# FMDQ SPOTLIGHT

FMDQ

...empowering the OTC markets

## *Newsletter Edition 12 – October 2015*

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# New Stories

## FMDQ supports Covenant University as MD/CEO speaks at Town & Gown Seminar

As part of efforts geared towards promoting financial markets knowledge among its stakeholders and the wider public as a whole, the MD/CEO of FMDQ OTC Securities Exchange (FMDQ), Mr. Bola Onadele. Koko, honored an invitation from the Banking and Finance Students Association (Covenant University Chapter) as the guest speaker at its September 2015 Town & Gown Seminar. This Seminar, which saw in attendance 100 level – 400 level students, lecturers, as well as the Dean of the College of Business and Social Sciences, provided insight into the functionalities of the Nigerian financial markets and in particular, the OTC securities exchange.

Covenant University is a growing, dynamic and vision-driven Nigerian university, committed to pioneering excellence at the cutting edge of learning. The University, with the aim of building a world-class institution that will be a pride of Africa as well as take its place among the Ivy League Universities on the global platform, has a mandate to revolutionise the educational landscape of Africa through its potential to institute a learning context that is rich in educational opportunities, research and scholarship.

FMDQ's participation at the Seminar presented an opportunity for further interactions on the proposed strategic alliance between the University and the Exchange, in line with its commitment to promote financial market literacy among students. Covenant University's Center for Learning Resources was presented with books and other corporate literature donated by FMDQ.

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## FMDQ hosts the 2015 Nigerian Debt Capital Markets Workshop

FMDQ, in collaboration with the International Finance Corporation (IFC), and supported by the Securities and Exchange Commission (SEC), organised a 2-day Workshop, from October 27 to October 28, 2015, on the Nigerian debt capital markets (DCM). The Workshop, which was themed *"The Nigerian Debt Capital Markets – Towards a Brighter Future"*, was aimed at diagnosing the issues hindering the empowerment of the Nigerian DCM and propounding practical and implementable remedies to the issues, positioning the markets unprecedented growth.

With a focus strategy outlined in its Vision 2020 document and supported by the 7-Point Agenda, Nigeria has the potential to become one of the twenty (20) largest economies in the world by the year 2020. The role of the capital markets in driving the actualisation of the nation's development agenda cannot be overemphasised, taking into consideration the ability of the markets to pool and mobilise both local and foreign capital towards financing economic growth and development. With the host of challenges Nigeria is currently faced in its DCM, ranging from, among others, low credit transmission to inadequate infrastructure (power, housing and transportation) and long issuance time-to-market, the Workshop could not have come at a more appropriate time.

The well-attended Workshop highlighted the role and impact of the DCM – to the government, regulators, issuers, investors, market operators, and economy as a whole – providing a high-level forum for stakeholders of the Nigerian DCM, including subject-matter experts from global model markets to brainstorm, with a view to bridging the developmental gaps and fostering sustainable growth in the Nigerian DCM. Pertinent issues (ranging from interest rates, infrastructure (power, transportation, housing) development, education and health, wealth and employment creation, through to individual prosperity) impacting on the development of any nation and in particular, Nigeria, via the DCM, were focused on. Resolutions to these issues, arrived at during the Workshop, and their successful implementation have the potential to positively impact every sphere of the nation, from the government echelons all the way to the citizen levels.

FMDQ, in conjunction with SEC, will project-manage the resolutions from the Workshop, championing the identified DCM-focused initiatives which will impact the real sectors of the Nigerian economy, ultimately serving to promote the nation's vision. An implementation roadmap, the Nigerian DCM Roadmap, which will serve as the basis for all the DCM Projects to be spearheaded by FMDQ and SEC, will be developed and executed accordingly. The Implementation Team will provide periodic updates to stakeholders, via organised forums, on the progress of the initiatives to ensure accountability.

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# *FMDQ Listings & Quotations*

## FMDQ admits the listing of the ₦30.00bn Fidelity Bank PLC Bond

On the heels of circa ₦72.04bn corporate bonds listed on the platform of FMDQ, comes yet another achievement with the listing of the **Fidelity Bank PLC ₦30,000,000,000.00 16.48% Subordinated Unsecured Fixed Rate Bond** (the "Fidelity Bank Bond"). As has become the tradition with the securities exchange, the Fidelity Bank Bond was welcomed onto the platform with a Listing Ceremony which saw in attendance, the issuer, represented by Mr. Nnamdi Okonkwo (Managing Director/CEO, Fidelity Bank PLC), the Registration Member

(Listings) of FMDQ, Mr. Tony Anonyai and Mr. Efe Akhigbe (Co-CEOs, Planet Capital Limited), among other key parties to the listing.

