CENTRAL BANK OF NIGERIA

FINANCIAL STABILITY REPORT

DECEMBER 2012

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List of Abbreviations and Acronyms

ACGS	-	Agricultural Credit Guarantee Scheme
ACSS	-	Agricultural Credit Support Scheme
AMCON	-	Asset Management Corporation of Nigeria
AML/CFT	-	Anti-Money Laundering and Combating the Financing of Terrorism
ASEAN	-	Association of South East Asian Nations
ASI	-	All Share Index (Nigerian Stock Exchange Index)
ATMs	-	Automated Teller Machines
BCEAO	-	Banque Centrale des Etats de l'Afrique de l'Ouest (Central Bank of West African States)
BDCs	-	Bureaux de Change
BIM	-	Bank Incentive Mechanism
BIS	-	Bank for International Settlements
BOI	-	Bank of Industry
BRICS	-	Brazil, Russia, India, China, and South Africa
BRS	-	Bank Rating System
CACS	-	Commercial Agricultural Credit Scheme
CAR	-	Capital Adequacy Ratio
CBN	-	Central Bank of Nigeria
CBSWCA	-	Committee of Banking Supervisors of West and Central Africa
CIFTS	-	CBN Interbank Fund Transfer System
CR_5	-	Concentration Ratio (of the five largest banks)
CRMS	-	Credit Risk Management System
CSD	-	Central Securities Depository
DFIs	-	Development Finance Institutions
DMBs	-	Deposit Money Banks
DvP	-	Delivery versus Payment
EBAs	-	Eligible Bank Assets
EDCs	-	Entrepreneurship Development Centres
EMLC	-	Emerging Markets Local Currency
FATF	-	Financial Action Task Force
FCs	-	Finance Companies
FGN	-	Federal Government of Nigeria
FMI	-	Financial Market Infranstructures
FPIs	-	Foreign Portfolio Investments
FRC	-	Financial Reporting Council of Nigeria
FSIs	-	Financial Soundness Indicators
FSRCC	-	Financial Services Regulation Coordinating Committee
GAAP	-	Generally Accepted Accounting Principles
GBI-EM	-	Global Bonds Index - Emerging Markets
GDP	-	Gross Domestic Product
GIABA	-	Inter-Governmental Action Group Against Money Laundering in West Africa

HHI	-	Herfindahl-Hirschman Index
IDP	-	Interest Drawback Programme
IF	-	Insurance Facility
IFRS	-	International Financial Reporting Standards
IMC	-	Inter-Ministerial Committee
IMF	-	International Monetary Fund
INEC	-	Independent National Electoral Commission
KYC	-	Know Your Customer
LR	-	Liquidity Ratio
M1	-	Narrow Money Supply
M2	-	Broad Money Supply
MCP	-	Microfinance Certification Programme
MENA	-	Middle East and North African countries
MFBs	-	Microfinance Banks
MPR	-	Monetary Policy Rate
NAICOM	-	National Insurance Commission
NEFT	-	NIBSS Electronic Fund Transfer
NGAAP+	-	Nigerian Generally Accepted Accounting Principles
NIFIs	-	Non-Interest Financial Instruments
NIBSS	-	Nigerian Interbank Settlement System
NIP	-	NIBSS Instant Payment
NIRSAL	-	Nigerian Incentive-based Risk Sharing System for Agricultural Lending
NPLs	-	Non-Performing Loans
NSBP	-	Nigerian Sustainable Banking Principles
NSE	-	Nigerian Stock Exchange
OBB	-	Open Buy Back
OFIs	-	Other Financial Institutions
PAIF	-	Power and Airline Infrastructure Fund
PCBs	-	Private Credit Bureaux
PENCOM	-	National Pension Commission of Nigeria
PFAs	-	Pension Fund Administrators
PMBs	-	Primary Mortgage Banks
PoS	-	Point of Sale
PTAD	-	Pension Transitional Arrangement Department
REPO	-	Repurchase Agreement
RSF	-	Risk Sharing Facility
RTGS	-	Real-Time Gross Settlement System
SDF	-	Standing Deposit Facility
SEC	-	Securities and Exchange Commission
SLF	-	Standing Lending Facility
SMEs	-	Small and Medium Enterprises
SMECGS	-	Small and Medium Enterprises Credit Guarantee Scheme
SWF	-	Sovereign Wealth Fund
TAF	-	Technical Assistance Facility
WAMZ	-	West African Monetary Zone
WDAS	-	Wholesale Dutch Auction System

Definition and Function of Financial Stability

'Financial stability' is the resilience of the financial system to unanticipated adverse shocks, while enabling the continuing smooth functioning of the financial system's intermediation process. The financial system supports the ability of households and firms to hold or transfer financial assets with confidence. A stable financial system contributes to broader economic growth and rising living standards.

Governor's Statement

The slow recovery of the global economy had implications for the international financial system as the sovereign debt crisis of the Euro Area and weak consumer demand continued to impinge on the system. The Nigerian financial system was not insulated as international trading partners and foreign portfolio investors occasionally responded adversely. The Nigerian financial system remained stable and resilient, despite the slower rate of growth in global output in the second half of 2012. The period witnessed renewed efforts by monetary authorities to cushion the adverse impacts of these global developments.

The key domestic challenges in the second half of 2012 included the persistent exclusion of a large segment of the populace from financial services, the oligopolistic nature of the banking system, paucity of long-term funds necessary for real sector development, and the likelihood of sudden reversals of foreign portfolio investments.

Most of the risks in the system were isolated and appropriate measures adopted to achieve financial stability. Specifically, new areas of growth and development that will impact the financial system include financial inclusion and pension funds. The growing pension funds are expected to provide the needed long-term funds for the growth of the real sector. The Bank continued its collaborative engagements with other regulatory agencies to achieve a safe and sound banking system, a vibrant capital market, and reliable insurance and pension sub-sectors. The attainment of a seamless conversion from NGAAP to IFRS and the full adoption of the Basel II/III also engaged regulatory attention.

In spite of the challenges, the Nigerian financial system remained stable over the period as evidenced by the stress tests on the banking sector. A positive outlook is envisaged over the short and medium terms.

Sanusi Lamido Sanusi (CON)
Governor, Central Bank of Nigeria

Deputy Governor's Remarks

This edition of the *FSR*, as the previous ones, assesses the stability of the Nigerian financial system in the second half of 2012 and chronicles the policies and initiatives adopted to address inherent challenges. The key policies include: the roll-out of the National Microfinance Strategy and Financial Inclusion Strategy; the establishment of NIRSAL Plc to promote affordable financial products to the agricultural value-chain; and the acquisition of a Central Securities Depository to be integrated with the new RTGS. The Sovereign Wealth Fund and the proposed Mortgage Refinance Company are also highlighted.

In order to enhance CBN's supervisory framework, a consultant was engaged to review, with the aim of enhancing the Bank's specific tools and framework for managing the stability of the Nigerian financial system. The ring-fencing of Nigerian banks, through the new banking model, was also pursued with the commencement of holding companies by some of the banks and disengagement from non-banking subsidiaries by other banks.

It is hoped that, as with previous editions, this Report would assist stakeholders to appreciate the risks inherent in the system and facilitate informed discussion on the development and stability of the Nigerian financial system.

Your feedback on this Report will be appreciated. Please send your feedback to: **FSR@cbn.gov.ng.**

Dr. Kingsley C. Moghalu
Deputy Governor, Financial System Stability

Executive Summary

The impact of the global financial crisis was evident in the slowdown of global output in the second half of 2012. The sovereign debt crisis in the Euro Area and uncertainties surrounding the fiscal cliff in the USA were particularly significant. These developments moderated commodity prices, with global headline inflation falling to 1.7 per cent in December 2012, from 3.4 per cent in 2011. Similarly, demand for crude oil weakened during the period to an average of 90 mbd, leading to a fall in prices. In addition, the implementation of the US policy of achieving self-sufficiency in oil production contributed to a 44.6 per cent drop in the USA's oil imports from Nigeria. The plans for a further 50 per cent cut by 2013 and zero oil imports from Nigeria by 2015, could pose a significant risk for Nigeria, given the level of dependence on crude oil earnings for funding the budget and meeting external trade obligations.

