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# **OTC Foreign Exchange Futures Market Framework**

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**FMDQ Securities Exchange Limited**

**Version 8.0 – February 13, 2020**

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## 1. INTRODUCTION

The Naira-settled OTC Foreign Exchange (“FX”) Futures is essentially a local-currency non-deliverable forwards (“NDFs”) product. However, due to the adoption of features similar to those of conventional futures contracts and the popularity of the offshore Dollar/Naira (\$/₦) NDF market, the Central Bank of Nigeria (“CBN”) decided to give the product the name **OTC FX Futures**. Consequently, following the release of the *Revised Guidelines for the Operation of the Inter-Bank Foreign Exchange Market* and reintroduction of foreign exchange derivatives into the market, OTC FX Futures was included in the list of approved products. Key benefits of OTC FX Futures include the following, *inter alia*:

- (i) Provide protection against exchange rate fluctuations in investment portfolios
- (ii) Allow the holder of the contract(s) to fix prices for eligible transactions
- (iii) Help mitigate counterparty risk
- (iv) Boost liquidity in the Spot FX market

FMDQ Securities Exchange Limited (“**FMDQ Exchange**” or the “**Exchange**”), as the organiser of the fixed income and currencies (“**FIC**”) markets in Nigeria, is responsible for the establishment of a comprehensive framework to enable the trading of FX derivatives and ensure the efficient and secure execution of these products. To this effect, the OTC FX Futures market is organised and governed by FMDQ Exchange, with primary oversight and regulation provided by the CBN. FMDQ Exchange is therefore responsible for determining the market standards such as settlement periods, mode of settlement, participants in the market, quotation method, limits (as applicable), trading hours, termination process, *inter alia*.

***This Framework outlines the modalities of the OTC FX Futures market. In line with market dynamics, this Framework may subject to revision/amendments from time to time.***

## 2. MARKET STRUCTURE

Many of the features of the product align with conventional NDFs. However, as the market matures, the product may evolve to become more standardised in line with global standards.

### 2.1 Contract Tenors

- (i) Contract Cycle – The contracts shall be traded in monthly trading cycles and consist of sixty (60) consecutive monthly contracts at any point in time
- (ii) There shall be a contract maturing every calendar month
- (iii) Contracts shall expire and be settled on the last Wednesday of the calendar month subject to the provisions of paragraph 3.5.(v) below

**Trading shall cease at 2:00 PM, eight (8) calendar days before the expiry date of each respective Contract. i.e. the Tuesday preceding the week the contract expires**

Examples of the contract settlement dates as at February 13, 2020 are as follows:

Contract Tenor (Month)	Contract Code	Settlement Date
3	NGUS APR 29 2020	29-Apr-2020
6	NGUS JUL 29 2020	29-Jul-2020
9	NGUS OCT 28 2020	28-Oct-2020
12	NGUS JAN 27 2021	27-Jan-2021
13	NGUS FEB 24 2021	24-Feb-2021
24	NGUS JAN 26 2022	26-Jan-2022
36	NGUS JAN 25 2023	25-Jan-2023
48	NGUS JAN 31 2024	24-Jan-2024
60	NGUS JAN 29 2025	29-Jan-2025