In his brief remark, the MD/CEO of FMDQ, Mr. Bola Onadele. Koko, expressed his delight at the level of market acceptance which FMDQ had gained following its launch onto the Nigerian financial markets landscape. He noted that FMDQ, as a debt-focused securities exchange had an unwavering commitment to facilitate growth and development in the financial markets through its efficient platform for the registration, listing, quotation and valuation of bonds. He further highlighted that listing of debt securities on FMDQ provided a wide range of benefits across the debt market value chain to include global visibility and transparency to the listed debts, improved secondary market liquidity, price formation and benchmark pricing.

Speaking at the Listing Ceremony, Mr. Okonkwo commented, "as a Dealing Member of FMDQ, the bank relishes the depth and transparency of the FMDQ platform. Through the provision of reliable market data, FMDQ has empowered the Nigerian DCM with price discovery, transparency and market integrity. Following our successful experiences with FMDQ, we decided to list the Fidelity Bank Bond on the Exchange, to be a part of the bond market revolution in Nigeria". According to Okonkwo, the registration and listing process was straightforward and quick, adding that "the FMDQ team worked assiduously to obtain requisite approvals and prepare the Bond for instantaneous listing on the Exchange". He further added, "by virtue of this listing, the bank is offering greater value to its esteemed shareholders and investors by improving liquidity, visibility and transparency of transactions."

Also speaking at the Ceremony, Mr. Anonyai, stated that Planet Capital Limited was pleased to have led the club of underwriters and congratulated Fidelity Bank PLC on the success of the issue. He noted that the listing of the Bond on FMDQ was good for investors as it enhanced liquidity of the security. He praised FMDQ for the simplified registration process on its platform, noting that the Exchange was facilitating the growth and development of the Nigerian financial markets.

As Nigeria's foremost debt capital securities exchange, FMDQ recognises the growth potentials of issuers of debt in the Nigerian DCM and thus provides them with a remarkable opportunity to raise the profile of their issues and access a deep pool of capital. By institutionalising robust market development and governance infrastructures, the securities exchange positively impacts the stakeholders of the Nigerian DCM i.e. issuers, issuing houses, investors, market makers and regulators, thus resulting in a more globally competitive capital market.

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# FMDQ Turnover & Dealing Members' League Table

The FMDQ OTC Market Turnover Report shows the turnover on all products traded on the FMDQ secondary market – Foreign Exchange (FX), Treasury Bills (T.Bills), Money Market (Repurchase Agreements (Repos)/Buy-Backs and Unsecured Placements/Takings) and Bonds (Federal Government of Nigeria (FGN) Bonds, Eurobonds & Other Bonds (Agency, Sub-national, Corporate & Supranational)). FX and Money Market Derivatives are embedded in the FX and Unsecured products categories respectively. These figures exclude primary market auctions in T.Bills, Bonds and FX.

The data, collated from the weekly trade data submissions by FMDQ Dealing Members, represents trades executed between Dealing Members, Dealing Members & Clients, and Dealing Members & the Central Bank of Nigeria (CBN).

## FMDQ OTC Market Turnover (January – September 2015)

| | Turnover (₦'bn) |
|---|---|
| **Foreign Exchange** | 21,590 |
| **Foreign Exchange Derivatives** | 5,913 |
| **Treasury Bills** | 35,980 |
| **FGN Bonds** | 6,924 |
| **Other Bonds** | 114 |
| **Eurobonds** | 33 |
| **Repurchase Agreements/Buy-Backs** | 24,673 |
| **Unsecured Placements/Takings** | 10,045 |
| **Money Market Derivatives** | 101 |
| | 105,374 |
| *USD equivalent ('bn)* | *536* |
| | |
| **No. of Business Days** | 162 |
| **Average Daily Turnover** | 650 |
| *USD equivalent ('bn)* | *3* |

Note: USD/₦ @196.72

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The FMDQ League Table shows the rankings of its Dealing Members across all products traded on the FMDQ platform – FX, FX Derivatives, T.Bills, Bonds (FGN Bonds, Eurobonds and Other Bonds), Money Market (Repos/Buy-Backs and Unsecured Placements/Takings) and Money Market Derivatives. The rankings represent the cumulative value across all products traded by the Dealing Members.