In the second half of 2012, monetary policy rates remained low in most advanced economies, with the US Federal Reserve Bank, the Bank of England, the Bank of Canada, the Bank of Japan and the European Central Bank holding interest rates at between 0.25 and 1.00 per cent. Some central banks, such as the Reserve Bank of Australia and the Bank of Korea, progressively reduced their rates, while others left their policy rates unchanged. For most developing and emerging economies, monetary policy remained accommodating with policy rates rarely changing in the second half of 2012.

In Nigeria, economic growth remained strong at 6.5 per cent in the second half of 2012, despite the uncertainties in the global economy. The non-oil sector continued to drive growth with agriculture, wholesale and retail trade, and services constituting 40.4, 19.7 and 19.2 per cent of total output, respectively. Inflation moderated but remained at double digits during the review period. The Central Bank sustained a tight monetary policy stance, maintaining the Monetary Policy Rate at 12 per cent throughout the year. This posture ensured that money market rates were relatively stable during the period, except for the spike in August after an increase in Cash Reserve Requirement to 12.0 per cent, from 8.0 per cent, in July 2012.

The Naira exchange rate appreciated in all segments of the market in the second half of 2012, with the spread between the inter-bank and BDC rates narrowing with the WDAS rate. Gross External Reserves also increased to US$43.83 billion during the period, which was adequate to finance 11.3 months of imports.

The dominance of a few banks in the industry continued in the second half of 2012. The maturity mismatch and the near-absence of long-term deposits constrained the ability of banks to create long-tenored risk assets necessary for economic development. However, asset quality and the level of capitalization improved significantly during the period.

The results of the examination of banks and other financial institutions showed improvements in risk ratings. Meanwhile, AMCON continued to play its stabilizing role in the banking system by acquiring additional eligible bank assets (EBAs). The contribution of banks to the Banking Sector Resolution Cost Sinking Fund was increased from 30 to 50 basis points of their total assets at the end of each year to minimise the risk of crystallization of the FGN Guarantee.

The NSE All Share Index (ASI) rose, owing to increased demand resulting from growth in earnings and investor-confidence.

The following factors underpin a positive outlook for 2013:

- Moody's rating of Nigeria as Ba3, with a stable outlook for 2013;
- Expected improvements in liquidity in the financial markets, buoyed by growing foreign inflows;
- Inclusion of Nigeria in the *JP Morgan Global Bonds Index – Emerging Markets (GBI – EM)* and the Barclays EMLC Index will improve confidence in the Nigerian financial markets;
- The take-off of the Sovereign Wealth Fund (SWF);
- Expected trending down of inflation with strong growth prospects in 2013; and
- Expected improvement in socio-economic infrastructure, notably power.

1.0 MACROECONOMIC DEVELOPMENTS AND FINANCIAL STABILITY

1.1 Global Economic and Financial Developments

1.1.1 Output

Global output grew at a slower rate of 3.2 per cent in 2012, compared with 3.9 per cent in 2011, owing to the sovereign debts crisis and weak aggregate demand in the Euro Area, recession in Japan and slow economic growth in the BRICS countries. However, it is projected to grow at 3.5 per cent in 2013, as the risks underlying the slowdown are expected to subside.

Real GDP growth in the advanced economies was estimated at 1.3 per cent in 2012, compared with 1.6 per cent in 2011. The slow growth was partly attributed to austerity measures and continued contraction of growth in the Euro Area, difficulties associated with China's effort to "rebalance" its growth and the onset of recession in Japan. The decline was, however, moderated by the surprise growth in the US, despite the fiscal standoff.

Euro Area real GDP contracted significantly to -0.4 per cent in 2012, in contrast to 1.4 per cent growth in 2011. The sharp decline was due largely to austerity and fiscal consolidation measures aimed at containing the region's debt crisis. Euro Area output is projected at -0.2 per cent in 2013. Although the European Central Bank (ECB) has taken steps to address the negative growth, the impact is not expected to be fully realized in 2013, owing to the lag in the transmission mechanism.

Growth in the emerging and developing economies slowed to 5.1 per cent in 2012, from 6.3 per cent in 2011, owing to declining exports to the Euro Area. Activities in Russia, which also lost momentum, contributed to the slowdown in these economies.

Output growth in China declined to 7.8 per cent in 2012, from 9.3 per cent in 2011, as a result of contraction in manufacturing output, weak external demand and tight credit conditions. India's economic activities suffered from waning business confidence amid slow approvals for new projects, sluggish structural reforms, policy rate hikes to rein in inflation, and flagging external demand. However, the situation is expected to improve in 2013, with a projected output growth of 3.2 per cent.

Real GDP growth also decelerated in Latin America to about 3.0 per cent in 2012, largely owing to the drop in Brazil's GDP growth to 1.0 per cent, from 2.7 per cent in 2011. It also reflects the impact of past policy tightening to contain inflationary pressure and moderate credit growth in some market segments.

Growth in Sub-Saharan Africa declined to 4.8 per cent in 2012, from 5.3 per cent in 2011, which was in part, due to the impact of the global slowdown on the region's economies. It is projected to grow by 5.8 per cent in 2013.

Overall, global output growth is projected to be moderate in 2013, as it is expected to increase marginally to 3.5 per cent, from 3.2 per cent in 2012. This forecast is on the premise of projected improvements in economic performance of the US (2.0 per cent), expanded activity in Japan (1.2 per cent) and China in (8.2 per cent), improvements in growth projections of countries and moderate US and Japanese GDP growth. Inflationary pressures were well contained in

Table 1: World Output Growth and Projections (2011-2013)

		Projections	
	2011	2012	2013
World Output	**3.9**	**3.2**	**3.5**
Advanced Economies	**1.6**	**1.3**	**1.4**
United States	**1.8**	**2.3**	**2.0**
Japan	**-0.6**	**2.0**	**1.2**
Euro Area	**1.4**	**-0.4**	**-0.2**
Germany	3.1	0.9	0.6
France	1.7	0.1	0.4
Italy	0.4	-2.1	-1.0
Spain	0.4	-1.4	-1.5
United Kingdom	0.9	-0.2	1.0
Emerging and Developing Economies	**6.3**	**5.1**	**5.5**
Sub Saharan Africa	**5.3**	**4.8**	**5.8**
China	9.3	7.8	8.2
India	7.9	4.5	5.9
Brazil	2.7	1.0	3.5
Mexico	3.9	3.8	3.5
MENA	3.5	5.2	3.4

Source: IMF's World Economic Outlook, January Update 2013

emerging and developing economies (5.5 per cent), and robust growth in Sub-Saharan Africa (5.8 per cent).

1.1.2 Inflation

Global inflation declined in 2012 as a result of low average commodity prices relative to 2011, following lower aggregate demand in the Euro Area, less than expected growth in the BRICS advanced countries, averaging 2.0 per cent in 2012. This was as a result of persistent economic slack and adequately anchored inflation expectations. Likewise, inflation is projected to fall to 5.6 per cent in 2013, from 6.1 per cent in 2012 in the emerging and developing economies (IMF WEO, January 2013).

Table 2: Global Consumer Price Inflation

REGION	2010	2011	2012 ESTIMATE	2013 PROJECTIONS
Advanced Economies	1.8	2.7	2.0	1.5
Emerging and Developing Economies	6.1	7.2	6.1	5.6

Source: IMF's World Economic Outlook, January 2013

The slowdown in global activity and the slack in demand in many advanced economies have had a moderating effect on inflation. In the US, headline inflation fell to 1.7 per cent in December 2012 from 3.4 per cent in 2011. Likewise, inflation declined in Canada, UK and France. The same trend was recorded among the emerging economies (Table 3). Brazil had 5.84 per cent inflation in December 2012, down from 6.6 per cent in 2011; Egypt, in spite of political instability, recorded a sharp decline in inflation to 5.6 per cent in December 2012, from 9.5 per cent in 2011. Some of the emerging economies, such as Russia and Argentina, however, experienced higher inflation at the end of 2012.

The IMF forecasts further easing of inflationary pressure in the advanced economies, with headline inflation declining to 1.75 per cent in 2013. In the emerging and developing economies, headline inflation is projected to remain unchanged.

