FMDQ SPOTLIGHT

Newsletter Edition 20 – June 2016

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New Stories

FMDQ Signs MOU with NMRC … Towards Building the Nigerian Housing Sector through the Debt Capital Market

Sharing in the objective of the Nigeria Mortgage Refinance Company PLC (NMRC) to intermediate long-term funds from the capital market towards the development of the mortgage industry, ultimately bridging Nigeria's housing deficit through the provision of affordable housing finance, FMDQ OTC Securities Exchange ("FMDQ" or "the Exchange") has signed a Memorandum of Understanding (MOU) with NMRC. This is coming on the heels of the Regulatory Supervision Collaboration Agreement which the Exchange recently executed with the National Pension Commission, towards enhanced and efficient pension fund governance, regulation and supervision.
To mark this laudable feat, a Signing Ceremony, for the formal execution of the MOU, was held on June 8, 2016 at the NMRC offices in Abuja. In attendance were the Managing Director/CEO, NMRC, Prof. Charles Inyangete; Managing Director/CEO, FMDQ, Mr. Bola Onadele. Koko and other key representatives from NMRC and FMDQ.

Speaking during the event, Prof. Inyangete commended FMDQ for its immense contribution to the development of the Nigerian debt capital market (DCM), and noted that the MOU executed with the Exchange demonstrates NMRC's commitment to deepening the DCM. According to Mr. Onadele, "the need for effective cooperation and collaboration between FMDQ and NMRC cannot be overemphasised, as this partnership will mark an essential step towards the development of the Nigerian housing sector through, among others, the introduction and deployment of initiatives aimed at launching a range of mortgage products; the articulation of strategies aimed at developing the Nigerian mortgage industry through non-interest finance (e.g. Sukuk); partnership on awareness programmes, investor/market education and capacity building in Nigeria; and the expansion of listing opportunities for NMRC debt securities. These initiatives are geared towards engendering market confidence and allowing NMRC to effectively connect the Nigerian mortgage industry to the DCM; and collaboration on pricing methodology, valuation framework and index development for mortgage bonds."

FMDQ, in partnership with NMRC and other key stakeholders, will engage in relevant initiatives and campaigns to educate the market on mortgage-related debt instruments such as Mortgage-Backed Securities, Real Estate Investment Trusts, among others, in readiness for the ensuing housing revolution which the Nigerian market is positioned to experience.

Nigeria's housing crisis is undoubtedly treading a path towards resolution, with institutions like NMRC, putting in place the necessary requisites for vibrant primary and secondary mortgage markets, and FMDQ, providing the necessary DCM support, collaboratively working towards the ultimate goal of developing the Nigerian economy.

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The Nigerian Spot FX Two-Way Quote Market Goes Live Post Revised CBN Guidelines Release

Following the release of the revised Central Bank of Nigeria (CBN) Guidelines for the Operation of the Nigerian Inter-Bank Foreign Exchange (FX) Market, the two-way quote (2-WQ) inter-bank FX Market went live, Monday, June 20, on the platform of FMDQ, with the CBN's Authorised Dealers (ADs) setting the pace for this market-driven trading window through the FMDQ Thomson Reuters Foreign Exchange Trading System (the System).

The Guidelines, which set out a single and autonomous inter-bank FX market structure for the nation, support the CBN's desire to enhance efficiency and facilitate a liquid and transparent Nigerian FX market. The CBN will perform its role as a market intervention participant, in line with global standards, while market forces are left to determine demand and supply dynamics of the market. CBN FX Primary Dealers have also been introduced to help facilitate the CBN's market interventionist role.

Through the FMDQ Thomson Reuters FX Trading System, a dealing solution for the FX trading value chain (ADs, Authorised Buyers, International Oil Companies, Oil Servicing Companies, Exporters, End-Users etc.), towards providing an enhanced user experience, improved market access and ultimately, credibility in the nation's FX market, will be provided. The CBN ADs (as well as the FX Primary Dealers (FXPDs)) shall buy and sell FX among themselves on a two-way quote basis via the System, trade with the CBN, and will also offer one-way quotes (bid or offer) on requests-to-quote to other Authorised participants (Corporates, End-Users etc.).

