



## **QUESTIONS & SOLUTIONS**

### **Examination Paper 2.4**

**Ethics and Professional Standards  
Law relating to Securities and Investments  
Regulations of Securities and Corporate Finance**

**Professional Examination  
March 2021**

**Level 2**

## **Question 2 – Ethics and Professional Standards**

- 2a) An Authorized Dealing Clerk of the NSE has been alleged to be involved in “front-running” while executing his trades on 14<sup>th</sup> March, 2021 in violation of NSE rule 17.12. What does this mean? Give an example. (2 marks)

### **Solution to 2a)**

Front-running is the unethical practice of a stockbroker, trading shares for his own account while taking advantage of advance knowledge of pending orders from his customers. It is also known as forward trading (1 mark)

For example, a stockbroker is aware of an order to purchase 10 million units of the shares of ABC Limited by one of his firm’s large clients. Knowing that this large order will push up the price of the stock, the stockbroker purchases 1,000 units of ABC Limited’s shares for his own account hoping to profit from the price increase. (1 mark)

- 2b) A dealing member firm of the NSE has been alleged to be involved in “Churning” while executing trades on the account of one of the clients, Jimmy James, in violation of NSE Rule 17.16. What does this mean? Exemplify. (2 marks)

### **Solution to 2b)**

Churning is excessive trading by a dealing member on a client’s account which does little to meet the client’s investment objectives and is largely done to generate commissions. (1 mark)

Example: buying non-dividend stocks for a pensioner; buying and selling the same stocks same day at a loss or break even or marginal profit. (1 mark)

## **Question 5 – Ethics and Professional Standards**

### **5a)**

Joseph Smart, FCS is a portfolio manager at Front Line Securities Ltd which manages Omega Treasure Fund, one of the most successful hedge funds on Broad Street, Lagos. Treasure Fund assets are invested in a wide range of securities including equities, fixed income securities, venture capital and derivatives.

Joseph Smart regularly obtains useful information from Dr. Yakubu, a renowned physician who serves as a consultant to HMP Plc, a biotechnology firm, during the clinical trials of Covinol, a drug which offers a possible treatment for Covid-19. Dr Yakubu also works as a consultant for an expert networking firm. The firm puts the doctor in contact with portfolio managers such as Joseph Smart for a fee.

Beginning in November 2020 Dr. Yakubu and Joseph Smart developed a personal relationship independent of the one they had through the expert networking firm. On different occasions Joseph Smart gives the doctor cash or pays for expenses he incurs. He also offers to hire Dr. Yakubu as a consultant or permanent advisor in a new hedge fund he is about to float.

In early 2020, while the clinical trials for Covinol are in progress, Dr. Yakubu furnishes Joseph Smart information not publicly available about the trials. Specifically, in January he learns from an independent safety committee at HMP Plc that a portion of the trials would be discontinued following serious adverse side effects suffered by some patients.

A press release is scheduled to be issued on January 30, 2021. Prior to that date, January 28, 2021, Dr. Yakubu informs Joseph Smart about the decision of the committee and the

upcoming press release. Joseph Smart immediately directs that the entire portfolio of Omega Treasure Fund Ltd assets invested in HMP Plc be sold. By selling two million shares at N25.10 per share, the fund avoided losses totaling about N300 million. The sell mandate was executed on the same day.

- 5a1) With reference to CIS Codes of Ethics and Standards of Professional Conduct and other relevant securities and investment regulation, identify the ethical issues arising from this case. (8 marks)
- 5a2) What are the possible consequences of the unethical practices and/infractions identified in (5a) above. (Note: Clearly highlight the consequences both to the individuals and the companies concerned). (8 marks)
- 5a3) Prepare the contract note for the sale of shares (4 marks)

### **Solution to Question 5**

#### **5a1) Ethical issues arising from the case, with reference to CIS Codes of Ethics and Standards of Professional Conduct and other relevant Securities and Investment Regulation.**

