



Central Bank of Nigeria

GUIDELINES FOR THE OPERATION OF THE FOREIGN EXCHANGE MARKET: WHOLESALE DUTCH AUCTION SYSTEM FORWARDS (WDAS-FWD)

March, 2011

FINANCIAL MARKETS DEPARTMENT

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REVISED GUIDELINES FOR THE OPERATION OF THE FOREIGN EXCHANGE MARKET: WHOLESALE DUTCH AUCTION SYSTEM FORWARDS (WDAS-FWD)

Issued March 22, 2011

1.0 Introduction

Consistent with the objectives of enhancing efficiency in the Foreign Exchange Market and deepening trading liquidity and risk management in the Nigerian foreign exchange market, the Central Bank of Nigeria (CBN) is releasing these guidelines for operating its foreign exchange (FX) forwards auctions.

2.0 Guidelines

The Central Bank of Nigeria (CBN) shall adopt the Wholesale Dutch Auction System for the forwards auction. Consequently, the guidelines for operating the system are as follows:

- 2.1. The Central Bank of Nigeria (CBN) shall offer to Authorised Dealers short-tenored FX forwards of 1, 2 and 3 months through the Wholesale Dutch Auction System (WDAS-FWD).
- 2.2. The CBN shall announce on Wednesdays the specific maturity dates for each tenor being auctioned alongside the WDAS-SPT notice by 8:30am on the auction days through the Reuters Dealing 3000 Xtra system. The CBN may state the amounts on offer in the notice. Copies of the announcement shall also be published on the CBN website www.cbn.gov.ng and may be obtained from the Financial Markets Department of the Central Bank of Nigeria at the following location:

Abuja: 8th floor, Wing C
CBN Head Office
Central Business District, Abuja
Fax: 09-46237841
Tel: 09-46237871, 46237870, 4627838, 46237836

- 2.3. The CBN's objective for boosting trading liquidity in the forwards market is to offer risk management support to the exchange rate risk exposures of the end-users. Therefore, all the FX forward purchases by the Authorised Dealers from the CBN must be trade-backed. Authorised Dealers are therefore expected to evidence the existence of the trade transactions before bidding for FX forward purchases from the CBN on behalf of their customers.

- 2.4. Authorised Dealers shall submit their bids on Wednesdays via Reuters Dealing 3000 Xtra system to the Abuja dealing line. In the event that the Reuters Dealing system is unavailable at 2.45pm, Authorised Dealers shall place bids by calling directly the CBN Dealing Room, Abuja. All bids received via the telephone calls must be regularised and a hard copy delivered to either the CBN FMD Lagos or Abuja office no later than 5pm on the day of the auction. The hard copies shall be signed by the persons whose signatures are given on the Authorised Dealers' valid specimen form at the CBN's disposal. The hard copies submitted to CBN FMD are only to regularise the bids already placed via the telephone.
- 2.5. The Authorised Dealers shall submit their bids stating the forward points (i.e. forward rates minus the spot rate) and not forward rates, duly signed by two authorised signatories for any particular auction session between 2:00pm and 3:00pm on the day of auction. The Authorised Dealers will explicitly state the points as (+) points for premium or (-) points for discount. The relevant spot rate shall be the weighted average rate of successful bids of the just concluded WDAS-SPT of that day. The weighted average rate shall be announced with the WDAS-SPT result. The points bid shall be expressed to four decimal places.
- For example, from a calculated forward rate by the Authorised Dealer of N152.1704 for a 1M forward, the Authorised Dealer shall bid +1.8696 which is the N152.1704 less the communicated weighted average rate of N150.3008. However, if the forward rate is N148.4312 and the spot rate remains N150.3008, the Authorised Dealer shall bid -1.8696. The signs are important as in some cases they may be negative.
- 2.6. An Authorised Dealer shall submit a single bid on a single tenor per auction. The bid format shall be advised by the Financial Markets Department.
- 2.7. The minimum bid amount by an Authorised Dealer for each tenor offered shall be \$500,000.00 (five hundred thousand dollars) and the currencies of transaction shall be the Nigerian Naira (NGN) and United States dollar (USD).
- 2.8. The CBN reserves the right to determine the amount sold on each tenor and shall exercise its discretion over the amount sold on each tenor to a single Authorised Dealer.
- 2.9. The CBN shall announce the result of each auction by 4:00pm on the day of the auction via an electronic platform – CBN website and/or news wire service e.g. Reuters. This announcement may include both the marginal and weighted average points of all the successful bids at the auction. A copy of the results shall be communicated by Financial Markets Department (FMD) to the Financial Markets Dealers Association. The detailed results shall later be made available to the market.
- 2.10. The maximum spread of 50 kobo is allowed on the sale of forwards with less than three (3) months tenor whilst 75 kobo is allowed for tenors above 3 months.

