UDO UDOMA &
BELO-OSAGIE

Recent Reforms in the Nigeria Foreign Exchange Market and the Introduction of the Electronic Foreign Exchange Matching System

Joseph Eimunjeze
Partner

Itoro Uwemedimo Etim
Associate

INTRODUCTION

The Central Bank of Nigeria (the "CBN"), on 2nd October, 2024, issued a circular titled "Introduction of the Electronic Foreign Exchange Matching System in the Interbank Foreign Exchange Market" (the "EFEMS Circular") to introduce the Electronic Foreign Exchange Matching System (the "EFEMS") – an electronic matching system for foreign exchange ("FX") transactions. The EFEMS is to serve as the platform for conducting all FX transactions in the Nigeria Foreign Exchange Market (the "NFEM"). Please refer to our earlier publication on the EFEMS Circular using the link here for context.

To commence the operation of the EFEMS, the CBN released the Guidelines for the EFEMS dated 25th November, 2024 (the "EFEMS Guidelines") to set out guidelines to regulate interbank FX trading on the EFEMS by Market Participants. The term 'Market Participants' is defined in the EFEMS Guidelines as institutions authorised by the CBN to participate in the Nigerian interbank FX market. These include banks (licensed as authorised dealers) that can generally engage in FX transactions and bureaux de change operators (licensed as authorised buyers) ("BDCs") approved by the CBN and permitted to participate in the NFEM for very limited FX transactions. In addition, as a step to further deepen operations and transactions in the NFEM, the CBN issued the Revised Guidelines for the Nigeria Foreign Exchange Market dated 29th November, 2024 (the "FX Guidelines") to guide Market Participants on the regulatory framework governing FX transactions and activities in the NFEM.

We seek to highlight in this publication some of the key provisions of both the EFEMS Guidelines and FX Guidelines and offer insights on their implications for FX transactions and operations in the NFEM.

HIGHLIGHTS OF THE EFEMS GUIDELINES

The guidelines contain provisions and requirements aimed at enhancing market efficiency, promoting transparency in transactions, enhancing reporting of transactions and facilitating timely and efficient resolution of disputes.

(a) Purpose and Designation of Platform

The guidelines are aimed towards ensuring transparency, fairness, and efficiency in FX trading while minimising counterparty risk. To this end, the CBN has designated Bloomberg BMatch as the platform for interbank FX trading. The platform is expected to offer real-time support for technical issues and contingency protocols for downtimes. In the event of prolonged downtimes of the platform, alternative trading protocols will be activated as may be prescribed by the CBN.

We believe that by adopting Bloomberg BMatch as the trading platform, the CBN seeks to align transactions in the NFEM with global best practices, improve trust and reduce risks. Market Participants are required to adapt operations regarding FX transactions to the technological and operational requirements of the platform.

(b) Composition of Market Participants

All authorised dealers are Market Participants on the EFEMS by default. Other entities must obtain CBN's approval and comply with agreements with CBN-approved platform providers to become Market Participants. Bloomberg BMatch will issue unique dealing codes for each participant, who must maintain accurate and updated profiles. Market Participants that intend to exit the platform are required to provide a 30-day written notice and resolve all obligations before exiting the platform. This is to ensure accountability and systematic oversight over the activities of Market Participants. The CBN's stringent approval and monitoring process are aimed at preventing unauthorised access to the platform and to enhance market discipline.

(c) Trading and Operational Requirements for EFEMS

(i) Trading Hours and Binding Trades

To protect the sanctity of contracts and prevent undue manipulation of the NFEM, trades consummated on the EFEMS are deemed binding unless cancelled by mutual agreement of both parties with CBN's written approval. Trading hours on the EFEMS are restricted to 09:00am to 4:00pm (WAT) on each trading/business day. Unmatched orders are required to be cleared at the close of the market each trading day and may be resubmitted on the following trading day. To maintain the confidentiality of Market Participants, trades on the EFEMS are required to be anonymous until matched. Once matched, counterparty details will be revealed for settlement purposes. This anonymity of available trades before matching is to encourage fair pricing of FX transactions while reducing counterparty bias.

(ii) Trade Limits

The CBN mandates a minimum trade value of US$100,000 for all interbank FX transactions, and an incremental clip sizes of US$50,000, which Market Participants must comply with. Market Participants are, however, given the flexibility to set credit and settlement limits for other counterparties in the system. These thresholds help to streamline large-scale transactions and seek to reduce administrative inefficiencies.

