



# Share Certificates and Dematerialization of Shares in Nigeria

Aina Blankson LP

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## Introduction

A share in a company is the expression of a proprietary relationship between the proportionate owner of the company (the shareholder) and the company itself. To serve as evidence of ownership, the Companies and Allied Matters Act<sup>1</sup> ("CAMA" or the "Act") requires companies to issue share certificates to their shareholders and have their names registered in the companies' register of members. This system is paper-based and fast becoming obsolete especially in foreign climes as the advancement of technology has resulted in a global preference for electronic mechanisms of recognizing the ownership of shares.

However, following recent developments in the Nigerian capital market, there has been a clamour by the Nigerian Stock Exchange ("NSE") and the Central Bank of Nigeria ("CBN") for a dematerialized shares regime in the country. While this has become an important milestone in the annals of our history, there have been bottlenecks militating against its enforcement.

This Newsletter therefore examines the process of allotment of shares; the relevance of share certificates; dematerialization of share certificates *vis-a-vis* the relevant provisions of CAMA; and

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<sup>1</sup> Cap C20, Laws of the Federation of Nigeria, 2004

the place of the Central Securities Clearing Systems ("CSCS") in the scheme of things.

## Shares and the relevance of shares certificates

CAMA defines shares as "the interests in a company's share capital of a member who is entitled to share in the capital or income of such company..."<sup>2</sup> The significance of this interest is that it is the "object through which the holders become members of a company"<sup>3</sup>, such that the issuance of a share certificate under the common seal of a company to shareholders constitutes *prima facie* evidence of the title of the members to those shares.<sup>4</sup>

Where these shares are publicly traded on the Stock Exchange, the importance of possessing a share certificate evidencing ownership cannot be over emphasized. The CSCS was incorporated to serve as a clearing settlement and delivery system for transactions in shares listed on the NSE and operates a computerized system in this process.

## Allotment of Shares under CAMA

As indivisible units of a company's capital, shares express the proprietary relationship between a company and its shareholders, in which the shareholder's interest in the ownership of the company is

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<sup>2</sup> Section 567 CAMA

<sup>3</sup> Principles of Nigerian Company Law, page 145.

<sup>4</sup> Section 147 (1) CAMA



proportionate to the amount of shareholding he possesses.

In most cases, the contract<sup>5</sup> with the company is constituted by an application being made by the intending shareholder to the company for an allotment of a certain number of shares, and by an allotment being made, and notified to him.<sup>6</sup> The provisions of section 125 of the Act in respect of allotment of issued shares of a company are to the effect that:

- a) in the case of a private company or a public company where the issue of shares is not public, there shall be submitted to the company a written application signed by the person wishing to purchase shares and indicating the number of shares required;
- b) in the case of a public company, subject to any conditions imposed by the Securities and Exchange Commission where the issue of shares is public, there shall be returned to the company a form of application as prescribed in the company's Articles, duly completed and signed by the person wishing to purchase shares.

Where the company wholly or partially accepts the application, an allotment will be made to the applicant and within 42 days after the allotment, the applicant is to

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<sup>5</sup> The nature of allotment is contractual in law as there is basically an offer, consideration and acceptance in the transaction.

<sup>6</sup> Halsbury Laws of England, 4<sup>th</sup> Edition, Vol 7, para 364

be notified of the allotment and the number of shares allotted to him.<sup>7</sup> The contract thus takes effect on the day on which the allotment was made by the company.<sup>8</sup> As such, once an allotment has been made, it cannot be cancelled by the company and upon registration of the name in the company's register, the allottee becomes a member of the company.<sup>9</sup>

### **Nature of Share Certificates under CAMA**

Section 146 (1) of the Act provides that every company must, within two months after the allotment of any of its shares and within three months after the date on which a transfer of any such shares is lodged with the company, complete and have ready for delivery, the certificate of shares allotted or transferred, unless the conditions of issue of the shares provide otherwise.

The nature of share certificates is such that it confers proprietary rights on the holder, and similar to any other property belonging to an individual, can be sold or transferred by the shareholder.<sup>10</sup> Since, like the membership register, a share certificate is *prima facie* evidence<sup>11</sup> only, it can be said that it is far from being a document of title in the sense that a share warrant is<sup>12</sup>. However, where there is

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<sup>7</sup> Section 125 (c)

<sup>8</sup> Section 126

<sup>9</sup> *Edokpolor and Co Ltd v. Sem-Edo Ind Ltd* (1984) 7 SC 119

<sup>10</sup> *London Foundries Association v. Clarke* (1838) Q.B.D. 576

<sup>11</sup> Section 147 CAMA

<sup>12</sup> By the provision of section 149, the Act abolished the issuance of share warrants.

conflict between the register of members and the shares certificate, the former is stronger *prima facie* evidence than the latter as to evidence of title and membership of the company.

