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2013 OpenSpaces Survey of Compliance in Nigeria's Capital Market

THE SURVEY TEAM

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Welcome to the report of the 2013 OpenSpaces Compliance Survey (the survey) of Broker Dealers in the Nigerian Capital Market.

The recent global financial crisis has resulted in governments and regulators focusing on building a more robust regulatory, business and control environment. As Nigeria seeks to be a major player in the world financial markets, it is paramount that it embraces and adapts to these changes whilst simultaneously developing a compliance culture that meets international best practice.

The 2013 survey builds on the insights we gained from the 2011 survey. The 2011 survey focused on compliance in the Banking sector and respondents were the Chief Compliance Officers of the 25 Banks. The data and findings from both surveys should contribute to the availability of reliable data on compliance and regulation in Nigeria's financial services industry. The 2013 survey provides rich and substantive information that can be used to establish priorities for the future development of regulation, risk and compliance in the Nigerian Capital Market.

In undertaking the survey, we sought the views of the 160 Compliance Officers who attended the joint Nigerian Stock Exchange / OpenSpaces 2 day training workshop conducted in May 2013 to equip compliance officers with the core skills required to discharge their responsibilities. The workshop covered topics such as the role of the Compliance Officer, Compliance Monitoring etc

Despite the initial scepticism experienced regarding taking part in the survey , 96 compliance officers, representing a broad spectrum of firms in the Nigerian Capital Market i.e. Market Makers, Fund Managers, Issuing Houses and Broker Dealers, took part in the survey thus providing us with statistically valid data to understand the common practices and challenges faced. We appreciate your time and efforts in completing the survey and would like to say THANK YOU.

The 30-question survey was designed to capture some of the pertinent issues facing Compliance Officers. It also drew extensively on some of the key findings of the training session referred to above.

The survey sought participants view on the following matters:

- Duties and responsibilities of the compliance officer
- Experience and expertise of the compliance officer
- The role of the regulators
- Compliance Officers' relationship with the regulators
- Visibility and Independence of the Compliance Officer
- Respondents suggestion on how Compliance can be strengthened in Nigeria

We hope that the data gathered and analysed is useful and provides all stakeholders in the Nigerian Capital Market with in-depth information and data that will contribute to the development of a robust compliance and regulatory framework

The 2nd OpenSpaces survey of compliance in Nigeria. The first survey in 2011, focused on the banking sector.

Survey was sent to over 160 compliance officers of capital market operators. In Nigeria including Broker Dealers, Issuing Houses, Market Makers and Fund Managers.

Majority of compliance officers report to their CEO but with no evidence of any checks and balances on the power of the CEO.

Sector is dominated by small sized firms.

85% of compliance officers have less than 5 years cognate compliance experience.

NSE commended for providing support and guidance.

The survey confirms that there is an increased awareness of the role of compliance within the Broker Dealer sector of Nigeria's capital market. The survey also indicates a steady progress towards building compliance as an independent function with 77% of our respondents' confirming independence to varying degrees. Interestingly, this is slightly at odds with feedback provided during the summer training session.

The survey also provided the following findings:

