

SEC and the Shareholders Association – Matters Arising

It has been said that history repeats itself; that certainly seems to be the case in today's environment. After the Great Depression, the United States saw landmark legislation and regulations that dramatically altered the oversight and structure of the financial markets, including the creation of the Securities and Exchange Commission.

As a result of the current economic crisis, there are ongoing discussions among the Nigerian Organised Private Sector, National Assembly, the CBN, the SEC, and other stakeholders regarding the need for significant reform; or re-regulation of the Nigerian financial system.

In the last few weeks, the discourse within the financial community had been varied – ranging from CBN's new policy on executive directorship, CBN's pronouncements on the 'rescued' banks and the non- rendition of December 2009 year end financials, SEC's new rules for quoted companies, SEC's code of conduct guidelines for operators and their employees, SEC's new approach to enforcement and the naming & shaming of violators, SEC's plans to review the role of approved operators, brokers and dealers in the banking crises that ensued, the unresolved leadership issue within the NSE and what role (if any) must and can the SEC play, the resolution of the AMC bill and the impact on the market up to the efforts of SEC to regulate shareholders' activities, through the code of conduct for shareholders' groups.

This has been a season of activities unlike ever seen before in the financial market; yet we have all travelled this road before with consequential failures owing to the lack of rigour in the execution and management of the regulator-market schisms.

The mood currently is one of uncertainty – a natural reaction to a clime no one is certain how the end game would look like. Strikingly, the attempt by the SEC to paint a picture of what the market would look like after the interventions have been made is left to individual/personal conjecture and a religion-like impartation of faith in the definition of what is 'world class'.

It is this drive towards 'El-Dora Do' that is causing the friction and not the desire to embark on neither the journey nor the immediate dislocation this journey would cause.

For one, the market is unsure how long the journey will take, how well the two principal apex regulators have agreed on the implications of individual actions from either on the overall market and most certainly; what steps to take to get life to their entrepreneurial spirit and daily desire to outdo the competition – a cornerstone of the capitalist mindset that informs the workings of the capital market; nay financial market space.

Driven by the moral and professional fervour to save the markets, the regulatory leadership has embarked on the much needed but 'simultaneously delivered series' or plethora of initiatives designed to 'rein in' the rot that has occurred through years of, wait for it - ineffectual regulatory control.

In this season, it is quite possible for the market to deviate into a political type response – as one would expect during any transformation endeavour. Yet, as all change champions know – the inability to sell the change and its benefits to the larger audience and secure the buy-in from relevant stakeholder group often forms the most critical success factor in such endeavours.

Recognising that one of the fairest ways to sell this change would require a change both in the administrative structure, process and legal empowerment of SEC itself – i.e. the review of the ISA laws to align it with world class practices – along with the CAMA rules and the introduction of a code of conduct for the SEC Board itself – may take a longer time; we agree with the decision of SEC to focus on the low-hanging fruits that underpin market credibility and designed to energise the change program and instil confidence in the market in serious need of belief.

Today, we re-engage the market on the issue of the shareholder associations.

The SEC Directive – Motives and parties Involved

The Director General of SEC, Ms. Arunma Oteh, at an interactive session communicated a directive to shareholders' interest advocacy group in the country to register with the Corporate Affairs Commission (CAC), and file in their CAC registration with the Commission if they want to get recognition as part of the wider definition of stakeholders in the emerging Nigerian Capital Market (NCM).

The essence was for the identification of the various leaderships of the associations, their membership and to be able to register them.

The regulatory authority was said to have given the directive, following the call by stakeholders in the market for ***proper regulation of shareholders associations for effective monitoring of company managers especially at the audit committee level.***

It was represented that the commission was miffed at the various groups' engagement in unruly behaviours, as some of them turned 'praise singers' or 'trouble makers' at Annual General Meetings (AGM) proceedings.

SEC represents that ***only seven (7) shareholders groups in the country have filed for and acquired registration certificates from the CAC, as required by the Investment and Securities Act (ISA).*** The seven shareholders groups are:

1. Lagos Zone Shareholders Association,
2. Renaissance Shareholders Association,
3. Association for the Advancement of the Rights of Nigerian Shareholders,
4. Dynamic Shareholders Association of Nigeria,
5. Nigerian Shareholders Solidarity Association,
6. Proactive Shareholder Association of Nigeria, and
7. Pace Setter Shareholders Association of Nigeria.