According to Tumi Sekoni, Vice President & Divisional Head, Marketing & Business Development, "The inter-bank 2-WQ FX market will, through the concerted efforts of the over-the-counter (OTC) Exchange and all market participants, serve to endear an even greater investor confidence in the Nigerian FX market. With its potential to drive transparency and liquidity, FMDQ, through the System, is adequately equipped to provide a complete and consolidated marketplace for FX trading and reporting, offering market participants and regulators a robust and flexible set of tools to support the full trade workflow. The reforming of the 2-WQ inter-bank FX market brings about a lot of promise for the resuscitation of the Nigerian FX market and by extension the development of the nation's economy." She further highlighted that the goal of FMDQ as the front-line market organiser for the OTC fixed income, FX and derivatives markets is to make the Nigerian financial market globally competitive, operationally excellent, liquid and diverse.

For further enquiries on participation and membership of FMDQ, kindly contact bog@fmdqotc.com.

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The Central Bank of Nigeria, FMDQ Launch the Naira-settled OTC FX Futures Market

The CBN made history in the Nigerian FX market as it became the pioneer seller of the Naira-settled OTC FX Futures contracts on FMDQ on Monday, June 27, 2016. This came exactly one (1) week after two-way quote trading commenced in the Nigerian FX market on the back of the recent release of the revised CBN Guidelines for the Operation of the Nigerian Inter-Bank FX Market (the Guidelines), essentially transitioning the market from a pegged FX rate regime to a floating one.

This landmark achievement in the Nigerian Financial Markets has indeed been a long time coming, spanning thirty (30) years, when the inter-bank FX market in Nigeria commenced and the Exchange Rate Liberalisation Policy was introduced in 1986, to the introduction of the Foreign Exchange (Monitoring & Miscellaneous Provisions) (FEMM) Decree 1995 (which became an Act in 2004), the commencement of the Two-way Quote System (market making) in the inter-bank FX market in 1996, then further liberalisation of the FX Market by the introduction of the Wholesale Dutch Auction System (WDAS) in 2006, to the commencement of the fixed exchange rate regime in 2015, and now, coming on the heels of a tumultuous Nigerian economic climate in 2015, the welcome development in 2016 in the form of the revised Guidelines, bestowing upon the nation, the ground-breaking Naira-settled OTC FX Futures, making history and upgrading the Nigerian FX market to global standards.

The Naira-settled OTC FX Futures market kicked off with the CBN selling OTC FX Futures contracts of non-standardised amounts for different tenors from one (1) month through to twelve (12) months which will settle on bespoke maturity dates, providing liquidity in the product that will enable corporate treasurers effectively and efficiently manage their FX risk. With FMDQ, as the OTC FX Futures Exchange, organising the smooth running of this market through its System, the FMDQ Futures Trading & Reporting System and its market trading standards and rules, serving to provide the requisite transparency and governance for the success of the market, and the Nigeria Inter-Bank Settlement System PLC (NIBSS), acting as the clearing and settlement infrastructure for the margining and settlement of the OTC FX Futures contracts, ahead of the establishment of a Central Counterparty (CCP), the market has been positioned for a successful operation. To ensure credibility of the contracts, especially at maturity, the Spot FX rate will be the FMDQ Spot FX Rate Benchmark – the Nigerian Inter-Bank Foreign Exchange Fixing (NIFEX), an independent fixing of the inter-bank FX market.

The Naira-settled OTC FX Futures product, whilst of tremendous benefit to Nigerian corporates, is equally of immense importance and advantage to, among others, the CBN, the Nigerian FX market, and the nation's economy as a whole. The OTC FX Futures market will serve to, inter alia, minimise the disequilibrium in the Spot FX market and cause the rate to moderate; attract significant capital flows to the Nigerian fixed income and equity markets; and achieve exchange rate stability. There is no longer the need to front-load FX requirements, which puts immense pressure on and distorts the Spot FX rate. Corporate treasurers are better able to make judgements on when to access the Spot FX market, managing more effectively, their liquidity positions. The demand for the US Dollar by end-users can be staggered appropriately as there will be no requirement for “panic-buying” as end-users are guaranteed a fixed rate for their FX needs when required.

