CHAPTER TWO

MONETARY POLICY, SURVEILLANCE ACTIVITIES AND OPERATIONS OF THE CBN IN 2011

Monetary management in 2011 was influenced largely by developments in the domestic and external environment. Growth in the major monetary aggregates, which remained moderate for most of the year, rose substantially towards the end of the year, exceeding the programme benchmark and the level attained at the end of the preceding year. Open market operation (OMO) was the main instrument of monetary policy, complemented with foreign exchange market interventions and discount window operations, such as the standing facilities. The Monetary Policy Rate (MPR) was reviewed upwards six times during the year, in line with the liquidity conditions. Interest rates were generally higher than in the preceding year. Also, the yields on fixed income securities across various maturities were higher than in 2010.

The Wholesale Dutch Auction System (wDAS) subsisted in the foreign exchange market, while the Naira exchange rate remained relatively stable in 2011. The payments and settlement landscape improved with increased use of e-money products. Furthermore, the CBN continued its 'clean naira note' policy and also outsourced the maintenance of currency processing machines to equipment manufacturers, for greater efficiency and cost-effectiveness. The Bank sustained its developmental functions through the Agricultural Credit Guarantee Scheme Fund (ACGSF) and infrastructure financing, among other programmes.

2.1 MONETARY OPERATIONS

2.1.1 Monetary and Credit Developments

Monetary growth rose sharply at the end of 2011 after moderate growth for most of the year and despite the tight policy stance of the Bank. The development reflected largely the substantial growth in domestic credit arising from fiscal operations and increased claims on AMCON. Consequently, the growth of key monetary aggregates at end-December 2011 exceeded the indicative benchmark for fiscal 2011 and the outcome at the end of the preceding year.

Relative to end-December 2010, the broad measure of money, M_2, grew by 15.4 per cent to ₦13,300.3 billion, compared with the growth rate of 6.9 per cent at end of the preceding year and the indicative benchmark of 13.6 per cent for fiscal 2011. The growth in M_2 was driven by the significant increase in domestic credit (net) and foreign assets (net) of the banking system, but was moderated by the substantial decline of 70.3 per cent in other assets (net) of the banking system. Narrow money (M_1) grew by 21.5 per cent at end-December 2011, compared with the growth of 11.1 per cent at the end of the preceding year. Aggregate bank credit to the domestic economy (net) grew by 42.4 per cent, compared with the indicative benchmark of 29.3 per cent for fiscal 2011 and the growth of 10.0 per cent at end-December 2010. The development reflected the 52.7 and 31.3 per cent growth in net claims on the Federal Government and the private sector, respectively. Base money, the Bank's operating target for monetary policy, stood at ₦2,784.3 billion, representing an increase of 50.9 and 12.7 per cent over the level at the end of the preceding year and the indicative benchmark for 2011, respectively.

Monetary growth rose sharply at the end of 2011 despite the tight policy stance of the Bank. The development reflected largely the substantial growth in domestic credit arising from fiscal operations and increased claims on AMCON.

Table 2.1 : Key Policy Targets and Outcomes, 2007 - 2011 (per cent)

	2007		2008		2009		2010		2011	
	Outcome	Target	Outcome	Target	Outcome	Target	Outcome	Target	Outcome	Target
Growth in base money	22.6	3.3	29.6	20.8	6.8	3.6	11.6	35.9	50.9	12.7
Growth in broad money (M2)	44.2	24.1	57.8	45.0	17.6	20.8	6.90	29.3	15.4	13.6
Growth in narrow money (M1)	36.6	37.64	55.9	65.4	3.3	32.2	11.1	22.4	21.5	15.8
Growth in aggregate bank credit	276.4	-29.9	84.2	65.7	59.6	87.0	10.0	51.4	42.4	29.3
Growth in bank credit to private sector	90.8	30.0	59.4	54.7	26.6	44.9	-3.8	31.5	31.6	29.1
Inflation rate	6.6	9.0	15.1	9.0	13.9	9.0	11.8	11.2	10.3	10.0
Growth in real GDP	6.5	10.0	6.0	7.5	7.0	5.0	7.9	6.1	7.7	7.0

Source: CBN

1/ Revised

2/Provisional

Table 2.2: WAMZ Convergence Criteria, 2007 - 2011

	Target	Achievement				
		2007	2008	2009	2010	2011
Inflation rate	< 10.0 per cent	6.6	15.1	**12**	**11.8**	**10.3**
Ways & Means Advances	≤ 5.0 per cent of retained revenue of the Government	Nil	Nil	**Nil**	**Nil**	**Nil**
Deficit to GDP Ratio	≤ 4.0 per cent	0.5	0.2	**3.3**	**3.7**	**3.2**
Gross Official Reserve	≥ 3 Months of import cover	21.6	15.9	**16.3**	**7.2**	**6.5**

Source: CBN

Nigeria met all but one WAMZ convergence criteria, inflation, in 2011 despite the weak global economic recovery.

2.1.2 Liquidity Management

Monetary policy in 2011, as in the preceding year, was conducted to ensure adequate liquidity in the banking system. Liquidity management was, therefore, geared towards a continuous improvement in the liquidity condition and efficiency of the financial markets in order to achieve the objective of monetary and price stability.

The Bank embarked on a mix of policy measures to ensure price stability and a steady flow of credit to the real sector of the economy, including: six upward reviews of the Monetary Policy Rate (MPR) from 6.25 per cent in December 2010 to 12.00 per cent in December 2011 and retention of the symmetric corridor of +/- 200 basis points around the MPR. During the year, the Bank adopted an operational framework of Reserve Averaging for monetary policy implementation in an attempt to smoothen interest rate volatility. This framework was, however, suspended at an extraordinary meeting of the MPC held on October 10, 2011 to rein in liquidity surfeit arising largely from fiscal operations. In addition, the Bank reduced the net open position limit of banks from 5.00 to 1.00 per cent and later reviewed it to 3.0 per cent. Furthermore, the Bank introduced the wDAS-Forwards in the foreign exchange market to mitigate financial market risks. The

Liquidity management was, therefore, geared towards a continuous improvement in the liquidity and efficiency of the financial markets in order to achieve the objective of monetary and price stability.

Bank also adjusted the mid-point of the official exchange rate band from N150/US$1 +/-3 per cent to N155/US$1 +/-3 per cent in order to maintain adequate reserves and safeguard the value of the Naira

Other policy measures included the upward review of the Liquidity Ratio (LR) of DMBs to 30.00 per cent from 25.00 per cent, at the MPC meeting of January 24 – 25, 2011. The Bank conducted open market operations (OMOs), complemented by cash and liquidity ratios, standing facilities and repurchase transactions in moderating liquidity in the system. The domestic money market instruments were supplemented by foreign exchange market interventions at both the wholesale Dutch Auction System (wDAS) and the interbank segments. The banking sector crisis resolution, involving the transfer of non-performing loans from the balance sheets of DMBs to the AMCON, resulted in improvement in the liquidity position of banks. That position was further exacerbated by the fiscal operations of the Federal Government in the review period.

The monetary policy measures implemented in 2011 moderated the growth of banking system liquidity and interest rate volatility. Consequently, reserve money and monetary aggregates surpassed the targets for the year. Reserve money, which stood at ₦2,784.3 billion at end-December 2011, was ₦269.0 billion or 10.7 per cent above the indicative benchmark of ₦2,515.3 billion for the year. This was in contrast to the reserve money of ₦1,845.7 billion at end-December 2010, which was ₦386.7 billion (17.32 per cent) below the indicative benchmark of ₦2,232.4 billion for that year. The development was due to fiscal expansion and liquidity injection through purchases of AMCON bonds as well as the upward review of the CRR from 1 per cent to 0.8 per cent during the year.

2.1.3 Interest Rate Policy and Developments

Developments in interest rates reflected the credit and liquidity conditions in the banking system.

Developments in interest rates reflected the credit and liquidity conditions in the banking system during 2011. The MPR was raised six (6) times, from 6.25 per cent in January to 12.0 per cent in October 2011; Cash Reserve Requirement (CRR) was raised three (3) times from 1.0 per cent in January 2011 to 8.0 per cent in October; while the Liquidity Ratio (LR) was raised once from 25.0 to 30.0 per cent in January 2011. The MPC decisions signalled to the market the clear and unambiguous commitment to the attainment of the Bank's key mandate of monetary and price stability. The upward review of the MPR during the year was aimed at containing the adverse effects of excess liquidity that arose from government fiscal operations and the purchase of AMCON Bonds.

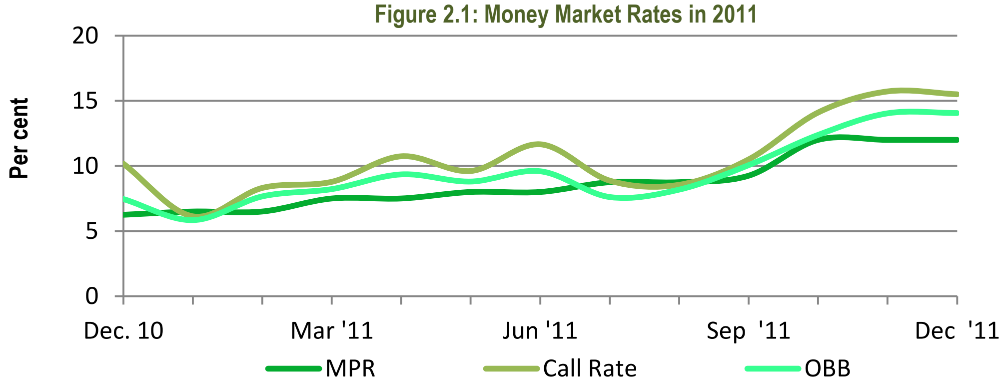
2.1.3.1 Money Market Rates

The annual average of money market rates was generally higher than their levels in 2010. The development was attributable to the suspension of the Reserve Averaging Scheme and the tight monetary policy, involving the upward review of MPR and CRR, from 6.25 and 1.00 to 12.00 and 8.00 per cent, respectively. Interbank rates remained stable in the first quarter of 2011, but fluctuated thereafter. The weighted average collaterised open-buy-back (OBB) rate increased from 7.5 per cent at end-December 2010 to 9.6 per cent at end-June 2011, and further to 14.1 per cent at end-December 2011. The annual weighted average interbank call rate and open-buy-back (OBB) rate rose to 10.71 and 9.65 per cent, from their respective levels of 4.32 and 2.86 per cent in 2010. The Nigerian Interbank Offer Rate (NIBOR) for 7-day and 30-day tenors averaged 11.70 and 12.80 per cent, respectively, in 2011, from 6.00 and 8.55 per cent in 2010.

