CAPITAL & MONEY MARKET OPERATIONS

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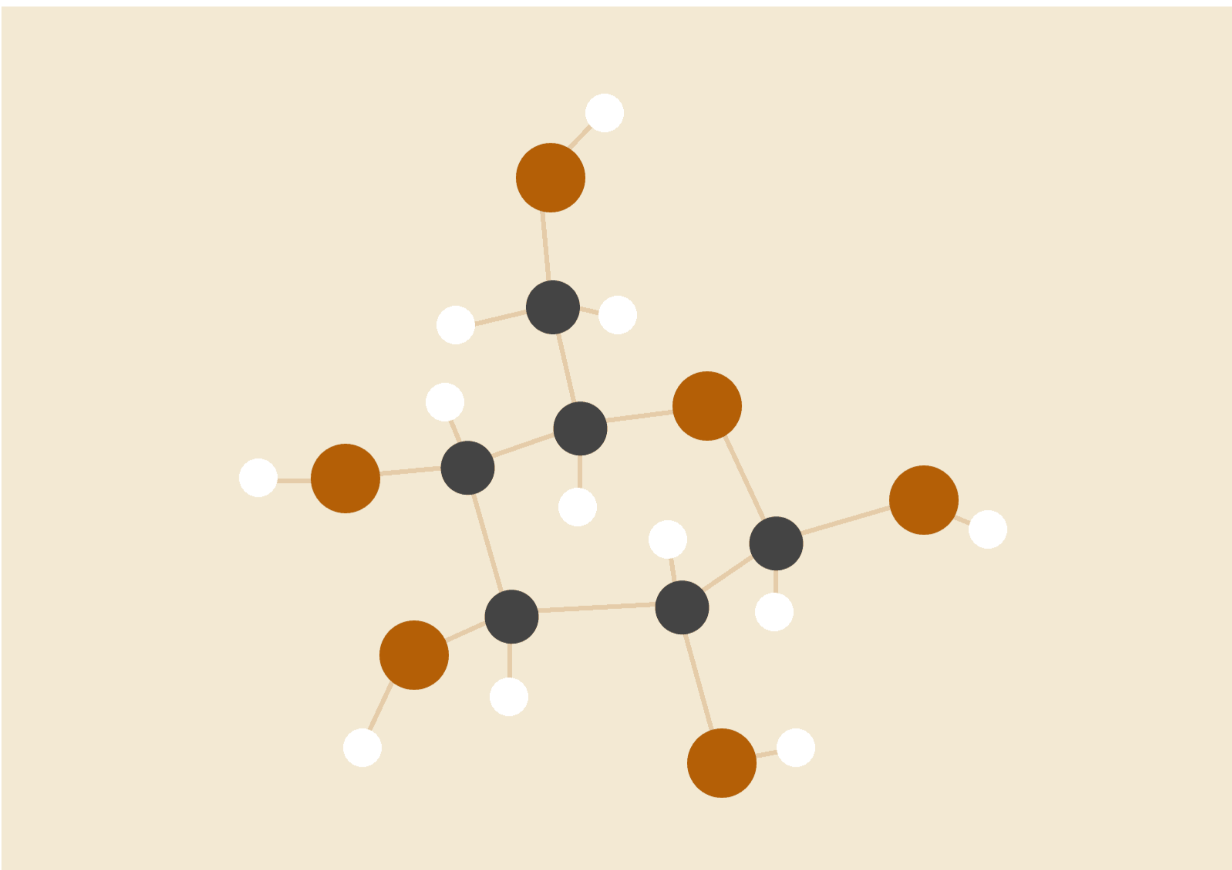

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INTRODUCTION

Financial markets are a platform that facilitates the mobilisation of funds for economic activities by governments, businesses, and individuals. The two main parts of Financial Markets are Capital and Money Markets.

Capital Market movements are constantly monitored from hour to hour and analyzed for clues as to the health of the economy at large, the status of every industry in it, and the consensus for the short-term future.