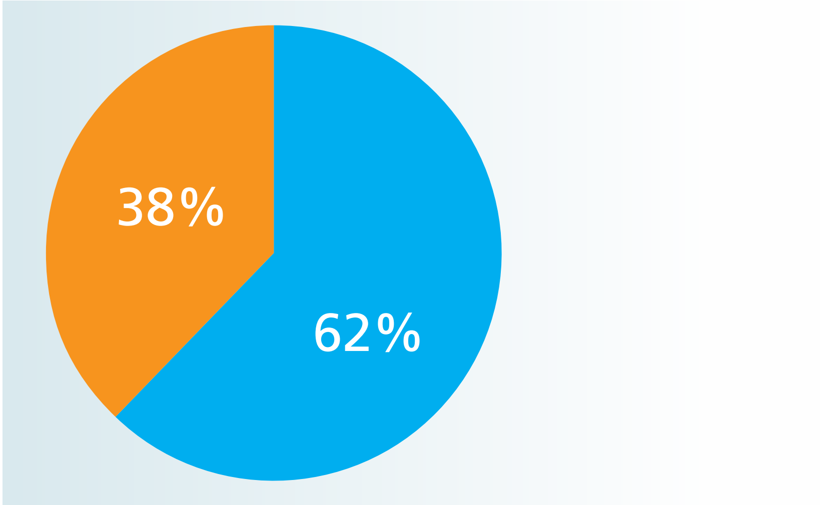
- The majority of broker dealer firms are small sized with 90% of the firms polled having less than 100 employees. This perhaps supports the need to restructure the sector either through consolidation including mergers or specialisation of activities.
- 85% of Compliance Officers have less than 5 years' experience. Of this proportion, about 9 in 10 are the registered Chief Compliance Officers of their firm which raises concerns about expertise and full understanding of the responsibilities of a compliance officer.
- Majortiy of Compliance Officers report directly to their CEO but there is no evidence of board oversight of compliance. This is a particular worrying fact as it exposes the Compliance Officer to being directly influenced particularly where the CEO is dominant. Thus adequate check and balance Is required and this finding supports the view of compliance officers who stated that the regulators support is required to facilitate their independence and influence within their respective firms.
- 62% of the respondents confirmed implementing an annual compliance monitoring program. However, less than half of this population reviewed suitability and appropriateness of advice provided to customers to ensure fairness, clarity and accuracy of information provided during the sales process. This is a concern as the last crisis in the capital market was partly attributed to mis-selling and lack of impartial and proper advice to retail customers. Most importantly, it is also at odds with recent regulatory efforts to encourage financial inclusion and that customers are treated fairly.
- 74% of our respondents indicated that guidance and support received from the regulators were adequate but with room for improvement. The NSE, in particular, was commended for providing guidance and training programmes.

Role of the Compliance Officer

The principal role of the Compliance Officer is to monitor their firms' compliance with regulatory requirements which includes establishing adequate compliance systems and controls. To ascertain how firms were meeting these responsibilities, we asked respondents a series of questions designed to understand their approach towards meeting their regulatory obligations.

Our findings indicate that 62% of firms achieve this through implementing an annual compliance-monitoring program.

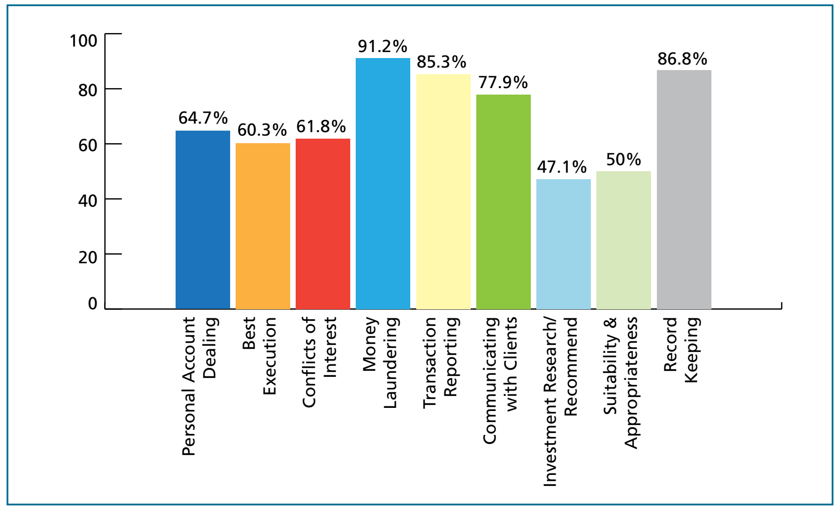
Fig 1. Firms operating an annual compliance monitoring program (CMP)



38% - Do not have a CMP
62% - Do have a CMP

We also observed that the scope of the CMP appeared comprehensive, and covered issues that are high on the regulatory agenda in advanced markets. Fig 2 below illustrates the range of issues covered in CMP and the percentages of respondents with active monitoring and oversight in these areas.