Table 2.3: Money Market Rates (per cent)					
WEIGHTED AVERAGE					
Month	MPR	Call Rate	OBB	NIBOR 7-days	NIBOR 30-days
Dec-10	6.25	10.17	7.46	10.74	12.27
Jan-11	6.50	6.13	5.84	7.83	10.15
Feb-11	6.50	8.31	7.66	9.50	11.19
Mar-11	7.50	8.78	8.22	10.26	11.47
Apr-11	7.50	10.74	9.35	11.54	12.51
May-11	8.00	9.61	8.80	10.41	11.67
Jun-11	8.00	11.66	9.59	12.39	13.15
Jul-11	8.75	8.87	7.61	9.91	11.45
Aug-11	8.75	8.55	8.18	9.47	10.79
Sep-11	9.25	10.50	10.06	11.07	11.74
Oct-11	12.00	14.10	12.38	15.21	15.74
Nov-11	12.00	15.72	14.04	16.47	17.00
Dec-11	12.00	15.50	14.06	16.30	16.74
Average 2011	**8.90**	**10.71**	**9.65**	**11.70**	**12.80**
Average 2010	**6.08**	**4.32**	**2.86**	**6.00**	**8.55**

Source: CBN

Figure 2.1: Money Market Rates in 2011



2.1.3.2 Deposit Rates

Available data showed that, in general, DMBs' deposit rates fell in 2011. The annual average savings deposit rate fell slightly by 0.7 percentage point to 1.4 per cent. Similarly, the average deposit rates on various maturities declined to a range of 2.4 – 6.1 per cent in 2011, from a range of 2.5 – 6.9 per cent at end-December 2010.

2.1.3.3 Lending Rates

The annual weighted average prime and maximum lending rates decreased by 1.6 and 0.1 percentage points to 16.03 and 22.44 per cent, respectively, in 2011.

Figure 2.2 Savings and Lending Rates (Prime and Maximum)

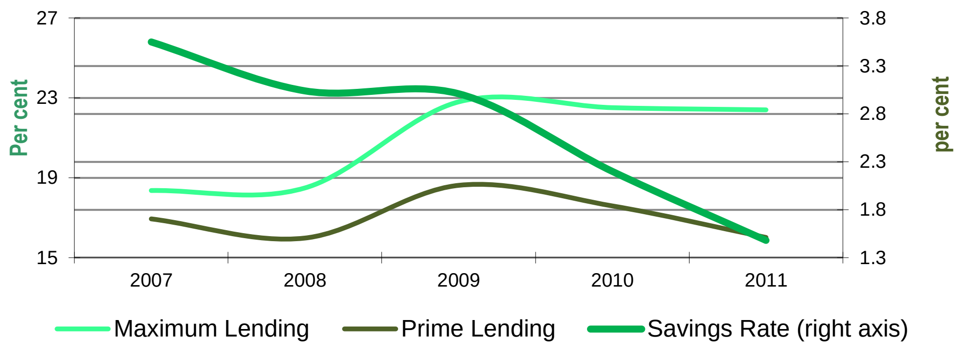
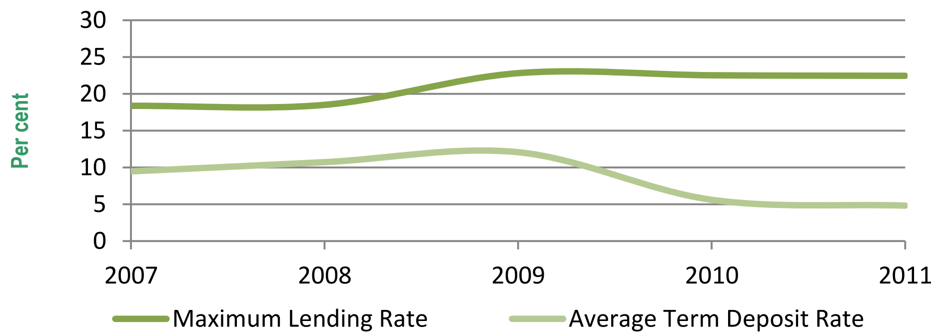


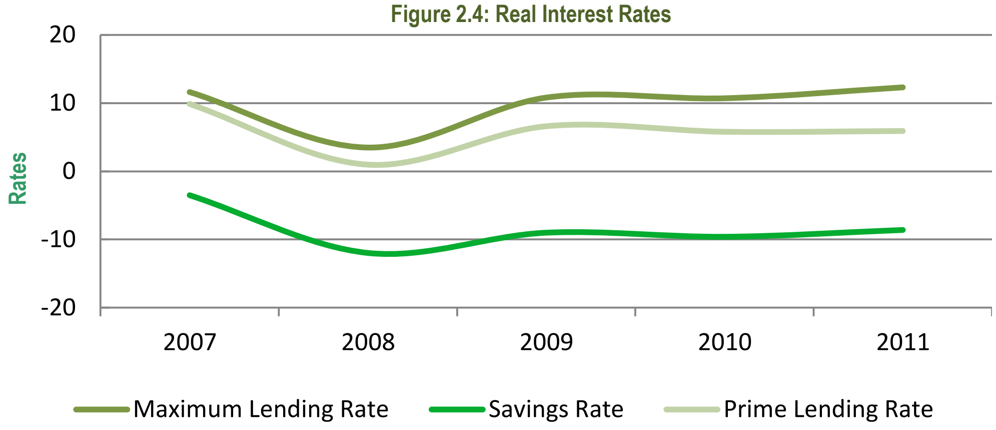
Figure 2.3: Spread between the Average Deposit and Maximum Lending Rates



The spread between the average term deposit and maximum lending rates widened to 17.6 percentage points, from 16.9 percentage points in 2010.

Consequently, the spread between the average term deposit and maximum lending rates widened to 17.65, from 16.91 percentage points in 2010. With the year-on-year inflation rate at 10.3 per cent in December 2011, all the deposit rates were negative in real terms, while lending rates were positive in real terms.

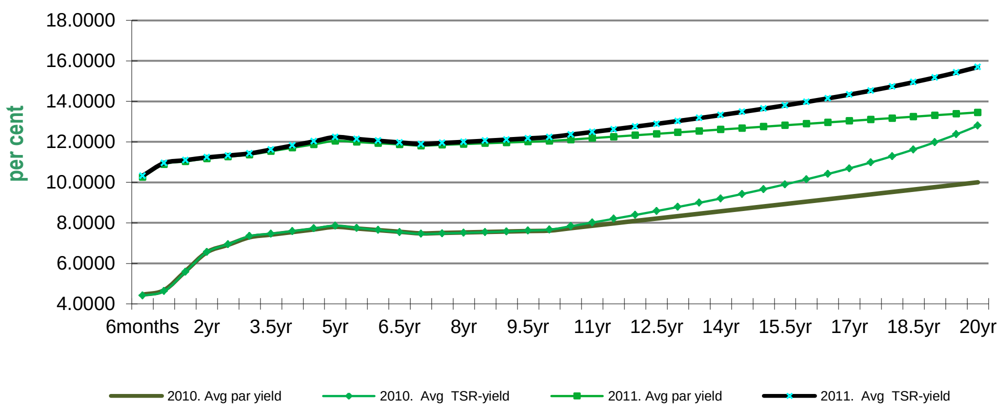
Figure 2.4: Real Interest Rates



2.1.3.4 Return on Fixed Income Securities - The Yield Curve

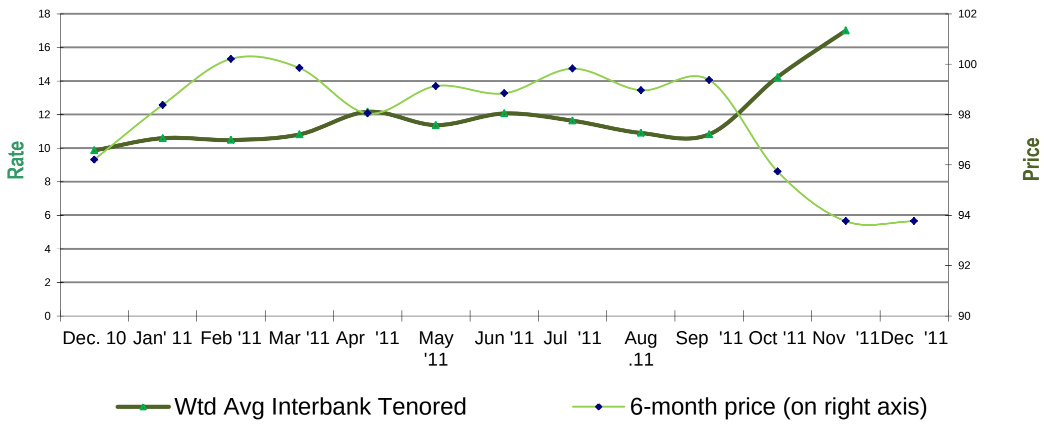
Analysis of the return on fixed income securities in 2011 showed that average yields were generally higher in 2011 than 2010. The yield curve, as in the preceding year, remained typically upward-sloping, reflecting investors' optimism about the future growth prospects of the economy. Towards the end of the year, bond yields on short-term maturities increased progressively, reflecting the impact of the upward review of the Banks' policy rate. The yield spread (the difference between the yield on the longest and shortest maturities) stood at 3.2 percentage points, compared with 5.5 percentage points recorded in the preceding year.

Figure 2.5 Government Bonds and Average Yield



A plot of the bond price of the 6-month maturity and weighted average inter-bank tenored rate showed that the bond price and interest rates typically moved in opposite directions.

Figure 2.6 Interest Rate & Price of 6-Month Maturity



2.1.4 Payments, Clearing and Settlement Developments

The CBN, in collaboration with other stakeholders, continued to take measures aimed at improving the efficiency of the payments system, including the following measures:

- Granted 14 mobile payment licences to enhance financial inclusion;
- Conducted nationwide sensitization workshops for MDAs on the adoption of end-to-end electronic payment (for government suppliers, salaries, pensions and taxes);
- Approved guidelines on the underlisted initiatives, with a view to increasing public confidence in the system:
    - Electronic payment of taxes,
    - Electronic payment of salaries and pensions by organisations with more than 50 employees, and
    - Electronic payment of government suppliers;
- Acquired a new Real -Time Gross Settlement (RTGS)system to meet the requirement of FSS20-2020;
- Followed-up on the *Payments Management Bill* earlier presented to the National Assembly, through the Federal Ministry of Justice;
- Issued a new Point-of-Sale(POS) guidelines, which define the industry structure for POS services as well as the roles and responsibilities of various stakeholders, including the introduction of a Payment Terminal Services

Aggregator (PTSA) and the introduction of a standardised T+1 settlement, amongst other things;

- Licensed six (6) Payment Terminal Service Providers (PTSPs);
- Facilitated the negotiation with POS terminal manufacturers in order to obtain discounted prices and increased local service/support;
- Sensitized the public as a means of creating awareness on the cash-less policy;
- Launched the Nigerian Electronic Fraud Forum (NeFF) to proactively manage e-fraud attempts and losses;
- Facilitated the transformation of Nigeria Interbank Settlement System (NIBSS) Plc to effectively play the role of PTSA;
- Developed a detailed Monitoring Framework to track and assess the impact of cash-less Lagos on a monthly basis, in terms of usage of electronic channels and cash circulation and cash holding rates. These would enable the CBN monitor the progress of the scheme and engender public confidence; and
- Facilitated the mass deployment of shared POS terminals by banks and service providers, under the shared services project, with a view to reducing operational cost.

The Bank also initiated a cash-less policy in 2011 as part of its efforts to further improve efficiency of the payments system, among others.

Box 2: The CBN's Cash-less Policy

The Central Bank of Nigeria (CBN) introduced a new policy that aims at reducing the amount of physical cash (coins and notes) in circulation, and encouraging more electronic-based transactions.