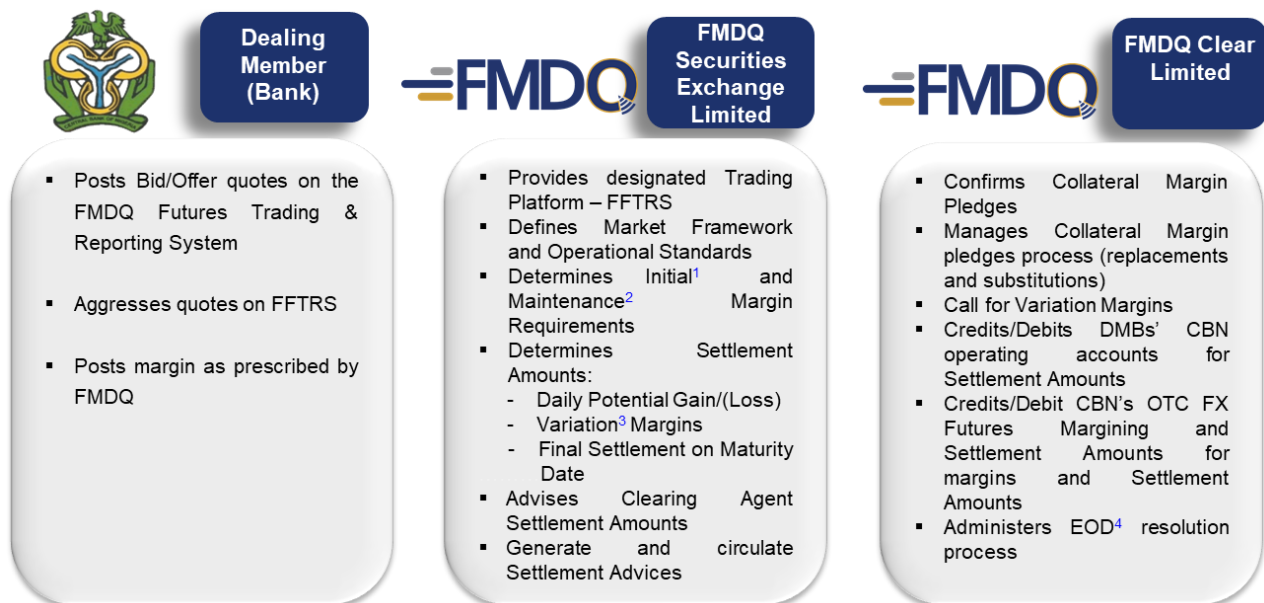
## 2.2 Stakeholders

The major participants in the FMDQ OTC FX Futures market are:

S/N	Stakeholder	Description
1.	FMDQ Exchange	<p>FMDQ Exchange is the Securities Exchange on which the OTC FX Futures contracts are executed. It ensures the efficiency of the OTC FX Futures market through its discharge of the following responsibilities:</p> <ul style="list-style-type: none"> <li>▪ <b>Organising the market:</b> by establishing the Framework and Operational Standards which will govern the conduct of all market participants in the market</li> <li>▪ <b>Promoting market standards:</b> by standardising the agreements for all contracts with stakeholders - CBN, FMDQ Exchange and the Dealing Member (Banks) (“DMBs”)</li> <li>▪ <b>Establishing a robust market structure:</b> by defining products and margin specification, collateral valuation requirements, settlement periods, mode of settlement, limits (if any), quotation method, etc.</li> </ul>
2.	FMDQ Clear Limited (“FMDQ Clear” or the “Clearing Agent”)	<p>FMDQ Clear is the designated clearing and settlement agent. It ensures that the relevant pledge indicators are placed on the collateral accounts of all participants, including the CBN.</p> <p>FMDQ Clear will also be responsible for appointing custodian(s) for the securities pledged by the DMBs, Clients that have entered into OTC FX Futures transactions with the DMBs and the CBN, in addition to ensuring the risk management structures put in place are implemented in a timely and orderly manner.</p>
3.	CBN	<p>CBN is a Transaction Counterparty in the OTC FX Futures market. The CBN, in its capacity as a market intervention participant may</p>

S/N	Stakeholder	Description
		also provide liquidity in the market by offering bespoke OTC FX Futures contracts.
4.	DMBs	DMBs serve as Transaction Counterparties in the OTC FX Futures market and may also serve as Settlement Banks in respect of their Clients' OTC FX Futures transactions.
5.	Clients	These are end-users of OTC FX Futures contracts and include but are not limited to institutional investors, foreign portfolio investors ("FPIs"), asset/fund managers, corporate and commercial institutions, pension fund administrators and individuals

**Figure 1: Key OTC FX Futures Stakeholders' Roles**



**Notes:**

1. Initial Margin – Amount paid by the parties to cover the counterparty risk, based on the estimated volatility
2. Maintenance Margin – Minimum amount that must be maintained in a margin account
3. Variation Margin – Additional funds that must be deposited to top-up to the initial margin requirement
4. Event of Default

**2.3 Systems**

OTC FX Futures contracts shall be traded and/or voice trade reported (“VTR”) on the FMDQ Futures Trading & Reporting System (“FFTRS”).

**2.4 Position Limits**

DMBs shall hold OTC FX Futures open positions subject to the CBN-advised Foreign Currency Trading Position Limit.

**3. OPERATIONAL STRUCTURE**

### 3.1. Trading

- (i) OTC FX Futures contracts shall be traded initially on the FFTRS Order Book and, subsequently, a Request-for-Quote (“**RFQ**”) module shall be introduced for inter-bank trading. The Order Book shall not be anonymous but display the details of the relevant quoting DMB.
- (ii) Transaction Counterparties (i.e. CBN and DMBs) can post “**BID**” and “**OFFER**” quotes to the Order Book.
- (iii) DMBs may apply the two-way quote (2WQ) style when trading amongst themselves.
- (iv) FFTRS shall reflect the orders available in the market on a real-time basis.
- (v) Outstanding orders shall be cancelled from FFTRS at the end of the trading day and new orders shall be placed at the start of the following trading day.
- (vi) Trades on the Order Book shall be based on availability and the notional amount the price taker specifies.
- (vii) Initial margin shall be stated at the point of execution of the trade.
- (viii) All transactions concluded on the FFTRS or such other FMDQ Exchange-advised system constitute valid and binding obligations of all parties.