1.1.3 Oil Prices

Oil demand remained flat during the second half of 2012, averaging about 90 mbd, thus contributing to the easing in crude oil prices. The lack of growth in oil demand reflected the declining trend in OECD countries (except Japan) which was moderated by growth in China and India. Increased Japanese demand reflected the use of oil for power generation, after nuclear production was halted in the wake of the Fukushima

Table 3: Global Inflation

Country/Region	2012	2011	2013 Projection
Africa			
Nigeria	12.7	12.4	13.57
South Africa	5.6 Nov	6.1	5.5
Egypt	5.6 Dec	9.5	8.5
Ghana	9.1 Dec	8.7	9.3
North America			
US	1.8 Nov	3.4	1.9
Canada	0.8 Nov	2.9	1.7
Mexico	3.6 Dec	3.8	3.9
Latin America			
Brazil	5.84 Dec	6.6	5.6
Argentina	10.6 Nov	9.5	10.6
Columbia	2.4 Dec	3.7	3.1
Europe			
UK	2.7 Nov	4.8	2.5
France	1.3 Dec	2.5	1.7
Germany	2.1 Dec	2.1	1.9
Russia	6.5 Dec	6.1	6.5
Asia			
Japan	-0.2 Nov	-0.5	0.0
China	2.0 Nov	4.2	3.1
India	9.9 Nov	10.8	8.5

Sources: NBS, Bloomberg and the Economist

nuclear disaster. The demand for oil in Japan is expected to remain high, given the country's recent decision to phase out nuclear power by 2040. Much of China's demand was attributed to its decision to build up its strategic petroleum reserves and to support the expanding vehicle usage and growth in petrochemical demand. India's demand intensified owing to irrigation needs and power shortages during the third quarter (WEO, October 2012).

1.1.4 The Monetary Policy

Monetary policy remained accommodative in most advanced economies in the second half of 2012. The US Federal Reserve, the Bank of England, the Bank of Canada, the Bank of Japan and the ECB had interest rates ranging between 0.25 and 1.00 per cent. The Reserve Bank of Australia and the Bank of Korea also progressively reduced their policy rates during the review period to 3.00 and 2.75 per cent respectively at end-December 2012, from 3.50 and 3.25 per cent at end-June.

Among the BRICS economies, monetary policy remained largely accommodative except Russia which reviewed its policy rate upwards to 8.25 per cent at end-December 2012, from 8.00 per cent at end-June 2012. Brazil reduced its rate to 7.25 per cent at end-December 2012 from 8.00 per cent at end-June, while China, India and South Africa left their rates unchanged at 0.50, 9.00 and 5.00 per cent, respectively, during the review period (Table 4).

Table 4: Summary Table of Policy Rates Across Selected Countries (January – December 2012)

	Monthly Policy Rate											
Country	January	February	March	April	May	June	July	August	September	October	November	December
Developed Economies												
Japan	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Europe	1.00	1.00	1.00	1.00	1.00	1.00	0.75	0.75	0.75	0.75	0.75	0.75
UK	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
USA	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Canada	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
South Korea	3.25	3.25	3.25	3.25	3.25	3.25	3.00	3.00	3.00	2.75	2.75	2.75
New Zealand	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50
Australia	4.25	4.25	4.25	4.25	3.75	3.50	3.50	3.50	3.50	3.25	3.25	3.00
ASEAN												
Indonesia	4.00	3.75	3.75	3.75	3.75	3.75	3.75	4.00	4.00	4.00	4.00	4.00
Malaysia	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00
Phillipines	4.25	4.25	4.00	4.00	4.00	4.00	3.75	3.75	3.75	3.50	3.50	3.50
BRICS												
Brazil	10.50	10.50	9.75	9.00	8.50	8.50	8.00	7.50	7.50	7.25	7.25	7.25
Russia	8.00	8.00	8.00	8.00	8.00	8.00	8.00	8.25	8.25	8.25	8.25	8.25
India	9.50	9.50	9.50	9.00	9.00	9.00	9.00	9.00	9.00	9.00	9.00	9.00
HK Base	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
South Africa	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00
Other Emerging Economies & South America												
Mexico	4.50	4.50	4.50	4.50	4.50	4.50	4.50	4.50	4.50	4.50	4.50	4.50
Turkey	5.75	5.75	5.75	5.75	5.75	5.75	5.75	5.75	5.75	5.75	5.75	5.75
Chile	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00
Colombia	5.00	5.25	5.25	5.25	5.25	5.25	5.00	4.75	4.75	4.75	4.50	4.25
Africa												
Morocco	3.25	3.25	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00
Ghana	12.50	13.50	13.50	14.50	14.50	15.00	15.00	15.00	15.00	15.00	15.00	15.00
Nigeria	12.00	12.00	12.00	12.00	12.00	12.00	12.00	12.00	12.00	12.00	12.00	12.00

Source: Bloomberg

1.2 Domestic Developments

1.2.1 Output

Growth of the domestic economy remained strong at 6.5 per cent in the second half of 2012 despite the uncertainties in the global economy. The non-oil sector continued to drive growth with agriculture, wholesale and retail trade, and services constituting 40.4, 19.7 and 19.2 per cent of the total, respectively.

A growth rate of 6.8 per cent had been projected for the second half of 2012; the growth of 6.5 per cent was slightly higher than the 6.4 per cent recorded in the first half of the year. The slight increase in GDP reflected the relative macroeconomic stability observed, following the resolution of the fuel subsidy crisis in the first half of the year. As in the preceding year, the growth in GDP was entirely accounted for by the growth of the non-oil sector comprising agriculture (3.90%), industry (2.20%), building and construction (12.10%), wholesale and retail trade (10.20%), and services (14.30%). Growth in the oil sector component of the GDP declined by 0.05 per cent in the second half of 2012. The sector, nevertheless, contributed 13.05 per cent to GDP in the same period.

In anticipation of the resolution of the European debt crisis, the continued accommodative stance of monetary policy, and the robust performance of the emerging and developing economies, global economic growth would be expected to gradually stimulate output growth in Nigeria during the year 2013.

Figure 1: Real Gross Domestic Product

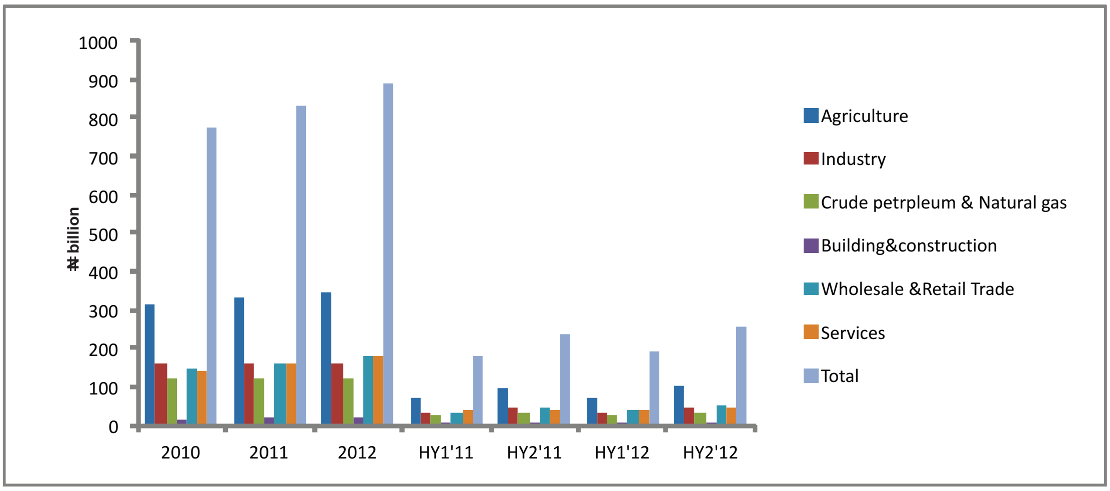
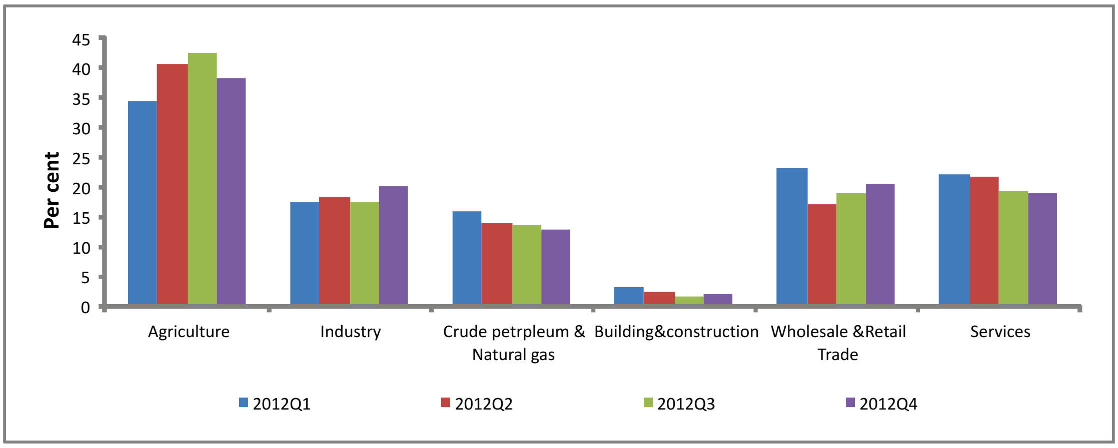


