

THE NEW CBN FOREIGN EXCHANGE CODE AND ITS IMPLICATIONS



With the introduction of the CBN FX code, Nigeria has aligned with leading financial jurisdictions, such as the United Kingdom and Hong Kong, in establishing regulatory frameworks aimed at strengthening its foreign exchange market.

BACKGROUND

The considerable growth of activities in the Nigerian Foreign Exchange Market (NFEM) has necessitated the development of initiatives to effectively address the dynamic nature and emerging challenges in the market. In a bid to rebuild and stabilise the NFEM, the Central Bank of Nigeria (CBN), in January 2025, issued the Nigeria Foreign Exchange Code, pursuant to its powers under the CBN Act of 2007 and BOFIA 2020, as a means of promoting the integrity and functioning of the wholesale Nigerian FX market. The FX code retroactively came into effect on 2 December 2024.

The code aims to build a robust and transparent market, ensuring compliance with best practices from leading jurisdictions in the Nigerian FX market. The new CBN regulation applies to all authorised dealers, including commercial and investment banks and other specialised banks licensed by the CBN to deal on foreign exchange, and other players who utilise Nigeria's wholesale foreign exchange business as part of their licensed business. The applicability of the FX code on the market participants vary as certain provisions/principles of the regulation may be more relevant to a specific market participant than the other in a given circumstance.

The provisions of the regulatory code are based on six fundamental principles, namely ethics, governance, execution, information sharing and reporting obligation, risk management and compliance, and confirmation and settlement processes.

These principles form the basis on which obligations are imposed on market participants as well as requirements laid for compliance.

This article seeks to provide an analytical review of the FX code, highlighting these fundamental principles underpinning it. It then proceeds to analyse key implications of the code for market participants.

KEY PROVISIONS

To achieve its objectives of promoting transparency, ethical conduct, and good governance in the Nigerian foreign exchange market, the FX code is founded on the principles highlighted below.

Ethics: Under the ethics principles, market participants are mandated to act professionally to promote the fairness and integrity of the NFEM. In this regard, market participants, particularly members of senior management, are to adopt a proactive stance in pre-empting unethical practices and incorporating ethical practices in their institutional frameworks. This entails identifying and establishing structures that aid in managing potential conflicts of interest. The code further mandates market participants to disclose potential conflicts of interest to affected parties where they cannot be reasonably averted or managed, allowing them to decide whether they wish to proceed with the transaction.

Governance: The code requires market participants to have a sound and effective governance framework that provides clear responsibilities and comprehensive oversight of their NFEM activities and promotes responsible engagement in the FX market. It further mandates that the governance structures established should be commensurate to the size and complexities of the market participant's activities in the NFEM. Also, market participants are required to have remuneration and promotion structures that promote market practices and behaviours that are consistent with their ethical and professional conduct expectations. In addition, market participants should have appropriate policies and procedures to effectively handle and respond to potentially improper practices and behaviour.

Execution: This principle primarily requires market participants to exercise caution in negotiating and executing transactions, in order to promote a robust, fair, open, liquid, and appropriately transparent NFEM. In doing so, they should clearly define their capacities or roles in trade executions, ensuring that the counterparties have a clear understanding of their roles. This could be in the capacity of an agent or a principal. A market participant acts as an agent where it executes orders on behalf of the client pursuant to the client mandate, and without taking on market risk in connection with the order. On the other hand, a principal takes on one or more risks in connection with the client's order, including credit and market risks.

Information Sharing: Market participants are expected to be clear and accurate in their communications and to protect confidential information. This is to promote effective communication that supports a robust, fair, open, liquid, and appropriately transparent FX market. This principle aims to prevent any form of false or misleading information. It, therefore, requires the market participants to respect standard confidentiality policies, restricting access to confidential information and sharing only when expedient for compliance or trade execution.

Risk Management and Compliance: This principle requires market participants to maintain a robust control and compliance environment to effectively identify, manage, report, and mitigate risks associated with their activities in the NFEM. It further highlights the various risks which may be encountered in the market, such as credit, market, operational, technological, compliance, and settlement risks. The principle mandates real-time monitoring of FX exposures and risk limits. It also requires financial institutions to implement automated monitoring systems for FX trades.

Additionally, the principle requires that structures, which require oversight from senior management, who would be responsible for making strategic decisions relating to risk management, such as defining the risk appetite, enforcing policies, and receiving timely risk reports, be put in place.

Confirmation and Settlement: This principle requires market participants to establish robust and transparent risk-mitigating, post-trade processes to facilitate predictable, smooth, and timely settlement of transactions. It also mandates that market participants establish adequate systems that allow them to project, monitor, and manage their funding requirements to reduce potential complications during settlement processes. Such processes must be consistent with the market participant's operating policies, documentation, and policies for mitigating credit and legal risks. Furthermore, market participants are required to improve their technical and operational capability to cater for their end-to-end FX processing in both normal and peak conditions. Lastly, market participants are to obtain clearance from the CBN before engaging in any form of amendments, novation, or cancellation of transactions.



IMPLICATIONS

Full implementation of the FX code is expected to strengthen Nigerian foreign exchange market, enhance transparency, and boost public confidence in it. It is also expected to improve market liquidity and overall trading conditions as well as address price speculation and market distortions. In the same vein, the principles on information sharing are anticipated to facilitate greater access to market data, thereby reducing speculation and fostering a more efficient exchange system. Additionally, implementation of the code is expected to support the stability and proper valuation of the naira.

But despite these potential benefits, a key drawback of the FX code is the compliance burden imposed on market participants. This challenge primarily arises from the costs associated with the manpower requirement and the acquisition of necessary information technology infrastructure to meet the compliance obligations.

For instance, the code mandates market participants to submit a self-assessment compliance report, with the first submission deadline set for 31 January 2025. Additionally, market participants must provide CBN with a detailed compliance implementation plan, approved and signed by their Board, along with extracts from the relevant Board meetings. Furthermore, market participants are to submit quarterly compliance reports to the Financial Markets Department of the Central Bank of Nigeria within 14 days after the end of each calendar quarter. The initial deadline for this requirement is set for 31 March 2025.

All these requirements will place a huge burden on the market participants who risk been sanctioned for non-compliance.



CONCLUSION

Based on our review, it would appear the CBN has taken steps to domesticate the provisions of the Global Foreign Exchange Code issued by the Global Foreign Exchange Committee. The initial version of the global code was published in May 2017, with subsequent updates aimed at addressing evolving challenges of the global foreign exchange market. With the introduction of the new CBN FX code, Nigeria has aligned with leading financial jurisdictions, such as the United Kingdom and Hong Kong, in establishing regulatory frameworks aimed at strengthening its foreign exchange market. However, the full impact of the code remains uncertain, and time will tell whether its objectives would be achieved.

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