chapter 5

OBJECTIVES

At the end of this chapter, students should be able to:
â€¢ Explain the term â€˜Money Marketsâ€™ and agencies that regulate money market;
â€¢ Mention their objectives and their tools;
â€¢ Explain the regulation of capital market, their agencies, objectives and tools;
â€¢ Explain the significance of financial market regulatory agencies.

5.1 Introduction

Finance is required for different purposes, by different persons and at varying periods of time. Thus, there is a greater variety in the institutions providing credit facilities, loans and the types of facilities arranged. Financial institutions are establishments that issue financial obligations in order to acquire funds from the public. This chapter shall examine the agencies responsible for the regulation of money market, their objectives and their tools of regulation. Agencies responsible for the regulation of capital market, their objectives and tools of regulation as well as the functions of financial market regulatory agencies are also discussed.

5.2 Meaning of Financial Markets

Financial market is a market in which financial instruments are bought and sold.
Financial instruments include shares, stocks, bonds and so on. Financial markets are divided into two as follows:
(a) Money market
(b) Capital market

5.3 Money Markets

Money market is a financial market for lending and borrowing of short-term loans and aids all forms of business transactions.
Several financial institutions operate in the money market. They include the following:
(a) Commercial banks or joint stock banks
(b) Microfinance banks
(c) Discount houses
(d) Hire purchase companies
(e) Finance companies
(f) Central bank
The financial instruments used by money market to transfer money from lenders to borrowers are treasury bills, treasury certificates, bills of exchange and money at call.

Agencies Regulating the Money Market

(a) Central Bank
(b) Commercial Banks

5.4 Capital Market

Capital market is a financial market for the lending and borrowing of long-term loans.
The money lent or borrowed from this type of market is used to finance capital projects.
The institutions involved in the capital market include the following:
(a) Central bank
(b) Development banks
(c) Building societies
(d) National Provident Fund (NPF)
(e) Insurance companies
(f) Stock exchange

5.5 Regulation of Money Markets

The Central Bank of Nigeria does this by using the following tools:
(a) Open market operation: This is used to increase or reduce the volume of money in circulation. If the Central Bank wants to increase the volume of money in circulation, it will buy securities from commercial banks. This will make money available to the commercial banks, which will increase their ability to give more loans to members of the public. On the other hand, if the Central Bank feels that there is much money in circulation and wants to reduce it, it will sell securities to the commercial banks.
This will extract money from the commercial banks thereby reducing their lending capacity and reducing the volume of money in circulation.
(b) Special deposit: This is a mechanism used by the Central Bank to curtail credit facilities of commercial banks. The Central Bank gives

instruction to the commercial banks to keep with it special deposits over and above their statutory requirements. This will reduce the money with the commercial banks and their lending abilities will also reduce.
(c) Bank rate: The Central Bank raises this when it feels like curtailing the lending powers of the commercial banks. It is the rate of interest that the Central Bank charges commercial banks and other financial institutions for discounting their bills.
(d) Moral suasion: This is a gentle appeal by the Central Bank to commercial banks as to the kind of lending policy they should adopt regarding the expansion or contraction of money supply. If the commercial banks refuse, the Central Bank can apply the force of law.
(e) Cash ratio or cash reserve: This is the minimum legal cash reserve requirement of the commercial banks if the money in circulation is made and the Central Bank wants to reduce it and the Central Bank reduces the cash deposit when it wants to increase the volume of money in circulation.
(f) Special directives: The Central Bank gives special directives as to which direction the commercial banksâ€™ lending policies should follow. The apex bank directs the commercial banks on
the sector of the economy they should direct their lending policies.

5.6 Regulation of Capital Markets

Regulations are principally aimed at strengthening investorsâ€™ confidence in the capital market by creating the necessary environment for the orderly trading of securities and by ensuring that fair and equitable prices prevail. To play this very important role, the Nigerian Securities and Exchange Commission (NSEC) ensures among other things the following:
(a) Comprehensive and unbiased information about securities and their issuers are disclosed to the public on a regular and timely basis.
(b) All relevant rules and regulations are adequately complied with.
(c) Transactions on the trading floor of Nigerian Stock Exchange are not crippled by fraudulent, exploitative and manipulative practices particularly through insider trading.
(d) Professional code of ethics is established to guide all operators of the market.

Tools or Instruments Used in Capital Markets

The tools used in capital market include stocks and shares. They are securities bought by individuals as an evidence of contributing part of the total capital used to run an existing company. At the end of every financial year, the shareholder or stockholder receives the price for providing part of his money for running the affairs of the company.

