file monthly reports with the SEC indicating whatever changes in the beneficial ownership of those securities.[181] In 1966, the SEC extended this obligation to spouses and family members.[182] This thesis proposes that such a law will be beneficial in tackling insider trading in a developing country like Nigeria because it identifies a specific period when insiders cannot deal which is from the time the information is generated and possibly extended to the point where the likely effect would have expired. This will prevent unfair exploitation of inside information as well as reduce the temptation to trade on inside information.[183] Furthermore, the fact that it is extended to spouses and family members is commendable. This thesis recommends, the addition of close associates to the category of persons this obligation is extended to.

Fifth, there should be provisions for private right of action by companies and individuals against insider trading. The ISA criminalises insider trading with prescribed punishment of imprisonment or fines. When an insider is fined, such money goes back to the government and when he is incarcerated it is the tax of the victims of insider trading that are used to maintain insiders whilst in prison.[184] Furthermore, the right of prosecution lies with the Attorney General of various states and the Federation.[185] Minimal attention is paid to cases such as insider trading and

[180] A. Agraval and J. F. Jaffe, 'Does section 16(b) deter insider trading by target managers', (1995) 39 Journal of Financial Economics 296
[181] United States of America Securities Exchange Act, 1934, s16 (a).
[182] Securities Exchange Act release, 1966, No. 7793 & 7824.
[183] W. Bewaji (n 58) 217
[184] *ibid* 228
[185] CFRN, 1999, s 174 and 211,

there is no arm of the ministry dedicated to neither financial crimes nor insider trading cases.

The MOU signed by the EFCC and the Nigerian stock exchange and more recently the SEC led to the assumption that there would be rapid investigations and trials, however, till date there have been little amount of reported cases of either arms investigating or prosecuting insider trading. In view of the above, this thesis proposes that the SEC align with the Ministry of Justice to generate a medium through which insider trading cases can be prosecuted by the provision of a specialist unit charged with prosecuting market abuse like insider dealing. This, it is argued, will go a long way in the fight against insiders. As a substitute to the foregoing, this thesis proposes the need to statutorily empower the EFCC to carry out investigations and prosecute cases of market abuse such as insider trading.

Furthermore, this thesis proposes the need for provisions that permit institution of civil suits for insider trading with civil remedies made available as possible admonishment. Instituting civil actions should not be limited to individuals alone but a company should have a right to institute actions because it is regarded as a separate legal entity and as such should possess the capacity to institute an action in the event of suffering any harm.[186] Section 299 of the CAMA underlines the possibility of instituting such an action by a company. [187]

In the United States of America, the responsibility is on the company to institute actions to recover any profit made by any director, officer or shareholder or substantial shareholder in breach of s16 (b) of the Securities and Exchange Act 1934. Where such a company fails, or refuses to bring such an action within 60 days after a

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[186] *Foss v Harbottle* (1843) 2 Hare 461
[187] CAMA, 2004, s.299

request in that regard is made or fails to diligently prosecute it, a shareholder may bring an action in the name or on behalf of the company in a manner known as 'derivative action'.[188] The prospects for a derivative action were enhanced under Part 11 of the Companies Act 2006. They are instituted to remedy a situation or correct a wrong done to the corporation and in some instances against insiders of the company. It is usually commenced in a representative capacity for the corporation and provides a means for shareholders to enforce claims of the corporation against managing officers and directors of the corporation. The effect of this is the fact that companies can protect their images through such actions. If the company does not pursue such an action it can be implied that the company is protecting its own. The UK has adopted the concept of derivative actions in section 260(1) Companies Act 2006. There have been more derivative claims brought since this change.

In Nigeria, the CAMA provides that an applicant may apply for leave of court to bring an action in the name or on behalf of a company.[189] The prerequisites for commencing such action are listed as, the fact that the wrongdoers must be the directors in control, such directors must have been notified of the intention to apply to the court for such an action, applicant must be acting in good faith and in the best interest of the company.[190] Although there is the provision for such actions in the CAMA, this thesis submits that the concept of derivative actions is not properly addressed by virtue of the fact that the money realised from such an action is paid to former and existing shareholders with the exclusion of the company that the action was instituted on its behalf. In view of these arguments, this thesis submits that

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[188] *Heron International Ltd v Lord Grade* [1983] BCLC 261-3
Shareholders are regarded as the owners of the company and they employ individuals such as directors to run the day-to-day affairs of the company. Based on this fact, there is the likelihood of directors protecting themselves and will not instigate such action.
[189] CAMA 2004, s303 (1)
[190] *ibid* s303 (2) (a-d)

provisions of section 304 (2) (c) of CAMA is impractical because such payments if made will usually be at the expense of the company and the corporate assets, which will be to the detriment of creditors and fellow shareholders.[191] Further, derivative actions are usually not pursued because of the cost implications. However, in a commendable manner the provision of CAMA by virtue of s304 (2) (d) indemnifies shareholders from such legal expenses.[192]

In addition to the above, this thesis proposes that there is the need for civil remedies to be available to serve as a viable alternative to criminal prosecutions against insiders. The provisions of the ISA place strict reliance on criminal prosecution for insider trading with a brief provision for civil remedies.[193] However, history has shown that these criminal provisions have not been effective in the regulation of insider trading as there has just been one reported case of insider trading since the inception of these laws. In view of this and reiterating what has been discussed in this chapter, it is important that there is the enactment of adequate civil remedies to serve as a viable alternative to criminal prosecution. The recommended remedies have the likelihood to save time and not obstruct the provisions of the ISA criminalising insider trading, rather it will complement the provisions of the ISA and serve as an alternative for victims of insider trading with lower evidentiary requirement as witnessed in the UK through the provision of the FSMA. This thesis submits that if properly implemented, these recommendations have the likelihood of decreasing the operation of insider trading to a reasonable extent in the Nigerian Capital Market.

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[191] W. Bewaji (n 58) 226
[192] *Wallersteiner v Moir* (No. 2) [1975] QB 373, CA
[193] ISA, 2007, s116

4.6. Conclusion

Suspicion amongst shareholders as to transparency of directors and officers of companies vis-à-vis handling price sensitive information of companies has generated the upsurge of insider trading regulations. Several countries have utilised the enactment of laws prohibiting insider trading as a mechanism to preserve the integrity of their capital markets as well as revive investor confidence. Some countries have recorded success in attempting to regulate the act of insider trading and at the top of the list are the UK and the US. They started with self-regulatory market codes and the common law doctrine of disclosure, which have been adopted by developing countries such as Nigeria. It is arguable that insider trading is practiced in the Nigerian capital market. Its effects are evident on the confidence of the public in the Nigerian capital market. This thesis submits that insider trading is one of the reasons attributable to presumed lack of depth of the market. Ultimately, if the recommendations (provision of clear regulations, enforcement, adoption of civil remedies and investigation) highlighted in this chapter are conspicuously implemented, there is the likelihood that the incidence of insider trading would be reduced to a considerable extent, thus enhancing investor confidence.

5. Rule of Law and Corporate Governance in the Nigerian Capital Market

5.1. Introduction

This thesis in the preceding chapters has highlighted the importance and impact of an efficient capital market. The benefits of such machinery are manifold. Its importance cannot be taken for granted as there is general consensus that a country equipped with an efficient capital market, free from market abuse and improprieties have the tendency to spur economic growth. This will have a substantial impact on improving the standard of living because of the increment in the amount of goods and services produced per head of a population.[1] This argument is tied to the idea that when the capital market is fully functional and effective, there is sufficient access to capital thus making businesses effective and possibly more productive because they have the access to capital.

The Nigerian economy is currently in recession and is experiencing an all-time low due to deflation/devaluation of the Nigerian Naira, dwindling price of crude oil, scarcity of foreign exchange, and low productivity amongst other factors. The situation has been described as frightening.[2] This thesis argues that, an efficient capital market in Nigeria would generate positive contribution to the sustainability of the Nigerian economy. This has the likelihood to reduce the negative impact associated with economic depressions/recessions. This argument is borne out of the fact that, there will be more investors willing to invest in the capital market, hence providing the requisite capital for exploration of the other sectors as well as granting corporations access to funds for their businesses, thus reducing over reliance on crude

[1] J. E. Stiglitz, 'Capital market liberalisation, economic growth and instability' (2000) 28 World Development 1077

[2] J. O. Nwachukwu, 'Nigerian economy in a frightening situation-NLC NUC', *Daily Post* (Nigeria, March 21, 2016) <http://dailypost.ng/2016/03/21/nigerian-economy-in-a-frightening-situation-nlc-tuc/> accessed 5 April 2016

oil as the primary source of revenue. In view of this, it is important to develop the right machinery that will be used to spur economic growth and avoid negative impacts associated with economic depression/recession. There have been suggestions for the diversification of the Nigerian revenue generated through crude oil.[3] This thesis argues the urgent need to diversify the economy, as the possibility of attaining a strengthened economy is not possible if the country depends on one source of revenue. Moreover, the primary source will also benefit from a robust/efficient capital market. The drop in oil prices has heightened these suggestions in recent times, which has significantly reduced the income of the country.[4] The case of Nigeria and other African countries that depend heavily on exploration of crude oil ought to serve as a blue print. These countries neglect other sectors that can generate some revenue and with the recent crash of oil prices globally, such countries are struggling for survival and in the case of Nigeria, there is an on-going recession.[5]

This thesis identifies some issues hindering the efficiency of the Nigerian capital market and recommends the implementation of the suggestions highlighted with a view to attaining efficiency in the Nigerian capital market. It is the contention of this thesis that implementing the core suggestions as articulated in the thesis has the propensity to make the capital market efficient and make it an investors choice because countries described to have strong capital market at some point experienced

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[3] A. A. Awe and S. O. Ajayi, 'Diversification of Nigerian revenue base for development: The contribution of the non-oil sector', (2009) 6 Pakistan Journal of Social Science 138
G. O. Odularu, 'Crude oil and the Nigerian economic performance', (2008) Oil and Gas Business <http://s3.amazonaws.com/academia.edu.documents/5921722/odularo_1.pdf?AWSAccessKeyId=AKIAIWOWYYGZ2Y53UL3A&Expires=1490018938&Signature=5frXOcLUqVlyzbZSZdIpYn9b%2Fgk%3D&response-content-disposition=inline%3B%20filename%3DCrude_Oil_and_the_Nigerian_Economic_Perf.pdf> accessed 20 March 2017
[4] G. Steinhauser, 'Oil-price drop pushes Nigeria into first recession since 2004', (2016) The Wall Street Journal <https://www.wsj.com/articles/naira-oil-price-fall-push-nigeria-into-recession-1472647749> accessed 2 February, 2017
[5] A. Bedwei, 'Doing business in a low oil price environment: The impact on Africa', (*pwc Blog,* 17th October, 2016) <http://pwc.blogs.com/energy_spotlight/2016/10/doing-business-in-a-low-oil-price-environment-the-impact-on-africa.html> accessed 2 February, 2017

these problems, and their approach towards reducing/terminating these issues have yielded admirable results.

Developing a sturdy capital market rests on a complex network of legal and market institutions, which ensures that investors receive adequate and efficient information about the value of a company's business as well as ensuring that investors are confident that managers and controlling shareholders will not appropriate their investments or what is due to them.[6] Furthermore, in developing a strong capital market, the operational efficiency of such market is an essential factor that can influence investors in the market. Operational efficiency in this instance includes the provision and regulation of a transparent system for disclosure coupled with practices that will deter market malpractices. Additionally, the enactment of impermeable laws and adequate enforcement mechanisms aimed at protecting the interests of investors as well as ensuring they get their money back is off paramount importance. Such laws can double as a guide for market operators in carrying out their operations.

It is arguable that the primary reasons individuals and institutional investors avoid the Nigerian capital market is because of the possibility of being provided with unreliable, falsified or incomplete information as well the operation of market malpractices such as insider trading. This arguably is accountable for the reason the market lacks depth and is considered volatile.[7] It is important to note that there are other problems associated with the capital market in Nigeria. However, these problems highlighted serve as the root for the other problems that may emerge.[8]

[6] B. S. Black, 'The legal and institutional preconditions for strong securities markets', (2001) 781 UCLA Law Review, 783

[7] A. Babatunde and O. Olaniran, 'The effects of internal and external mechanism on governance and performance of corporate firms in Nigeria', (2009) 7 Corporate Ownership and Control 332

[8] This argument spawns from the fact that information is the most important thing when investing in a capital market and the major problems associated with capital market transactions are provision of inaccurate information or falsified information. Chapter 3

The importance of utilising legal provisions to tackle these problems cannot be undervalued as academics have argued that law is the best way to tackle the problems underlined in this thesis.[9] Countries have adopted the model of using legal provisions to eliminate these problems and the practice is no different in Nigeria. There are regulatory provisions concentrating on eradicating these problems such as the Companies and Allied Matters Act 2004 (CAMA), Investment and Securities Act 2007 (ISA), and the Rules and Regulations of the SEC. This thesis compared some of the provisions contained in the Nigerian statutes with similar provisions in the UK and argued that the laws in Nigeria are incapable of handling such issues as there are instances of the laws not adequately and completely handling the issues identified or in some instances, there are no provisions for the regulation of such issues. Furthermore, a predominant problem associated with these rules is the issue of enforcement.

This chapter seeks to explore some other elements that hinder the possibility of these laws bestowing credibility to the Nigerian capital market. However, it is important to state that these recommendations do not provide all the possible solutions to the problems accorded with the capital market in Nigeria, it only highlights select actions, procedures and mechanisms that hold the most potential to deliver impact based on similar approach by countries that are considered to possess strong capital markets. The issues discussed in this chapter is the operation of the rule of law in the capital market through the enactment of efficient rules and appropriate enforcement mechanisms through the IST, SEC and rule of law personnel (judges, lawyers) as well as the effective operation of corporate governance.

