FMDQ SPOTLIGHT

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FMDQ Positions the Nigerian DCM for Growth; Holds the 2017 Nigerian Debt Capital Markets Conference & Awards

On Thursday, September 28, 2017, FMDQ OTC Securities Exchange (FMDQ or the OTC Exchange) played host to a wide audience of local and international financial markets participants, who turned out in large numbers for the 2017 Nigerian Debt Capital Markets Conference & Awards, at the Eko Hotel & Suites, Victoria Island, Lagos. The Conference & Awards, which brought together subject matter experts with varying focuses and interests in the Nigerian and global financial markets space, provided a platform to deliberate on strategies and other pre-requisites needed to position the Nigerian debt capital markets (DCM) to support sustainable economic growth and development.

The 2017 Conference was adequately supported by the Federal Government of Nigeria as the Vice President of the Federal Republic of Nigeria, Professor Yemi Osinbajo, SAN, GCON, represented by the Director-General of the Debt Management Office, Ms. Pat Oniha underscored the importance of the debt capital market to its overall economic recovery and growth plan in his special address. The legislative arm of government was also ably represented at the conference via the active participation of respective Chairmen of the Senate and House Committees on Capital Markets, Senator Foster Ogola and Honourable Tajudeen Yusuf. Further, the Director-General of the Securities and Exchange Commission, Mr. Mounir Gwarzo, ably represented by Ms. Mary Uduk, Director, Investment Management also lent his voice to the growing relevance of the debt capital market to the much-desired turnaround of the Nigerian economy. A major highlight of this year's conference was the active and prominent participation of a number of subject market experts from the International Finance Corporation (IFC) led by Mr. Jingdong Hua, Vice President & Treasurer, alongside other senior executives of the IFC. Other notable participants include Mr. Joseph Okwu Nnanna, Chairman, FMDQ, represented by Mr. Jibril Aku, Vice Chairman, FMDQ; Ms. Razia Khan, Managing Director, Chief Economist Africa, Standard Chartered Bank, London; Mr. Bolaji Balogun, Chief Executive Officer, Chapel Hill Denham; and a host of other international subject matter experts and captains of the Nigerian financial markets.

Welcoming guests to the Conference & Awards, Mr. Jibril Aku commended all stakeholders for the support given to FMDQ thus far, whilst noting that the OTC Exchange will continue to provide the requisite platform to power growth and foster the deepening of the Nigerian DCM. In his special keynote address, the Vice President Yemi Osinbajo, SAN, GCON charged all participants to support the Federal Government's diversification efforts by embracing the DCM and the opportunities therein. He noted the pivotal role being played by FMDQ in transforming the Nigerian DCM and called for greater commitment from the private sector to complement the government's efforts especially in the area of infrastructure development. The Honourable Minister of Finance, Mrs. Kemi Adeosun, who gave a special address, recognised the opportunities inherent in the DCM and assured the participants that the Federal Government was taking bold steps towards putting the necessary reforms to support private sector-led growth, even as the country exits recession.

Mr. Mounir Gwarzo's keynote address provided an overview of the recent milestones achieved in the Nigerian DCM and further highlighted that the Nigerian Economic Recovery and Growth Plan underscores the role of the private sector in leading the growth that Nigeria desires. In his words, "to sustainably develop Nigeria, reliance must be shifted from 'owners' capital' and short-term funding from commercial banks to long-term capital from the DCM". Mr. Jingdong Hua, in his address noted that for Africa to meet and maximise its potential in the global financial markets space, Nigeria must be one of its greatest engines. He called on the government to create an enabling environment to support the DCM and also promote financial markets education for capacity building of market participants, and the general public. In her "one-on-one" discourse with Mr. Frank Aigbogun, Publisher/CEO of BusinessDay Media, Ms. Pat Oniha examined Nigeria's debt strategy amidst the economic headwinds and other policy considerations towards realisation of the country's development agenda.

From the high-powered presentations to panel sessions which drew from the experiences of model markets and subject matter experts, there were discussions and recommendations on market and product development strategies for the Nigerian DCM, capital inflows and opportunities for operational excellence in the Nigerian fixed income and currency markets, infrastructure projects financing, sustainable finance strategy and non-interest capital market, amongst others. To deepen the discussions and stimulate active engagement amongst participants, the conference featured two (2) breakout sessions on the "introduction of fixed income and interest rate derivatives" and the "corporate debt issuances in the Nigerian DCM."

