



SECURITIES AND EXCHANGE COMMISSION

**THE CHALLENGES OF ESTABLISHING EFFICIENT
SECURITIES SETTLEMENT SYSTEM IN AN
EMERGING MARKET**

**Being a paper delivered at a colloquium on Financial Markets Law
at the first meeting of Committee on Emerging Markets Issues,
Follow-up and Implementation, organized by UNIDROIT in Rome,
Italy, 6-9, September, 2010.**

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7th September, 2010.

The views expressed in this paper are those of the author and not that of the Securities and Exchange Commission Nigeria.

Introduction

The capital market plays an increasingly important role in many emerging markets in the raising of funds needed for economic development and growth. The transfer of ownership of securities issued through the capital raising process can only be achieved where there is an effective clearing and settlement system.

Therefore without an efficient and effective securities settlement system, the transfer of ownership of securities to the buyer and the final payment of funds to the seller may be put at risk or result in unnecessary costs for market participants.

Clearing and settlement is therefore a critical component of capital markets. When this process functions effectively and efficiently, it allows market participants to determine accurately their payment and securities delivery obligations and to discharge those obligations in a predictable, safe and cost effective manner. Confidence in the mechanics for clearing and settling and holding securities is essential for well functioning markets.

CLEARING AND SETTLEMENT EXPERIENCE IN NIGERIA

In Nigeria, before the establishment of the Central Securities Clearing System (CSCS) in 1997, transactions on the Nigerian Stock Exchange took an average of between 6 and 12 months to conclude (i.e. for a certificate to be issued to the investor). Under the Nigerian Companies law transfers could not be effected without a share certificate. Investors could not take advantage of capital appreciation and transactions were delayed due to signature verification process. The system was also characterized by some dealing members selling securities they did not have while others bought securities they could not pay for. The risk in investments was significantly high, resulting in institutional and high net worth investors' unwillingness to entrust their funds and securities in the hands of many operators due to undue delays, minimal transparency, manually operated processes and the problems associated with keeping accurate record of numerous certificates to determine actual stock holdings at any point in time. It was in an effort to address these problems that the Central Securities Clearing System was established by the Nigerian stock exchange.

THE CENTRAL SECURITIES CLEARING SYSTEM (CSCS)

The CSCS was established in 1997 to provide an integrated and technologically driven central depository as well as clearing and settlement facilities for all stock market transactions in Nigeria.

Objectives of Establishing the CSCS

- To speed up delivery and Settlement System in the Nigerian Capital Market.
- To institutionalise transparency in the Market.
- To enhance Market Confidence and Integrity.

Functions and Responsibilities

- Central depository for shares of Companies
- Sub-registry for all quoted securities (in conjunction with Registrars of such Companies).
- Issuer of Central Securities Identification number to stock broking firms and investors.
- Clearing and Settlement of transactions
- Safe Keeping / Custodian of securities (in conjunction with Custodian Members for local & foreign instruments).

Ownership Structure

a) The Nigerian Stock Exchange	28.93%
b) Settlement Banks	50.76%
c) RNSE Nominees Ltd	1.18%
d) DNSE Nominees Ltd	4.91%
e) DNSE Investors Ltd	4.01%
f) DNSE Dealers Investment Ltd	0.64%
g) DNSE Digital Investment Ltd	2.22%
h) DNSE Multiple Investment Ltd	2.32%
i) Other Institutional Investors	5.03%
	<hr/>
	100%

Account Holding Pattern

- Beneficial ownership level in the CSD and as sub accounts to the stock broking firms.
- Omnibus & Segregated in the CSD and as sub accounts to the custodians.