Fig 2. Activities covered in Annual CMP



Focus of compliance monitoring is largely determined by agenda of the regulator.

Insufficient review of conduct of business issues especially the selling of securities and advice provided to clients.

The results indicate that the most common areas of monitoring for Compliance Officers were AML, Transaction Reporting, Record Keeping and Communicating with Clients. These issues were covered in at least 77% of Monitoring programs whilst areas of Best Execution, Personal Account Dealing and Conflicts of Interest were monitored less with 60-65% of programs covering these issues.

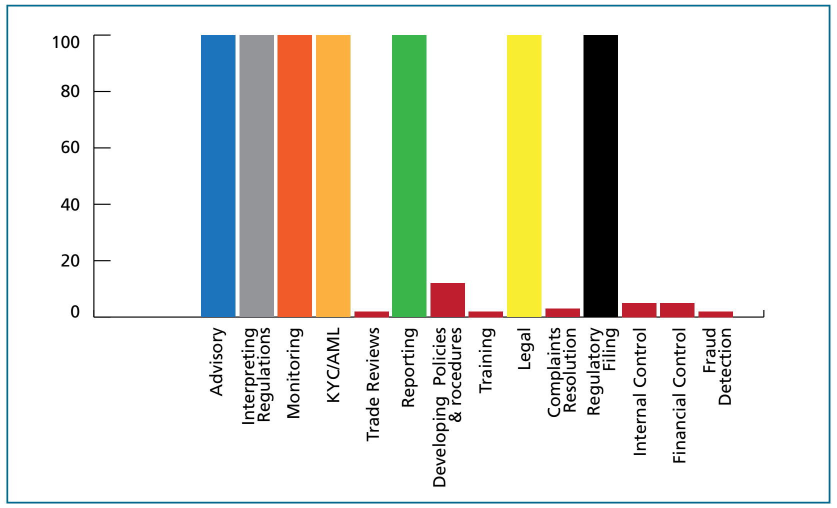
An important statistic observed was that about half of the monitoring programs reviewed the suitability and appropriateness of products or advice given to customers. If 77.9% of Monitoring programs cover communication with clients with only 50% reviewing suitability and appropriateness, it suggests that 28% of firms simply review communications to ensure their interests are protected and there is somewhat little regard for the fairness, clarity and accuracy of information provided to the customer during the sales process.

Further analysis indicates that 87% of respondents' firms CEO approve their compliance monitoring programs whilst the remaining 13% undergo no approval process for their compliance monitoring program. As previously highlighted, sole approval of the compliance monitoring programs by the CEO is a source of concern as it could possibly constrain the independence of the Compliance Officer.

B. Other duties of the Compliance Officer

Aside from compliance monitoring, figure 3 below indicates that Compliance Officers also undertake advisory duties e.g. regulation interpretation, KYC/AML due diligence, regulatory filing and reporting. The Compliance function is observed to be rarely involved in, training, formulation of policies and procedures, trade reviews and complaints resolution.

Fig 3. Role of Compliance Officers



These results reveal that the compliance monitoring activities of compliance officer is driven by the agenda of the regulators and/or what issues they consider to be of high risk. This explains why KYC/AML due diligence and regulatory reporting is the top activity undertaken by compliance officers. Whilst this is not common to Nigeria alone, it does leave the compliance function hostage to the changing agenda of the regulators

