CENTRAL BANK OF NIGERIA

HOW THE CBN NAIRA-SETTLED OTC FX FUTURES MARKET WILL WORK

The proposed Naira-settled OTC FX Futures are Non-Deliverable Forwards. (i.e. a contract where parties agree to an exchange rate for a predetermined date in the future, without the obligation to deliver the underlying US Dollar (notional amount) on the maturity date i.e. the settlement date). On the maturity date, it will be assumed that both parties would have transacted at the Spot FX market rate. The party that would have suffered a loss with the Spot FX rate will be paid a settlement amount in Naira. This ensures that both parties enjoy the rate that had been guaranteed to each other through the OTC FX Futures.

Settlement Amount = (Difference between the Agreed Rate and Spot Rate on the Maturity Date) x Notional Contract Sum

The Spot FX Rate will be the FMDQ[1] Spot FX Rate Benchmark - Nigerian Inter-Bank Foreign Exchange Fixing (NIFEX[2]) which is an independent fixing of the inter-bank FX market. The OTC FX Futures contract is an effective exchange rate management tool supported by a

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[1] FMDQ OTC Securities Exchange

[2] NIFEX represents the daily average of the prevailing spot market rate of some selected Banks at which the US Dollar (USD) is traded against the Nigerian Naira (NGN). NIFEX is a 'polled' rate, meaning that a set of selected banks known as Reference Banks submit quotes which are processed to derive the NIFEX.

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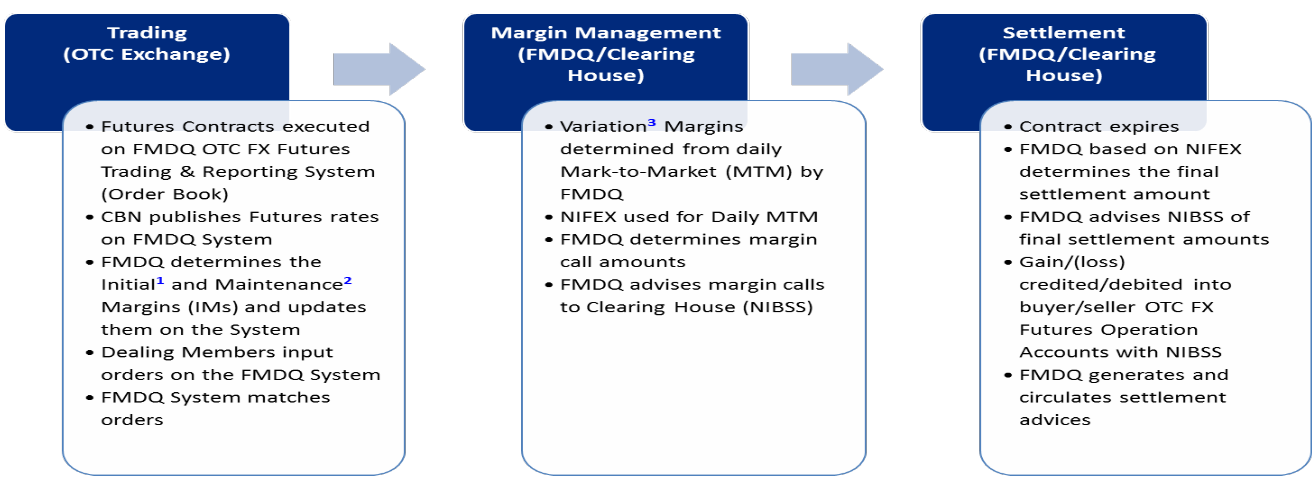
transparent price driven two-way quote (2WQ) market. The CBN will kick off the market by acting as the seller of OTC FX Futures contracts for defined tenors i.e. 1M, 2M, 3M, 6M, 9M, 12M, 18M and 24M. The USD/NGN OTC FX Futures contracts will provide the CBN the opportunity to kick-start the liquidity of risk management products available to end-users in the FMDQ OTC Markets. The contracts will assist the CBN in managing the volatility in the Spot FX market thereby promoting stability and entrenching confidence in the FX market.

All OTC FX Futures contracts will be trade-backed. Visible, invisible and investments qualify for OTC FX Futures.

