CEO INTERVIEW

Interview with Private Sector Leaders

BOLA ONADELE. KOKO

Managing Director/Chief Executive Officer, FMDQ OTC Securities Exchange

FMDQ's conceptual identity is prosperity

"The Managing Director/Chief Executive Officer of FMDQ OTC Securities Exchange, **BOLA ONADELE. KOKO**, in this interview, shares his views on the need for the market stakeholders – government, regulators, banks, Nigerian corporates, foreign investors, Nigerians – to effectively harness the potential and opportunities inherent in the Nigerian debt capital market (DCM).

With 2018 now in its 4th quarter and the year almost drawing to a close, how will you say FMDQ and its markets have fared so far and what can one expect in the final quarter of the year?

Thank you for the two-in-one question to which I shall endeavour to provide a comprehensive response. However, before I do that, I will like to, on behalf of FMDQ Board and Management, commend the BusinessDay Media Limited (BusinessDay) for its unalloyed support to FMDQ since its launch on November 7, 2013.

The year 2018 began for us at FMDQ with great optimism for the markets, amidst a period of continued and gradual recovery from economic headwinds which had hitherto stagnated the markets. The high crude oil price, the Central Bank of Nigeria (CBN)'s Investors' & Exporters' (I&E) Foreign Exchange (FX) Window, amongst others, have motivated the Nigerian economy to steadily shed off the recessionary trends.

In the FMDQ markets (i.e. the fixed income, currency and derivatives markets), turnover for the first nine months of the year totalled c. N132 trillion, about 28% increase when compared to the same period last year. The market will really be excited with a 2018 annual turnover of N160 trillion. The debt market size stood at c. N26 trillion as at September. The FX and FX derivatives markets performed reasonably better than we all expected, and I must commend the efforts of the CBN for sustaining its FX hedging product, the Naira-settled OTC FX Futures. Indeed, the imminent quiescence and stability in the Spot FX market, untypical of periods of political uncertainty, can partly be attributable to the availability of the CBN's risk management product.

Away from the quantitative, the OTC Exchange has also continued to add depth and breadth to the markets by championing and deploying strategic initiatives which have direct and indirect effects on developing the nation. From the pioneer listings of the Federal Government of Nigeria (FGN) Sukuk and FGN Green Bond on FMDQ's platform, to the listing of the first infrastructure bond in Nigeria - the Viathan Funding PLC Power Bond - our markets have shown huge potential in bridging the funding gap required by government and the private sector to boost development of the economy. The Viathan Funding PLC Power Bond, just like the FGN Sukuk which is targeted at construction and rehabilitation of roads in the six (6) geopolitical zones, are both welcome developments given the huge infrastructure deficit which the country is burdened with. In addition to these, the value of programmes in the FMDQ commercial paper (CP) market crossed the ₦1 trillion mark in July, showing not only a growing interest by corporates seeking to prosper their businesses but the increased renewed confidence in the Nigerian CP market; even as we welcomed the quotation of the largest CP issuance on FMDQ – the ₦50 billion Dangote Cement PLC CP Notes – in July. This was the first time, since 2009, the Dangote Group – the largest indigenous industrial conglomerate in Sub-Saharan Africa – approached the domestic debt markets to raise finance; and FMDQ provided that reliable and efficient platform where these were realised. We are optimistic that other corporates would key into the CP market as an alternative source of funding and tap into the array of opportunities availed by the Nigerian debt capital markets (DCM), particularly in the light of the regulatory provisions and standards like Basel 3 and International Financial Reporting Standard 9 (IFRS 9).