Suppose for instance that Shareholder A, whose name is on the company's register and is so entitled to be registered, loses his certificate, subsequently obtains a duplicate from the company<sup>13</sup> and then transfers to B who is registered by the company. Afterwards, the original certificate is found by A, who then, either because he is a rogue or has forgotten about the initial transfer to B, purports to sell the shares to C. Rightly, the company will refuse to register C as a shareholder unless same can successfully invoke the doctrine of *estoppel by share certificate* against the company. While this may be beyond the scope of this topic, the above scenario highlights some of the challenges with issuance of share certificates under the Act.

Where a person entitled to a share certificate does not receive it within the time stipulated by the Act, he may serve notice on the company requiring it to make good the default. Where the company fails to furnish the share certificate within 10 days, an application may be made to the Federal High Court for an order directing the company to issue the said certificate. The court may also order that any incidental costs to the

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<sup>13</sup> Usually the company will require the registered holder to depose to an affidavit regarding the loss and ask that the holder furnish it with an indemnity against any liability that it may incur. See Section 146 (4) CAMA

application be borne by the company and any officer responsible for the default<sup>14</sup>.

### ***Dematerialization of Shares and the Central Securities Clearing System***

Prior to the advent of the CSCS, share certificates were issued as physical paper certificates which indicated that the holder owned a certain amount of shares in the company. Commissioned on April 8, 1997 and managed by the Central Securities Clearing System Limited, the CSCS is one of the revolutionary developments with respect to dealings in company securities in the Nigerian capital market. The CSCS incorporates a Central Securities Depository (CSD) for the share certificates of listed securities and a sub-registry for all listed securities. It is estimated that the facility has the capacity to manage over 9 billion investor accounts.

Upon opening a CSCS account, a shareholder's data is captured and transferred into an electronic register with the equivalent number of securities credited in electronic form to the CSCS depository. An electronic statement reflecting the shareholder's shareholding and its current value replaces the physical paper share certificates earlier issued. This process, otherwise known as dematerialization, facilitates paperless trading whereby transactions are executed electronically.

Dematerialization is the conversion of a share certificate from its physical form to electronic form for the same number of holding which is credited to an individual's

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<sup>14</sup> Section 146 (5) CAMA

demat account that is opened with the Central Securities Clearing Systems Limited through a licensed Stockbroker or Depository Participants (DP). The dematerialization procedure requires an investor to open an account with the CSCS through a Stockbroker or a DP. Thereafter, the shareholder/investor would request for the dematerialization of his share certificates through the Stockbroker or DP so that the dematerialized holdings can be credited into that account.

Typically, under the CSCS, a transfer of shares will take the following outline: the shareholder contacts and deposits his share certificate with a licensed broker with a mandate to sell the shares. Thereafter, the shareholder executes a share transfer form which is then forwarded with the certificate to the Registrar for verification, after which the verified certificate and form are forwarded to the CSCS by the Registrar. After being notified of the verified certificate and form, the broker subsequently completes the necessary CSCS forms after which the CSCS issues an approved certificate deposit form which certifies the stock broker to trade<sup>15</sup>. The broker then offers the shares for sale electronically on the trading floor, and when the right bid comes in, a deal is consummated through the computer<sup>16</sup> and bargain slips exchanged by the respective brokers. Subsequently, the buying broker informs the CSCS of the allotment, and the CSCS

notifies the broker's bank and inter broker settlement is carried out. The sold shares are then moved from the selling broker's account to that of the buying broker and the CSCS forwards the transaction diskette to the Registrar in order to update the register of members. The shareholder is then notified of the allotment by the broker and receives his shareholding statement.

The system of dematerialization offers capacity for paperless trading through state-of-the-art technology, whereby share transactions and transfers are processed electronically without the need for share certificate or transfer deed once the certificates have been converted to electronic form. The benefits of dematerialization to the economy, companies, shareholders/investors and stockbrokers are endless, such as that:

- (a) it provides more acceptability and liquidity of securities in the capital market thereby building confidence in the capital market and attracting foreign investors;
- (b) it provides a safe, convenient and efficient way to hold securities;
- (c) it minimizes settlement risks and frauds in carrying out transactions in the capital market e.g., loss, theft, mutilation, forgery, etc;
- (d) it ensures transfer settlements and reduces delay in registration of shares;
- (e) it ensures faster payment on sale of shares and allows for a shorter transaction cycle;
- (f) it helps avoid bad delivery problem due to signature differences, etc;

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<sup>15</sup> Due to the immobilization, share certificates deposited with the CSCS cannot be withdrawn

<sup>16</sup> The Automated Trading System used on the floor of the Stock Exchange allows a consummated transaction to be automatically recognized by the CSCS.