The Nigerian capital market dates as far back as 1946 when the colonial government floated it with a 300,000 pounds bond to implement a 10-year development plan. It is a market structured to be regulated by the Securities and Exchange Commission (SEC), as the apex regulatory body of the Nigerian Capital Market. Capital markets are so vital to the development of all economies and therefore countries seek to put in place measures to regulate the activities of the market. Consequently, governments promote the orderly growth and development of capital (as well as money) markets in order to have viable, long and short term, investment opportunities at various points in time. The Nigerian capital and money market is principally a market for both short and long-term investments where government bonds, corporate equities and long-term debt securities are issued and traded.

The money market plays a key role in ensuring that banks, other companies, and governments maintain the appropriate level of liquidity on a daily basis, without hoarding excess cash that isn't earning interest and without falling short and needing more expensive loans.

Supervised by the Federal Ministry of Finance, the Securities and Exchange Commission, (SEC) is a Government Agency mandated to regulate and develop the Nigerian Capital Market. It was established by the Investments and Securities Act of 2007.

The Nigerian Stock Exchange (**NSE**) is privately owned and self-regulating, having evolved from the initial Lagos Stock Exchange established in 1959 as a company limited by guarantee. The **SEC,** as mentioned earlier**,** maintains surveillance over it with the mandate of ensuring orderly and equitable dealings in securities and protecting the market against insider trading abuses.

CAPITAL MARKET & OPERATIONS

Capital market is a market where buying and selling are undertaken by participants such as individuals and institutions. Here the buyers and sellers engage themselves in the trading of financial securities like bonds, stocks, etc. Generally, this market trades in long-term securities i.e. it is structured to mobilise and distribute funds for long-term needs, to economic units.

Basically, Capital markets help move surplus funds from savers to institutions. These in turn then invest such surpluses into productive use.

Capital market consists of primary markets and secondary markets.

Primary markets - deal with the trade of new issues of stocks and other securities. Initial public offers or IPOs are characteristic of this market.

Secondary markets - deals with the exchange of existing or previously issued securities. The capital market can be further divided on the basis of the nature of security traded, i.e. stock market and bond market.

Here mention needs to be made of the government agency called the **Debt Management Office** (DMO) established in 2000. It is a principal operator in the bond market and takes charge of the governments foray into this sector by virtue of its stipulated mandate.

Aside from managing the entire debt of the nation, which was hitherto being managed by four different departments with all its inter-departmental complexities and corresponding communication and cooperation challenges, the Debt Management Office issues different types of bonds for different purposes and in supporting the Central Bank of Nigeria with liquidity management. Bonds like FGN bonds, Eurobonds, Green Bonds, Savings bonds, Sovereign Sukuk, Treasury Bills, Promissory Notes, etc are all within their purview and give that stamp of authority that such instruments have the sovereign might of the nation behind it.

FUNCTIONS OF CAPITAL MARKETS

- Facilitates the movement of capital to be used more profitably and productively to boost the national income.
- Boosts economic growth. Individuals and business entities are all economic units in a society and the aggregate of their earning power form part of the earning potentials of a nation. It therefore follows that when these units get more from the capital market e.g. they sell their shares through a public offer, for instance, they are able to invest in modern equipment and technology and thus do more by being more productive. This provides more employment opportunities, enhanced business activities and overall increased national productivity.
- Mobilisation of savings to finance long-term investment.
- Facilitates trading of securities. The capital market provides a veritable platform for the exchange of funds so those who need it get it and those who provide it earn some additional value.

OPERATORS IN THE CAPITAL MARKET

The players on the capital market are the operators who act as intermediaries between the providers of the funds and the fund users. They include:

- Securities Exchanges, SEC, NSE. These exchanges provide a trustworthy platform for trades to take place with proper monitoring and regulation that engenders (the job of SEC, Securities and Exchange Commission) as well as a basket of verified and authentic equities (NSE, Nigerian Stock Exchange) to trade in.
- Brokers/Dealers,
- Issuing Houses,
- Registrars and,
- Investment Advisors.