- 1) Joseph Smart regularly obtaining useful information from Dr. Yakubu, a renowned physician and a consultant to HMP Plc, where his Omega Treasure Fund has sizeable units is unethical and amounts to insider information and weak professional standard.
- 2) Joseph Smart on different occasion giving Dr. Yakubu cash (who serves as a Consultant to HMP Plc, where his firm has sizeable holdings) and paying for expenses he incurs could also impair the independence and objectivity of Dr. Yakubu and capable of inducing him to keep giving out more privileged information to Joseph Smart through inducements, independence and objectivity of Dr Yakubu is in question.
- 3) Joseph Smart offering to hire Dr. Yakubu as a Consultant or Permanent Advisor in a new hedge fund he is about to float, is unethical and could also impair the independence and objectivity of Dr. Yakubu as this offer might encourage/bribe him to keep giving out other privileged information to Joseph Smart.
- 4) Dr. Yakubu furnishing Joseph Smart with information not publicly available, and Joseph Smart accepting same amounts to violation of integrity, ethics and professional standards.
- 5) Sale by Joseph Smart of the entire portfolio/units that Omega Treasure Fund Ltd assets invested in HMP Plc based on a material, price sensitive non- public information he got from Dr. Yakubu is unprofessional.
- 6) Immediate sale of 2 million shares of HMP Plc by Joseph Smart on 28/01/2021 amounted to a privileged and unfair dealing, as well as it being an unfair practice on the entire market participants/stakeholders.
- 7) Joseph Smart (FCS), a portfolio manager, who ought to have a thorough understanding of securities and investment committed several breaches and violated many market rules on trading with insider information, ethics and professional standards
- 8) Joseph breached the standard on responsibility to the employer by promising to hire Dr. Yakubu in a new hedge fund he is about to float.

(1 mark for each point = 8 marks)

**5a2) POSSIBLE CONSEQUENCES OF THE UNETHICAL PRACTICES AND/INFRACTIONS IDENTIFIED IN (5A) ABOVE TO THE INDIVIDUALS CONCERNED).**

Joseph smart (FCS), a Portfolio Manager and Dr. Yakubu, a Consultant to a PLC. Possible consequences of the unethical practices and/infractions identified:

- (a) Admonition
- (b) Fine Payment
- (c) Suspension
- (d) Expulsion
- (e) Withdrawal of practicing license
- (f) Revocation of registration with SEC
- (g) Censure & Warning (Public Naming & Shaming)
- (h) Disqualification of individual professionals from practicing by SEC
- (i) Being barred from public and private positions in the Market.
- (j) Prevention from seeking jobs within the industry.
- (k) Sanction by CIS
- (l) Legal Action

(½ mark for each point = 4 marks)

FRONT LINE SECURITIES LTD, A CAPITAL MARKET OPERATOR (INSTITUTION/COMPANY) COULD FACE POSSIBLE REGULATORY SANCTIONS SUCH AS:

- (a) Admonition
- (b) Fine Payment
- (c) Suspension
- (d) Expulsion
- (e) Withdrawal of dealing license by The NSE
- (f) Nullification and voiding of the insider dealing transactions
- (g) Revocation of Suspension or cancellation of registration with SEC
- (h) Censure & Warning (Public Naming & Shaming)

(½ mark for each point = 4 marks)

**5a3) THE CONTRACT NOTE FOR THE SALE OF SHARES**

<b>FRONTLINE SECURITIES LIMITED</b>		(1 mark)
<b>(Member of Nigerian Stock Exchange)</b>		
<b>SOLD CONTRACT NOTES</b>		
OMEGA TREASURE FUND		
NO 50 BROAD STREET, LAGOS		
Tel: 08033333330		
E-mail: <a href="mailto:omegatreasure@yahoo.com">omegatreasure@yahoo.com</a>		
Date: 28/01/2021		
<b>DESCRIPTIONS</b>	<b>SALES</b>	
<b>SECURITY</b>	<b>HMP PLC</b>	
UNITS	2,000,000	
PRICE	25.10	

	CONSIDERATION	50,200,000.00	(¼ mark)
	LESS CHARGES:		
1	STAMP DUTY	40,160.00	(¼ mark)
*2	*COMMISSION	*677,700.00	(¼ mark)
*3	*VAT ON COMM	*50,827.50	(¼ mark)
4	SEC FEE	-	(¼ mark)
5	NSE FEE	150,600.00	(¼ mark)
6	VAT ON NSE FEE	11,295.00	(¼ mark)
7	CSCS FEE	150,600.00	(¼ mark)
8	VAT ON CSCS FEE	11,295.00	(¼ mark)
9	TRADE ALERT	4.00	(¼ mark)
10	VAT ON TRADE ALERT	0.30	(¼ mark)
12	FINAL NET PROCEEDS	49,107,518.20	(¼ mark)