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[9] R. La Porta, F. Lopez-de-Silanes, A. Shleifer, R. Vishny, 'Law and Finance', (1998) 106 The Journal of Political Economy 1114
S. Djankov, C. McLeish and A. Shleifer, 'Private credit in 129 countries', (2007) 84 Journal of Financial Economics 301

5.2. Rule of Law

In its simplest form, rule of law connotes that the law should govern every facet of a nation (including its capital market) as opposed to being governed by arbitrary decisions of individual government officials.[10] It is described as less formal and more substantive in the sense that rights should be recognised and enforced by courts or other judicial institutions as far as practicable as it is important in promoting the rights of individuals.[11] The idea of rule of law not only requires the government to rule through laws but also is ruled by laws.[12] In view of this the courts are described a viable means to enforce the rights of citizens against the government and bodies that aim to breach these rights.[13]

Rule of law is important not only for the legal development, but also for economic and political development, which are also constitutive parts of national development as a whole. Based on the importance of capital markets, there is the vital requirement for regulation to avoid sharp practices, market abuse and improprieties. In achieving this, the importance of rule of law cannot be challenged as it guarantees the continued existence and operational efficiency of the capital market.[14]

Economic development has been described to advance the rule of law.[15] That said, it is arguable that absence of rule of law can hinder economic and business growth. According to the World Bank, Africa must unleash the power of its

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[10] T. Bingham, *The rule of law,* (Penguin Books, 2011) 3
[11] G. F. Gaus, 'Public reason and the rule of law', in I. Shapiro, *The rule of law,* (New York University Press, 1994) 329
[12] *ibid*
[13] J. R. Lucas, *The principles of politics,* (Oxford: Clarendon, 1966) 113
[14] R. La Porta, F. Lopez-De-Silanes, A. Shleifer and R. Vishny, 'Legal determinants of external finance', (1997) 52 Journal of Finance 1149
[15] American Bar Association, 'The rule of law and economic development', *International Rule of Law Symposium,* April 2007, p. 2

enterprises to create jobs, expand exports and greater wealth to grow economically.[16] The 'Africa action plan' is held to be hindered by the combination of high regulatory costs, unsecured land property rights, ineffective judiciary, policy uncertainty and corruption, thus making the cost of conducting business in Africa 20-40% higher than that of other developing regions.[17] Ultimately, the consequences are difficulty in job creation, wealth generation and economic development.[18]

The thesis argues that the unavailability of a standard set of rules is partly attributable to the hindrance of the operation of rule of law in the Nigerian capital market as research suggests that total stock market returns positively correlate with overall measures of the quality of institutions, such as judicial efficiency and rule of law as well as controlling for risk.[19] Additionally, dividend yields and earnings also correlate positively with judicial efficiency and rule of law.[20]

This thesis has previously highlighted some of the legal provisions regulating the Nigerian capital market, which is aimed at protecting investors as well as promoting its operational efficiency.[21] However, some of the provisions are not easily comprehendible, or they fail to realise their objectives. Some of the laws are of average quality and do not amplify the need to protect investors. These laws were adopted from similar provisions in the UK and USA that have now being updated whilst the laws in Nigeria remain unchanged. These provisions, still contain some of

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[16] Unleashing Africa's private sector: a key to shared growth <http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/AFRICAEXT/0,,contentMDK:20639324~menuPK:258649~pagePK:146736~piPK:226340~theSitePK:258644,00.html> accessed, 5 April 2016

[17] The African action plan on development is based on development priorities as expressed by the African Union and New Partnership for Africa's Development and is aimed at achieving an integrated and prosperous Africa, driven by its own citizens and representing a dynamic force in the global arena. <http://www.nepad.org/resource/africa-action-plan-development-effectiveness> accessed 20 March 2017

[18] (n 16)

[19] D. Lombardo and M. Pagano, 'Legal determinants of the return on equity', (1999) Centre for studies in Economics and Finance, Working paper, No. 24, 26

[20] *ibid*

[21] See 3.6.1(a) (b), 3.7.1, 4.3.3, 4.4.1, 4.4.2, 4.4.3, 4.4.4 above

the mistakes of the previous provisions and not meeting societal/economical innovations such as technological and credit advancements.[22] Some of these regulations are due to be amended and or repealed if the capital market is desirous of growth. The rule of law should guide the application of these laws. However, it is arguable that it has not being applied properly or can be considered not useful for the purpose of investor protection. Furthermore, its application in the capital market has not succeeded in transforming the market to a desirable investment hub for investors.

In view of the foregoing, this thesis recommends the immediate and persistent promotion of the rule of law in Nigeria as the likelihood of the capital market benefitting from a nation that pays attention to the rule of law are manifold. The rule of law can be promoted through an effective regulatory regime charged with fostering capital market development by encouraging the participation of investors and issuers in capital market transactions.[23] It should reprimand anyone that impairs the regulations governing the market as well as practices criminal activities. However, it is important to achieve a balance by excluding characteristics that are robust enough to protect investors without acting as a disincentive to the participation of issuers. The regulations enacted should not be too strict to make people avoid the market as well as not feeble to make it easy to avoid compliance. Furthermore, to achieve and promote the rule of law as an ultimate guide for market participants, the rules contained in the ISA and Rules and Regulations of the SEC must be updated to achieve regulatory efficiency because their primary purpose is to ensure operational efficiency of the capital market and guarantee investors adequate protection.

[22] V. O. Okoye, K. J. Nwisienyi and O.Eze, 'Capital market and industrial section development in Nigeria: A theoretical analysis', (2013) 4 Journal of Emerging Trends in Economics and Management Sciences, 20

[23] S. Kiyingi and E. Uwaifo, 'Nigerian capital markets: Legal and regulatory review and recommendations', (2015) The Nigeria-UK Capital Markets Projects 23

Examples of such laws that require updating are highlighted in the next section.[24] Furthermore, it is arguable that the effects of these rules have not been felt in the market due to exploitable ambiguities and lack of enforcement.

This thesis argues that for the rule of law to be engaged appropriately to derive an appreciable result within the Nigerian capital market, there is the need for auspices of the rule of law to function appropriately. These factors include the provision of efficient and impermeable rules as well as the cogent operation of the factors needed to enforce these legal provisions. These factors are examined in turn below.

5.2.1. **Efficient rules**

The provision of rules aimed at promoting market efficiency serves as the primary means to engage the rule of law in the Nigerian capital market. To achieve an efficient regulatory regime, it is important that there are impermeable rules that prescribe how capital market operations should be conducted as well as provide adequate punishment for individuals and corporations that do not adhere to these rules. Formal legal and regulatory obligations are part of the external incentive structure designed to ensure that companies abide by common standards of fairness, transparency, accountability as well as develops the responsibility to protect shareholders, consumers, workers, the environment and even competitors from abusive practices. It would efficiently address the entry operations, develop best practices on quality of disclosure, as well as accounting and auditing standards.[25] This thesis argues that with efficient rules and adequate enforcement investors will be more willing to invest which becomes savings for their use either in short term or in

[24] Details of these provisions are addressed in the subsequent sections of this chapter.
[25] A. Babatunde and O. Olaniran, (n 7) 334

the future, thus enhancing liquidity in the market. Furthermore, this has the propensity to attract prospective investors to invest in the market.[26]

Historically, the Nigerian capital market was without any form of regulation for almost twenty years from 1960.[27] This meant that if any dispute had occurred during that period, chances of success in courts were very minimal as there were no legally enforceable principles governing the system. However, in recent years, rules were enacted to regulate the capital market. Paradoxically, these rules, arguably, have not regulated the market efficiently as it has been suggested in this thesis that the inefficiency of some of the rules governing disclosure is accountable for the lack of depth of the Nigerian capital market.[28] This, coupled with inadequate/lack of enforcement, is largely accountable for the Nigerian capital market being occupied by corporations that do not adhere to disclosure obligations.

This thesis argues that the growth of the statutory provisions regulating the Nigerian capital market has been slow and has not evolved with the global innovations of recent years.[29] It has been argued that regulatory accountability in relation to the capital market has not received much attention.[30] The regulatory provisions are described to have adopted similar provisions in the Criminal Justice Act 1993 of the UK and the SEC Rules and Regulations in the USA.[31] These statutes have constantly been updated or have adopted other statutory provisions in a bid to complement the existing ones, e.g. the enactment of the Financial Services and Markets Act 2000 that provides civil regulations for market abuse such as insider

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[26] A.C. Fernando, *Business Environment*, (Pearson, 2011) 326

[27] A. Sanda, S. Mikailu and T. Garba, 'Corporate governance mechanisms and firm financial performance in Nigeria' (2005) 149 African Economic Research Consortium 5

[28] Chapter 3 above

[29] A. B. Ahmed and M. Bello, 'Regulatory failures and the collapse of the capital market in Nigeria: Aligning responsibilities with accountability', (2015) 40 Journal of Law, Policy and Globalization 167

[30] *ibid*

[31] A. A. Oluwabiyi, 'A comparative legal appraisal of the problem of insider trading in mergers and acquisitions', (2014) 2 Frontiers of Legal Research 1

trading and disclosure in the United Kingdom. The Nigerian statutes cannot be viewed to have developed at the same pace with its foreign counterparts. There are few advances in the regulatory provisions that are still considerably inadequate to sufficiently regulate the market, as they still contain exploitable loopholes as highlighted in this thesis. This becomes a major issue for the market, as investors are likely to avoid the market due to lack of confidence in the system as well as the legal regulations overseeing the market. The importance of these laws cannot be underestimated as their proficiency has the possibility of enhancing the confidence of investors because of improved operational efficiency.[32]

Whilst this thesis commends the attempt at promoting regulation of the capital market, it argues that the contents of both regulatory instruments in the capital market are likely to generate confusion when attempting to establish liability. Particularly, this is because that there are provisions contained in one of the instruments and absent in the other. With the prevalence of financial markets illiteracy in Nigeria, it is important that the rules governing the market are not confusing not only to members of the public, but also to members of the investing sphere and legal practitioners. Therefore, this thesis recommends restructuring the focal point of both regulations and proposes the following:

a) The Investment and Securities Act should be redrafted to contain specific offence, which include, insider trading, market manipulation, falsified disclosure etc. for which an action can be maintained as well as likely punishment if the regulations are not obeyed
b) The Rules and Regulations of the SEC should be redrafted in the form of a rulebook, which highlights and defines the rules governing capital market

[32] B. R. Cheffins, 'Does law matter? The separation of ownership and control in the United Kingdom', (2001) 30 Journal of Legal Studies 459

operations. This thesis proposes that this rulebook should include specific practices that should be observed by capital market operators and companies registered in the capital market in observing best practices. Further, issues such as disclosure of information required by corporations in the capital market should be contained, inclusive of practices that companies and capital market operators should desist from. It should also contain the offences contained in the ISA or in the alternative, it should be referenced so as to draw the attention of market operators and corporations of the likely offences that can be committed and potential punishment.

As identified by this thesis, some key issues, such as that for mandatory disclosure are not concisely set out in the ISA when compared to the rules and regulations of the SEC. This becomes tricky because disclosure of accurate information is a likely factor that persuades both retail and institutional investors to invest. In view of the foregoing, it is imperative that such provision should be conspicuously evident in both provisions as it is important both for the running of the securities markets and for establishing liability if necessary. Although section 313 (1) (p) of the ISA gives effect to a more robust SEC rules and regulations by prescribing that the SEC may make rules and regulations for the effect of carrying out the principles, this thesis proposes the need for important issues like disclosure and avoidance of market abuse to be clear in both regulations. In alternative to the foregoing, this thesis recommends that the ISA include a provision to the end that infractions of the Rules and Regulations of the SEC would be handled in the same manner as infractions of the ISA.

There are other regulatory provisions that require updating in a bid to attain capital market efficiency. These provisions are examined in turn.

First, the need to grant jurisdiction to the Investment and Securities Tribunal (IST) to adjudicate for wrong committed against an individual in the capital market by corporations. Section 284 (1) of the ISA grants exclusive jurisdiction to the IST to exercise jurisdiction, hear and determine any question of law dispute arising from the capital market. It lists the type of disputes to include, disputes between capital market operators, operators and their clients, between an investor and a securities exchange or capital trade point but does not include adjudication between investors and listed companies.[33] This is an issue that should be addressed because if the IST is established for the purpose of adjudicating disputes that arise out of the capital market, it is important that it caters for disputes between an investor and a corporation and vice versa. Although such disputes are brought to the Federal High Court in the form of contractual disputes, this thesis recommends that issues emanating from the capital market be adjudicated in the IST because of the presumed expertise the judges of the IST possess in capital market operations. Furthermore, if such issues are adjudicated in the Federal High Court, the purpose of the IST is arguably defeated if it cannot hear disputes between investors and corporations. The foregoing has the potential to further enhance the confidence of potential investors in the system because they are aware of where to institute actions if anything goes wrong between the investor and a corporation in the market and potentially the ability to institute an action against the commission.

Second, the need to confirm where actions from the securities market are to commence is important for clarity purpose. Section, 251(e) of the Constitution of the Federal Republic of Nigeria (CFRN) confers exclusive jurisdiction on the Federal High Court for civil cases arising from the operation of the Companies and Allied

[33] ISA, s. 284(1)

Matters Act (CAMA) or any enactment replacing the Act or regulating the operation of companies incorporated under the CAMA.[34] Section 251 (e), CFRN and section 284 (1) ISA are likely to cause difficulties because they contradict each other in relation to commencing civil cases emanating from the capital market. The ISA was enacted after substantive provisions governing issues such as insider trading were repealed in the CAMA, which makes it fall under this category in section 251 (e). Such contradiction paves the way for unnecessary time wastage technicalities that can be exploited by defence attorneys. Although there is the possibility of appealing such judgments/rulings if they occur, the cost implication may not be encouraging to a party whose case has been struck out, or judgment/ruling not given in his favour.

