UNDERSTANDING MONETARY POLICY SERIES
NO 31

THE NIGERIAN BONDS MARKET

Oluwafemi I. Ajayi

©2013 Central Bank of Nigeria
Aims and Scope
Understanding Monetary Policy Series are designed to improve monetary policy communication as well as economic literacy. The series attempt to bring the technical aspects of monetary policy closer to the critical stakeholders who may not have had formal training in Monetary Management. The contents of the publication are therefore, intended for general information only. While necessary care was taken to ensure the inclusion of information in the publication to aid proper understanding of the monetary policy process and concepts, the Bank would not be liable for the interpretation or application of any piece of information contained herein.

Subscription and Copyright
Subscription to Understanding Monetary Policy Series is available to the general public free of charge. The copyright of this publication is vested in the Central Bank of Nigeria. However, contents may be cited, reproduced, stored or transmitted without permission. Nonetheless, due credit must be given to the Central Bank of Nigeria.

Correspondence
Enquiries concerning this publication should be forwarded to: Director, Monetary Policy Department, Central Bank of Nigeria, P.M.B. 0187, Garki, Abuja, Nigeria, Email:info.dmp@cbn.gov.ng
Central Bank of Nigeria

Mandate

- Ensure monetary and price stability
- Issue legal tender currency in Nigeria
- Maintain external reserves to safeguard the international value of the legal tender currency
- Promote a sound financial system in Nigeria
- Act as banker and provide economic and financial advice to the Federal Government

Vision

“By 2015, be the model Central Bank delivering Price and Financial System Stability and promoting Sustainable Economic Development”

Mission Statement

“To be proactive in providing a stable framework for the economic development of Nigeria through the effective, efficient and transparent implementation of monetary and exchange rate policy and management of the financial sector”

Core Values

- Meritocracy
- Leadership
- Learning
- Customer-Focus
MONETARY POLICY DEPARTMENT

Mandate
To Facilitate the Conceptualization and Design of Monetary Policy of the Central Bank of Nigeria

Vision
To be Efficient and Effective in Promoting the Attainment and Sustenance of Monetary and Price Stability Objective of the Central Bank of Nigeria

Mission
To Provide a Dynamic Evidence-based Analytical Framework for the Formulation and Implementation of Monetary Policy for Optimal Economic Growth
The understanding monetary policy series is designed to support the communication of monetary policy by the Central Bank of Nigeria (CBN). The series therefore, provides a platform for explaining the basic concepts/operations, required to effectively understand the monetary policy of the Bank.

Monetary policy remains a very vague subject area to the vast majority of people; in spite of the abundance of literature available on the subject matter, most of which tend to adopt a formal and rigorous professional approach, typical of macroeconomic analysis. However, most public analysts tend to pontificate on what direction monetary policy should be, and are quick to identify when in their opinion, the Central Bank has taken a wrong turn in its monetary policy, often however, wrongly because they do not have the data for such back of the envelope analysis.

In this series, public policy makers, policy analysts, businessmen, politicians, public sector administrators and other professionals, who are keen to learn the basic concepts of monetary policy and some technical aspects of central banking and their applications, would be treated to a menu of key monetary policy subject areas and may also have an opportunity to enrich their knowledge base of the key issues. In order to achieve the primary objective of the series therefore, our target audience include people with little or no knowledge of macroeconomics and the science of central banking and yet are keen to follow the debate on monetary policy issues, and have a vision to extract beneficial information from the process, and the audience for whom decisions of the central bank makes them crucial stakeholders. The series will therefore, be useful not only to policy makers, businessmen, academicians and investors, but to a wide range of people from all walks of life.

As a central bank, we hope that this series will help improve the level of literacy in monetary policy as well as demystify the general idea surrounding monetary policy formulation. We welcome insights from the public as we look forward to delivering content that directly address the requirements of our readers and to ensure that the series are constantly updated as well as being widely and readily available to the stakeholders.