Whilst reiterating FMDQ's commitment to remain steadfast towards the development of the Nigerian DCM, and the Nigerian economy at large, the Managing Director/CEO of FMDQ, Mr. Bola Onadele. Koko, went on, on behalf of FMDQ, to recognise and present awards to market participants/key stakeholders in the Nigerian DCM who had performed creditably in relation to primary market activities, over the past two (2) years (September 2015 – August 2017). He noted that the exceptional performances by these market players had contributed to the overall development and progress of the markets in different ways. The performance categories recognised included, Largest Corporate Bond Issuer on FMDQ won by Lafarge Africa PLC, Largest Sub-national Bond Issuer on FMDQ won by the Lagos State Government, Largest Fund Manager on FMDQ won by Chapel Hill Denham Management Limited, Largest Commercial Paper Issuer on FMDQ won Access Bank PLC, Most Compliant Bond Issuer on FMDQ won by Nigeria Mortgage Refinance Company PLC, Best FMDQ Registration Member (Listings) won by Chapel Hill Advisory Partners Limited, Best FMDQ Registration Member (Quotations) won by Stanbic IBTC Capital Limited, Best DCM Solicitor on FMDQ won by Banwo & Ighodalo, Sustainable Finance in the DCM won by Municipality Waste Contractors Limited and Most Innovative Listing on FMDQ which was won by the Debt Management Office, Nigeria.

FMDQ has continued to champion market transforming initiatives in the Nigerian DCM, and with the collective effort and support of all stakeholders resolute to making the Nigerian financial markets globally competitive, operationally excellent, liquid and diverse.

Further details on the Conference & Awards can be found on the Conference website – www.fmdqconferences.com

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The Debt Capital Markets Development (DCMD) Project 2020/25 Launches Sustainable Finance Sub-Committee & Holds Maiden Issuers/Investors Roundtable

In its bid to ensure the transformation of the Nigerian DCM into a world class, properly functioning and globally competitive DCM; the Debt Capital Market Development (DCMD) Project launched the Sustainable Finance Sub-Committee (SFS). The Sub-Committee's areas of focus will include – Impact Investing, Green Bonds, Microfinance, Credits for Sustainable Projects, Active Ownership, Financial Inclusion, etc. This initiative stems from the growing global recognition of the role sustainability plays in strengthening financial stability and supporting overall economic growth. The membership of this Sub-Committee is comprised of local and international stakeholders drawn from relevant government agencies/ministries, regulators, development finance institutions, and the financial market. The launch event which took place on September 29, 2017, in Lagos, officially kicked off the activities of the Sustainable Finance Sub-Committee.

In addition, the event also included a Roundtable Session, organised in collaboration with the Climate Bonds Initiative (CBI). The session focused on contemporary issues affecting the successful development of sustainable finance related bonds such as green bonds principles, standards and benchmarks for the issuance of green finance notes, amongst others. Attendance of the session included key representatives and strategic subject matter experts from various institutions including the United Nations Environment Programme (UNEP) Inquiry, Climate Bonds Initiative, International Finance Corporation (IFC), , the Securities and Exchange Commission, Debt Management Office, other regulators and government agencies, as well as various market stakeholders with presentations by Mr. Jingdong Hua, Vice President/Treasurer, IFC; Mr. Iain Henderson, Head, International Cooperation, UNEP Inquiry and Ms. Justine Leigh-Bell, Director, Business Development, CBI. In addition to the launch and roundtable, the occasion highlights the ongoing partnership/collaboration between FMDQ and UNEP in advancing the concept of Sustainable Finance in Nigeria. As part of this collaboration, the UNEP Inquiry is currently conducting a survey on a Sustainable Nigerian Financial System, which is being administered through the DCMD Project Office, to members of its Implementation Committees. The outcome of this survey will form the key focus of discussions in a one-day Sustainable Finance Workshop to be organised by UNEP in November 2017 and in collaboration with FMDQ.

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The FMDQ PenDealer System Goes Live

As part of its effort towards ensuring transparency in the markets within its purview, FMDQ launched the PenDealer System, its Clients' Fixed Income Trading, Reporting and Surveillance System. This FMDQ-wholly owned System aims to ensure that the National Pension Commission maintains adequate oversight over the pension fund industry, in addition to monitoring the activities of its supervisees, the pension fund operators, who are FMDQ's Associate Members (Clients).

