FMDQ SPOTLIGHT

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FMDQ

OTC Securities Exchange

...empowering the Nigerian debt capital & FX markets

FMDQ OTC Securities Exchange

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The Pacesetter, The Bond Market, & The OTC Exchange… FMDQ Honours Outgoing Director-General of the Debt Management Office

Following a decade of dedicated service, Dr. Abraham Nwankwo, whose highly successful tenure as the Director-General (DG) of the DMO, from July 2007 to June 2017, was honoured by FMDQ OTC Securities Exchange (FMDQ or the OTC Exchange) and key financial market stakeholders at a memorable ceremony held at the FMDQ offices in Lagos. This Ceremony, which was in acknowledgement of his efforts towards the growth of the Nigerian bond market, and invariably, the economy, brought together key financial market stakeholders, friends and well-wishers, all wishing to celebrate Dr. Nwankwo on his retirement from the DMO. Among those present at the Ceremony were the newly-appointed DG of the DMO, Ms. Patience Oniha; the DG, Securities and Exchange Commission (SEC), represented by Mr. Stephen A. Falomo, Head, Lagos Zonal Office, SEC; Chairman of FMDQ, Dr. Okwu Joseph Nnanna (Deputy Governor, Financial System Stability, Central Bank of Nigeria [CBN]), ably represented by Mr. Jibril Aku, Vice Chairman of FMDQ; Mr. Bolaji Balogun, Founder/Chief Executive Officer of Chapel Hill Denham Group (CHAPS) represented by Mr. Ayo Fashina; Mr. Ayo Gbeleyi, former Commissioner for Finance, Lagos State; Mr. Frank Aigbogun, Publisher/CEO of BusinessDay; Mr. Olufemi Awoyemi, Founder/Managing Director, Proshare Nigeria, representatives of the Primary Dealer Market Makers (PDMMs) who are also Dealing Member (Banks) of FMDQ, amongst others.

The rains did not douse the guard of honour-reception the FMDQ staff had planned for Dr. Nwankwo. The staff, along with some erected balloons, formed a path on both sides of a blue carpet, for him, his wife and daughter to walk through the entrance, to the humble OTC Exchange building, with FMDQ-branded umbrellas held high by the staff in a spectacle akin to the military pulling out parade! It was indeed a wonderful sight to experience.

From the very eloquently delivered citation to the series of well-articulated and goodwill messages, and even the level of attendance at the Ceremony, it was clear that the positive impact Dr. Nwankwo had made in the bond market, and by extension, the economy, over the last decade, was indeed felt and very much appreciated by all. In reliving the decade-long and successful tenure, a one-on-one discourse, anchored by FMDQ’s MD/CEO, Mr. Bola Onadele. Koko was held with the outgoing DG, DMO, following which a special symbol depicting Dr. Nwankwo’s key achievements, including, the developments which the Nigerian bond market had experienced over the last decade, was presented to and unveiled by the guest of honour, among other mementos.

Described as a “Pacesetter” in the goodwill messages which flocked in, Dr. Nwankwo set out to redefine the public debt management landscape in Nigeria, bringing on commendable verve and innovativeness to the hitherto conservative area of public finance management. From the development of a comprehensive and accurate national debt database to deepening the domestic bond market via the introduction of regular monthly bond issuances supported with the Primary Dealer Market Makers System and the consistent launch of innovative bond products including the Federal Government of Nigeria (FGN) Savings Bond, Sukuk, and the soon to be finalised FGN Dollar and Green Bonds, the DMO, under Dr. Nwankwo's leadership, progressively pursued the alignment of the Nigerian debt capital markets (DCM) to international standards.

In recording landmark achievements, including the first-ever domestic listing of the Federal Government of Nigeria Eurobond, the Agency is seen to have set an audacious pace towards effectively developing the domestic bond market. Dr. Nwankwo's quest for excellence, his consistency, integrity, professionalism and humility, were a few of the words and phrases used to describe the outgoing DG and were attributed to his exceptional performance during his 10-year tenure, under four (4) different administrations.