Table 5: Changes in GDP by Sector

Sector	2012Q1	2012Q2	2012Q3	2012Q4
Agriculture	4.37	4.21	3.89	3.83
Industry	-1.64	1.21	1.64	2.7
Crude Petroleum & Natural Gas	-2.32	-0.73	0.08	-0.17
Building and Construction	13.28	12.73	11.52	12.6
Wholesale and Retail Trade	8.42	8.65	9.62	10.76
Services	13.67	13.14	13.73	14.85
Total	6.34	6.39	6.48	7.09

Source: National Bureau of Statistics

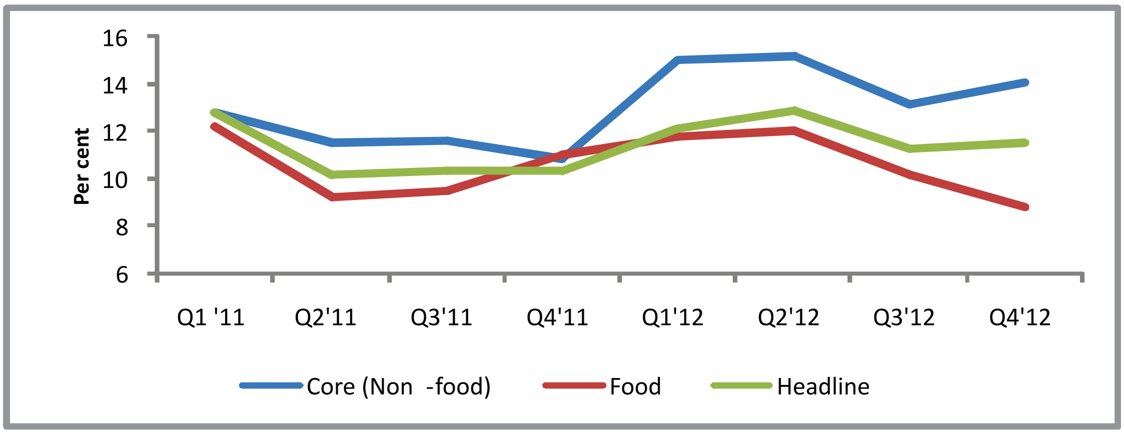
Figure 2: Share in total GDP (%)



1.2.2 Inflation

Inflation moderated but remained at double digit during the review period. The year-on-year headline inflation declined to 12.0 per cent in December 2012, from 12.9 per cent in June. The decline was attributed to the stability in the supply of petroleum products, following the partial removal of the subsidy on premium motor spirit (PMS) in January 2012 and the tight monetary policy stance.

Figure 3: Inflationary Trend (Year-on-Year)



1.2.3 Interest Rates

The Central Bank of Nigeria (CBN) maintained a contractionary monetary policy stance, with the Monetary Policy Rate at 12 per cent throughout 2012. Consequently, interest rates rose generally in the money market. The average inter-bank rate stood at 13.61 per cent for the second half of 2012, slightly down from 14.28 per cent for the first half. The average term deposit rate rose marginally by 0.70 percentage point to 6.61 per cent. Similarly, the average maximum lending rate rose by 125 basis points to 24.52 per cent in the second half of the year. Thus, the spread between the maximum lending rate and the average term deposit rate stood at 17.01 percentage points, a 0.55 percentage point rise over that of the first half of the year. With the inflation rate at 12.0 per cent, deposit rates were negative in real terms.

Figure 4: Money Market Interest Rates

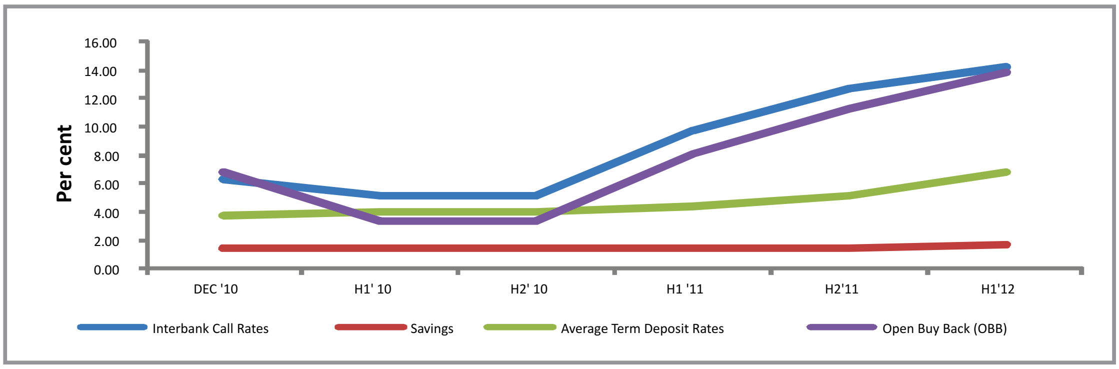
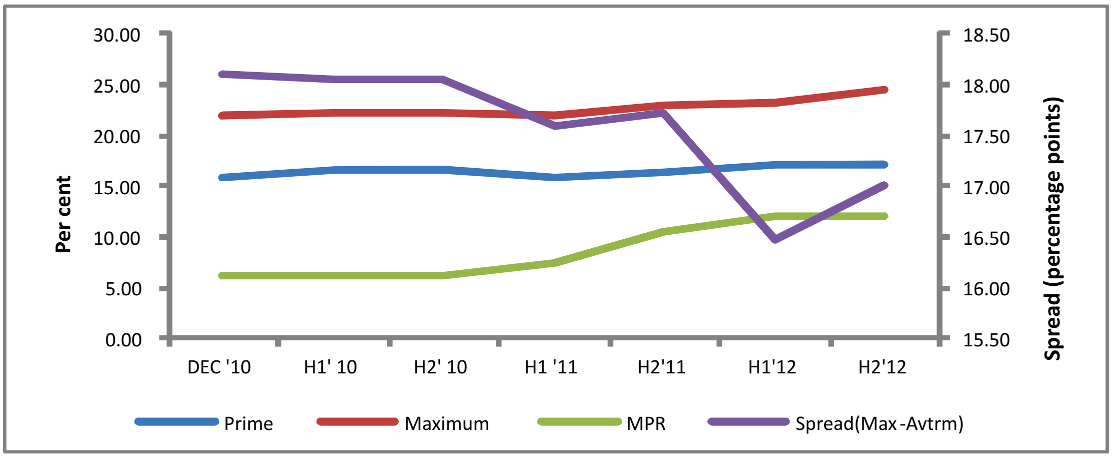


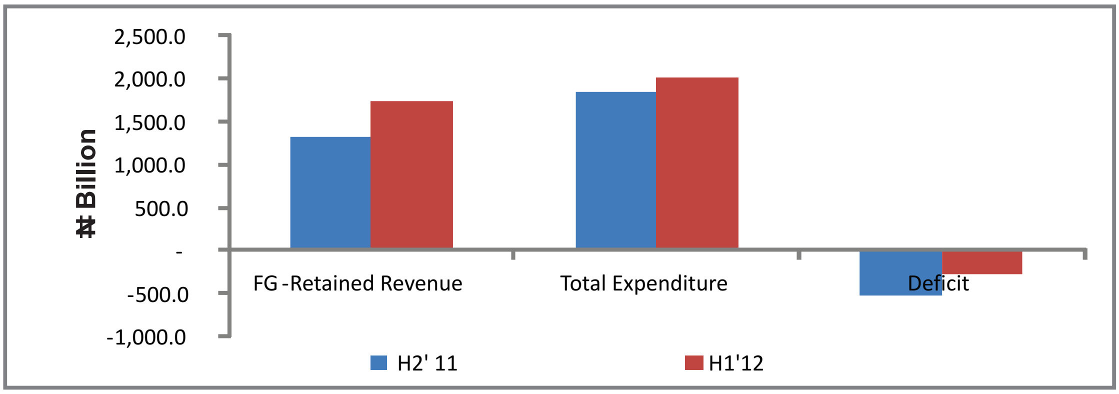
Figure 5: Lending and Deposit Rates



1.2.4 Fiscal Operations

The retained revenue of the Federal Government was ₦1,887.62 billion, while the total expenditure was ₦ 2,581.5 billion. Thus, the fiscal operations of the Federal Government in the second half of 2012 resulted in an estimated deficit of ₦693.88 billion, compared with ₦281.82 billion in the first half. The cumulative deficit for the year was thus ₦ 975.70 billion, representing 2.4 per cent of GDP. At that level, the deficit to GDP ratio was within the 3.0 per cent benchmark for the WAMZ Convergence criteria. The deficit was financed largely from the proceeds of FGN Bonds.