PenDealer is a bespoke application developed by FMDQ with the aim of fostering governance and transparency in the activities of Institutional Clients in the fixed income market. The System will serve as a platform for Institutional Clients to transact with FMDQ-licensed market makers and brokers to promote improved market transparency, efficiency and surveillance of the activities of Institutional Clients. PenDealer is a web-based application and is accessible via the URL – https://pendealer.fmdqotc.com

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15th OTC FX Futures Contract Matures and Settles on FMDQ

The 15th OTC FX Futures contract, NGUS SEP 20 2017, with a notional amount of $383.30mm, matured and settled on Wednesday, September 20, 2017 on FMDQ; bringing the total value of matured contracts so far on the OTC Exchange from year-to-date to circa $3.33bn, and over $7.00bn worth of OTC FX Futures contracts traded since inception.

The contract, which was valued against the Nigerian Autonomous Foreign Exchange Fixing (NAFEX) Spot rate as published by FMDQ on September 20, 2017, had its associated clearing/settlement effected by the Nigeria Inter-Bank Settlement System PLC (NIBSS), in line with the FMDQ OTC FX Futures Market Operational Standards

Consistent with its treatment for the previous maturities (July 2016 – August 2017), the Central Bank of Nigeria introduced a new contract, NGUS SEP 28 2017, for $1.00bn at $/₦361.41 to replace the matured contract and refreshed its quotes on the existing 1- to 11-month contracts

It is expected that the efforts of the Central Bank of Nigeria towards resuscitating the vibrancy of the nation's FX market will yield the desired results and invariably allow for the potential of the OTC FX Futures market to be fully maximised by businesses, investors, governments etc. with FX exposures.

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FMDQ Approves the Registration of Wema Bank's ₦50.00 billion Commercial Paper Programme

On September 14, 2017, FMDQ welcomed the commercial paper (CP) programme registration of Wema Bank PLC - the Wema Bank ₦50.00bn CP Programme (the Wema Bank CP Programme), to its platform. This CP Programme registration strategically positions Wema Bank PLC to easily and quickly raise short-term finance from the debt market at any time in the future it determines suitable, through CP issues, within the CP Programme limit.

FMDQ has continued to maintain its support for the development of the Nigerian DCM by steadfastly availing its efficient platform for the registration, listing, quotation and trading of debt securities. In line with the strategic objectives of the OTC Exchange to support institutional growth and stimulate continuous development of the Nigerian economy at large, FMDQ has continued to align the Nigerian financial markets to international standards, and has, through the promotion of product innovation and the championing of key market development initiatives, taken commendable steps to ensure that growth and development opportunities abound for the markets under its purview.

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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 (Federal Government of Nigeria (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 - August 2017)

Product Category	(₦'mm)	($'mm)
Foreign Exchange	10,240,306	32,776
Foreign Exchange Derivatives	10,544,909	33,751
Treasury Bills	41,632,837	133,255
FGN Bonds	6,420,967	20,552
Other Bonds*	25,475	82
Eurobonds	62,445	200
Repurchase Agreements/Buy-Backs	21,908,845	70,124
Unsecured Placements/Takings	944,215	3,022
Money Market Derivatives	21,572	69
Commercial Papers	-	-
Total	**91,801,571**	**293,831**

No. of Business Days	168	168
Average Daily Turnover	**546,438**	**1,749**

Average Rate $/₦ @ 312.43
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 @ September 6, 2017; Figures reported by Dealing Member (Banks) on a week-ending basis

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The month of August 2017 recorded ₦12.89trn in turnover, an increase of 11.78% when compared to ₦11.54trn recorded in July 2017, bringing the total year-to-date turnover to ₦91.80trn.

The month-on-month (MoM) increase was primarily driven by increased trading activities experienced in the following product categories; Foreign Exchange (Spot), with a MoM growth of 66.44%, Foreign Exchange Derivatives, a MoM growth of 46.28% and Treasury Bills, a marginal 4.98% MoM growth. They respectively make up circa 19.09%, 12.04% and 41.01% of overall turnover.

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

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

RANK	DEALING MEMBER (BANKS)
1	STANBIC IBTC BANK PLC
2	ACCESS 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	CITIBANK NIGERIA LIMITED
10	UNION BANK OF NIGERIA PLC

The top ten (10) Dealing Member (Banks) accounted for 70.71% (₦64.92trn) of the overall turnover in the market, with the top three (3) accounting for 45.47% (₦29.50trn). Stanbic IBTC Bank PLC, Access 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 five (5) consecutive months.

All other Dealing Member (Banks) maintained their positions on the League Tables with the exception of Stanbic IBTC Bank PLC and Access Bank PLC. Both banks swapped positions in the review period and are now occupying 1st and 2nd places respectively.

