



UNIVERSITY OF IBADAN JOURNAL OF PRIVATE AND BUSINESS LAW

U.I.J.P.L.

Vol. 5 2006

A Critical Appraisal of Conditions and Warranties Under the Sale of Goods Act 1893	Osuntogun A. J.	1
Should Corporate Governance Disclosures And Controls Be Permissive?	O. O. Candeje	27
The Investment And Securities Act 1999 As An Instrument For Investor Protection	J. O. Lokulo-Sodipe	46
Is A "Solicitor" A Capital Market Operator?	M. O. Sofowora	61
Nigerian Stock Exchange: An Overview	S. Onakoya	71
Recent Developments In Exchange Control Under Nigeria's Banking Regulations	Animi Awah	94
Recognition and Enforcement of Arbitral Awards: The Law and Practice	S. A. Fagbemi	111
Tax Implications of Transfer of Property in Nigeria.	O. A. Orifowomo	141
The Statutory Status Of Pre-incorporation Contracts In Nigeria: Resolved and Unresolved Issues	Kunle Aina	154
The Effects of Failure to Obtain Consent to Alienate Rights Under The Land Use Act and The Emerging Equities	E. A. Taiwo, Esq	171
Islamic Law as an Aspect of Customary Law In Nigeria – A Call For Review	B. R. Akinbola	186

Published by:
Department of Private and Business Law
Faculty of Law, University of Ibadan

ISSN 1595 - 2495

All rights Reserved

2006

All Correspondence should be directed to:

The Editor-in-Chief

Journal of Private and Business Law

Faculty of Law

University of Ibadan

Printed by:

Sceptre Prints Limited.

5, Lodge Street, Oke-Ado,
Ibadan.

Tel: 08033224738, 08057787874

UNIVERSITY OF IBADAN LIBRARY

THE INVESTMENT AND SECURITIES ACT 1999 AS AN INSTRUMENT FOR INVESTOR PROTECTION

BY

J.O. LOKULO-SODIPE *

The financial services industry encompasses several institutions in the financial system which provides one form of financial service or the other. These institutions would usually act as financial intermediaries, thus facilitating the savings and investment process.

These financial institutions play an important role in the nation's economy and their functions are overseen by certain statutory agencies such as the Central Bank of Nigeria, Nigeria Deposit Insurance Corporation, and the Securities and Exchange Commission.

Such institutions fall into two categories namely;

- ◆ Banking, which includes commercial banks and micro finance
- ◆ Non-banking financial institutions which include insurance companies, securities firms, stock exchanges, collective investment schemes and development finance institutions.

Financial services involve:

- ◆ Receiving deposits for onward lending to the business and household sectors; government and their agencies,
- ◆ Securities trading on behalf of clients, and
- ◆ Providing purely advisory or other services on investments.

In view of the fact that all these services involve monetary transactions

* Lecturer Department of Private and Business Law, University of Ibadan.

through the creation of instruments which are little understood by many, it is necessary to protect sundry investors from those who might take advantage of investors.

This paper focuses on protection of investors in the capital market. The capital market can be defined as the arm of the financial market, which is designed to facilitate flow of long term capital.

It is a truism that investment in securities carries some risks. These include market risks, which arise from normal fluctuations in the prices of securities. While investors are not protected from losses which may result from downward slide in the market, they are protected from being taken advantage of by others, such as those who might manipulate the market, engage in insider dealings¹, front running², or who might release false information to the market.

The need to protect investors and creditors in the financial market is also justified by the nature of financial instruments and the complexities of trading in them. Simply put, investor protection means the mechanism for safe guarding the investor from the fraudulent activities of capital market operators who may take undue advantage of their ignorance to defraud them. Confidence is built and participation is encouraged under a stable and safe environment.

WHY PROTECT INVESTORS?

Today's investors look to the securities industry for advice, securities, and products to help towards retirement and other critical savings objectives. With the investment landscape changing frequently, investors want to be certain they will receive fair treatment through well-regulated securities markets, and that they have somewhere to turn if things go wrong.

¹ Insider Dealing: Illegal share dealings by employees of a company where they have used confidential price-sensitive information for their own gain or gain of their associates.