About twelve (12) other 'known' associations are yet to provide evidence of their registration with SEC. These include

1. Association of Corporate Investors of Nigeria,
2. Ibadan Zone Shareholders Association,
3. Onitsha Zone Shareholders Association,
4. Port Harcourt Shareholders Association,
5. Jos Zone Shareholders Association of Nigeria,
6. Kaduna Zone Shareholders Association of Nigeria,
7. Kano Zone Shareholders Association of Nigeria,
8. Ekiti Zone Shareholders Association of Nigeria,
9. Independent Shareholders Association of Nigeria,
10. Shareholders United Front,
11. Progressive Shareholders Association of Nigeria, and
12. Pragmatic Shareholders Association.

The Shareholder Group(s) and the NCM

It is instructive to point out the need for all stakeholders to understand and appreciate the evolution of this shareholding groups to fully comprehend what led to their creation and role.

Suffice to say, the Zonal associations have played crucial roles in the market and indeed the NSE – up until the proliferation of associations took place.

One must not also forget that such a grouping would have only thrived because the people that made up such an organisation could not rely on the structure (or lack of it and processes) to fully achieve the finer goals in the investment drive – and because the directors of quoted companies 'took notice' of their role(s) at the AGM's and sought to 'manage' such a formidable constituency.

The management of such a grouping was a matter for discretion and not a subject of regulatory oversight – a much needed intervention as to definition of roles, relevance and responsibility at the time and up until now.

We must recall that at no time did a shareholder association's name appear on a share certificate (as a bulk investment) through a 'bundling' of investment to 'create' an aggregate – a situation that is recognisable under our laws if made through an investment club, collective investment scheme, co-operative society, mutual fund and any of the ilk – BUT most certainly not as a shareholder association.

Thus, the choice of shareholder associations was not a creation of our laws, save for the purpose of a class action act – again hitherto untested/uncharted water.

From the debate so far, a few issues have crystallised which can be aggregated thus:

1. Is the action of SEC within its jurisdiction, considering the fact that these shareholders' groups are voluntary organisations?
2. Should the shareholders' associations be left alone, considering some of the past actions, which has become a concern for stakeholders in the capital market?
3. Should the SEC not be focussing on the rules that affect shareholders within the definition of CAMA and the ISA and de-emphasize the role of the shareholders' associations through the efficient discharge of obligations, responsibilities and regulatory oversight on the part of the SEC itself which have failed to live up to the billing in the period under reference in (2) above?
4. How can we avoid a situation where then SEC may directly or inadvertently muzzle the voice of the investors through sanctions or rule changes?

The Shareholder Group(s) - Origin and Practice

Shareholder groups were a rarity in the NCM until 1985 when the late Otunba Akintunde Asalu formed the Nigerian Shareholders Solidarity Association (one of the seven duly registered with the CAC).

In the contributory work done by Obinna Chima and Meshack Idehen, Friday, April 25, 2008 – "Not a few corporate organisations felt he was wasting his time trying to form an association of shareholders that would put managements of companies to task about their operations and bookkeeping. It was virtually unheard of that shareholders would query the management of a quoted company on the use of funds available to it in a particular year. Shareholders' acceptance

of the result of audited accounts of concerned companies was taken for granted, as the “ayes” always had it.”

“Although some shareholders’ associations had existed earlier in some parts of the country, NISSA became much more vocal. It subjected the annual reports of companies to serious scrutiny; forcing managements to explain how they arrived at the figures they paraded.

This led to the prominent status, respect and recognition accorded shareholders which ultimately led to the membership of audit committees of listed companies long before the fad of corporate governance made it such an imperative.

With NISSA, it became obvious that managements of companies had a lot to answer for if they mismanaged shareholders’ funds.

Taking a cue from NISSA, other shareholders’ associations began to spring up. Some emerged as a function of location, others as a function of focus but in the main, others emerged to partake in the economic cum commercial benefits that some came the way of a ‘group’ with so much leverage and relevance. ***The proliferation of these associations, in the absence of measures to regulate them, became its very undoing.***

Soon, it emerged that this group – like all power blocs – soon became a victim of its own success.

Recall an incident at the AGM of Unilever, when the late Asalu group was engaged in fisticuffs with another shareholding group over the right to seat on the front row. This was merely a tip of the iceberg. There was to be many documented and unconfirmed instances of pre-AGM briefings, Q & A sessions that mirrored role-plays ahead of the AGM, company sponsored trips, accommodation and benefits, year end gifts, special gifts at birthdays, shareholder group leaders’ social functions or outright ‘storming of the events’ with products from the FGCM listed companies for use as take-away at such events, etc.