In support of the successful take-off of the market, the CBN, on Friday, June 24, 2016, released a Circular on the “Externalisation of Differentials on OTC FX Futures Contracts for Foreign Portfolio Investors”. This will no doubt have a positive impact on the Nigerian FX market as this serves as further encouragement for the flows of capital to the nation.

The official opening and launch of this market was commemorated with a Ceremony hosted by the Board and Management of FMDQ in Lagos on June 27, 2016. This Launch Ceremony had in attendance key stakeholders in the Nigerian financial market and particularly in the FX Futures market, including the Governor of the CBN, Mr. Godwin Emefiele, CON, ably represented by Mr. Emmanuel Ukeje, the Special Adviser to the CBN Governor on financial markets; and the Securities and Exchange Commission (SEC).

Mr. Bola Onadele. Koko, Managing Director/CEO of FMDQ, in a statement said, “The Naira-settled OTC FX Futures product is a major milestone development in the evolution of the Nigerian financial markets. The Futures market is an opportunity to transform risk into certainty – a major paradigm shift in the financial markets landscape. This innovation provides opportunities for government, businesses, pension fund administrators, investors, individuals etc. to hedge (not speculate) to cope with exchange rate risk. It also affords the CBN a greater opportunity to manage exchange rate volatility, thus achieving greater market confidence, liquidity, improvement in business planning, job security, employment, better allocation of resources, global competitiveness of the Nigerian financial markets, and all in all, a thriving economy.”

The first Naira-settled OTC FX Futures contract quotes by the CBN were unveiled during the Ceremony, after which the quotes were made available on the FMDQ website. “The CBN remains steadfast in its purpose to position the Nigerian FX market to be competitive, transparent, liquid and diversified, thereby ensuring requisite fundamentals that make for a thriving economy. The launching of the first Naira-settled OTC FX Futures contracts demonstrates this intent in a significant way, and I am honoured that the CBN is able to pave the way for what I believe will be an important innovation in Nigeria’s financial markets”, the CBN Governor said.

CBN Deputy Governor, Economic Policy & FMDQ Chairman, Dr. Sarah O. Alade, also said, “Today, the Nigerian financial market is celebrating a significant milestone, as the CBN launches its first set of OTC FX Futures quotes on FMDQ OTC Securities Exchange. This innovative product will bring liquidity, transparency, price formation and diversification into the Foreign Exchange market, making the market globally competitive. FMDQ, the market organiser and the ‘OTC FX Futures Exchange”, in collaboration with the CBN and other stakeholders, is adequately equipped to deliver the needed transformation in the Nigerian financial market. I am very proud to be part of the two institutions that made this day possible.”

The positive impact of the OTC FX futures market on the government, banks, corporate treasurers and other operators within the financial market, including businesses, households and individuals alike, cannot be overemphasised. The OTC FX Futures is a much needed innovation for the FX market and this is only just the beginning. The financial markets landscape of the nation has changed and is set for a full and certain revolution.

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How the Naira-Settled OTC FX Futures Market will work on FMDQ

The Naira-settled OTC FX Futures are non-deliverable Forwards (i.e. a contract where parties agree to an exchange rate for a predetermined date in the future, without the obligation to deliver the underlying US Dollar (notional amount) on the maturity/settlement date). On the maturity date, it will be assumed that both parties would have transacted at the Spot FX market rate. The party that would have suffered a loss with the Spot FX rate will be paid a settlement amount in Naira. This ensures that both parties enjoy the rate that had been guaranteed to each other through the OTC FX Futures.

