Capital Market
23rd October, 2024




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A REVIEW OF THE NIGERIA FOREIGN EXCHANGE CODE

1. Introduction

1.1 As part of its objectives of promoting a transparent, liquid, and efficient foreign exchange market, the Central Bank of Nigeria ("CBN") has released the Nigeria Foreign Exchange Code ("FX Code")[3] containing guidelines for good practice and responsible participation in the Nigerian Foreign Exchange Market ("the FX Market"). Just like the FX Global Code[4] upon which the FX Code is modelled, the FX Code is organised around six leading principles namely, ethics, governance, execution, information sharing, risk management and compliance, and confirmation and settlement processes.[5]

1.2 The FX Code seeks to establish a collaborative environment where market participants, including financial institutions and corporate organizations, act with honesty and mutual trust. By adhering to these principles, the CBN aims to reduce systemic risks and guarantee that all stakeholders, including foreign exchange buyers and sellers, have a fair playing field. In summary, the FX Code replicates worldwide best practices while also incorporating special measures designed to solve the Nigerian FX Market's unique difficulties, hence improving market stability and investor trust.

1.3 This article reviews the FX Code, assessing its implications on the Nigerian FX Market and the regulatory obligations imposed on Market Participants.

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3 The FX Code is made pursuant to the CBN Act 2007 and BOFIA Act 2020.
4 The FX Global Code is a set of global principles of good practice in the foreign exchange market maintained by the Global Foreign Exchange Committee (GFXC).
5 Section 1, page 3 of the Code.

2. Effective Date, Applicability, and Penalties for Non-Compliance

2.1 The effective date of the FX Code is 14th October 2024 when it will become applicable to all Market Participants and their personnel within the Nigerian FX Market.[6] The FX Global Code defines Market Participants to include financial institutions, asset managers, brokers, FX E-Trading Platforms, corporate treasury departments, quasi-sovereigns and supranational, affirmation, and settlement platforms, the CBN, etc.[7] Unlike the FX Global Code which does not impose legal or regulatory obligations on Market Participants, the FX Code prescribes sanctions for default in compliance. The FX Code provides that the CBN may take appropriate enforcement and other administrative action including monetary penalties as provided under the CBN Act 2007 and BOFIA 2020 against any Market Participants for failure to comply with the FX Code.[8]

3. Ethical and Professional Conduct

3.1 Under Principle 1 of the FX Code, Market Participants are expected to behave in an ethical and professional manner in order to promote the integrity of the FX Market. Market Participants should have appropriate policies and procedures to handle and respond to potentially improper practices and behaviours effectively. Market Participants should identify and resolve trade discrepancies as soon as practicable to contribute to a well-functioning FX market. In line with Principle 3, Market Participants are expected to identify and address potential conflicts of interest that may compromise the ethical judgment of Market Participants.

3.2 Under the code maintaining high standards of behavior is the collective responsibility of firms, management, and personnel. Market participants are to promote ethical values within their organizations, support efforts to uphold high standards in the wider FX market, and encourage employee involvement in these efforts. Senior and front-line management must proactively embed ethical practices into the firm's culture and provide guidance when necessary. Personnel are expected to exercise sound judgment when facing ethical dilemmas, expect accountability for unethical behavior, and seek advice when needed. Additionally, personnel must report or escalate concerns to the appropriate parties, both internally and externally, based on the situation.

4. Information Sharing

4.1 Market Participants are expected to maintain a high degree of professionalism by complying with applicable laws governing transactions in the FX market and by acting

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6 Section 1.5, page 5 of the Code.

7 Page 4 of the FX Global Code.

8 Reporting Mechanisms and Enforcement Mechanisms, Introduction, page 5 of the Code.

with competence and skill.[9] In line with its information-sharing principle, Market Participants are expected to identify and deal with Confidential Information with utmost discretion. Confidential Information is defined as information not in the public domain received or created by a Market Participant.[10] This includes FX trading information, including but not limited to details of a Market Participants order book, spread matrices provided by Market Participants to their clients, and orders for benchmark fixes.