- 2.11. FX forwards bought from the CBN are not transferable in the inter-bank market. Authorised Dealers shall bid only on behalf of their customers.
- 2.12. Authorised Dealers are only allowed to sell the forwards bought from the CBN only as forwards to their customers. US Dollars purchased from the WDAS-FWD must be utilised by the end-user that purchased the forwards within five (5) business days after settlement. However, where there have been swap transactions on the funds, the 5-day utilisation rule shall commence only after the maturity of the final swap. All unutilised funds would be sold to CBN at the lower of the WDAS-FWD rate at which the funds were purchased and current WDAS-SPT selling rate.
- 2.13. Authorised Dealers shall ensure that their operating accounts are adequately funded on the maturity dates of the forward purchase. The 1% commission shall be calculated on the forward rate and debited on the settlement date. Maturity dates shall be set at spot date (T+2) plus the number of days for the one-month, two-month or three-month benchmarks, in line with internationally accepted practice.

All forwards sold to the CBN must also be settled to the CBN SPECIAL FEM ACCOUNT with JP Morgan Chase, New York.

- 2.14. The CBN expects the Authorised Dealers not to have any position impact on the FX forwards bought from the CBN as the forwards are bought on behalf of customers. The blotters should be immediately updated once the Authorised Dealer's success at the auction is known through the announced result and the Authorised Dealers' purchases are simultaneously sold-down to customers.
- 2.15. Authorised Dealers are to maintain separate blotters for their CBN FX Trading (spot and forwards) transactions and their Inter-bank/Autonomous trading transactions.
- 2.16. Authorised Dealers are to file reports with the CBN on any customer that defaults on its obligations under forward contracts. The US Dollars shall be sold back to the CBN and treated as un-utilised funds. The CBN shall not tolerate defaults by the end-users. Authorised Dealers are expected to exercise due diligence and adopt counterparty risk management standards in managing their market risk exposures in their FX forwards trading business.
- 2.17. Furthermore, Authorised Dealers are advised to manage counterparty risk in the context of their overall credit risk management framework and encouraged to upgrade their market risk management practices and processes in order to achieve this goal.
- 2.18. The CBN shall also be prepared to purchase forwards from Authorised Dealers. Details of this facility shall be advised by the Financial Markets Department.
- 2.19. Forward contracts shall be recognized as off-balance sheet exposures in the books of Authorised Dealers.

3.0 FX Swaps

- 3.1. The CBN expects the Authorised Dealers to support the end-users' requests for extension and acceleration of their existing forward contracts with FX swap contracts.¹ The CBN cannot offer every tenor to match end-users' varying requirements so broken dates i.e. tenors in between 1M and 2M benchmarks or 2M or 3M benchmarks should be supported by a purchase of the nearest benchmark which can later be extended or accelerated by FX swap contracts.
- 3.2. The CBN shall offer Authorised Dealers standing FX swap facilities in 7-day, 14-day and 21-day tenors. Authorised Dealers shall call the CBN Dealing Room for swap transactions based on quotes published on the CBN website. The confirmation templates for FX swap transactions are annexed to the Nigerian Master FX Agreement (NMFA).
- 3.3. All FX swap transactions with customers must be appropriately priced, documented and posted in the books of the Authorised Dealers.
- 3.4. In order to ensure that the end-users have access to competitive swap rates, the Financial Markets Dealers Association (FMDA) will develop daily swap fixings for 7, 14 and 21 days. These swap fixings will be widely published in the newspapers.
- 3.5. Contravention of any of these regulations shall attract appropriate sanctions as spelt out in the provisions of relevant laws and CBN guidelines.

4.0 Supremacy of the Guidelines

These Guidelines supersede the Guidelines for FX Derivatives and Modalities for CBN FX Forwards dated January 2011.

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¹ The CBN recognises the fact that when an Authorised Dealer executes a swap sale (i.e. **buy spot/sell forward**) with an end-user, the USDollar from the forward will be delivered to the Authorised Dealer and the end-user will buy another forward. Due to the fact that the end-user is seeking an extension, the Authorised Dealer will invest the delivered USDollar for the tenor of the forward leg of the swap. When the Authorised Dealer executes a swap buy (i.e. **sell spot/buy forward**) the end-user is accelerating its request for USDollar utilisation. The Authorised Dealer will therefore be granting the end-user access to its USDollar liquidity ahead of the maturing forward. This is similar to a loan. The telex date for the end-user's transaction will therefore precede the date of the end-user's receipts of its USDollar from its FX forward transaction i.e. the maturity date of its original forward transaction. When the forward matures and the CBN delivers the USDollar, the Authorised Dealer will receive this from the end-user as repayment for the liquidity (loan) it granted the end-user via the spot sale and forward bought.