Drawing on an example from the UK, the method of commencing a civil action by an aggrieved investor is explained on the website of the Financial Conduct Authority.[35] The commercial courts of the England and Wales are the designated courts accorded with jurisdiction to hear disputes arising from the financial markets.[36] In October 2015, there was the introduction of the financial list that is to cater for financial services claims of £50 million and above or for complex disputes that raise issues concerning the domestic and international financial markets.[37] The system in the UK is unarguably easier to comprehend and likely attributable to the success of the London Stock Exchange because it gives adequate information of where to make formal complaints as well as the courts to institute such actions if need be. This thesis argues that this is an additional factor that will influence an investor to invest in such a market because of the belief that if anything goes wrong, they are aware of the procedure to resolve such disputes. In view of foregoing, this thesis proposes the

[34] CFRN, 1999, s.251 (e)
[35] <http://www.fca.org.uk/consumers/complaints-and-compensation/how-to-complain>
[36] <https://www.gov.uk/courts-tribunals/commercial-court>
[37] Civil Procedure Rules, part 63A

adoption of a system similar to that in the UK by the Nigerian capital market that provides adequate information to investors on where to make complaints as well as the right court/tribunal to institute actions. This has the likelihood to enhance the confidence of potential investors in the capital market.

Third, the rules governing disclosure should be available in both the ISA and the Rules and Regulations of the SEC. Disclosure of information relating to a company and its business is of paramount importance when investing in the capital market as investors rely on the documents provided by companies in the securities market when they are making the decision to invest and as such it should be contained in the Rules and Regulations of the SEC for participants in the market to know their obligations and also used to establish liability against anyone that does not adhere to the regulatory provisions. Adequate rules governing disclosure have the likelihood to generate coherent disclosure by corporations and ignore sharp practices.

Other than the fact that both regulatory instruments should contain concise rules pertaining to disclosure, this thesis submits that it is important that sanctions available for contravention of these rules are also made available. Currently, the ISA lists the sanctions for non-adherence to disclosure. However, they are absent in the Rules and Regulations of the SEC. This thesis recommends that such sanctions should be made available in the rules and regulations to enable participants in the markets and corporations be aware of the likely sanctions they would face if they do not adhere to mandatory disclosure, which has the propensity to make them desist from such practice.

Another issue that is of paramount importance and needs some clarification is that both regulatory instruments should specify the extent to which disclosure should be carried out under both statutes. This is important because firms that are in default of appropriate disclosure can claim that the disclosure carried out was reasonably sufficient within its capability. This will go a long way in enhancing the provisions relating to negligent misstatements. *Hedley Byrne & Co v Heller & Partners* established the possibility to claim damages for negligent misstatements.[38] It was held that a duty of care could exist where there was an assumption of responsibility, thus creating a special relationship between the parties.[39] Furthermore, section 2 (1) of the Misrepresentation Act 1967 established a statutory right to damages where a person has entered into a contract after misrepresentation has being made to him and as a result suffered loss.[40] Although it can be argued that the provision of section 313 (1) (L) (i) of the ISA caters for this by providing;

> '*The commission may from time to time, make rules and regulations for the purpose of giving to the provision of this Act and may in particular without prejudice to the generally foregoing provisions, make rules and regulations without prejudice to the Companies and Allied Matters Act specifying for the protection of investors;*
>
> *(i) the matters to be disclosed relating to the public issue of securities transfer of securities of public companies and other matters incidental thereto;'*

This thesis argues that the provision highlighted above does not adequately cater for the extent to which disclosure should be carried out. It prescribes that information to be disclosed should involve matters that are '*incidental thereto*'. Giving the ordinary meaning, (information you accidentally come across) this has the propensity to cause problems and can be used to evade liability because it does not give an obligation to seek this information. This thesis recommends that rules should have provisions that

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[38] [1964] AC 465
[39] *ibid*
[40] J. Beatson, A. Burrows, and J. Cartwright, *Ansons Law of Contract,* (30th Edition, Oxford University Press, 2016) 327

explicitly identify what it is attempting to cover as well as be made easily comprehendible. This thesis recommends that such rule be drafted to have similarities with this:

> '…*without prejudice to the provisions of the Companies and Allied Matters Act specifying for the protection of investors:*
>
> *(i) the matters to be disclosed relate to issue of securities, transfer of securities of public companies and extended to information that can influence the decision to invest. Such information should include those that will be reasonably obtainable by adequate due diligence*'.

The above has the propensity to imbibe some caution on parties disclosing to do it carefully and diligently. The above draft shares similar attributes to that provided in the Financial Services and Markets Act 2000.[41]

In 2011, it was announced that 48 firms were suspended from the market for failing to publish annual reports and in 2012 some 72 firms were penalised for not meeting reporting requirements.[42] The emergence of rules regulating the market has led to its subsequent compliance by participants of the market. This is commendable, however, there is room for improvement, which should stir the direction of the SEC and courts towards this direction when the need arises.

Fourth, this thesis recommends the need to provide clearer and concise rules regulating market malpractices such as insider trading. This thesis identified some inconsistencies and insufficiencies in the rules intended at prohibiting this act as provided by the Rules and Regulations of the SEC and ISA.[43] This thesis argued that these inconsistencies are possibly accountable for the inability to protect the market

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[41] FSMA 2000, s. 80 (3)

[42] <http://www.nigerianstockexchange.com/mediacenter/Press%20Releases/Aug%2002,%202011%20-%20Exchange%20Places%2024%20Companies%20on%20Full%20Suspension.pdf> accessed 14 August 2016

[43] Chapter 4

from the act.[44] Insider trading is rife. It is considered more obvious in countries where the laws prohibiting it are lax. This coupled with the lack of knowledge of the act can constitute a disastrous outcome in the future. It is important that the regulations highlighted be updated to contain certain provisions.

The role legal rules and regulations play in the capital market is off paramount importance. It is therefore imperative that the provisions of these rules and regulations be adequate and succinct to aid in the running of capital markets and make it easier to establish liability against defaulters

5.2.2. Enforcement

To achieve an efficient capital market that is operational based on the rule of law, it is important that the legal rules that are enacted to regulate the market are adequately, appropriately and timeously enforced. This has the likelihood to generate a good impact on the market because it is argued that legal and regulatory mechanisms alone cannot protect the interests of shareholders and investors.[45] To propel investor confidence, this thesis proposes adequate enforcement of legal provisions regulating the capital market. For this to be achievable, officers of the law must be willing to enforce the rules in a fair and consistent manner for it to be effective.[46] The difference in the nature and effectiveness of financial systems around the world is held to be traceable in part to the differences in investor protection against expropriation by insiders, as reflected by legal rules and the quality of their

[44] *ibid*
[45] D.Larcker and B. Tayan, *Corporate governance matters*, (2nd Edition Pearson Education Inc, 2016)
[46] *ibid*

enforcement.[47] Furthermore, it is argued that the content of regulation is not as important as the resources directed towards enforcement.[48]

The importance of enforcement cannot be taken for granted as it mitigates agency problems because executives are dissuaded from engaging in behaviours such as insider trading, misleading/falsified disclosure, or fraud because they are aware of the possibility of a real risk of punishments. Furthermore, research indicates that countries with developed securities regulations and legal enforcement mechanisms have a lower cost of capital than countries where these characteristics are absent.[49] Enforcement input is considered to generate output in the form of sanctions imposed on wrong doers as well as serves as a method for dealing with the minority of organisations that do not comply, and as a deterring factor to prevent others from non-compliance.[50]

Enforcement is vital in emerging economies not as integrated as those of advanced economies. When a country's economy is integrated in the international capital markets, the efficiency of those markets can partially make up for deficiencies in the country specific securities regulation and legal system.[51] The intensity of enforcement is crucial to the development of the capital market and may matter more than differences in substantive law.[52]

Enforcement indicates a clear operation of the rule of law in the market as it contributes to investor confidence because management is monitored and property rights are protected. Emerging markets in developing countries are advised to take the

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[47] R. La Porta et al (n 9)
[48] J. C. Coffee, 'Law and the market: The impact of enforcement', (2007) 156 University of Pennsylvania Law Review 229, 242
[49] L. Hail and C. Leuz, 'International differences in the cost of equity capital: Do legal institutions and securities regulation matter?' (2006) 44 Journal of Accounting Research 485
[50] J.C. Coffee (n 48)
[51] *ibid*
[52] *ibid*

issue of enforcement seriously because it indicates some credibility in the system protecting the capital market thereby instilling confidence in investors. This would create a significant difference in the market because their regulatory provisions are currently considered less credible than those of their developed counterparts.[53]

Companies are considered to apply a more conservative accounting approach in countries where enforcement of securities regulation is strong and because regulators are likely to be penalised if, under their watch, there are cases of overstating accounting results and market malpractices, they are likely to be more rigorous in their enforcement.[54] Research indicates that participation in equity markets increases when countries adopt market malpractice laws, such as controlling insider trading, because those laws put outside investors on more even footing with insiders who have access to non-public information.[55] This spawns some caution in companies and likely leads to the effectiveness in its operation. A probable consequence of this is that when companies recognise bad news in their financial reports, they will investigate and report to the appropriate authorities in a bid to avoid regulatory infractions.[56] When enforcement is weak or inconsistent, shareholders avoid the market because of the belief that the official channels may not protect their interests, thus making them seek a more direct role in governance oversight, either through greater rights afforded through the byelaws and charters or through direct

[53] CRA International, 'Assessing the effectiveness of enforcement and regulation', 2009, p 24
[54] J.C. Coffee (n 48)
[55] V. Brudney, 'Insiders, outsiders and informational advantages under the Federal securities laws', (1973) 93 Harvard Law Review 322; L. M. Ausubel, 'Insider trading in rational expectations economy', (1990) 80 American Economic Review 1022, 1041; H.E. Leland, 'Insider trading: Should it be prohibited?' (1992) 100 Journal of Political Economy 859, 870
[56] R. M Bushman and J. D Piotroski, 'Financial reporting incentives for conservative accounting: The influence of legal and political institutions', (2006) 42 Journal of Accounting and Economics 107

representation on the board. Without these tools, they will demand higher returns on capital to compensate for the greater risk of investing their money.[57]

The role of enforcement has gained increased recognition in recent years and its importance has been highlighted by academics and in some instances institutions charged with regulating capital markets around the world. For example, the European Securities Markets Experts (ESME) highlighted the importance of enforcement in the following statement:

> *'There is a concern that without market abuse directives being seen to be implemented (i.e. enforced), abusive practices are continuing. There is little incentive for compliance among general market users where there appears to be a low risk of being caught, which is partly a result of settlements that are not published and where sanctions are light'.*[58]

Furthermore, the FSA has also recognised the effect of enforcement and stated as follows:

> '*Where enforcement is key is where we need to be visible In the market place sending tough messages about wrongful behaviour and imposing sanctions (which does not just mean fines) which are severe enough to have a deterrent effect. We recognize that we need to do enough enforcement cases of the right sort to have demonstration effect to bring about out strategy of credible deterrence'.*[59]

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[57] E. Berglof and S. Claessens, 'Corporate governance and enforcement', in *Enforcement and Corporate Governance: Three views,* Global Corporate Governance Forum, Focus 3, 27-29

[58] ESME, 'Market abuse EU legal framework and its implementation by member states: a first evaluation', (2007) <http://ec.europa.eu/internal_market/securities/docs/esme/mad_070706_en.pdf> accessed 22 February 2017

[59] M. Cole, 'Enforcing financial services regulation: The UK FSA Perspective', Proceedings at the FSA, European Policy Forum, 4th April 2008

In promoting enforcement, there are different activities accessible to regulators that can be implemented as part of their compliance gaining strategies. Strategies based on persuasion, education, and co-operation holds a coercive measure in reserve to handle a minority of non-compliers.[60] A holistic mix of tools employed flexibly in constructive engagement is suggested as an appropriate way forward so long as there is always the real possibility of escalation to tougher measures.