Settlement Amount = (Difference between the Agreed Rate and Spot Rate on the Maturity Date) x Notional Contract Sum

The Spot FX Rate will be the FMDQ[1] Spot FX Rate Benchmark - Nigerian Inter-Bank Foreign Exchange Fixing (NIFEX[2]) which is an independent fixing of the inter-bank FX market. The OTC FX Futures contract is an effective exchange rate management tool supported by a transparent price driven two-way quote (2-WQ) market. The Central Bank of Nigeria (CBN) will kick off the market by acting as the seller of OTC FX Futures contracts for defined tenors i.e. 1M through to 12M. The USD/NGN OTC FX Futures contracts will provide the CBN the opportunity to kick-start the liquidity of risk management products available to end-users in the FMDQ OTC markets. The contracts will assist the CBN in managing the volatility in the Spot FX market thereby promoting stability and entrenching confidence in the FX market.

All OTC FX Futures contracts will be trade-backed. Visible, invisible and investments qualify for OTC FX Futures.

Naira-settled OTC FX Futures Contracts Trade Flow

FMDQ will act as the 'OTC FX Futures Exchange' and its appointed agent, the Nigeria Inter-Bank Settlement System PLC (NIBSS) will clear the inter-bank OTC FX Futures i.e. collect initial and variation margins and settle the party to compensate on the maturity date.

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[1] FMDQ OTC Securities Exchange

[2] NIFEX represents the daily average of the prevailing spot market rate at mid-day at which the US Dollar (USD) is traded against the Nigerian Naira (NGN)

All trading of Naira-settled OTC FX Futures contracts will be executed on the FMDQ OTC FX Futures Trading & Reporting System.

Trading (OTC Exchange)

- Futures Contracts executed on FMDQ OTC FX Futures Trading & Reporting System (Order Book)
- CBN publishes OTC FX Futures rates on the FMDQ System
- FMDQ determines the Initial[1] and Maintenance[2] Margins (IMs) and updates them on the System
- Dealing Member (Banks) input orders on the FMDQ System
- FMDQ System matches orders

Margin Management (FMDQ/Clearing House)

- Variation[3] Margins determined from daily Mark-to-Market (MTM) by FMDQ
- NIFEX used for Daily MTM
- FMDQ determines margin call amounts
- FMDQ advises margin calls to the Clearing House (NIBSS)

Settlement (FMDQ/Clearing House)

- Contract expires
- FMDQ, based on NIFEX, determines the final settlement amount
- FMDQ advises NIBSS of final settlement amounts
- Gain/(loss) credited/debited into buyer/seller OTC FX Futures Operation Accounts with NIBSS
- FMDQ generates and circulates settlement advices

Note:

***Tenor** – 1M, 2M, 3M, 4M, 5M, 6M, 7M, 8M, 9M, 10M, 11M & 12M (M – Month)*

1. *Initial Margin - Amount paid by the parties to cover the counterparty risk, based on the estimated volatility*
2. *Maintenance Margin – Minimum amount that must be maintained in a margin account*
3. *Variation Margin - Additional funds that must be deposited to balance up to the initial margin requirement*

Benefits of the Naira-settled OTC FX Futures

- The introduction of the OTC FX Futures market will encourage end-users to spread out their demand for Spot FX deals as they are now able to lock down the exchange rates for future FX requirements. This has the potential to eradicate the constant front-loading of FX requirements and minimise the disequilibrium in the Spot FX market. End-users will make better judgement as to the timing of accessing the Spot FX market
- The availability of the OTC FX Futures will improve the business planning practice of end-users and FX sellers, as the future exchange rate is guaranteed through the OTC FX Futures
- An end-user (buyer of USD) may consider it wiser to delay the purchase of its USD requirement in the Spot FX market if the Spot FX rate is higher than the OTC FX Futures rate of a particular tenor. The end-user will borrow USD or obtain trade finance and simultaneously hedge its exchange rate exposure with an attractive OTC FX Futures contract sold by the CBN. At maturity of the OTC FX Futures contract, the end-user will access the Spot FX market
- The OTC FX Futures will be used to attract significant capital flows to the Nigerian fixed income and equity markets as returns can now be enhanced as FX exposures are hedged. Foreign Portfolio Investors (FPIs) will be able to use the OTC FX Futures for capital protection
- The envisaged increase of supply of US Dollars due to the OTC FX Futures offered by the CBN in the Spot FX market will cause the Spot FX rate to moderate
- OTC FX Futures which are non-deliverable are ideal for FPIs and even Foreign Direct Investors (FDIs). OTC FX Futures can be used when the investor wants to hedge the exchange rate risk without interest in buying outright Forwards which will necessitate liquidation of its investment to pay for outright Forwards