Objectives of the Policy were to:

- Drive the development and modernization of the country's payments system, in line with Nigeria's Vision 2020 goal of being amongst the top 20 economies by the year 2020;
- Reduce the cost of banking services (including cost of credit) and drive financial inclusion by providing more efficient transaction options and greater reach;
- Improve the effectiveness of monetary policy in managing inflation and driving economic growth;
- Curb some of the adverse consequences associated with the huge usage of physical cash in the economy, including:

a) the high cost of cash along the value chain - from the CBN & the banks to corporations, traders and individuals,

b) the high risk of using cash: such as robberies and other cash-related crimes, and
c) inefficiency and corruption, including leakages and money laundering, amongst other financial crimes.

Content of the Policy

The policy shall commence with a pilot run from January 1, 2012 in Lagos State ("tagged Cash-less Lagos") with application of the following aspects:

- Only cash-in-transit (CIT) licensed companies shall be allowed to provide cash pick-up services. Banks will cease cash in transit lodgement services rendered to merchant-customers in Lagos State from December 31, 2011. Any Bank that continues to offer cash in transit lodgement services to merchants shall be sanctioned.
- Third party cheques above ₦150, 000 shall not be eligible for encashment over the counter. Value for such cheques shall be received through the clearing house.

The service charges/fees will not apply until March 30, 2012, in order to give consumers time to migrate to electronic channels. DMBs would therefore continue to encourage their customers to migrate to available e-payments channels.

Account Application

The cash-less policy applies to all accounts, including collection accounts. Banks are expected to work with their corporate customers to arrange for suitable e-collection options.

Limits

The limits are cumulative withdrawal/deposits of ₦150,000 and ₦1,000,000 daily for individual and corporate customers, respectively.

The limits apply to the account irrespective of the payment channel used. It also applies to cash brought through CIT companies, as the CIT company only serves as a means of transportation.

Charges

The service charge for daily cumulative deposits above the limit into an account shall be borne by the account holder. However, during the pilot-run in Lagos, individuals paying money from Lagos, into an account outside Lagos, shall bear the charges for any single transaction above the daily limit.

Interstate Transactions

Charges/fees shall apply for all transactions in Lagos, and on Lagos State-based accounts.

Transactions above the cumulative daily limit initiated out of Lagos State, and affecting a Lagos based account shall not attract charges/fees, while transactions initiated from Lagos State, and affecting an account outside Lagos, shall attract charges/fees.

The policy will eventually be rolled out to other regions across the country from June 1, 2012. The policy however, does not prohibit withdrawals or deposits above the stipulated amounts, but such transactions are subject to a handling charge.

Current Awareness/Engagement Status

The CBN had engaged in various enlightenment and sensitization programmes with various stakeholders. The DMBs are expected to encourage their customers to migrate to available e-payment channels

Expected Benefits of the Policy

A variety of benefits are expected to be derived by various stakeholders from an increased utilization of e-payment. Such as:

- Increased convenience; more service options; reduced risk of cash-related crimes; cheaper access to cost of banking services for consumers;
- Faster access to funds; reduced revenue leakage; minimised cash handling costs for corporations; and
- Increased tax collections; greater financial inclusion; enhanced accountability for Government.

2.2 CURRENCY OPERATIONS

2.2.1 The Issue of Legal Tender

In order to meet the currency needs of the economy in 2011, the Bank projected an indent of 3549.52 million pieces of banknotes of various denominations. A total of 2, 649.52 million pieces or 74.6 per cent was ordered to be printed by the Nigeria Security and Minting (NSPM) Plc. Out of this order, the company delivered 2226.02 million pieces or 84.0 per cent by end December, 2011. The balance of 900 million pieces of ₦500 and ₦1000 were delivered during the year by foreign printers. The Bank's clean notes policy was sustained in 2011 through the processing of banknotes into clean and unfit notes, the withdrawal of unfit/soiled banknotes, and the re- issuance of the clean and fit banknotes into circulation. A total of 113,982 boxes valued at 793,526 billion were processed and 122,642 boxes valued at 828,398 billion audited. The total boxes audited included a closing balance of 8660 boxes in 2010 brought forward in 2011. Furthermore, a total of 6522.60 million pieces of mint notes were issued in 2011, compared to 6,677.9 million pieces issued in the corresponding period of 2010. The implementation of the approved outsourcing of maintenance of currency processing machines, in order to improve efficiency, continued under the year under review.

2.2.2 Currency in Circulation (CIC)

The currency in circulation at end-December 2011 stood at ₦1,565.76 billion, representing an increase of 13.6 per cent over the level in 2010.The growth in CIC reflected the high dominance of cash in the economy as well as an increase in economic activities. The ratio of CIC to nominal GDP, which measures the moniness of the economy, dropped from 4.7 per cent in 2010 to 4.3 per cent in 2011. The decline in the CIC/GDP ratio reflected increased use of e-payment products such as electronic payment cards.

Figure 2.7a Currency in Circulation, 2007 - 2011

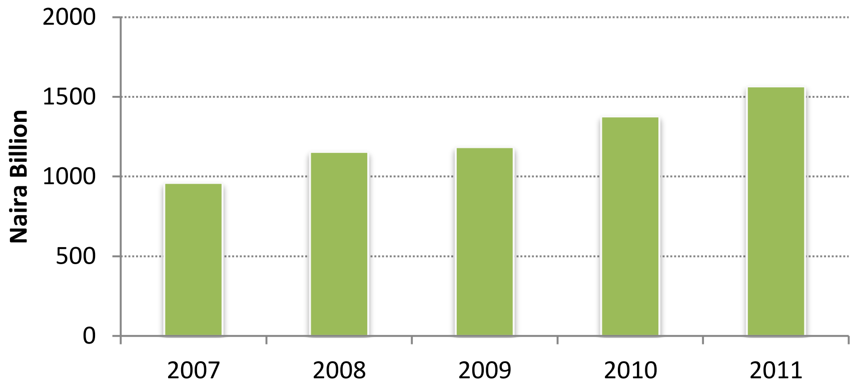
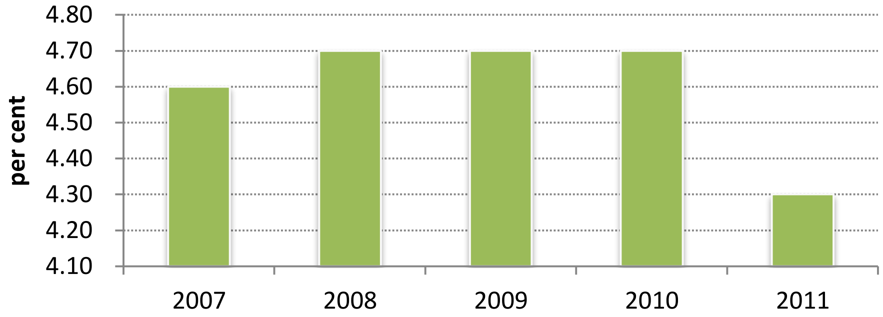


Figure 2.7b Ratio of Currency in Circulation to GDP



The denominational breakdown of the currency in circulation in 2011 is as shown below:

	2007		2008		2009		2010		2011	
Coins	Volume (million)	Value (₦ billion)	Volume (million)	Value (₦ billion)	Volume (million)	Value (₦ billion)	Volume (million)	Value (₦ billion)	Volume (million)	Value (₦ billion)
₦2	81.9	0.16	104.5	0.21	114.5	228.9	107.83	0.22	107.87	0.22
₦ 1	615.4	0.62	532.2	0.53	490.6	490.65	530.11	0.53	581.23	0.58
50k	738.3	0.37	463.1	0.23	454.5	227.26	434.48	0.22	529.72	0.26
25k	19	0.01	240.6	0.06	212	53	196.53	0.049	339.12	0.08
10k	2.2	0.0002	235.1	0.02	228.3	228.82	212.82	0.021	302.89	0.03
1k	0	0	51.2	0.0005	57.4	0.57	48.74	0.0048	12.75	0.08
Sub Total	**1,456.80**	**1.15**	**1,629.70**	**1.06**	**1,557.30**	**1,023.20**	**1,530.51**	**1.04**	**1,873.58**	**1.26**
Notes										
₦1000	264.4	264.4	572.9	572.91	584.4	584.39	663.76	663.7	959.45	959.45
₦500	707.2	353.6	801.9	400.93	852.8	426.4	1,027.78	513.89	726.22	363.10
₦200	1,256.00	251.3	571.6	114.32	491.9	98.38	501.27	100.25	621.75	124.31
₦100	494.9	49.5	323.6	32.36	350	35	341.12	34.11	507.90	50.77
₦50	351.3	17.6	228	11.4	344.9	17.25	782.27	39.11	777.94	38.89
₦20	823	16.5	827.3	16.55	769.5	15.39	752.65	15.1	788.67	15.77
₦10	355.9	3.6	283.2	2.83	285.5	2.85	680.61	6.81	789.13	7.89
₦5	579	2.9	533.1	2.67	720.5	3.6	837.93	4.19	865.38	4.33
Sub-Total	**4,831.70**	**959.4**	**4,141.60**	**1,153.97**	**4,399.50**	**1,183.27**	**5,587.39**	**1,377.16**	**6,036.43**	**1,564.50**
Total	**6,288.50**	**960.55**	**5,768.30**	**1,155.03**	**5,956.80**	**1,184.30**	**7,117.90**	**1,378.20**	**7,910.01**	**1,565.76**

Source: CBN

2.3 FOREIGN EXCHANGE MANAGEMENT

The Bank retained the Wholesale Dutch Auction System (wDAS) as the mechanism for the management of exchange rate in the foreign exchange market in 2011. As part of its efforts to develop a liquid, deep market, minimize risk in the Nigerian financial market and enhance the transmission of monetary policy, the Bank introduced the foreign exchange forwards market on March 23, 2011. Short-tenored forwards foreign exchange transactions were approved to provide hedging opportunities to end-users and smoothen foreign exchange demand pressure.

2.3.1 Foreign Exchange Flows

The total foreign exchange inflow into the economy amounted to US$105.11 billion, an increase of 19.3 per cent above the level in 2010. The development resulted from a significant growth in inflow through the CBN, which amounted to US$47.21 billion. This represented an increase of 69.5 per cent over the level of the previous year and accounted for 44.9 per cent of the total. The inflow through autonomous sources accounted for 55.1 per cent of the total and dropped by US$2.40 billion or 4.0 per cent to US$57.90 billion. This development was due to the fall in capital inflow and invisibles (mainly ordinary domiciliary account and over-the-counter purchases) by 48.4 and 4.3 per cent below their levels in 2010, respectively. The total foreign exchange outflow grew by 28.8 per cent from the level in 2010 to US$50.42 billion. A breakdown showed that the outflow through the CBN and autonomous sources rose by 28.6 and 33.0 per cent over the levels in the preceding year to US$48.77 billion and US$1.65 billion, respectively. Consequently, the net inflow position improved by US$5.70 billion over the position in 2010 to US$54.69 billion.