Moses K. Tule
Director, Monetary Policy Department
Central Bank of Nigeria
<table>
<thead>
<tr>
<th>Section One: Introduction</th>
<th>1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Section Two: The Classification of the Bond Market</td>
<td></td>
</tr>
<tr>
<td>2.1 Government bond</td>
<td>3</td>
</tr>
<tr>
<td>2.2 Corporate Bonds</td>
<td>3</td>
</tr>
<tr>
<td>2.3 State and Local Governments/Municipal Bonds (munis)</td>
<td>5</td>
</tr>
<tr>
<td>2.4 Zero-Coupon Bonds</td>
<td>5</td>
</tr>
<tr>
<td>Section Three: Evolution of the Nigerian Bond Market</td>
<td></td>
</tr>
<tr>
<td>3.1 Nigeria's Bond Market Instruments</td>
<td>9</td>
</tr>
<tr>
<td>3.1.1 The Federal Government of Nigeria (FGN) Development Stocks</td>
<td>9</td>
</tr>
<tr>
<td>3.1.2 The Federal Government of Nigeria (FGN) Treasury Bonds</td>
<td>9</td>
</tr>
<tr>
<td>3.1.3 The State and Local Governments Bonds</td>
<td>9</td>
</tr>
<tr>
<td>3.1.4 The Industrial Loan Stocks</td>
<td>9</td>
</tr>
<tr>
<td>3.1.5 The Unsecured Zero Coupon Redeemable Convertible Stocks</td>
<td>10</td>
</tr>
<tr>
<td>3.1.6 The AMCON Bonds</td>
<td>10</td>
</tr>
<tr>
<td>3.2 Main Institutions in the Bond Market</td>
<td>10</td>
</tr>
<tr>
<td>3.2.1 The Debt Management Office</td>
<td>10</td>
</tr>
<tr>
<td>3.2.2 The Central Bank of Nigeria (CBN)</td>
<td>11</td>
</tr>
<tr>
<td>3.2.3 The Nigerian Stock Exchange (NSE)</td>
<td>11</td>
</tr>
<tr>
<td>3.2.4 The Central Securities Clearing Systems Ltd (CSCS)</td>
<td>11</td>
</tr>
<tr>
<td>3.2.5 The Security and Exchange Commission (SEC)</td>
<td>12</td>
</tr>
<tr>
<td>Section Four: The Structure of the Bond Market in Nigeria</td>
<td></td>
</tr>
<tr>
<td>4.1 Issuers</td>
<td>13</td>
</tr>
<tr>
<td>4.2 Investors</td>
<td>13</td>
</tr>
<tr>
<td>4.3 Intermediaries &amp; Service Providers</td>
<td>13</td>
</tr>
<tr>
<td>4.4 Pricing Mechanisms: Quotes and Auction</td>
<td>13</td>
</tr>
<tr>
<td>Section Five: Characteristics of a Bond</td>
<td></td>
</tr>
<tr>
<td>5.1 Risk</td>
<td>15</td>
</tr>
<tr>
<td>5.2 Yield</td>
<td>16</td>
</tr>
<tr>
<td>5.3 Liquidity</td>
<td>17</td>
</tr>
<tr>
<td>Section Six: Challenges of the Nigerian Bond Market</td>
<td></td>
</tr>
<tr>
<td>Section Seven: Conclusion and Recommendations</td>
<td></td>
</tr>
<tr>
<td>Bibliography</td>
<td>23</td>
</tr>
</tbody>
</table>
THE NIGERIAN BONDS MARKET

THE NIGERIAN BONDS MARKET ¹

Oluwafemi I. Ajayi²

SECTION ONE

Introduction
By definition, a bond is a debt instrument issued by a government or a corporate entity to raise fund to finance budget or projects. It is usually issued for a period of time more than a year. It is an 'IOU' with a preset interest rate, redeemable at the expiration of the specified tenor. Individual investors can borrow money to expand their businesses through bond with different options from pension funds or mutual funds. Largely, bond is meant to be a promise to pay back the principal alongside with interest, which is the coupon, on a specified date, usually referred to as maturity date. The investor who buys/invests in bond becomes a creditor of the issuer. Unlike in the case of equities, the buyer of bond does not gain any kind of ownership right to the issuer. However, in the time of financial distress, the shareholders have lesser claim on an issuer's assets compared to bond holder. Companies issue bonds and sell them to the public at various interest rates, and investors buy with the full knowledge that the company will repay the original principal with interest at the maturity date.

The Bond market is an environment where debt securities are issued and traded. It comprises both the primary market where new debts are issued to participants, and secondary markets-where participants can buy and sell debt securities. The bond market mainly covers corporate debt securities and government-issued securities. The operation of the bonds market helps to move funds from savers to investors/fund users for business expansions or investments. It provides a platform for long term funding of public and private expenditures. In Nigeria, bonds issuing started in 1946 when the federal government was channeling the proceeds to finance construction projects. This continued until 1960, when the Nigeria Stock Exchange was established and became fully operational in 1961. After the establishment of the NSE, some of the bonds that were issued were on a yearly

¹This publication is not a product of vigorous empirical research. It is designed specifically as an educational material for enlightenment on the monetary policy of the Bank. Consequently, the Central Bank of Nigeria (CBN) does not take responsibility for the accuracy of the contents of this publication as it does not represent the official views or position of the Bank on the subject matter.

²Oluwafemi I. Ajayi is an Economist in the Monetary Policy Department, Central Bank of Nigeria.
basis and referred to as development stock for on-lending to state governments to finance various projects in their states. The Nigerian stock market has continued to grow from what it used to be in the 60’s. The various reforms embarked upon by the federal government to grow the Nigerian bond market has brought significant improvement, such that many state governments to come to the market to raise fund to finance their projects. Prior to 2002, the Federal Ministry of Finance (FMoF) and the Central Bank of Nigeria (CBN) were the managers of the country’s debt and the CBN was the main issuer of government debt. After a restructuring of the domestic debt markets, the Debt Management Office (DMO), which was originally established in 2000 to centrally coordinate the management of Nigeria’s debt, resumed the issuance of longer tenured bonds in 2003, thereby resuscitating the bond market, while the CBN was mandated to act as the Issuing House and the Registrar. This arrangement brought a significant success to the bond market, which had witnessed significant growth over the years, to emerge as one of the most liquid bond markets in Sub-Saharan Africa (SSA) after South Africa, supported by a considerable increase in market capitalization and turnover.

