

Understanding NGX Equity Index Futures

April 1, 2022





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Introducing NGX Equity Index Futures

Nigerian Exchange Limited ("NGX" or the "Exchange"), as a multi-assets Exchange, is poised to develop the Nigerian capital market through innovative product solutions. NGX recognizes the important role the derivatives market plays in the development of economies globally, and in line with the vision of the Exchange to be the foremost Exchange hub in Africa, the Exchange is launching NGX Equity Index Futures to boost the depth and diversity of product offerings in the Nigerian capital market.

The Exchange believes that the derivatives market has the potential to address significant risk management requirements of market participants such as PFAs, Fund Managers, Corporate Treasuries, and Trading License Holders. Also, it will provide investors and other market players with the necessary tools for asset allocation and cost management for effective portfolio management.



What are NGX Equities Index Futures?

NGX Equity Index futures are "futures contracts" on equity indices. They are cash-settled contracts and the majority have quarterly expiration dates scheduled for the months of March, June, September, and December.

Equity Index futures will provide market participants with tools to efficiently hedge or express an opinion on an equity index market. The Exchange is focusing on the most widely followed and recognized equity index benchmarks in our market:

- NGX 30 Index
- NGX Pension Index

Our goal is to introduce more equity futures contracts in response to market demand and to provide equity traders with a deep and liquid market in which to speculate or hedge their portfolio.

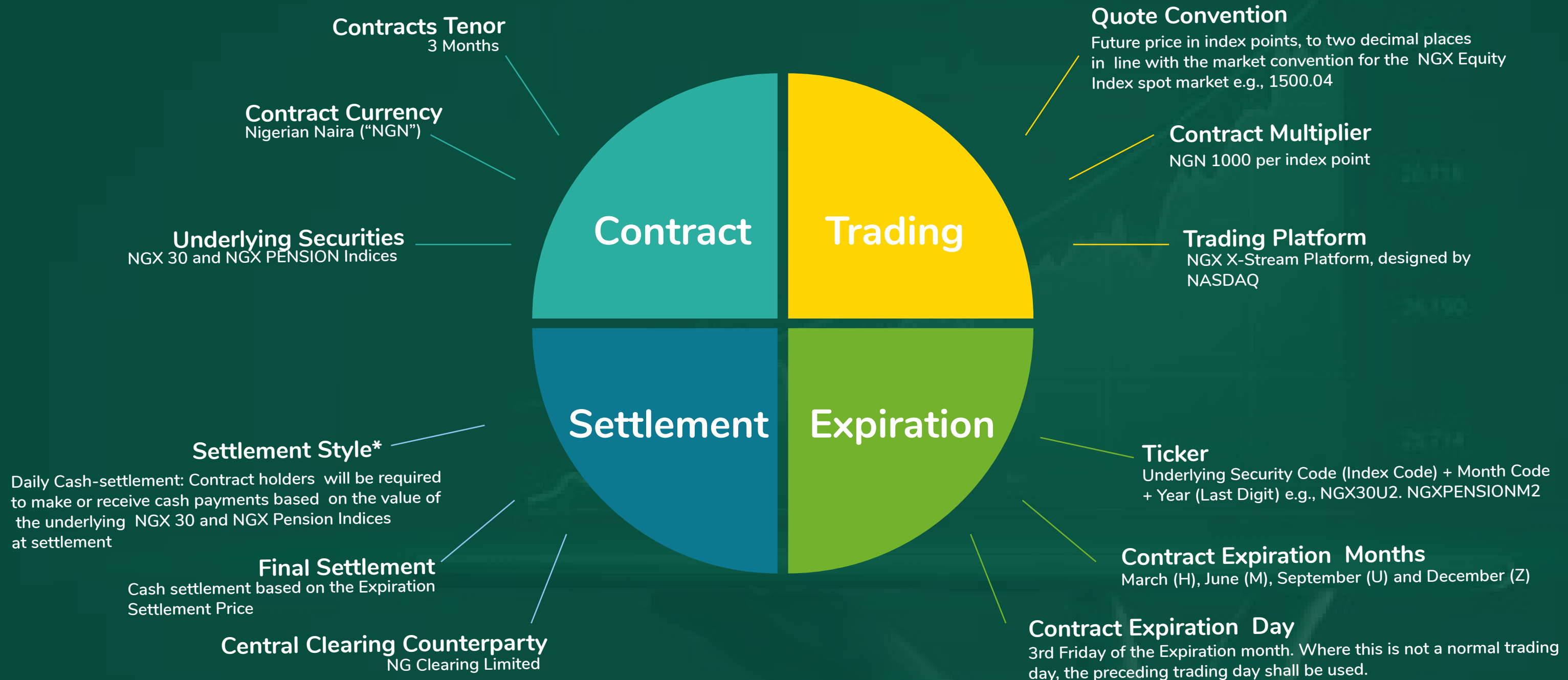
Creating NGX Equity Index Futures Contracts