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Credit Derivatives

The July 2017 edition of the Spotlight Newsletter explored fixed income derivatives. These were defined as financial contracts whose values are derived from those of fixed income securities such as bonds, treasury bills and certificates of deposit; with the two major classifications being Interest Rate Derivatives (IRDs) and Credit Derivatives. Furthermore, the August 2017 edition further explored the IRDs as well as their various classifications (plain vanilla, quasi-vanilla and exotic IRDs). This edition will focus on Credit Derivatives.

A Credit Derivative is a financial instrument that is designed to separate default risk of a corporate or sovereign instrument from other forms of risk (such as currency or interest rate risks) and then, transfer same to a third party. Though the terms differ from one type of credit derivative to another, the general procedure is for a lending party to enter into an agreement with a counterparty (a third party), who agrees, for a fee, to cover any losses incurred in the event that the borrower defaults. If the borrower does not default, then the insuring counterparty pays nothing to the original lender and keeps the fee as a gain.

As an illustration, suppose *Bank A* lends ₦100.00mm to *XYZ Limited* for a 10-year period. Suspecting that *XYZ Limited* has probable default risk as a borrower, *Bank A* enters into a credit derivative contract with *Bank B*, in order to transfer the default risk of the loan to a third party (i.e. *Bank B*); and in the event *XYZ Limited* defaults and is unable to repay the loan, *Bank B* will compensate *Bank A* for the remaining interest and principal in return for an annual fee through the end of the 10-year term. If on the other hand, *XYZ Limited* does not default on the loan, *Bank B* keeps the annual fee as a gain.

Credit Derivatives are strategically useful in the capital markets given that credit risk is arguably the most significant form of risk capital market participants face. These derivatives are broadly classified as either Funded Credit Derivatives or Unfunded Credit Derivatives.

Funded Credit Derivatives

For Funded Credit Derivatives, the credit protection is funded using securitisation techniques of a financial institution or designated special purpose vehicle. These derivatives could be in the form of Credit-linked Notes, Collateralised Debt Obligations, and Constant Proportion Debt Obligations, amongst others.

A collateralised debt obligation (CDO) is one of the most common types of Funded Credit Derivatives. It is a security that pools together cash flow-generating assets and repackages this asset pool into discrete tranches that can be sold to investors on the secondary market. They are called collateralised because the assets being packaged – mortgages, corporate debt, auto loans or credit card debt, etc. – serve as collateral for investors. The CDO is split into different risk classes known as tranches. Interest and principal payments are made in order of seniority so that senior tranches have the least risk. Junior tranches, which have higher default risk, usually have higher coupon payments. These CDOs typically allow banks and corporations to sell off debt and free up capital to re-invest or loan.

Unfunded Credit Derivatives

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. The most common types of this derivatives include Credit Default Swaps, Credit Default Swaptions, and Total Return Swaps, among others.

A Credit Default Swap (CDS) is regarded as the cornerstone of the Credit Derivatives market. In a CDS, the seller agrees, for an upfront or continuing premium or fee, to compensate the buyer when a specified event, such as default, restructuring of the issuer of the reference entity, or failure to pay, occurs. Buyers of CDS's can remove risky assets (loans) from their balance sheets without selling them. The value of a default swap depends not only on the credit quality of the underlying reference entity but also on the credit quality of the counterparty. If the counterparty defaults, the buyer of a default swap will not receive any payment if a default event occurs.

A Credit Default Swaption is also known as a Credit Default Swap Option. It is an Option on a CDS that gives its holder the right, but not the obligation, to buy (call) or sell (put) protection on a specified reference entity for a specified future time period for a certain spread. The Option is knocked out if the reference entity defaults during the life of the Option. This knock-out feature marks the fundamental difference between a CDS Option and a Vanilla Option. Most commonly traded CDS Options are European-Style Options (which may only be exercised at the expiration date of the Option, i.e. at a single pre-defined point in time). CDS Options can either be Payer Swaptions, where the option holder has the right to buy (enter into) a CDS where he/she pays premium; or Receiver Swaptions, where the option holder receives premiums.

In summary, Credit Derivatives enable a lender or bond investor to isolate and hedge its exposure to credit risk. It is essentially an insurance policy against losses due to borrower default. Improved governance across the global financial markets has made Credit Derivatives a useful risk management tool for credit risk transfer and management. Whilst these derivatives are relatively new (introduced in in the mid-1990s), the market for them is steadily developing.

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