This volume of understanding monetary policy series provides an insight into the bonds market and its operation in Nigerian. Following the introduction, the rest of the paper structured as follows: Section 2 discusses the structure of the Bond Market in Nigeria while evolution of bond market is handled in section 3.
SECTION TWO

The Classification of the Bond Market

The Bond Market in Nigeria can be classified to different categories. Usually, bonds market always consist the government bond and corporate securities. Government securities is made up of the federal government development stock, the treasury bonds (TBs) Treasury Certificates (TCs) and the development bond issued by states and local governments, while corporate securities are mainly in the form of debentures or loan stock. It may also be classified based on time, such as medium or long term bond to indicate the time dimension. The meaning and the classification of bond are discussed below for further understanding. Bonds are also called fixed-income securities due to the “fixed” amount of income bond attract. Bonds generate the same amount irrespective of what happens or who holds the bond.

2.1 Government bond

Generally, these are the type of bonds issued by a government with assurance of paying a periodic interest alongside with the principal at maturity. This type of bond usually comes in the country’s own currency, others that issued in foreign currency are called sovereign bonds. Mostly, debt securities that are issued in the domestic currency are used to support the government spending. Government debt is money owed by any level of government and is backed by the full faith of the government. Generally, there are several risks associated with national bonds. These include political risk, inflation risk, country risk and interest rate risk that investors need to assess before investing in government bonds.

2.2 Corporate Bonds

This is the type of bond with which companies sell their debts through the public securities market. Most companies make bond attractive enough to interest investors and avoid the incidence of very low subscription. Corporate bonds generally have higher interest rates than government bonds due to the risk that the company could default on the bonds or go bankrupt. Some corporate bonds are referred to as convertible bonds, as, they can be converted into stock, if certain requirements are met. Mostly, a short-term corporate bond is less than 5 years; intermediate is 5 to 12 years while the term is over 12 years. Cooperate bond is classified as follows:

a. Debenture Stock

This type of bond is common globally. It is a form of loan contract issued by the government or private company, stipulating requirement to pay the interest and the borrowed funds. This kind of bond is secured by part or all the companies’
properties. Lenders are issued certificates showing the stock amount attached with the coupon for interest. Stockholders’ interest is covered by the trust deed; which enables a trustee to act on behalf of the stockholders. Should the lender defaults, a receiver may be appointed by the debenture holder to seize and gather assets from the borrower and repay the money recovered.

**Secured or Naked Debenture:** In this type of bond, interest could be charged on the movable assets or fixed assets of the issuing company or may be unsecured by any charge.

**Unsecured or Clean Debenture:** This kind of debenture might consider a negative pledge during the tenor of the bond. It does not give room for other lenders to have any entitlement to specific charge of the company’s assets. Generally, blue chip companies with sound cash flow prospects are allowed to make clean lending with negative pledge.

**b. Debentures**

This is a type of debt instrument that is not secured by collateral or physical assets, it is only considered or backed by the reputation and the general creditworthiness of the issuer. Both federal government and the private sector issue debentures to secure capital. Debentures are documented in an indenture like other types of bonds.

**Types of Debentures**

**Redeemable debentures:** This is a type of debenture that may be issued by a company limited by shares, or at the option of the company are liable to be redeemed. An unlimited liability company or a public liability company may not be able to issue this type of debenture as the law specifically refers to a company limited by shares. **Non-convertible Debentures:** These are debentures that have specific coupon rate and are the most common type of debt instruments. The repayment and tenor is usually structured in one or more tranches.

**Floating Rate Debentures:** These are the type of debentures that the interest rates are fixed. The interest rates are normally fixed to either monetary policy rate or other determining indicative rate, but it must be with a ceiling or benchmark. The fixed interest rates were to protect the issuing company and the investors, should a rise in the interest rates occur during the tenor of the bond.

**Convertible Debentures:** Convertible debenture permits the company or the holder, to convert the debenture to shares in the company based on the conditions specified in the debentures. These bonds are related to the terms and
conditions that are in lieu of repayment or redemption; they always have provision that permit bond conversion to equity by holders in the future subject to the applicable conversion terms.

**Fixed Rate Bonds:** This is the type of bond whose coupon rate remains same throughout the period of the bond.

**c. Mortgage Bonds**
These types of bond are usually secured by physical property. Should any default occur, foreclosure is possible to cover claims that are due but could not be serviced under the terms of the bond issue.

**High Yield Bonds:** These bonds are also known as junk bonds. They are relatively risky and investors are expected to earn a higher yield due to the risk involved.

**Guaranteed Bonds:** These are the types of bond that is issued by a company and for which another company guarantees to pay, in case of default by the issuing company.

**Income Bonds:** This is the type of bond in which only the principal is promised and enterprise only pays the interest when earnings covers the cost.