It has been argued that higher enforcement intensity has the likelihood to discourage issuers from entering the market.[61] An example given of such is the United States of America where it is said that enforcement intensity is largely attributable for the decline in competitiveness of the capital market.[62] It is important to differentiate intensive enforcement from overregulation. The former connotes a system where the laws are impermeable and as such a breach of them leads to adequate reparation. The later connotes a system where the provisions are somewhat unattainable. Overregulation is said to be a force that constrains and retards financial development.[63] Whilst this argument is viable and has its merits, this thesis posits that developed countries such as the UK and USA have relatively older markets as well as efficient rules that have built their reputation for years. Furthermore, they have developed their reputational capital and as such entities listed in such markets have no option but to observe the rules. However, this argument is not applicable to developing countries as intensified rules and enforcement have the tendency to attract entities that will adhere to the rules and regulations, which subsequently enhances

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[60] *ibid*
[61] J. M. Mendoza, 'The untapped potential of alternative markets' (2011) 6 Capital Market Law Journal 364
[62] J. C. Coffee (n 48) 230
[63] *ibid*

investor confidence. Furthermore, this can lower the cost of a country's equity capital as well as has the likelihood to attract foreign issuers and investors.[64]

In buttressing the importance of enforcement, the law and finance theory highlighted in this thesis is considered the primary reason some countries have stronger capital market than others.[65] This theory has gained sufficient cognisance in the last decade and arguably has not being discredited. This theory argues that the enforcement variable is the likely reason for the prowess of such countries that have proven to be stronger because of the law and finance theory.[66] This is held out to be the apparent difference in the impact of legal origins on financial development. Furthermore, prioritising private recovery of investors' losses is essential to harness the incentives of market participants to enforce securities law.[67] It is stipulated that an efficient system would provide agents with incentives to collect and present information to investors and would hold them liable if they do not.[68]

In the context of securities markets, a public enforcer can be a securities commission, a central bank or some other supervisory body.[69] However, it has been argued that enforcement may only be effective in countries with efficient government bureaucracies.[70] A related concern is that enforcement may be ineffective if the supervisor of the market lacks adequate resources as enforcement is described to be statistically significant in countries with well-staffed regulators.[71]

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[64] *ibid*
[65] Chapter 2 above
[66] J.C. Coffee (n 48) 232
[67] J. Landis, *The administrative process*, (Yale University Press, New Haven, 1938)
J. Seligman, *The transformation of wall street: A history of the securities and exchange commission and moderate corporate finance*, (Northeastern University Press, Boston 1995)
[68] R. La Porta, F. Lopez-De-Silanes, and A. Shleifer, 'What works in securities laws? (2006) 61 Journal of Finance 10
[69] *ibid*
[70] *ibid*
[71] *ibid*

In enforcing the legal provisions regulating the Nigerian capital market, this thesis proposes a tripartite approach for effective enforcement of the rules and regulations of the market. The proposed system is highlighted below.

a) The first step would be to report to the SEC or relevant law enforcement agency. Such agency should be empowered to carry out preliminary enquiry into such complaints. This enquiry should serve as a method to determine the viability of the case and if it should undergo investigations. This approach will filter out any frivolous and unnecessary claims aimed at wasting the time of the commission. If the commission finds the case worthy of proper investigation, the commission should write to the party/parties involved, informing them of their decision to go further with the case request for further evidence if applicable and give a realistic estimate of how long such investigations will take. Upon carrying out their investigation, it is suggested that the commission utilises the best possible way to resolve the dispute. Furthermore, this thesis recommends the awareness of conducting investigations timeously. In achieving this, the Economic and Financial Crime Commission (EFCC) and Independent Corruption Practices Commission (ICPC) should be utilised. Both bodies are in charge of investigating and prosecuting corruption in Nigeria and as such, it is important that their scope be expanded to the capital market and serve as a means of enforcing the regulations governing the capital market. The foregoing factors are important and have the likelihood to bolster the confidence of investors in the system.

b) The second step would be to report and forward case to the IST. Cases that involve the rights of investors should be heard with candour and promptly without any unreasonable delays.

c) Third, law enforcement agencies should enforce the decision of the court/tribunal against erring market participants.

Whilst this may partially be the traditional system to enforce securities laws, this thesis proposes a stricter approach and significant increase in the amount of resources directed towards enforcing the laws in order to enhance investor confidence in Nigeria. This thesis suggests that with more resources be directed towards enforcement of regulations as it can bolster the confidence of investor in such a market. Paradoxically, this has not been the situation as the handful of reported cases indicates that the SEC does not treat complaints in a timeous manner thus depreciating the confidence of investors further. For example, in an on-going case involving BGL Nigeria, several petitions were brought against the company for failure, refusal and/or neglect to liquidate investments of investors in two companies run by BGL.[72] Although, the eventual suspension of the company from the market by the SEC was applauded, a lingering question in the mind of the individuals is the reason the process was so protracted, as the complaints had accumulated years before. Indeed, it was alleged that more than forty petitions were filed with the SEC against the company before the SEC eventually acted.[73] Several reasons can be attributable to this, such as the fact that the managing director of the company at that time was the president of the chartered institute of shareholders in Nigeria and as such possessed the required connections to block any investigation from going forward.

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[72] G. Eugene, 'Okumagba, Edozien get 20 years ban from capital market activities', Thisday Newspaper, 27 May 2016, <http://www.thisdaylive.com/index.php/2016/05/27/okumagba-edozien-get-20-years-ban-from-capital-market-activities/> accessed 15 June 2016

[73] T. Opeseitan, 'BGL crisis indicts SEC, NSE- Experts', (*All Africa* 26th April, 2015) <http://allafrica.com/stories/201504270339.html> accessed 15 June 2016

This thesis recommends adequate enforcement of rules that concern the capital markets because of the sensitive nature of its trade. Taking an example from cases that have to do with the Investor Protection Fund in Nigeria,[74] it is arguable that the application of the Fund has been inadequate. In *Ezemgbe v Nigerian Stock Exchange*[75] the investor claimed 3.7 million Naira but was awarded 200, 000 Naira because of the cap placed by Nigerian Stock Exchange Investor Protection Rules 2007. Although, there is no cap in the current Investor Protection Rules 2013, it provides that the board in a written policy will determine such amount.[76] This thesis asserts that this is not encouraging as compensation ought to restore the aggrieved person to his former position or so near it and as such it should be prescribe a figure that will potentially be sufficient to cater for investors' losses.

For effective enforcement of the regulations governing the capital market, this thesis submits that the SEC, Courts, law enforcement agencies must work efficiently and credibly to achieve the best results, which can enhance the confidence of investors in the capital market. The next section highlights the role of the SEC, and other law enforcement agencies with the aim of identifying reasons for their presumed lacklustre performance. Furthermore, it highlights possible reforms that can make them achieve operational efficiency.

5.2.3. Securities and Exchange Commission (SEC)

The Nigerian Securities and Exchange Commission is the apex regulatory institution of the Nigerian Capital Market. The provisions of the Investment and Securities Act

[74] For discussion on the IPF; Chapter 1, 1.2.5
[75] Unreported suit No. IST/OA/06/06 decided by the Investments and Securities Tribunal in 13th December 2006
[76] Nigerian Stock Exchange Investor Protection Fund Rules 2013, r.4.04

2007, establishes the commission and the Federal Ministry of Finance supervises it.[77] In regulating the market, the SEC utilises different activities that are aimed at protecting investors and market operators as well as guarantees that the market operates with utmost integrity. It is empowered by the ISA to register securities and market intermediaries to ensure that only fit and proper individuals can operate in the market.[78] In performing its duties, it carries out inspection on capital market operators to ensure that they adhere to common practices as well as ensure that they are not involved in fraudulent activities. At regular intervals, the commission requests for information from capital market operators to ensure they are operating efficiently and within the ambit of the law.[79] The SEC carries out surveillance over exchanges and trading systems to forestall breaches of market rules as well as deter and detect manipulations and trading practices that can cause market disruption.[80]

Typically, the SEC, by its provisions identified above, ought to be the first point of call when there is an issue arising from or during the course of a transaction. However, historical trends and recent occurrences in the market indicate that while the SEC is the regulatory compliance tool of the capital market, it has not performed this function adequately. The SEC has been described as lax in carrying out its investigatory functions and taking an example from the BGL case highlighted earlier in this chapter, it is evident that this assertion is confirmed as it is reported that different formal complaints and petitions were made to the commission, however, it was years later before any major step was taken.

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[77] ISA 2007, s. 1 (1)
[78] *ibid* s. 13 (a-d), (g-1), (m), (o), 28 (1)
[79] <http://sec.gov.ng/about/what-we-do/#tab-what-we-do> accessed 28 June 2016
[80] *ibid*

In carrying out their functions, the Commission is empowered to summarily sanction an erring operator or other regulated entity.[81] In according such sanctions, they are empowered to appoint one or more committees on its behalf to execute such function as determined by the Commission.[82] One of such committees enacted for enforcing the regulations of the capital market is the Administrative Proceedings Committee (APC). It is a quasi-judicial arm through which matters provided for in the ISA are heard. It hears matters between capital market operators and institutions as well as considers if they have violated or attempted to violate the provisions of the act or rules and regulations.[83] It also creates the possibility to negotiate settlement and is empowered to impose some administrative sanctions listed in rule 601 of the Rules and Regulations of the SEC. The SEC confirms the decision of the APC.[84] Furthermore, the APC levies penalties and administrative costs of proceedings as contained in the ISA.[85] This thesis proposes a more adept approach by the SEC in performing its functions because it occupies a strategic position in the Nigerian capital market and can serve as a medium to enhance investor confidence.

5.2.4. **Investment and Securities Tribunal (IST)**

The ISA was enacted in 1999 to promote a more efficient and virile capital market that is pivotal to meeting Nigeria's economic and development aspirations based on the recommendations made by the Dennis Odife Committee.[86] One of the

[81] Rules and Regulations of the SEC, 2013, s.598
[82] ISA s. 14, 310
[83] (n 81) s.599 (1)
[84] O. J Ikwunasi and A. Oguekwe- Adaeze, 'The investment and securities tribunal: A case for the division of the Federal High Court into specialized divisions', Available at SSRN <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2712448> accessed 1 July 2016
[85] *ibid*
[86] The committee was set up in 1996 to review the Nigerian capital market and one of the issues given to the committee was to deliberate on the possibility of setting up an appropriate informal judicial form within the capital market for prompt determination of any question, dispute or controversy that may arise between the institutions in the Nigerian capital market or market operators generally

recommendations of the committee was the establishment of the Investment and Securities Tribunal (IST) to be responsible for the adjudication of disputes emanating from the capital market in a speedy, informal and business-like manner.[87] Its enactment was as a result of the perceived philosophical standpoint that the administration of justice in the capital market required to be responsive to the needs of litigants above all else.[88] It is considered a fast-track medium for the resolution of capital market disputes, and is deemed for all intents and purposes to be a civil court.[89]

The IST is conferred with exclusive jurisdiction over disputes arising under the ISA. The ISA also confers the IST with appellate jurisdiction in relation to disputes between capital market operators. Appeals from the decisions of the tribunal are to lie in the first instance with the Federal High Court and thereafter with the Court of Appeal and subsequently the Supreme Court.[90]

The tribunal combines the rule of law applicable in traditional courts with the responsiveness, flexibility, speed and cost effectiveness associated with specialised courts and ADR systems.[91] The IST is empowered to enact rules regulating its procedure, however, for the purpose of discharging its power under the ISA, it is empowered to carry out a variety of functions such as summoning, receiving evidence, call for examination of witnesses, reviewing its decisions, and do anything that is within its power or ancillary to its functions under the Act.[92]

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[87] B. Ajibade and D. Ogunmuyiwa, 'Capitally complex', (*Commercial Dispute Resolution*, 5th November 2013) <http://www.cdr-news.co.uk/article-tags/nigeria/4556-capitally-complex> accessed 1 July 2016
[88] D. C. John, 'A critical appraisal of investment and securities tribunal in Nigeria', (1995) 1 University of Ibadan Journal 1
[89] ISA 2007 s.290 (3)
[90] B. Ajibade and D. Ogunmuyiwa (n 87)
[91] D.C. John (n 88)
[92] ISA, s.290 (1)-(2)

The tribunal has specialised knowledge of the capital market due to the presumed technical and operational skills of its members and staff that is applied when deciding cases before it as against what is obtainable in regular courts that are manned by judges who may not possess the cognate experience skills in capital market issues.[93] It has a three-month period to deliver judgment in a matter before it. This time frame is constrained because of the sensitivity of the capital market and the grave damage that a lapse of time can cause to investors. The tribunal also has appellate jurisdiction over actions or decisions from the APC.[94] Judgment from the tribunal is registered and enforced as if it is a judgment of the Federal High Court.[95]

The establishment of the IST has generated some concerns. These concerns are identified in turn.

It has been argued that the regulation of the IST as contained in the ISA implies that the decision of the tribunal is that of the Federal High Court thus obviating the need for an appeal to the Federal High Court since it cannot sit on appeal over its decision.[96] The establishment of the tribunal does not make it a department of the Federal High Court neither does the Federal High Court Act 1973 provide for anything in this regard, therefore, it is argued that the tribunal ought to be considered independent of the Federal High Court.[97] Furthermore, the argument over the jurisdiction of the IST and the Federal High Court as highlighted above is still an issue litigants' face. The issue concerning the jurisdiction to hear capital market disputes generate some confusion given that the provisions of section 284 (1) of the ISA and 251 (e) of the CFRN 1999 are contradictory. In the case of *SEC v Kasunmu*,

[93] B. Ajibade and D. Ogunmuyiwa (n 87)
[94] ISA 2007 s.289 (1)
[95] *ibid* s.293
[96] D.C. John (n 88)
[97] *ibid*

it was held that any Act of parliament that is inconsistent with the provisions of the constitution is void to the extent of such inconsistency.[98] The constitution was held to be the grundnorm of the country and supreme law to all other legislation as indicated in section 1 (1) of the Constitution of the Federal republic of Nigeria 1999.[99] In *Okeke v SEC* it was held that the jurisdiction conferred on the Federal High Court under section 251 (1) (e) and (r) cannot be whittled down or taken away by an ordinary Act of the National Assembly, in the absence of any amendment to the provision in question.[100] Moreover, the CFRN also provides that any other law that is inconsistent with its provision is void and the constitution shall prevail to the extent of the inconsistency.[101] This uncertainty in jurisdiction could be capitalised on by litigants and might make the tribunal ineffective. This thesis postulates that a major consequence of this is the detrimental effect it has on the capital market, as investors do not believe in the system thus hindering the growth of the development of the securities market.

Another issue that is of concern is the fact that the IST has not sat in the last 18 months due to prolonged delay in the reconstitution of the boards of ministries, departments and agencies that were dissolved on the 16th of July 2015 by the Federal government.[102] It is reported that the efforts to make the Federal Government realise the strategic importance of the tribunal to the national economy and the need for the reconstitution of its membership and reiterate its status as a civil court and not a board

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[98] (2009) 10 NWLR 509
[99] *ibid*
[100] (2012) 10 NWLR 1307
[101] Constitution of the Federal Republic of Nigeria 1999, s. 1 (3)
[102] K. Ugwuede, 'Reps decry absence of Investment and Securities Tribunal, board' *Business Day* (Nigeria, 15 March 2017) <http://www.businessdayonline.com/reps-decry-absence-investment-securities-tribunal-board/> accessed 22 March 2017

has yielded no positive results.[103] Inevitably, this affects the role of the tribunal as the capital market adjudicator through which disputes are resolved and can reduce the confidence of investors as there is no way to resolve disputes if any arises.