5.7 Agencies Regulating Financial Markets

(a) Central bank
(b) Development banks
(c) Mortgage bank

(d) Insurance companies
(e) Stock exchange

Functions of Financial Market Regulatory Agencies

Functions of Development Banks as a Regulatory Agency

1. Provides long-term loans for capital projects
2. Helps to implement government financial policies such as policies that will affect industrial development
3. Conducts extensive study on industrial sector in order to determine the viability of industries
4. Contributes to manpower development by making funds available to manpower-training institutions

Functions of Mortgage Banks as Regulatory Agencies

1. Accepting deposits from members of the public for safekeeping
2. Encourages people to build their own houses by offering them longterm loans
3. Advises and assists the government on housing matters
4. Constructs and produces houses and sold amenities to low-income groups

Functions of Insurance Companies as Regulatory Agencies

1. Protects persons and objects
2. Pools risks in businesses
3. Offers both long- and short-term loans
4. Offers advice to individuals, organizations and government on the best ways to save lives and properties

Functions of the Stock Exchange as a Regulatory Agency

1. It is a market for selling and buying of securities.
2. It assists companies to raise their capital by helping to change the securities to cash.
3. It assists the government in implementing its monetary policies.
4. Price quoted in stock exchange serves as an economic indicator.
High price indicates good economic condition.
Apart from the above, they perform the following additional functions:
(a) Oversee the safety and soundness of these funds on a consolidated basis
(b) Mirror the risk management practice
(c) Engage in consolidated supervision
(d) Strengthen performance measurement and collaboration
(e) Employ differing policies and approaches to provide consolidated supervision
(f) Improve programme objectives and performance measures

5.8 Objectives of Financial Markets

(a) It facilitates efficient and fair performance of economic functions.
(b) It sees to the welfare of end users.
(c) It should be a good incentive structure for providing information in financial market as information is very important to investors.
(d) It helps investors to evaluate the quality of the securities or services

offered, which calls for an intermediary to dismantle information and services that have to be regulated.
(e) It prevents monopoly of the capital market, which otherwise jeopardizes the market mechanism.

Summary

â€¢ A financial market is a market in which financial instruments are bought and sold.
â€¢ **Agencies that regulate money market include**
(a) Central bank **(b)** Commercial banks
(c) Discount houses **(d)** Insurance companies
(e) Finance houses **(f)** Acceptance houses
â€¢ **Agencies involved in capital market include**
(a) Central Bank **(b)** Building societies
(c) Development banks **(d)** National Provident Fund
(e) Stock exchange **(f)** Insurance companies

Class Activity

The teacher should organise students to go on an excursion to banks or stockbrokersâ€™ offices. Students should inquire about the functions of these banks and stock broking firms.

Revision Questions

Objective Questions

1. A financial institution that specializes in accepting responsibility for risks on persons and properties is called:
(a) A trust bank
(b) An investment bank
(c) A development company
(d) The stock exchange
2. The Federal Mortgage Bank specializes in the granting of credit to
(a) Textile dealers
(b) Prospective industrialists
(c) Prospective house owners
(d) Agriculturists
(e) Miners
3. Which of the following is not a function of an insurance company?
(a) Mobilisation of funds through premiums collected
(b) Encouragement of savings habit through life assurance
(c) Collection of deposits from the public
(d) Granting of loans on long-term basis for investment
(e) Encouragement of investment by security of capital
4. The clearing house for all commercial
banks in Nigeria is the:
(a) General post office
(b) Bank for Commerce and Industry

(c) Nigerian Industrial Development Bank
(d) Mortgage bank
(e) Central bank
5. A special deposit is a mechanism used by the central bank to curtail the credit facilities of:
(a) Commercial banks
(b) Merchant banks
(c) Community banks
(d) Mortgage banks
(e) Development banks

Essay Questions

1. Examine the important role played by the Nigerian Stock Exchange in the Nigerian financial market.
2. Explain the term â€˜capital marketâ€™ and show how it differs from stock exchange.
3. (a) What is a development bank?
(b) Examine its functions and show how a development bank differs from a commercial bank.
4. Explain comprehensively the role of insurance company as a financial regulatory agency.
5. Explain fully the functions of a development bank as a financial regulatory agency.

Glossary

Financial institutions: These are establishments that issue financial obligations in order to acquire funds from the public.
Financial market: It is a market in which financial instruments are bought and sold.
Money market: It is a financial market for the lending and borrowing of short-term loans.
Capital market: It is a financial market for the lending and borrowing of long-term loans.