FMDQ has further strengthened its collaboration with the market and key stakeholders, especially the CBN and the Financial Markets Dealers Association (FMDA), and one of the values created by this conscious effort was the launch of the FMDQ Proprietary Market System, Q-ex, and the introduction of a settlement solution for the fixed income market in June. FMDQ's Q-ex was successfully integrated with the CBN's Scripless Securities Settlement System (S4), enabling, for the first time ever in the history of the Nigerian financial market, straight-through-processing for settlement of sovereign fixed income trades, thereby facilitating the much-needed operational efficiency in the FMDQ fixed income market. In similar vein, FMDQ's wholly-owned clearing subsidiary, FMDQ Clear Limited (FMDQ Clear), having been registered by the Securities and Exchange Commission (SEC) in November 2017, was operationalised in January 2018 to act as a central clearing house providing post-trade workflow efficiency in the FMDQ markets. FMDQ Clear is particularly central to the take-off of the FMDQ derivatives market which is a much-awaited evolution, and one which will further propel the Nigerian financial markets onto the global space. Furthermore, the global financial markets landscape has continued to evolve, and the tenets of sustainable finance have become further entrenched into the broader markets' activities. Nigeria is most certainly not left out in this new dawn as, in July, FMDQ, in partnership with Financial Sector Deepening (FSD) Africa and Climate Bonds Initiative (CBI), formally launched a 3-year Nigerian Green Bond Market Development Programme.

Looking ahead into the coming months, and ahead of the 2019 elections, it may be expected that the scepticism of foreign portfolio investors may lead to a dump of investments with the associated capital flight and this will perhaps test the strength of the I&E FX Window. Whilst this test is something the markets may not need to be apprehensive about, given the resilience which the Window has shown in its over 18 months of activity, I would say that sound market initiatives, for example, the Naira-settled OTC FX Futures product, and the high crude oil price may have made for the likelihood of relatively stable markets for the remainder of the year. Having said this, however, as a nation, it is crucial that conscious efforts are made by the government, responsible agencies and market stakeholders to diversify the economy and lower the high dependency on foreign inflows, and indeed, crude oil, which goes without saying. For the financial markets, the urgent need to launch a robust derivatives market to enable investors in these markets access to a plethora of hedging products to manage their risk exposures is even more imminent and cannot be overemphasised. FMDQ, as part of its mandate, has taken up this responsibility in support of the development of Nigeria and the financial markets and is working assiduously towards delivering a viable Nigerian derivatives market and has, this year, already commenced activities in this regard.

That was comprehensive as promised. You mentioned that the FMDQ commercial paper market has hit the □1 trillion mark. With the recent issuance by Dangote, are we seeing more issuers in this space? What could be the driving force, if any?

The commercial paper, as an investible asset class, has been in the Nigerian market for well over three, if not four, decades now. However, the level of irregularities and operational deficiencies which characterised this market during the period prior to 2009 did not only severely hamper its growth into the world-class market it should have been, but also saw the sharp decline of the then budding market from trillions worth to bottom zero levels by 2013. With the formal launch of FMDQ in 2013, came a commitment, as part of our market development initiatives, to resuscitate the Nigerian CP market and working with the market stakeholders, especially, the rating agencies and the highly supportive CBN, we set out to revive and transform this market in line with the FMDQ "GOLD" agenda; GOLD being an acronym which FMDQ has become known for and which stands for Global competitiveness, Operational excellence, Liquidity and Diversity.

Predicated on the CBN's "Guidelines on the Issuance and Treatment of Bankers' Acceptances and Commercial Papers (2009)", FMDQ came on board and championed the necessary market reform; providing adequate governance and information transparency and restoring the much-needed confidence required by investors to actively participate in this market. So, issuers now have a renewed opportunity to grow their businesses and meet short-term funding obligations through a viable and cost-effective means for the achievement of their business objectives/goals. So far, about twenty-one (21) CP Programmes have been registered on the FMDQ platform and are well over the ₦1 trillion mark.