The lines were simply blurred out and soon a culture of incestuous relationships emerged. The protection of shareholder interest, driven by the failure of the regulatory authority to rapidly build up capacity to play that role, took a back seat and only a few associations were left committed to the cause.

The harm had been done and soon all shareholder groupings ended up being tainted by the same brush and the leadership of the few committed ones had to spend enormous time and resources defending their motives, causes and interests – taking a lot away from them.

The market crash of 2009 and the eventual expose on the activities of certain board directors opened up a ‘Pandora’ box that pitted the shareholders groups as a ‘blackmail’ organisation.

In all that has happened in the last five years, coupled with the advancement in capital market rule making, the shareholder groupings have difficulty in defining what they are really out for – what they are up to and what they seek to achieve that is not permissible within the law as an individual investor?

In spite of the above criticisms, promoters of some of these associations believe they are still relevant to the capital market. The National Coordinator, Independent Shareholders Association of Nigeria, Mr. Sunny Nwosu, described the criticisms as baseless.

He argued, in the work of Obinna Chima and Meshack Idehen that “the purpose of forming associations was to improve the relationship between the emerging shareholders population and the corporate world”.

According to him, “shareholders’ associations emerged during the Federal Government privatisation policy in the 70’s. He said the exercise brought in its wake the emergence of an era of shareholders’ activism and influence on the corporate existence of companies, adding that as more public enterprises became privately owned, shareholders of such companies sought explanations on the activities of their managements.”

Nwosu recalled that a late lawyer from Ekiti State, Mr. Gilbert Akinyele, first nurtured the idea of a shareholders’ association, with Asalu as the secretary-designate. But the association never came into being.

“What would have been the first shareholders association flopped after the merger talk between the then Lever Brothers Nigeria Limited and Lipton, because of some disagreement between Asalu and Akinyele on ratio and other benefits that would accrue to existing shareholders of both parties to the merger,” he explained.

Asalu was said to have left and formed NISSA, and used the platform to lead a crusade for investors’ awareness, thereby opening the way for the emergence of other groups.

Nwosu noted, “Ordinarily, a shareholders’ association must have a mission and vision, which it intends to achieve for the good of the investing public. Now that the population of shareholders has grown to more than six million people, **there is the need for NGOs to carter for them**, knowing full well that in a situation of a company having 50,000 or more shareholders, the AGM may not have more than 200 shareholders present, and it is this 200 people that would have to present a case for the other shareholders.

In the same vein, the President, Shareholders’ Renaissance Association, Mr. Olufemi Timothy, disagreed with those who said that there was a proliferation of shareholders association, saying that with the increasing number of investors in the stock market, there was also a need for shareholders’ groups to increase.

The SEC Code of Conduct in Existence before this Current Directive

In a bid to checkmate the ‘excesses’ of these associations, SEC inaugurated a code of conduct for shareholders’ associations in the country.

The code of conduct, which was inaugurated in 2007, is aimed at guiding the operations of shareholders’ associations. The highlights of the code include the following:

1. Establishment and membership of shareholders’ associations,
2. Attendance to annual or extra-ordinary general meetings, and
3. Membership of audit committees.

With regards to the establishment and membership of shareholders associations, the code says membership of a shareholders’ group must not be less than 50 shareholders of public companies, and must be duly registered with the Corporate Affairs Commission of Nigeria – an otherwise insufficient rule given the disperse nature of shareholding post the banking consolidation of 2006 which grew the number of shareholder 3-4 times fold.

The code also bars members and officers of shareholders associations from attending AGMs or EGM's of companies in which they are not shareholders except as legitimate proxies.

It is obvious that this code in itself did little to address the serious issues raised as regards role, relevance and conduct.

The SEC and its Mandate to Investors

The Securities and Exchange Commission (SEC) is the federal government agency (apex regulator) that oversees disclosure of information about companies to investors.

We have requested for, and will publish a legal guidance on the provisions of the ISA that specifically covers the role of SEC in relation with Shareholder Groups, outside of the specific responsibilities it has towards protecting investors and the general public through the enforcement of a set of rules that should ensure confidence in the conduct of the market and participants.

In the meantime, we would rely on the general notions as it relates to the basic objectives of the ISA in this regard – require that investors receive financial and other significant information concerning securities being offered for public sale; and prohibit deceit, misrepresentations, and other fraud in the sale of securities.