INSTRUMENTS

The instruments traded (media of exchange) in the capital market are:
(Instruments Traded In The Capital Market - The Securities and ...http://sec.gov.ng › instruments-traded-in-the-capital-market)

- Debt Instruments

A debt instrument is used by either companies or governments to generate funds for capital-intensive projects and can be obtained through the primary or secondary market. The relationship in this form of instrument ownership is that of a debtor (borrower) – creditor and thus, does not imply ownership in the business. The contract drawn is for a specific duration and interest is paid at specified periods as agreed in the trust deed (contract agreement). The principal sum invested is therefore repaid at the expiration of the contract period inline with such agreements i.e. interest is either paid quarterly, semi-annually, or annually. The interest stated in the trust deed may be either fixed or flexible, with tenure of this category ranging from 3 to 25 years. Investment in this instrument is mostly risk-free and therefore yields lower returns when compared to other instruments traded in the capital market. In the event of liquidation of a company, investors in this category get top priority.

- Equities (also called Common Stock)

This instrument is issued by companies only and can also be obtained in the primary market or the secondary market. Investment here translates to ownership of the business as the contract stands perpetually unless sold to another investor through the secondary market. The investor possesses certain rights and privileges (such as to hold position and/or vote) in the company. Whereas the investor in such debts may be entitled to the interest which must be paid, the equity holder receives dividends, that may or may not be declared.

The risk in this instrument is high and thus yields a higher return. Holders of such instruments are considered owners of the company and as such rank bottom on the scale of preference in the event of liquidation of a company.

- Preference Shares

Issued by corporate bodies, this instrument and the investors rank second (after bondholders) on the scale of preference when a company goes under. The instrument is like a hybrid as it possesses the characteristics of equity. They form part of the equity capital in arriving at the total when the authorised share capital and paid-up capital are being calculated. Preference shares are also treated as a debt instrument as they do not confer voting rights on their holders; they have a dividend payment that is structured like interest coupons paid for bond issues.

- Derivatives

These are instruments that are derived from other securities, and are referred to as underlying assets (since the derivative is derived from them). The price, risk, and function of the derivative depend on the underlying assets as whatever affects the underlying asset must affect the derivative. These derivatives might be assets, indexes, or even situations. Derivatives are more common in developed economies.

Derivatives can be bought or sold in two ways —

1) **over-the-counter** (OTC) - these derivatives are contracts that are made, in an unregulated venue, privately between parties, such as swap agreements.
2) on an **exchange** - derivatives that trade on an exchange are standardised contracts.

Some examples of derivatives are:

Mortgage-Backed Securities (MBS) - **Mortgage-backed securities**, called **MBS**, are bonds secured by home and other real estate loans. They are created when a number of these loans are pooled together, especially where they share similar characteristics. The Nigerian Mortgage Refinance Company specialises in issuance of such instruments by aggregating mortgage portfolios of partner banks so they can eventually provide for longer term mortgage loans.

Asset-Backed Securities (ABS) - **Asset-backed securities** (ABSs) are financial **securities backed** by income-generating **assets** such as credit card receivables, home equity loans, student loans, and vehicle loans. ... ABSs appeal to investors that are income-oriented, since they pay a steady stream of interest, like bonds.

Futures - A Future is a right and an obligation to buy or sell an underlying stock (or other assets) at a predetermined price and deliverable at a predetermined time.

Options - **Options** are a right without an obligation to buy or sell an equity or index. A Call **Option** is a right to buy while a Put **Option** is a right to sell.

Swaps - A **swap** is an agreement for a financial exchange in which one of the two parties promises to make in exchange for receiving another set of payments from the other party. They are usually made in a series of payments and an established frequency, Based on the nominal amount of the swap, these flows normally respond to interest payments**.**

Rights - Of all the above-stated derivatives, the common one in Nigeria is Rights whereby the holder of existing security gets the opportunity to acquire additional quantity to his holding in an allocated ratio. Rights issues of hitherto owned shares are then offered to existing holders, and they choose whether to acquire them or not.

Exchange-Traded Funds or commodities - An **exchange traded fund** (**ETF**) are types of securities that track an index, sector, commodity, or other asset, but which can be purchased or sold on a stock **exchange** the same as regular stocks. The Stanbic IBTC **ETF** 30 aims to replicate as closely as possible, before fees and expenses, the aggregate of total return of The **Nigerian** Stock **Exchange** 30 Index.