**Eurobonds:** these are the types of bonds that are issued and transacted outside the country in whose currency they are denominated. It is also not within one country’s regulatory authority.

**2.3 State and Local Governments/Municipal Bonds (munis)**
This is the debt security issued by a state and local government to finance their capital expenditures. It is also called Municipal bonds, and are exempted from federal government, state and local taxes. This type of bond offer competitive interest rates just like corporate bonds. The most popular means for state to generate income is through raising taxes on its citizens but in this situation, the federal government permits the state and local governments to trade bonds that are free of federal income tax on the interest paid.

**2.4 Zero-Coupon Bonds**
This is the type of bond that is sold at a price lower than its face value, which is realizable at maturity date. At the time of maturity, the investors receive the face value. There is no periodic payment of interest or the “coupon”. For example, if a zero-coupon bond with N100.0 par value with 7 years to maturity is traded at N60; the investor will only pay N60.0 for the bond as at the day and get the worth of N100.0 in 10 years.
Evolution of the Nigerian Bond Market
The Government of Nigeria started issuing bonds in 1946 and the earnings from it were channeled towards funding construction projects. The Nigerian Stock Exchange (NSE) was founded in 1960 as Lagos Stock Exchange, and became fully operational in 1961 with 19 securities listed for trading. Bonds were issued on a yearly basis by the federal government in the form of Development Stocks, generally for on-lending to states for various projects. These projects (mainly construction) were also part-financed through increased taxes and via the sale of bonds then known as “Development Stocks”. At the point of independence, the existing fiscal system was passed on to the government. By the mid-seventies however, there was a reduction in investment in the productive sectors as the economy gradually became heavily reliant on crude oil production and export which within a decade accounted for 80 per cent of fiscal revenues. The increase in revenues, driven primarily by the oil, brought about significant demographic changes as urbanization placed a demand for increased investment in infrastructure and better lifestyles. The crash in oil prices in the early eighties, however, led to a drop in revenues but without a corresponding reduction in demand, as Government’s long term development plans were already set in motion. This ultimately set the stage for fiscal deficits on the part of government and hence, the need arose for a bond market. In 1976, the state governments were permitted by the federal government to be raising long term capital on their own, based on the recommendation of the financial system review committee to the government. Five States (the defunct Ogun, Bendel, old Kaduna , Lagos and old Oyo) as well as one Local Government in Lagos (Lagos Island) were allowed to float bonds totaling N330m for various projects between 1978 and 1992. With the advent of democracy in 1999 and the significant reforms embarked upon since by government, more states have approached the bond market to raise funds for various projects. Moreover, the Federal Government also returned to the bond market in 2003, after almost a 30-year absence with the N150bn Bond issued in four tranches. The three and five year tranches recorded massive oversubscriptions, while the seven and ten year tranches were undersubscribed. Overall, total subscription was N72.6bn indicating a 48.0% subscription level. The Federal Government then issued treasury bills with maturities of up to 90 days. These were generally rolled over several times for further 90 days periods, thereby creating funding mismatches that subjected government and the larger economy to a lopsided reliance on short-term funding sources for long-term projects. Prior to 2002, The Federal Ministry of Finance (FMoF) and the Central Bank of Nigeria (CBN) were the major institutions that undertook the management of the country’s debt position. During this
period, the CBN acted as the main issuer of government debt, with the issues mainly of expensive short tenured securities in the form of treasury bills. This translated into a high cost of refinancing and frequent rollovers, as open market securities were used to finance long-term government needs. Following a restructuring of the domestic debt markets, the Debt Management Office (DMO), which was originally established in 2000 to centrally coordinate the management of Nigeria’s debt, resumed the issuance of longer tenured bonds in 2003. This resuscitated the bond market, while the CBN was mandated to act as the Issuing House and the Registrar. The development recorded significant success as there was a paradigm shift from short-term Treasury Bills, to longer tenor instruments with maturities of up to 20 years. Principally, maturing short term treasury bills were refinanced into longer term bonds starting from 2 to 3 years; then, 5, 7, 10 and 20 years. Nigeria currently has a 20-year yield curve. The appointment of Primary Dealer Market Makers (PDMMs), further boosted and deepened the primary and secondary market for FGN bonds, by providing liquidity to on-the-run bonds across the curve. The Nigerian bond market has witnessed significant growth over the years to emerge as one of the most liquid bond markets in Sub-Saharan Africa (SSA) – excluding South Africa, supported by a considerable increase in market capitalization and turnover.
3.1 Nigeria’s Bond Market Instruments

3.1.1 The Federal Government of Nigeria (FGN) Development Stocks
These are stocks issued for development financing and are project-tied. They are securities on which interest rates are paid yearly and usually issued in tranches. They also have stable interest rate and maturity dates. They are usually issued in tranches and the interest is paid bi-annually. The history of the Nigerian bond market may be traced to the 1946 issue of N600,000.00 Federal Government Stock of 7-25 years tenor, with the primary objective of promoting development finance for all tiers of government. Over the years, the share of government stocks in the capital market has declined, owing partly to the Federal Government recourse to other sources of financing outside the capital market.