In consolidation of the strategic and value-adding initiatives undertaken by the DMO in developing the Nigerian debt capital markets, FMDQ, with a deep sense of appreciation as Dr. Nwankwo retires, continues to show great commitment to actualising the objectives of the Agency vis-a-vis those of the OTC Exchange for the transformation of the markets within its purview. FMDQ looks forward, in excited anticipation, to maintaining this formidable collaboration with the DMO under the new leadership of Ms. Oniha, towards the further development of the Nigerian debt capital markets, and by extension, the economy.

By serving as a point of integration between the domestic and international markets, FMDQ has, in its short period of existence, become the ambassador of foreign portfolio capital for Nigeria and lent itself as an efficient and operationally excellent platform for fixed income and currency. This is well in line with its mission to empower the financial markets to be innovative and credible, in support of the Nigerian economy. In promoting and supporting economic development therefore, the active collaboration of all stakeholders is required to erect the necessary market infrastructures, transform and position the Nigerian financial markets towards maximising its potential, and its partnership with the DMO remains a steady and right path towards actualising the shared objectives and desires of the markets.

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FMDQ Holds First Members' Meeting for 2017

Desirous of a continued and effective collaboration with its Members, FMDQ played host to major players in the FMDQ markets represented by the respective membership categories of the OTC Exchange (Dealing, Associate & Registration Members) to its first "Members Only" Meeting for 2017. The Meeting, which held on July 14, 2017, at The Wheatbaker Hotel, Ikoyi, Lagos, brought together representatives from institutions represented in the FMDQ markets under the various FMDQ membership categories, and provided a platform for deliberating on key issues pertinent to the development of the markets. The session commenced with a presentation on FMDQ's market development and regulation initiatives, followed by updates on the technology initiatives and the FMDQ-led Debt Capital Markets Development Project.

From collective interactions, reviews and comments, issues relevant to the development of the FMDQ markets as related to the provision of services by the OTC Exchange, and participation of the Members in the markets were discussed.

In line with the commitment to drive market and product development, and in its capacity as a market organiser, FMDQ, through the collaborative efforts of its Members and other key stakeholders, will continue to shape the markets in alignment with international standards.

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FMDQ Holds Inaugural Induction Programme for its Members' Authorised Representatives

With a strategic focus to ensure all the Authorised Representatives of Members of FMDQ are appropriately sensitised of the market development, regulatory and governance mandates of FMDQ in the OTC markets, a series of Induction Programmes have been launched for all the OTC Exchange's Members' Authorised Representatives (MARs). The ultimate objectives of these Induction Programmes are to highlight the importance of regulation and governance to the development of the Nigerian financial markets, and to foster a culture of compliance and professionalism amongst participants in the market.

MARs are employees or such other persons as may be authorised by an FMDQ Member to perform activities on its behalf on the OTC Exchange. They include, but are not limited to, treasurers, dealers, compliance officers, risk officers, treasury operations staff, treasury sales staff and control & audit staff. Essentially, the Induction Programme provides an avenue to formally introduce the MARs to FMDQ's markets, systems, processes, standards, regulation, etc., and offer a holistic view of FMDQ's dual functions as a market organiser and self-regulatory organisation, as well as create a clear understanding of FMDQ's value proposition, membership benefits, market development and governance initiatives, *inter alia*.

To this end, the inaugural Induction Programme, which commenced with the first set of Authorised Representatives of the FMDQ Dealing Member (Banks) (DMBs) i.e. CBN-licenced banks, was held on Wednesday, July 26, 2017. Subsequent sessions shall be conducted for all the Authorised Representatives of the DMBs, Dealing Member (Specialists), Associate and Registration Members over time.

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13th Naira-Settled OTC FX Futures Market Settles on FMDQ

As the sophistication of the global financial markets remains on the rise, the need to maximise the opportunities which abound in these vis-à-vis the risks inherent becomes increasingly important. Hedging against risks of price movements in the market, therefore, remains strategically important owing to the volatile nature of currencies and the possible level of business exposures to these.

Progressively, therefore, following the 1-year anniversary of the launch of the Naira-settled OTC FX Futures market in Nigeria, **$657.57mm** of the 13th OTC FX Futures contract, NGUS JUL 19 2017 at $/₦ 363.67 matured and was settled on FMDQ on Wednesday, July 19, 2017.