Figure 6: Federal Government's Fiscal Operations



2.0 DEVELOPMENTS IN THE FINANCIAL SYSTEM

2.1 Monetary and Credit Developments

The growth of money supply remained modest in the second half of 2012 relative to the benchmark for 2012. Over the level at end-June 2012, broad money supply (M2), at ₦15,128.7 billion, grew by 12.2 per cent, compared with 1.4 per cent recorded at the end of the preceding half year. At that level, the growth in M2 was 12.4 percentage points below the benchmark for fiscal 2012. The development reflected the respective growth rates of 20.9 per cent and 4.8 per cent in net foreign assets and domestic assets of the banking system. Narrow money supply (M1) grew by 7.1 per cent, in contrast to a decline of 2.5 per cent in the preceding half year. The growth in M1 reflected increases of 19.6 per cent and 4.6 per cent in the currency and demand deposit components, respectively.

2.1.1 Aggregate Credit to the Economy

Aggregate credit to the domestic economy grew by 4.8 per cent to ₦ 13,937.4 billion in the second half of 2012, in contrast to the 2.7 per cent decline at the end of the first half of the year. This reflected largely the growth of 4.0 per cent in claims on the private sector, with the core private sector accounting for 3.6 percentage points.

Figure 7: Trend in Monetary Aggregates

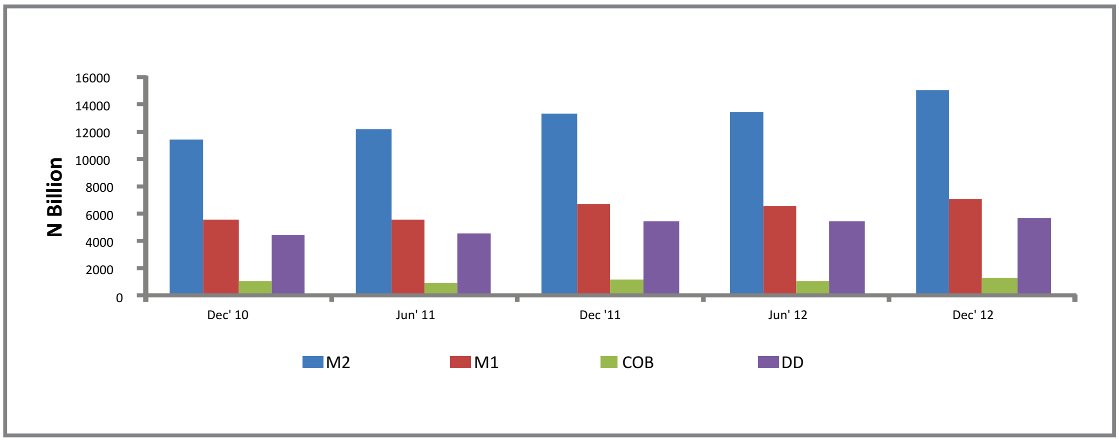
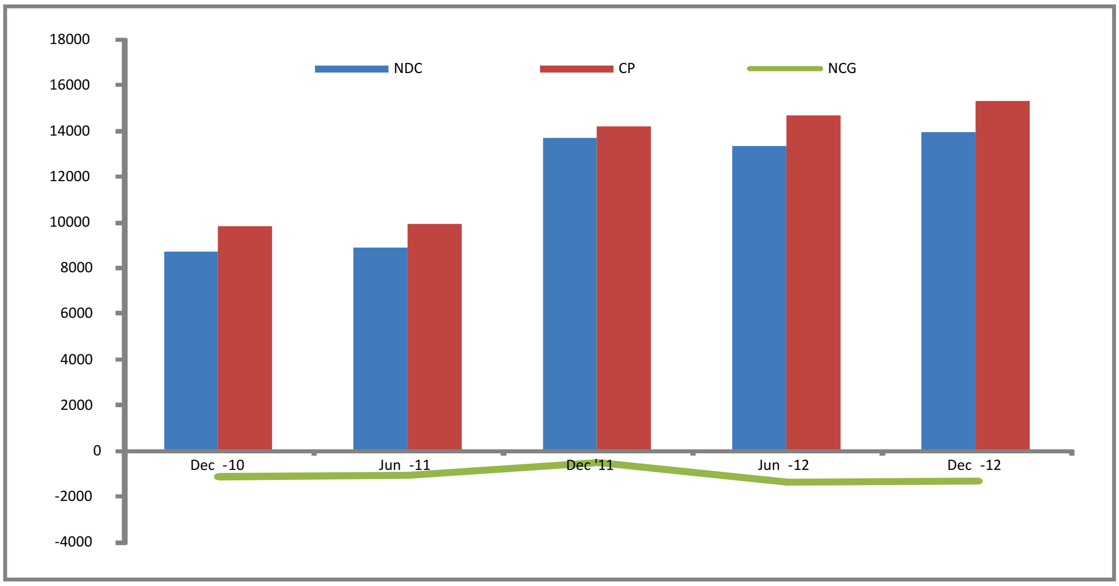


Figure 8: Credit to the Economy



2.1.1.1 Claims on the Federal Government

Claims on Federal Government increased marginally by 3.8 per cent to negative ₦1,327.9 billion end-December 2012, in contrast to a decline of 177.9 per cent at end-June 2012. The slight growth in Government claims was attributable to the growth of 9.2 and 3.4 per cent in Treasury bills and FGN bonds holdings, respectively. The Federal Government, however, remained a net lender to the banking system in the period under review.

2.1.1.2 Claims on the Private Sector

Credit to the private sector grew by 4.0 per cent to ₦15,285.3 billion at the end of the review period, compared with 3.6 per cent growth at the end of the first half of 2012.

The development was attributable mainly to the 3.6 per cent growth in claims on the core private sector.

The Household Sector

The rising trend of credit to the household sector in the first half of 2012 continued in the second half of the year. Loans to the sector increased by 5.7 per cent to ₦ 613.5 billion at end-December 2012, from ₦580.3 billion at end-June 2012. The growth is attributable to increased product innovations by banks.

The Corporate Sector

Total credit to the corporate sector increased by 2.3 per cent to ₦ 6,673.4 billion at end-December 2012, from ₦6,522.4 billion at end-June. The sector continued to face a number of challenges, including the high cost of doing business owing, largely, to dilapidated public infrastructure, high lending rates, increased fuel prices and security concerns.

The Real-Estate Sector

The real-estate sector contributed 1.73 per cent to the GDP in the third quarter of 2012[1]. Credit to the real-estate sector declined to ₦ 376.6 billion at end-December 2012, from ₦ 380.7 billion at end-June 2012. The quality of the exposures measured by the ratio of the

[1]National Bureau of Statistics

sector's NPLs to total credit, however, improved to 3.1 per cent at end-December 2012, from 4.2 per cent at end-June 2012.

The main challenge to the funding of the real estate sector is the dearth of long-term funds. The dominance of short-term funds has led to a mismatch between the long-term mortgage assets and short-term-oriented liabilities of primary mortgage banks (PMBs). As part of efforts to address this, the CBN is promoting the establishment of a mortgage re-finance company (MRC), in collaboration with other stakeholders. The PMBs are also being repositioned to serve as veritable channels for mortgage/housing finance and home ownership.

