PRESENTATION TO AIHN:
Benefits of a Consolidated Stockbroking Industry

Presented by
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for
M & A: Recapitalizing the Stockbroking Industry Workshop
Lagos, Nigeria
September 18, 2014

The Nigerian Stock Exchange
Agenda

1. Introduction: Change is Progress
2. Current Status of the Brokerage Industry
3. Where We’re Going
4. How We’ll Get There
5. Review of Minimum Standards
6. Road Map to Success
7. Benefits of Consolidation
8. Role of Issuing House Community
9. Conclusion
10. Thank You
"The secret of Change is to focus all of your energy, not on fighting the old, but on building the new.”

– Socrates

"The only thing that is constant is Change.”

– Heraclitus

"Change will not come if we wait for some other person or some other time. We are the ones we've been waiting for. We are the Change that we seek.”

– Obama

“If there is no struggle, there is no progress.”

– Frederick Douglass

“You must be the Change you wish to see in the world.”

– Gandhi
High number of very small members renders the broker business model economically non-viable for most players...

### Estimated distribution of broker revenue pool

<table>
<thead>
<tr>
<th># of brokers per $b market cap</th>
<th># of brokers</th>
<th>Estimated distribution of broker revenue pool</th>
</tr>
</thead>
<tbody>
<tr>
<td>0.53</td>
<td>103</td>
<td>Top 10 players ($1.7m per broker)</td>
</tr>
<tr>
<td>0.23</td>
<td>48</td>
<td>Remaining 297 players ($39k per broker)</td>
</tr>
<tr>
<td>0.13</td>
<td>27</td>
<td>NSE broker rev. pool</td>
</tr>
<tr>
<td>0.06</td>
<td>350</td>
<td></td>
</tr>
<tr>
<td>0.06</td>
<td>58</td>
<td></td>
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</table>

$100\% = 29$

...which leads to several issues regarding professionalization of the market:

1. **Unattractive for global players’ market entry** due to lack of potential partners
2. **Limited investor reach** due to long tail of small fringe players without adequate investor coverage
3. **Underdeveloped broker capabilities/capacities** due to lack of scale
4. **High costs of surveillance** due to granular structure of the market with multiple small instances of fraudulent behaviour that need to be prosecuted
5. **Low economic viability** due to lack of scale effects and low pricing power

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1 Assuming the average fee per trade
International Benchmarks

A. Low market concentration
   - Fragmented local broker market with long tail of inactive fringe players
   - Merely local game

B. Limited investor reach
   - Low retail penetration
   - Low institutional flows

C. Low broker capabilities
   - Elementary products and services
   - No deep research penetration

D. Weak regulatory structure
   - Evolving governance and policy framework
   - Low hurdles for local market participation

E. Low economic viability / financial efficiency
   - Structural low profitability
   - High broker commissions
   - Low operating margins

High market concentration
   - Professional local brokers
   - Participation of global players

High investor reach
   - High retail penetration
   - High institutional flows

High broker capabilities
   - Innovative products and services
   - Professional and responsible research

Strong regulatory structure
   - Robust governance and strong enforcement

High economic viability / financial efficiency
   - High operating margins
   - Scale effects
   - Low cost of trade

New minimum standards to be rolled out

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Nigeria

India

Brazil

Thailand

International Benchmarks

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Where we’re going

Exchange

- Fully demutualized, for-profit, listed with a global and local shareholder base
- Strong partnerships and co-operation with leading global exchange operators
- Operationally efficient, competitive, with robust infrastructure and systems
- Frequent product innovation including new asset classes and data services

Issuers

- The first choice for access to growth capital for Nigerian companies
- The exchange of choice for African Oil, Gas and Power sectors
- A brand name stock market where issuers list on to enhance their international reputation and ratings

Investors

- A diversified investor base with local and international institutional, HNWI and retail investors
- Local PFAs approaching cap allocation in corporate equities and bond markets
- Investments from leading international fund managers
- Strong presence on International indices
- High-frequency trading supported with full breadth of trading technology

Intermediaries

- <100 to 50 members, local and foreign, with easy access to the exchange
- A competitive broker market with large players providing value added services (e.g. analysis, coverage, road shows) as the NSE’s distribution channel locally and internationally
- Cross membership agreements with other exchanges allowing trade on NSE

Regulation

- Streamlined and standardized listing regulation process
- Effective trust enhancing regulation and enforcement
How we’ll get there: The 5 Key Levers

In addition to a consolidated brokerage industry, it is imperative to consider other factors that will drive efficiency in the Nigerian capital market.

Such factors include:
- Expanding investor reach, both internationally and domestically;
- Elevating broker capabilities;
- Strengthening the regulatory framework; and
- Ensuring clear vision and economic viability of the brokerage industry.

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<table>
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<tr>
<th>Main levers</th>
<th>Examples</th>
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<tbody>
<tr>
<td><strong>1. Advance consolidation and professionalization</strong></td>
<td>- WSE launched remote membership program for foreign brokers in 2005</td>
</tr>
<tr>
<td></td>
<td>- SET removed limit of foreign ownership in brokerage firms in 1998</td>
</tr>
<tr>
<td></td>
<td>- SGX successful demutualization</td>
</tr>
<tr>
<td><strong>2. Increase investor reach</strong></td>
<td>- SET launched a program to attract foreign investor interest via roadshows</td>
</tr>
<tr>
<td></td>
<td>- Implementation of sub-broker model in India in 1992</td>
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<td><strong>3. Elevate broker capabilities</strong></td>
<td>- India introduced enabling regulations to expand product portfolio and value-added services</td>
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<tr>
<td><strong>4. Strengthen the regulatory framework</strong></td>
<td>- SEBI issued arbitration guidelines for stock exchanges in India</td>
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<tr>
<td><strong>5. Ensure clear vision and economic viability of brokerage industry</strong></td>
<td>- Malaysia launched highly successful capital markets master plan in 2001</td>
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How we’ll get there: A Two Pronged Approach

• In order to maintain the stability of the Nigerian capital market, the NSE and the Securities and Exchange Commission (SEC) have developed a two pronged approach to strengthen intermediaries.