**Question 3 – Laws Relating to Securities and Investments**

- 3a) In respect of a Bill of Exchange, what is the essential distinction between a holder for value, and a holder in due course. (2 marks)
- 3b) Clearly explain the term “Del Credere Agent” (1 mark)

**Solution to Question 1**

- 3a) A holder for value under S.27 of Bill of Exchange Act 1990 takes the bill subject to existing rights or equities. (1 mark)

While a holder in due course under S.29 of Bill of Exchange Act 1990 takes the bill free from all existing rights or equities. (1 mark)

- 3b) “Del Credere Agent” is the type of agent who in consideration of extra commission, guarantees his principal that any third party introduced by him to the principal will perform his obligations under the transaction between them. (1 mark)

**Question 6 – Law Relating to Securities and Investments**

(12 marks)

- 6a1) Enumerate the persons who are disqualified from joining in the formation of a company under the Companies and Allied Matters Act 2004 (4 marks)
- 6a2) Mr Farmer was the owner of a cocoa farm measuring ten hectares of land in Ekiti State which he insured in his name with Konisanwo Insurance Plc. He sold the cocoa farm to Onigbese Plc three years ago for N20 million and was paid with N10 million in cash and 10 million fully paid ordinary shares of Onigbese Plc. In the meantime, he continued to pay the premium of the insurance to Konisanwo Insurance Plc. Unfortunately a mammoth bush fire destroyed the farm a few weeks ago Mr. Farmer made a claim for compensation from Konisanwo Insurance Plc which has denied liability Advise Mr Farmer (4 marks)
- 6a3) State the grounds upon which a company may be wound-up by the Federal High Court under S.408 of the Companies and Allied Matters Act (CAMA) 2004 (2 marks)
- 6a4) Enumerate for (4) types of negotiable instruments (2 marks)

**Solution to Question 6**

6a)

6a1) The following persons are disqualified:

- i). A minor or infant below the age of 18 years
- ii). A certified insane person
- iii). An undischarged bankrupt
- iv). A person disqualified from being a director under S. 254 of the CAMA
- v). v. A corporate body in liquidation (1 for any 4)

6a2) A person must have insurable interest in the subject matter of insurance. (1 mark)

This means that he must gain a benefit in its preservation or suffer a loss in its destruction (2 marks)

Mr Farmer has no insurable interest in the cocoa farm and therefore he cannot make a claim for compensation from the insurance company (1 mark)

6a3)

- i. Special resolution
- ii). Default in respect of holding statutory meeting or in delivering the statutory report

- iii). Reduction of members below two
- iv). Inability to pay debts
- v). If it is just and equitable in the court's opinion

(½ mark for any 4)

6a4)

- i. Bearer debentures
- ii. Bills of Exchange
- iii. Dividend warrants
- iv. Treasury bills
- v. Traveller's cheques
- vi. Promissory notes
- vii. Bearer bonds

½ marks for any 4

#### **Question 4 – Regulations of Securities and Corporate Finance**

- 4a) What is e-dividend? (1 mark)  
4b) Briefly state its procedures and list any 2 of its benefits (2 marks)

#### **Solution to Question 4**

4a)

E-dividend refers to the electronic payment of dividend due to a shareholder through a direct credit into his or her nominated bank account rather than issuance of cheque or warrant. It is a new, convenient, secure online means of paying dividends directly to shareholders' accounts instead of printing and mailing dividend warrants as previously done. (1 mark)

4b)

The procedure involves an investor completing an e-div mandate form and submitting same through the registrars/banks/stockbroking firms. Shareholders' accounts will then be credited immediately, that is, within 24 hours of the dividend being declared by PLCs. (1 mark)