Depository Participants (CSDPs)

- Stock broking firms
- Custodians

- Registrars
- Settlement Banks
- Money Market Institutions

Clearing & Settlement System

- T + 3 transaction cycle
- Delivery – Versus – Payment (DVP)
- Transfer of Securities & Fund occur on T + 3

Securities Being Cleared & Settled

- Equities
- Government Bonds (Federal & State)
- Corporate Bonds
- Treasury Bills

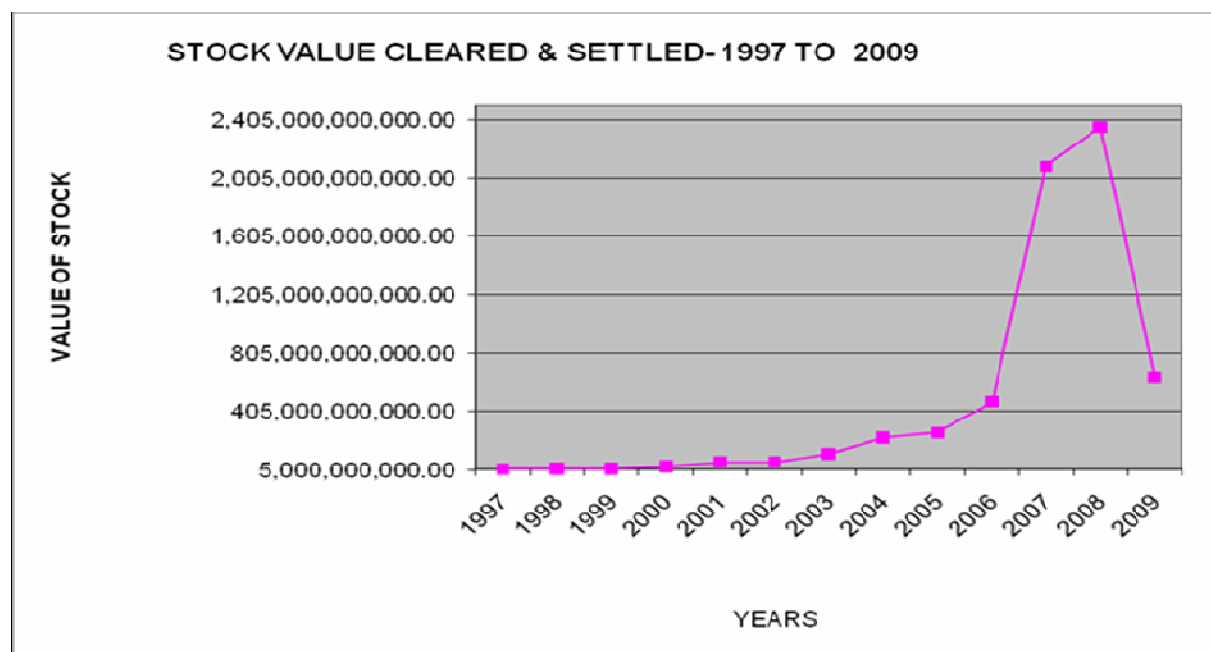
STOCK VALUE CLEARED AND SETTLED

CSCS STATISTICS (1997 TO 2009)

**STOCK VALUE CLEARED AND
SETTLED**

YEAR	VALUE =N=
1997	10,250,061,072.27
1998	13,417,635,490.39
1999	13,526,667,684.62
2000	28,362,787,550.50

2001	57,546,585,916.66
2002	59,055,275,344.97
2003	113,609,569,757.10
2004	225,526,771,388.31
2005	258,559,541,079.16
2006	469,619,953,223.99
2007	2,083,491,851,247.59
2008	2,353,491,447,642.53
2009	684,263,892,290.23
TOTAL	6,370,722,039,688.32 or USD 41.9 billion