• The two approaches include minimum operating standards (MOS) as introduced by the NSE and minimum capital requirements as specified by the SEC.

• Enforcement of these two standards is imperative for the success of the Exchange in meeting its strategic objective to be the leading exchange in Africa.

<table>
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<th>Enforcement of Minimum Operating Standards</th>
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<tr>
<td>▪ To ensure long term market protection of the capital market, the NSE has set new minimum operating standards for all Dealing Members licensed by the bourse, effective January 1, 2015.</td>
</tr>
<tr>
<td>▪ The new standards will cater for all three classes of dealing members (broker dealers, brokers and dealers) and address five broad areas of concentration.</td>
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<td>▪ The objective is to transform market operators now with minimum operating standards in a concise manner that is both easy to comprehend and implement.</td>
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<td>▪ The SEC has approved new minimum capital requirements for all categories of Capital Market Operators.</td>
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<tr>
<td>▪ The new minimum capital requirements are as follows:</td>
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<tr>
<td>▪ Broker/Dealer: N300 million</td>
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<tr>
<td>▪ Brokers: N200 million</td>
</tr>
<tr>
<td>▪ Dealers: N100 million</td>
</tr>
<tr>
<td>▪ Underwriters: N200 million</td>
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<tr>
<td>▪ Issuing Houses: N200 million</td>
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Why Minimum Operating Standards?

**PURPOSE OF MINIMUM OPERATING STANDARDS**

- To improve corporate governance.
- To strengthen and deepen the market.
- To build a world class market.
- To restore investor confidence and create wealth.
- Investor protection and to secure a sustainable market.
- Reduce the cost of capital formation and increase economic growth.

**FIVE BROAD AREAS OF CONCENTRATION**

- Manpower and equipment;
- Organizational structure and governance;
- Effective processes;
- Global competitiveness; and
- Technology.
Road Map to Success

A: Low market concentration
- Fragmented local broker market with long tail of inactive fringe players
- Merely local game
Consolidate local brokers, attract foreign brokers

B: Limited investor reach
- Low retail penetration
- Low institutional flows
Promote alternate channels, sub-broker model and leveraging of existing distribution networks

C: Low broker capabilities
- Elementary products and services
- No deep research penetration
Mandate product coverage capacity and support/subsidize industry research

D: Weak regulatory structure
- Evolving governance and policy framework
- Low hurdles for local market participation
Review existing regulations and empower enforcement rights of NSE and SEC

E: Low economic viability / financial efficiency
- High broker commissions
- Low operating margins
Attract global brokers and gradually liberalize pricing

High market concentration
- Professional local brokers
- Participation of global players

High investor reach
- High retail penetration
- High institutional flows

High broker capabilities
- Innovative products and services
- Professional and responsible research

Strong reg. structure
- Robust governance and strong enforcement

High economic viability / financial efficiency
- Low cost of trade
- High operating margins
<table>
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<th>Key initiatives</th>
<th>Impact</th>
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<tr>
<td><strong>Thailand</strong></td>
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<td>Post 1998 crisis, ceiling of 40% foreign ownership in a brokerage firm was removed</td>
<td></td>
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<tr>
<td><strong>Poland</strong></td>
<td></td>
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<tr>
<td>July 2005, WSE launched its remote membership program for foreign brokers</td>
<td></td>
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<tr>
<td>▪ Direct access to the WSE system without physical presence in Poland and without the service of local intermediaries</td>
<td>▪ WSE admitted 7 remote members, within 6 months of launch</td>
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<td></td>
<td>▪ Today exchange has 31 foreign brokers and 29 domestic ones</td>
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**Benefits of Consolidation – Case Study**

**Attraction of Major Global Brokers to the Market:**

- Merrill took 51% stake in Phatra securities
  - Today, Merrill contributes ~50% of revenues
- Societe Generale took 51% stake in Asia Credit
- Dutch player ABN Amro took a controlling stake in Asia Securities Trading
Benefits of Consolidation – Case Study

- Sub broker concept was inherent in Indian brokerage industry
- Sub-broker model became the main distribution channel for tier 2 and tier 3 cities, allowing leading brokerage houses to establish pan-India network

- Implementation of “SEBI brokers and sub-brokers rules” in 1992, provided the enabling framework

- Average number of sub-brokers per broker, NSE

- +39% p.a.

- 586 cities across
- 1,607 business locations (branches plus franchisees)
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The brokerage community & the NSE have developed 5 working groups to support each MOS theme. The issuing house community is also invited to develop groups to support MOS. The NSE has dedicated staff on call for each area of concentration.

Drive M&A Activity

Issuing houses should strive to engage the brokerage community to promote M&A activity. Dealings with brokerage clients should be in line with standard client engagement procedures.

Support MOS Working Groups

Act as Information Clearing House

In the role as an information clearing house, issuing houses can provide information on processes /benefits of consolidation, provide introductions to potential domestic or foreign partnerships/investors, etc.
Conclusion: Why Change?

If you wish to move mountains tomorrow…

...you must start by lifting stones today
THANK YOU

Questions & Answers

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