Benefits of e-Dividends

- a) It allows dividends to be credited directly into shareholders' accounts within few days of payment by the company.
  - b) Quick and direct access to cash dividends by investors.
  - c) It will help reduce the quantum of unclaimed dividends in the system.
  - d) Increase transparency and efficiency in the administration of dividend payment.
  - e) More satisfied investors as dividends are received promptly, and so more investors will be attracted into the capital market.
  - f) Saves time as there will be no more waiting for the dividend warrant in the mail or queuing to pay in the bank.
  - g) Implementation of the e-dividend programme would also enable investors enjoy the benefits of the Direct Cash Settlement (DCS) as e-Dividend platform creates an avenue for a transparent compliance with the DCS.
- (1 mark for any 4)

#### **Question 7 – Regulations of Securities and Corporate Finance**

An issue of rights to a company's existing shareholders entitles them to buy additional shares directly from the company in proportion to their existing holdings, within a fixed time period. In a rights offering, the subscription price at which each share may be purchased is generally at a discount to the current market price.

- 7a1) Clearly specify and discuss the procedures to be observed before a company could issue rights to its shareholders. (5 marks)

7a2) "Rights are transferable, allowing the holder to sell them on the open market".

Discuss the procedure for trading rights on the floor of the Nigerian Stock Exchange. (6 marks)

- 7a3) Briefly discuss six important information that the rights circular is expected to contain, in line with SEC Rule 56. (5 marks)

- 7a4) Pursuant to SEC Rule 301, what are the events that could warrant SEC to grant extension of time to the closing date of a rights issue? (2 marks)  
(Total: 18 marks)

#### **Solution to Question 7**

7a1):

- 1) The management of the firm decides:
  - That rights issue is the most appropriate option to raise more funds.
  - The exercise price (the price existing shareholders must pay for new shares).
  - How many rights will be required to purchase one new share.



- 2) Management gets the approval of the Board of Directors.
- 3) Shareholders give approval at an AGM.
- 4) The firm prepares and files a registration statement with the SEC.
- 5) If everything is agreeable with the SEC, the rights issue is approved.
- 6) A price is set and a full-fledged selling effort gets underway.

(1 mark for any 5)

**7a2:**

- 1) Shareholder completes and signs the renunciation portion of right circular.
- 2) Signs transfer form as transferor.
- 3) Signature is witnessed by stockbroker.
- 4) Transfer form and right circular sent to registrar for verification.
- 5) Rights are traded at NSE.
- 6) Transfer forms of both transferor and transferee are sent to NSE for noting.
- 7) Noted transfer forms and right circular are lodged with the registrar accompanied by the amount for the rights.

(1 for any 6)

**7a3:**

Contents of a Rights Issue Every right circular shall contain the following information:

- 1) The front cover shall state the name of the issuer, the issuing house, certificate of incorporation (RC number) of the issuer shall be printed on the right circular, type of the offer, total amount / number of shares to be offered, the basis for the rights issue, the price and amount payable in full on application;
- 2) A detailed table of contents in the fore part of the right circular showing the subject matter of the various sections or subscriptions;
- 3) Summary of the offer stating the amount/number of shares on offer, the offer price , purpose of the offer, the opening and closing date of the offer, shareholding structure, authorized share capital, issued and fully paid, indebtedness of the company stating details of bridging loan if any;
- 4) The chairman's letter / statement which should disclose ,working capital adequacy and future developments of the company and any other material information;
- 5) Five years historical financial information on balance sheets, profit and loss account, cash flow and notes to the accounts;
- 6) Statutory and general information including the history and business of the company, date of incorporation, registration number and shareholding structure, claims and litigation, material contracts, consents, documents available for inspection and any other material information, directors interest, related party transactions, indebtedness, costs and expenses;
- 7) Procedure for application and allotment;
- 8) Receiving agents and receiving banks;
- 9) Application form.

(1 for any 5)

**7a4:**

The Commission may, on an application by the issuer, grant extension of time on the happening of any of the following events:

- i. Upheavals, which could be either religious, political or social. These must be national or within the catchment areas of the issuer (i.e. Where most of the shareholders reside); (½ marks)
- ii. Crisis such as labor unrest or riots which could lead to office shutdowns; (½ mark)
- iii. A minimum of three (3) days public holidays within an offer period; (½ marks)
- iv. Natural disasters such as earthquake, fire outbreaks, etc. (½ marks)  
(2 mark)