C. Visibility & Independence of the compliance function

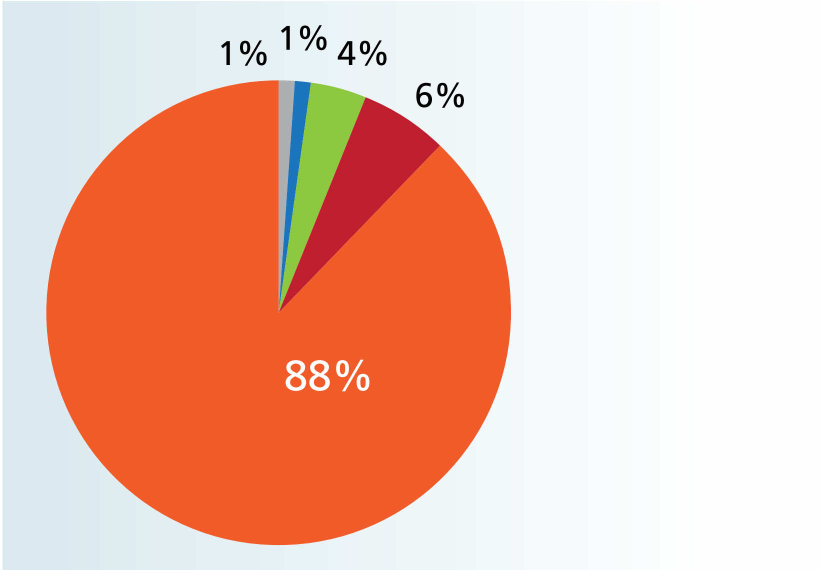
The effectiveness of a compliance function is in part determined by its visibility and to a greater extent, its independence. Visibility of the compliance function extends beyond the physical presence to how integrated "into the fabric" of the organization it is. In addition to being visible, a compliance function must be independent in order to discharge its function effectively and without fear or favour.

To ascertain the level of interaction and independence of the compliance function, we asked respondents a series of questions ranging from their involvement in their firm's executive management team and the role of a Board level committee in providing compliance oversight.

Our analysis of respondent's answers to the questions of visibility and independence are detailed below:

88% of respondents report directly to their CEO whilst 12% report to other senior executive e.g. Company Secretary.

Fig 4. Reporting lines of Compliance Officers



The large number of respondents reporting to their CEO is very encouraging and, on the face of it, suggests that the CEO takes compliance seriously. However, it could also be a source of concern if there is no oversight of compliance at the Board level acting as a check on the power of the CEO. The absence of such check could have serious implications on the independence of the Compliance Officer.

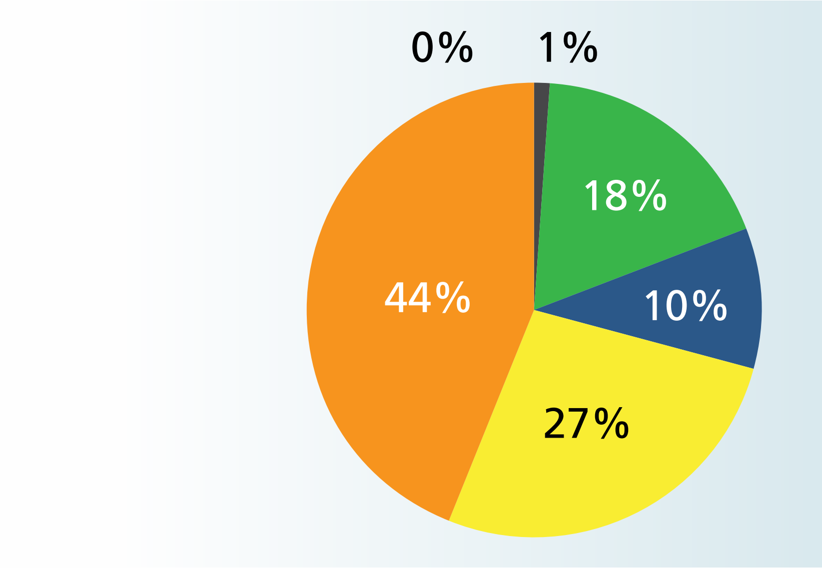
88% of Compliance Officers report directly to CEO without without clear evidence of adequate checks and balances to safeguard the independence of the Compliance Officer.

Compliance Officers generally held regular meetings with their CEOs or senior management.

