OTC FX Futures Market Close-Out Methodology

Appendix to the OTC FX Futures Market Operational Standards

February 10, 2020

1. Definitions

The following terms and expressions shall, unless the context otherwise requires, have the following meanings in the Standards and this Methodology. However, in the event of an inconsistency in the definitions provided in the Standards and this Methodology, the definitions in this Methodology shall prevail.

"**Clearing Agent**"	has the meaning provided in the Standards
"**Defaulting Party**" or "**DP**"	means the party with respect to which an Event of Default is declared
"**Early Termination Date**" or "**ETD**"	has the meaning provided in the Standards
"**Event of Default**" or "**EOD**"	has the meaning provided in the Standards
"**FMDQ Exchange**" or the "**Exchange**"	means FMDQ Securities Exchange Limited
"**Market Notice**"	means a written communication issued periodically and specific to information on products and markets issues, ranging from new product releases, amendments to existing operating procedures, risk management arrangements, products, markets activities, and decisions that may affect members and stakeholders on the Exchange
"**Methodology**"	means this OTC FX Futures Market Close-Out Methodology
"**Non-Defaulting Party**" or "**NDP**"	means the counterparty to a Defaulting Party
"**Terminated Transaction**"	means, with respect to an Early Termination Date resulting from the declaration of an Event of Default, all open contracts immediately preceding the effectiveness of the Market Notice issued by FMDQ Exchange, designating an Early Termination Date for the relevant open contracts
"**Termination Currency**"	means Nigerian Naira

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[1] Endorsed by the CBN on July 27, 2016, revised August 24, 2016

2. Introduction

This Methodology outlines the mechanism for the calculation of Early Termination Amounts due where early terminations of OTC FX Futures contracts occur following the declaration of an Event of Default by FMDQ Exchange. In the interest of clarity, FMDQ Exchange shall be the determining party for all/any amounts due to/from non-defaulting party or defaulting party upon the declaration of an EOD.

3. Close-Out Triggers

As provided in the Standards, upon the declaration of an EOD by the Exchange, all open OTC FX Futures contracts of a defaulting Dealing Member (Bank) ("**DMB**") executed with Transaction Counterparties (i.e. other DMBs and the Central Bank of Nigeria ("**CBN**")) shall be closed out and terminated ("**Terminated Transactions**"), following which all Early Termination Amounts due to/from relevant Transaction Counterparties shall be determined and debited/credited to the defaulting DMB's CBN operating account by the Clearing Agent.

In addition to the above, the following circumstances shall also give rise to the close-out of OTC FX Futures contracts executed by a defaulting DMB with Clients upon the declaration of an EOD by the Exchange, *inter alia*:

(i)   Where a Client with an open position(s) in an OTC FX Futures contract opts to close-out its open contract(s) with a defaulting DMB

(ii)   Where a Client opts for a transfer of the OTC FX Futures contract to a substitute DMB(s) but is unable to effect the transfer of its open contract within ten (10) business days of the declaration of an EOD

(iii)   Where, at the time of the declaration of an EOD, an OTC FX Futures contract is within thirty (30) calendar days or less to maturity

4. Determination of Early Termination Amounts in the Event of Default

Upon the designation of an ETD by FMDQ Exchange, the amount payable by either party is referred to as the Early Termination Amount, which is the amount equal to the sum of the equivalent of the Close-Out Amount in the Termination Currency (whether positive or negative) for each open contract, and the equivalent of the Unpaid Amounts in the Termination Currency owing to the Non-Defaulting Party less the equivalent of the Unpaid Amounts owing to the Defaulting Party in the Termination Currency.

Based on the foregoing, in the process of closing out an OTC FX Futures contract in the Event of Default, the Early Termination Amount due to/from Transaction Counterparties and/or Clients, is determined using the following formula:

$$\textit{Early Termination Amount} = \textit{Close-Out Amount} + [\textit{Unpaid Amount} \ (\textit{NDP}) - \textit{Unpaid Amount} \ (\textit{DP})]$$

(i)   Unpaid Amount is the equivalent of the amount in the termination currency being owed to or by the non-defaulting party on or prior to such ETD and which remains unpaid as at such ETD, expressed in either a positive number, where defaulting party owes the non-defaulting party or

a negative number, where non-defaulting party owes the defaulting party. In the interest of clarity, Unpaid Amounts are all amounts due and payable under the open OTC FX Futures contracts upon the declaration of an EOD, that remain unpaid as at the ETD. These include but are not limited to the following:

- Margin payments due and payable to either party prior to the ETD
- Margin payments due and payable to either party on the ETD

(ii) Close-Out Amount means with respect to each Terminated Transaction and non-defaulting party, the amount of losses or costs to the non-defaulting party that are or would be incurred under the then prevailing circumstances (expressed as a positive number) or gains to the nondefaulting party that are or would be realised under the then prevailing circumstances (expressed as a negative number) in replacing or providing for the non-defaulting party the economic equivalent of the material terms of that Terminated Transaction including payments by the parties in respect of the Terminated Transaction that would, but for the occurrence of the relevant ETD, have been required at the settlement date. The Close-Out Amount shall be determined by FMDQ Exchange which shall base its determinations on one or more of the following procedures, *inter alia*:

(a) the OTC FX Futures rate for the nearest corresponding contract tenor (contract term to maturity) as at ETD of the Terminated Transaction as published on the FMDQ Exchange website

(b) information consisting of relevant market data in the relevant market [supplied by one or more third parties] including, without limitation, relevant rates, prices, yields, yield curves, volatilities, spreads, correlations, or other relevant market data in the relevant market

In the determination of Close-Out Amounts and Unpaid Amounts, legal fees and out-of-pocket expenses shall be excluded. Furthermore, in determining the Close-Out Amount, FMDQ Exchange shall apply the standards and procedures outlined in (a) and (b) above, unless FMDQ Exchange reasonably believes in good faith that such information as provided in (a) and (b) above are not readily available or would produce a result that would not satisfy those standards. When considering information described in (a) and (b) above, FMDQ Exchange may include the costs of funding, to the extent that costs of funding are not and would not be a component of other information being utilised. Third parties providing any of the information described in (a) and (b) above, may include, without limitation, dealers in the FMDQ Exchange markets, end-users of the relevant product, information vendors, brokers, and other sources of market information.

Without duplication of amounts calculated based on the information described in (a) and (b) above, or other relevant information, and when it is commercially reasonable to do so, FMDQ Exchange may in addition consider in calculating a Close-Out Amount, any loss or cost incurred in connection with the termination, liquidation or reestablishment of any hedge related to a Terminated Transaction(s) (or any gain resulting from any of them). Consequently, commercially reasonable procedures which may be applied in determining a Close-Out Amount include the following, *inter alia*:

- Application of relevant market data from third parties as described in (b) above or such other information at the time of the determination of the Close-Out Amount, used by FMDQ Exchange in the regular course of business in pricing or valuing transactions that are similar to the Terminated Transaction(s) executed on the Exchange

- Application of different valuation methods to Terminated Transactions depending on the type, complexity, size, or number of the Termination Transactions

5. Treatment of Early Termination Amounts

The following steps shall be taken upon the determination of the Early Termination Amount.

(i) Where the ETA is expressed as a positive number i.e. the ETA is owed to the NDP, the CBN operating account of the Defaulting Party shall be debited for the ETA and same credited to the relevant account of the Non-Defaulting Party.

(ii) Where the ETA is expressed as a negative number i.e. the ETA is owed by the NDP, the account of the Non-Defaulting Party is debited for the ETA and same credited to the CBN operating account of the Defaulting Party.

6. Interest on Unpaid Amounts and Early Termination Amounts

(i) *Interests on Unpaid Amounts*: If an ETA is due in respect of an ETD, that amount will, to the extent permitted by applicable law, be paid together with interest (before as well as after judgment) on that amount in the termination currency, for the period from (and including) such ETD to (but excluding) the date the amount is paid, at the applicable close-out rate.

(ii) *Interest on Early Termination Amounts*: For the purpose of determining an Unpaid Amount in respect of a Terminated Transaction(s), and to the extent permitted by applicable law, interest will accrue on the amount of any payment obligation for the period from (and including) the date the relevant obligation was (or would have been) required to have been performed to (but excluding) the relevant ETD, at the applicable close-out rate.

(iii) *Interest Calculation*: Any interest pursuant to Section 4 shall be calculated on the basis of the daily compounding and actual number of days elapsed.