4.2 Market Participants may crystallise their non-disclosure in formalised non-disclosure agreements, or a similar confidentiality agreement and confidential information obtained from a client should be used only for the purpose for which it was given. Market Participants should not disclose confidential information to external parties except where requested by the CBN for policy purposes with the consent of the client, to agents, consultants, advisors, or other market intermediaries who shall also protect the confidential information in the same manner as the market participant and with the consent of the client.[11]

5. Regulatory Compliance and Enforcement

5.1 Market Participants are required to conduct a self-assessment and submit to the CBN a report on the institution's level of compliance and a detailed compliance implementation plan approved by its board with the FX Code by 31st December 2024. Market Participants are to submit a quarterly report to the Financial Markets Department (FMD) on the level of compliance with the FX Code within 14 days after the end of every calendar quarter, with the first report due by 31st December 2024.

5.2 Market Participants are expected to avoid legal and compliance risks by keeping appropriate levels of transparency and auditability and have processes in place to prevent unauthorised transactions. This should entail having in place legal agreements with counterparties and using standard and specific terms and conditions where appropriate, and keeping a record of these agreements.[12] They should also monitor their own compliance with internal policies as well as adherence to appropriate market behaviour standards. Market Participants should perform know-your-customer (KYC) checks on their counterparties to ascertain that their transactions are not used to facilitate money laundering, financing of terrorism, or other illegal activities.[13]

6. Risk management

9 Principle 2 of the Code.
10 Principle 17 of the Code.
11 Principle 18 of the Code.
12 Principle 27 of the Code.
13 Principle 35 of the Code.

6.1 On risk management, Market Participants are expected to establish robust and appropriate risk management, compliance, and review framework to manage and mitigate the risks that arise from a market participant's activities in the FX Market.[14] Such framework may include a comprehensive strategy for the identification, measurement, aggregation, and monitoring of risks across the FX business, and robust incident management, including appropriate escalation and mitigating actions. This framework should start with effective identification and understanding of the various types of risks to which they may be exposed in the FX Market. The FX Code highlights some Key Risk Types which include credit/counterparty risks which may be mitigated by an effective counterparty creditworthiness assessment prior to a transaction and sufficient diversification of counterparty risk exposure where appropriate, and also by ensuring that transactions are accepted only if they fall within approved limits.[15] There are also market risks like changes in FX rates or prices which could have an adverse effect on the financial condition of a market participant.[16]

6.2 There are also operational risks such as time differences in cross-border transactions or differences in industry conventions. Operational and technology risks may also arise from human error, personnel misconduct, systems issues, etc. Market Participants should put strict security and operational measures in place to limit their susceptibility to possible operational disruptions, sabotage, or security breach. There are also settlement risks. To reduce settlement risks, Market Participants should endeavour to settle FX transactions through services that provide payment-versus-payment (PVP) settlement. And where PVP is not used, Market Participants should reduce the size and duration of their settlement risk where available. The FX Code also requires Market Participants to have Business Continuity Plans (BCPs) that are appropriate to the nature, scale, and complexity of their FX business. These BCPs may include contingency plans, disaster recovery plans, etc.[17]

7. Conclusion

7.1 In conclusion, the Nigeria Foreign Exchange Code is, in essence, a rehash of the FX Global Code, adapted to the Nigerian market's unique regulatory landscape. However, it stands out as more than a mere guideline due to its enforceability, distinguishing it from the FX Global Code. By implementing sanctions and other administrative actions for non-compliance, the Central Bank of Nigeria has reinforced the FX Code with the power to hold Market Participants accountable, thus promoting a transparent and

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14 Principles 22 - 24 of the Code.
15 Principle 27 of the Code.
16 Principle 28 of the Code.
17 Principle 31 of the Code.

efficient FX market. This enforceability underscores the FX Code's significance beyond standard principles, making it a robust framework that demands ethical conduct, sound governance, and comprehensive risk management. Through these measures, the FX Code ensures that Market Participants are not only aligned with global standards but are also subject to a regulatory structure that upholds integrity and promotes stability within the Nigerian Foreign Exchange Market.

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