- Banks will increase the liquidity in the OTC FX Futures market (by selling OTC FX Futures) if $/₦ Spot FX rate starts dropping. This may cause the Spot FX rate to drop further

Settlement Analysis for Naira-settled OTC FX Futures Contracts

****For Illustration Purposes Only****

Day 1: June 1, 2016 - Bank A buys a 3-month OTC FX Futures contract from the CBN on the FMDQ OTC FX Futures Trading & Reporting System with the following details:

- Buyer: Bank A
- Seller: CBN
- Notional amount: $1,000,000.00
- OTC FX Futures Rate: $/₦260.00
- Benchmark: NIFEX
- Maturity Date: August 31, 2016
- Initial Margin: 5% (payable by both parties)
- Maintenance Margin: 3.75% of the contract size
- Settlement Currency: Naira

The OTC FX Futures contract will be valued on a daily basis against the NIFEX to determine payment of variation margin amount.

Maturity Day: August 31, 2016 - NIFEX is $/₦270.00

It is assumed that Bank A would have transacted (bought USD in the Spot FX market) at $/₦270.00 which is higher than the OTC FX Futures contract rate of $/₦260.00. The Clearing House, NIBSS, will pay Bank A ₦10,000,000.00 (i.e. ₦10.00 [₦270.00-₦260.00] per USD) thereby bringing Bank A's effective rate to $/₦260.00 (₦270.00 assumed paid in buying USD less ₦10.00 received on the OTC FX Futures) which is the OTC FX Futures rate.

CBN is assumed to have transacted (sold USD in the Spot FX market) at $/₦270.00 which is higher than the OTC FX Futures contract rate of $/₦260.00.

The Clearing House, NIBSS, will take ₦10,000,000.00 (i.e. ₦10.00 per USD) from the Margin Account of the CBN thereby bringing CBN's effective rate to $/₦260.00 (₦270.00 assumed received in selling USD less ₦10.00 paid out on the OTC FX Futures) which is the OTC FX Futures rate.

Both parties end up with an effective rate of $/₦260.00 as this was the guaranteed rate for both parties.

If NIFEX had been $/₦250.00 on maturity date, Bank A would pay CBN ₦10.00 per USD.

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Revision of NIFEX Methodology and Publication Standard

As the administrator of the NIFEX, FMDQ continues to ensure the benchmark complies with international best practices and standards. Therefore, FMDQ announces the revision of NIFEX methodology and publication standard in line with the Principles for Financial Benchmarks of the International Organisation of Securities Commissions (IOSCO).

The revision is centered on enhancing and formalising the NIFEX process towards strengthening its credibility as a foreign exchange market benchmark reflecting current market dynamics and trends.

Consequently, effective Friday, June 24, 2016:

1. NIFEX Spot shall be a single rate

2. The single rate shall be determined by deriving the "trimmed" arithmetic mean of the mid-rates from the Reference Banks' submissions

FMDQ NIFEX Spot Rate is available in three (3) packages - Live Fix, Delayed and Historical:

- Live Fix: Available at 12:00 noon daily via the FMDQ e-markets portal
- Delayed (24hrs): Published centrally via the FMDQ website
- NIFEX Spot Historical: Available via the FMDQ e-markets portal

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FMDQ Holds a Sensitisation Session for Corporate Treasurers

Following the recent launch of the Naira-Settled OTC FX Futures market on Monday, June 27, 2017, FMDQ held an OTC FX Futures Sensitisation Session for corporate treasurers, which took place on June 29, 2016 in Victoria Island, Lagos. This Session was the first of more to come, with the aim of educating the corporate treasurers on exactly how the Naira-Settled OTC FX Futures Market will work and to also empower the treasurers to participate and not miss out on what the FX market has to offer.

