DEMUTUALIZATION OF THE NIGERIAN STOCK EXCHANGE

INTRODUCTION

On 10th March 2021, The Nigerian Stock Exchange (NSE) announced that it had formally completed the process of the demutualisation of the stock exchange having received the requisite approvals from the Securities and Exchange Commission (SEC) and the Corporate Affairs Commission (CAC). This move by the NSE essentially means that the bourse which had operated as mutual not-for profit entity will now be a for profit entity.

What is Demutualization
Demutualization refers to the change in the legal status of an entity from a mutually owned association into a company limited by shares. It is the process of converting a non-profit member owned organization to a for-profit, investor-owned corporation.

In this regard, it is the conversion of the Nigerian Capital Market from a company limited by guarantee to a publicly traded company owned by shareholders.
Put simply, in a traditional system of operating a stock exchange, a broker who wishes to trade on an exchange has to be approved as an owner and or member in order to trade, however in a demutualized exchange, the broker need not be a member of the exchange before using the exchange's system and facilities to execute transactions.

An essential feature of a demutualized exchange is that it separates trading and ownership rights.
The subject of the demutualization of the Nigerian Stock Exchange is not new, as it had been a reoccurring subject as early as 2001. However, it gained significant traction on the 30th of March 2017 at an Extraordinary General Meeting of the NSE where there was a unanimous vote assenting to the Demutualization of the Nigerian Capital Market. It gained further cognizance in August of 2018, when the Demutualization Bill was passed into law, which marked the officially commencement of the demutualization process.

By the Demutualization of the exchange the capital market will birthe a non-operating holding company (Nigerian Exchange Group) with three operating subsidiaries Nigerian Exchange Limited (NGX) responsible with operating the demutualized exchange, NGX Regulation Limited (NGX REGCO) responsible for regulating the demutualized exchange and NGX Real Estate Limited (NGX RELCO) responsible for the real estate arms of the exchange.

Reasons of Demutualization
In the early 1990's countries in a bid to make their bourses more efficicent and competitive have adopted and taken the model of demutualizing their capital markets

There have been different reasons highlighted for demutualiztion. Whilst the reasons are non-exhaustive, the following appear to be more prevalent:

a. **Revenue Generation:** Increased competition and the possibility of listing in multiple exchanges both within region and abroad inevitably leads to a reduction in membership fees, listing fees and transaction fees. This is somewhat foreseeable as the possibility of listing in multiple exchanges which gives more visibility and exposure to prospective investors is most likely to be the preferred choice of broker-dealers. In view of this, it is thus inevitable that exchanges will seek to formulate means of generating revenue which has been described to be mainly by transactions and related services.

b. **Technological Innovations:** The emergence of technology in capital market operations has garnered competition between exchanges by eliminating barriers and monopolies. Thus, one of the reasons some bourses embark on demutualization is as a result of technological innovations.

c. **Operational Structure:** This would be inevitable as a new structure is essential to make the exchange a profitable organization. Furthermore, some exchanges have engaged in demutualization for the purpose of mergers.

d. **Competition:** Bourses demutualize in a bid to meet up with ardent competition generated by the possibility of dual listing, alternative forms of trading amongst others. To avoid remaining obsolete, exchanges embrace these new competitive measures to remain a viable business, and one of the best ways of doing this by converting into a for-profit entity.

There is no doubt that the demutualization of the Nigerian bourse has the propensity to yield fruitful outcomes as it has been described by relevant stakeholders to be a well thought through and carefully implemented process. Some of the potential benefits of demutualization have been listed to include but not limited to:

a. Flexible and improved government structure of the bourse which will foster decisive action in response to changes in the ever-evolving business environment. This is can be made possible due to the separation of ownership rights from trading rights.

b. Greater investor participation in the governance of the exchange as a demutualized exchange affords both institutional investors and retail investors the opportunity to become shareholders in the bourse.

c. Enhancement of the ability to raise capital. A demutualized bourse would attract investors instead of reliance on donor funding or mutual members.

d. It has the propensity to lead to an improved trading platform especially in the bid to be competitive as well as adopt financial innovation, complying with the demand for new risk management, and derivative products which are fueling global growth in exchange-traded and over the counter.

Whilst this development is considered a good move, there still are some grey areas that have not been sufficiently addressed and it is pertinent to note that if the new demutualized entity is desirous of attaining a great level of efficiency and attract investors these areas must be addressed.

REGULATION OF THE NEW ENTITY.

Regulating the securities market is essential to ensure efficiency, integrity and fairness of the markets that together lend credibility to markets and safeguard investor interest and confidence. In this regard, not much has been said in relation to the regulatory regime the new demutualized will adopt. Addressing this will be essential to attracting investors both institutional and retail investors as well as instill the requisite confidence to trade in such a market. Whilst it is arguable that there is the formulation of the NGX Regulation Limited (NGX REGCO) which is stated to be responsible for regulating the demutualized exchange, how will its operations be effected? How will it be funded? Will it serve as an SRO? These need to be specifically highlighted to enhance the confidence of investors in the system and the need for this further accentuated by the fact that the exchange is now been operated as a business for profit thus giving the room for the possibility to ignore malpractices in the bid to enhance its profitability.

Safeguards towards avoiding issues of conflict of interest.

One prevailing issue that has been evident with demutualized bourses around the globe is the issue of conflict of interest that may arise in different forms. There is the constant battle of protecting the integrity of the bourse as against making more profit for shareholders who may be tempted to allow some wrong practices go unpunished in a bid not to give the bourse. This still goes on to highlight to a considerable extent the regulation of the new entity, it should be relatively clear and explicit as this may have the propensity to enhance the confidence prospective investors in the market.

CONCLUSION

The demutualization of the Nigerian Stock Exchange is one that has the likelihood of placing the bourse at par with its international counterparts. However, to get to this level, it is important that the regulatory structure is well panned out, with its principles explicitly implemented especially in adopting international best practices with no room for malpractices in other to enhance the confidence of investors in the market.

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