The matured contract, which settled at the Nigerian Autonomous Foreign Exchange Fixing (NAFEX) rate of $/₦365.33, had, unlike the 12th contract in June 2017, settled at a rate higher than the respective contract prices agreed at the point of execution of the contracts, resulting in a net payout to holders of the contract. The credibility of the market and its operational modalities are again highlighted; and the effectiveness in and indeed importance of risk management for the Nigerian FX market are further demonstrated.

Till date, over $7.00bn worth of contracts have so far traded on the FMDQ platform, with about $5.00bn matured, whilst $2.00bn remain open. Undoubtedly, the resilience in maintaining this market and ensuring its viability and sustainability, have remained of paramount importance to the CBN, market participants and FMDQ. Steps and requisite infrastructure shall continually be put in place to support the FMDQ objective of making the Nigerian markets globally competitive.

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FMDQ Lists Pioneer Infrastructure Debt Fund in Nigeria and Sub-Saharan Africa

Globally, infrastructure contributes to economic development by increasing productivity and providing amenities, which enhance quality of life and business activities. The DCM provide a key avenue through which infrastructural growth can be sustained to promote economic development, and Nigeria is beginning to take a cue from model markets like the United States, United Kingdom and Malaysia, which have used the strength of their DCM to power growth, fund and set up viable infrastructure projects to support development for the good of their citizenry. The Chapel Hill Denham Nigeria Infrastructure Debt Fund is the latest in these laudable initiatives that are paving the way for the development of Nigeria's infrastructure sectors via the Nigerian DCM. Thus, having successfully obtained the SEC's approval, Chapel Hill Denham Management Limited registered and established the Nigeria Infrastructure Debt Fund (NDIF) ₦200,000,000,000.00 Issuance Programme, and subsequently issued the first series under this Programme – Series I 49,450,000 Units of ₦101.20 each. **The NIDF (or the Fund)** – ***the Chapel Hill Denham Nigeria Infrastructure Debt Fund Series I 49,450,000 Units of ₦101.20 each, under the ₦200,000,000,000.00 Issuance Programme*** – following a very swift and efficient application process, was granted approval on July 14, 2017, by the FMDQ Board Listings, Markets and Technology Committee, to be listed on FMDQ's platform.

The Fund, which is the first-ever listed infrastructure debt fund in Nigeria (and Sub-Saharan Africa), is a close-ended fund and has its investment focus on the traditional infrastructure sectors, primarily transport, power, renewable energy, utilities, energy infrastructure (e.g. storage terminals), logistics and other public-private-partnership type investments, thereby supporting infrastructural development in Nigeria. The Fund aims to enable investors access infrastructure as an asset class, while providing the benefit of predictable returns available from long-dated infrastructure debt investments.

To commemorate this remarkable and historic feat, a prestigious Listing Ceremony was held at the offices of the OTC Exchange on Monday, July 17, 2017. In recognition of the profound significance of this achievement, FMDQ pulled out all the stops during this Ceremony, to not only express this recognition and commend Chapel Hill Denham's efforts in leveraging the Nigerian DCM in an attempt to close the nation's infrastructure gap, but also to increase awareness, towards garnering additional nationwide support for this creditable initiative. From the dedication of a live one-hour Channels Television Business Morning Show focused on the NIDF and the listing of the Fund, to the live airing of the actual hour-long Listing Ceremony, it is clear that FMDQ, in partnership with key stakeholders – the DCM community, financial services regulators and media – are total advocates of using the Nigerian DCM to finance the development of the nation.

Present at the well-organised Ceremony were the CEO, CHAPS & Chief Investment Officer, the NIDF, Mr. Bolaji Balogun; the Managing Director, Chapel Hill Denham Management Ltd. (the Fund Manager), Mrs. Ononuju Irukwu; the Director-General of SEC, ably represented by Ms. Ojone Umoru, Assistant Director (Legal), Investment Management Department, SEC;

the Managing Director, AIICO Pension & Chairman, Pension Fund Operators Association of Nigeria, Mr. Eguarekhide Longe; the Chairman, Investment Committee, NIDF, Mr. Phillip Southwell; and other senior representatives from Chapel Hill Advisory Partners Ltd. (FMDQ's Registration Member [Listings] & Sponsor of the Fund on the OTC Exchange), the Nigeria Sovereign Investment Authority, the African Development Bank, Pension Fund Administrators and other buy-side investors, amongst others.