88% - CEO
6% - Executive Director
4% - Head of legal/ Company Secretary
1% - Chief Financial Officer
1% - General Council

71% of respondents held weekly (44%) or monthly (27%) meetings with their senior management team whilst 28%had either quarterly or infrequent (ad-hoc) meeting and 1% never held meeting with senior management as shown in Figure 9 below

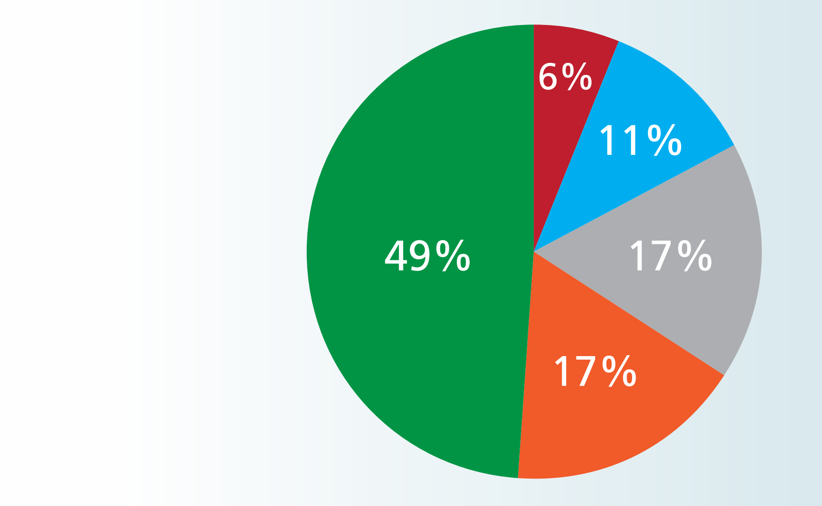
Fig. 5 Senior Management



44% - Weekly
27% - Monthly
18% - Infrequently
1% - Never
0% - Annually

The high number of respondents who reported meeting with senior management is also encouraging as it shows regular engagement with the compliance team. It shows that the compliance team has ready access to senior management and that there is an opportunity to bring compliance issues to the attention of senior management on a regular basis.

Fig. 6 Independence of the Compliance Officer



49% - Reasonable amount of Independence
17% - Not much independence
17% - Independent
11% - Very independent
6% - Little or no independence

In Fig 6 77% of respondents consider that they are independent. This should be treated with caution as 85.5% of respondents wanted the regulators to to facilitate the independence of the compliance function (see pages 10 & 11)

Experience and Expertise

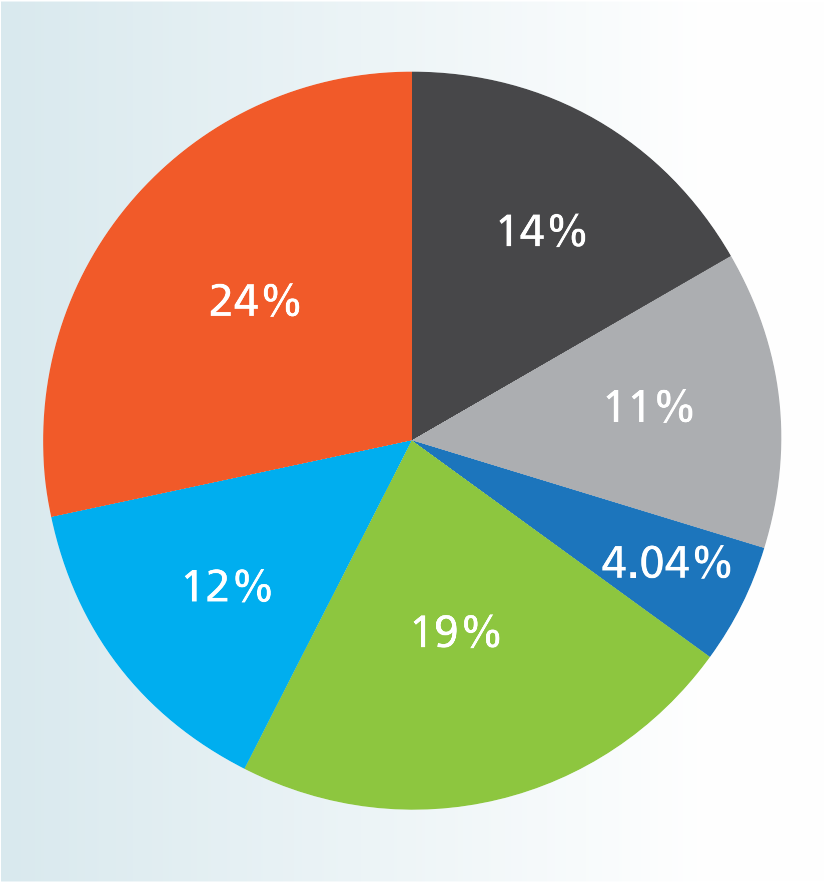
The compliance function is only as effective as the knowledge and experience of the Compliance Officer. Compliance is still considered a relatively new profession in Nigeria and we thought it would be interesting to assess the experience and expertise of the respondents.