² Front Running: Is the illegal practice of a stock broker executing orders on a security for their own account (and thus affecting prices) before filling orders previously submitted by their customers. Front Running may involve either buying (where the broker buys for their account, driving up the price before filling customer buy orders) or selling (where the broker sells for their own account, driving down the price before filling customer's sell orders).

An examination of the history of Law of Business Associations show, that most laws and regulations emerged out of the need to check re-occurrence of undesirable circumstances in the society. These were introduced within the objective of protecting investors from unscrupulous practices which may jeopardize market stability and other socio-economic progress.

Given the economies of large scale production in contemporary times, companies would usually require external source of financing. Indeed firms which have grown to be major international companies and players, are probably the greatest beneficiaries of external capital which can be sourced through borrowing and/or by attracting equity (ownership) capital from members of the company and / or other investor (as in private placement).

Those who part with their monies for this purpose, except that the funds would be properly utilized by the recipient company to enable them reap the benefits of their investments. What motivates investments is the confidence that an investor/creditor has in a company's performance and the belief that his investment would be safe.

One other reason for investor protection is the uniqueness of instruments which are traded in the capital market. The language used in the marked is still largely not understood by many. A lot of ignorance is still being displayed by investors on the intricacies of securities instruments. Besides knowing that shares represent ownership rights in a company, which also entitles an investor to distributed profit, there is a general ignorance about equities. This ignorance cuts across all spectrum of the society.

Given the vital role of the financial services industry to National development and the fact that its growth is amongst others predicated upon public confidence and perception, certain measures must be taken by government to safeguard the market's integrity and stability.

For these reasons, governments try to put in place adequate regulatory mechanism to prevent, or at least to minimize, market abuses which could lead to loss of confidence in the securities market to the detriment of its growth as well as national economic growth and development resulting from the slow down of the flow of savings into long term investment.

The internationalization of the Financial Market and electronic linkages

have brought many of the world's capital markets closer together to the extent that a major development in one of the world's markets quickly filters into others³. With such close links between securities markets, particularly cross border issuance of securities, listings, trading as well as the opening up of domestic securities markets to foreign operators, the concept of investor protection has assumed cross border dimensions.

National Securities Commission therefore try to ensure that persons within their jurisdiction are adequately protected through, *inter alia* stiff disclosure of information on foreign issuers and operators etc.

Additionally, bilateral cooperation agreements are entered into by securities commissions to ensure that cross border violators are brought to book. It is particularly important to protect investors, in view of the uniqueness of the instruments traded on it.

The essence of investor protection is two fold, namely:

- ◆ To protect depositors/investors from mismanagement of their funds, fraud, insider dealings and other forms of market malpractices, and
- ◆ To protect the financial system from systematic risk i.e. the possibility that the failure of one financial institution could lead to the failure of several others and result in the loss of confidence in the entire system.

One of such measures is the enactment of the Banking and Securities Laws⁴. This paper is concerned with the regulatory tools for investor protection within the Investments and Securities Act (ISA) 1999 and the "Securities and Exchange Commission" Rules and Regulations made pursuant to it.

The ISA is a statutory instrument which regulates the Securities Market. Securities Market regulation is a public interest regulation which is primarily aimed at protecting investors from abusive practices in the issuance

3. *Salamatu H. Sulaiman "Investor Protection: The Role of SEC", being paper presented at a Public enlightenment workshop on :Opportunities in the Nigeria Capital Market for the Industrial Development of Kebbi State" Where on 3rd and 4th October, 2001.*

4. See: (a) *Investments and Securities Act 1999*
(b) *Companies and Allied Matters Act 2004*
(c) *Banking and Other Financial Institutions Act 1991*
(d) *Insurance Act 1991*

and trading of securities, thereby preserving the integrity of the market and also encouraging participation. It should be noted that positive investor's perception of the capital market is important to the capital market and indeed to economic development.