The Listing Ceremony, in line with FMDQ's tradition, was marked with memorable highlights which included, amongst other activties, a short video on FMDQ as an innovative OTC Exchange; the signing of the FMDQ Funds Listing Register and presentation of the FMDQ Funds Listing Certificate; the unveiling of the FMDQ Listing Scrolls; and the special autograph impressions by the guests of honour.

Whilst delivering the keynote address, Mr. Bolaji Balogun said "Infrastructure funding has been a major investment theme in our firm over the last decade. We are very proud of this pioneering role and NIDF is a natural fit with our commitment to developing Nigeria and Africa's productive infrastructure. The progressive regulatory environment in Nigeria, which enabled NIDF to be conceptualised, reaffirms the forward-thinking approach of PenCom, SEC and FMDQ. Infrastructure debt provides a uniquely attractive combination of long term, stable, predictable income and a yield higher than that available from government bonds."

In the same vein, Mr. Philip Southwell, Chairman of NIDF's Investment Committee, said "NIDF aims to provide investors regular and stable income by making debt investments in Nigerian infrastructure projects. The market opportunity is huge in Nigeria not only because of the size of the pension fund assets available for investment in NIDF, but also by the number of high quality, investable projects."

In his closing address, Mr. Bola Onadele. Koko, Managing Director/CEO of FMDQ, called on governments in Nigeria to unlock the potentials of the Nigerian economy by facilitating private sector funding for infrastructure. He encouraged government reforms and regulation to position key sectors to be commercially viable to galvanise huge capital to infrastructure. Mr. Onadele stated also, that the OTC Exchange was working hard, in collaboration with other key stakeholders, to facilitate the development of a sustainable finance strategy for the country.

The listing of the NIDF on FMDQ serves to further validate the recent recognition of FMDQ as the most innovative securities exchange in the Nigerian financial markets by BusinessDay at its 2017 Top 25 Most Innovative Companies & Institutions in Nigeria Awards. FMDQ will remain steadfast in its commitment towards the development of the Nigerian DCM, and the Nigerian economy at large, and provide the requisite platform to power the growth in the Nigerian DCM, offering the highest credible markets for capital transfers.

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FMDQ TURNOVER & DEALING MEMBER (BANKS) LEAGUE TABLE

The FMDQ OTC Market Turnover Report shows the turnover on all products traded on the FMDQ secondary market – FX, Treasury Bills (T.bills), Bonds (FGN Bonds, other Bonds [Agency, Sub-national, Corporate & Supranational) & Eurobonds]) and Money Market (Repos/Buy-Backs and Unsecured Placements/Takings). These figures exclude primary market auctions in T.bills and Bonds.

The data, collated from the weekly trade data submissions by FMDQ Dealing Member (Banks), represents trades executed amongst the Dealing Member (Banks), Dealing Member (Banks) & Clients, and Dealing Member (Banks) & the CBN.

FMDQ OTC Market Turnover (January - June 2017)

Product Category	(₦'mm)	($'mm)
Foreign Exchange	6,300,470	20,174
Foreign Exchange Derivatives	7,930,750	25,365
Treasury Bills	31,309,556	100,348
FGN Bonds	5,353,372	17,169
Other Bonds*	1,631	5
Eurobonds	51,347	164
Repurchase Agreements/Buy-Backs	15,734,788	50,468
Unsecured Placements/Takings	671,796	2,150
Money Market Derivatives	19,590	63
Commercial Papers	-	-
Total	**67,373,300**	**215,906**
No. of Business Days	124	124
Average Daily Turnover	**543,333**	**1,741**

Average Rate $/₦ @ 311.99
mm - million
*Other Bonds include Agency, Sub-national, Corporate & Supranational Bonds
Note: Figures may be subject to change due to potential adjustments from Dealing Member (Banks)
Source: FMDQ Data Portal as @ July 5, 2017; Figures reported by Dealing Member (Banks) on a week-ending basis

The month of June 2017 recorded ₦12.62trn in turnover, a growth of circa 33% when compared to ₦9.49trn recorded in May 2017, bringing the total year-to-date turnover to ₦67.37trn.