As indicated in the chart below, the majority (84%) of Compliance Officers have 5 years and less experience. This finding raises serious concerns as 82% of respondent were the Chief Compliance Officers of their firm. This lack of substantive experience and expertise may well be one of the main factors that is inhibiting the growth of the profession in Nigeria and the development of a strong compliance culture. This is an area that the regulatory agencies and other stakeholders need to address

84% of compliance officers who responded had less than 5 years experience.

Lack of experience and expertise is one of the main factors holding back the development of the compliance function in Nigeria.

Fig. 7 Year of Experience of Compliance Officers



24% - 3 Years
19% - 5 Years
14% - 2 Years
12% - 4 Years
11% - A Year
4.04% - Less than a year

D. The role of the regulators

The regulators can substantially strengthen the compliance function in Nigeria by a) introducing measures to safeguard the independence of the compliance function and b) providing more support and guidance.

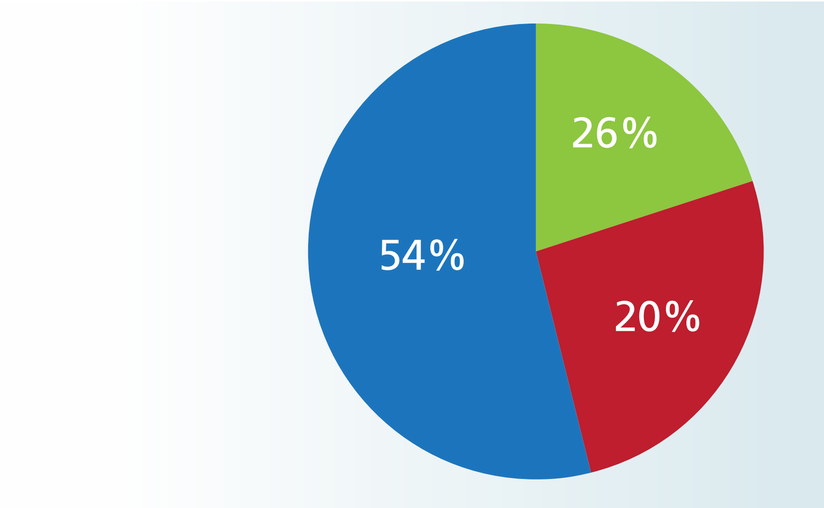
The role of the regulators in developing and strengthening the compliance function cannot be overstated. In response to a series of questions on the role, effectiveness and how the regulatory agencies can strengthen the compliance function in Nigeria, survey respondents indicated the following:

14% of survey respondents were not registered with the relevant regulatory agencies as illustrated below despite it being a requirement of the NSE and SEC Rules (Article 15 and Rule 14 respectively)

Whilst the oversight mechanism of the regulators in this regard has often been questioned, the NSE on 9th September, 2013, fined and suspended 39 dealing member firms for operating without Compliance Officers.
The stance and severity of the NSE's actions is without doubt a welcome development as it demonstrates the compliance culture within the Nigerian capital market is been ushered into a new era, where firms must act responsibly or be held accountable for regulatory failings.