REGULATORY TOOLS FOR INVESTOR PROTECTION IN THE INVESTMENTS AND SECURITIES ACT 1999

The Investments and Securities Act (ISA) 1999 regulates securities dealings in Nigeria. It consolidated and repealed some existing Laws⁵. It is the most comprehensive legislation on the capital market so far, with 265 sections in 16 parts covering every conceivable aspect of the capital market, including registration of securities. Securities Exchanges, Capital Trade Points⁶ and Capital Market Operators. It makes provisions for public offerings and sale of securities and listed prohibited activities in securities trading. Mergers, acquisitions and takeovers were extensively dealt with. The Act makes provision for collective Investment Schemes. Every securities exchange is expected to maintain an investor protection fund to compensate investors⁷.

In addition to this, a nation wide trust scheme, which would compensate investors outside the schemes maintained by the Exchange and Capital trade points, is to be set up by the Securities and Exchange Commission⁸. Section 8 ISA 1999 provides for the establishment of the Securities and Exchange Commission (SEC) and spells out the functions and responsibilities of the SEC.

These include:

- ◆ Regulating securities business in Nigeria
- ◆ Registering securities to be offered for subscription or sale to the public.

5. *Part XVII of the Companies and Allied Matters Act 1990 and Securities and Exchange Decree 1988.*

6. *Capital Trade Points and mini stock exchanges, which are intended to engender capital culture across the country.*

7. *to be discussed later*

8. *Part xi ISA 1999*

- ◆ Registering and regulating corporate and individual capital market operators.
- ◆ Protecting the integrity of the market against abuses arising from the practice of insider trading.

The SEC in carrying out these functions has designed a variety of tools aimed at protecting investors, and these include:

- i) Registration of Securities and Capital Market operators
- ii) Surveillance and Investigation of the players in the capital market
- iii) Enforcement of securities laws
- iv) Administrative Hearing Proceedings in respect of grievances between market operators and their clients.

1. REGISTRATION

A. REGISTRATION OF MARKET OPERATORS⁹: This is the most potent instrument of investors protection, as it provides the Commission with extensive information to critically assess operators in the capital market. SEC, as empowered under section 29 ISA 1999 sets the minimum entry standards for prospective intermediaries and others who wish to do business in the capital market.

The entry requirements are to ensure that those who participate are fit and proper to act as intermediaries. The fit and proper principle centers on integrity assessment, that is, those wishing to participate in capital market activities are not quacks or crooks. It also centers on financial evaluation, which is to the effect that those wishing to operate in the capital market have adequate capital to do so. Rules 28-39 of the SEC Rules and Regulations provide for registration of capital market operators. This registration is subject to renewal every two (2) years to determine the continued stability of the operator on the market¹⁰. Violation of the terms of registration attracts sanctions, ranging from fine to suspension from market activities¹¹.

9. See Part VI ISA 1999

10. See Part VI ISA 1999

11. Rule 19 SEC Rules and Regulations; S.29 ISA 1999

Finally, entry requirements are set so as to determine the professionalism and competence of intermediaries. This is necessary to ensure that those wishing to operate in the market have requisite knowledge and skill to undertake the function.

Fit and proper assessment of intermediaries is usually on going. This enables SEC to

determine whether or not intermediaries are still in good standing and to spot any potential risk.

B. REGISTRATION OF SECURITIES

Securities are also required to be registered to ascertain their worthiness and the credibility of the issuer¹².

As an important disclosure and thus protection document, a prospectus approved by the SEC must accompany all public offers of securities¹³. All facts material to the issue must be fully disclosed. Material facts include 5 years financial information, material contracts

involving the company, profit forecast incorporation and share capital history, share holding structure, Directors' beneficial interest, subsidiaries (if any) and other investments, claims and litigation indebtedness. The vetting process of the prospectus ensures the adequacy and clarity of information contained therein which are likely to assist in making a rational investment judgment. Investors are also protected when all material facts are given to them about a public offering. This allows them to make informed decision on the issue.

The full disclosure principle thus enables an assessment of the risk and rewards of investing in an issue. Investors are with all vital information laid out, able to protect themselves. It is important to state that capital market regulation is not to prevent risk taking but to enable investors have adequate information to evaluate the risk and benefits of investing in the instrument. It should also be noted that there are sanctions for providing false or misleading information.¹⁴

C. REGISTRATION OF SECURITIES EXCHANGE AND CAPITAL TRADE POINTS¹⁵

12. Rule 19 (7) SEC Regulations

13. Part VII ISA (SS. 31-43)

14. SS. 62-64 ISA 1999

15. Part V ISA 1999

SEC has power under S.20 ISA to register all securities Exchange and Capital Trade Points.