The MRC will provide short-term liquidity and long-term funding or guarantees to mortgage originators and housing finance lenders. It will also serve as a catalyst for the development of the secondary mortgage market and a precursor to mortgage-backed securitization.

In order to minimize the risks associated with the operation of the MRC and ensure it remains mission-focused, the Regulatory and Supervisory Framework for the operation of the Mortgage Refinance Company was drafted, in collaboration with the World Bank, in the second half of 2012.

2.1.2 Reserve Money

In the second half of 2012, reserve money grew by 40.6 per cent to ₦ 3,532.05 billion, in contrast to the decline of 9.8 per cent at end-June 2012. The growth in reserve money reflected the respective 19.7 and 65.4 per cent growth in currency in circulation and DMB's reserves with the CBN. At that level, reserve money was 16.98 per cent above its benchmark for fiscal 2012.

2.1.3 Maturity Structure of DMBs' Deposits and Credits

The structure of DMBs' credit at end-December 2012 indicated that short-term maturities remained dominant. Outstanding credits maturing within one year accounted for 57.6 per cent, compared with 59.1 per cent at the end of the first half of 2012. The medium-term (≥1yr and < 3yrs) and long-term (3yrs and above) maturities stood at 18.4 and 24.0 per cent, respectively, compared with 14.8 and 26.1 per cent, in the first half of 2012. Similarly, deposits below one year constituted 97.5 per cent of the total, of which 76.31 per cent had maturities of less than 30 days, while long-term deposits constituted only 0.01 per cent. In addition to the consequences of the maturity mismatch, the near-absence of long-term deposits continued to constrain the ability of banks to create long-tenored risk assets crucial for economic development.

The pattern has been spurred in the past by instability of the macroeconomic indicators, such as inflation, interest and exchange rates. To address the challenge, the Bank, through its reform agenda, has been able to bolster confidence in the financial system. Also, the relative stability so far achieved in the macro-economic indicators, would engender greater confidence for customers to place their monies for longer periods in the near future.

Figure 9: Distribution of DMBs' Loans and Advances by Maturity (June 2011 to December 2012)

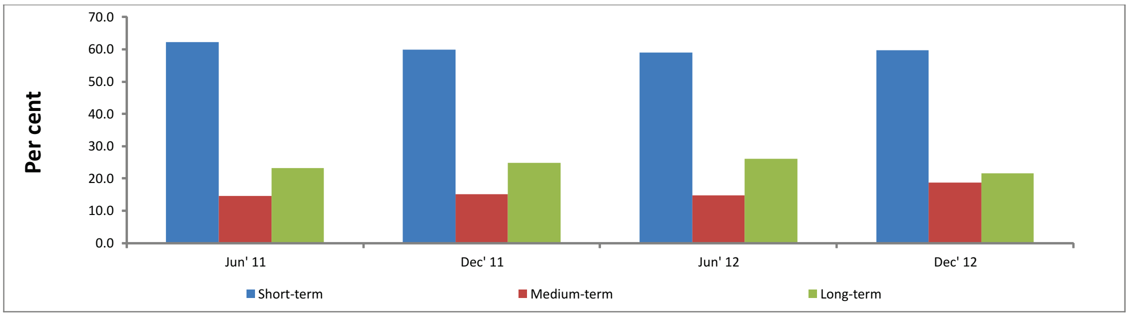
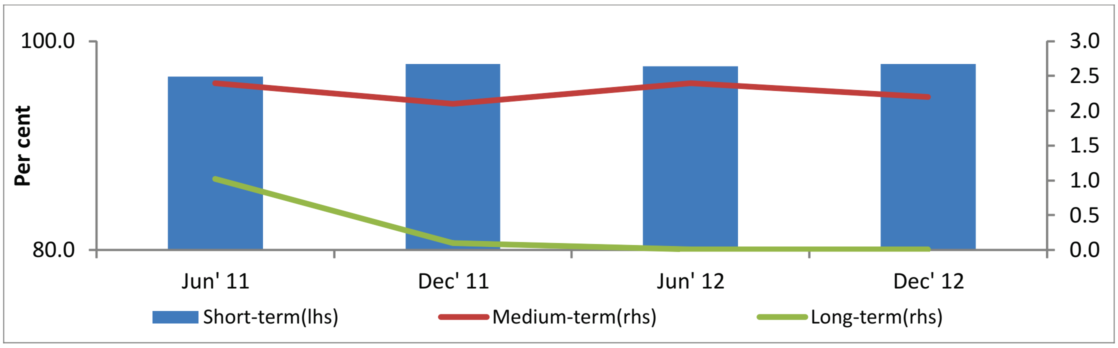


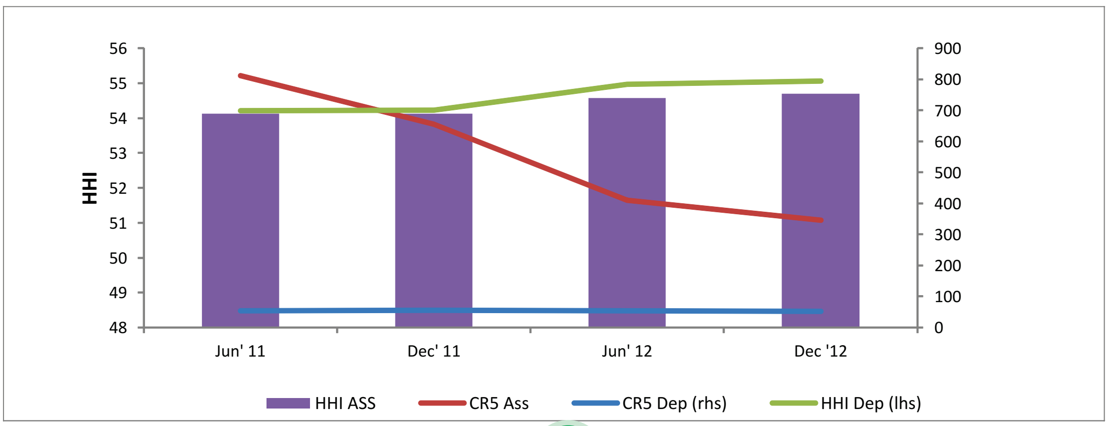
Figure 10: Distribution of DMBs' Deposit Structure (June 2011 to December 2012)



2.1.4 The Market Structure of the Banking Industry

The dominance of a few major players in the banking industry continued as in the first half of 2012. Available data showed that the average market share of assets and deposits of the five largest banks (concentration ratio – CR_5) stood at 52.36 and 51.07 per cent, respectively, compared with 51.64 and 53.14 per cent at the end of the first half of 2012. The market share of the largest bank, with respect to assets and deposits, stood at 14.99 and 13.47 per cent, respectively, at end-December 2012, compared with 14.05 and 15.60 per cent at end-June 2012. This showed that competition remained limited in the banking system as confirmed by the Herfindahl-Hirschman Index (HHI) of 790.66 and 741.43 for total deposits and total assets, compared with 699.10 and 690.10, respectively, at end-June 2012.

Figure 11: Market Concentration Ratios of DMBs (Assets)



2.2 The Banking Sector

The banking sector and capital market reforms continued to drive growth and a vibrant financial system. The Nigerian banking sector sustained the improvements in the level of capitalization. The capital adequacy and Tier I to risk-weighted assets ratios stood at 18.1 per cent and 16.1 per cent at end-December 2012, compared with 17.7 per cent and 16.0 per cent, respectively at end-June 2012. The increase in the level of capitalization of the banks was attributable to half-year profits and raising of Tier II capital.

Total loans increased by 3.5 per cent to ₦8,150.0 billion at end-December 2012, from ₦ 7,870.9 billion at end-June. Increased income from intermediation accounted for the increases in earnings performance. Interest margin to gross income declined from 48.8 per cent at end-June 2012 to 46.0 per cent at end-December 2012. Non-interest expense to gross income increased from 50.9 per cent at end-June 2012 to 51.5 per cent at end-December 2012. Sustained improvement was observed in the level of liquidity in the system, with the ratio of liquid assets (core) to total assets increasing from 24.3 per cent at end-June 2012 to 28.9 per cent at end-December 2012, indicating that the industry was very liquid.

