



CENTRAL BANK OF NIGERIA PUBLIC NOTICE

THE CENTRAL BANK OF NIGERIA COMMENCES FOREIGN EXCHANGE FORWARDS

The Central Bank of Nigeria (CBN) is moving forward in its bid to transform and deepen the Nigerian financial markets by commencing foreign exchange forwards transactions from Wednesday 23rd March, 2011, with authorised dealers in the market, for the benefit of foreign exchange users in the economy.

It would be recalled that the commencement of the foreign exchange forwards was initially intended to kick-start on 16th March, 2011, but, was delayed while the CBN worked with operators on the adoption of reserve averaging as a new framework for implementing monetary policy. It is worthy of note that guidelines for the foreign exchange forwards have been released earlier to the public and can be accessed on the CBN website, www.cbn.gov.ng.

The aims of the foreign exchange forwards operations by the CBN are to:

- improve the effectiveness of the financial markets in monetary policy implementation;
- deepen the FX market, thus, allowing minimal disequilibrium in the exchange rate pricing and smoothening out the demand for foreign exchange;
- redefine the psychology of Nigerian treasury risk management and enable a sound culture of risk management in the Nigerian business climate; and,

As a new product in the market, members of the public may need to know more about the operations of the foreign exchange forwards. Consequently, some frequently asked questions are answered below to provide relevant clarifications.

What is a forward transaction?

A forward transaction is a binding agreement by two parties where one commits to buy and another commits to sell a predefined amount of a currency for settlement on a future date at a pre-agreed exchange rate

Can I back out of the transaction if the spot market is more favourable on the settlement date of the transaction?

No, a forward is a legally binding obligation. The product that allows a buyer to back out is an option

Why is there a difference between the spot and forward rates?

This is because in arriving at the forward rate, the difference in the interest rates of the US Dollar and Naira over the tenor is considered and is the key variable when computing the forward rate

Is the forward rate an estimation of CBN's spot in the future?

No, the forward rate is computed mathematically factoring in other variables. It is neither an estimation nor a forecast

If the forward rate is higher than spot, does it mean CBN intends to devalue?

No, the forward rate is not an estimation of future exchange rate. It simply means that Naira interest rates are higher than US Dollar interest rates. It is a mathematical expression.

Is it an indication of where the future spot prices will be?

No

Why should I use forwards for my business?

Where you are involved in eligible trade (visible or invisible) transactions across currencies, a forward contract helps your business hedge against fluctuations in future exchange rates and aids planning and costing

Why should I buy a forward?

A forward should be purchased where there is a confirmed known eligible foreign currency liability at a determinable future date and you wish to mitigate the risk of an adverse currency movement

Can I sell a forward?

Yes, you can either buy or sell a forward, via your bank

Why should I sell one?

A forward should be sold where there is a known foreign currency amount to be received at a determinable future date. Exporters may find selling forwards desirable

How do I buy the CBN-offered forward contract which is offered through the Wholesale Dutch Auction System – Forwards (WDAS-FWD)?

You are to submit your bids (amounts and rates) through your bank for WDAS-FWD (which offers US Dollar forwards against the Naira). Your bank will demand from you

evidence of trade to ensure your demand is based on a future foreign currency liability and not speculative (i.e. to determine eligibility)

Do I need to put margins down with the banks for the future Naira amount?

Engaging in Forward FX transaction involves a credit exposure to the extent that there can be adverse movements in exchange rate and counterparty default before settlement. Banks will manage these risks in the context of their overall credit exposure. Margin call is one way a bank might choose to manage these risks

What are the standard tenor benchmarks offered by CBN?

Currently 1-month, 2-month and 3-month but this may be reviewed depending upon demand

What fees do I pay my bank on my successful forwards?

50k maximum on tenors of 3 months and below (payable on the settlement date) or as may be advised by the CBN

Will the 1% CBN commission also apply to WDAS-FWD?

Yes (payable on the settlement date)

What should I do if the specific trade transaction I did the forward on falls through?

The funds can be used for other eligible transactions at maturity

Can I cancel a forward transaction during the life of the transaction?

No, a forward contract is a legally binding obligation and once an Authorised Dealer enters into the forward contract on a Customer's behalf with the CBN, it cannot be cancelled. However, just as in other transactions, the two parties (Authorised Dealer and Customer) to the forward transaction may agree to cancel. The rules do not permit unilateral cancellations. The CBN will expect banks to report customers that unilaterally cancel their forward obligations.

What happens in case of partial usage?

The unutilised amount can be applied for other eligible transactions or sold back to the CBN after five business days at a rate advised by the CBN (current rate is the lower of the forward rate and the ruling CBN WDAS-SPT selling rate)

What if the trade transaction crystallises earlier (acceleration) or requires postponement than the forward date (extension) or a customer requires a forward

maturity date in between two of the standard tenor benchmarks offered by the CBN (broken dates, e.g. 45 days)?

A swap transaction (combination of spot and forward contracts) can be entered into with the bank to accommodate the earlier or later settlement or broken dates. The details of the swap contracts will be communicated by your banks.

Signed:

**M. M. Abdullahi
Head, Corporate Communications
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