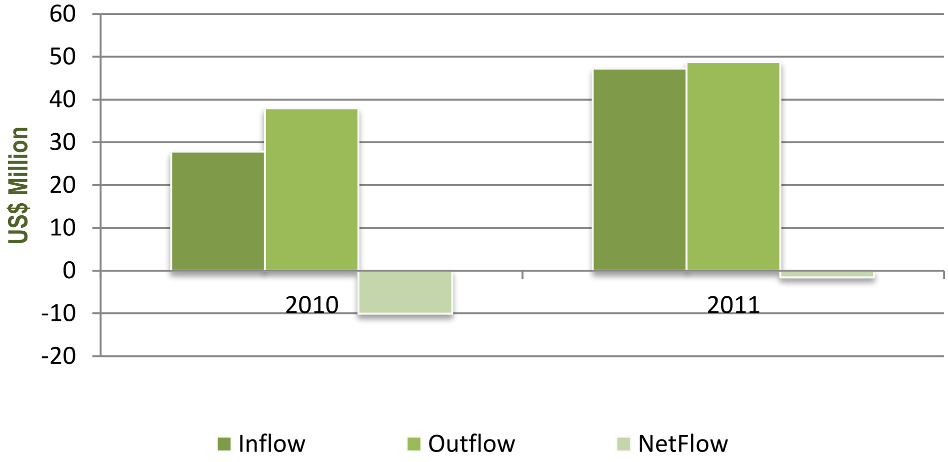
The total foreign exchange inflow into the economy amounted to US$105.11 billion, an increase of 19.3 per cent above the levels in 2010.

Analysis of foreign exchange inflow through the CBN showed that receipts from crude oil sales rose by 58.0 per cent above the level in 2010 to US$41.33 billion and accounted for 87.6 per cent of the total. The increase in receipts was as a result of the rise in crude oil output and prices in 2011. The non-oil component of inflow through the CBN grew significantly by 249.0 per cent above the level in 2010 to US$5.88 billion. This was driven by a 145.1 per cent growth in other official receipts to US$2.89 billion, wDAS purchases of US$2.0 billion and foreign exchange swaps totaling US$0.78 billion. Earnings on reserves and investments, however, fell by 56.5 per cent to US$0.22 billion as a result of the continued weak recovery of the financial markets in the developed economies.

Foreign exchange outflow through the Bank rose by 28.6 per cent to US$48.77 billion in 2011. A disaggregation of the outflow indicated that the amount that went to the foreign exchange market rose by US$11.02 billion to US$41.19 billion and accounted for 84.4 per cent of the total in 2011. Of this, total wDAS utilization was US$34.57 billion (US$29.78 billion in wDAS Sales, wDAS-forward US$2.79 billion and interbank sales of US$2.0 billion). Foreign exchange sales to BDCs amounted to US$5.91 billion, accounting for 12.1 per cent of the total and was 10.8 per cent higher than the level in 2010. Other outflows were drawings on letters of credit and National Priority Projects, which increased by 49.8 and 264.6 per cent to US$1.45 billion and US$0.07 billion, respectively. As a component of total outflow, other official payments (payments to international organizations and embassies, parastatals and estacode, NNPC/JV Cash calls, contributions and grants and miscellaneous) declined by 10.3 per cent to US$5.72 billion.

This resulted in an outflow of US$1.57 billion, compared with US$10.07 billion in 2010.

Figure 2.8: Foreign Exchange Flows through the CBN



2.3.2 Developments in the Foreign Exchange Market

Ninety-five (95) trading sessions were held in the wDAS segment of the foreign exchange market during the year, compared with ninety-six (96) in 2010. The aggregate demand for foreign exchange grew by 37.3 per cent above the level in the preceding year to US$48.2 billion. The surge in demand was attributed largely to the increased importation of petroleum products, settlements of matured letters of credit, and dividend payments. Further analysis showed that in the wDAS segment, spot and forward market demands amounted to US$42.3 billion (87.7 per cent of the total) and the BDC demand accounted for the balance. Total supply of foreign exchange rose by 37.7 per cent over the level in 2010 to US$41.6 billion. Of this, wDAS sales (wDAS and wDAS-FWD) amounted to US$33.0 billion and BDCs US$5.9 billion, an increase of 32.9 and 10.8 per cent, respectively, over the levels in 2010. The balance was accounted for by the intervention of the Bank in the interbank market through the sale of US$2.0 billion and swap contracts worth US$0.7 billion in the last quarter of 2011.

Figure 2.9: Foreign Exchange Disbursement, 2011 ($'Billion)

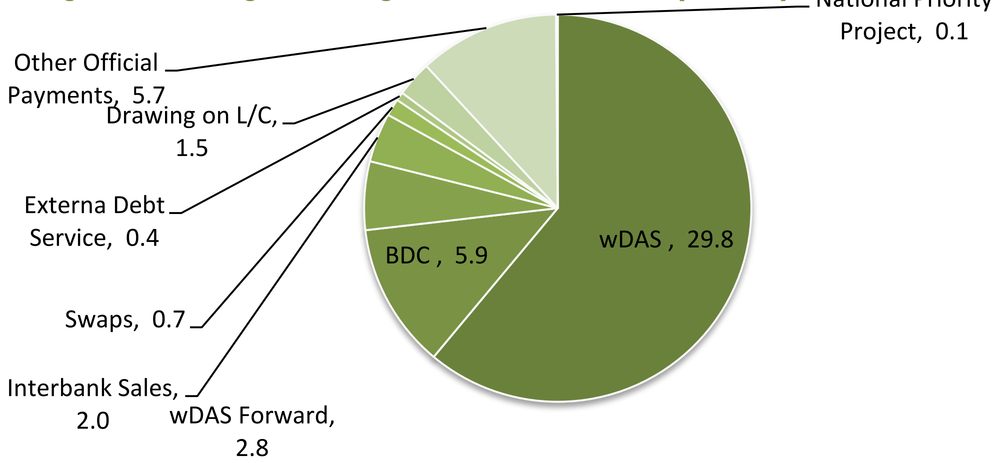


Figure 2.10: Developments in the Foreign Exchange Market

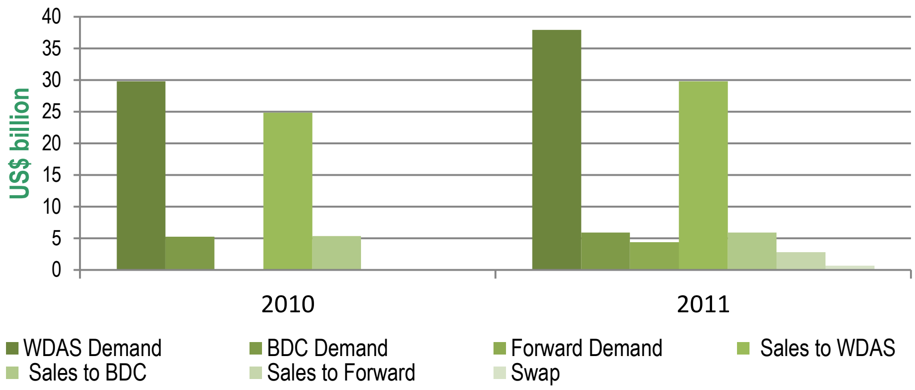
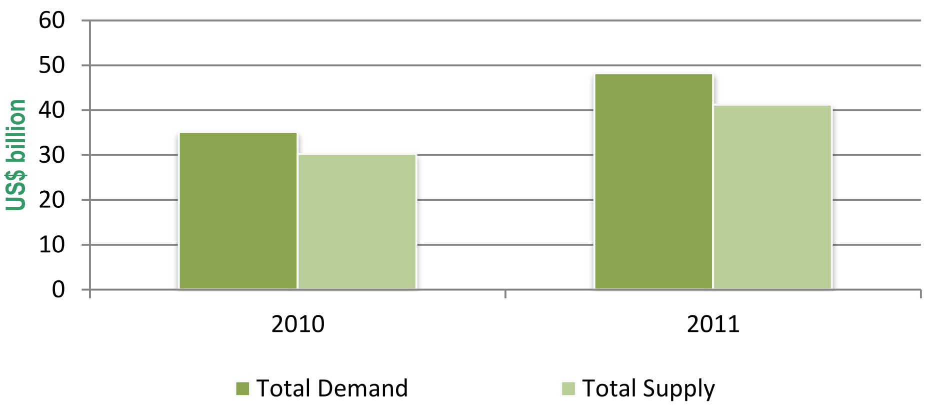


Figure 2.11: Demand for, and Supply of, Foreign Exchange



In the wDAS Forward contract segment, thirty-six (36) auctions for 1-, 2- and 3-month tenors were conducted. The total demand of US$4.4 billion comprised of 1-, 2- and 3- month tenors of US$1.9 billion, US$1.4 billion and US$1.05 billion, respectively. The Bank approved US$3.2 billion wDAS-Forward but redeemed a total of US$2.8 billion at maturity in 2011.

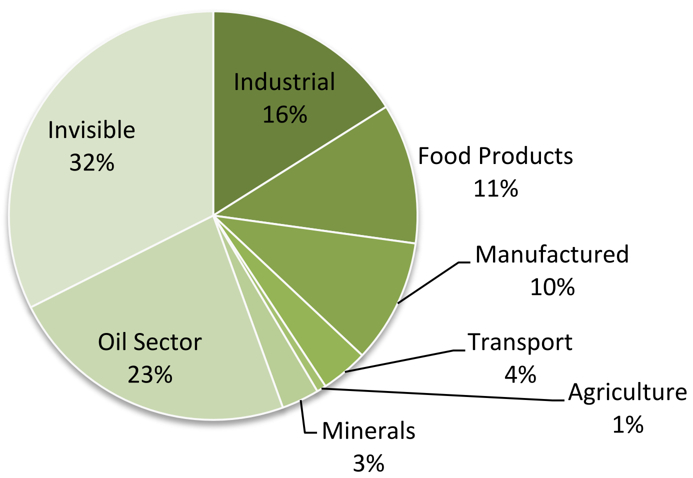
2.3.3 Sectoral Utilization of Foreign Exchange

The utilization of foreign exchange for import through the DMBs in 2011 grew by 38.9 per cent above the level in 2010 to US$47.2 billion. Of the total, US$31.9 billion (67.6 per cent) was utilized on visible trade transactions, compared with US$24.3 billion in 2010. Invisible trade transactions accounted for US$15.3 billion (32.4 per cent), compared with US$9.7 billion in 2010.

Analysis of visible trade transactions showed that mineral and oil sector imports rose by US$1.2 billion and US$4.8 billion to US$1.4 billion and US$10.9 billion, respectively, in 2011. Similarly, imports under the industrial and food products categories grew by 20.4 and 17.2 per cent to US$7.6 billion and US$5.3 billion, respectively. Furthermore, imports of transport and agriculture related goods increased by 17.6 and 9.8 per cent to US$1.8 billion and US$0.4 billion, respectively, in 2011. However, the share of manufactured products fell by 14.4 per cent from the level in 2010 to US$4.6 billion.