- Equity Index Futures contracts may be introduced by either The Exchange or by a Market Participant. The Exchange will only admit for trading derivatives contracts that meet the Product Specifications of The Exchange. All requests for admission of contracts on the Order Book will be considered at the discretion of The Exchange.
- A derivatives contract being introduced by a member shall be by means of a written request addressed and sent to Product Development Department of The Exchange at productsdevelopment@ngxgroup.com. The Listing Request must comply with section 7.2 of the Rulebook of The Exchange Derivatives Rules in order to be considered. Contracts that meet the Product Specifications of The Exchange will be admitted on the Order Book after the approval of The Exchange and the Securities and Exchange Commission (SEC), Nigeria.
- The SEC Rules on Regulation of Derivatives Trading require the registration of exchange-traded derivatives contracts with the SEC. It shall be the responsibility of The Exchange to undertake the registration of contracts that it decides to admit on its Order Book. Where the admission of a contract is pursuant to the request of a Market Participant, the Market Participant shall bear the cost of registration of the contract with the SEC.

You can access the Rulebook of NGX Derivatives Market via <https://ngxgroup.com/ngx-download/rule-book-of-the-nigeran-stock-exchange-derivatives-market-sec-approved-august-2019/>



Features of NGX Equity Index Futures



* At Settlement There is no actual trade and associated physical delivery of the underlying NGX 30 and NGX Pension Indices

How NGX Equity Index Futures Work

NGX Equity Index Futures contracts approved by the Securities and Exchange Commission (SEC), Nigeria will be listed for trading on NGX X-Stream Derivatives Trading Platform and clearing on the NG Clearing System.

The NG Clearing System will facilitate effective market risk management, transparency, competitive pricing and seamless execution of trades in NGX Equity Index Futures. The listed contracts will be accessible to Derivatives Trading License Holders of the Exchange for the initiation, execution and management of trades for all users of NGX Equity Index Futures.

To further improve transparency and price discovery, NGX shall also publish relevant price information for the NGX Equity Index Futures via channels accessible to market participants. Derivatives Trading License Holders of The Exchange will initiate and execute trades in NGX Equity Index Futures for themselves and their clients on NGX X-Stream Derivatives Trading Platform. Upon execution of trades in NGX Equity Index Futures, transactions will be centrally cleared by NG Clearing Limited (NGCL) via novation (i.e., becoming the buyer to every seller and the seller to every buyer)

Consequently, to protect against counterparty risk associated with derivatives transactions, users of NGX Equity Index Futures will be required to provide "good-faith-deposit" or collateral or Initial Margin to NG Clearing for trades executed in NGX Equity Index Futures.

The required amount of Initial Margin for each NGX Equity Index Futures contract will be determined by NG Clearing and displayed as a percentage of the notional value of the contract on the contract specification published on the NGX website.