- (ii) **SURVEILANCE AND INVESTIGATION:** To ensure the protection of investors, market authorities must constantly and vigilantly monitor the activities of registrants to detect and check the abusive practices as well as to ensure compliance with governing best execution, insider trading, money laundering and other trading obligations. This

brings about transparency and a level playing field. The various trading points and stock

exchange are monitored with the aim of spotting abnormal trading and price movement in individual security for scrutiny. Appropriate actions are taken if violations are established.¹⁶ Routine checks are carried out on market operators to ensure that proper records are kept and that there has been no breach of market rules. All stock exchange and trade points are expected to submit to the SEC, inspection reports on its members.

- (iii) **ENFORCEMENT:** Section 8(7) ISA 1999 empowers the SEC to perform as is necessary or expedient for giving full effect to the provisions of the Act, which is mainly to protect investors and the integrity of the market. Section 9 also empowers it to establish specialized departments for the purpose of regulating the operators of the market. These departments, the Administrative Proceedings Committee and the Investment and Securities Tribunal ensure compliance with the Laws and Regulations affecting the market.¹⁷

ADMINISTRATIVE HEARING COMMITTEE AND INVESTMENT SECURITIES TRIBUNAL

In order to maintain discipline, transparency and maintain the integrity

16. SS. 22(C), 24;26;27;29(7) ISA 1999

17. Part XIV of the ISA 1999

of the capital market, institutions were created to enforce the Laws and Rules and Regulations guiding operations in the market.

These include the Administrative Hearing Committee (AHC) established pursuant to Section 289 ISA to deal administratively with disputes amongst operators or between operators and their clients, and violations of the ISA and the Rules and Regulations made pursuant to it.

The other institution which deals judicially with disputes arising from the operators of the ISA and the Rules and Regulations is the Investment and Securities Tribunal (IST), established under S. 224 of the ISA. Both the AHC and the IST constitute the tools for the enforcement of the Capital Market Laws.

Prior to the ISA 1999, the AHC was the only body that adjudged grievances between the stake holders in the market. Appeals against the decision of the AHC were made to the Minister¹⁸, and the decision of the minister on appeal was final.¹⁹ This provision was criticized for the following reasons, namely:

1. It created a "monster" of regulator who exercised quasi judicial powers.
2. The minister being the administrative head of the commission was not sufficiently independent of the commission to guarantee fair hearing to aggrieved persons.
3. The absence of right of appeal from the decision of the minister was said to be unconstitutional.

A case in point is **Udensi and Others Vs. SEC & Others**²⁰, where the Federal High Court overturned the decision of the Administrative Hearing Committee revoking allotment of shares in Afribank Plc on the basis of multiple applications. In that case, it was argued that the Administrative Hearing Committee was not a creation of statute, and was therefore illegal and incapable of exercising the powers of SEC, which powers

18. *S.19(1) SEC Act Cap 406 LFN 1990*

19. *S.19(2) SEC Act 1990*

20. *Suit No. FHC/LCS/160/99*

could only be exercised by the Commission itself.

Also argued was the fact that SEC was the accuser and the judge and that the affected persons were not given the opportunity to defend themselves. Lastly, it was argued that S.19 of the SEC Act 1990 which provided for appeals to the Minister was unconstitutional. The court upheld the plaintiff's arguments of breach of the doctrine of fair hearing²¹.

THE INVESTMENT AND SECURITIES TRIBUNAL

The Investment and Securities Tribunal (IST or the Tribunal) was established under S. 224 of the ISA to exercise jurisdiction, powers and authority conferred on it by the Act. With the creation of the Investment and Securities Tribunal, capital market operators now have an independent court where they can take their grievances.

The Tribunal is unique to the Nigerian Capital Market in that this is the first time a specialized court is dedicated to the trial of cases arising from transactions in the capital market. Any proceeding of the Tribunal is deemed to be a judicial proceeding. To this end, the Tribunal is empowered under section 237(1) to make rules regulating its procedures. Pursuant to this, the IST (Procedure) Rules 2003 were formulated to regulate all proceedings before the Tribunal.

