



**THE Nigerian  
STOCK EXCHANGE**

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**Supervision  
Priorities *for*  
2019/2020**

# I. INTRODUCTION

The Nigerian Stock Exchange (“The Exchange”) hereby publishes its 2019 to 2020 supervision priorities to communicate to Dealing Members, the investing public, and other stakeholders the issues and business practices which are considered to be the highest risk areas to investors and the integrity of the Capital Market (“The Market”).

This is to enable the Dealing Member Firms (“DMFs”) to build appropriate risk management programs which could possibly mitigate these risks in order to support The Exchange’s regulatory objective to protect investors and maintain a fair, orderly and efficient market. The 2019 to 2020 priorities are set by The Exchange to highlight material areas of regulatory concern, discuss ongoing areas of non-compliance, prevent fraud, communicate policies, monitor firm-wide and systemic risk, and ultimately to improve investors’ confidence in the Market.

The supervision priorities and focus areas for 2019 to 2020 were selected by The Exchange following an assessment and analysis of available information, including:

- Data gathered through 2017/2018 examinations conducted by The Exchange;
- Regulatory reports submitted to The Exchange by DMFs;
- Industry and media publications;
- Tips and complaints received directly from stakeholders including investors and market operators;
- Interaction with market operators and

other stakeholders; and

- Emerging and evolving trends within the global capital market, including the impact of the Fourth Industrial Revolution.

The supervision priorities set out in this document addresses key risk areas relating to DMFs. But, it is important to note that these risk areas are not exhaustive. Each DMF is expected to have a risk framework to adequately dimension the risks it faces and take appropriate action to mitigate or eliminate such risks. While The Exchange plans to allocate a significant portion of its resources in 2019 and 2020 through a risk based approach to the supervision of the risk areas described below, additional examinations will be conducted during the year at the discretion of The Exchange on emerging and exigent risk areas to control weaknesses and policy matters that are not addressed in this document. Collaboration and coordination with the Securities and Exchange Commission (“SEC”) as well as other domestic and foreign financial regulators may also result in the revision of the scope of these priorities.

## II. AREAS OF PRIORITY

It will be recalled that in 2017, The Exchange developed its supervision priorities for years 2017 and 2018 focussing the review primarily on those business practices considered to be of significant risk to investors and the integrity of the Nigerian Capital Market. Within this period, a total of one hundred and thirty seven (137)<sup>1</sup> examinations were conducted on one hundred and nine (109) Broker Dealers, twenty seven (27) Brokers and one (1) Dealer. Circa seventy percent (70%) of the DMFs examined within the period did not have adequate controls in place to mitigate the key risk areas highlighted in the 2017/2018 priorities document. Consequently, the priorities from 2017/2018 will be adopted for 2019 along with the addition of new emerging risk areas in Technology and identified market activities such as Securities Lending and Margin Trading.

The Exchange will adjust its Risk Based Supervision (RBS) framework in response to these changes in this priority document. The priority areas are described below, both in general and specific terms:



<sup>1</sup> One Hundred and Thirty eight (138) DMFs were examined and One (1) DMF reclassified to the Sub-broker function with the SEC and was exempted from examination, as Sub-brokers are not to be classified as Dealing Members of The Exchange.

### Conflicts of Interest

Information Leakage/Chinese Wall

Related Party Transactions

### Technology

Information Security Governance

Data Quality and Management Information System

Cloud Security and Vendor Management

Cloud Security and Penetration Testing

### Anti-Money Laundering/ Combating the Financing of Terrorism

Suspicious Activity Monitoring

Politically Exposed Persons

Source of Funds/ KYC.

### Market Integrity

Insider Dealing

Guaranteed Return Investments/Pooling Funds

Fraud Detection & Prevention

Market Manipulation

### Finance

Asset Mix Ratio

Manipulation of Financial Statements

Minimum Capital Requirement

Net Capital

Valuation of Assets and Liabilities

### General

Minimum Operating Standards

Corporate Governance

Approved Persons Regime

Complaints Management

### Emerging Trends

Margin Trading

Securities Lending

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Risk Management Control Functions