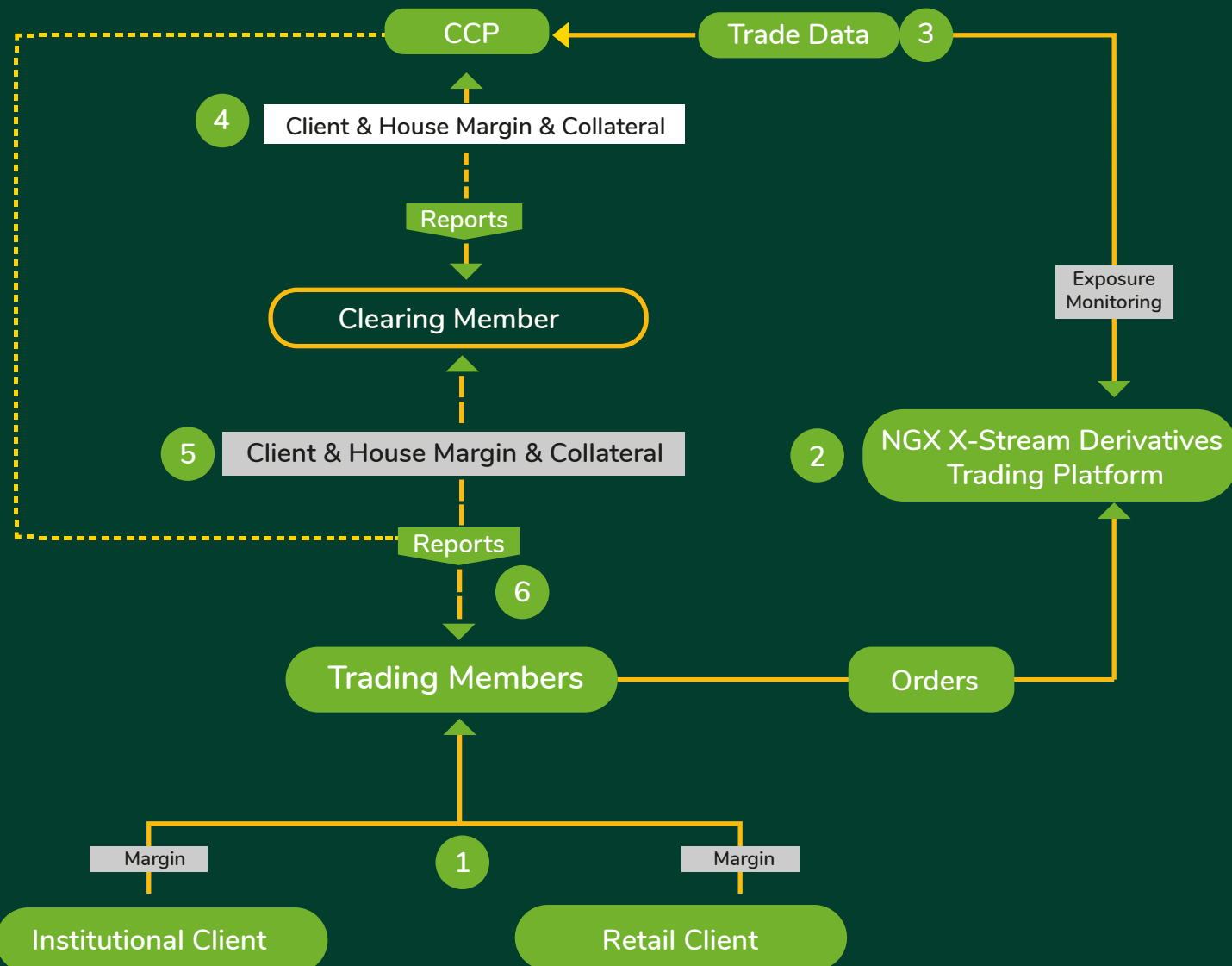


In addition to the Initial Margin, to further minimize the risk of default in the market, all open positions in NGX Equity Index Futures contracts will be valued (marked-to-market) daily by NG Clearing, and the resultant daily gains/losses from such valuation will be received/paid as Variation Margins by the holders of such open positions from/to NG Clearing through their designated Clearing Members.

