MARKET BULLETIN

February 17, 2020 **FMDQ/MRG/170220/MB-38**

To: **ALL DEALING MEMBER (BANKS)**

From: **MARKET REGULATION GROUP**

ADDITIONAL CLARIFICATIONS ON AND NEW REQUIREMENTS FOR THE OTC FX FUTURES MARKET

1. Further to the introduction of long-term OTC FX Futures contracts (i.e. 14-month to 60-month OTC FX Futures contracts) - MB-37 - this Market Bulletin serves to provide requisite clarifications and reiterate specific requirements of the OTC FX Futures Market Operational Standards (the "**Standards**"), and introduce new features of the OTC FX Futures Market to all Dealing Member (Banks) ("**DMBs**") of FMDQ Securities Exchange Limited ("**FMDQ Exchange**" or the "**Exchange**").

2. All OTC FX Futures contracts must be backed by Eligible Underlying Transactions ("**EUTs**") as defined in the Standards.

3. Further guidelines on foreign portfolio investments ("**FPIs**"), foreign direct investments ("**FDIs**"), and foreign currency ("**FCY**") loan transactions as EUTs for long-term OTC FX Futures contracts are as follows:

Certificates of Capital Importation as EUTs

(i) Foreign capital inflows sought to be hedged using OTC FX Futures must be evidenced by Certificates of Capital Importation ("**CCIs**") and their corresponding conversion to Nigerian Naira ("**NGN**") in the Investors' & Exporters' Foreign Exchange ("**I&E FX**") Window, where applicable.

(ii) CCIs not evidenced by a corresponding NGN conversion, other than CCIs involving plant and machinery (i.e. non-cash CCIs), shall not immediately qualify as EUTs for OTC FX Futures transactions. These include CCIs issued in transactions which only create a contingent foreign exchange ("**FX**") risk e.g. Foreign Currency Repos with NGN collateral, Cross Currency Swaps, Total Return Swaps, and Foreign Currency Borrowings collaterised with NGN collateral. Attendant market risk of such transactions should be addressed via agreed haircuts between counterparties or administered by the FMDQ-designated Clearing House for such transactions.

(iii) All such CCIs (existing and new) with contingent FX risk should be reported to and registered with the Exchange. Where the FX risk crystallises, i.e. repayment default in collateralised transactions, the attendant CCIs shall become EUTs for hedging with OTC FX Futures, **subject to** validation and determination by the Exchange of the CCIs' eligibility. Further guidelines and operational modalities to be communicated by FMDQ Exchange.

(iv) For existing (i.e. outstanding) OTC FX Futures contracts for FPIs having CCIs with contingent FX risk and not in line with the above provisions, the settlement process, in line with the Standards, shall still be effected. Consequently, in the event that the OTC FX Futures contract is at a loss, the attendant Futures DMB's Central Bank of Nigeria ("**CBN**") operating account shall be debited for the Settlement Amount. Where the contract gains, the Settlement Amount shall not be released to the Futures DMB but transferred to the OTC FX Futures Resolution Account with the product's designated Clearing House.

(v) For the avoidance of doubt, CCIs issued that involve a conversion to NGN, in line with the extant Standards and such other OTC FX Futures Market-related documentation, shall qualify as EUTs for hedges in OTC FX Futures.

OTC FX Futures Contract Restrictions for Long-Term Investments

(vi) Capital hedges for FDIs shall be restricted to the longest-tenored OTC FX Futures contract, except for where the FDI is cash-based (e.g. private equity investment), wherein the capital hedge shall be restricted to a minimum contract tenor of three (3) years i.e. the 36-month contract.

(vii) Hedges for FCY loan amounts (evidenced by conversion to NGN and attendant CCIs) shall maintain the provisions of the extant Standards and shall be restricted to the longest-tenored OTC FX Futures contract or matched with the OTC FX Futures contract closest in tenor to the loan maturity date. The attendant interest amounts shall be matched with OTC FX Futures contracts' maturity dates as applicable.