Asset quality improved during the review period as the ratio of non-performing loans (NPLs) to total loans improved to 3.5 per cent at end-December 2012, from 4.3 per cent at end-June. Although the industry NPL ratio was within the 5.0 per cent regulatory threshold, a number of banks operated above it. The ratio of provisions to NPLs stood at 68.7 per cent at end-December 2012, indicating that the prevailing level of NPL did not pose a significant risk to the industry. The CBN will continue to monitor developments to ensure that the NPL ratios remain within the threshold.

The recent crisis in the Nigerian banking industry highlighted several weaknesses in the system, key of which was the excessive concentration of credit in the asset portfolios of banks. To ensure that banks properly manage these concentration, or pools of exposures whose collective performance may potentially affect a bank negatively, the CBN, in line with its risk-based supervisory process, reviewed the risk weights assigned to some exposures in the computation of capital adequacy ratio.

Cross-Border Collaboration

In the period under review, the CBN executed memoranda of understanding on information sharing with the central banks of Tanzania, Mozambique, and Burundi and the Banking Commission of West Africa (BCEAO). It also collaborated with regulatory authorities in the sub-region to harmonize supervisory standards in West Africa and signed the charter of the Committee of Banking Supervisors of West and Central Africa (CBSWCA).

2.3 Other Financial Institutions (OFIs)

The sector witnessed significant activities in all the OFI categories in the second half of 2012. The highlights of these developments are described in sub-sections 2.3.1 to 2.3.3.

2.3.1 Microfinance Banks (MFBs)

Access to finance through microfinance banks improved significantly during the review period with the main performance indicators recording positive changes. Total assets of MFBs rose to ₦222.8 billion at end-December

2012, from ₦196.5 billion at end-June, representing a 13.4 per cent increase. Similarly, the paid-up capital and shareholders' funds of MFBs increased by 23.6 and 12.0 per cent respectively to ₦60.7 billion and ₦53.3 billion, from ₦49.1 billion and ₦47.6 billion. The increase in capital was due largely to the recapitalization of some Unit-MFBs to attain the prescribed minimum capital of ₦100 million for state-MFBs.

Total deposit liabilities and net loans/advances of MFBs also increased by 26.9 and 12.0 per cent to ₦132.2 billion and ₦97.0 billion respectively at end-December 2012, compared with ₦104.2 billion and ₦86.6 billion at end-June. The rise in deposit liabilities was indicative of increased depositors' confidence, while the growth in net loans/advances reflected the enhanced mission-focus on the part of operators. However, reserves plummeted by ₦5.9 billion to negative ₦7.4 billion, owing due mainly to the erosion of earnings by large non-performing loans. The CBN, therefore, continued to pursue policies and initiatives for the sustainability of MFBs, including the adoption of risk-based supervision and the extension of its funding of the Microfinance Certification Programme (MCP) to December 2013. Meanwhile, the number of MFB officers certified under the MCP at end-December 2012, stood at 1,420.

During the review period, efforts were made to extend the banking sector reform initiatives to MFBs, with a view to repositioning them for greater efficiency and viability. These initiatives included the adoption of:

- December 31 as the common year-end for all MFBs;
- The use of International Financial Reporting Standards (IFRS) in the preparation of financial statements; and
- Approved persons regime procedures in evaluating the suitability of nominees to board and top management positions of the institutions.

2.3.2 Primary Mortgage Banks (PMBs)

The consolidated financial position of the sub-sector declined marginally at end-December 2012 due largely to the absorption of two (2) PMBs by their parent DMBs, under the new banking model. Total assets of PMBs decreased by 3.7 per cent to ₦348.1 billion at end-December 2012, from ₦361.4 billion at end-June. Paid up capital and shareholders' funds also reduced by 6.4 and 4.1 per cent to ₦62.9 billion and ₦74.6 billion, respectively, from ₦67.2 billion and ₦ 77.8 billion. Similarly, loans and advances declined by 12.8 per cent to ₦120.9 billion from ₦138.7 billion.

Activities in the sub-sector focused on the implementation of the three pillars of the PMB reform programme. These included:

- Compliance with the higher minimum capital requirements before April 30, 2013;
- Establishment of a Mortgage Refinance/Liquidity Company as a specialised second-tier institution to provide short-term liquidity and long-term funding to mortgage lenders; and
- Establishment of uniform underwriting standards for mortgage loan origination, in collaboration with industry stakeholders and in consonance with the Regulatory Framework for the Mortgage Refinancing

Company (MRC).

2.3.3 Finance Companies (FCs)

The total assets of FCs decreased to ₦109.5 billion at end-December 2012, from ₦117.6 billion at end-December 2011, representing a decline of 6.9 per cent. Total paid-up capital and shareholders' funds also decreased by 5.0 and 13.6 per cent respectively, to ₦19.1 billion and ₦13.3 billion at end-December 2012, from ₦20.1 billion and ₦15.4 billion, at end-December 2011. Furthermore, net loans/advances and total borrowings decreased by 5.3 and 17.4 per cent respectively, to ₦30.2 billion and ₦65.1 billion at end-December 2012, from ₦31.9 billion and ₦78.8 billion, at end-December 2011. The decrease was largely attributed to the revocation of the licences of 40 FCs and cancellation of the licences of 11 others. Investible funds available to the sub-sector during the period totalled ₦19.8 billion. The funds were sourced mainly from the reduction in placements with banks of ₦9.7 billion and an increase in other liabilities of ₦8.3 billion. They were utilized mainly to reduce borrowings by ₦13.7 billion and to increase investments by ₦2.3 billion.

As part of the efforts to sanitize the financial system, the Inter-agency Committee on Illegal Fund Managers/"Wonder Banks" closed 32 unlicensed/illegal finance companies in the second half of 2012. Also, the Committee commenced investigations preparatory to instituting legal action against directors of such companies and settled the claims of depositors to one of the closed companies.

2.4 Financial Inclusion Activities

During the review period, the CBN rolled out a financial inclusion strategy document with emphasis on financial access, inclusion and literacy. The strategy aims at leveraging the geographical spread and branch network of the Nigerian Postal Service (NIPOST) to reach the target population. To this end, the Bank commenced the implementation of a public/private partnership arrangement that would enable the private sector to support NIPOST to effectively participate in the implementation of the financial inclusion strategy.

In order to deepen access to financial services, the CBN issued a Three-Tiered KYC Guideline designed to lower requirements for low-income applicants who do not possess the requisite documents for the opening of standard bank accounts. The tiered KYC presupposes that when the financial status of such low-income customers improves, higher KYC requirements would automatically apply.

In the second half of the year, the Ministry of Communication Technology, also rolled out an all-inclusive ICT policy document. Implementation of the policy will address some of the challenges associated with the payments system, and thereby enhance financial inclusion.

2.5 Financial Markets

2.5.1 The Money Market

In line with its objective of ensuring price stability, the Bank sustained a tight monetary policy stance in the second half of 2012. This ensured that money market rates were relatively stable in the period, except for a spike in August, which was occasioned by an increase, in July, of the Cash Reserve Requirement (CRR) from 8.0 per cent to 12.0 per cent. The tight monetary stance was complemented by the issuance of a Revised Guideline for Accessing CBN

Lending Window and Repurchase Transactions which prohibited authorized dealers from concurrently accessing the Wholesale Dutch Auction System (WDAS) and the Repurchase/Standing Lending Facility (SLF) windows, throughout the term of a repurchase or SLF transaction.