The settlement of all Variation Margin obligations must occur before the opening of the market on the next business day. Valuation of open positions to determine Variation Margins will be calculated based on the mark-to-market approach stipulated on the contract specification.



Market Structure and Ecosystem



Steps	Descriptions of Activities
1	A Client engages the Derivatives License Holder (Trading Member) with a trade request.
2	The Trading Member initiates an order during market hours on NGX X-Stream Derivatives Trading Platform, the Exchange's dedicated Trading System. Orders can be initiated anonymously and matched centrally on a central orderbook on NGX X-Stream Derivatives Trading Platform.
3	Trade information flows to NG Clearing, the Central Counterparty (CCP), for novation at end of day. Daily mark-to-market and transmission of margin requirements to Clearing Members occur.
4	Daily mark-to-market and transmission of margin requirements to Clearing Members occur
5	Margin calls are settled daily before the market opens on the next business day. Final settlement is effected on the contract maturity date.
6	Margins are transmitted during daily margin calls and full value recovered at contract maturity.



Target Market for NGX Equities Index Futures

Fund Managers

Fund Managers such as Pension Funds Administrators (PFAs), Asset Managers, Endowment, Mutual and ETFs, etc., face price volatility risk and potential financial losses due to their investment activities. As a result, they need the NGX Equity Index Futures contracts to manage their risks and possibly guarantee/enhance return levels on their portfolios.

Proprietary Traders

Proprietary Traders such as Banks, Trading License Holders, etc., who want to gain exposure to a much larger investment in a cost-effective manner and to hedge against price volatility risk, also need NGX Equity Index Futures



Fund
Managers



Proprietary
Traders



Portfolio
Managers



Retail
Investors

Portfolio Managers

Portfolio managers who want to manage their exposure and improve investment performance in actively managed portfolio would need NGX Equity index futures to hedge their equity positions against a loss in stocks and, to minimize market risk component in their portfolio.

Retail Investors

Retail investors including High Net-worth Individuals who want to gain exposure to a much larger investment in a cost-effective manner and to hedge against price volatility risk, also need NGX Equity Index Futures

Utilization of NGX Equity Index Futures.

Proprietary Traders and Retail Investors

Maximum Capital Efficiency

- ◆ The leverage available in derivatives trading allows you to utilize your capital more efficiently.

Take Position

- ◆ Proprietary Traders and retail Investors can use Equity Index futures to express a view on the overall equity market.
- ◆ Rather than having to evaluate individual share values they can trade the entire index using the futures contract

Fund Managers

Long-term investment view

- ◆ Certain Equity Index futures strategies can be applied by risk managers to efficiently create a long equity position. This way, they can gain the equity market exposure they want, while only using a fraction of the capital. The remaining capital can be used for other investment opportunities.

Cash Drag

- ◆ A Fund Manager can combat cash drag by using a technique called cash equitization, which makes putting excess cash to work much easier. The primary tool for implementing a cash equitization strategy is stock index futures contracts
- ◆ Cash equitization is a strategy whereby an investor can transform his cash into an investment that will track his benchmark; in this case, the NGX 30 or NGXPENSION

Portfolio Managers

Equity Index futures lend themselves to a variety of risk management overlay strategies to either reduce risk or enhance returns. Including:

- ◆ Beta replication - Beta describes the return achieved from exposure to the overall market. Hence, if an investor was “buying beta,” it would refer to investing in the whole market, usually through derivatives. Futures are a cheap and efficient way to obtain beta exposure and investors can replicate exposure to the market
- ◆ Hedging - Some funds have to hold statutory positions in certain types of stocks regardless of their view on the direction of those stocks. Index Futures that have a prevalence of those stocks can provide a risk mitigation option for hedging those statutory positions

Practical Example of the Use of NGX Equity Index Futures

Managing the Cash Drag: Setting up the Trade

Suppose that a ₦1,200m fund is benchmarked to the NGX Pension Index and ₦56m is currently held in cash (aggregated over time from dividends, plus contributions less withdrawals)

The Dec NGX Pension futures is trading at 1565 index points

How many futures should the fund manager buy/sell to be fully invested?