Although tribunals are considered to consist mainly of experts in particular fields, which in this case ought to be capital market related, it however, has to conform to the grundnorm i.e. the constitution for it to be viably accepted. It was stated by Hon. Justice Ogunwumiju J.C.A:

> "*There is no doubt that to ensure speedy disposition of certain genres of cases, the National Assembly had thought it fit to create specialist tribunals, however, such creation must conform with the constitution. Under the inconsistency rule, the validity of any law or act is determined by its consistency"*.[104]

The impact of an uncertain medium for the resolution of disputes is a great hindrance to investment. It was stated:

> "*it might interest you to note that one of the earliest opinions of foreign investors typically seek from commercial lawyers is the dispute resolution architecture available in the country and any uncertainty in this might dampen the investment appetite for any given country, hence the need to resolve any uncertainties in our laws"*.[105]

[103] *ibid*
[104] *Nospecto Oil & Gac Ltd v Olorunnimbe* (2011) CA/L/474/11
[105] D.C. John (n 88)

5.2.5. The rule of law: personnel

A major hindrance to the smooth operation of rule of law is the enforcement of legal provisions through the judicial system which is described as severely run down with their current form not offering a reliable basis for dispute resolution, protection of participants in the capital markets as well as property rights and enforcement of contracts.[106]

The importance of the judicial system cannot be ignored, particularly in the role that they play in the survival of a capital market because there is the propensity for a capital market to fail if the judicial system does not function effectively in enforcing the rules aimed at supervising activities of the capital market, and discharge its role in punishing offenders. It has been argued that if there is no efficient judicial system, organised crime, extortion, bribery etc. will be the reigning corporate model.[107] In view of this, this thesis recommends that the legal/judicial framework be strengthened in its aim to credibly protect investors.[108]

There are allegations of practices of market abuse such as insider trading, manipulations of annual accounts, deliberately withholding share certificates in the Nigeria capital market.[109] These crimes are committed in the market irrespective of the availability of several regulatory institutions and measures enacted by the Nigerian government for proper management of the market with a view of protecting investors from losing their funds.[110]

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[106] Unleashing Africa's private sector: A key to shared growth (n 16)

[107] D. J. Amy, *Government is good: an unapologetic defense of a vital institution*, (Dog Ear Publishing, 2011) 122

[108] S. Naya, and M. Plummer, *The economics of the enterprise for ASEAN initiative*, (ISEAS Publication, 2005) 248

[109] A. Aliyu, 'The nature and prevention of corporate crime in Nigeria's capital market', (Unpublished master's thesis) Bayero University, Kano, Nigeria, 2011

[110] A. Aliyu, 'Managing capital market crimes: the role of Nigeria's Securities and Exchange Commission', (2014) 19 Journal of Humanities and Social Science 57

For a capital market to attain its full potential, it is important that it is governed by the rule of law. For this to be attainable, it is imperative that the personnel/officers be adept and upright in handling their role of upholding the rule law.[111] This thesis highlighted prevalent ignorance of capital market operations as well as corrupt practices evident in the Nigerian judiciary, members of the capital market and the public. When dealing with cases involving investing in the capital market, the function played by judges both at the IST and the Federal High Court are of paramount importance in upholding the rule of law. Judges in carrying out their duties of interpreting statutory provisions, hearing cases, giving rulings and judgment of cases before them must be proficient to enable the rule of law prevail without any obstruction by corrupt practices.

In performing these duties, it is imperative that judges are knowledgeable to enable them uphold decisions that are justiciable. In view of this, this thesis proposes the practice of appointing members of the IST be based on merit. Section 275 of the ISA prescribes that the individual that chairs the tribunal should be a legal practitioner with no less than 15 years cognate experience in capital market matters. However, presently this is not the practice as the Chairman/ Chief Judge of the tribunal worked as a director of public prosecution before becoming the Solicitor General of Abia State in Nigeria and subsequently working as the acting registrar for the corporate affairs commission. There is no evidence to indicate or suggest that she has any experience with the securities matters.[112] Given the temperament and complexities of the capital market, it is important that individuals with experience in capital market matters be employed to occupy such strategic positions because s/he has understanding of how the system works and the importance of conducting cases

[111] G. O'Donnell, 'Why the rule of law matters', (2004) 14 Journal of Democracy 35
[112] <http://www.iaca.ws/ngozi-chianakwalam.html> accessed 22 March 2017

timeously.[113] The practice of appointments made based on favouritism and nepotism should be abandoned with the aim of appointing individuals with the requisite experience.

Additionally, it is imperative that judges seek continuous education and training. This is particularly so in light of the evolvement of the market, the digitalised and technological innovations that are developing rapidly. To address this, it is necessary for there to be constant training of judges aimed at keeping them abreast of the different ways offences can be committed and keep them well informed of any innovations in the securities world. Training should also extend to markets participants and to the members of the Nigerian bicameral houses charged with making rules and regulations for the capital market. With adequate training, such individuals will acquire the required understanding in the innovations with capital markets around the world, thus equipping them with adequate knowledge and appreciation to enact suitable rules that will govern capital market operations.

Another issue that is of primary concern to individuals that rely on the judicial system generally is the time frame within which cases are instituted to its completion date. The typical timeframe from institution to conclusion of an action in Nigerian courts is two to three years and in some instances extend as long as fifteen years.[114] This thesis argues that delay in hearing cases that emanate from the capital market has a negative effect on investors and has the likely effect to make them avoid the market because of the belief that if anything goes wrong, they cannot rely on the

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[113] J. Agbonkhese, 'My greatest desire is to take this tribunal to the grassroots: Dr Ngozi Chianakwalam, Chairman IST', *Vanguard* (Nigeria, 24 January 2016) <http://www.vanguardngr.com/2016/01/my-greatest-desire-is-to-take-this-tribunal-to-the-grassroots-dr-ngozi-chianakwalam-chairman-ist/> accessed 8 April 2016

[114] Strachan Partners, 'Effects of appeals on course of trials', <http://www.mondaq.com/Nigeria/x/309008/trials+appeals+compensation/Effect+Of+Appeals+On+Course+Of+Trials> accessed April 9th 2016

courts/tribunal to hear the case timeously.[115] The reasons for delay are usually attributed to judges not appearing in court daily or in some instances they appear but do not address the underlying issues timeously.[116] Furthermore, some lawyers bring irrelevant applications before the court with the aim to cause some delay and frustrate the other party.[117] This practice should be discouraged in cases involving securities market and investors. Delay in deciding cases has the likelihood of frustrating investors and make them avoid the capital market. The fact that the Nigerian judicial system is known for delay in cases has developed lack of confidence in the system. In this instance, it would apply to cases in the IST and Federal High Court. This thesis recommends granting of adequate costs in a bid to eradicate delay tactics. Judges in Nigerian courts usually give meagre sums as costs/fines. This inevitably makes it easier for desperate litigants to employ delay tactics because even with the delay, the amount they are likely to pay as costs is little. It has been recommended that courts should strive to exercise its power to award costs properly, which can discourage irresponsible litigation.[118] Furthermore, litigants utilise frivolous applications as delay tactics in Nigeria. This problem is further compounded by the fact that judges adjourn for a long period (two-six weeks, sometimes longer) before they hear such applications and a further two to six weeks to give their ruling on such applications. This thesis proposes the need for such applications to be heard expeditiously and

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[115] H. Oji, 'Shareholders flay delays in dispensing capital markets cases', *The Guardian Newspaper* (Nigeria, 14 June 2015) <http://guardian.ng/business-services/shareholders-flay-delays-in-dispensing-capital-market-cases/> accessed 9 April 2016

[116] T. Maiwada, 'Dealing with delayed justice syndrome', *Dailypost* (Nigeria, 30 January 2014) <http://dailypost.ng/2014/01/30/dealing-delayed-justice-syndrome/> accessed 9 April 2016

[117] Y. Abdulsalam, 'Justice delayed is justice denied', *National Review* (Nigeria, 2 February 2015) <http://www.nationalreview.ng/component/k2/item/769-justice-delayed-is-justice-denied.html> accessed 9 April 2016

[118] R. Oladimeji, 'High court judges who make conflicting orders should be punished: Prof Fidelis Oditah QC, SAN', *Punch Newspaper* (Nigeria, 11 August 2016) <http://punchng.com/high-court-judges-make-conflicting-orders-punished-oditah/> accessed 23 March 2017

rulings given on the same day, thus creating the possibility of attaining the three months limit as prescribed by the ISA.

This thesis submits that an efficient judicial system known for hearing cases promptly and giving judicious judgments will enhance the confidence of investors. Additionally, in carrying out their duties, judges should employ different orders available to them. They should appreciate the use of freezing orders and subpoenas to enable cases go on easily and unobstructed. However, in utilising these orders, the courts should employ some caution so as not to create difficulties for a company's business.

Lawyers also have a substantial role to play in ensuring the rule of law is upheld in relation to capital market transactions. They have a duty to ensure that they carry out the instructions of their clients diligently and honesty. This necessitates the need to be sufficiently informed of any innovations and relevant provisions when seeking for any order of court. In performing their duties, lawyers should also seek to ensure that they are operating within the ambits of the law and not acting illegally. They should dissuade their clients against engaging in acts that will lead to breaking the law.

These issues highlighted in the preceding sections have the propensity to improve the operation of rule of law in the Nigerian capital market as well as lead to achieving an efficient capital market. The next section highlights the importance of awareness amongst the Nigerian inhabitants of capital market operations to make the market attain some efficiency.

5.3. Awareness

One of the reasons the Nigerian capital market is described as illiquid and lacking depth is because of lack of awareness of capital market operations and protection accorded to investors who participate in the market. The individuals aware of the market and its operations are sometimes not aware of the protection accorded to investors because of lack of enforcement of the regulations. A major consequence is that a substantial amount of the Nigerian population eschews the capital market.[119] The need for awareness/enlightenment is not limited to outsiders because operatives of the markets are sometimes not aware of sharp practices corporations exploit in an attempt beat the system. This issue is worsened by the fact that the individuals charged with detecting such practices are sometimes not aware of their occurrence or do not know how to detect it.[120]

This thesis recommends continuous training for capital market operatives to keep them abreast of the innovations associated with capital markets as well as how markets are to be operated efficiently. This has the propensity to curb the practices of individuals or corporations attempting to perform illegal acts in the market. Furthermore, such training should be mandated for brokers and advisors because they are driving force behind new products and innovations and to carry out such functions, they must continually engage and update their knowledge of the ever-evolving global capital markets. In relation to market operatives, there appears to be an information asymmetry within the industry in relation to what training or certification is available and or required amongst investment professionals. This is considered to influence investor confidence in the market because the advice of investment managers and stockbrokers in some instances contribute to adverse

[119] This is partly accountable to the fact that investors are afraid of investing and losing their money.
[120] Chapter 4, 4.3.2

fluctuations in the pricing of securities due to lack of broker knowledge.[121] Additionally, this thesis proposes the need for market operatives to be well apprised with the regulatory provisions governing the market aimed at promoting efficiency in the market and protecting investors. Thus giving them the expertise to advise to investors if need be.

There are traces of market growth initiatives in the Nigerian capital market such as the certification of investment advisors provided by the Chartered Institute of Stockbrokers, FMDQ in conjunction with Financial Market Dealers Association (FMDA) developed a financial market competency framework, which is aligned with the Central Bank of Nigeria's competency framework. However, it is arguable that they have not being effective because there are still traces of market malpractices that are hindering the Nigerian capital market from attaining its full potential and research indicates that market operatives are unaware of market abuse such as insider trading operating in the capital market.[122] There is the need for adoption of a more cohesive industry wide approach.

This thesis proposes the need to mandate such training and failure to complete such training should lead to suspension of such a broker or advisor pending when they get the required training. Furthermore, for individual brokers and advisors that do not obtain the required training and subsequently handles clients that eventually loses some money or there is the occurrence of an unforeseen circumstance, there should be severe punishments accorded to such persons especially when it is evident that this loss or unforeseen circumstance could have being avoided if he had the appropriate training. Additionally, this thesis proposes the use of punishments such as suspension,

[121] S. Kiyingi and E. Uwaifo (n 23) 58
[122] W. Bewaji, *Insider trading in developing jurisdictions: Achieving an effective regulatory regime,* (Routledge, 2012)

expulsion and fines for lack of the required training. Taking an example from the United Kingdom, the Financial Conduct Authority through their training and competence regime ensures that market operatives are well equipped by ensuring that the financial services workforce is qualified and well regulated.[123] The regime provides a list of appropriate qualifications for firm activities, services, as well as level of qualification, which is prescribed through examination standards.[124] It operates a two-tier system where both individuals and firms maintain their competence through training as well as meeting the required standard of behaviour. An accredited body sometimes grants these qualifications. For example, investment advisers obtain specific level of annual continuous professional development and they are granted annual statement of professional standing. Firms on the other hand are required to meet the competence requirement in **three** principal areas; assessing competence, maintaining competence, keeping records.[125] The duty is placed on the individual to get the appropriate certification within thirty months but on the firm to assess the employee's competence that is defined as having the skills knowledge and expertise needed to discharge the responsibilities of an employee's role.[126]

In addition to the above, the Nigerian capital market should provide a mechanism that potential investors can be adequately informed of their operations as well as how they are protected if they invest. Currently, there are nine trading centres for the Nigerian capital market as listed on the website of the NSE, which has led to the presumption that the capital market is only available to occupants of that part of the country.[127] This is not encouraging as there are other individuals that are interested in investing the market, but not within the trading zone. Inevitably this will

[123] <https://www.handbook.fca.org.uk/handbook/TC/2/1.html> accessed 12 August 2017
[124] *ibid*
[125] *ibid*
[126] <https://www.handbook.fca.org.uk/handbook/TC.pdf> accessed 12 August 2017
[127] < http://www.nse.com.ng/about-us/contact-us> accessed 12 August 2017

discourage people as well as make the market to be viewed as elitist.[128] In view of this, this thesis recommends that the SEC in collaboration with market operatives should aim to communicate to potential investors the possibility of trading in the capital market from where they are situated, in some instances via online provisions. Furthermore, the SEC and market participants should be open to the idea of trading through modern technology to bring members and dealers together so as to enable them trade with one another electronically rather than on a trading floor. The use of modern technology could facilitate a more transparent, rapid and disciplined trading.[129] This has the potential to diversify the people who will be trading in the market thus providing more investors and liquidity.