A disaggregation of invisible trade showed that the financial services sector constituted the bulk of invisible transactions, with a total foreign exchange outflow of US$6.8 billion, an increase of 1.4 per cent over the level in 2010. Environmental services grew substantially from US$0.1 million in 2010 to US$1.3 billion, reflecting the efforts by government to improve the environment. Transport services and education grew by 4.8 and 1.5 per cent, respectively, over the levels in 2010. The outflow by business, communication, construction, distribution and health services fell by 11.1, 28.8, 32.0, 19.3 and 78.3 per cent, respectively, below the levels in the corresponding period of 2010.

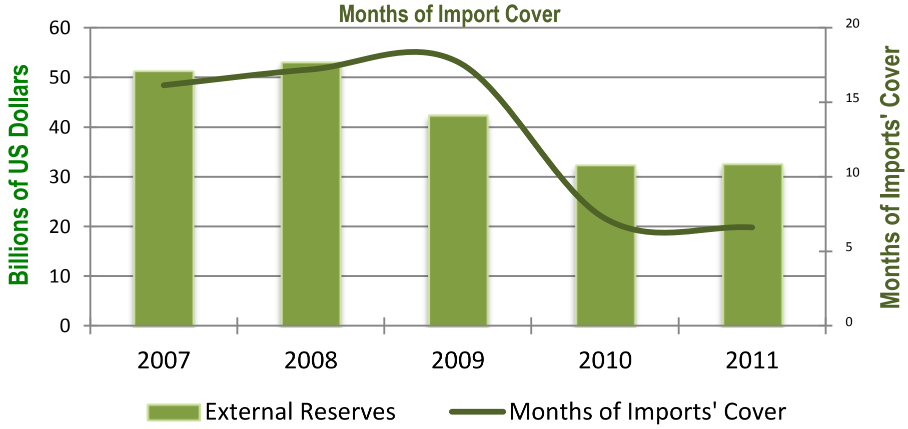
Figure 2.12: Sectoral Utilization of Foreign Exchange in 2011



2.3.4 External Reserves Management

Nigeria's gross external reserves at end-December 2011 stood at US$32.6 billion, an increase of 0.9 per cent when compared with the level at end-December 2010. The external reserves could support 6.5 months of goods and services import cover, compared with 7.9 months in 2010.

Figure 2.13: Nigeria's Gross External Reserves Position (US$billion) and Months of Import Cover

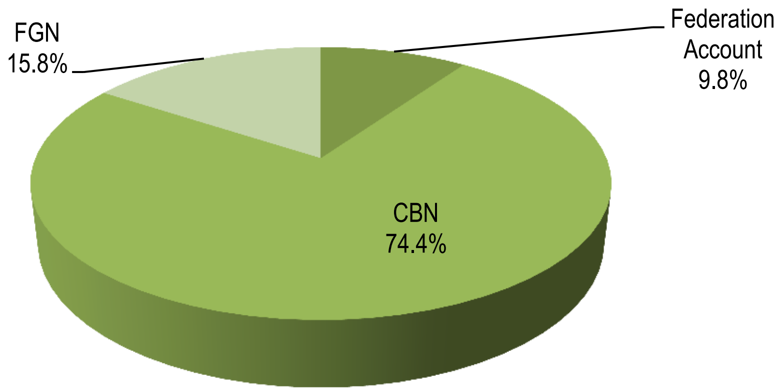


A breakdown of the external reserves by components showed that the Federation Account, the Federal Government and CBN reserves stood at US$3.2 billion, US$5.2 billion and US$24.3 billion, respectively, accounting for 9.8, 15.8 and 74.4 per cent, respectively.

The total earnings from investment of the external reserves amounted to ₦36.3 billion, 47.4 per cent lower than the level in 2010. The development was due largely to the weak economic performance and low interest rates in developed economies in 2011. As part of efforts to diversify foreign reserves and minimize risks in reserves management, the Bank's Investment Committee approved the inclusion of the Chinese yuan as part of the foreign reserves currency portfolio.

The Bank continued with the External Asset Manager Programme in 2011. The market value of the assets under the programme stood at US$9.655 billion as at December 31, 2011 and was managed by the World Bank, under the Reserve Advisory Management Programme (RAMP) and eleven other asset managers. Analysis of the performance of the programme, from its inception to December 31, 2011, showed that nine of the managers (including the World Bank) outperformed the benchmark, while three managers underperformed, albeit within the approved risk budget. The performance of the eleven asset managers is measured against the Bank of America Merrill Lynch G7 Government Index 1-3 year 100 per cent hedged to the US Dollar, while that of the World Bank is measured against the Bank of America Merrill Lynch 1-3 year US Treasury Index.

Figure 2.14: Holdings of External Reserves as at End-December 2011



Box 3: The Forwards Foreign Exchange Market

The foreign exchange forwards market provides the institutional arrangement through which foreign currencies are purchased for delivery at a predetermined exchange rate (delivery price) at a future date (settlement date). The forward rate is the future value of one currency against another.

The value is determined for a period that exceeds the spot rate in advance of 2 days (two days after the deal date). The forward rate is priced, based on the spot rate, interest differentials, interest risk differentials and a flexible built-in commission for the contract provider. The two reference currencies are referred to as currency pair. Where the forward rate is higher than the spot rate, it is referred to as forward premium; if it is less, it is referred to as forward discount. The fixed currency in the currency pair is referred to as the base currency and the variable currency is called the terms currency.

For the contracting parties, forward rate contracts provide opportunities for hedging exchange rate risk as the future exchange rate is locked in the contract and it is not affected by changes in interest rate. Its limitations, however, include the risk of an uncompetitive exchange rate in the future, absence of a secondary market, fixed contract inflexibility and the additional cost to obtain a delivery before the settlement date.

A Forward exchange rate contract could be fixed, partially optional, or fully optional. In a fixed contract, foreign currency can only be delivered at the agreed future date. Partially optional contract has two periods, the first locks in the contract until the agreed beginning date of the second period termed optional period, which stretches to settlement date during which delivery of foreign currency can occur anytime. The third variant is the fully optional contract, which gives the option of delivery of foreign currency at any time within the contract. The delivery of exchange rate before the maturity date under the fixed contract period is referred to as early delivery and attracts an additional administrative cost.

Trading under the foreign exchange forwards market in Nigeria is conducted in a multiple price Dutch Auction System referred to as the Wholesale Dutch Auction System–Forward (wDAS-FWD) in US Dollar/Nigerian Naira (currency pair) with a minimum allowable bid of US$500,000.00 by an authorized dealer. Maturity dates are set at the spot date (T+2) plus 1-, 2- and 3- month tenors. All foreign exchange bought through the forward market are not transferable in the interbank market as authorized dealers are expected to bid on behalf of their customers.

2 .4 SURVEILLANCE REPORT ON THE ACTIVITIES OF FINANCIAL INSTITUTIONS

2.4.1 Banking Supervision

The Bank intensified its banking reform programme aimed at fostering the stability of the financial system. In that regard, the Bank's surveillance activities continued to focus on the implementation of the revised prudential guidelines, the revised banking model and crisis mitigation measures through the AMCON. Other complementary measures included regular appraisal and review of banks' periodic returns, spot checks, monitoring, special investigations, risk-based and consolidated supervision. To further improve the effectiveness of supervision, the Bank issued three key supervisory guidelines, namely the Supervisory Intervention Framework, the Framework for Cross-Border Supervision, and the Risk-based Pricing Model for the industry.

To further improve the effectiveness of supervision, the Bank issued three key supervisory guidelines, namely, the supervisory intervention framework; the framework for cross-border supervision; and the risk-based pricing model for the industry.

The CBN Credit Risk Management System (CRMS) infrastructure recorded significant improvement in the management of basic credit information on customers. The database at end-December 2011 had 77,246 registered borrowers, indicating an increase of 3.3 per cent. Of this, 25,828 borrowers had 32,614 facilities with a total outstanding balance of ₦4.65 trillion. This represented a decline of ₦0.58 trillion or 11.1 per cent, compared with ₦5.23 trillion for 28,093 borrowers at end-December 2010. The development was attributed, largely, to the increased awareness among banks and customers of the critical role of the infrastructure, reinforced by the co-operation among stakeholders in the industry.

Table 2.5: Borrowers from the Banking Sector

Description	2010	2011	Absolute Change	% Change
Total No. of Borrowers	74,786	77,246	2,460	3.3
No. of Borrowers with outstanding credits	28,093	25,828	-2,265	-8.1
No. of Credits/facilities	26,367	32,614	5,958	23.7
Total outstanding balance (₦'000 bn)	**5,227**	**4,649**	**-578**	**11.1**

Derived from the Bank's CRMS

The Bank's CRMS was complemented by the activities of the three (3) licensed private credit bureaux (PCBs) in the industry. The range of products and services provided by the PCBs during the period under review were: customer identity verification, credit reports, self-enquiry, bulk portfolio review, credit rating and scoring, and referencing and credit risk assessment, among others. The growing demand for borrower/customer credit information and status enquiries by financial and non-financial entities buoyed the activities of these institutions.

Following the adoption of the new banking model, six (6) of the twenty (20) DMBs applied for commercial banking licence with international authorization, five (5) for commercial licence with national authorization, one (1) for commercial banking licence with regional authorization, four (4) for mixed holding company (HoldCo)comprised of three (3) with international authorization and one (1) with national authorization. Of these, approvals-in-principle (AIPs) were granted to twelve (12) banks that applied for monoline commercial banking licence, while final approval was granted to four that applied for HoldCo in order to restructure their operations in line with their approved compliance plans.

In order to promote financial inclusion, the CBN on June 21, 2011 issued guidelines on the Framework for the Regulation and Supervision of Institutions offering non-interest financial services in Nigeria.

In order to promote financial inclusion, the CBN, on June 21, 2011, issued guidelines on the Framework for the Regulation and Supervision of Institutions offering non-interest financial services in Nigeria. The issuance of the guidelines formally opened the window for the licensing and operation of non-interest banking, based on the principles of Islamic commercial jurisprudence, among others. At end-December 2011, Jaiz Bank Plc was licensed as a full-fledged non-interest bank with regional authorisation, while Stanbic IBTC Bank Plc was granted approval to offer non-interest (Islamic) banking products.

In addition, the CBN participated in all meetings organized by the Islamic Financial Services Board (IFSB), including its Council Meetings and those of its working groups on stress testing, liquidity risk management, capital adequacy and *Takaful* undertakings. The Bank also participated in the Board's capacity building initiatives, aimed at enhancing examiners' understanding of non-interest banking.

The CBN sustained its support for the re-capitalization drive of the eight banks in which it had intervened to contain systemic distress. In that regard, the Bank adopted mergers and acquisitions or outright sale to new investors, as part of the resolution options for the affected banks. The re-capitalization process was initially slowed down by litigations instituted by shareholders of some of the banks. Following the signing of Transaction Implementation Agreements (TIAs) between five of the intervened banks and their preferred bidder, AMCON injected funds into these banks that brought their shareholders' fund to a positive position, preparatory to their acquisition/merger with other entities. After reviewing the progress of the re-capitalization effort, three of the eight banks (Spring Bank Plc, Bank PHB Plc and Afribank Nigeria Plc) were viewed as lacking the capacity to recapitalize before the stipulated deadline of September 2011. Consequently, the CBN revoked the licences of the three banks, in accordance with the powers granted to it by the *BOFI Act 1991* (as amended), while the Nigeria Deposit Insurance Corporation (NDIC) incorporated new banks (bridge banks as provided for in Section 29 of the *NDIC Act 2006*), namely, Enterprise Bank Ltd, Keystone Bank Ltd and Mainstreet Bank Ltd. The bridge banks assumed the deposit liabilities and certain other liabilities and assets of Spring Bank Plc, Bank PHB Plc and Afribank Nigeria Plc, respectively, effective August 5, 2011. Sequel to an arrangement with the NDIC, the AMCON purchased the equity of the bridge banks on August 6, 2011. This resulted in the termination of their status as bridge banks and were subsequently re-capitalized by AMCON.