The overriding objective of the rules as stated in the document is to enable the Tribunal, with the assistance of the parties, deal with cases fairly and justly by providing amongst others, reliable and expedient settlement mechanism, promoting the integrity of the market and avoiding delay on the consideration of issues²².

In carrying out its objectives, the Tribunal also seeks to promote alternative dispute resolution through reconciliation amongst parties and facilitate the amicable settlement of disputes²³.

The Tribunal is also vested with the following powers: to²⁴

-
21. See also *Owena Bank Plc. V. Nigerian Stock Exchange & Anor* (1997) 8 NWLR (Pt 515)1
 22. Rule 2 Investment and Securities Tribunal (IST) Procedure Rules 2003
 23. Rule 4. IST Procedure Rules 2003
 24. Section 237

1. Summon and enforce the attendance of any person and to examine persons on oath.
2. Require the discovery and production of documents.
3. Call for the examination of witnesses or documents.
4. Review its decisions.
5. Dismiss an application for default.
6. Set aside any Order or dismissal of any application for default or any Order passed by it *ex parte*.
7. Do anything, which in the opinion of the Tribunal is incidental or ancillary to its functions under the Act.

In enforcing Capital Market Laws, the Tribunal employs the following processes:²⁵

1. It adjudicates on disputes and controversies arising from operations in the capital market. This involves the interpretation of laws as well as a fair and professional appraisal of issues before it, so that a just decision can be reached without undue delays.
2. It issues directives
3. It makes awards and gives judgements.

S.241 ISA empowers the IST to make or impose sanctions "such as are not limited to fines, suspensions, withdrawal of licenses, specific performance, restitution as it may deem appropriate in each case".

Where the Tribunal has concluded its hearings, it may give its judgment in written orders. It should be noted that a judgment of the IST is enforced, as if it was the judgment of the Federal High Court, by registering it with the Registrar of that court. This way, the judgment of the Tribunal could be enforced the same way as that of the regular courts. From the foregoing, it is clear that the Tribunal is sufficiently empowered to carry out its role of ensuring enforcement of Capital Market Laws.

However, the issue that has been contentious is the fact that S.242 ISA 1999 has ousted the jurisdiction of the civil courts to entertain matters in respect of which the tribunal was constituted.

It has been argued that this provision contradicts sections 251(1)(a); 257 and 272 of the 1999 constitution, which provides that the High Courts shall have jurisdiction in respect of all civil matters²⁶. In view of this conflict and the constitutional provision which states that, where there is any inconsistency between the constitution and any other, the constitution takes precedence, one may ask, "can the ISA through the creation of the IST oust the jurisdiction of the High Courts on matters relating to capital market?"

The provision to oust the jurisdiction of all other civil courts from matters which the tribunal is empowered to determine may seem unconstitutional: considering the fact that the State High Courts have original jurisdiction to determine disputes between persons. However, it is my opinion that the provision of Section 242 ISA is constitutional. This is because the constitution recognizes the creation of other courts by any law duly passed by the National Assembly or State Assembly²⁷. The ISA is an existing law deemed to have been passed by the National Assembly²⁸ and therefore the position of the IST in the judicial system is not in doubt.

The provision is designed to eliminate delays in disposing cases and to realize the objective of creating the Tribunal in the first place; which is to provide a reliable, informed, expedient, flexible and affordable dispute resolution mechanism for investors and other players in the market.

To subject the Tribunal to injunctions by other civil courts would defeat the essence of establishing the Tribunal as a specialized court especially in view of the fact that proceedings before it are deemed to be judicial proceedings²⁹.

INVESTOR PROTECTION FUND

Investors are also protected by having an effective investor compensation

26. Dr. Timi Austen-Peters "Limits of Restitution for investors under ISA" being a paper delivered at the joint workshop on the Investment and Securities Tribunal and investors Protection held on 6th June, 2004

27. S.6(5) (j); (k) of the 1999 Constitution of the Federal Republic of Nigeria.

28. S.315 (4) (b) of the 1999 Constitution of the Federal Republic of Nigeria

29. S. 237 (3) ISA 1999

30. S.S 149-171 ISA 1999

system.