Another issue that can be linked to the issue of awareness is the fact that participation of domestic retail investors in the Nigerian capital market is not as large as it should be because retail investors believe the best securities are those that pay dividends. Consequently, they buy and hold securities in order to receive dividends. As at 2015, retail participation in the Nigerian capital market stood at 66% compared to 34% participation by institutional investors.[130] This is bad for the market as well as investors because in limiting investments to dividend paying companies, they miss out on investing in a wider pool of potentially valuable stocks. This thesis recommends training of market operatives be made mandatory to make them well informed of relevant developments both in the regulation of the market and products. This will further enhance investor confidence as they can give investors succinct advice and recommendations based on the knowledge they have amassed.

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[128] W. Bewaji (n 122) 159

[129] S. Gurusamy, *Capital markets,* (2nd Edition, Tata McGraw-Hill Education Private Limited, 2009) 350

[130] NSE report on domestic and foreign portfolio participation in equity trading, January 2015

This thesis proposes the collaboration between the SEC and market operators to spearhead a retail investor education campaign that focuses on communicating issues to consider when investing in capital markets as well as inform them of the protection accorded to them by virtue of legal provisions in an attempt to make them invest. Additionally, online trading platforms and the use of other innovative technologies should be encouraged. This goes without highlighting the fact that the SEC should to develop rules governing online trading platforms and other innovative technologies that may provide retail investors with access to the capital markets. At minimum online trading platforms should ensure the provision of live price feeds, up to date market research and access to collective investment schemes and mutual funds.

Whilst determining the issue for awareness, it is important to note that the awareness campaign has to be developed from the root. Rules in Nigeria are developed at the bicameral chambers. For one to enact rules that are credible enough to protect capital market operations, it is important that individuals promoting such a bill that subsequently becomes a law appreciate the importance of enacting laws that are impermeable. History indicates that both at the lower and higher bicameral houses, the individuals accorded with the duty to head capital market committees are individuals with no relevant or previous experience in the capital market.[131] The current government of Nigeria was inaugurated in May 2015. Presently, the individuals heading the capital market committee both at the senate and Federal House of Assembly are individuals with no record to indicate that they have any experience in capital market operations.[132]

[131] Chapter 4, 4.3.2
[132] *ibid*

Given the profiles of such individuals leading the committee for capital market, it is arguable that they may not appreciate the importance of enacting substantial legal provisions that will tackle problems as they arise in the capital market. In the bid to ensure efficient rules governing the capital market, it is important that individuals with the adequate qualifications and expertise are placed to head such committees. Although, an argument has been put forward that the idea is to give everyone equal opportunity to participate in the Federal House of Assembly and Senate. This thesis refutes this argument because individuals that are nominated to head such committees are usually appointed based on favouritism and they usually lobby for the juicier committees that can accord them some benefits. Furthermore, and in alternative to the foregoing, this thesis recommends adequate consultation with professionals that possess the requisite training, qualification and experience to advise them appropriately to guide them in enacting rules that will be beneficial as well as enlighten them on the likely innovations going on around the world.

Other than the emergence of appropriate regulations and adequate enforcement and provision of awareness of capital market operations, another factor that should function efficiently is the operation of corporate governance to guide companies in their day-to-day affairs.

5.4. Corporate governance

Corporate governance has been described as the system through which companies are directed and controlled.[133] It is comprised of formal and informal institutions, laws, values and rules that generate the menu of legal and organisational forms available in a country, which in turn determines the distribution of power, how ownership is

[133] A. Cadbury, *Report of the committee on the financial aspects of corporate governance*, (London, 1992) para 2.5

assigned, managerial decisions are made and monitored, information is audited and released as well as how profits are allocated.[134] It is more or less the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment.[135] The assurance provided by corporate governance is a major determinant when investors are making the decision to invest.[136] It is also described as a set of relationships between a company's management, its board, its shareholders and other stakeholders. This relationship is developed through the provision of a structure that identifies the objectives of the company and the way the objectives can be attained through monitoring performance.[137]

The rules apply to specific financial markets and organisational forms that establish the discretion of parties that possess control, rights and information as well as mechanism at their disposal to choose management, propose or confirm major strategic decisions and to determine the distribution of remuneration and profit.[138] Corporations adopt this mechanism in a bid to prevent or dissuade potentially self-interested managers from engaging in activities that are detrimental to the welfare of shareholders and stakeholders.[139]

The system consists of a board of directors that oversee management and an external auditor that gives its opinion on the reliability of financial statements. Corporate governance is applicable to the capital market, as the corporate players need to be put in check so as not to engage in activities that are injurious to the

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[134] P. K Cornelius and B. Kogurt, *Corporate governance and capital flows in a global economy*, (Oxford University Press, 2003) 3
[135] A. Shleifer and R.W. Vishny, 'A survey of corporate governance', (1997) 52 Journal of Finance 737
[136] F. Haque, T. Arun and C. Kirkpatrik, 'Corporate governance and capital markets: a conceptual framework', (2008) White paper, Heriot-Watt University
[137] Organization for Economic Co-operation and Development, 'OECD principles of corporate governance,' 2004 14 <http://www.oecd.org/corporate/ca/corporategovernanceprinciples/31557724.pdf accessed 8 May 2016
[138] *ibid*
[139] D. Larcker and B. Tayan, (n 79) 7

market.[140] It is considered to be at the nub of financial markets development, and research has indicated that emerging markets that improve corporate governance are likely to experience greater equity valuation.[141] Furthermore, research on corporate governance around the world has established a number of empirical findings, amongst which is the fact that diverse elements of countries financial systems such as the breadth and depth of their capital markets, the pace of new security issues, corporate ownership structures, dividends policies and efficiency of investment allocation appear to be explained both conceptually and empirically by how well the laws in these countries protect outside investors through the operation of corporate governance.[142]

The importance of a fully functional corporate governance regime that is operational in a capital market cannot be taken for granted. Some benefits that corporate governance bestows on capital markets are highlighted in turn below.

First, better corporate governance standards play a significant role in helping the world's newest market economies realise their full economic potential through economic enterprise and not state directed enterprise.[143]

Second, corporate governance is considered a major factor that conduits success to stock performance as evidence indicates that companies that engage in shareholder friendly features outperform companies that do not.[144]

Third, it provides shareholders and the public with reliable reports and financial information as well as ensures that decisions incorporate the best interests of

[140] O. A, Akinpelu, 'Corporate governance framework in Nigeria: An international review', (2012) iUniverse 262
[141] *ibid*
[142] R. La Porta, et al (n 68)
[143] P. K Cornelius and B. Kogurt, (n 134) 7
[144] O. A. Akinpelu, (n 140) 262

all shareholders whether majority or minority shareholders.[145] Furthermore, it ensures that rights, assets or resources will not be siphoned from shareholders unfairly or unequally.[146]

Fourth, it has been argued that legal compliance and voluntary activism in corporate governance can reduce the expropriation costs in governance process and partly compensate for the inefficiency in the institutional arrangement in a developing economy.[147]

Fifth, with better firm level corporate governance there is reduction in agency costs and enhanced investor optimism in the firm's future cash flow and growth prospect. Furthermore, better investor protection and lower expropriation by controlling shareholders gives outside investors the incentive to invest more and generates willingness to pay a premium for a well-governed company's shares in the hopes that more of the firm's profits would come back to them as interest or dividends.[148]

Sixth, it has been advanced that apart from the systematic risks, corporate governance is an additional risk factor that investors require than higher expected returns.[149] Furthermore, it has been argued that the effectiveness of the capital market in influencing the rate of return is more likely to be constrained by the critical issues of transparency and disclosure.[150]

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[145] R. La Porta, et al (n 68)

[146] B. R. Cheffins, 'Does law matter? The separation of ownership and control in the United Kingdom', (2001) 30 Journal of Legal Studies 459

[147] L. F. Klapper and I. Love, 'Corporate governance, investor and performance in emerging markets', (2004) 10 Journal of Corporate Finance 723

[148] R. La Porta, F. Lopez- De- Silanes, A. Shleifer, and R. Vishny, 'Investor protection and corporate valuation', (2002) 57 Journal of Finance 1147; P. Coombes and M. Watson, 'Global investor opinion survey2002: Key findings', Mckinsey & Co, 2002 <http://www.eiod.org/uploads/Publications/Pdf/II-Rp-4-1.pdf> accessed 8 May 2016

[149] M. Pagano and P. F. Volpin, 'The political economy of corporate governance', (2005) The American Economic Review

[150] P. K Cornelius and B. Kogurt, (n 134)

The legal system of a country outlines the corporate governance structure in relation to the rules of ownership, board structure, liquidation and shareholders rights.[151] Legal protection of a firm's external financiers in developing economies is regarded to be low because of the differences in interpreting legal systems and poor enforcement.[152] Furthermore, the effectiveness of pricing mechanisms in capital markets have being linked to corporate governance as it has being described that the pricing of securities in developing economies remain rudimentary because of poor corporate governance associated with transparency and disclosure.[153]

Corporate governance reform in emerging markets has recently become one of the most discussed topics in financial circles. Academics, business personnel, investors, economists and policy makers are eager to help emerging markets improve their standards of corporate governance because countries around the world have at some point had issues of ineffective corporate governance practices.[154] Formal legal and regulatory obligations are part of the external incentive structure designed to ensure that competing companies abide by common standards of fairness, transparency, accountability and responsibility to protect shareholders, consumers, workers and environment and even competitors from abusive practices. In highlighting the importance of corporate governance, it was asserted that a good legal and regulatory framework would efficiently address the entry operations and exit of firms into a capital market.[155]

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[151] K. Gulger, D. C. Mueller, and B. B. Yurtoglu 'The impact of corporate governance on investment returns in developed and developing countries', (2003) 113 The Economic Journal 516
[152] *ibid*
[153] S. Claessens, and L. Laeven, 'Financial development, property rights and growth', (2003) 58 Journal of Finance; R. Morck, B. Yeung, and W. Yu, 'The information content of stock markets: Why do emerging markets have synchronous stock price movements? (2008) 58 Journal of Financial Economics 215
[154] A. Shleifer and R. W. Vishny, (n 135) 737
[155] *ibid*

The Nigerian capital market has historically been underdeveloped and corporate governance has played little role in its processes. The small size of the capital market combined with the ownership structure entails that a threat of takeover has no effect in disciplining management and protecting minority shareholders' rights. This highlights the failure and or ineffectiveness of governance structure in the market. This thesis highlighted some issues that are problematic in the Nigerian capital market ranging from disclosure, to market abuse such as insider trading etc. This thesis argues that poor corporate governance structure is largely accountable for the emergence of these problems, which subsequently hinders the smooth operation of the capital market as well as hinders it from being efficient.

Historically, corporate governance was foreign to the indigenous customary business practices of the pre-colonial Nigeria.[156] This thesis argues that corporate governance has not achieved its full potential because of certain practices that are engaged by corporations in Nigeria. For example, family members occupy strategic and important positions in Nigerian corporations. Family dominance in a corporation is held out to be a major constraint in developing economies.[157] The consequence of this includes weak incentives to improve disclosure and governance, poor protection of minority shareholders as well as weak accounting standards and practices, which obstructs the operational efficiency of a corporation.[158]

Furthermore, managers and directors are known to utilise corporate opportunities and resources for their own personal benefit at the expense of the

[156] E. Samuel, 'Corporate governance and Nigeria capital market development', [website], November 2012, <http://thecolloq.blogspot.co.uk/2012/11/corporate-governance-and-nigeria.html> accessed 15 June 2016

[157] E. Berglof, 'The changing corporate governance paradigm: Implications for transition and developing countries', (Conference paper, Annual World Bank conference and Development Economics, 29th September 1999

[158] P. Alba, S. Claessens and S. Djankov, 'Thailand's corporate financing and governance structures: impact on firm's competitiveness', Proceedings of the conference on Thailand's dynamic economic recovery and competitiveness, 2006

corporation and its shareholders. This is a clear indication of corporate governance not operating efficiently in the market. Taking an example from the BGL case and the Lever Brothers Nigeria case highlighted in the earlier chapter of this thesis, both cases illustrate examples of the effects of poor governance and commentators have argued that these cases were further compromised by the inability of regulatory bodies to monitor the activities of listed companies.[159] Issues such as board appointments, senior management positions, and in some instances, lower cadres of appointment are often based on political connections, ethnic loyalty and or religious faith as opposed to consideration of professional qualification and experience.

