Nigerian Foreign Exchange Market
Developments and Private Equity Investment

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Nigeria’s economy is highly dependent on crude oil, which constitutes a major source of the country’s foreign exchange earnings and government revenue. As a result, the sharp decline in crude oil prices has adversely affected Nigeria’s foreign earnings and reserves, the value of the Naira against major world currencies, the availability of foreign exchange in Nigeria and contributed to widening of the disparity between the exchange rates in the official and the parallel foreign exchange markets.

In a bid to control the decline in the country’s foreign reserves, the Central Bank of Nigeria (CBN) has adopted a number of measures to manage access to the official foreign exchange market that has, traditionally, been subsidised by the federal government of Nigeria. These changes portend well for private equity and other investments as foreign investors, following the recent developments, can now convert any capital (brought into Nigeria for investment) into Naira at a market-determined rather than a fixed CBN determined exchange rate, which has been the subject of recent criticism.

The foreign exchange regime

Although significantly deregulated, foreign exchange restrictions remain in Nigeria. Foreign exchange laws and regulations generally empower the CBN to regulate foreign exchange dealings in Nigeria and provide that, except where a transaction is prohibited by law, any transaction adequately supported by appropriate documentation shall be an ‘eligible transaction’ for the purchase of foreign exchange in the Nigerian official foreign exchange market, which, prior to 20th June, 2016, comprised of the autonomous foreign exchange market and the interbank foreign exchange market. The autonomous foreign exchange market is the market in which authorised dealers (that is, Nigerian banks that have been licensed by the CBN to deal in foreign exchange) and authorized buyers (being corporate bodies approved by the CBN to buy foreign exchange), together with foreign exchange end-users and the CBN itself are participants. The inter-bank foreign exchange market is the market in which end-users, authorised dealers and authorised buyers participate. Residents and non-residents alike may only access the official foreign exchange market to purchase foreign exchange for qualifying eligible transactions.

Changes

Some of the measures that the CBN had taken to address the declining Naira include:

- closing the Retail Dutch Auction System / Wholesale Dutch Auction System foreign exchange window from which foreign exchange could be purchased at a subsidised rate and directing that all demand for foreign exchange should be channelled towards the inter-bank foreign exchange market;
- prohibiting payment and pricing of domestic transactions (i.e. transactions consummated in Nigeria) in foreign currency; and
- prohibiting access to foreign currency from the interbank market for the importation of 41 specified items including investments by Nigerian residents in Eurobonds, foreign currency bonds and purchase of shares.

The measures put in place by the CBN had not, however, succeeded in slowing the decline in the value of the Naira against other major international currencies. As a result, the CBN collapsed the autonomous foreign exchange market and the interbank foreign exchange market into a single flexible foreign exchange market in Nigeria. This means that, with effect from 20 June 2016, the CBN now operates a single market structure through the autonomous/interbank market under the Interbank Foreign Exchange Market (Interbank Market). Participants in the Interbank Market include Authorised Dealers, Authorised Buyers, oil companies, oil service companies, exporters, end-users and any other entity that the CBN may designate from time to time. The CBN may only participate in the Interbank Market through direct or dynamic secondary market intervention mechanisms such as the sale of FX to Authorised Dealers on a wholesale basis or to end-users through Authorised Dealers on a retail basis.

New Guidelines

Following this change, the CBN issued the Revised Guidelines for the Operation of the Nigerian Interbank Foreign Exchange Market June 2016 (Guidelines). One of the objectives of the Guidelines is to promote the global competitiveness of the Interbank Market, which will be supported by the introduction
of risk management products offered by the CBN and Authorised Dealers to further deepen the FX market, boost liquidity and promote financial security in the market. The risk management / hedging products introduced by the CBN include FX Options, forwards (outright and non-deliverable), FX swaps, cross-currency interest rate swaps and Naira-settled, non-deliverable, over the counter (OTC) FX futures. Any of these approved hedge transactions that an Authorised Dealer enters into with a customer is required to be backed by visible and invisible trade transactions, or evidenced by investments.

Unlike in the past, when the CBN fixed the exchange rates, the new Interbank Market exchange rates will be purely market driven via the FMDQ Thomson Reuters platform i.e. it will be dependent on demand and supply. The CBN will only participate in the Interbank Market through periodic interventions to either directly buy or sell FX spots upon the receipt of valid two-way quotes on the standard amount or to enter into futures or forwards contracts. The CBN has also introduced and registered FX primary dealers that will deal with the CBN on a two-way quote basis for large deal sizes of USD10 million and above. The FX primary dealers will deal with other Authorised Dealers and other participants in the Interbank Market.

The OTC FX futures introduced by the Guidelines may be sold by Authorised Dealers to end-users on the back of visible and invisible trade transactions or evidenced by investments. Settlement amounts on OTC FX futures may be repatriated for foreign portfolio investors with certificates of capital importation (CCIs) and FMDQ OTC PLC OTC FX Futures Settlement Advice (FMDQ Advice). Authorised Dealers are not permitted to treat any request for repatriation not supported with a CCI and FMDQ Advice.

Impact of changes on foreign PE investors?

In order for a foreign private equity investor to be able to freely remit the proceeds of an investment that it makes in Nigeria for its own account, it is necessary for that PE Investor to obtain a CCI from an Authorised Dealer at the time that the capital for the investment is brought into Nigeria and converted into Naira. A CCI will be issued in the name of the PE Investor upon the PE Investor providing appropriate and complete documentation to an Authorised Dealer. It serves as documentary evidence that the investor actually brought foreign currency into Nigeria for the purpose of making investments in Nigeria. Once obtained, a CCI will permit the PE Investor to repatriate proceeds from its investment or its capital in the event of the partial or complete sale of its investment. The law requires a CCI to be issued within 24 hours of the funds being brought into Nigeria. In practice, however, it takes about 48 hours following the inflow of capital into Nigeria for Authorised Dealers to issue CCIs.

The recent changes to the foreign exchange market do not appear to have affected the applicable requirements for a PE Investor making investment in Nigeria. All investors are still required to obtain CCIs for investments, subject to the conversion of the capital into Naira and the provision of appropriate documentation, and this forms the basis on which they will be entitled to repatriate proceeds from their investment out of Nigeria. All CCIs issued before the market changes remain valid. All foreign investors that bring foreign currency into Nigeria, convert such currency into Naira, and invests the resulting capital in Nigeria are still guaranteed unconditional transferability of dividends or profits from the investment; payments in respect of servicing a foreign loan; and the remittance of proceeds and other payments obligations in the event of sale or liquidation of the investment, through an Authorised Dealer in freely convertible currency and in the official foreign exchange market.

Conclusion

The key change for PE Investors, which is a positive one, is that they are now able to convert any capital (brought into Nigeria for investment) into Naira at a market-determined exchange rate since, as indicated above, the applicable rate is no longer tied to a CBN determined rate. The requirements and documents for obtaining CCIs remain the same. In conclusion, the good news is that the measures put in place by the CBN, and the introduction of the Interbank Market, do not impact negatively on private equity investments in Nigeria and have the potential to liberalise the market and impact positively on the market. It remains to be seen, however, whether the current challenges of a scarcity of foreign exchange in the market and an illiquid Interbank Market, which impact on Nigeria’s attractiveness as a destination for private equity and other investments, will be addressed.

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