## Top 10 Dealing Members in FMDQ Market (January – September 2015)

| Ranking | Dealing Member |
|---|---|
| 1 | STANBIC IBTC BANK PLC |
| 2 | ACCESS BANK PLC |
| 3 | FIRST BANK OF NIGERIA LIMITED |
| 4 | DIAMOND BANK PLC |
| 5 | UNITED BANK FOR AFRICA PLC |
| 6 | SKYE BANK PLC |
| 7 | ECOBANK NIGERIA LIMITED |
| 8 | UNION BANK OF NIGERIA PLC |
| 9 | STANDARD CHARTERED BANK NIGERIA LIMITED |
| 10 | CITIBANK NIGERIA LIMITED |

All Dealing Members maintained their positions on the League Table except First Bank of Nigeria Ltd. (First Bank) and Diamond Bank PLC (Diamond Bank) swapping 3rd and 4th positions respectively due to increased trading activity in T.Bills, FGN Bonds and Repos/Buy-Back transactions by First Bank. The top ten (10) Dealing Members account for 72% (₦75.7 trillion) of the overall turnover in the market, with the top three (3) accounting for 38% (₦28.6 trillion) of this sub-section of the market.

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# *Upcoming Events*

## FMDQ ''Members Only'' Bi-Annual Meeting

As part of its commitment to develop the Nigerian financial markets and in recognition of the crucial roles its various stakeholders play in this development, FMDQ is thrilled to host its Members to the second FMDQ Bi-Annual "Members Only" Meeting scheduled to hold on December 11, 2015. Following on from the first bi-annual "Members only" meeting for 2015 which held in July, where the FMDQ Market Architecture Report was presented and reviewed by all stakeholders present, the second Meeting will focus on, among other agenda items, determining and finalising resolutions and deferred decisions from previous Members Meetings.

The Meeting will, as is customary, provide the opportunity for different players in the FMDQ market, represented by Dealing, Associate and Registration Members of FMDQ, to deliberate on and make contributions towards the development of the markets. Outcomes of the just-concluded Nigerian Debt Capital Markets Workshop will also be discussed.

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# FMDQ Learning

## An Introduction to Credit Derivatives: Credit Default Swaps

### What is a Credit Default Swap?

A Credit Default Swap (CDS) is a contract that is designed to transfer the credit exposure of a fixed income security between two or more parties. It is in effect, insurance against the risk of a default by a particular company. Often, corporate bond investors buy CDSs for protection against the default by the issuer of the corporate bond. A CDS may also involve municipal bonds, emerging market bonds or mortgage-backed securities.

The company issuing the bond is known as the *reference entity* (and is not a party to the contract) and the default by the company is known as a *credit event.* The bond is known as the *reference obligation* and the total par value of the bond is known as the *swaps notional principal.*

### How does a Credit Default Swap work?

The parties involved in a CDS are:

- The Reference Entity or Debt Issuer – Not a party to the CDS contract
- The Buyer of the CDS/ Bondholder – A party to the CDS contract
- The Seller of the CDS – A party to the CDS contract

In a CDS contract, the buyer of the CDS makes periodic premium payments to the seller of the CDS to receive credit protection against the risk that the reference entity defaults. The premium amount constitutes the 'spread' charged by the seller, which is the annual amount the buyer must pay the seller over the length of the contract, expressed as a percentage of the notional amount, in order to insure against a credit event. In return, the seller of the CDS guarantees the credit worthiness of the debt security, essentially insuring the buyer against the reference entity defaulting.