In December 2011, the shareholders of Access Bank, Ecobank, FCMB and Sterling Bank held court-ordered meetings to approve the issuance and allotment of their respective shares in consideration of the acquisition of the assets, liabilities and undertakings of Intercontinental Bank, Oceanic Bank, Finbank and Equitorial Trust Bank (ETB), respectively. By end-December 2011, the CBN and SEC had granted the necessary approval, while the courts had sanctioned the resolutions. A core investor, Union Global Partners Ltd injected funds into Union Bank, and on December 14, 2011, the bank opened a Rights Issue of 1.407 billion shares at ₦6.81035 per share (5 new shares for every 9 existing shares held), which was scheduled to close on February 10, 2012.

The Bank strengthened its collaborative effort with other stakeholders, under the aegis of the Roadmap Committee of Stakeholders on the adoption of International Financial Reporting Standards (IFRS) in Nigeria. The main objective was to ensure a phased transition to IFRS over a three-year period, beginning with the 2012 reporting date for all listed companies and major public entities. In that regard, the following milestones were attained during the year: engagement of consultants to guide the Bank on the implementation of both the Basel II and IFRS projects in the Nigerian banking system; sensitization of the industry on IFRS implementation; establishment of relevant committees and workgroups; gap/impact analysis of IFRS conversion in the banking system; and capacity building. The adoption of IFRS would facilitate the implementation of Basel II requirements by banks in Nigeria.

Following the creation of a Cross-Border Supervision Unit in the Bank in 2010, a framework for cross-border supervision was issued in 2011.The framework was intended to provide guidance on the supervision of Nigerian banks with offshore branches/subsidiaries and also on the level of cooperation expected from host countries in the supervision of cross-border entities. In that regard, the CBN, during the year under review, conducted the first joint examination with host regulators of fourteen (14) banks in five (5) WAMZ member countries, namely, Ghana, Liberia, Sierra Leone, Guinea and The Gambia. The CBN also hosted and participated in various meetings of the College of Supervisors in the West African Monetary Zone (CSWAMZ) in 2011. Other cross-border supervision activities were: the execution of additional Memoranda of Understanding (MoUs) with regulators in various jurisdictions; approvals and supervisory checks on banks with representative offices in Nigeria; as well as the supervision of the activities of the offshore operations of some Nigerian banks.

The Bank issued a number of circulars/guidelines to the DMBs, as part of its efforts to promote a safe and sound financial system.

Table 2.6: Circulars and Guidelines to DMBs in 2011

- Review of the prudential requirement of 1% provision on performing loans.
- Re: Monthly submission of credit portfolio classification by banks.
- Letter to all banks: Reporting of AMCON Bonds.
- Re: Reinstatement of capital verification for banks.
- Re: Circular to all banks on funds withdrawal by Federal, States and Local Governments and Parastatals.
- Supervisory Intervention Framework for the banking industry in Nigeria.
- Framework for Cross Border Supervision of banks.
- Guidance document to deposit money banks on the restatement of December 31, 2010 financial balances to IFRS-based figures as required by IFRS 1.
- Re: Data exchange agreements with at least two licensed credit bureaux in Nigeria.
- Request for information on capital exportation.
- Re: Management and custody of pension funds by some licensed banks.
- Corporate account opening requirements - Tax Identification Number.
- Dial-up connectivity options for external stakeholders.
- Request for information on terrorists and related accounts.
- The requirement for Credit Risk Management System (CRMS) checks for credit requests.
- Compliance with the provisions of the *Fiscal Responsibility Act 2007*.
- De-Marketing of Banks by Other Banks.
- Guarantee of Foreign Credit Lines.
- Re: Treatment of loans fully provided for by banks.
- Re: The need for banks to develop and implement a risk-based pricing model.

- All DMBs to expand their existing ATM help desks and discount houses and other financial institutions to establish help desks to handle all consumer complaints.
- Re: IT requirements for NUBAN Account Numbering Scheme.
- Time frame to access the CBN IT Application.
- Re: Circular on the need to combat card fraud.
- Inter-bank Funds Transfers and Settlement Arrangements on behalf of Payment Solution Providers.
- One year extension of transition period for NUBAN.
- Circular to all Mobile Operators.

Box 4: THE INTERNATIONAL FINANCIAL REPORTING STANDARD

The International Financial Reporting Standards (IFRS) was issued by the International Accounting Standard Board (IASB). It was issued to serve as the global accounting language for the purpose of meeting the information needs of global business investors, shareholders and financial services providers. Specifically, the IFRS is a globally-accepted set of accounting standards, framework and interpretations, adopted by the IASB and its interpretative body (The International Financial Reporting Interpretations Committee - IFRIC). For a truly global economy (where companies and accounts issuers interrelate around the globe) to be efficient, it is appropriate to have a common standard in business and financial reporting. IFRS thus, became the set of high quality, transparent and globally renowned accounting standards and framework that provide for international comparison. At the global level, such standards are regarded as a major component of a good financial system that reduces cost of capital, allowing for transparency and disclosure, as well as facilitating increase in capital formation. Its basic components include:

- International Accounting Standards – IASs;
- International Financial Reporting Standards (IFRSs);
- IASB Framework for preparation and presentation of financial statements; and
- Interpretations of International Financial Reporting.

The world-wide adoption of IFRS is expected to facilitate presentation of financial information in a manner that:

- Allows and helps evaluators and users to determine the financial status and liquidity position of a company;
- Breaks down the information about a company's activities and operations so as to show clearly its future cash flow; and
- Every organization's financial statement supports and backs one another, while giving a cohesive picture of all its activities;

The number of countries that have either moved, or are in the process of moving, to IFRS increased to 117 (involving more than 12,000 companies) at end-December 2011 from 100 at end-December 2009. At end-December 2011, 15 African countries, including Nigeria, had either adopted, converged to or made a commitment to implement IFRS.

In Nigeria, the bodies responsible for the regulation of accounting information are statutory agencies such as the Nigerian Accounting Standards Board (NASB), the Securities and Exchange Commission (SEC), Nigerian Stock Exchange (NSE) and the Central Bank of Nigeria (CBN). The NASB, established in September 1982, under the sponsorship of the Institute of Chartered Accountants of Nigeria (ICAN), is a government agency statutorily responsible for issuing Statements of Accounting Standards (SAS) in Nigeria on various accounting matters, after taking into account all peculiarities of the business environment, customs, laws and level of development. The NASB had earlier announced its decision to converge to IFRS in the last quarter of 2010, but the commencement date was later shifted to January 1, 2012 in order to ensure legal and capacity building in the project. The road map requires that the entire business community in the country would implement and converge in phases, while the phases are submerged within a general implementation framework. The general plan would ensure appropriate changes and restructuring are made to processes, systems and the people in terms of training and capacity building.

Based on this Roadmap, companies listed on the Nigerian Stock Exchange and "significant public interest entities" ("PIEs") would be required to comply with IFRS for periods ending after January1, 2012. Other PIEs would be required to comply for periods ending after January1, 2013 while small and medium sized entities would need to comply for periods ending after January1, 2014. Businesses would, therefore, be required to identify and understand the similarities and differences between the Nigeria General Accepted Accounting Practice (Nigeria GAAP), including changes that would occur within the transition period up to its full adoption and implementation. In Nigeria, the migration process to IFRS has been mixed, especially among the organizations in the first phase with commencement date of January 1, 2012. The banking and discount houses sub-sectors had the greatest momentum, while most other corporations waited on their external auditors to drive implementation and compliance. This requires that regulators would do well to institutionalize close monitoring and compliance processes.

In general, convergence to IFRS would promote uniformity in operations and auditing of companies. This is expected to have a significant impact on firms' financial performance and ultimately on their financial position. It is expected that implementation of the IFRS (Uniform Global Accounting Language) would, among other things, allow for easy access to efficient global capital; increase demand for, and enhance practice of public accountability and transparency; enhance understanding and ability to generate value from strategic activities and synergies; facilitate comparison between entities as well as enhance attraction and encouragement of foreign investors.

2.4.2 Prudential Examinations

Available data revealed that the banking industry's liquidity significantly improved in 2011. The industry's average liquidity ratio, which stood at 47.5 per cent at end-December 2010 rose by 21.6 percentage points to 69.1 per cent at end-December 2011. All the banks in the industry met the prescribed minimum liquidity ratio (LR) of 30.0 per cent at end-December 2011. The development was attributed, largely, to AMCON's intervention in the banks. Similarly, the banking industry's cash reserve ratio (CRR) was 8.0 per cent, compared with 1.0 per cent at end-December 2010. The average capital adequacy ratio (CAR) of the industry stood at 17.9 per cent at end-December 2011, representing an increase of 13.9 and 9.9 percentage points over its levels at end-December 2010 and the Basel II minimum requirement of 8.0 per cent, respectively. One (1) of the banks, however, failed to meet the CBN statutory minimum CAR of 10.0 per cent at end-December 2011, compared with eight (8) at end-December 2010.

Eight hundred microfinance banks (MFBs) were examined during the year. The exercise included the licence validation/capital verification undertaken on the

119 MFBs that were granted provisional licences in 2010, post-examination monitoring of the 50 MFBs adjudged sound in 2010, and routine examination of 631 other MFBs. The examinations revealed that 24 MFBs had either closed shop or ceased to operate in their registered offices, while two (2) were undergoing restructuring. Analysis of the examination reports of the remaining 774 MFBs indicated that 70.4 per cent of the institutions met the prescribed capital adequacy ratio of 10.0 per cent, with 52.0 per cent having capital funds in excess of the minimum regulatory capital. Also, 84.0 per cent of the institutions met the prescribed minimum liquidity ratio of 20.0 per cent, translating to an average liquidity ratio of 88.0 per cent for the sub-sector. This reflected the pervasive under-trading and placement of funds with DMBs. The average portfolio-at-risk (PAR) or non-performing loan to total, on the other hand, was 46.0 per cent, reflecting a high level of non-performing loans. A total of twenty-nine (29) MFBs, however, had PAR ratios below the prudential maximum of 2.5 per cent. Each MFB with a regulatory/ supervisory issue of concern was served an appropriate supervisory letter with prescribed timelines for compliance. Holding actions were imposed in 54 cases entailing the cessation of the grant of fresh loans and further acquisition of fixed assets.

