SPECIAL REMARKS BY THE GOVERNOR OF THE CENTRAL BANK OF NIGERIA, PROFESSOR CHARLES SOLUDO AT THE 2005 NIGERIAN BOND MARKET TECHNICAL ROUNDTABLE HELD AT THE LE MERIDIEN HOTEL, ABUJA ON TUESDAY, JUNE 28, 2005.

The Honourable Minister of Finance,

The Chairman, Senate Committee on Banking, Insurance & Financial Institutions,

The Director General, Debt Management Office,

The Director General, Securities and Exchange Commission (SEC),

The Director General/ CEO, Nigerian Stock Exchange (NSE),

Ladies and Gentlemen,

INTRODUCTION

1. I am pleased to be in your midst today on the occasion of the Nigerian Bond Market Technical Roundtable Discussion. You will all agree with me that the topic for discussion, "Developing the Bond Market in Nigeria: Challenges and Prospects", is quite apt, given its relevance to the current efforts at reforming the financial market. When the National Economic Empowerment and Development Strategy (NEEDS) was envisioned, a critical component was the mobilization of long-term funds which presupposes, among other things, a well functioning bond market.

2. A well-functioning and developed bond market provides a secure and flexible investment outlet for investors as well as stimulates economic activities through provision of appropriate long-term finance for both government and non-government borrowers. Thus, the market contributes

towards financial system diversification, reduces the concentration of risk in the banking system while promoting long-term savings.

THE CHALLENGES FOR THE BOND MARKET

3. The bond market has been in existence since 1946 in our country with the first issue of £300,000 Government loan stocks in that year. Since then, a period of about forty-five years, the bond market, which has remained shallow and inactive has been dominated mainly by Federal Government Development Stocks. These were issued annually until 1986 when they were suspended. Until recently, the CBN was the sole Issuing House and Underwriter of the Government debt instruments, due largely to the absence of Primary Dealers. For the development stocks, the Bank remains the sole market maker, ready to buy and sell at the prevailing prices. The treasury bonds issued by the Bank on behalf of the Federal Government are largely held by the former. One distinct feature of the instrument is its non-transferability. It is note worthy that the Federal Government has resumed the issuance of development bonds with the first FGN Bond in 2003 which had maturities ranging between 3 and 10 years.

4. Given the high expectations of Nigerians under the new democratic dispensation, a re-invigorated bonds market would be required to support various developmental efforts, such as public infrastructure investment, private sector industrial expansion, and housing development. In addition, the bond market is expected to provide a viable investment avenue for long-term funds to be pooled together from the new pension scheme.

5. Developing the Nigerian bonds market poses serious challenges to the financial authorities as well as to the market participants. The immediate challenges include; developing a viable secondary market to provide liquidity; ensuring autonomy and efficiency of the regulators; provision of market infrastructure and ensuring effective communication and transparency. Other challenges include: the internationalization of the market to attract foreign investors, encouraging professionalism in the market, and improving the payments system.

6. Distinguished ladies and gentlemen, permit me to elaborate on some of these issues. It is clear that the development of a robust secondary market is a sine qua non for the growth and sustainability of the domestic bonds market. This will broaden participation and deepen the market as investors' liquidity risks are mitigated. The primary challenge is the establishment and sustenance of an efficient and functional secondary market for bonds issued in Nigeria. In the past, the Federal Government Development Stock enjoyed liquidity support from the Central Bank of Nigeria, acting as the sole market maker. The challenge therefore is to provide a market maker that will enhance the level of confidence in the market. This will engender investor enthusiasm in the primary market, provide a basis for efficient rate determination, and ensure low intermediation costs. Furthermore, it would encourage the establishment of infrastructure that would promote efficient and acceptable securities trading structures, enhance accountability, and ensure investor protection. It is against this backdrop that the CBN has redefined a "liquid-asset" as any approved market instrument with a tenor of one to three years. This redefinition has become necessary, in order to deepen the capital market.

7. Another important issue for consideration is the high cost of issuing instruments in the market. A significant part of the transaction costs are the fees paid to SEC, NSE and the Central Securities Clearing System (CSCS). Let me reiterate here, that there is a need to adjust these and other costs downwards, so as to ensure compatibility with the development of a viable bonds market.

8. The experience with the issuance of Federal Government bonds in 2003 showed some market preference for short-tenured instruments. This, I believe, will change with time, as the macro economy becomes stable, more institutional investors patronise the market and the yield becomes more attractive.

9. I will like to emphasise that the success of the bonds market, like that of many other similar markets, is predicated on the creation and sustenance of a viable market infrastructure. Thus, the ICT infrastructure that will ensure bonds quotation, bidding and payment settlement, must be of the highest standard and also transparent. Transparency requires that the traders and members of the public know the prices which different parties in the market are quoting. Currently, equity traders on the Nigerian Stock Exchange have access to the quotations of other brokers during trading hours through the NSE's Automated Trading System (ATS). In this regard, it is necessary to deploy the Bonds Trading module (BTM) of the ATS to facilitate greater transparency in the market.

CONCLUDING OBSERVATIONS

10. Ladies and gentlemen, you will agree with me that globalization and liberalization have thrown up new challenges to the bond market. The Nigerian bonds market needs to improve its system of trading through automation and benefit from the various innovations in the international capital market. We must therefore encourage the entry of professionals and retain them in the market to enhance its performance and credibility. Similarly, any regulatory impediments, including regulatory, which may hamper trading in bonds should be reviewed, while the scope of other money market and risk management instruments such as repos, futures, and swaps should be enlarged.

11. A well-developed and robust bond market also depends on the ability of the regulating agencies to take decisions effectively, speedily and objectively, so as to provide stability and engender confidence in the market. Therefore, the regulators need to be provided with an adequate level of autonomy, so as to foster transparency and equity in consonance with international standards.

12. Permit me to also observe that the prospects for a viable bonds market in Nigeria that enjoys national and international confidence are high. We have quite a lot of issues that will sustain demand in the market. For instance, a large pool of long-term funds will be required to restore capacity in the energy sector, refineries, manufacturing, roads and rail transportation, telecommunications, among others. Privatization will also generate increased demand in the market as privatized enterprises seek funds for rehabilitation and expansion. Thus, governments at all levels will need to

expand their infrastructure to sustain the tempo of private sector investment. Furthermore, the new Pension Scheme provides a ready market for bond issues in Nigeria.

13. As the nation consolidates its democratic culture, confidence will be built and foreign investors will like to participate in the emerging Nigerian capital market. This will enhance the demand for bonds issued in our jurisdiction. In furtherance of these objectives, the CBN has put in place measures that will help improve the environment for the effective functioning of the financial market in general, and the capital market in particular, by redefining liquid assets to include 3-year bonds. The Government, funds managers, banks and other stakeholders will be required to support and assist in the development of a bonds market which will engender public confidence and serve as a vehicle for mobilization of long-term funds for national development. In order to realise these potentials, the current judicial reform efforts must be intensified, so as to guarantee speedy dispensation of justice and thus engender public confidence in the financial market.

14. In conclusion, ladies and gentlemen, it is my belief that through our interaction today, very useful suggestions will emerge that will assist in addressing the challenges facing the development of the bonds market in Nigeria. Let me also add that the deepening of the bonds market should be seen as a collective responsibility of the regulatory authorities and all the other stakeholders. I urge you all to be frank in your discussions and come up with recommendations that will solidify the foundations of the Nigerian bonds market.

Thank you for your attention.