54% of survey respondents agreed that they received adequate guidance and support from their regulators whilst 46% indicated that they received less than satisfactory support from the regulators. Of the 46%, 20% stated that they did not receive adequate support and guidance as shown in the chart below.

Fig. 8 Effectiveness of the regulators

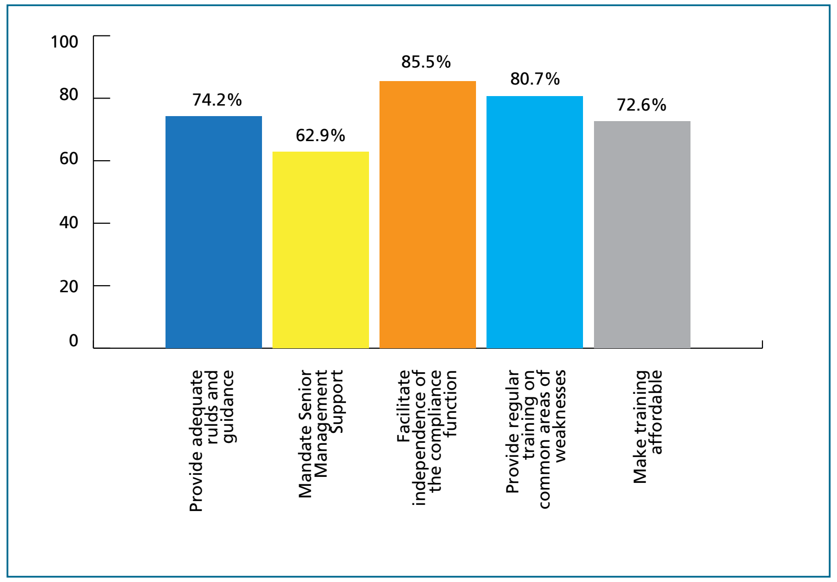


54% - Yes
26% - No
20% - Somewhat

On a positive note, the responses showed that visibility of regulators is improving with a strong focus on providing compliance function related training. Noticeably, the NSE received more commentary on providing adequate guidance and facilitation of training programmes but very limited credit was given to the SEC and NSE neither for providing support. Despite this, the relatively high number of compliance officers who are not satisfied with the level of supoort received from the regulators is a source of concern that needs to be addressed by the regulatory agencies.

85.5 % of respondents as indicated in the chart below stated that regulators could significantly strengthen the compliance function in Nigeria by facilitating its independence. This was followed closely by providing regular training and providing adequate rules and guidance. Other suggested measures included mandating senior management support and providing affordable training.

Fig. 9 How the regulators can strengthen the compliance function



Conclusion

The 2013 survey in common with the 2011 survey confirms that there is an increasing awareness of compliance by operators in the Broker Dealer Sector. This awareness is also complemented with a robust drive to improve oversight of the sector and the role of compliance officers by the regulators especially the Nigerian Stock Exchange. However, this awareness needs to translate into tangible improvements in the level of regulatory compliance in the industry. This can only be achieved through investment in developing the skills and capacity of compliance officers. As the survey shows, 85% of surveyed compliance officers have less than 5 years experience, this is a source of concern.

Readers may recall that the IMF in its survey of the broker dealer sector in Nigeria, stated that the sector is a potential source of systemic risk in the Nigerian Capital Market.[1] In addition to improving the capacity of compliance officers, the regulatory agencies also need to improve the supervisory framework especially the risk based approach and provide adequate safeguards that will ensure the independence of compliance officers.

1. http://www.imf.org/external/pubs/ft/scr/2013/cr13144.pdf

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