The evolution of corporate governance in Nigeria was as a result of various corporate failures and the country gaining independence from prolonged military regime in a new democratic administration, which necessitated the need for a policy capable of attracting new and sustainable foreign investments.[160] The regulation, control and governance of business within provisions of company legislation in Nigeria have their roots from British colonies, which is their source of political independence.[161] However, its effects have not been adequately evident in Nigerian corporate sphere. The regulations indicating the presence of corporate governance in Nigeria are contained in CAMA, ISA, SEC Rules and regulations etc. However, the regulatory institutions such as the Securities and Exchange Commission, Central Bank of Nigeria, Corporate Affairs Commission, and Nigerian Deposit Insurance Corporation are staffed with executives that are interested in enriching themselves by colluding with company's senior executives to compromise shareholders' interests.[162]

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[159] A. A. Afolabi, 'Examining corporate governance practices in Nigerian and South African firms', (2015) 3 European Journal of Accounting and Finance Research 12

[160] *ibid*

[161] E. Okike, 'Corporate governance in Nigeria: the status quo', (2007) 15 Corporate Governance An International Review 175

[162] A. A. Afolabi (n 159) 13

This is partly attributable to the fact that board members are described to lack the requisite skills and competencies to effectively contribute to the leadership of modern corporations.[163]

Regulators and companies are beginning to realise the importance of corporate governance and the fact that it is necessary to avert financial crisis as well as aiding growth and development of entities. In view of this, there was the call for appropriate a corporate governance guideline that is relevant to socio-political, economic and cultural environment of Nigeria and additionally, effective laws, will, and commitment on the part of the government to enforce compliance of corporate governance policy.[164] In response to this, there was a review of the existence, adequacy and relevance of corporate governance in Nigeria in relation to the international best practices in response to the new internal economic order. Subsequently, the Federal Government of Nigeria through some agencies came up with different institutional arrangements aimed at protecting investors. These arrangements were enacted in the code of corporate governance of 2003.[165] The code identifies the roles and responsibilities of the board, management, shareholders, audit committee and external auditors etc. It is developed to channel the principles of transparency accountability and fairness in running the affairs of public companies.

In 2011, the SEC enacted the code of best practices on corporate governance and part of its content was aimed at increasing the operations of corporate governance. Some of its content includes, the fact that the board should be a sufficient size relative to the scale complexity of the company's operation and be composed in

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[163] A. Adewale, 'An evaluation of the limitations of the corporate governance codes in preventing corporate collapses in Nigeria', (2013) 7 Journal of Business and Management 110

[164] S. A. Bakare, 'A theoretical analysis of capital formation and growth in Nigeria', (2011) 3 Far East Journal of Psychology and Business

[165] S. O. Kajola, 'Corporate governance and firm performance: The case of Nigerian listed firms', (2008) 14, European Journal of Economics, Finance and Administrative Sciences 17

such a way that ensures diversity of experience without compromising independence, compatibility and integrity. Other issues include the attendance of meetings, constitution of the board etc. The code also addresses the issues of the responsibility of the chairman, which is to ensure the effective operation of the board in such a way that it works towards achieving the company's strategic objectives. He ought not to be involved in the day-to-day operations of the company as that is the primary responsibility of the CEO. It also explains the ideal constitution of the remuneration committee (i.e. should consist of only non-executive directors). Additionally, it provided that the board should undertake periodic peer review of director compensation and remuneration levels. Furthermore, in 2016, the Financial Reporting Council of Nigeria issued the National Code of Corporate Governance 2016 with its commencement date 17 October 2016. However, the Federal Government of Nigeria suspended the new code because it was inconsistent and sought to amend the provisions of the CAMA and other statutory legislations.[166]

A noteworthy component of good corporate governance is the presence of an audit committee within a company.[167] It is an operating committee on the board of directors charged with oversight of financial reporting.[168] They monitor the integrity of financial statements and any formal announcements relating to financial performance.[169] The importance of an audit committee within a company is well documented as they are charged with ensuring that shareholders' interests are protected in relation to financial reporting and internal control, reviewing

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[166] Editorial Team, FG suspends Obazee's code of corporate governance', *Businessday* (Nigeria, 7 November 2016) <http://www.businessdayonline.com/fg-suspends-obazees-code-of-corporate-governance/> accessed 31 July 2017
[167] I. Gray and S. Mason, *The audit process: Principles, practice and cases,* (5th Edition, South-Western Cengage Learning, 2011) 129
[168] B. Soltani, *Auditing: An international approach,* (Pearson Education Limited, 2007) 84
[169] *ibid*

arrangements by which staff of the company may in confidence raise concern about possible improprieties in matter for financial reporting or other matters, as well as overseeing the company's relation with the external auditor, negotiate fees and define the parameters of the audit. With such duties, this thesis postulates that if they function properly, it would lead to efficient capital market transactions as they ensure the correctness of financial statements that are disclosed to investors.

Audit committees developed in Nigeria because the investing public were getting sceptical about the credibility of financial reports and the performance of directors.[170] Also, there was the recommendation in the Nigeria Law Reform Commission 1988 that audit committees be set up in companies and should comprise of representatives of directors and shareholders.[171] This recommendation was founded on the fact that the preceding practice of auditors dealing with the executive members of the board who are part of the management was considered unsatisfactory with many pitfalls.[172] In view of this, the CAMA of 1990 required corporations to have audit committees as an additional layer of control and certification in the bid to make annual accounts of public corporations more acceptable and reliable. This was incorporated into the CAMA 2004. Section 359 (3) prescribes the provision of an audit committee within a company. This thesis argues that whilst the introduction of audit committee is a welcome development, there is the need for the review of the existing laws governing the appointment, remuneration, duration of tenure and qualifications of audit committee members.

In relation to qualification of the auditors, CAMA 2004, s. 358 does not prescribe the qualification requirement of members of the committee. This implies

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[170] O. Ekumankama and C. Uche, 'Audit committees in Nigeria', (2009) 6 Corporate Ownership and Control 117; Chapter 3 above
[171] J. O. Ukoli, 'Corporate governance and Audit committee in Nigeria', (2014) 9 Journal of Policy and Development Studies 226, 229
[172] O. Ekumankama and C. Uche (n 170) 119

that persons with little or no understanding of financial reports could be elected into such an important committee.[173] Although the Code of Corporate Governance 2011 prescribes that the members should have basic financial literacy with at least one of them having knowledge of accounting or financial management.[174] This thesis argues that such a provision should also be in the CAMA.[175] Taking an example from the UK, the FRC prescribes that members of the audit committee should have competence that is relevant to the sector in which the company operates and at least one of its member has recent financial experience with a professional qualification from one of the professional accountancy bodies.[176] If both provisions are analysed it is evident that the FRC's requirement is likely to attract persons with sufficient knowledge of accounting than that of the Nigerian Corporate Governance Code. Given the technical nature of their assignment, it is pertinent that all members of the committee should be knowledgeable enough in accounting in order to be effective and make their opinion credible and in order to command adherence to such provision, it is important that it is contained in a legally enforceable regime such as the CAMA.

Section 359 (4) of the CAMA 2004 prescribes that the committee compose of an equal amount of directors and representatives of shareholders of the company subject to a maximum number of six members. Members of the committee are to be elected yearly at the annual general meeting.[177] It is argued that the most experienced members of the committee are usually board nominees that are rarely changed.[178] The same cannot be said for shareholding members of the committee because board members are usually in a strong position to influence those elected to the committee,

[173] *ibid* 121
[174] Code of Corporate Governance 2011, s.30.1 and 30.2
[175] A. Omimi-Ejoor, 'Audit committees: The Journey so far in Nigeria', (2014) 3 Journal of Economics and Finance, 40, 42
[176] Financial Reporting Council, 'Guidance on Audit Committee', 2012, 2.16
[177] CAMA 2004, s.359 (4)
[178] O. Ekumankama and C. Uche (n 170) 122

thus creating the avenue for persons with no integrity who are willing to sacrifice shareholder goals for personal gains. Furthermore, the fact that the CAMA does not prescribe the minimum qualification or experience to be members of the committee ensures the availability of a steady army of volunteers shareholders that are willing to deal with the board and compromise the interest of shareholders.[179] This thesis recommends that the tenure of members be extended to three years and further extendable with no more than two additional three-year periods as practiced in the UK.[180] This recommendation is on the basis that it provides some certainty and allows for the development of constructive change strategy that will enable the injection of new ideas into the financial reporting of the company.[181] It is arguable that if members exit yearly, the continuity of the work started by one committee may not be finished and subsequently not taken over by the new committee. Furthermore, there has been the recommendation that no member of the committee be allowed to serve for more than two consecutive terms.[182] This will help prevent possible collusion that familiarity between executive directors and audit committee may bring.

Another issue that is of concern is the requirement that audit committee members should not be remunerated.[183] Members of the audit committee employ their expertise and time towards a venture mainly to enhance the credibility and performance of the business. In view of this, it is only right that they are remunerated. A likely consequence of this is the fact that there will be shortage of competent audit committee members. This thesis argues that this practice has the likelihood to compromise the independence of the committee as research indicates that in Nigeria

[179] *ibid*
[180] Financial Reporting Council, 'Guidance on Audit Committee', 2012, 2.5
[181] O. Ekumankama and C. Uche (n 170) 122; A. Omimi-Ejoor (n 175) 43
[182] *ibid*
[183] CAMA 2004, s. 359 (4)

there are no shortages of members for audit committees.[184] This leads to the likely assumption that management of a company use covert ways to remunerate audit committee members as well as the possibility of there being other intrinsic benefits derived from being a member of the committee. This unarguably questions the independence of auditors because if the foregoing assertions are true, there is the likelihood that the auditors will ignore any accounting improprieties they become aware of. The FRC in the UK prescribes that audit committee members be remunerated and they list the things to be considered when considering remuneration to include, skills they bring, onerous duties they take on and the value of their work to the company.[185] This thesis recommends the remuneration of audit committee members. This will stimulate the interest of persons with the required qualifications and experience as well as integrity in such committee.

Despite these reforms documented above on corporate governance, there remain corporate failures of firms in Nigeria.[186] This can partly be accountable for the lack of confidence in the market by investors. This is further fuelled by the indications that the banking industries and other firms are collapsing in numbers leaving trail of woes to investors, shareholders, suppliers, depositor, employees and other stakeholders. This thesis proposes the urgent need to embrace and enforce the provisions of corporate governance in the Nigerian corporate sphere. This would go a long way to enhance the confidence of potential investors in the market because investors are willing to pay a premium for a well-governed firm. Furthermore, this thesis posits that a company that operates within the ambit of the provisions of

[184] O. Ekumankama and C. Uche (n 170) 123
[185] Financial Reporting Council, 'Guidance on Audit Committee', 2012, 2.15
[186] A.A. Afolabi, (n 159) 12

corporate governance will bring such effective practices when listing in the capital market and desist from wrong practices.

5.5. Conclusion

This chapter was structured to identify further reasons that hinder the Nigerian capital market from operating efficiently. It identified the operation of rule of law, importance of awareness as well as the corporate governance as important factors that are not functioning to the best of their capability by various reasons identified in this chapter. This chapter argues that if these factors are functioning effectively in the capital market, there is the likelihood that investors will be interested in the investing in the capital market. It is important to note that these factors are not the sole issues that will enhance investor confidence. However, if the capital market is to be efficient, there is the need for evidence of the operation of the rule of law governing market operations. This thesis submits that these factors each constitute of a segment of law that can assist the market in attaining efficiency and compete with its international counterparts.

6. Conclusion

6.1. Introduction

Capital realisation is one of the factors accountable for economic growth; the availability and cost of capital is therefore a central theme in discussions of growth possibilities in developing countries.[1] An efficient capital market of a country is of paramount importance as it is considered the bedrock of growth in modern economies.[2] Based on the sensitive nature of capital market transactions, it is imperative that the operations are adequately regulated as this not only ensures that business is carried on smoothly in the market, but also has the propensity to attract more investors as highlighted in this thesis. The focal point of this thesis was on the regulation of the Nigerian capital market. It analysed the legal regulations and enforcement mechanisms governing the Nigerian capital market in comparison to that of the UK. The findings of this thesis identified and highlighted several exploitable loopholes in the substantive rules regulating the market and made some recommendations on how to make the Nigerian capital market efficient.

The central theme/ research question for this thesis was **'to what extent are the legal frameworks and enforcement procedures in the Nigerian capital market laws and practices effective as compared to those in the United Kingdom'?** This was used to propel the fact that the Nigerian capital market is categorised as a weak market in terms of market efficiency and is not considered an investors' choice due to scandals/events that seem to have diminished the confidence

[1] E. A. Arowolo, 'The development of capital markets in Africa, with particular reference to Kenya and Nigeria', (1971) 18, International Monetary Fund Staff Papers 420

[2] R. Levine and S. Zervous, 'Stock markets, banks and economic growth', (1988) 88 American Economic Review, 554.

of investors in its capital market.[3] In view of the foregoing, this thesis examined the laws and regulations governing the Nigerian capital market in a bid to ascertain the cause of the events that have diminished and can diminish the confidence of investors in the market. Based on the research carried out, this thesis argues that the laws and practices regulating the Nigerian capital market are not totally capable of regulating the market to attain its full potential, as there are reports of unethical practices in the capital market. Furthermore, the legal regulations contain loopholes that can be used to evade liability. This arguably is accountable for the weak operational efficiency of the market as well as the presumed low confidence exuded by potential investors. This thesis analysed the major issues that are responsible for the state of the capital market, amongst which are; the regulation of information asymmetry, regulation of insider trading and other issues such as the importance of corporate governance, enforcement of the regulations governing these acts. The summaries of the findings of this thesis are highlighted in turn.

6.2. Nigerian capital market falls under the weak form efficiency theory

Research indicates that the Nigerian capital market falls under the weak form efficiency.[4] The reasons given for this categorisation includes the fact that technical and other forms of analysis based on historical prices appear to be valueless in the Nigerian capital market and the fact that stockbrokers are sometimes not familiar with the operations of the company to enable them place a fair price on the company's

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[3] C. Nwachukwu and H. Oji, 'Stockbroker's N10 billion scandal rocks stock market', Guardian Newspapers (Nigeria 2 February 2017) also available at <https://guardian.ng/news/stockbrokers-n10-billion-scandal-rocks-stock-market/> accessed 12 June 2017) ; Chapters 2 and 5 above

[4] R. Olowe, 'Weak form efficiency in the Nigerian stock market; Further evidence' (1999) 11 African Development Review 64; O. F. Ayadi, 'The Nigerian capital market and the random walk hypothesis' (1990) Unpublished MSc dissertation, University of Lagos; J. M. Samuels and N. Yacot, 'Stock exchanges in developing countries' (1981) 4 Savings and Developments

shares.[5] Furthermore, it is asserted that prior to public offers and announcement in the Nigerian capital market, there is usually an erratic price movement that usually has a minimal effect because the information had already arrived in the market before it is made public.[6] The findings of this thesis indicate that this is a principal reason for the presumed lack of depth of the market as investors may not be interested in investing if the information emanating from such a market is characterised as inadequate and inaccurate.

