

Market Making FAQs

1. What is Market Making?

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.

2. Who is a Market Maker?

A Market Maker is a broker dealer licensed to execute and maintain firm bids and offer according to the rules of The Exchange. Market makers add to liquidity by being ready to buy and sell designated securities during the trading day (as specified by The Exchange).

3. What is National Best Bid and Offer (NBBO)?

NBBO is the best (lowest) available ask price and the best (highest) available bid price to investors when they buy and sell securities throughout a country. The NBBO is important to market makers, because they indicate what they should charge or expect for the shares they make markets for.

4. Can Market Makers swap securities?

Securities can only be swapped with the NSE's consent under defined conditions. For example, where the market maker has a potential conflict of interest because of an existing relationship with the allocated company.

5. Are Market Maker Limited to only Market Making Activities?

No, Market Makers can engage in other trading business activities or may be affiliated with dealing member firms that trade. However, best practices require that there is an information barrier between the market making activities and the other business activities.

6. Are Market Makers Allowed to Short Sell?

Yes, like other broker-dealers, Market makers are allowed to make a covered short 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. All market participants including Market Makers are prohibited from naked short selling.

7. How do Market Makers make Profit?



THE Nigerian STOCK EXCHANGE

The Market Maker's primary source of income is from the spread. The market-maker spread is the difference between the price at which a market maker is willing to buy a security and the price at which it is willing to sell the security. While the spread between the bid and ask is only a few cents, market makers can profit by executing thousands of trades in a day and expertly trading their "book." However, these profits can be wiped out by volatile markets if the market maker is caught on the wrong side of the trade. His profit is highly dependent on inventory turnover.

8. What Obligations are Market Makers Typically to Fulfil?

- I. Maintain continuous two-sided quotes (bid and ask) within a predefined spread.
- II. Meet the anticipated needs of the market by sometimes maintaining inventory in order to facilitate trading in specific stocks.
- III. Play the role of a secondary market catalyst by enhancing stock liquidity.

9. What are General Requirements for Market Makers?

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

10. What are the Benefits of Market Making?

- I. More liquidity in the market place, which in turn allows for easy entry and exit, as well as portfolio diversification and management.
- II. Issuers enjoy more activity in their securities, thereby increasing their liquidity and attractiveness, eventually leading to cheaper capital raising.
- III. Increased market place liquidity for ease of entry and exit.
- IV. Greater market depth.
- V. Increased number of executed trades with minimal price movement.
- VI. Reduced market impact from price fluctuation as spreads continue to narrow.
- VII. Reduced transaction and regulatory fees for Market Makers.
- VIII. Enhanced revenue opportunities from trading activities.

NOTES:

1. The above information does not constitute investment or legal advice. Professional advice should be sought by stakeholders or potential investors where required.
2. For further information: Please visit our website or email productmanagement@nse.com.ng.