2.4.3 Compliance with the Provisions of the Code of Corporate Governance for Banks in Nigeria

The CBN continued to monitor compliance with the Code of Corporate Governance, as part of its routine review to ensure safety and soundness in the governance structures of the DMBs in 2011. During the year, several banks experienced changes in the composition of their boards and management, and replacements were made in accordance with the requirements of extant guidelines. Accordingly, five banks made changes to their board membership, in compliance with the tenure limitation provisions of CBN's Code, and three banks changed their external auditors following the expiration of their tenures. To ensure continuity in operations, the Bank sustained its efforts to promote the development of, and adherence to, clearly defined succession plans in the

DMBs. In addition, compliance with CBN guidelines on the appointment of Chief Compliance Officers was closely monitored.

2.4.4 Financial Crime Surveillance/Money Laundering

The on-going efforts of the CBN to combat money laundering and financing of terrorism received a boost with the enactment of the *Money Laundering Prohibition Act* (MLPA), as amended during the review period. The *Act* criminalises the financing of terrorism and addresses the issues of freezing, seizure and confiscation of both laundered money and terrorist funds. Furthermore, the Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) Office established in the CBN undertook some key activities. These included: the preparation of a draft AML/CFT risk-based examination manual and an AML/CFT risk–based regulation for financial institutions; review of the Inter-governmental Action Group Against Money Laundering in West Africa (GIABA) Country Report on Nigeria for 2010; and the establishment of an enforcement unit for monitoring compliance.

The Bank also developed 'Standard Account Opening Forms' for banks, in conjunction with the Committee of Chief Compliance Officers of Banks in Nigeria (CCCOBIN). Furthermore, the CBN, collaborated with the US Department of State and the US Embassy in Nigeria in respect of individuals and entities sanctioned by the United Nations (UN), in the areas of training and provision of information on Al-Qaeda in the Arabian Peninsula (AQAP). The CBN worked in the joint Inter-Departmental and Nigerian Financial Intelligence Unit (NFIU) Committee to prepare an acceptable format to receive information on politically- exposed persons (PEPs) from financial institutions and to prepare an acceptable national data base for PEPs. It investigated and provided information in respect of a request from the Nigeria Police on individuals/entities being investigated for alleged laundering of US$2.5 million; and granted the Bank of Ghana's request to undertake a working visit to the CBN in March 2012, in line with the Financial Action Task Force (FATF) Recommendation 40 on international cooperation.

2.4.5 The Special/Target Examination

A Joint CBN/NDIC risk-based examination was conducted on sixteen (16) DMBs, excluding the bridge banks and some of the CBN-intervened banks. The exercise involved assessment of risk assets to determine the extent of compliance with the regulatory thresholds on non-performing loans and capital adequacy ratio, among others. The adequacy of the risk management processes of the banks was also appraised. The assessments were concluded by allotment of ratings, based on the significance of the business activity undertaken. The findings and the recommendations for improvement were communicated to the Boards and Managements of the affected banks for appropriate action.

In addition, the CBN undertook various spot checks and *ad-hoc* reviews on the DMBs' operations. These included: the extraction of top users of banks' funds; first quarter foreign exchange review; investigation of seven (7) major petroleum products marketers' utilization of foreign exchange for importation of refined products; extraction of total public sector deposits with the DMBs; and investigation of selected banks' liquidity positions.

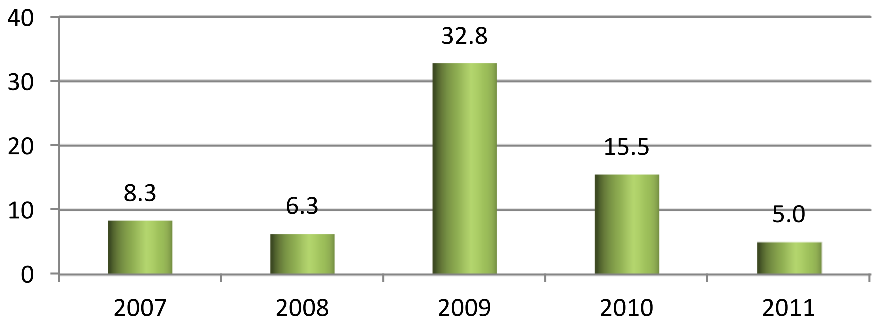
2.4.6 Foreign Exchange Monitoring/Examination

In order to enhance the supervision of the foreign exchange operations of the DMBs, a Foreign Exchange Monitoring Unit, was created by the Bank. Prior to the creation of the Unit, the review of the foreign exchange operations of banks was integrated into the Bank's routine risk-based examination. Consequently, the first quarter review of the foreign exchange operation (sources and utilization) of all the DMBs was carried out in the first half of 2011. The review focused on the various sources of foreign exchange, the quantum of BDCs sales, the impact of domiciliary accounts on the volume of foreign exchange available for the banks' use, and utilization of foreign exchange acquired. A special foreign exchange examination was conducted in the second half of 2011. The enhanced scrutiny of the foreign exchange market operations in 2011 resulted in an improvement in the enforcement of extant rules and regulations governing foreign exchange disbursement and highlighted the need to review some of the existing foreign exchange regulations.

2.4.7 Banking Sector Soundness

The health of banks significantly improved at end-December 2011 with the sale of the non-performing loans of the intervened banks to AMCON. The industry's average CAR was 17.9 per cent, compared with 4.0 per cent at end-December 2010. Further analysis showed that with the exception of one bank, other DMBs had a CAR above the 10.0 per cent minimum for the industry at end- December 2011, with the lowest at 10.0 per cent and the highest at 41.0 per cent. This was an improvement over the preceding year's level when the eight intervened banks had negative CAR. The industry's ratio of non-performing loans to total loans significantly declined to 5.0 per cent, from 15.5 per cent at end-December 2010. This was below the maximum threshold of 12.5 per cent set by the supervisory intervention framework. The development was attributed to the acquisition of non-performing loans in the industry by AMCON. All the banks in the industry met the prescribed minimum liquidity ratio (LR) of 30.0 per cent at end-December 2011. The banking industry's cash reserve ratio (CRR) was 8.0 per cent, compared with 1.0 per cent at end-December 2010. The developments indicated that the overall health of the industry had further improved.

Figure 2.15: Banks' Non-Performing Loans (% Total Credit)



2.4.8 Examination of Other Financial Institutions

On-site examination was conducted by the CBN/NDIC on nine hundred and thirty-six (936) other financial institutions (OFIs). This included the on-site examination of eight hundred (800) microfinance banks (MFBs), routine examination of eighty-five (85) primary mortgage banks (PMBs), and spot-checks on fifty-one (51) bureaux-de-change (BDCs).

A special validation/capital verification exercise was carried out on one hundred and nineteen (119) MFBs that were granted a provisional license sequel to the revocation of the licenses of two hundred and twenty-four (224) MFBs in September 2010. The exercise was undertaken to verify compliance with the conditions precedent to the granting of a final license. Routine examination was also conducted on six hundred and thirty-one (631) MFBs, in collaboration with NDIC, while special post-examination monitoring was carried out on fifty (50) others that were adjudged sound during the 2010 examination. Overall, the examination revealed that 70.4 per cent of the MFBs met the minimum regulatory capital, while 29.6 per cent had shareholders' funds unimpaired by losses below the minimum regulatory capital. The erosion of capital was due, largely, to the huge provisions made for bad loans, which stood at 46.0 per cent, and high overheads. Appropriate supervisory letters have been issued to the errant institutions. The examination further revealed that the average liquidity ratio of the sub-sector, at 88.0 per cent, was well above the prescribed minimum level of 20.0 per cent, due to under-trading and placement of available funds with DMBs. Furthermore, twenty-four (24) MFBs had either closed shop or ceased to operate in their registered offices, while two (2) were undergoing restructuring.

Similarly, a special/routine examination was conducted on eighty-five (85) PMBs, in collaboration with the NDIC. Nine (9) of them were found to be at various stages of restructuring and re-capitalization and were given three (3) months to conclude the process. The examination of the seventy-six (76) other PMBs was conducted principally to verify the claims made by the PMBs in response to the supervisory letters issued to them on the findings of the 2010 examination. It also aimed at establishing the status of the institutions with regard to the critical parameters on which their compliance with the recently issued guidelines for the sub-sector would be based. Also, on-site verification was conducted on the existence claims filed by twelve (12) PMBs, in response to the published notice on the planned revocation of the licences of sixteen (16) PMBs that were found to have ceased operations during the 2010 examination.

Post-examination monitoring was conducted on FCs during the review period as a critical follow-up action to the examination conducted in the last quarter of 2010. The issues of supervisory concern included pervasive low capital base, weak corporate governance, large volumes of delinquent facilities, and excessive exposure to capital market activities. The exercise led to an increase in the number of FCs classified as inactive, from 33 to 47, and the procurement of necessary approval to proceed with the revocation of their licences. In addition, the thirty-three (33) FCs that were either rated marginal, unsound or technically insolvent were issued supervisory letters, imposing various holding and corrective actions to be complied with within a 3-month timeframe, ending March 31, 2012. Similarly, three (3) others undergoing restructuring were given up to March 31, 2012 to conclude the restructuring exercise, failing which their licenses would be revoked.

A pilot target examination was carried out on fifty-four (54) out of the two thousand and fifty-one (2,051) BDCs with the aim of ascertaining their level of compliance with the operating guidelines, particularly in the area of utilization of foreign exchange purchased from the CBN window and autonomous sources. The exercise revealed that over 50.0 per cent of the foreign exchange purchased were from autonomous sources and were sold mainly to end-users for personal travel allowance; most BDCs did not have anti-money laundering policies and procedures in place and did not keep proper accounting records that could serve as the basis for rendering returns on their assets, liabilities, income and expenditure. Appropriate sanctions were handed down to thirty-seven (37) of the BDCs for infractions. In addition, the exercise set the stage for the commencement of regular comprehensive assessments of the operational status of BDCs with respect to their assets and liabilities, corporate governance and risk management structures.

2.5 DEVELOPMENTAL FUNCTIONS OF THE CBN

2.5.1 The Agricultural Credit Guarantee Scheme Fund (ACGSF)

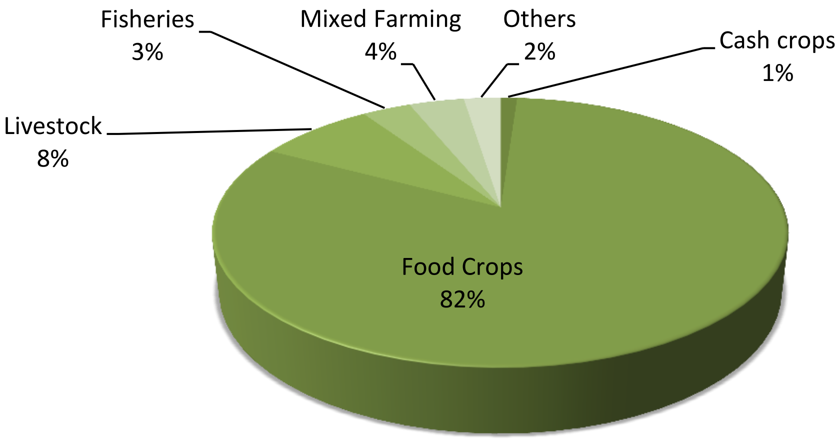
The CBN guaranteed 56,232 loans valued at ₦10.19 billion in 2011, which were, respectively 10.8 and 31.6 per cent higher than the number and value guaranteed in 2010.