The month-on-month growth was primarily driven by increased trading activities experienced in the Treasury Bills and Repurchase Agreements (Repos)/ Buy-Backs product categories, which respectively make up circa 43% and circa 28% of overall turnover; whilst FX market transactions accounted for circa 22%, Bonds, circa 6%, with Unsecured Placement & Takings, Money Market Derivatives and Commercial Papers representing circa 1% of overall market turnover.

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Top Ten (10) Dealing Member (Banks) in FMDQ Markets (January – June 2017)

The FMDQ League Table shows the rankings of its top ten (10) Dealing Member (Banks).

RANK	DEALING MEMBER (BANKS)
1	ACCESS BANK PLC
2	STANBIC IBTC BANK PLC
3	ECOBANK NIGERIA LIMITED
4	UNITED BANK FOR AFRICA PLC
5	FIRST BANK OF NIGERIA LIMITED
6	DIAMOND BANK PLC
7	STANDARD CHARTERED BANK NIGERIA LIMITED
8	GUARANTY TRUST BANK PLC
9	UNION BANK OF NIGERIA PLC
10	CITIBANK NIGERIA LIMITED

The top ten (10) Dealing Member (Banks) accounted for 70.31% (₦47.37trn) of the overall turnover in the market, with the top three (3) accounting for 45.28% (₦21.45trn) of this sub-section of the market. Access Bank PLC, Stanbic IBTC Bank PLC and Ecobank Nigeria Ltd. topped the League Table, ranking 1st, 2nd and 3rd respectively, in the value traded for the overall over-the-counter (OTC) market, maintaining their position in the League Table as the top three (3) banks for three (3) consecutive months. Access Bank PLC and Ecobank Nigeria Ltd. have, however, maintained this position for six (6) months running i.e. since the start of the year. All other Dealing Member (Banks) maintained their positions on the League Table, with the exception of Union Bank of Nigeria PLC, moving from 11th place to now occupy 9th and Citibank Nigeria Limited moving from 9th place to now occupy 10th place.

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UPCOMING EVENTS

The 2017 Nigerian Debt Capital Markets Conference

Sequel to the maiden Nigerian Debt Capital Markets Workshop which held from October 27 – 28, 2015, the FMDQ-led 2017 Nigerian DCM Conference, themed – "*Positioning for Growth*" - has been scheduled to hold in September 2017. This Conference aims to provide an enabling platform to discuss and map out strategies between various domestic and international financial market participants (model market experts, governments, regulators etc.), on effectively positioning the Nigerian DCM for growth within the global financial markets space. Further details will be communicated in due course.

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Fixed Income Derivatives

The concept of derivatives as an asset class was explored, in a three-part series, which commenced in the April 2017 through to the June 2017 editions of FMDQ Spotlight. This edition will look more specifically at a type of derivatives product, “Fixed Income Derivatives”.

Essentially, derivatives are financial market products whose values are ‘derived’ from those of one (1) or more underlying assets or sets of assets, which can be bonds, stocks, commodities, precious metals, market indices, etc. Derivatives enable investors manage exposure to certain market factors (such as movement in market prices or rates) and/or manage various risks more effectively. This is in addition to providing an avenue for speculation and arbitrage. Fixed income securities, on the other hand, are investments that offer returns in the form of fixed periodic payments (coupons), with the principals returned at maturity.

Fixed income derivatives are, therefore, financial contracts whose values are derived from the values of fixed income securities such as bonds, treasury bills and certificates of deposit. These derivatives can be traded on organised securities exchanges such as FMDQ. There are two (2) major classifications of fixed income derivatives: Interest Rate Derivatives and Credit Derivatives.

Interest Rate Derivatives

Interest Rate Derivatives (IRD) are derivative securities that derive their value from the movement of interest rates or sets of different interest rates. The interest rates could be on treasury instruments (such as government bonds, treasury bills, etc.), inter-bank rates (such as the London Inter-bank Offer Rate (LIBOR) or the Nigerian Inter-bank Offered Rate (NIBOR)) and Repurchase Agreement rates, among others.