6.3. Different factors determine the strength of a capital market

This thesis recognises the importance of the **three** theories (law and finance, politics and finance, endowment and finance) towards the growth of a capital market and posits that the chances of building a strong capital market in Nigeria that can compete with its international counterparts rests on all theories functioning efficiently and concurrently.[7] The reasoning behind this argument is that Nigeria is well endowed with adequate resources that can be properly explored to enhance growth of the economy. However, this is not the case as research has indicated that there is large reliance on crude oil that has led to the subsequent neglect of other areas that will be essential to boosting the economy.[8] However, regardless of the large reliance, crude oil is not the largest contributor to the GDP as statistics show other sectors such as agriculture that have contributed immensely to the GDP. This thesis argues that an efficient capital market would facilitate the accumulation of requisite capital for exploration of other areas that can lead to economic growth.[9] Additionally, areas that

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[5] Chapter 2, 2.1.2
[6] W. Bewaji, *Insider Trading in developing Jurisdictions: Achieving an effective regulatory regime*, (Routledge 2012) 147
[7] Chapter 2, 2.5
[8] Chapter 1, 1.2.1
[9] *ibid*

contribute a great deal to the GDP will also benefit from a properly functioning capital market. This would only be achievable if the market is adequately regulated by provisions of the laws that are enacted by the government as well as enforcement of the said laws by the regulatory bodies enacted by government. This propels the argument that for the capital market to attain international standards, the three theories must work concurrently.

6.4. Information asymmetry is a primary reason for the lack of confidence in the Nigerian capital market

This thesis finds that a market tainted with information asymmetry has the propensity to discourage investors from investing because entrepreneurs are considered to have superior information of the business and sometimes overstate their value in a bid to attract investors.[10] This thesis finds that although mandatory disclosure is present in the Nigerian capital market it is not appropriately regulated because of the absence of some key provisions as well as lack of enforcement of the substantive rules.[11] This thesis argues that utilising two regulatory provisions in the Nigerian capital market may not be ideal in every instance because of the possibility that investors may not be aware of both provisions as well as the presumed financial regulation illiteracy.[12] Furthermore, issues such as disclosure of directors' earnings should be available in both regulatory provisions as well as the extent to which disclosure is to be effected in a bid to prohibit companies from disclosing only favourable information

The issue of enforcement has been analysed. This thesis highlighted the fact that the regulatory provisions are not enforced because they are either unattainable or

[10] Chapter 3, 3.1
[11] Chapter 3, 3.7.3
[12] *ibid*

too lenient when compared to similar provisions in the UK.[13] Additionally, this thesis highlights the fact that courts in Nigeria are known to award meagre sums as fines and hardly utilise custodial sentences for such offence, as there is no record of any.[14]

This thesis also explored the concept of voluntary disclosure and argues that it is a concept that should be encouraged and regulated as research indicates that bigger firms operating in the Nigerian capital market tend to voluntarily disclose information and that better performing firms are those that carry out disclosure voluntarily.[15]

This thesis finds that the regulation of reputational intermediaries is inefficient in Nigeria and may not guarantee the needed competence that instils caution in them to perform their duties proficiently. It finds that regulation of auditors is deficient, as it does not prescribe behaviour that auditors should desist from.[16] This is further accentuated by the fact that the provision for fines for erring auditors is meagre when compared to its counterpart in the UK. Similarly credit rating agencies lack competition that may lead them to exude lackadaisical attitude towards their jobs.[17] Furthermore, they are not adequately regulated as the regulations only provide procedure and lists accompanying documents for registration with the SEC without providing any regulation if they act inappropriately or unprofessionally.[18] Additionally, this thesis finds that the remuneration of credit rating agencies by the companies they rate is not ideal in a country like Nigeria because of the widespread corruption and recommends that there should be a reversion back to the principal agency relationship (i.e. the credit rating agency serves as agents of the investors).

[13] Chapter 3, 3.7.3
[14] E. N. M Okike, 'Corporate governance in Nigeria: the status quo', (2007) 15 Corporate Governance: An International Review
[15] I. Adelopo, 'Voluntary disclosure practices amongst listed companies in Nigeria', (2011) 27 Advances in International Accounting 344
[16] Chapter 3, 3.9.1
[17] Chapter 3, 3.9.2
[18] Rules and Regulations of the SEC 2013, r. 114

The thesis also finds that lawyers as reputational intermediaries are arguably well regulated because of the due diligence requirement and the fact that erring lawyers can be reported and cautioned by the Legal Practitioners Disciplinary Committee of the Nigerian Bar Association and the Capital Markets Solicitors Association in Nigeria.[19] This thesis recommends that the requirement for compulsory affixing of stamp and seal by legal practitioners in Nigeria be extended to documents related to capital market transactions.[20]

6.5. Regulation of insider trading is not adequately enforced in the Nigerian capital market

This thesis argues that insider trading is practiced in the Nigerian capital market as it is alleged to be one of the reasons for the crash of the Nigerian capital market in 2008.[21] This thesis identifies **three** main reasons for the alleged widespread practice of insider trading in the Nigerian capital market; corruption, lack of knowledge of the act and its consequences and insufficient regulations/ enforcement.[22]This thesis finds that regulation of insider trading is not effective in Nigeria because since its introduction into the Nigerian regulatory regimes there has been only one conviction.[23] This thesis argues that one of the reasons for inadequate enforcement of the act is partly because the rules prohibiting the act do not completely cater for the offence it is attempting to prohibit. This thesis identified several elements that need to

[19] Chapter 3, 3.9.3
[20] Rules of Professional Conduct for Legal Practitioners (Nigeria) 2007, r 10
[21] O.F. Oladipupo, 'The crash of the Nigerian Capital Market: Explanation beyond the global meltdown', (2010) 4 International Business Management 37 <http://www.medwelljournals.com/fulltext/?doi=ibm.2010.35.40> accessed 8 February 2015.
[22] Chapter 4, 4.2
[23] Sir Kingsley Ikpe the Chief Executive officer of Thomas King Securities Limited was sentenced to 151 years in prison for insider dealing in 2005. http://www.proshareng.com/news/197

be impermeably defined or its definition expanded to cover every angle within which the offence can be committed.[24]

This thesis argues that although there is a trivial provision for instituting civil claims against insider trading in Nigeria, the regulations are not sufficient in tackling the act as it makes provision for just compensation with no mention of possible suspension or expulsion from the market.[25] Thus creating the likelihood for erring companies to perform this act without any remorse knowing that they would be ordered to pay compensation. This is further compounded by the fact that the Nigerian judicial system awards insufficient sums as fines/costs.

This thesis proposes the use of other civil remedies such as freezing orders, injunctions etc. in a bid to dissuade companies from engaging in the act. It is important to note that there are provisions for remedies as expulsion and suspension in the Nigerian regulatory regime; however, they are not in respect to insider trading. Furthermore, the provision does not create the avenue for private individuals to institute private civil actions in competent courts of civil jurisdiction. Such cases are instituted in the Investment and Securities Tribunal (IST) by virtue of section 116 of the ISA, which operates contrary to the provision of section 251 (e) of the Constitution of the Federal Republic of Nigeria (CFRN) thus eliminating the possibility of establishing such claims.[26] This thesis argues that the Nigerian capital market will benefit from a better worded insider trading provision that links the offence to particular punishments.

This thesis makes some recommendations that ought to sufficiently prevent the act from being practiced in the Nigerian capital market. Amongst these

[24] Chapter 4, 4.4.1-4.4.3
[25] ISA 2007, s. 116
[26] W. Bewaji, *Insider Trading in developing Jurisdictions: Achieving an effective regulatory regime*, (Routledge 2012)

recommendations, there is the need to establish adequate and efficient disclosure regime, reform and enactment of rules regulating insider trading, the need for enforcement of the rules and regulations, creating the possibility to institute derivative actions and private rights of action by individuals and the use of civil remedies.

6.6. The operation of Rule of Law in the Nigerian capital market is not efficient

This thesis argues that for regulations to work efficiently there is the need for the operation of rule of law within the capital market, which is currently not evident in the Nigerian capital market.[27] It highlights several factors that will be essential for the efficient operation of rule of law such as the need for efficient rules, which arguably is the primary means to engage rule of law.[28] This thesis argues that in order to achieve adequate operation of the rule of law in the capital market it is important that the rules adequately prescribe capital market operations and provide adequate penalties for individuals and corporations that do not adhere to these rules.[29] This thesis highlights the importance of certain issues to be contained in both regulatory regimes such as mandatory disclosure.[30] Other issues identified includes the need to grant jurisdiction to the IST in adjudicating wrongs committed against an individual in the capital market,[31] confirmation of where disputes from the capital market be instituted,[32] issues pertaining to establishing liability against insiders through the

[27] Chapter 5, 5.2
[28] Chapter 5, 5.2.1
[29] *ibid*
[30] Chapter 5, 5.2.1, Chapter 3, 3.7.3
[31] Chapter 5, 5.2.1
[32] *ibid*

provision of adequate and broad definitions of the offence and the elements required to prove them.[33]

Furthermore, this thesis finds that enforcement of the rules is unarguably deficient, as it has been described as slow, inefficient and inadequate.[34] This thesis recommends a stricter approach to the tripartite system of enforcement in the Nigerian capital market.[35] It also finds that for effective enforcement of the regulations governing the capital market, the SEC, courts and law enforcement agencies must work efficiently and credibly to achieve the best results which further enhances investor confidence.[36]

Another issue appurtenant to the smooth operation of rule of law in the capital market is the role played by judges and law enforcement agencies in upholding legal rules. This thesis proposes that judges appointed to the IST should be persons with integrity that will avoid the temptation of bribes, carry out their duties competently as well as determine cases promptly.[37] Furthermore, they should always strive to uphold the rule of law by applying the laws effectively as well as penalties. Additionally, judges should seek to get continuous education that will keep them updated with the evolving global financial markets.[38]

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[33] Chapter 4, 4.6
[34] Chapter 5. 5.2.2
[35] *ibid*
[36] *ibid*
[37] Chapter 5, 5.2.2(c)
[38] *ibid*

6.7. Lack of awareness of capital market operations and lack of knowledge of protection accorded to investors is partly accountable for the presumed illiquid nature of the Nigerian capital market

This thesis finds that one of the reasons the Nigerian capital market is described as illiquid and lacking depth is by virtue of lack of awareness of capital market operations and sometimes lack of knowledge of the availability of protection accorded to investors.[39] This thesis highlighted a few ways in which the issue of awareness can be resolved such as continuous training for capital market operators so as to make them knowledgeable of new ways desperate persons attempt to use to beat the system. It also recommended that individuals appointed to chair the committee on capital markets in the Senate and Federal House of Representatives be individuals with some financial knowledge/experience, as they would appreciate the need to enact rules that will aid in smooth operation of the capital market. Furthermore, it proposed the need for adequate enforcement that will give members of the public some confidence in the system as well as collaboration between the SEC and market operators for retail investor education campaign that focuses on communicating issues to consider when investing in the capital market as well as informing them of protection provided by law.

6.8. Insufficient operation of corporate of governance is partly accountable for the inefficiency of the Nigerian capital market

This thesis finds that another reason for the inefficiency of the Nigerian capital market is by virtue of the poor practice of corporate governance by Nigerian corporations. This is described to hinder the smooth operation of the capital market and hinders it

[39] Chapter 5, 5.3

from being efficient.[40] This thesis finds that the problem of inadequate operation of corporate governance is highlighted by practices such as family dominance/nepotism in appointment of board members, managers and directors utilising corporate opportunities, and resources for their personal benefit that are practiced by corporations in Nigeria.[41] Furthermore, this thesis finds that regulation of corporate governance is not adequately evident in the Nigerian corporate sphere and although there have been attempts to salvage the situation through the enactment of different corporate governance codes (2003 and 2011) there still remain corporate failures because of the alleged lack of confidence in the market by investors.[42] This thesis proposed the urgent need to enforce and uphold the provisions of corporate governance in the Nigerian corporate sphere. If properly practiced, companies will bring such practices to the capital market, thus enhancing investor confidence.

6.9. Final Thoughts

The importance of the capital market has been emphasised throughout this thesis and its role in economic growth is documented by different academics. The Nigerian capital market has the propensity to attain great heights if adequately operated, managed and regulated. However, attaining these is not an easy or automatic task; there is the need to enhance confidence of retail and institutional investors, both local and international to invest in the market. In realising this, the system needs to function efficiently by adopting best market practices from countries that have strong capital markets, enacting impermeable rules and regulations, prescribing adequate punishment both custodial and otherwise for erring participants, and most importantly

[40] Chapter 5, 5.5
[41] Chapter 5, 5.5
[42] A.A. Afolabi, 'Examining corporate governance practices in Nigerian and South African firms', (2015) 3 European Journal of Accounting and Finance Research 12

enforcing these rules and regulations. In relation to enforcement, the judicial system has to decide cases timeously, apply penalties adequately, avoid corrupt practices for favourable decisions and ensuring that these rules are adhered to. This thesis acknowledges the fact that the foregoing may not be easily attainable. However, as the discourse in this thesis clearly demonstrates, there is the need for the market to start adopting such practices in a bid to compete with its international counterparts as well as attract more investors.

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