3.1.2 The Federal Government of Nigeria (FGN) Treasury Bonds
The Central Bank of Nigeria introduced the Federal Government Treasury Bonds in 1989, with the objective of minimizing debt service obligations of the Federal Government. The bonds grew from the conversion of treasury certificates that had been used to finance the Federal Government deficits over the years. Thus, the instrument is used to finance the fiscal deficits of the government each year and held solely by the CBN. Over the years, the value of the bonds has grown relative to total debt instruments. The management of the debt was handled by the CBN before the creation of the Debt Management Office (DMO).

3.1.3 The State and Local Governments Bonds
The inadequacy of bank financing has necessitated the lower tiers of government to seek funds from the bond market to augment their internally generated revenues and allocation from the Federation Account, with the aim of financing vital development projects. The first state bond was floated by the then Bendel State Government in 1978, and since then several other states and local governments have been patronizing the bond market.

3.1.4 The Industrial Loan Stocks
These are project-tied loans, issued by companies on the stock exchange and carry fixed or floating rates, with a maturity date, and are backed by sinking fund arrangements for the retirement of the loans. Since the 1990s, industrial loan stocks have become popular as they provide cheaper sources of funds. Industrial loan stocks take the form of debenture stocks, preferred shares and corporate bonds. Firms in the banking sector (UBA, First Bank, GTBank, Diamond Bank and Access Bank) provided the lead in corporate bond offerings seeking to raise additional funds.
3.1.5 The Unsecured Zero Coupon Redeemable Convertible Stocks
Unsecured Zero Coupon Redeemable Convertible Stock was introduced in a bid to further diversify instruments/securities on the Stock Exchange. The security listing is unsecured and has no periodic interest payments obligation. It is redeemable at full face value at maturity, and could be converted into ordinary shares after a specified period of moratorium.

3.1.6 The AMCON Bonds
The Asset Management Corporation of Nigeria (AMCON) has played a vital role in distress resolution in the banking sector in Nigeria since its establishment. The AMCON bought a total of N1,230.0 billion non-performing loans (NPL) of the banking system in December 2010. The company issued 2 three-year consideration bonds to 22 DMBs with the face value of N534.48 billion in the first half of 2011, in exchange for the DMBs eligible assts. This made the total face value of the bonds issued by AMCON to sum up to N1,764.48 billion, against the eligible assets of the banks valued at N2,827.0 billion, which was acquired by the company at end-June 2011. This represents 33.28 per cent of the entire outstanding bonds issued in the market.

3.2 Main Institutions in the Bond Market

3.2.1 The Debt Management Office
The Debt Management Office (DMO) was set up in October 2000, and the Act establishing the Office was enacted in June 2003, for the purpose of providing a one-stop shop for clearing all Nigerian government debts at all levels. Prior to its establishment, Nigeria had a grossly underdeveloped domestic debt market as debt management responsibilities were split among several agencies and departments of both the CBN and the Federal Ministry of Finance.

The DMO is in charge of coordinating and centralizing the debt activities and profile of the country, which include debt service forecasts and debt payment. It also has the responsibility of advising the government on debt negotiation and new borrowings. The DMO issues prospectuses in respect of bond issues and agrees with the CBN to draw up issue programmes on quarterly or half yearly basis, depending on government requirements. The DMO facilitates the listing of newly issued Federal Government of Nigeria (FGN) Bonds by paying listing fees to the Nigerian Stock Exchange annually.

The DMO in 2007 introduced the new Strategic Focus for Domestic Debt Management, which will facilitate with the following: Reduction in the cost of fund to the federal government by integrating cash management with the debt management operations; the use of financial derivatives instrument to deepen
the domestic market; Ensuring access to cheapest available fund in the market by introducing foreign denominated FGN bonds in the domestic market as well as supporting the pricing of long term instrument; developing debt management unit (DMUs) using DMO platform in all 36 states in the federation integrating and introduction of educative programmes and aggressive public enlightenment on debt as a vehicle of economic development.

3.2.2 The Central Bank of Nigeria (CBN)
The CBN performs the following roles in the Nigerian Bond market:

- Acts as issuing house and registrar to all issues by
  - Keeping a record of all bond holders;
  - Warehousing the total volume of bonds issued;
  - Effecting interest payments; and
  - Redeeming bonds on redemption/maturity dates.
- Maintains a link with the bond market by acting as settlement bank:
  - Updates bondholders’ portfolio positions; and
  - Settles the fund aspect of OTC transactions.
- Participates in the Bond Market Steering Committee to monitor the bond market and ensure its efficiency.