### 3.2. Eligible Margin Collateral

- (i) The following qualify as eligible collateral for use as margin collateral with respect to OTC FX Futures contracts:
  - (a) Cash.
  - (b) Federal Government of Nigeria (“**FGN**”) Securities (FGN Bonds and Nigerian Treasury bills (“**NTBs**”).
  - (c) CBN Open-Market-Operation (“**OMO**”) Bills.
  - (d) Such other eligible collateral as may be determined by CBN and FMDQ Exchange.
- (ii) DMBs may pledge any eligible collateral including cash in any currency.
- (iii) Fixed income securities shall be pledged to the Clearing Agent. Only securities pledge instructions acknowledged by CBN and FMDQ Clear shall be accepted as a prerequisite to be profiled on FFTRS by FMDQ Exchange.
- (iv) Value of the eligible securities shall be determined based on FMDQ Fixed Income Margin Collateral Valuation (“**FIMCV**”) Schedule.
- (v) All fixed income securities pledged as margin collateral will be marked-to-market on a daily basis at 4:00 PM (or such other frequency as the Clearing Agent may deem appropriate) using FMDQ FIMCV Schedule.
- (vi) DMBs shall substitute pledged securities that is maturing with another acceptable security no later than 2:00 PM, five (5) business days prior to the maturity date of the pledged security.
- (vii) Failure to substitute a maturing security in the manner specified above shall result in the Clearing Agent debiting cash to the DMB’s CBN operating account as substitute for the security.
- (viii) Substitutions of margin collateral may be done by submitting a deposit and withdrawal, in that order. The withdrawal will be processed following verification that the deposit has been received by the Clearing Agent and meets the requisite conditions.

- (ix) DMBs may substitute fixed income collateral margins with cash. Cash collected as margin collateral shall be invested in NTBs. Upon expiry of the OTC FX Futures contract, the NTBs and any interest earned on the cash collateral shall be credited to the cash contributor.
- (x) Counterparties may withdraw excess collateral from the collateral pool upon request.
- (xi) The collateral margin pledged shall remain the assets of the DMBs, the Clients margined for their OTC FX Futures trades executed with the DMBs, and the CBN, and the Clearing Agent shall hold the collateral margin in trust.

### 3.3. Margining

- (i) FMDQ Exchange shall set the margin thresholds from time to time.
- (ii) Transaction Counterparties shall operate margin accounts with the Clearing Agent. The CBN margin collateral shall be in the form of cash.
- (iii) CBN shall pledge cash collateral on an executed trade basis. This shall be equal to the difference between the Nigerian Autonomous Foreign Exchange Rate Fixing (“NAFEX”) Spot and OTC FX Futures rate on a daily basis.
- (iv) Where a DMB’s margin collateral falls below the required maintenance level, cash shall be debited to its CBN operating account by FMDQ Clear. Cash will be returned as soon as collateral is pledged.
- (v) Transaction Counterparties shall have access to their individual Daily Margin Reports on FFTRS.

### 3.4. Daily Valuation: Mark-to-Market

- (i) FMDQ Exchange shall value open contracts at 4:00 PM on a daily basis. Valuations may also be conducted intra-day based on the level of volatility in the Spot FX market.
- (ii) This process shall result in potential gains or losses which shall be credited or debited to the margin accounts of the counterparties to the contract. DMBs are advised to ensure adequate buffers are available on their margin collateral accounts.
- (iii) As margin account balances change, counterparties shall be required to maintain balances above the maintenance margin level (in cash or securities).

### 3.5. Settlement Procedures

- (i) OTC FX Futures contracts are cash-settled in Nigerian Naira. In other words, no physical delivery of the underlying foreign currency (US Dollar) will ever take place.
- (ii) The settlement procedure (variation margin and settlement amounts) is designed to collect losses and distribute gains in such a manner that losses are accrued before posing a serious risk of default. However, while FMDQ Exchange has taken measures to establish secure and efficient clearing mechanisms, these contracts are still traded bilaterally.
- (iii) At maturity, each counterparty shall receive/pay a final settlement amount which is calculated using the expiry rate.
- (iv) FMDQ Exchange shall provide secure settlement advices at maturity of the OTC FX Futures contracts stating the final settlement amounts.

