GlobalCapital

Pair team up to bring clearing house to Nigeria

A fund and a local securities exchange will create the first clearing house in Nigeria. Both hope it will bolster liquidity and improve financial stability in the Nigerian capital markets.

By Nell Mackenzie *06 Jun 2018*

FMDQ OTC Securities Exchange and Frontclear, a fund that provides credit guarantees to emerging and developing countries are working together to create a central clearing house. The project is called FMDQ Clear.

The joint venture will not use the normal clearing house model built on novating existing trades between two counterparties to trades where each faces the clearing house. Instead the trades will remain between the original counterparties but the counterparty risk will be guaranteed by the outside fund, Frontclear.

In the event of a counterparty default, Frontclear will guarantee any mark-to-market losses up to an agreed maximum amount.

Frontclear is a fund that provides credit guarantees to cover credit risk in emerging market countries on the condition that local currency assets can be used for collateral management. This is because in Nigeria, since the naira was depegged from the dollar, the country's central bank has tightened liquidity to protect its currency.

The joint venture will start with repo trades and move on to derivatives. Its creators ultimately intend the clearing house to create a fertile secondary market for the performance of Nigeria's primary capital markets. The parent company, FMDQ Group already owns an exchange that provides trading, listing, market quotation, order execution and trade reporting for fixed income, derivatives, and currencies.

It is registered and licensed, as most traded securities in Nigeria must be, with the Central Bank of Nigeria and the Securities and Exchange Commission (SEC).

The financing that supports the Frontclear guarantees comes from the German development bank, KfW, while technical assistance and further financing comes from the European Bank for Reconstruction and Development (EBRD), the Dutch development bank FMO, Financial Sector Deepening Africa (FSDA), the French development bank Proparco, The Currency Exchange Fund (TCX), the UK's Department for International Development (DfID) and the German Ministry of Development Co-operation (BMZ).

Recovery risks

Nigeria is still recovering from an economic crash that was driven by the 2014 slump in oil prices. Then naira was pegged to the dollar until it was devalued in June 2016. The country already sports a local futures forex and swap markets, which the clearing house hopes to service.

Trading in Nigeria is still viewed as a risky activity from a credit perspective and that and the upcoming election have dampened corporates, banks and investors' risk appetite, according to a research note released this week by Exotix Capital.

There are also risks to the Nigerian economic recovery, the note says. They are central bank tightening, falling margins due to falling loan yields and the risk of rising inflation which currently sits at 12.5%.

But the economic picture in Nigeria is not bleak by any means. It is sub-Saharan Africa's largest economy. The price of oil, the country's biggest export, is on the rise and with the building of the country's first refinery, expectations are that the country might finally find more ways to profit from its largest natural resource.

The note says that in general there is a rising focus on behalf of the banks to employ technology to cut processing costs and acquire new customers.

Against this backdrop FMDQ has positioned itself as the only major securities exchange, and now clearing house. The company launched the exchange in 2016 and its current structure includes the only central securities depository in Nigeria.

The exchange handles mostly government bonds, other fixed income securities, OTC forex futures, and currencies. The company says it felt it was the right moment to move forward with the establishment of a clearing house as there was a gap in the market for clearing derivatives products.

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