To the recent issuance by the Dangote Cement PLC, this was long-awaited and in fact, overdue. FMDQ works hard to offer benchmarks to the market as part of its market organiser role. The Dangote Group is one of those institutions we engaged to create benchmarks for the Nigerian debt capital markets and the market is excited they finally responded. Indeed, this was testament to the increased confidence in the CP market, arguably due to the improved governance and transparency brought about by the advent of the FMDQ Quotations Service. Furthermore, with the current market conditions making shorter-term funding more favourable, and the commendably efficient processes which have continued to result in a quick time to market, for which the FMDQ Quotations Service avails, we have indeed seen more issuers tapping into the CP market. I cannot overemphasise that the DCM is the powerhouse where every business should derive its energy to operate from. Soon enough banks will no longer be able to apply short-term funds to finance long-term assets per the implementation of global regulatory provisions and standards i.e. the Net Stable Funding Requirement. It is therefore commendable that at such time when banks, non-bank financial institutions and small and medium-scale enterprises alike are striving to prosper despite the economic headwinds in the country, the CP market can be looked to and corporates tapping this market are able to build confidence in their brands as well as raise their corporate profiles ahead of tapping the market for longer-term debts such as bonds. We are optimistic that the appreciation of brand equity and leverage will motivate our banks, especially the national icons, to support us in establishing benchmarks in a highly transparent manner through the quotation of their Bankers' Acceptances on FMDQ. Indeed, on a larger scale, FMDQ is also positioned to work with local and international export-import banks to facilitate an efficient Bankers' Acceptance market.

BusinessDay has closely followed the news on the planned introduction of derivative products into the Nigerian financial market by FMDQ. When is the market likely to take off and what products should the market anticipate?

As I previously noted, a crucial step towards managing the uncertainty which the financial markets pose for investors and issuers the world over is via risk management products offered in the derivatives market. For a country like Nigeria, a derivatives market is not only long overdue but very much-needed to support the effort of the government and key stakeholders such as the CBN in managing capital flight and related volatilities. If you recall, in 2016, working with the CBN, the centrally cleared Naira-settled OTC FX Futures was introduced into the market – the first of its kind in Nigeria – as one of the means to address the FX crisis which was crippling the Nigerian economy. As at October 2018, when the 28th contract matured, the total value of matured OTC FX Futures contracts, since the inception of the market in June 2016, stood at circa $12 billion; with a total of about $17 billion worth of contracts executed on the platform so far. There are cogent lessons from operating this product for slightly over two years now. 1. Hedging instruments help to calm the spot markets because they promote business planning, as well as attract, protect and retain capital. 2. The CBN, as a market participant, is central to financial market development. 3. Central clearing mitigates systemic risk and with a clearinghouse, like FMDQ Clear, the CBN no longer has to carry the burden of being the lender of last resort for the defaults in the financial markets. A market mechanism operated with world-class standards will mitigate financial market-induced systemic risk. 4. Our markets can be world-class if having imbibed market philosophy, we adopt market principles as the basis for our economic initiatives. This does not stop us from offering rebates where highly necessary. 5. Regulatory support, as exhibited by the Securities and Exchange Commission, improves the capital markets landscape and growth. I am not saying the current construction cannot be improved upon. It can, and we will build on it to develop a sustainable world-class futures market.

Championing the development of the Nigerian derivatives market by FMDQ could therefore, not have come at a better time. From the engagement with the market stakeholders and relevant regulators, to the gap analysis and feasibility study conducted, and finally to the launch of the Project Plan, the FMDQ Derivatives Market Development Project ("the Project") has been quite interesting and has continued to incite ideas and enlighten us at FMDQ on the need for and importance of risk management to our markets. We have gained valuable insights into the base challenges facing the introduction of derivatives in our market - from the awareness and educational gaps which need to be bridged in order to build support and capacity amongst the market participants, to the depth of the legal and operational frameworks required for the introduction of derivatives products. It is common knowledge that people are naturally opposed to change and as with every change process, there is bound to be some 'teething' problems. Recognising that the introduction and active trading of derivative products are central to aligning our markets to international standards, we have however, taken key steps to address these concerns and intensely drive the knowledge and need for derivatives into our markets. FMDQ and its promoters – the FMDA, banks and CBN – carry out a rigorous assessment of the multiplier effects of initiatives before lending their support. A derivatives market will bolster functional capacities, create many jobs and attract capital, financial and human, to the Nigerian financial market.

We therefore, set out working on these pre-requisites and have since made considerable progress in this regard. In addition to developing the requisite market architecture and system and promoting the establishment of the required legal framework to support the effectiveness and efficiency of this market, we are also developing draft Rules and Guidelines to govern the activities of this market to ensure credibility is maintained as is the case with others within FMDQ's purview.