Sponsorship of Sub-Broker Relationships

Unregulated Businesses

Comingling of Clients Assets & Segregation of Accounts

Market Making

Inter-member Transfers from Inactive Firms

Direct Cash Settlement

Best Execution

Unauthorized sales

Unfunded transaction

Outsourcing



Brokers on the trading floor of The Nigerian Stock Exchange during trading hours

# 1 CONFLICTS OF INTEREST

Conflict of interest arises from divergence between the private interests and the official responsibilities of the person in a position of trust. Conflicts of interest, where they are not eliminated or properly mitigated and managed, are a leading indicator and cause of significant regulatory issues for individuals, DMFs and sometimes the entire market. The Exchange has identified conflicts of interest as a key area of focus in its risk-based strategy. The focus will be on specific conflicts of interests, steps taken by DMFs to identify, mitigate or eliminate conflicts and the sufficiency of disclosure made to investors and relevant stakeholders. The overall risk governance framework that DMFs have in place to manage conflicts will also be reviewed on an ongoing basis.

## a. Information Leakage/Chinese Wall

The Exchange will review the procedures and measures deployed by DMFs in order to handle information, including the identification, classification and management of information, generally, and particularly in situations where there is a real or perceived conflict of interest.

Where a DMF is a market maker, The Exchange will pay particular attention to its Chinese Wall procedure, aimed at ensuring that its market making activities are kept separate from its proprietary activities.

## b. Related Party Transactions

The Exchange will review transactions that involve related parties of the DMF, especially between companies operating within a Group to ensure that such transactions are carried out at arm's length and in line with all relevant laws, regulations and professional standards.



With the advent of the Fourth Industrial Revolution, the Capital Markets have not been spared the ongoing revolution in technology. Indeed, the increasing complexity, interconnectedness and speed fostered by technology is a continual challenge to market participants and regulators. A number of market events over the past couple of years have underscored how important it is for The Exchange and other regulators to stay abreast of new trading technologies, emerging cyber risks and their implications for maintaining a transparent and stable market that provides a level playing field to all market participants without giving inappropriate advantages to some market participants over others. We plan to conduct examinations on Governance and Supervision of Information Technology systems for issues bordering around Operational Capability, Market Access, Vendor Management, Cloud Services and Information Security, including risks of system outages, and

data integrity compromises which may adversely affect investors' confidence. Among other things, we hope that these examinations will help the DMFs and Regulators to better understand operational information technology risks and potential methods to help mitigate and effectively manage those risks.

#### **a. Information Security Governance**

The Exchange recognizes the need to align business processes with information security to effectively and efficiently raise the information security level across the entire market. In order to achieve this, DMFs are expected to set the tone at the top with respect to Information Security by instituting proper Information Security Governance.

Based on this, The Exchange has developed policies which the DMFs can tailor to their processes or establish their own policies. These policies are to be approved by Management and the Board to establish the oversight. The Exchange will assess the adequacy of each firms' documented policies and the compliance of the DMFs to their individual policies.

#### **b. Data Quality and Management Information System**

The Exchange has identified potential complications which stem from the quality and integrity of data, and could possibly impact a DMF's ability to observe or report key information

necessary to efficiently manage risk and business activities.

During the 2018 Risk Based Supervision (RBS) Examination, The Exchange noted that most of the DMFs did not pay attention to I.T risks, and some firms did not have any data on I.T risks. Data relating to I.T. For example, a Technology Asset inventory is a vital prerequisite of risk management that will drive each firm to monitor the risks associated with each asset, I.T. incidents are to be documented in an Incident Register in order to monitor risk events which could crystallize into losses.

The Exchange will assess the data governance structure within member firms, including the accuracy, completeness, and timeliness of the data reported and utilized by management for decision making.

#### **c. Cloud Security and Vendor Management**

Cloud Service for the Order Management System (OMS) application has become a necessity to enable DMFs to focus on their core business without being bogged down with issues relating to infrastructure and maintenance. Whilst cloud computing is becoming popular with the DMFs, cloud security has to be enforced to ensure that applications, application data and investors' funds/data are secure.

The Exchange will assess the entire cloud software/infrastructure/platform provided by the OMS vendor to guard against risks pertaining to unauthorised users on the application, excess privileges granted to the vendor's profile, unauthorised changes made by the vendor, cloud vendor service monitoring and issue management.