3.2.3 The Nigerian Stock Exchange (NSE)
Federal Government bonds are listed and traded on the Floors of the Nigerian Stock Exchange. NSE was founded in 1960 as the Lagos Stock Exchange and became fully operational in 1961. At the initial stage, 19 securities listed for trading in Lagos state and the name was changed to the Nigerian Stock Exchange in December 1977. It has branches established in some of the major commercial cities across the country, and its activities are regulated by the Securities and Exchange Commission. The SEC has the mandate of Surveillance over the activities of the NSE to prevent breaches of market rules and detect and correct any unfair manipulations and trading practices. Since 1999, the NSE introduced an Automated Trading System (ATS) for the dealer to be able to trade through the network of computers connected to a server. The ATS has some important features that facilitate remote trading and surveillance. Trading on the Exchange starts at 9.30 a.m. every business day and closes at 2.30 p.m. The federal government has introduced several policies to encourage the flow of foreign capital as investment into the economy. This give rooms for foreign brokers to enlist as dealers on the Nigerian Stock Exchange. Nigerian companies are also allowed multiple and cross border listings on foreign markets.

3.2.4 The Central Securities Clearing Systems Ltd (CSCS)
The CSCS was incorporated on as a subsidiary of The Nigerian Stock Exchange in July 29, 1992. The CSCS has the sole responsibility of settlement and clearing of
securities transaction of the NSE as well as bond transaction on the OTC market. In 1997, the CSCS was commissioned and commenced operations same year. The CSCS enables easy delivery and settlement of securities transactions on the floor of the NSE by facilitating stock processing in electronic form, thereby reducing transaction time considerably.

3.2.5 The Security and Exchange Commission (SEC)
The SEC is the main regulatory institution of the Nigerian capital market and is under the supervision of the Federal Ministry of Finance. The SEC has the mandate to supervise the Nigerian Stock Exchange in order to ensure orderly and equitable dealings in securities, and preventing the market against unwanted trading activities. The Commission has the responsibility to regulate the capital market and the activities of all operators to ensure that investors are protected.
SECTION FOUR

The Structure of the Bond Market in Nigeria
An overview of the market structure and brief assessment of underlying features of established, fully functional global markets is undertaken below in order to understand necessary processes and appreciate the current stage of the development in the Nigerian bond market.

4.1 Issuers
The Issuers of bonds may be governments, publicly held corporations and financial institutions. Worldwide, governments are still the largest issuer of bonds across all economies. The government bonds are considered as low-risk, and in most cases, totally risk-free investments. In Nigeria, the federal government has zero record on default of bond till date, despite the fact that the government is responsible for about 90.0 per cent of outstanding bond issues in the country. The Nigerian bond market is also witnessing increased participation by states governments and corporates.

4.2 Investors
Investors include individuals, pension fund administrators, insurance companies and commercial banks, which are always the largest investors in bonds. In the Nigerian market, foreign investors are allowed to participate, but are not allowed to have access to securities that have a tenor of more than one year.

4.3 Intermediaries & Service Providers
The key intermediaries in the domestic bond market include
i. Stock Brokers
ii. Issuing Houses- these provide financial advisory and structuring services
iii. Underwriters- these provide underwriting services
iv. Legal practitioners – these draft and review legal documentation
v. Rating agencies - establish credit risk profile of issuers
vi. Auditors and reporting accountants - express an independent opinion on the financial health of issuers
vii. Placement Agents- provide selling capacity for the bonds

4.4 Pricing Mechanisms: Quotes and Auction
Bonds are sold through Quotes or Auction system on a formal exchange or Over the Counter (OTC). In the absence of a formal trading platform like a standardized exchange, bond trading in Nigeria is predominantly done via OTC auction based system on Reuters terminal.
Characteristics of a Bond

5.1 Risk

Government bonds are considered risk-free, but in the actual sense, bond instruments have some measure of risk associated with them. Some of the risks identified are as follows:

a. **Inflation Risk:** Bonds are not meant to provide extraordinarily high returns as they are considered relatively safe. Due to this and the fact that the coupon payments are fixed, it makes them vulnerable when inflation rises. Bond prices tend to fall as inflation rises because the purchasing power must have been eroded. However, in the recent time, the Nigerian inflation has been on the single digits and all FGN Bond yields were above the current inflation rate of 9.05 per cent as at April, 2013.

b. **Interest Rate Risk:** This is a major risk to all bondholders. Interest rate affects bonds directly as bond prices are inversely related to movements in interest rates. An increase in interest rate will lead to the fall in the price of bonds and vice versa. The logic is that when interest rates move up, the opportunity cost of holding a bond decreases since investors are able to realize greater yields by switching to other investments that reflect the higher interest rate.

c. **Exchange Rate or Currency Risk:** This type of risk is relevant to internationally issued bonds and affects both investors and issuers in varying degrees. It is the risk that is associated with a bond that is designated in another currency other than that of the home country. Investors of such bonds are exposed to exchange risk. In this situation, investors purchase the bond in foreign currency and the payment of interest and principal will also be in foreign currency. At maturity, the investors will have to go into the foreign currency markets and sell it to purchase their home currency. The risk is that if foreign currency is devalued relative to the currency of the home countries, there will be lower receipt than expected. In the case of the local corporates, currency risk arises when a devaluation of the Naira results in higher coupon payments by the issuer. Foreign investors would face a currency risk when the local currency appreciates in value.

d. **Default Risk:** This is the situation where individual or companies are unable to meet the required payments on their debt obligation. Both investors and Lenders are open to default risk in nearly all forms of credit extensions.
times, lenders often charge rates of return that match the debtor's level of default risk to lessen the effect of this risk on them. The higher the risk, the higher the required return, and vice versa. Largely, FGN has maintained a zero default rate, implying that this type of risk is generally low within the Nigerian bond market.

e. Credit Risk: This is the type of risk that varies with issuers of bond. The FGN sovereign bonds are considered to have practically no risk of default. Credit risks available to borrower are calculated based on the ability to repay. The investor charges more interest rate on the capital, if the borrower has high credit risk profile. The calculation of the interest is based on the borrower revenue generation ability and collateral asset.