4. FMDQ Exchange hereby wishes to introduce the following for **FPIs only**:

A. Pre-liquidation of OTC FX Futures Contracts

Pre-liquidation of OTC FX Futures contracts are now permitted strictly for FPIs and subject to the following:

(i) The minimum OTC FX Futures contract tenor allowable for pre-liquidation is a 13-month contract, of which half of the contract tenor must have elapsed for said contract to qualify for pre-liquidation.

(ii) Existing as well as new contracts that meet the above criteria qualify for pre-liquidation.

(iii) Pre-liquidation of a contract will trigger the settlement, in accordance with the OTC FX Futures Market Standards and operations, of the value of the contract being pre-liquidated. Any Settlement Amount gain on the pre-liquidation date to the pre-liquidating Transaction Counterparty shall be forfeited by the pre-liquidating Transaction Counterparty, and where there is a Settlement Amount loss, this amount shall be debited to the pre-liquidating Transaction Counterparty's operating account and credited to the non-pre-liquidating Transaction Counterparty's account.

(iv) Pre-liquidation costs, to include a pre-liquidation penalty (payable to the non-pre-liquidating Transaction Counterparty) and other pre-liquidation charges, shall be levied on the pre-liquidating Transaction Counterparty.

(v) Further guidelines and operational modalities on OTC FX Futures contract pre-liquidations to be communicated by FMDQ Exchange.

B. Hedging of FX Exposures of Returns Earned on Naira Investments by Foreign Portfolio Investors

(i) In view of the improved liquidity in the FX market, this has reduced the necessity of the restriction on foreign portfolio investors' ability to hedge not only capital imported into Nigeria, but also returns earned on investments using OTC FX Futures contracts.

(ii) Therefore, foreign portfolio investors are now permitted to hedge, with the current OTC FX Futures, the full value of their FX exposure to include the principal and returns earned on underlying FPIs subject to the following:

- FPI with EUTs valid from February 13, 2020. Consequently, EUTs with validity and OTC FX Futures contracts executed prior to February 13, 2020, are only permitted on originally imported capital
- Pre-determined fixed income (i.e. interest and discount amounts)
- Dividend payments duly reported in the latest audited annual report and accounts as evidenced by a Board Resolution of the entity in which the FPI is made
- Settlement Amounts gained on OTC FX Futures contracts executed by foreign portfolio investors remain prohibited from being hedged with the current OTC FX Futures contracts offered by the CBN

(iii) All other provisions as communicated in Exchange-issued Market Bulletin, (MB-16), of October 25, 2016, remain valid.

5. For the continuing success of the OTC FX Futures Market, it is important that all DMBs are fully compliant with the extant Standards and other FMDQ OTC FX Futures Market-related documentation, CBN's Foreign Exchange Manual and such other relevant FX-related regulation as advised by CBN and the Exchange from time to time.

6. Therefore, we wish to reiterate that DMBs are required to ensure that all relevant documentation provided are valid prior to purchase of an OTC FX Futures contract and release of Settlement Amounts at maturity. DMBs will bear full responsibility for any breach in the Standards and all other related OTC FX Futures regulation, wherein appropriate sanctions will be applied.

7. All DMBs are instructed to conduct a validation exercise to ensure that all documentation for existing and future OTC FX Futures contracts are in order. Transactions based on invalid documentation must immediately be reported to the Exchange, for appropriate action to be implemented.

8. DMBs are directed to take note of the above guidance as failure to comply with the contents of this Market Bulletin and all other OTC FX Futures-related regulation, shall be considered a violation of the OTC FX Futures Market Operational Standards and shall attract appropriate sanctions.

9. This Market Bulletin shall be read in conjunction with extant Standards and other OTC FX Futures Market-related documentation, relevant Market Bulletins, and such other CBN FX-related regulation as may be prescribed from time to time.

Please be guided accordingly.