The Session had in attendance over sixty (60) corporate treasurers from different sectors of the economy, and commenced with a welcome note from Mr. Dipo Odeyemi, Senior Vice President and Divisional Head, Market Operations & Technology. This was then followed by a presentation by Ms. Tumi Sekoni, Vice President and Divisional Head, Marketing & Business Development which focused on the following areas:

- The Naira-Settled OTC FX Futures Product and its Participants
- The Benefits of the Product: To the Economy and Corporates
- Naira-Settled OTC FX Futures Contract Specification

- Naira-Settled OTC FX Futures Contract Trade Flow
- The Role of FMDQ as a Change Agent

The Questions and Discussion segment was very interactive and educative. The Session ended with a cocktail and networking reception.

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FMDQ Holds First ''Members Only'' Bi-Annual Meeting for 2016

As part of its commitment to develop the Nigerian financial markets and in its capacity as a market organiser, FMDQ hosted its Members to the first "Members Only" Meeting for 2016, which held on June 30, 2016, at Radisson Blu Anchorage Hotel, Victoria Island, Lagos. The Meeting, like the last which was held in December 2015, had in attendance major players in the FMDQ markets, as represented by the respective FMDQ membership categories (Dealing, Associate & Registration Members), and commenced with a special welcome note from Ms. Tumi Sekoni, Vice President, Marketing & Business Development. This was followed by presentations and discussions around various matters of importance anchored by FMDQ's Ms. Jumoke Olaniyan, Assistant Vice President, Market Development and Regulation, Mr. Emmanuel Etaderhi, Vice President, Government & Regulatory Relations, Mr. Emmanuel Alao, Associate Vice President, Information Technology, and Mr. Bola Onadele. Koko, Managing Director/CEO.

The deliberations at the Meeting were centered on, among others, the following Agenda items;

- FMDQ Market Development Initiatives
- Naira-Settled OTC FX Futures Market
- FMDQ Debt Capital Market Development Program
- FMDQ New Membership Categories
- Proprietary Trading System – Update

The Meeting was quite interactive and Members had the opportunity to deliberate on issues and make significant contributions towards the progress of the debt capital market and financial market as a whole.

The Meeting concluded with a networking cocktail reception. The next Members Meeting for 2016 will hold in December.

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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 – Foreign Exchange (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). FX and Money Market Derivatives are embedded in the FX and Unsecured products categories respectively. 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 - May 2016)

	Turnover
Foreign Exchange	5,469,825
Foreign Exchange Derivatives	2,335,192
Treasury Bills	15,026,101
FGN Bonds	4,520,250
Other Bonds*	24,430
Eurobonds	23,827
Repurchase Agreements/Buy-Backs	11,286,243
Unsecured Placements/Takings	896,806
Money Market Derivatives	495
	39,583,168
USD equivalent (mm)	*199,512*
No. of Business Days	**105**
Average Daily Turnover	**376,983**
USD equivalent (mm)	*1,900*

mm - million

Note: USD/₦ @ 198.40

*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 @ June 7, 2016; Figures reported by Dealing Member (Banks) on a week-ending basis

The total turnover for the period January to May 2016 amounted to ₦39.58trn. Trading activities in T.bills contributed the largest to overall turnover, accounting for 37.96%, secured market transactions (Repos/Buy-backs) accounted for 28.51%, while FX market transactions accounted for 19.72% and FGN Bonds, 11.42%.

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Top Ten (10) Dealing Member (Banks) in FMDQ Market (January - May 2016)

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

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

The top ten (10) Dealing Member (Banks) accounted for 71% (₦48.24trn) of the overall turnover in the market, with the top three (3) accounting for 30% (₦20.06trn) of this sub-section of the market. Diamond Bank PLC, Access Bank PLC and Stanbic IBTC Bank PLC maintained their positions as leaders for the 3rd month running, ranking 1st, 2nd and 3rd respectively, in the value traded for the overall OTC market. Other institutions also maintained their positions on the League Table with the exception of Union Bank of Nigeria PLC, moving a step up the League table from 10th to 9th position; swapping places with Guarantee Trust Bank PLC now occupying 10th position.