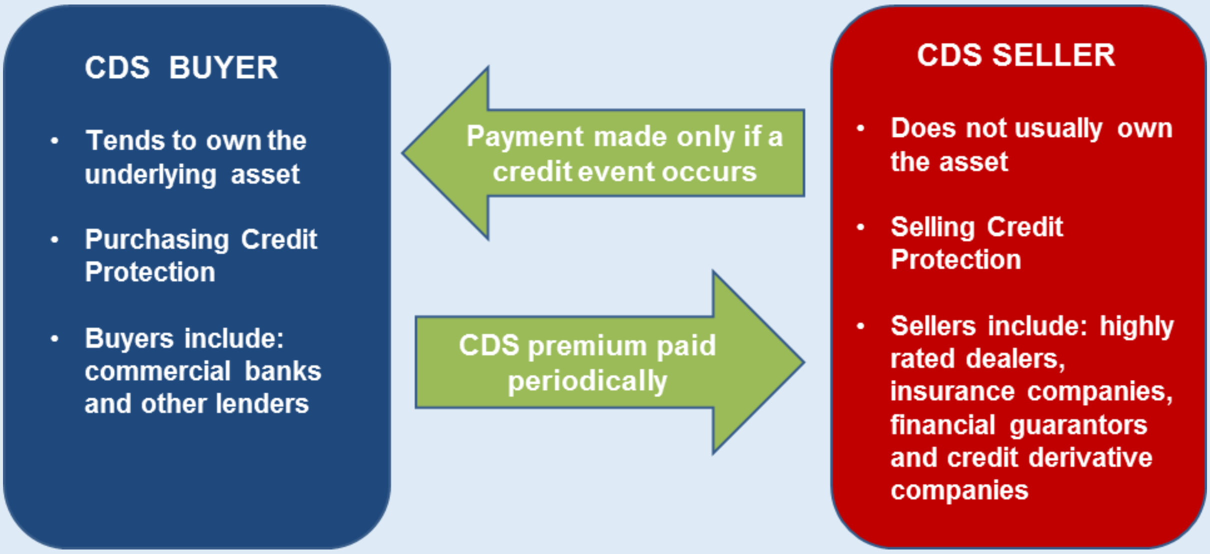
In the event of the debt issuer defaulting or a credit event occurring, which may include bankruptcy, failure to pay, debt restructuring or a credit rating downgrade, the seller will compensate the buyer by paying the par value of the bond including any lost interest and in exchange the seller takes possession of the defaulted security through settlement in cash or auction[1].

On the other hand, if the debt issuer does not default and all goes well, the CDS buyer will forfeit the money paid to the seller, while the seller profits from the income payments without having to compensate the buyer/bondholder for the par value and remaining

[1] Pimco Education (June 2006) - What are Credit Default Swaps and How do they work?

interest. The buyer, however, stands to lose a much greater proportion of their investment if the issuer defaults and the bondholder has not bought a CDS for protection. See Illustration 1 below.

**Illustration 1**




**Uses of Credit Default Swaps**

Credit default swaps are used mainly for two (2) purposes:

- **Hedging** – As described above, these products can be used to hedge against the credit risk of holding corporate bonds. An investor that is exposed to credit risk can transfer the risk by buying protection in a CDS contract. This may be preferable to selling the security outright if the investor wants to reduce exposure and not eliminate it completely
- **Trading** - In this category, these products are used for trading purposes whereby investors can buy and sell protection without owning the debt of the reference entity. Here, an investor who believes that the issuer of a debt security is unlikely to default may offer to **sell** a CDS contract to a holder of the security of the reference entity and earn an attractive premium from the holder rather than investing in the security. On the other hand, an investor who believes that the reference entity is likely to default can **purchase** a CDS by paying a premium and receive a payoff if the company does default. This way, premium and interest are received even though it is believed that the reference entity risk has been undervalued[2]

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[2] International Journal of Academic Research in Business and Social Sciences January 2012, Vol. 2, No. 1: Credit Default Swaps (CDS) and their Role in the Credit Risk Market.

## Pros and Cons of Credit Default Swaps

### Pros

- Help complete markets, as they provide an effective means to hedge and trade credit risks
- Allow credit risks to be separated from the underlying credit relationships and to be traded separately
- Help promote market liquidity and facilitate risk shifting and price discovery, and ultimately reduce costs of borrowing
- CDS markets have price leadership over bond markets and act as a clear indicator of upcoming credit downgrades by rating agencies

### Cons

- Typical of derivative contracts, they could encourage market manipulation, especially where there is a lack of transparency in the market
- They may create market instability by facilitating speculative attacks
- A number of factors could weaken the price link between CDS and bond markets. These include liquidity restrictions, tax treatments, limited short-selling opportunities, callable bonds and an additional counterparty default risk (John Hull (2001))
- Developments in CDS markets may also increase the threat of systemic crises
- It has been argued that excessive trading of CDS contracts may distort the pricing mechanism and reverse causality by forcing corporate or sovereign borrowers to pay excessively high rates on their debts

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