IRDs can be classified either as vanilla (i.e. simple and common derivative contracts such as Interest Rate Swaps, Interest Rate Swaptions, Interest Rate Futures and Forward Rate Agreements), Quasi-vanilla (i.e. fairly liquid derivatives, such as Floating-for-Floating Interest Rate Swap, Corridor Swaps, Arrears Swap, Constant Maturity Swap/Floor, etc.), or exotic (i.e. more illiquid and complex, unusual and specific derivative contracts such as Cross Currency Swaptions and Target Redemption Notes). IRDs are classified based on their liquidity, tradability and complexity, with the vanilla derivatives being the most liquid and basic, and the exotic, the most illiquid and complex. These will be addressed in further detail in a subsequent edition of FMDQ Spotlight.

Typical examples of IRDs include: Interest Rate Futures (e.g. Bond Futures and Treasury Bills Futures) Interest Rate Options (e.g. Bond Options and Interest Rate Caps & Floors) and Interest Rate Swaps.

Interest Rate Futures

- **Bond Futures**

Interest Rate Futures essentially provide a means for hedging against interest rate risk (to protect actual or expected cash positions of market participants), even as speculators have the opportunity of making profits in this product, in return for bearing the risk of future interest rate fluctuations. A Bond Futures contract is one in which bonds, which are classified as interest-bearing assets, serve as the underlying assets. A Bond Futures contract is an agreement to buy or sell a bond in the future at a predetermined price. The buyer (long position) of the contract is obliged to buy the underlying bond at the agreed price on expiry of the contract, whilst the seller (short position) of the contract, is obliged to deliver the underlying bond at the agreed price. Organised Exchanges offer Bond Futures, providing platforms to reduce the counterparty risks and transaction costs, as well as improve market liquidity. Users of Bond Futures include hedgers - to protect existing portfolios against adverse interest rate movements; arbitrageurs - to profit from bond price differentials across markets; speculators –to make profit on short-term movements in bond prices; and investors - to enhance the long-term performance of a portfolio of assets.

The risks associated with Bond Futures can be huge, since bond prices can change drastically between the initial agreement date and expiry of the contract. Typically, the anticipated future price of the underlying bond theoretically determines the price of the futures contract; whereas the actual contract prices are determined by supply and demand on the Exchanges. As expected, Bond Futures are subject to margining, allowing the counterparties to make upfront payments to the market organiser, the Exchange, to reduce the risk of default.

- **Treasury Bills Futures**

Similar to Bond Futures, Treasury Bills Futures contracts are those derivatives with Treasury Bills as the underlying asset. Their prices are quoted on a discount basis. Treasury Bills Futures contracts essentially give an indication of the market's expectation of the direction of short-term interest rates, providing hedgers with a means to protect their cash flows. The equilibrium price of a contract can be determined or closely approximated from the spot Treasury Bills prices. Since market expectation of interest rates is generally an important factor in economic relationships, the information on expectations contained in the Treasury Bill Futures market remains of interest to businessmen, financial managers, policymakers, and other economic analysts.

Interest Rate Options

- **Bond Options**

A Bond Option gives the holder of the contract the right to buy or sell a specific bond within a particular period or by some future date for a set price. A Callable Bond is an example of a bond with an embedded option allowing the issuer to redeem or buy back the bond at a predetermined price before, after, or by a certain future time or even at certain different times in the future. Bonds with call options generally offer higher yields than those without due to the embedded options. A Puttable Bond, on the other hand, contains an embedded option that allows the holder to redeem his money, i.e., sell back his bond to the issuer, at a date prior to maturity and at a predetermined price, or at certain times in the future. Puttable Bonds provide lower yields than regular bonds because their prices are higher due to the embedded put option.

- **Interest Rate Caps/Floors**

An Interest Rate Cap protects the contract holder from exposure to upward interest rate movements by putting a ceiling on such movements. It is a portfolio of individual caplets (or floorlets), each representing an option on the underlying interest rate index. An Interest Rate Floor, on the other hand, is a tool used to protect the contract holder from adverse downward movements in interest rate. Thus, imposing a lower limit on interest rate movements. These kinds of derivatives are paid for upfront and their benefits can be realised over the life of the contract.