For the first time in Nigeria, the ISA 1999¹ has made provision for such a fund known as the Investor Protection Fund (IPF)³⁰

The Fund is to be applied (as noted earlier) for the purpose of compensating persons who suffer pecuniary loss from any defalcation committed by a member company or any of its directors or employees in relation to any money or other property which was entrusted or received by a member company or any of its directors or employees whether before or after the commencement of the ISA in the course of or in connection with the business of that company³¹. Compensation is payable not only in respect of losses arising from transactions made after the commencement of the Act, but also in respect of those made prior to the commencement of the Act.

All Securities Exchange and Capital Trade Points are mandated to establish and maintain an Investor Protection Fund³².

The Fund is to be administered by a governing board and the constituent funds are sourced from the following³³.

- ◆ Contributions by the member companies.
- ◆ Interest and profit from investment of the fund.
- ◆ Moneys paid by the Securities Exchanges and the Capital Trade Points.
- ◆ All moneys recovered by or on behalf of the Securities Exchange or Capital trade Point in the exercise of any right of action conferred by Part XII of the ISA.
- ◆ All moneys paid by an insurer pursuant to a contract of insurance or indemnity entered into by the governing board.
- ◆ Any other moneys lawfully paid thereto.

A claimant for compensation from the IPF is not precluded from

31. S. 160(1)

32. S. 148(1)

33. S. 149(1)

34. S. 160(3)

instituting appropriate judicial proceedings³⁴. The claimant is entitled to the amount of actual pecuniary loss suffered including the legal cost incurred by him.

However, the value of other monies or benefits received or receivable by the claimant from any other source other than the fund, in respect of the same claim would be deducted from the award. Section 160(4) makes provision for interest to be payable on the compensation paid. Interest would be calculated at the rate of 50% per annum from the day on which the defalcation was committed and continuing until the day on which the claim is satisfied.

It is the best practice for the legal and regulatory environment to provide for the compensation of investors in the event of the failure of an intermediary. Such compensation would however, not cover loss arising from market risk, which is normal risk of investing in the capital market.

The Investor Protection Fund as provided for in Part XII of the ISA is not yet in operation although, the Nigerian Stock Exchange has an operative fund known as Investors' Compensation / Protection Fund.

CONCLUSION

A look at the SEC Quarterly Reports reveal an alarming increase in the number of malpractices leveled against and being vigorously pursued by Market authorities against Market operators and brokerage firms.

Alleged malpractices include failure to properly account for clients' funds deposited for purchase of shares, failure to remit funds from disposal of shares on behalf of clients, returns that do not conform with the reporting format and most returns contain arithmetic inaccuracies.

The Investment and Securities Act 1999 was enacted with the broad objective of positioning the Nigerian capital market as the major propellant of the nation's economic development by strengthening its capacity in all respects.

It re-established SEC, charging it with the dual responsibilities of regulating and developing the capital market. Under the Act, all instruments, operators/consultants, exchanges and depositories must be registered and regulated by the Commission.

The essence is to ensure that players in the capital market are "fit and proper" to carry out business in it, trading is fair and transparent; facilities are efficient and the financial instruments issued are not intended to swindle or defraud investors.

A true assessment of the enforcement of the provisions of the ISA cannot be ascertained due to the fact that many market abuses are not being reported by investors themselves. Many are

either not aware of their rights under the law or they are not willing to exercise them³⁵. This is one reason why in Nigeria, there has been no prosecution for insider trading). For instance, no investor has challenged the National Council on Privatization, the Bureau of Public Enterprises and the Management of African Petroleum for the scandal that went into the company's public share sale in year 2000, neither has anyone called for the release of the white paper on the issue.

Be that as it may, the ISA 1999 as an instrument of investor protection:

- ◆ Ensures the existence of a fair and transparent securities market
- ◆ Prescribes the standards for registration of market operators
- ◆ Makes provisions for prompt investigation of suspected breaches of securities laws and market operations
- ◆ Lastly, it provides for investors education.

35. SEC in a bid to correct this has embarked on a nationwide enlightenment and investor education programme.