MONEY MARKET & OPERATIONS

The Money Market refers to trading in very short-term debt investments. While at the wholesale level, it involves large-volume transactions between traders and institutions, at the retail level it includes money market mutual funds bought by individual investors (and money market accounts opened by customers of banks).

FUNCTIONS OF MONEY MARKETS

The functions or roles of the money market in the economy are varied. It provides liquidity for businesses, government, and individual; provides the platform through which the Central Bank of Nigeria performs its monetary policy functions and helps to ensure self-sufficiency for the banks being the major intermediaries in the money market.

- Growth of industries: companies have another platform to access funds to use for further investments in their business in order to achieve growth.
- Commercial Banks Self-Sufficiency
- Treasury Bills
- Certificate of Deposit
- Banker’s Acceptance

OPERATORS IN THE MONEY MARKET

Participants include the various institutions that transact business in the money markets either as providers of funds or users of funds. These key money market operators include:

- Banks

The banks play the role of intermediaries by bringing providers of funds and users of funds together.

Providers of funds include the business units, government agencies, corporate organisations and individuals.

- Central Bank of Nigeria (CBN)

The Central Bank is the regulator of money market activities whose roles include providing policy direction for operators to conduct their business in accordance with provided laws. The CBN uses some monetary policy instruments to regulate activities of the banks which ultimately have an impact on key economic indicators like money supply, interest rates, and inflation.

- Large corporate organisations and the investing and/or banking public.

On the other hand, the users of funds are the segment of these units, i.e. businesses, corporate organisations, agencies, and individuals who borrow money from the banks to fund their different needs.

INSTRUMENTS

Money market instruments are the tools by which the financial intermediation process is carried out. The most common of these instruments are:

- Treasury Bills

Treasury Bills are short term securities issued by the Federal Government of Nigeria for the purpose of borrowing money from the investing public. However, beyond being an instrument of government borrowing, the Central Bank of Nigeria can use the instrumentality of TBs to control the amount of money in circulation in order to tame inflation.

NIGERIAN TREASURY BILLS ISSUE PROGRAMME
FOURTH QUARTER 2020

Issue Date	Maturing Bills			Issue Bills		
	91-day	182-day	364-day	91-day	182-day	364-day
10/09/20	4,405,140	14,002,523	129,651,700	4,405,140	14,002,523	109,651,700
17/09/20	2,000,000	8,385,196	168,361,351	2,000,000	8,385,196	148,361,351
24/09/20	-	-	-	-	-	-
01/10/20	10,000,000	17,600,581	106,370,499	10,000,000	17,600,581	86,370,499
08/10/20	-	-	-	-	-	-
15/10/20	8,849,034	3,500,000	112,535,643	8,849,034	3,500,000	92,535,643
22/10/20	-	-	-	-	-	-
29/10/20	49,839,651	10,615,398	93,915,151	29,839,651	10,615,398	93,915,151
05/11/20	-	-	-	-	-	-
12/11/20	19,783,588	40,093,992	107,938,478	19,783,588	40,093,992	87,938,478
19/11/20	-	-	-	-	-	-
26/11/20	20,372,790	19,157,656	111,071,723	20,372,790	19,157,656	91,071,723
TOTAL	**115,250,203**	**113,355,346**	**829,844,545**	**95,250,203**	**113,355,346**	**709,844,545**

NOTES: Subject to change at short notice, 1 unit of NTB = ₦ 1,000

Interest earned on Treasury Bills is tax free during the period you hold the investment, income is realisable upfront and you can use it as collateral for short term loans. Investment in Treasury Bills are very safe. In fact, it is considered the safest investment in the money market because of the guarantee of the government that it has. And because there is an active secondary market for investors who do not wish to hold to maturity, the instrument is very liquid.

- Bankers Acceptances

A Banker's Acceptance has features similar to both commercial papers and treasury bills. Like a commercial paper, banker's acceptances are issued by institutions to raise money from the investing public for a short period of time. But where CPs are unsecured, Banker's Acceptances are guaranteed by the Bank. Of course TB guarantees are more weighty coming from the government.