A breakdown of the loans guaranteed by states showed that Katsina State had the highest volume with 8,420 loans (15.0 per cent), valued at ₦1.09 billion (10.7 per cent), followed by Kebbi State with 5,346 loans (9.5 per cent), valued at ₦0.43 billion (4.2 per cent). Jigawa State came third with 5,346 loans (9.5 per cent) valued at ₦0.29 billion (2.8 per cent). A sub-sectoral analysis of number of loans guaranteed indicated that food crops were dominant with 46,037 or 82.0 per cent, followed by livestock with 4,349 or 8.0 per cent. Mixed farming, fisheries, 'others', and cash crops accounted for 2,083 or 4.0 per cent, 1,842 or

3.0 per cent, 1,396 or 2.0 per cent and 621 or 1.0 per cent, respectively. Analysis of loans guaranteed by size in 2011 showed that beneficiaries with loan that amounted to ₦100, 000 or below were 32,857 or 58.3 per cent, while those above were 23,471 or 41.70 per cent. This indicated a preponderance of small holder farmers in the scheme.

Since the scheme's inception in 1978 to 2011, a cumulative of 754,528 loans valued at ₦52.34 billion had been guaranteed.

Figure 2.16: Distribution of Number of Loans Guaranteed by Purpose under ACGS in 2011



The volume of recovered loans in 2011 was 50,366, valued at ₦7.2 billion, thus bringing the cumulative volume and value of fully repaid loans since the inception of the Scheme to 543,211 and ₦31.2 billion, respectively. Analysis of repaid loans by state showed that Katsina State had the highest volume with 7,933 valuedat ₦855.0 million, followed by Kebbi and Jigawa States in second and third places, respectively. A total of 2,162 claims, valued at ₦123.7million were settled in 2011, bringing the cumulative number and value settled since the scheme's inception to 11,354 and ₦354.2 million, respectively.

Table 2.7: Distribution of Loans under the ACGSF by Volume and Value in 2011		
Category	**Volume**	**Value in ₦' billion**
₦100,001 and above	23,471	8.19
₦100,000 and below	32,857	2
Total	**56,328**	**10.19**

Source: CBN

2.5.2 The Trust Fund Model (TFM)

There was no new placement of fund under the TFM in 2011. The total number of MoUs signed and the sum pledged under the model remained at fifty-six (56) and ₦5.52 billion, respectively, as in 2010.

Table 2.8: Funds Placement under the Trust Fund Model (TFM) at end–December, 2011			
Type of Stakeholder	**Amount (N'Billion)**	**Number**	**Remarks**
Multinationals/Oil Companies	0,444	4	₦5 million less due to suspension of MISCAD
SGs/LGAs	2.438	35	
Federal Govt. Agencies	2.000	4	
Individuals/Organizations	0.634	13	
TOTAL	**5.516**	**56**	**₦5 million less due to suspension of MISCAD**

Source: CBN

2.5.3 Operations of the Agricultural Credit Support Scheme (ACSS)

No claim was settled by the Bank under the ACSS in 2011. The cumulative claims settled since the inception of the scheme in 2006 amounted to ₦844.3 million for 42 projects.

Table 2.9: Performance of the Agricultural Credit Support Scheme (ACSS)

Performance Parameter	Jan - December 2009		Jan - December 2010		Jan - December 2011		2006 - December 2011	
	No.	Value (₦) million	No.	Value (₦) million	No.	Value (₦) million	No.	Value (₦) million
Application Received from banks	5	167.0	2	1,100.0	3	1.114	199	38,992.8
Approval by banks	5	147.5	2	1,100.0	3	1.114	199	29,772.3
Project submitted to CBN for verification	5	147.5	2	1,100.0	3	1.114	108	22,467.3
Project verified	5	147.5	-	-	2	1.014	103	19,907.3
Disbursement by banks	5	147.5	2	1,100.0	3	1.114	104	20,541.3
Approval for 6% interest rebate	20	356.9	7	119.1	-	-	42	0.844,281

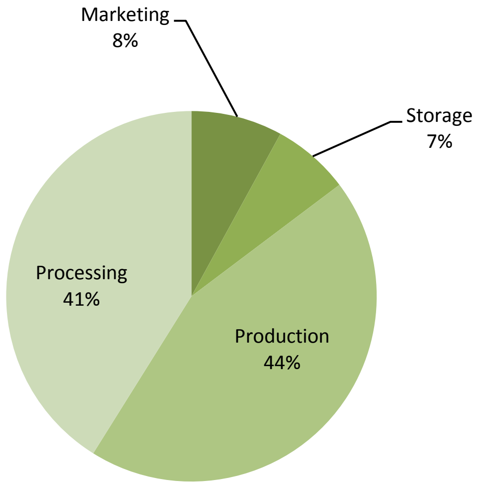
Source: CBN

2.5.4 The Commercial Agriculture Credit Scheme (CACS)

The sum of ₦56.75 billion was disbursed to 102 private projects in 2011. Additional five (5) DMBs joined the Scheme in 2011, bringing the number of participating banks to sixteen (16). Cumulatively, ₦151.02 billion had been disbursed to 190 projects (163 private projects and 27 state governments, including the FCT), leaving an undisbursed balance of ₦48.98 billion. A breakdown of disbursement by value-chain showed that production accounted for 44.2 per cent, followed by processing at 41.1 per cent. Marketing received 8.0 per cent, while storage accounted for the balance of 6.8 per cent.

A total of 32,801 jobs were created under CACS in 2011. Disbursements in respect of private projects accounted for 61.6 per cent of the total jobs created, while disbursements backed by state governments, including the FCT, accounted for the balance of 38.4 per cent.

Figure 2.17: Analysis of Private Projects under the Commercial Agriculture Credit Scheme (CACS) as at December 2011

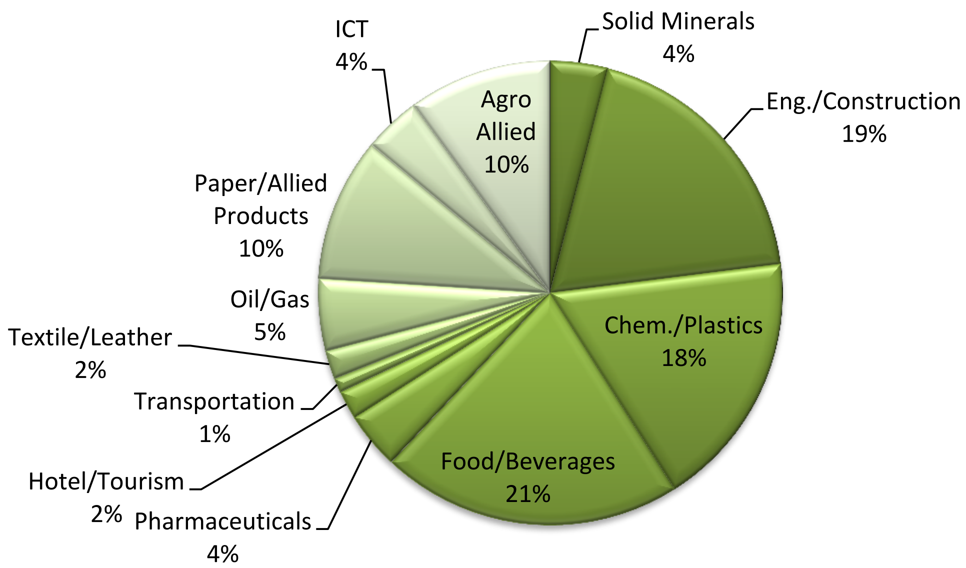


2.5.5 The SME/Manufacturing Refinancing and Restructuring Fund

The Fund, established in 2010, with an initial sum of ₦200.00 billion had additional approval for ₦35.0 billion in 2011, bringing the resources under the scheme to ₦235.0 billion. The sum of ₦30.0 billion was disbursed in the same period, bringing the cumulative to ₦220.64 billion for 486 projects. The sum of ₦11.24 billion was repaid during the review period. The sectoral distribution of disbursements showed that food and beverages had the highest share with 21.0 per cent, followed by engineering and construction and chemicals/plastics, which recorded 19.0 and 18.0 per cent, respectively. Agro-allied and paper/allied had 10.0 per cent each, oil and gas 5.0 per cent, while pharmaceuticals, ICT and solid minerals recorded 4.0 per cent each. Textile/leather, and hotel and tourism got 2.0 per cent each, while transportation got 1.0 per cent.

The Scheme had since its inception generated 16,422 new jobs, sustained the operations of 347 projects and resuscitated 9 moribund companies. In addition, capacity utilization and turnover of the beneficiaries increased from a pre-intervention level of 25.0 to 36.0 per cent and ₦2.97 billion to ₦5.34 billion, respectively. Under the Scheme, beneficiary companies accessed long-tenored funds, culminating in an annual interest cost-saving of ₦35.30 billion, while boosting the liquidity of the participating banks.

Figure 2.18: Sectoral Distribution of Loans under RRF



2.5.6 The Small and Medium Enterprises Credit Guarantee Scheme

A total of eighteen (18) applications, valued at N0.89 billion, were guaranteed under the Scheme in 2011, as against the position in 2010 when none was guaranteed.

2.5.7 The Power and Airline Intervention Fund

At end-December 2011, the sum of ₦158.87 billion had been released to the Bank of Industry (BOI). Of this, ₦144.61 billion was disbursed to 21 projects comprised of ₦58.99 billion and ₦85.62 billion for power and airline projects, respectively. The intervention in the power and aviation sub-sectors had begun to impact on the economy. Beneficiaries made an average cost-savings on interest expense of ₦19.0 billion. Furthermore, the 10 power projects financed under the initiative have a generating capacity of 679 MW. About 568.4 MW of capacity was already being generated in 2011, of which 349.2 MW was fed to the national grid.

2.5.8 Entrepreneurship Development Centres (EDCs)

The three EDCs trained 29,323 participants involving 4,113 degree holders and 25,210 non-graduates in 2011. In the process, 631 jobs were created. Since its inception, the scheme had trained 101, 847 entrepreneurs out of which 802 or 2.3 per cent were able to access ₦185.40 million from DMBs and MFBs for business start-ups, and another 4,373 secured jobs. Approval was secured for the establishment of three (3) more EDCs in the North-East, North-Central and South- South geo-political zones of the country.

2.5.9 Nigeria Incentive – based Risk Sharing System for Agricultural Lending (NIRSAL)

The CBN established NIRSAL in 2010, following an agreement with the Alliance for a Green Revolution in Africa (AGRA), to address the weaknesses of existing agricultural financing schemes. It was an innovative mechanism for unlocking finance to serve the needs of all farmers, particularly smallholder farmers, agro-processors, agribusinesses as input suppliers in the agricultural value-chain. The aim was to provide farmers with affordable financial products while reducing the risk of loans to farmers offered by the financial institutions. The scheme would build the capacity of banks to lend to agriculture, deploy risk sharing instruments to lower risks of lending, and develop a rating scheme for banks based on their commitment to lending to the agricultural sector. Since its establishment in 2010, several activities have been recorded, including engagements with both local and international stakeholders to secure their buy-in, charting the implementation road-map, and organization of a national conference. On the completion of the framework in 2011, the scheme was formally launched.