5.2 Yield
A bond yield is inversely related to its price. Yields tend to fall as bond prices increase. It is the amount of return an investor will receive on its investment. Nominal yield is the most common, and is calculated by dividing the amount of interest paid by the face value.

<table>
<thead>
<tr>
<th>Rating/Agency</th>
<th>Issuer</th>
<th>Description</th>
<th>Issue Date</th>
<th>Coupon (%)</th>
<th>Outstanding Value (N'bn)</th>
<th>Maturity Date</th>
<th>TTM Yrs</th>
<th>Bid Yield (%)</th>
<th>Offer Yield (%)</th>
<th>Bid Price</th>
<th>Offer Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>NA</td>
<td>NA</td>
<td>9.20-29-JUN-2014</td>
<td>29-Jun-07</td>
<td>9.20</td>
<td>45.00</td>
<td>29-Jun-14</td>
<td>0.24</td>
<td>13.57</td>
<td>12.92</td>
<td>98.93</td>
<td>99.08</td>
</tr>
<tr>
<td>9.25-28-SEP-2014</td>
<td>28-Sep-07</td>
<td>9.25</td>
<td>100.00</td>
<td>28-Sep-14</td>
<td>0.48</td>
<td>13.75</td>
<td>13.41</td>
<td>97.96</td>
<td>98.11</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.00-23-APR-2015</td>
<td>23-Apr-10</td>
<td>4.00</td>
<td>535.00</td>
<td>23-Apr-15</td>
<td>1.05</td>
<td>13.92</td>
<td>13.75</td>
<td>90.58</td>
<td>90.73</td>
<td></td>
<td></td>
</tr>
<tr>
<td>13.05-16-AUG-2016</td>
<td>16-Aug-13</td>
<td>13.05</td>
<td>327.47</td>
<td>16-Aug-16</td>
<td>2.37</td>
<td>13.54</td>
<td>13.46</td>
<td>99.00</td>
<td>99.15</td>
<td></td>
<td></td>
</tr>
<tr>
<td>15.10-27-APR-2017</td>
<td>27-Apr-12</td>
<td>15.10</td>
<td>452.80</td>
<td>27-Apr-17</td>
<td>3.06</td>
<td>13.51</td>
<td>13.39</td>
<td>102.85</td>
<td>104.15</td>
<td></td>
<td></td>
</tr>
<tr>
<td>9.35-31-AUG-2017</td>
<td>31-Aug-07</td>
<td>9.35</td>
<td>100.00</td>
<td>31-Aug-17</td>
<td>3.41</td>
<td>13.42</td>
<td>13.30</td>
<td>89.14</td>
<td>89.44</td>
<td></td>
<td></td>
</tr>
<tr>
<td>10.70-30-MAY-2018</td>
<td>30-May-08</td>
<td>10.70</td>
<td>300.00</td>
<td>30-May-18</td>
<td>4.15</td>
<td>13.45</td>
<td>13.35</td>
<td>91.42</td>
<td>91.72</td>
<td></td>
<td></td>
</tr>
<tr>
<td>16.00-29-JUN-2019</td>
<td>29-Jun-12</td>
<td>16.00</td>
<td>351.30</td>
<td>29-Jun-19</td>
<td>5.24</td>
<td>13.58</td>
<td>13.50</td>
<td>108.80</td>
<td>109.10</td>
<td></td>
<td></td>
</tr>
<tr>
<td>7.00-23-OCT-2019</td>
<td>23-Oct-09</td>
<td>7.00</td>
<td>233.90</td>
<td>23-Oct-19</td>
<td>5.55</td>
<td>13.48</td>
<td>13.38</td>
<td>75.23</td>
<td>75.53</td>
<td></td>
<td></td>
</tr>
<tr>
<td>15.00-28-NOV-2028</td>
<td>28-Nov-08</td>
<td>15.00</td>
<td>75.00</td>
<td>28-Nov-28</td>
<td>14.65</td>
<td>13.50</td>
<td>13.46</td>
<td>109.39</td>
<td>109.69</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
5.3 Liquidity

Liquidity refers to the ease and speed with which bonds can be sold at fair market value, in a timely fashion and without affecting the bond’s price. A part of liquidity relates to the cost of engaging in transactions, particularly the bid-ask spread. Another part is the price impact; the adverse movement in price that can be encountered when attempting to execute a large trade. Yet another component is immediacy; the ability to sell the asset quickly without reverting to fire-sales price. In other words, liquidity is characterized by a high level of trading activity and ability to convert assets to cash quickly. This increases the incentives for investors to hold these assets. As a result, it is related to the monetary policy and the financial stability of a country. Deficiencies in market liquidity can lead to extreme price volatility. When the bond market liquidity is insufficient, the open market operations of the CBN may encounter difficulties. Thus, bond market liquidity enhances the tools of financial mediation, which are essential for efficient market pricing, effective borrowing and investment practices.