- Commercial Papers and Certificate of deposits

Big corporate organisations with good credit rating, preferably AA ratings for example, from very credible rating organisations may issue Commercial Papers to enable them raise funds to finance working capital needs, meet immediate orders, fund receivables, and generally meet short-term obligations. With this class of issuers, raising CP's is considered a low-cost alternative to bank loans. It may also be more feasible to raise CP's to cover immediate short-term funding gaps than to approach the stock market where regulatory issues may make fundraising cumbersome. The return on CPs is competitive but is generally higher than that on TBs because CPs are riskier. Of course, the quality of the instrument is largely a function of the credibility and capacity of the Issuer.

- Certificate of Deposit

Otherwise known as a time deposit or fixed deposit, a Certificate of Deposit is an instrument issued by the bank through which they mobilise funds from the banking public for their trading activities, usually for maturities ranging from 30 days to one year at specified interest rates. The interest you will receive on a time deposit, usually differs from bank to bank and is determined by a lot of factors such as: the going money market rate at the time, the liquidity levels of the bank, and general interest rate.

- Call Deposits

These are deposits you place with your bank without a fixed maturity date. If you have money that you may need at any time, you may place it with your bank on call which means that you are at liberty to call for your money at any time. Your bank will then pay you an interest rate but not as much as you will earn on a Fixed deposit with specific tenor.

- Money Market Funds

Money Market Funds are mutual funds managed by fund managers who are registered by the Securities and Exchange Commission, and who invest primarily in highly liquid money market instruments like Treasury Bills, Bankers Acceptances, Promissory Notes and Bank Deposits.

The benefits are many apart from taking the burden of managing the risk off your plate. Some mutual funds accept as low as NGN5,000 minimum investments and you can add to your investments as your capacity increases. The risks are lower because your investment is managed by professionals.

Most, if not all, registered fund managers in Nigeria have open-ended money market funds you can easily invest in. Some of these include FBN, ARM, and Stanbic IBTC Money Market Fund.

CAPITAL MARKET VS. MONEY MARKET

A "money" market is a place of exchange for debt instruments with original maturity of less than one year, while the "capital" market is a place of exchange for debt instruments with original maturity of more than one year; and they are also the market for equity securities (common stocks and preferred stocks).

Take our Nigerian banks for instance, they have both fixed deposits with a determined date of 30, 60, 90 days etc. and call deposits without a determined maturity date, so an investor could request their money at any time without notice. To be sure, even those with determined dates can be liquidated subject to some penalty fee for reneging on the agreed contract.

The money market is the place for trade in short-term debt. It is a constant flow of cash between governments, corporations, banks, and financial institutions, borrowing and lending for a term as short as overnight and no longer than a year. The Central Bank of Nigeria uses this market via various policies at its disposal to affect the quantity of money in circulation. It buys or sells government securities through a process known as open market operations (OMO). Therefore when CBN is looking to increase the quantity of money in circulation, it purchases government securities from commercial banks and institutions.

The capital market encompasses the trade in both stocks and bonds. These are long-term assets bought by financial institutions, professional brokers, and individual investors.

The money market is a short-term lending system. Borrowers tap it for the cash they need to operate from day to day. Lenders use it to put spare cash to work.

The capital market is geared toward long-term investing. Companies issue stocks and bonds to raise money to grow their businesses. Investors buy them to share in that growth.

The money market is less risky than the capital market while the capital market is potentially more rewarding.

The significance of these two markets in economic development therefore can not be overemphasised. They ensure the mobilisation for funds towards productive investments in commerce and industry for economic growth, while improving the efficiency of such flows. Liquidity management of the banking system can not be done without the money market to balance as well as stabilise the almost constant surplus and deficits that characterise such systems.

CONCLUSION

As explained earlier, the capital market is roughly divided into a primary and a secondary market. Companies that issue a round of stock or a new bond places it in the primary market for sale directly to investors or institutions. Any sale of such shares or bonds by such buyers is done on the secondary market. While the original issuer of those stocks or bonds does not immediately benefit from their resale, these companies certainly have an interest in the price of their stock shares rising over time as such valuation raises the profile of the organisations .

Naturally, the capital market is riskier than the money market hence the greater potential gains and losses. Some of us may remember the age old mantra - '*the higher the risk, the higher the reward and vice versa*.'