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FMDQ Learning

Introduction to the Securities Markets – Part 3

In the first part of this series, we explained what a security was, the typical types of securities (debt and equity) and highlighted their key differences[3]. The second part of the series explained what a securities market was, the participants within it, the types of securities markets and their key differences[4]. The final part of this series will touch on the secondary market, distinguishing between the two (2) types of secondary markets.

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[3] Please click on the link to access Part 1 of the Series – Introduction to the Securities Markets – Part 1
[4] Please click on the link to access Part 2 of the Series – Introduction to the Securities Markets – Part 2

A secondary market is a type of market where existing shares, debentures, bonds, options, commercial papers, treasury bills and other securities of corporates, governments, etc. are traded. This market enables the buying and selling of previously issued securities. The secondary market can either be a market where trading of securities is done through an organised or centralised exchange, or a dealer market, popularly known as over-the-counter (OTC), where trading may be done informally without an exchange.

Types of Secondary Markets

Secondary markets are mainly organised in two ways, via a centralised exchange or OTC, however recent electronic facilities slightly blur the traditional distinctions.

Centralised Exchange Market

A centralised exchange is an organised trading system where all buyers and sellers (or their representative agents) interact to buy and sell securities[5]. Transactions tend to be completed through a centralised source. There is a specified number of traders that will trade on that single centralised system. Here, public traders cannot directly trade on these exchanges; they must route their orders through a securities broker who is a member of the exchange. This situation positions the mediator in a powerful position, which is the key disadvantage to this type of trading. However, a key advantage is that this also allows for better transaction enforcement and stricter security[6]. Some examples of this form of secondary markets are the Nigerian Stock Exchange, London Stock Exchange or New York Stock Exchange (NYSE). The more investors participate in a market, the greater the centralisation of that market, and the more liquid the market.

OTC Market

An OTC market is a secondary market where securities are traded directly between two parties. Securities are traded amongst dealers over computerised networks, telephone or other electronic network instead of a physical trading floor, as you may find in a centralised exchange. OTC dealers quote a bid price at which they would buy, and an ask price at which they would sell. An example of an OTC securities market is that of the National Association of Securities Dealers Automated Quotations System (Nasdaq). Most deals on such markets tend to be institutional in nature and are of sizable volumes. The foreign exchange market globally is an OTC market, and most of the trading in bonds, derivatives and structured products also takes place on such markets. Equities can also be traded in the OTC market. A key advantage of OTC market trading is that terms of a contract do not have to be those specified by an exchange. Market participants are free to negotiate any mutually attractive deal[7]. A problem, however, arises if securities are not reliably priced, this could impact liquidity and lead to the withdrawal of dealers/buyers from their market making functions, worsening the liquidity problem. It is worth mentioning that recent electronic facilities slightly blur the traditional distinctions between Exchange Traded markets and OTC markets, such as in the case of FMDQ OTC Securities Exchange (FMDQ). Although it operates in the OTC market it has some similar features to that of an Exchange. For instance, OTC markets generally tend to be decentralised and not well regulated, in the case of FMDQ it is

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[5] Sunil Parameswaran (2011) Fundamental of Financial Instruments: An Introduction to Stocks, Bonds, Foreign Exchange, and Derivatives
[6] A. Kivumbi (2010) Difference between OTC and Exchange
[7] John Hull (2004) Options, Futures and Other Derivatives (Fifth Edition)

centralised and acts as a self-regulatory organisation (SRO) that is also regulated and accountable to the Securities Exchange Commission (SEC). This role helps mitigate the typical issues (which include price manipulation, fraud, dishonest traders etc.) generally found in OTC markets.

To conclude, securities markets play an important role in the mobilisation of money in a country's economy. The different market structures solve different needs and is important in determining profitability. Therefore, knowledge of the types of securities markets is essential in determining the best market for effective redistribution of funds.

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