In addition to this, we are proactively driving market education for all stakeholder groups to ensure uniform understanding of our objectives of making our market globally competitive. FMDQ has hosted a series of 2-day training sessions for different categories of market stakeholders, drawing from a wide array of experiences and functions such as Treasury (including Asset/Liability Management), Investment/Portfolio Management, Risk Management and Compliance, Finance, Strategy etc., as well as the financial market regulators. In the coming months, a similar training is being planned for the media and other stakeholders who are central to the success to the derivatives market. With FMDQ's commitment to improve the breadth and depth of products available to market participants looking to manage their exposures to different market factors – interest rates, FX rates, etc. - the OTC Exchange is set to finalise and rollout a series of derivatives, from interest rate futures through to swaps, effectively minimising financial losses from operational lapses and inefficiencies and providing the markets capacity to respond to financial stress risks. Engagements will therefore continue with key stakeholders to boost development of in-house appreciation of and technical knowledge on derivatives, and sensitise market participants and the public in general, on derivatives and the FMDQ derivatives market. Timing unfortunately may be highly dependent on key legislation being passed.

Congratulations once again on the set up of FMDQ Clear. Do you believe the market is mature for this initiative and infrastructure?

Thank you very much. You see, with the different types of risks, including counterparty, credit and settlement risks, that can potentially burden the fixed income, currency and derivatives markets - where FMDQ is set to introduce a complement of products – I will say that the introduction of FMDQ Clear has been long overdue and there is no better time than the present for the implementation of this crucial market infrastructure. Indeed, when we look at the product depth and sophistication obtainable from other climes, particularly risk management products, you will see that Nigeria, with the size of its current market and innate potential, is lagging way behind, but we are determined to fix this country.

The Nigerian repurchase agreement (repo) market today, where market participants essentially borrow cash for short dates using securities as collateral, has not developed to the extent it possibly can as investor confidence in that market is not at the level whereby market activity, and thereby turnover, is considerably increased. The introduction of repo with collateral management by FMDQ and the attendant risk management and operational efficiencies via FMDQ Clear, will address the concerns of risks, among others, that have hampered growth in the market, thereby promoting markets integrity and facilitating increased transactions amongst market participants. A centrally cleared repo market will inspire confidence and encourage pension fund administrators to avail on the opportunity to boost the return on the managed retirement savings. Today they hold these securities without any opportunity to apply them to generate more income. Currently, FMDQ Clear offers post-trade services for the Naira-settled OTC FX Futures contracts, being the pioneer derivative product developed and launched into the markets in 2016, facilitating trade matching, risk management (margining), collateral management and settlement.

FMDQ Clear is the first financial markets Central Clearing House in Nigeria, and its operations are critically aimed at addressing pertinent issues which have continued to hinder the growth and development of the Nigerian fixed income and derivative markets, including but not limited to risk mitigation, capital efficiency and market data integrity, whilst ensuring safety, stability, confidence and inclusiveness in the marketplace. A key requirement of the G20 recommendations for OTC derivatives, post the 2007/2008 financial crisis, is the institution of pre-and post-trade transparency as well as central clearing and recording of the transactions. As a crucial step towards vertical integration, having successfully met the stringent requirements laid out by the SEC, FMDQ Clear is therefore, a critical and much-needed financial market infrastructure essential for efficient workflows and the provision of post-trade services.

From reducing pre-settlement risks, enhancing productivity gains and optimising the allocation of resources amongst market participants, FMDQ Clear addresses some of the key drivers for the development of the markets. The high standard which FMDQ has instituted into its operations will undoubtedly bolster and position FMDQ Clear into a globally recognised Central Clearing House and in the near future, a Central Counterparty, acting as the buyer to all sellers and seller to all buyers. FMDQ Clear is, no doubt, a worthy addition to the Nigerian capital market ecosystem and I believe that its operations will support the growth and alignment of the Nigerian markets to its global counterparts.

Continues tomorrow