#### d. Cyber Security/Penetration Testing

The Exchange recognizes that Cyber Security is a global challenge that could result in significant loss if not appropriately mitigated. As such DMFs are expected to take the necessary steps to ensure the security of their Information systems. Firewalls must be installed to protect the network from intruders as well as anti-phishing software which consists of computer programs that attempt to identify phishing content contained in websites and emails. Also, DMFs are required to implement adequate Network Admission Controls in administering the Local Area Networks (LANs), i.e., DMFs that make use of wireless LANs should consider NAC options such as MAC address filtering, DMFs with wired LANs should ensure unused ports are disabled, and DMFs operating a group structure should implement adequate network segregation.

Additionally, DMFs that operate

online trading portals or mobile trading applications must subject these digital/electronic trading platforms to regular vulnerability and penetration testing, and other appropriate security measures.

### 3 ANTI-MONEY LAUNDERING/ COMBATING THE FINANCING OF TERRORISM (AML/CFT)

AML/CFT remains a challenge to the stability of the Financial System, as such The Exchange will focus on activities that will enhance AML/CFT processes. In this regard, The Exchange will assess the DMFs AML/CFT programs, especially Know Your Client (KYC), record keeping, suspicious activity identification and reporting deficiencies, and due diligence procedures regarding certain accounts. The supervision program will focus on the firm's risk assessment of its business practices and implementation of the AML/CFT program related to those risks.

#### a. Suspicious Activity Reporting

The Exchange will assess the ability of the DMF to identify and report suspicious money movements and trading activities in all its offices.

#### b. Politically Exposed Persons

The Exchange will assess the DMFs' processes regarding the classification, recording, and enhanced due diligence procedures for all Politically Exposed persons and

other high risk clientele.

### c. Source of Funds/Know Your Customer (KYC)

The Exchange will review the adequacy of DMFs' procedures designed to establish the identity of existing and prospective clients as well as the legitimacy of their source of funds in compliance with such other requirements for identification of clients as prescribed by the laws of the Federal Republic of Nigeria and such other Rules and Regulations as may be prescribed from time to time by regulatory agencies including the Securities and Exchange Commission (SEC) and the Central Bank of Nigeria (CBN). The review will also cover the DMFs' procedures for tracking expired means of identification and updating client information.

itself or any person

DMFs are prohibited from engaging in such activity, this is a major violation of Capital Market rules and regulations. Our supervision programs have been strengthened to not only prevent but also to swiftly detect and sanction offenders.

### b. Guaranteed Return Investments/Pooling

The appreciation of investments in the Capital Market is dependent on several factors such as the forces of demand and supply, and other varied indices, including but not limited to the profitability of the company, investors' views on its intrinsic value and the general economic performance. As such, the guarantee of any interest or appreciation on investments is prohibited. The risk and exposure arising from guaranteed return products offered by DMFs poses a great challenge for the capital market. The Exchange in its supervision will focus on this aspect and enjoins DMFs to desist from engaging or offering any form of guaranteed return investment and to discontinue with any product premised on guarantee.

### c. Fraud Detection and Prevention

Firms are expected to have developed and implemented a robust control in

## 4 MARKET INTEGRITY

The integrity of the market and investor confidence is necessary to ensure the stability of the Capital Market. The Exchange will continue to focus on the following issues:

### a. Insider Trading

Insider Trading occurs when a person or group of persons who being in possession of some confidential and price sensitive information not generally available to the public, utilizes such information to buy or sell securities for the benefit of himself,

order to prevent and detect fraudulent transactions. The Exchange will continue to utilize and enhance quantitative and qualitative tools to identify market participants engaged in fraudulent or unethical behaviour. We encourage tips, complaints and referrals from investors, DMFs and other stakeholders which could assist in identifying potential fraud/fraudsters.

#### **d. Market Manipulation**

This is a deliberate attempt to interfere with the free and fair operations of the market and to create artificial, false or misleading appearances with respect to the price or market for a security. Our Market control, Surveillance, Monitoring and Examination programs have been strengthened to work on eliminating these practices from the market.

capital requirement prescribed by the SEC. We will examine the DMFs using criteria's such as the total volume and value traded by each firm, focus on the internal controls in place for managing liquidity risks and other financial risks. The Exchange will also review DMFs' contingency funding plans to determine if a sufficient plan has been put in place to shore up the capital whenever it falls below the regulatory threshold.