Naira-settled OTC FX Futures Contracts Trade Flow

FMDQ will act as the 'OTC FX Futures Exchange' and its appointed agent, the Nigeria Inter-Bank Settlement System PLC (NIBSS) will clear the inter-bank OTC FX Futures i.e. collect initial and variation margins and settle the party to compensate on the maturity date.



Note:

Tenor *– 1M, 2M, 3M, 6M, 9M, 12M, 18M & 24M (M – Month)*

1. *Initial Margin - the percentage of the purchase price of securities that the investor must pay for with his or her own cash or marginable securities*
2. *Maintenance Margin – Minimum amount that must be maintained in a margin account*
3. *Variation Margin - Additional funds that must be deposited to balance up to the initial margin requirement*

Benefits of the Naira-settled OTC FX Futures

- The introduction of the OTC FX Futures market will encourage end-users to spread out their demand for Spot FX deals as they are now able to lock down the exchange rates for future FX requirements. This has the potential to eradicate the constant frontloading of FX requirements and minimize the disequilibrium in the Spot FX market. End-users will make better judgement as to the timing of accessing the Spot FX market.
- The availability of the OTC FX Futures will improve the business planning practice of end-users and FX sellers, as the future exchange rate is guaranteed through the OTC FX Futures.
- An end-user (buyer of USD) may consider it wiser to delay the purchase of its USD requirement in the Spot FX market if the Spot FX rate is higher than the OTC FX Futures rate of a particular tenor. The end-user will borrow USD or obtain trade finance and simultaneously hedge its exchange rate exposure with an attractive OTC FX Futures sold by the CBN. At maturity of the OTC FX Futures contract, the end-user will access the Spot FX market.
- The OTC FX Futures will be used to attract significant capital flows to the Nigerian fixed income and equity markets as returns can now be enhanced as FX exposures are hedged. Foreign Portfolio Investors (FPIs) will be able to use the OTC FX Futures for capital protection.
- The envisaged increase of supply of US Dollars due to the OTC FX Futures offered by the CBN in the Spot FX market will cause the Spot FX rate to moderate.
- OTC FX Futures which are non-deliverable are ideal for FPIs and even Foreign Direct Investors (FDIs). OTC FX Futures can be used when the investor wants to hedge the exchange rate risk without

interest in buying outright Forwards which will necessitate liquidation of its investment to pay for outright Forwards.

- Banks will increase the liquidity in the OTC FX Futures market (by selling OTC FX Futures) if $/₦ Spot FX rate starts dropping. This may cause the Spot FX rate to drop further.

Settlement Analysis for Naira-settled OTC FX Futures Contracts

Day 1: June 15, 2016 - Bank A buys a 3-month OTC FX Futures contract from the CBN on the FMDQ OTC FX Futures Trading & Reporting System with the following details:

- Buyer: Bank A
- Seller: CBN
- Notional amount: $1,000,000.00
- OTC FX Futures Rate: $/₦260.00
- Benchmark: NIFEX
- Maturity Date: September 14, 2016
- Initial Margin: 5% (payable by both parties)
- Maintenance Margin: 60% of initial margin
- Settlement Currency: Naira

The OTC FX Futures contract will be valued on a daily basis against the NIFEX to determine payment of variation margin amount.

Maturity Day: September 14, 2016 - NIFEX is $/₦270.00

It is assumed that Bank A would have transacted (bought USD in the Spot FX market) at $/₦270.00 which is higher than the OTC FX Futures contract rate of $/₦260.00.

The Clearing House, NIBSS, will pay Bank A ₦10,000,000.00 (i.e. ₦10.00 [₦270.00-₦260.00] per USD) thereby bringing Bank A's effective rate to $/₦260.00 (₦270.00 assumed paid in buying USD less ₦10.00 received on the OTC FX Futures) which is the OTC FX Futures rate.

CBN is assumed to have transacted (sold USD in the Spot FX market) at $/₦270.00 which is higher than the OTC FX Futures contract rate of $/₦260.00.

The Clearing House, NIBSS, will take ₦10,000,000.00 (i.e. ₦10.00 per USD) from the Margin Account of the CBN thereby bringing CBN's effective rate to $/₦260.00 (₦270.00 assumed received in selling USD less ₦10.00 paid out on the OTC FX Futures) which is the OTC FX Futures rate.

Both parties end up with $/₦260.00 as the effective rate. This is the rate they guaranteed each other.

If NIFEX had been $/₦250.00 on maturity date, Bank A would pay CBN ₦10.00 per USD.