- (a) **Variation Margin:** means the amount of margin payable by a counterparty as a result of the marking-to-market of positions in OTC FX Futures contracts in order that the balance in the margin account returns to the Initial Margin requirement.

- (b) **Potential Gain or Loss:** means the differential between the OTC FX Futures contract price and the daily NAFEX rate.
- (c) **Expiry Rate:** The rate at which the OTC FX Futures contract settles on the expiry date (which is the FMDQ NAFEX Spot rate on the corresponding contract expiry date).
- (d) **Settlement Times:** The settlement times for payment of margin requirements are set out in the table below:

S/N	Margin Requirement	Settlement Time
1.	Daily Variation Margin Calls	4:00 PM same day
2.	Intra-day Margin Calls	Within one (1) hour of receipt of OTC FX Futures margin notification

- (v) Settlement date rollover in the event of a bank holiday shall be as follows:
  - (a) where the settlement date falls on a bank holiday, the effective settlement day shall be rolled forward to the next business day (Thursday).
  - (b) If both the settlement date and the next day business day (Thursday) are public holidays, the settlement day shall be rolled backward one (1) day (Tuesday) to the business day preceding the expiry date.
  - (c) Dates will always be adjusted to the next business day unless that day falls in the next calendar month in which case the date is adjusted to the previous good business day.
  - (d) In all cases, the final valuation will be based on the NAFEX Spot rate on the effective settlement date i.e. Tuesday, Wednesday or Thursday, as the case may be.
  - (e) The above will be applicable where bank holidays are pre-defined and, where otherwise, FMDQ Exchange will take reasonable steps to determine the appropriate settlement dates.

### 3.6. Surveillance

In order to prevent undue speculation from occurring in the OTC FX Futures market, DMBs shall be required to report, via FFTRS, details of customer transactions. The FFTRS Reporting and Surveillance Module shall monitor the following:

- (i) Real-time positions of all market participants.
- (ii) Real-time view of customers' demands that are filled with OTC FX Futures trades detailing:
  - (a) Name of DMB
  - (b) Name of Client
  - (c) Type of Client (e.g. FPI, domestic client, etc.)
  - (d) Purpose of Trade
  - (e) Application Reference
  - (f) Notional Amount
  - (g) Filled Amount
  - (h) Outstanding Amount
  - (i) OTC FX Futures positions



- (j) Daily valuation of DMB open contracts
- (k) Collateral margin levels and alerts to FMDQ Clear and participants of action(s) to be taken

#### **4. EVENT OF DEFAULT (EOD)**

Events of Defaults shall be determined in accordance with the provisions of the OTC FX Futures Market Operational Standards and such other documentation as may be prescribed by the OTC Exchange from time to time.

**APPENDIX: OTC FX FUTURES CONTRACT SPECIFICATIONS**

<b>Name</b>	<b>FMDQ Naira-settled OTC FX Futures</b>
<b>Contract</b>	US Dollar/Nigerian Naira OTC FX Futures Contract
<b>Underlying Instrument</b>	Rate of exchange between one (1) US Dollar and Nigerian Naira (USD/NGN)
<b>Contract Code</b>	NGUS [Contract Expiry Month, Day & Year]; e.g. NGUS JUN 24 2020
<b>Quote Convention</b>	Price; in NGN per USD to two (2) decimal points
<b>Trading System</b>	FMDQ Futures Trading & Reporting System (FFTRS)
<b>Trading Hours</b>	9:00 AM – 2:00 PM
<b>Standard Contract Tenors</b>	The contract cycle consists of sixty (60) consecutive monthly contracts
<b>Expiry Date</b>	Contracts expire on the last Wednesday of each calendar month
<b>Termination of Trading</b>	Trading shall cease at 2:00 PM, eight (8) calendar days before the expiry date of each respective contract. i.e. the Tuesday preceding the week the contract expires
<b>Settlement Method</b>	<ul style="list-style-type: none"> <li>▪ Cash-settled in Nigerian Naira</li> <li>▪ Margin Calls: T + 0</li> <li>▪ Final Settlement: T + 0</li> </ul>
<b>Mark-to-Market Model</b>	As determined in the FMDQ NAFEX <sup>1</sup> Methodology
<b>Final Settlement Price</b>	NAFEX Spot on Expiry Date
<b>Clearing Agent</b>	FMDQ Clear Limited (FMDQ Clear)
<b>Margin Requirements</b>	Initial Margin – As determined and communicated by FMDQ Clear Maintenance Margin – 75% of Initial Margin
<b>Position Limit</b>	Subject to CBN-advised Foreign Currency Trading Position Limit

***For additional information, contact:***

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<sup>1</sup> Nigerian Autonomous Foreign Exchange Fixing