We expect that Market Participants would, in executing transactions for their customers, assess counterparty risk rigorously to comply with limits.

(iii) Execution and Settlement of Transactions

The EFEMS is required to be used exclusively for executing spot FX transactions involving the Naira against the USD. Other convertible currency pairs (such as British Pounds, Euro, etc.) may be introduced from time to time upon the CBN's directive. FX transactions are also required to be settled through approved settlement systems. Market Participants bear responsibility for their obligations. We believe that limiting the use of the EFEMS to specific transaction types would ensure clarity and enable the CBN to have regulatory focus.

(iv) Governance and Reporting Obligations

To ensure market integrity and transparency, the CBN is empowered to monitor all FX transactions on the EFEMS. Market Participants are also required to submit daily transaction reports to the CBN detailing trade volumes, counterparties, and settlement status. All whole/interbank trades conducted between authorised dealers and non-bank Market Participants on the telephone and other acceptable channels in the NFEM must be confirmed on the Request for Quote (”RFQ”) and reported on the EFEMS immediately. In addition, all FX transactions that fall outside the EFEMS parameters, such as same-day or next-day settlements delivery-vs-payment transactions where limits are exceeded and deals with non-standard amounts, are required to be booked via the RFQ functionality and uploaded automatically to the FX blotter not later than 10 minutes after the completion of the trade.

We expect that the stricter reporting requirements will enhance market transparency and facilitate timely regulatory oversight. Market Participants may, however, face operational challenges regarding meeting the tight reporting timelines. To mitigate this challenge, we expect that Market Participants will deploy robust automated systems that would enable them to meet this compliance requirement.

(v) Intellectual Property and Data Considerations

Under the EFEMS Guidelines, the CBN owns all trade data generated on the EFEMS. This data ownership will strengthen the CBN’s regulatory capacity while promoting informed policymaking. The CBN reserves the right to publish aggregated or disaggregated data for market analysis, subject to confidentiality agreements with Market Participants.

The CBN also has the right to periodically review the operations of the EFEMS, Market Participants' activities and the efficiency of the system.

(vi) Dispute Resolution

Disputes arising from transactions in the EFEMS are required to be resolved bilaterally between counterparties as a first option. If the dispute remains unresolved, it shall be escalated to the Financial Markets Dealers Association for arbitration. Where the disputing parties are not satisfied with the arbitral decision, a final appeal may be submitted to the CBN for resolution. The decision of the shall be binding on the parties. This tiered dispute resolution mechanism will help to foster accountability and ensure efficient conflict management in respect of activities in the EFEMS.

HIGHLIGHTS OF THE FX GUIDELINES

The FX Guidelines cover critical regulatory and operational issues and changes to the regulatory regime, including the roles of participants in the NFEM, FX transaction pricing mechanisms, and market participants' compliance and reporting standards. The FX Guidelines has far-reaching provisions and supersede the following FX circulars and guidelines:

(i) Press Release: Operational Changes to the Foreign Exchange Markets, dated 14th June, 2023 (which announced the liberalisation of the FX market);
(ii) Circular to All Authorized Dealers: Establishment of Investors' & Exporters' FX Window, with Ref: FMD/DIR/CIR/GEN/08/007, dated 21st April, 2017 (which introduced the Investors' & Exporters' FX Window now known as the NFEM); and
(iii) Revised Guidelines for the Operation of the Nigerian Inter-Bank Foreign Exchange Market.

The key aspects of the FX Guidelines are as follows:

(a) Eligible Transactions in the NFEM

The FX Guidelines provide that only trade-backed (visible and invisible) transactions as defined in the Revised CBN Foreign Exchange Manual 2018 (as amended) (the "FX Manual") are eligible for the purchase of FX in the NFEM. This is subject to the parties meeting all applicable regulatory requirements such as providing the prescribed documentation.

To this end, all documentary requirements for eligible transactions are required to be verified by the authorised dealers to ensure their legitimacy before transactions are settled. Authorised dealers are to maintain adequate records for audit purposes in line with the requirements of the FX Manual.