A primary means of accomplishing these goals is the disclosure of important financial information through the registration of securities. This information enables investors (*and here is the tricky part – not shareholder groups, not the government, and most definitely not advisers*) to make informed judgments about whether to purchase a company's securities.

While the SEC requires that the information provided be accurate, **it does not guarantee it**. Investors who purchase securities and suffer losses have important recovery rights if they can prove that there was incomplete or inaccurate disclosure of important information (*which the SEC could not have detected through concealment or misrepresentation directly or aided by registered professional service providers*).

In general, the rules regarding registration of parties involved in the securities business compels the registration of all securities sold in the country – and provide essential facts.

The ISA equally requires a variety of market participants to register with the SEC. Such includes exchanges, brokers and dealers, operators, professional service firms and clearing agencies such as the CSCS. Registration for these organizations involves filing disclosure documents that are updated on a regular basis.

The Nigerian Stock Exchange is identified as a self-regulatory organization (SRO) – which means that it is empowered to create rules that allow for disciplining members for improper conduct and for establishing measures to ensure market integrity and investor protection.

SRO proposed rules ought to be published for comment from the market before final SEC review and approval.

The SEC however, both in our clime and in other jurisdictions with like roles and responsibilities, have an obligation to make such rules as they seem fit and can justify as critical to the protection of shareholder rights, access, independence and conduct.

While this currently appears contentious, it is devoid of any lack of clarity both in intent and the responsible discharge of obligations.

If the shareholder associations are compelled to register with the CAC and intend to function as a collective body, exercising collective bargaining powers and ostensibly pursuing a shared goal – they have therefore decided to come in to the main theatre of capital market activity as an 'institutional investor'.

Role of Institutional Investors

Many years ago, worldwide, buyers and sellers of company stocks were individual investors, such as wealthy businessmen or families, who often had a vested, personal and emotional interest in the company whose shares they owned.

Over time, markets have become largely institutionalized: buyers and sellers are largely institutions (e.g., pension funds, mutual funds, hedge funds, exchange-traded funds, other investor groups such as co-operative societies, investment clubs, etc; insurance companies, banks, brokers, and other financial institutions).

The rise of the institutional investor has brought with it some increase of professional diligence which has tended to improve regulation of the stock market (***but not necessarily in the interest of the small investor or even of the naïve institutions, of which there are many***). Note that this process occurred simultaneously with the direct growth of individuals investing indirectly in the market (for example individuals have twice as much money in mutual funds as they do in bank accounts). However this growth occurred primarily by way of individuals turning over their funds to 'professionals' to manage, such as in mutual funds.

In this way, the majority of investment now is described as "**institutional investment**" even though the vast majority of the funds are for the benefit of individual investors.

Unfortunately, there has been a concurrent lapse in the oversight of large companies, which are now almost all owned by large institutions.

The Board of Directors of large companies used to be chosen by the principal shareholders, who usually had an emotional as well as monetary investment in the company, and the Board diligently kept an eye on the company and its principal executives (they usually hired and fired the MD/CEO).

Nowadays, the Board is now mostly chosen by the MD/CEO, and may be made up primarily of their friends and associates, such as officers of the company or business colleagues. Since the (institutional) shareholders rarely object, the MD/CEO generally works in tandem with or influences who becomes the Chair of the Board (which makes it much more difficult for the institutional owners to "fire" him/her).

Conclusion

Up until the market crash experienced by the NCM in 2009, shareholder associations were not required to be registered with any other federal government agency other than the CAC.

Most of the shareholding associations thus existed to foster their collective interest in firms in which they have an aggregate interest and have felt that they

needed to have more influence on the direction of the firms and by extension, protect their own investments.

The truth however is that it is about time that we resolved the questions raised above and we commend to all our conclusions on page 9 of **THE BULL IN THE CHINA SHOP** (www.proshareng.com/reports/view.php?id=2016) report that looked at the financial services industry post August 14, 2009, viz:

CBN – The Shareholder Associations - This point is quite ironic.....Over the years, unverified complaints and outright claims of compromise against the association and its numerous versions led to a weakening of the voice and perhaps, value/relevance.

At best, they positioned themselves to question and put on enquiry, CEO's, management and the board on the misuse of power and excesses.

The relevance and place of this, hitherto whistle blowing apparatus of our market should be reconsidered and a pronouncement made on the value or otherwise of continuing to retain the vehicle in the scheme of things. The market developments, it must be said, have altered the historical relevance of such an organisation/grouping.

End.