One futures contract controls
₦1,565,000 = $[1565 \times ₦1,000]$

The fund manager should buy
36 Dec NGX Pension futures
 $[₦56m / ₦1,565,000]$

Practical Example of the Use of NGX Equity Index Futures

Hedging An Equity Index

A fund manager oversees a diversified fund of large cap stocks quoted on NGX with a market value of ₦150,000,000 and a beta with respect to the NGX 30 index of 0.95

The NGX 30 is trading at 1650, and the nearby Mar futures at 1674.25

How many contracts should the fund manager buy/sell to hedge overnight?

$$\text{Number of Contracts} = \frac{1674.25 \times ₦1,000}{₦150,000,000} \times 0.95 = 85.11$$

The fund manager should sell 85 NGX 30 March futures

Note, if the manager was hedging to the delivery day, you would substitute the cash index price for the futures price



The Index Contract Specs

	NGX 30 Index Futures	NGX PENSION Index futures
Contract multiplier	₦1,000 x NGX 30Index	₦1,000 x NGX Pension Index
Tick size and value	0.25 index points; ₦250	
Contract months	Two months in the March quarterly cycle	
Trading hours	09:30 –14:30	
Last trading day	Third Friday of the delivery month	
Contract Expiration Day	3rd Friday of the Expiration month. Where this is not a normal trading day, the preceding trading day shall be used.	
Position limits	NG Clearing shall specify client level open position limits as the maximum limit of an open position that can be maintained at the client level across all futures contracts on a particular underlying security or Index	



Key Takeaways

- NGX Equity Index Futures are standardized derivatives contracts that create an obligation for the contract holder to purchase or sell an NGX Equity Indices on a specified date at a predetermined price.
- NGX Equity Index Futures are cash-settled contracts traded on the NGX X-Stream Derivatives Trading Platform or any other system designated by the Nigerian Exchange Limited.
- NGX Equity Index Futures can be used by Fund Manager, Portfolio Managers, Retails and other corporates to hedge price volatility risk on their NGX Equity Indices and other equities investments

About Nigerian Exchange Limited (NGX)

Innovation Driven Market

Nigerian Exchange (NGX), a wholly-owned subsidiary of Nigerian Exchange Group (NGX Group), is a leading listing and trading venue in Africa with its history dating back to 1960. It is an open, professional, and vibrant exchange, connecting Nigeria, Africa, and the world.

NGX is a multi-asset exchange providing a home to the best of African enterprises listed on its Premium, Main, and Growth Boards; diverse fixed income securities; Exchange Traded Products (ETPs); Mutual and other investment funds. Through its vibrant secondary market, NGX provides domestic and international investors access to these securities. In addition, NGX provides licensing services, market data solutions, ancillary technology services, and more in its quest to be Africa's preferred exchange hub.

At NGX, we deploy innovative capital market solutions that provide a globally competitive platform for Issuers to raise capital, and investors to meet their financial objectives across markets and geographies while maintaining a seamless flow of information. We

prioritise outstanding customer service and experience, creating loyal and delighted clients and stakeholders by elevating our ecosystem and providing a portfolio of globally competitive products and services that help our customers achieve their financial ambitions.

NGX is licensed under the Investments and Securities Act (ISA) and is regulated by the Securities and Exchange Commission ("SEC") of Nigeria.

To learn more about the NGX Equity Index Futures and other products provided by NGX, contact our Product Development Team

productsdevelopment@ngxgroup.com or visit:
<https://ngxgroup.com/exchange/trade/derivatives/>

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