(b) Obligations of Authorised Dealers and other Market Participants

The FX Guidelines sets out some of the specific roles of Market Participants in the NFEM. For instance, authorised dealers roles include facilitating FX transactions for all firms and persons with eligible transactions in the NFEM, completing due diligence of their customers, ensuring compliance with extant FX laws and regulations, providing convenient market access channels (including via digital solutions), and ensuring transparent pricing to their customers. Authorised dealers are also required to maintain adequate risk management practices to keep price and liquidity risk exposures within acceptable thresholds and ensure that all interbank FX transactions are conducted on the EFEMS and all FX transactions are conducted within Net Open Position limits stipulated by the CBN. In addition, all legitimate transactions in the NFEM must be concluded with an authorised dealer and any dealing with unlicensed intermediaries is unlawful.

(c) Access to FX from Authorised Dealers by BDCs

BDCs are now permitted to access FX from authorised dealers in the NFEM to meet their customer s' eligible needs. This is, however, subject to the aggregate monthly cap as may be stipulated by the CBN from time to time. This development is commendable as it increases BDCs' sources of FX and liquidity to meet customer needs, thereby promoting broader market access.

(d) Reporting and Compliance Obligations for Market Participants

Authorised dealers are required to record all FX transactions in a processing system and report same to the CBN within the timeline of 10 minutes. Real-time reporting is aimed to strengthen the monitoring of the market. It, however, imposes significant operational demands on authorised dealers who will need to ensure that their automated systems are robust enough to meet this reporting requirement. On the other hand, BDCs are required to submit reports of all their activities to the CBN daily through relevant portals. In addition, the Board, CEO, and Chief Compliance Officer of authorised dealers must annually attest to their respective institution's compliance with the Nigeria Foreign Exchange Code ("FX Code") and comply with guidelines and circulars released by the CBN. Commercial, Merchant, and Non-Interest Banks are also required to adopt real-time reporting to improve transaction monitoring.

(e) Pricing of FX Transaction

The pricing of FX transactions in the NFEM is required to be undertaken on the EFEMS to ensure price transparency. FX market statistics, including the daily transactional rates of all qualifying transactions on the NFEM, is required to be made publicly available on the CBN's website to guide Market Participants. All customer transactions conducted outside the EFEMS is required to be guided by the prevailing NFEM rate at the time of execution. Authorised dealers are required to adopt a transparent pricing framework for customers' FX transactions as described in the FX Code. The CBN may request authorised dealers to provide information on their respective pricing methodology. The CBN, as the apex regulator of the NFEM, will be the primary custodian of all FX transactions data in the NFEM and will publish reliable market data on its website daily. All EFEMS platforms are required to publish live market data to the public during market trading hours. The FX Guidelines also provides that the CBN may partner with market infrastructure providers to ensure timely and accurate dissemination of market data to the public. The prohibitions regarding FX transactions in the extant regulations governing the NFEM remain in place. One of such prohibition is that negotiation of exchange rates with customers outside of the NFEM is prohibited. Ultimately, we expect that the transparent pricing methodologies in the NFEM could help to deter market manipulations, enhance transparency and instil confidence among participants in the market.

CONCLUSION

The EFEM Guidelines and FX Guidelines are new policy changes introduced by the CBN in the operations of the NFEM. They are expected to enhance transparency and efficiency, promote accountability and enhance appropriate pricing in conducting FX transactions on the NFEM through the EFEMS. We expect that the revised guidelines and clear standards for Market Participants will bring about an efficient EFEM and NFEM with the ultimate objective of spurring FX liquidity in the NFEM. Market Participants should ensure compliance with the requirements of the EFEM Guidelines and FX Guidelines in their operations in the NFEM. Non-compliance would attract penalties, including suspension from the market or revocation of EFEMS access rights in the case of EFEM. These changes have not impacted on the types of transactions eligible for participation in the NFEM and the prescribed documentation under the FX Manual. More specifically, they have not changed the requirement, issuance and utilisation of certificates of capital importation for debt and equity investments in Nigeria.

Lastly, the CBN will continue to monitor activities in the market and reserves the right to amend the EFEM Guidelines and FX Guidelines to align with market developments and regulatory changes as it deems appropriate. In this regard, Market Participants will be duly notified of such amendments if made by the CBN.

This publication has been provided by Joseph Eimunjeze and Itoro Uwemedimo Etim of the Banking & Finance team at Udo Udoma & Belo-Osagie. For more information about our Banking & Finance practice group offerings, please visit our website at www.uubo.org or email us at uubo@uubo.org.