#### **c. Net Liquid Capital**

The Exchange will also assess the capital adequacy of DMFs by reviewing their compliance with the net liquid capital rule. The firm's risk capital will also be assessed against its regulatory capital to ensure there are sufficient buffers in place to manage intraday liquidity risks and other financial risks which may crystalize.

## **5 FINANCE**

#### **a. Asset Mix Ratio**

The Exchange will continue to monitor the asset mix ratio as prescribed by the SEC to ensure that DMFs maintain the required mix of assets prescribed for their respective functions.

#### **b. Minimum Capital Requirement**

The Exchange intends to focus on the adherence to the minimum

#### **d. Valuation of Assets and Liabilities**

The Exchange will review DMFs' method of measuring assets and liabilities whose values are based on prices or valuation techniques that require input which are both unobservable and significant to the overall fair value measurement. This is to ensure sound reporting in line with the requirements of the International Financial Reporting Standards (IFRS).

### e. Manipulation of Financial Statements

The Exchange's supervision program has identified practices that call into question the accuracy of the books and records maintained by DMFs. Some examples of manipulation of financial statements identified include, amongst other practices the following: the recognition of deposit for shares as part of capital and reserves for the purpose of meeting regulatory capital requirements; recognition of fictitious or toxic assets; and understatement of liabilities the name a few. Our supervision program will continue to monitor the accuracy of the firm's books and records as well as compliance with the minimum capital requirements closely.

- enterprise risk management;
- Evaluate the tone at the top;
- Assess the effectiveness of all the necessary control functions i.e. The Board of Directors, Board Committees, Chief Executive Officer, Chief Compliance Officer, Chief Risk Officer and Internal Audit and Control; and
- Review the documented risk assessment and implementation processes.

### b. Sponsorship of Sub-brokers Relationship

The Exchange will assess the supervisory controls put in place to monitor the activities of Sub-Brokers registered under DMFs, to ascertain compliance levels with the Rules and Regulations Governing Dealing Members and all Capital Market rules and regulations, including the KYC requirements.

### c. Scope of Business Activities

The Exchange has observed that many DMFs engage in business activities outside stockbroking activities. Dealing Member are expected to carry on the business of buying and or selling securities and activities which are ancillary thereto. In 2019, The Exchange will focus on this area to ensure that the books and records of all DMFs are kept separate from other businesses, including the business of associated or subsidiary entities.

## 6 OPERATIONS

### a. Risk Management and Control Functions

As part of The Exchange's oversight functions, meetings will be held with the directors and senior management of DMFs to discuss how a firm identifies and mitigates financial, legal, compliance, operational and reputational risks. This initiative is designed to:

- Understand DMFs' approach to

#### **d. Commingling of Clients Assets and Segregation of Accounts**

The Exchange's rules require complete segregation of assets held on behalf of clients in a separate account from a firm's assets. The firm's account should be maintained in the name in which the firm carries on its stockbroking business. The Exchange will continue to monitor and enforce these requirements to ensure compliance.

#### **e. Market Makers**

The Exchange will continue to monitor Market Makers (MM) to ensure that they meet the MM requirements including the qualification, financial, operational and performance standards on an ongoing basis.

#### **f. Inter-Member Transfers from Inactive Dealing Member Firms and Expelled Firms**

Due to the prevalence of fraudulent transfers from inactive DMFs and expelled firms, The Exchange will increase its focus in this area to ensure DMFs put in place appropriate measures to mitigate the risks which may arise from the transfer of investors stocks without their knowledge and the subsequent disposals of such stocks without their consent. The Exchange will collaborate with the Central

Securities Clearing System Plc. (CSCS) to ensure that the laid down procedures are followed before stocks are transferred from one firm to another.

#### **g. Direct Cash Settlement**

As part of The Exchange's plan to ensure that investors are protected, The Exchange will monitor the compliance of its members with the direct cash settlement rule of the SEC (DCS Rules). We expect all DMFs to take reasonable steps to ensure all client monies are paid directly into the client's personal account unless a client elects others in accordance with the DCS Rules.

#### **h. Best Execution**

DMFs are expected to have a policy in place which specifies reasonable steps to be taken in ensuring the best possible result on a consistent basis when executing orders on behalf of clients.