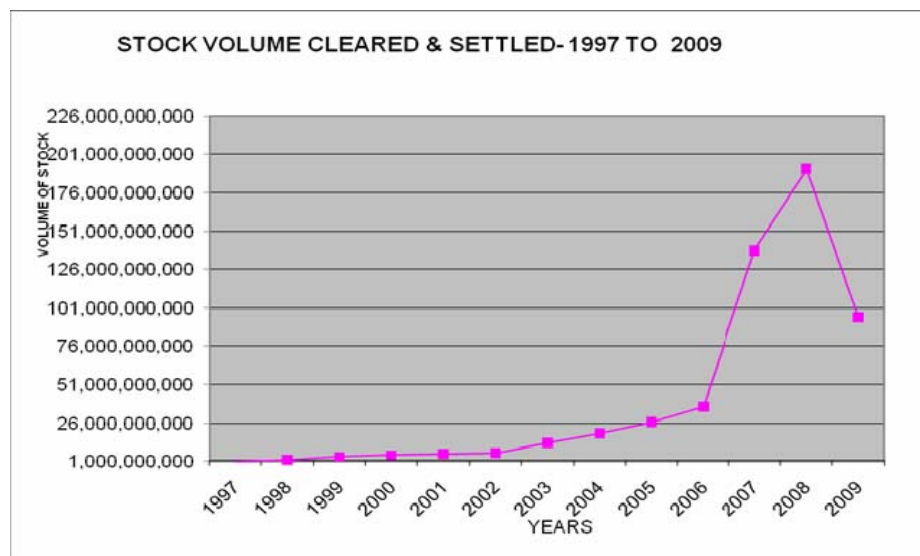


STOCK VOLUME CLEARED AND SETTLED

CSCS STATISTICS (1997 TO 2009)

STOCK VOLUME CLEARED AND
SETTLED

YEAR	VOLUME
1997	701,721,018
1998	2,057,218,468
1999	3,969,981,318
2000	5,111,120,336
2001	6,013,330,728
2002	6,550,780,753
2003	13,219,753,314
2004	19,338,911,689
2005	26,707,348,403
2006	36,661,813,166
2007	138,163,672,644
2008	191,593,887,369
2009	102,671,352,433
TOTAL	552,760,891,639

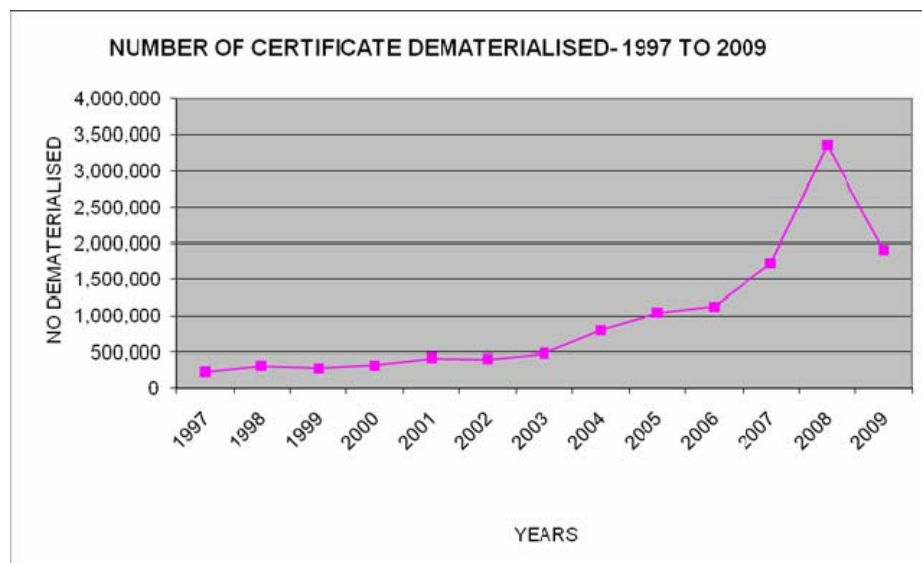


NUMBER OF CERTIFICATES DEMATERIALIZED

CSCS STATISTICS (1997 TO 2009)

**NUMBER OF CERTIFICATES
DEMATERIALIZED**

YEARS	NUMBER
1997	229,359
1998	311,107
1999	277,395
2000	318,048
2001	417,212
2002	405,798
2003	484,615
2004	800,421
2005	1,046,789
2006	1,128,071
2007	1,725,644
2008	3,357,064
2009	1,999,093
TOTAL	12,500,616