Interest Rate Swaps

- **Interest Rate Swaps**

An Interest Rate Swap is a type of derivatives contract where the counterparties agree to exchange different cash flows based on specific interest rates on a notional principal amount. One cash flow is based on a fixed interest rate (or a different floating interest rate), while the other cash flow is based on a floating interest rate. Such floating rates are ideally tied to well-known indexes, such as the LIBOR or NIBOR. Participants in the Swaps market use Interest Rate Swaps to transform interest liabilities, manage their interest rate exposure or lock in a predetermined profit level. These Swaps transactions reflect the advantages derivable from better information and lower transactions costs in the derivatives markets.

Credit Derivatives

Credit Derivatives refer to various products designed to separate and then transfer the credit risk of a corporate or sovereign borrower to a different entity other than the lender/debt-holder. They are broadly classified as either Funded Credit Derivatives or Unfunded Credit Derivatives. Whilst the credit protection is funded using securitisation techniques of a financial institution or designated special purpose vehicle in the case of the Funded Credit Derivatives, the Unfunded Credit Derivatives, on the other hand, have credit protection bought and sold between bilateral counterparties without any need for upfront payment unless a default event occurs. Funded Credit Derivatives could be in the form of Credit-linked Notes, Collateralised Debt Obligations, and Constant Proportion Debt Obligations, amongst others; whilst Unfunded Credit Derivatives include Credit Default Swaps, Credit Default Swaptions, and Total Return Swaps, among others. Credit Derivatives contracts are typically rated by rating agencies, which allow investors to appropriately position their investments in line with their risk appetites. Typical examples of Credit Derivatives include Credit Default Swaps and Collaterised Debt Obligations.

- **Credit Default Swaps**

Credit Default Swaps (CDSs) are the most common form of Credit Derivatives and may involve mortgage-backed securities and corporate bonds, amongst others. They are designed to transfer the credit exposure of debt securities between two (2) or more parties. In a CDS, the buyer makes payments to the seller up until the maturity date of the contract.

In return, the seller agrees that, in the event of a default or credit event (defined as any reduction of the creditworthiness of a debt such as rating downgrades, bankruptcies and corporate restructurings) the buyer will be paid the security's premium as well as all interest payments that would have been paid between the contract's effective date and the security's maturity date. The case for CDSs is often supported by the long-term to maturity (usually ten [10] years or more) of some applicable fixed income securities, which increase the odds of possible deterioration in the issuer's financial position. In principle, the more the holder of a security thinks its issuer is likely to default, the more desirable a CDS becomes and the more premium it commands.

- **Collateralised Debt Obligations**

A Collateralised Debt Obligation (CDO) is a structured credit derivatives product, which purchases and pools cash flow generating assets (such as mortgages, bonds and loans) together, and repackages same into a pool of discrete tranches that can be sold to investors. Each tranche essentially assumes a different risk profile, with the 'senior' tranche having a high credit rating and lower coupon rate, whilst the 'junior' tranche has a higher default risk and higher coupon rate. Parties that are involved in a CDO transaction include securities firms (who select and structure the assets into tranches and sell them to investors), CDO managers (who manage the CDO portfolios), rating agencies (who assess the CDOs and assign them credit ratings), financial guarantors (who guarantee investors for any losses on the CDO tranches in exchange for premium payments) and investors, such as hedge funds, insurance companies, banks and pension funds. Examples of CDOs are Collateralised Mortgage Obligations and Collateralised Bond Obligations in which the loans that make up the pools of debt in the CDOs are mortgages and bonds respectively.

Fixed income derivatives are financial products whose values are derived from underlying fixed income securities such as bonds and treasury bills; and offer the benefits of risk hedging, arbitrage and income opportunities to hedgers, arbitrageurs, and investors respectively. They could be structured around a broad range of derivatives products such as Options, Swaps, Futures, as well as Forward contracts. As fixed income derivatives offer customisation of exposure to various risks, they offer immense opportunities when applied appropriately and prudently.

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