Consequently, The Exchange will be considering the following factors in reviewing the trades executed by DMFs to determine compliance with the best execution policy:

- Fairness of price
- Speed and likelihood of execution and settlement
- The size and nature of the order

### i. Unauthorized Sales

The Exchange will continue to intensify its supervisory role to detect and prevent instances of unauthorized sales of client assets, as this practice remains a key area of concern. DMFs are reminded to continuously review their risk management systems and Internal Controls towards assessing their ability to detect and prevent unauthorized sale of client assets.

### j. Unfunded Transactions

The Capital Market is a pre-funded market, DMFs are required to fund their settlement accounts prior to the execution of transactions to prevent instances of unfunded transactions and to safeguard market integrity. In addition, firms are required to adopt the procedures for Personal Account Dealing prescribed in the Compliance Manual & Code of Ethics circulated by The Exchange as part of the policies required for the Minimum Operating Standards (MOS). The Exchange will assess each DMFs' internal control system in compliance with its Personal Dealing policy and review its settlement account, internal cash account statements for all directors, staff and related parties.

### k. Outsourcing

The Exchange will assess the initial and ongoing due diligence conducted by DMFs for outsourced services. The process and functions outsourced will be assessed to ensure compliance with The Exchanges guidelines.

## 7 EMERGING TRENDS

The Exchange has observed emerging trends amongst its DMFs and has recognised the need for increased focus in these new areas of development. These new market trends will be monitored in compliance with laws, regulations and rules, and, where appropriate, also exercise regulatory powers to enforce actions and impose sanctions. Some of these trends are listed below:

### a. Margin Trading

The Exchange, through its 2017/2018 RBS examination program, has observed the increased involvement of its DMFs towards margin lending activities. Margin Trading means the buying and selling of securities by the Broker for themselves or for their Clients through Margin Financing.

The Exchange will increase its focus on monitoring DMFs that have margin agreements with their customers ensuring that these activities are in compliance with the prescribed framework by the SEC and the Central Bank of Nigeria. Information on Margin list can be found on SEC's website;

[www.sec.gov.ng/files/SEC%20Margin%20list/Margin%20List\\_28-02-2013.pdf](http://www.sec.gov.ng/files/SEC%20Margin%20list/Margin%20List_28-02-2013.pdf)

### **b. Securities Lending**

Securities lending is an arrangement under which a holder of securities agrees to provide its securities to a borrower for a specified period of time, with an associated agreement by the borrower to return equivalent securities at the end of an agreed period. Securities lending requires the borrower to put up Collateral, whether cash or security. Title to the securities passes to borrower temporarily, but the lender customarily maintains the right to dividends and other disbursements which accrue on the security. In this case, the borrower of the stock will then be required to pay such distributions whenever they occur. The Exchange will focus on monitoring approved DMFs who are accredited as intermediary agents for securities lending.

that all DMFs have an effective corporate governance system to enable them comply with the Code.

The NCCG 2018 was developed to drive good governance practices, increase levels of transparency, trust, integrity and create an environment for sustainable business operations. DMFs are required to apply the Code and provide detailed explanations as to how they complied with the Code.

Therefore, DMFs are required to establish a system of good Corporate Governance which is imperative to ensure that the Directors, Management and Staff of DMFs perform their duties professionally.

### **b. Complaints Management**

The Exchange will continue with its objective of maintaining a fair and orderly market with a key focus on market integrity and investor protection.

### **c. Approved Persons Regime**

The Exchange will increase its focus on the supervision of approved persons appointed by DMFs. These are the key officers who drive the day to day activities of the firm and whose influence cannot be underestimated. DMFs are therefore required to ensure that only individuals with proven integrity and experience are engaged and put forward to The Exchange for

## **8 GENERAL**

In addition to the other categories mentioned above. The Exchange has also included the following areas:

### **a. Corporate Governance**

Following the introduction of the Nigerian Code of Corporate Governance (NCCG) in 2018 by the Financial Reporting Council of Nigeria (FRC), The Exchange's focus will be geared towards assessing

approval. DMFs need to verify and certify that they are fit and proper to perform their role.

The approved persons are Directors and Principal Officers, including the Chief Executive Officer, Chief Finance Officer, Chief Compliance Officer, Chief Risk Officer and Authorized Dealing Clerks.



# THE Nigerian STOCK EXCHANGE

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