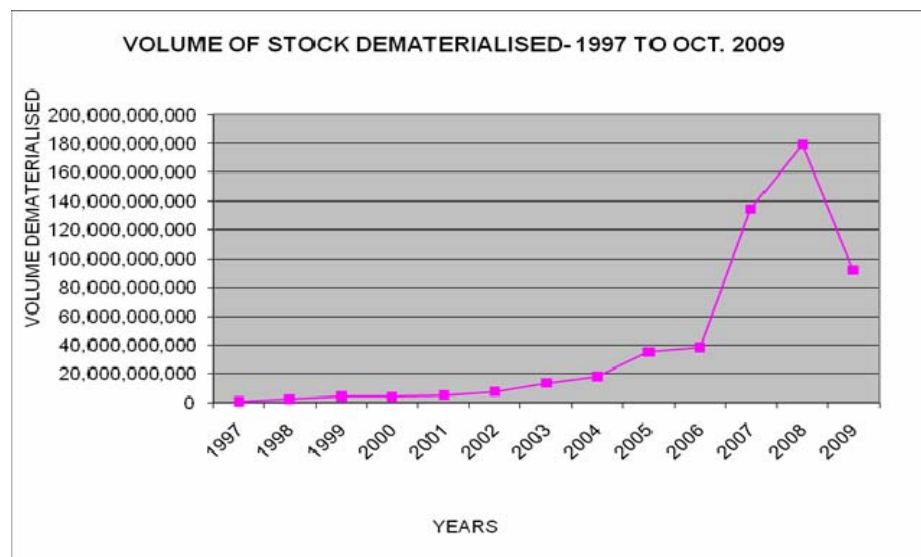


VOLUME OF STOCKS DEMATERIALIZED

CSCS STATISTICS (1997 TO 2009)

VOLUME OF STOCK DEMATERIALIZED

YEARS	VOLUME
1997	884,229,295
1998	2,415,018,638
1999	4,308,959,485
2000	4,204,695,343
2001	5,241,187,070
2002	7,580,614,086
2003	13,665,421,373
2004	18,164,094,856
2005	35,240,568,082
2006	38,537,172,592
2007	134,422,131,950
2008	179,523,820,165
2009	100,536,867,772
TOTAL	544,724,780,707



CHALLENGES

The establishment of securities settlement system in many emerging markets is not without some challenges despite the obvious benefits of the system. Some of these challenges that are peculiar to many markets in sub Saharan Africa include the following:

1. RESISTANCE TO CHANGE

A substantial number of investors are retail investors, many of whom are not sophisticated and lack sufficient knowledge of market operations and processes. They prefer to buy and hold their securities and not willing to immobilize their certificates. The implication of this is that they are reluctant to accept the change and participate in any settlement system that mandates immobilization of certificates for purpose of trading and settlement of the trades.

Therefore while immobilization of share certificates into a central depository may eliminate most of the risks associated with physical movement of certificates, the attitude of investors in holding on to share certificates as veritable properties could affect the acceptance or otherwise of a central depository in some emerging markets. For example in Nigeria, prior to the establishment of the CSCS, market capitalization increased steadily from N6.79 billion (USD400) in 1986 to N285.82 billion (USD1.88bn) in 1996 and dropped to N281.96 (USD1.85bn) and N262.52 (USD1.72bn) in 1997 and 1998

respectively. It however rose to N300.04 billion (USD1.97bn) in 1999 two years after the CSCS commenced operations.

The integrity of the settlement system and its employees is therefore very essential in building investors' confidence.

2. MARKET TECHNOLOGY AND INNOVATION

It is a fairly settled issue as regards the minimum technology required to ensure the efficiency of a securities settlement system. The cost of acquiring and replacing this infrastructure in the face of technological innovation (which occur regularly) can be a big challenge to a settlement system in an emerging market and so interface with global settlement systems in situations of cross-border transactions can become problematic.

3. COST OF INFRASTRUCTURE

The high cost of acquiring the appropriate IT infrastructure is a big challenge for participants and this can affect the efficiency of a settlement system. A number of participants are not adequately capitalized and therefore do not have the resources to acquire these facilities that will ensure speedy settlement of trades.

