



THE Nigerian STOCK EXCHANGE

RC: 2321

MARKET MAKING

1. DEFINITION

Market Making is the process whereby a broker-dealer provides continuous two-way quotes (comprising of buy and sell prices and sizes) to the market for the securities that they make markets on during the trading day – one indicating the price and size he/she is willing to buy a particular security, called the 'bid'; the other indicating the price and size he/she is willing to sell that same security, called the 'ask', or 'offer'. The difference between the bid and offer prices is known as the bid-ask spread, and is the market maker's profit. A broker-dealer licensed to execute such trades is known as a Market Maker.

2. MARKET STRUCTURE

The Nigerian Stock Exchange will operate a 'hybrid' market, allowing market makers to provide two-way quotes and licensed broker/dealers of The Exchange to submit orders. These quotes and orders interact on the order book to "discover" the best price for a security.

The programme will be rolled out over a six-month period when securities will be gradually phased in on a week interval. The lower/upper trading limit (circuit breaker) will increase from 5% to 10% for securities that get rolled out into the programme.

Types of market making constructs:

Market makers will provide quotes in securities that they make market in

- Quote-driven market making: only the bids and asks of market makers are displayed in the market. The orders of regular broker-dealers are not displayed.
- Order-driven market making: all the orders of buyers and sellers are displayed in the market, showing the quantity and the price at which a buyer/seller is willing to trade.

The new structure will allow Broker/dealers to short Sell – the sale of a security that a seller does not own but has borrowed before the sale is made.

- Market makers have the additional privilege to make a covered sale –where the seller has entered into a bonafide agreement with a securities lending agent to borrow or is in the process of borrowing a security when the sale is made.
- Naked short selling is prohibited.

3. BENEFITS TO THE MARKET

- Compete for customer order flow by providing a two-way firm quotes (Bid & Offer) at or better than the best bid or offer a minimum percentage of the time, as determined by the Exchange.
- Maintain continuous two-sided quotes (bid and ask) within a predefined spread.
- Meet the anticipated needs of the market by sometimes maintaining inventory in order to facilitate trading in specific stocks.
- Play an important role in the secondary market as catalyst particularly for enhancing stock liquidity.
- Anchor opening, closing and intra-day auctions to enhance the price discovery process.

4. OBLIGATIONS OF MARKET MAKERS

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5. REQUIREMENTS FOR MARKET MAKERS

- Risk Management.
- Inventory Control.
- Access to Securities Lending facilities.
- Appropriate level of capital commitment.
- Excellent knowledge of trading.
- Understanding of the securities in which the market maker is making markets.

For Market Making to be vibrant there must be Securities Lending and Short Selling structures in place, i.e. there must be a place and arrangements to borrow some of those securities for trading.

6. BENEFITS OF MARKET MAKING INCLUDE

Institutional Investors:

- More liquidity in the market place, which in turn allows for easy entry and exit.
- Enhanced portfolio diversification and management.
- Potential income derivable from making available their stock for securities lending.

Listed Companies:

- More activity in their securities, thereby increasing their liquidity and attractiveness.
- Price improvement.
- Increased market capitalization.
- Cheap source of funding.

Retail Investors:

- Potential income derivable from making available their stock for securities lending.
- Increased market place liquidity for ease of entry and exit.
- Enhanced portfolio diversification and management.

Stockbrokers/Broker-Dealer:

- Increased liquidity.
- Greater market depth.
- Increased number of executed trades without price movement.
- Reduced market impact from price fluctuation.

Market Makers:

- Enhanced revenue opportunities at the Opening, Closing and intra-day auctions.
- Reduced transaction and regulatory fees.
- Enhanced revenue opportunities from regular trading.

7. NSE PRIMARY MARKET MAKERS

The Broker/Dealers below were selected by The Nigerian Exchange to perform the role of market makers. The market makers will start with a limited number of securities and roll out the rest of the securities in their basket over a period of 6 months.

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| • Capital Bancorp | • Greenwich Securities |
| • CSL Stockbrokers | • Renaissance Capital |
| • ESS/Dunn Loren Merrifield | • Stanbic IBTC |
| • FBN Capital | • Vetiva Capital |
| • Future View Securities | • WSTC |

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