Considering the foregoing economic benefits of dematerialization, it is indeed regretful that CAMA is yet to make dematerialization compulsory. As at today, this process is only optional as a shareholder or investor can still have his shares in physical form. Dematerialization is only required for securities intended to be traded on the Stock Exchange.

### ***Dematerialization and the provisions of CAMA***

It is quite regrettable that the provisions of CAMA do not provide for the issuance of share certificates in electronic form. In view of technological advancements with respect to ownership and transfer of shares, we consider this to be a shortcoming of the Act that needs urgent redress. While the form of the certificate is governed by the Articles of the company, the Act requires that the certificate be issued under the common seal of the company.<sup>17</sup> In effect, the Act only recognizes physical paper certificate as opposed to electronic certificates. In practice however, most companies, especially publicly listed companies, do not issue share certificates; rather they direct allottees to open CSCS accounts so that their shareholding will be reflected therein. In effect, the actions of these companies are a contravention of the provisions of the Act, notwithstanding the fact that the shareholder or investor can demand for physical share certificates.<sup>18</sup> Paper share certificates used to be the

only way for shareholders to prove and record ownership of shares, however that no longer seems to be the case, as the rapid acceptance of technology has caught on, allowing companies and brokers keep track of shareholders electronically.

For companies trading on the floor of the Stock Exchange, the Securities and Exchange Commission ("SEC") rules<sup>19</sup> require that the shares of these companies be held in dematerialized form.<sup>20</sup> One question that comes to mind however is "can the rules and regulations made by SEC supersede the provisions of CAMA?" There is no specific case law on this subject, it is however worthy of note that while the SEC rules is a subsidiary legislation, CAMA is a parent legislation, being an Act of the National Assembly. It would therefore appear that the provisions of CAMA ought to supersede the SEC rules where there is a conflict on the one hand.

On the other hand, it is possible to argue that there can be no conflict as only those companies or corporations operating in the capital market will be affected by the SEC rules whilst all other companies who do not have listed shares or operations within the capital market will be governed under CAMA.

Irrespective of the foregoing analyses on conflicts between the SEC rules and CAMA, we must applaud the notable strides of SEC in publishing these rules and we admonish the Corporate Affairs Commission to liaise with the National

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<sup>17</sup> Section 146(3) CAMA

<sup>18</sup> Section 146(5) accords the shareholder the right to seek redress in court where the company fails to issue physical share certificate.

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<sup>19</sup> Consolidated Rules and Regulations 2011

<sup>20</sup> See Rule 168(a)

Assembly towards an amendment of the relevant provisions of CAMA to cater for electronic certificates, with the penalty whittled down. So far as these provisions are still operative under CAMA and pending harmonization with the SEC rules, the non-issuance of share certificates constitutes an offence under the Act.

### **Conclusion**

In Nigeria, dematerialization of share certificates started in 1997 and over a decade after, it is sad that the compliance level is only a meager 30%. This is the resultant effect of the discretion allowed investors as well as investors' resistance to change or hold-tight syndrome even as Securities and Exchange Commission (SEC) – the capital market regulatory authority – intensifies efforts at dematerialization.

Like India, it is time to adopt a compulsory dematerialization policy to enable us harness the full benefits of the dematerialization system. It however becomes an urgent responsibility for the regulatory authorities to put in place the legal framework for its implementation and to sensitize the investing public of the benefits therein.

Just as the new Evidence Act 2011 provides for the admissibility of electronic signature and documents, it is high time that the importance of technology as a tool for business and advancement is recognized by our legislations. Consequently, we advocate for a review of the relevant provisions of the Act so as to bring it in conformity with developments in most parts of the world as it pertains specifically to dematerialization of shares

as well as other contemporary corporate issues.

Furthermore, all stakeholders are enjoined to embrace the dematerialization system and to continually seek to improve the efficiency and effectiveness of the clearing and settlement systems which are essential to sustained growth of any capital market.

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**Compliance & Secretarial  
Department  
Aina Blankson LP  
5/7 Ademola Street  
South-West Ikoyi  
Lagos  
Tel: +234 1 8980882-3  
Fax: +234 1 2710566  
[www.ainablankson.com](http://www.ainablankson.com)**

*For further information please contact any of the contributors:*



**Eghosa Isibor**

[c.isibor@ainablankson.com](mailto:c.isibor@ainablankson.com)



**Banji Adenusi**

[o.adenusi@ainablankson.com](mailto:o.adenusi@ainablankson.com)



**Ayo Adisa**

[a.adisa@ainablankson.com](mailto:a.adisa@ainablankson.com)

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