The lack of resources by participants can also impact on their ability to acquire the appropriate IT infrastructure that will facilitate speedy data exchange with the settlement system. Also the lack of adequate power supply in many emerging markets and the huge cost of providing alternatives to run the system significantly affect its efficiency.

4. SLOW PACE OF GROWTH IN THE NATIONAL PAYMENT SYSTEM

The payment systems in many emerging markets have been slow in developing structures that are in line with international best practices. Although the Central Banks in many of these countries have set up inter-bank settlement systems, quite a number of them are not seamless. Only recently in Nigeria, the government directed that all payments by ministries and agencies must be made through electronic transfers. This has made payments more efficient. The CSCS in Nigeria is only just considering applying for a special banking license to facilitate securities settlement and make the system more efficient.

5. INADEQUATE ACCESS TO INFORMATION

In some emerging markets access to information by investors and some of the participants is hampered by poor infrastructure. This has also impacted on the accuracy of information which is a big challenge in many of these jurisdictions.

6. TRANSPARENCY AND RELIABILITY OF INFORMATION

The financial markets are information driven. An efficient securities settlement system requires transparent and reliable information. The inadequacy of appropriate IT infrastructure in many emerging markets impact on the integrity and reliability of some of the market information and this can pose a challenge to

the settlement system as some of the critical participants are unable to meet the IT requirement for data exchange.

7. DELIVERY v PAYMENT PROBLEMS

Delivery v. Payment is a settlement mechanism which links a securities transfer and a funds transfer in such a way as to ensure that delivery occurs if and only if the corresponding payments occur. A settlement system as in some emerging markets where there is no central counterparty is a challenge to its efficiency.

8. PROBLEMS ASSOCIATED WITH NON-STRAIGHT THROUGH PROCESSING PROCEDURE

Straight -Through Processing (STP) is the automated end-to-end processing of trades/payment transfers and this includes where relevant, the automated completion of confirmation, matching, generation, clearing and settlement of orders. In many emerging markets there is no direct link between the securities settlement system and critical participants such as custodians. In many instances there is automation gap between the settlement systems and the registrars (share transfer agents). There is therefore the need for more investment in IT infrastructure in line with global best practices.

9. MANPOWER DEVELOPMENT/CAPACITY BUILDING

While effort to develop capacity is vigorously pursued in most emerging markets, the low level of well trained personnel to effectively manage the system may pose a problem to its efficient

functioning. Inadequate training funds may be a challenge to participants' effort to build staff capacity. Apart from this, there is an obvious gap in knowledge of the dynamics of the market between participants and most investors in many emerging markets.

CURRENT EFFORTS TO ADDRESS CHALLENGES

1. Investor Education

Efforts are being stepped up in many emerging markets to increase investment in investor education programme. In Nigeria for example a capital market institute was established by the Securities and Exchange Commission to provide training facilities for both operators and investors. In addition, capital market studies has been introduced in some Nigerian Universities while a curriculum for capital market studies was developed and has now been incorporated into the secondary school system. Other public enlightenment programmes are undertaken on a regular basis to educate the general investing public on market operations.

2. Dematerialization Of Securities

The dematerialization of securities will enhance the efficiency of the settlement system. Given the attitude of many investors in some emerging markets regarding immobilization of

certificates, a gradual dematerialization of securities is being implemented in Nigeria. This will give enough time for investors to become aware of the benefits of dematerialization.

3. Use of Custodians in Securities Transactions

Investors are generally being encouraged to use the services of custodians. The Securities and Exchange Commission Nigeria has published a proposal on the use of custodians in securities transaction and in collective investment schemes. This is another way of immobilizing share certificates and enhancing the efficiency of the settlement system.

4. Emphasis on e-processes in the market

Many emerging markets have established e-processes in their markets. This it is believed will enhance market integrity and reduce transaction time which ultimately impacts on the efficiency of the settlement system.

CONCLUSION

There is no doubt that an efficient securities settlement system can enhance the integrity of a market. It is important for the governance structure of the settlement system to meet the desired best practices that will ensure a transparent and well functioning system. The quality of the governance regime will have a positive impact on sustenance of investors' confidence.

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September 7, 2010.