Source: FMDQ Daily Quotations List
SECTION SIX

Challenges of the Nigerian Bond Market

a. **Lack of Education & Awareness**: This is one of the major challenges facing a number of end-users, because they do not have a full understanding of the Federal Government bonds, while some others are not even aware of its existence.

b. **Poor Transparency of Markets**: Most of the end-users find it difficult to get information regarding activities in both primary and secondary markets.

c. **Lack of Depth in Issue Size**: In Nigeria, most of the sub-national and corporate issues bonds lack depth, and this constitutes a challenge to trading, thus cavorting liquidity.

d. **Ease of Raising Money from Equity Market**: Prior to the price correction and investor losses incurred on the Nigerian Stock Exchange, equity was the preferred mode of raising capital.

e. **High Implied Cost of Borrowing**: Another factor that hindered the development of Fixed Income Market in Nigeria is the various regulatory costs associated with bond issuance, which makes it more unattractive.

f. **Regulatory Bottlenecks** – Though the NSE/SEC have tried to make bond issuance easier, issuers still encounter various bottlenecks in the process. The absence of a registered Over the Counter (OTC) platform for corporate and sub-national bonds creates bottlenecks.

h. **Instrument Design**: Inadequate market constrains the instrument design to reveal the important features of bonds for attraction to its target.

i. **Liquidity**: insufficient liquidity in the stock market continues to make bond less attractive to investors.

j. **Information Provision**: Insufficient information is one of the major challenges that prevents investment in the bond market.

k. **Legal and Supervisory Framework**: Bureaucratic delay in the Floating of Government bonds is one of the major challenges. For example, the Irrevocable Standing Payment Order as legal requirement creates a
bottleneck in respect of every bond issue as the Accountant-General of the Federation must issue it before an application is granted.
Conclusion and Recommendations

The Nigerian bond market is potentially a viable market, which will free up capital for investment in small businesses, allow the government to focus on economic development and fuel economic growth through government spending. It will also increase investment and support the development of other segment of the financial market. Overall, the bond market will contribute significantly to the government’s plans for diversifying Nigeria’s economy and ensure its long-term viability. In order to realize the benefits of a viable bond market, there is need to address the challenges earlier identified.

The following will go a long way in deepening of the bond market in Nigeria:

- There is need to maintain a stable macroeconomic environment in order to deepen the bond market.
- There is need to strengthen the regulatory framework of the bond market to boost the confidence of investors.
- There is need to encourage border transactions/international participation in the market.
- The number of active market makers should be increased in order to boost liquidity in the bond market.
- There is need for increased awareness by the public and private sector regarding the importance and advantages of bond market.
- Transaction cost should be reduced in the financial markets.
THE NIGERIAN BONDS MARKET

TERMS AND FEATURES OF BONDS

Issuer: Is the organization or company that issues the bond

Principal or Nominal Amount: This is the total amount that has to be repaid at the maturity date and which the issuer of the bond pays interest

Issue Price: This is the price which investors pay at the time the bonds were issued.

Maturity Date: This is the date the nominal amount has to be repaid by the issue of the bond. Once all the necessary payment has been made, the issuer of the bond has no more obligations to the bond holders. A debt security that has less that a year is referred to as money market instruments. Most bonds have lengthy time to maturity; some may be up to twenty five years

Coupon: This is the interest rate that bond holders receive from the issuer of the bond. Generally, interest rate is fixed throughout the life of the bond.

Coupon Rate: It is the rate at which interest rates are computed to get the face value of the bond.

Coupon Dates: Is the date that the bond holders receive coupon from the issuer of the bond.

Yield: The yield is the return on investment

Par Value: It is the face value in which is the bond is denominated.

Tenor: It is the maturity date of the bond when all the obligations would have been met and all liabilities settled.

Call Dates and Put Dates: These are the dates on which all callable and puttable bonds can be redeemed early.

Trustee: Trustee is the third party whose job is to ensure that the covenants and the terms of the bond are actually fulfilled on behalf of investors.
Bibliography


Nigerian stock exchanges (2013). The Role of NSE FIMMs - An Introduction to Retail Bond Market. An NSE Presentation by Segun George and Dunn Loren Merrifield


Tavershima Adyorough (2009). The Mechanics of a Bond Market in Nigeria Solutions to Liquidity Constraints in Over-the-Counter Bond Trading@studenthousingforsale.org

Chinyelu Ezeilo (2010). Corporate Bonds in Perspective- Nigeria as a Case Study@http://www.jesmajoesolicitors.com