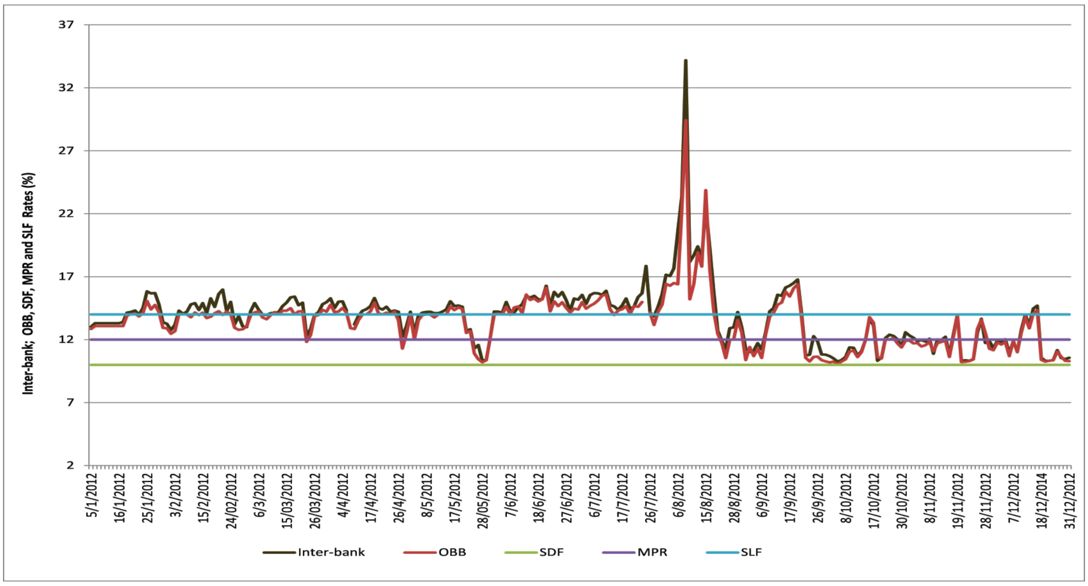
The average weighted open-buy-back (OBB) and inter-bank call rates stood at 10.29 and 10.56 per cent, respectively, at end-December 2012, down from 14.46 and 15.26 per cent at end-June 2012. This development was attributed to increased liquidity in the financial system through payments from the Excess Crude Account to sub-national governments, repayment of matured CBN Bills and the build-up of liquidity by DMBs to meet anticipated withdrawals associated with year-end festivities.

To further deepen the money market, enhance financial inclusion, facilitate effective liquidity management and achieve price stability, the Bank released the guidelines for the operation of the following Non-Interest Financial Instruments (NIFIs):

- CBN Safe-Custody Account;
- CBN Non-interest Note; and
- CBN Non-interest Asset-backed Securities.

These instruments are accessible to licensed non-interest banks, DMBs with a non-interest banking window, and any other authorised dealer approved by the Bank. Appropriate governance structures, including the establishment of a Market Support Committee and a NIFI Product Development Committee, have been put in place to ensure the effective implementation and administration of the instruments.

Figure 12: Inter-bank Rates Movements



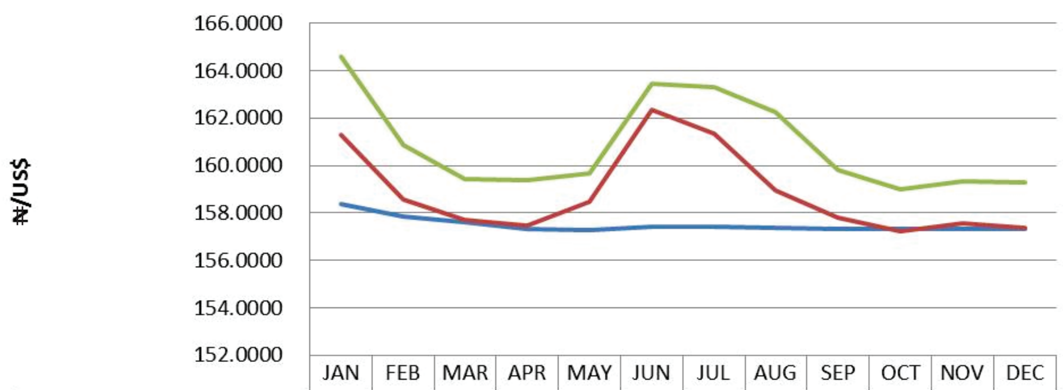
2.5.2 The Foreign Exchange Market

The average exchange rate of the Naira appreciated in all segments of the market in the second half of 2012, with the inter-bank and BDC rates closing in on the WDAS rate. The average WDAS, inter-bank and BDC exchange rates appreciated by 0.07, 3.16 and 2.62 per cent respectively, to close at ₦157.3240, ₦157.3542 and ₦159.2632 to the US Dollar, at end-December 2012 (Figure 13). The appreciation was attributed to increased Foreign Portfolio Investments (FPIs), following the inclusion of Federal Government of Nigeria (FGN) bonds on the Global Bond Index for Emerging Markets (GBI-EM) by JPMorgan Chase & Co. on October 1, 2012. In addition, the announcement by Barclays Plc, in November 2012, that it would include the FGN bonds in its Emerging Markets Local Currency (EMLC) government bond index in March 2013 further enhanced investor confidence.

2.5.3 The Bond Market

FGN Bond yields at end-December 2012 declined when compared with end-June 2012 (Figure 14). The development was attributed to the increased trading and liquidity associated with the inclusion of FGN Bonds on the JPMorgan GBI-EM index, the inflow of foreign funds due to the continued Euro-zone debt crisis, the relative stability of the foreign exchange rate, and increased liquidity in the banking system.

Figure 13: WDAS, Inter-bank and BDC Rates, 2012



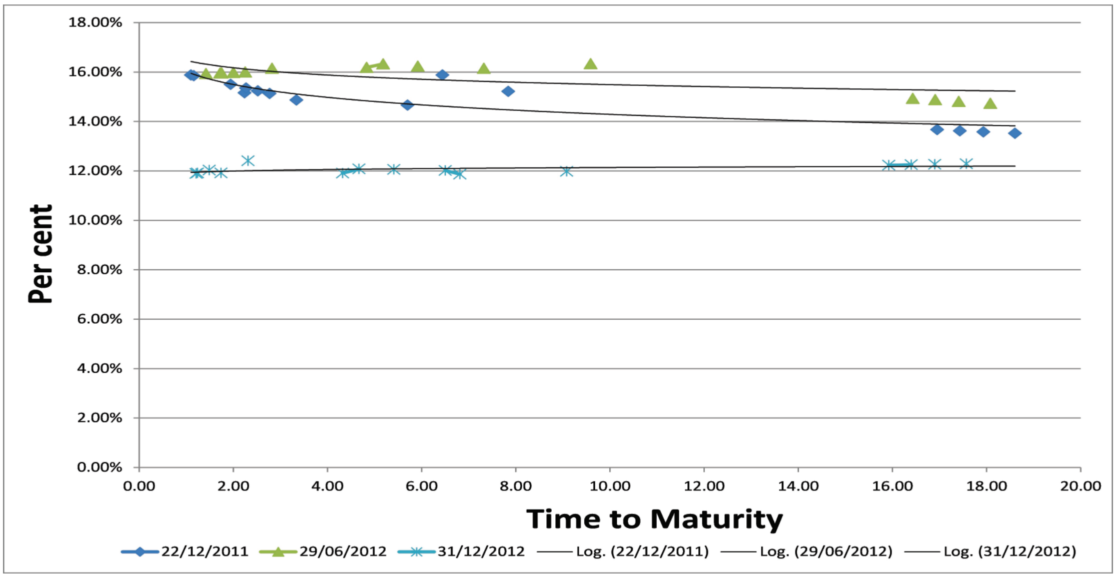
	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
WDAS (incl. 1% comm.)	158.3	157.8	157.5	157.3	157.2	157.4	157.4	157.3	157.3	157.3	157.3	157.3
INTERBANK	161.3	158.5	157.7	157.4	158.4	162.3	161.3	158.9	157.7	157.2	157.5	157.3
BDC	164.6	160.8	159.4	159.3	159.6	163.4	163.3	162.2	159.8	159.0	159.3	159.2

During the review period, FPIs valued at US$8.06 billion (with 87.16, 4.70 and 8.14 per cent, invested in equity, bonds, and money market instruments, respectively) were recorded in the country, compared with US$5.26 billion (87.98, 3.92 and 8.09 per cent respectively, invested in equity, bonds and money market instruments) in the first half of 2012. The Bank, mindful of the adverse impact of sudden reversals, continued to monitor FPIs in-flow into the country and has put in place adequate arrangements to mitigate such impact on the Nigerian financial markets.

JPMorgan Chase & Co. included FGN Bonds maturing in 2014, 2019 and 2022 on the GBI-EM index on October 1, 2012. The FGN Bonds are estimated to represent about 0.59 percent of the index. Furthermore, Barclays Plc, in November 2012, announced the inclusion of FGN Bonds in its EMLC government bond index from March 2013, reflecting increased government efforts at developing the bond market, as well as the integration of the Nigerian financial markets into the international financial markets as envisioned by the Financial System Stability 2020 programme. These developments are expected to increase foreign portfolio investments in the country.

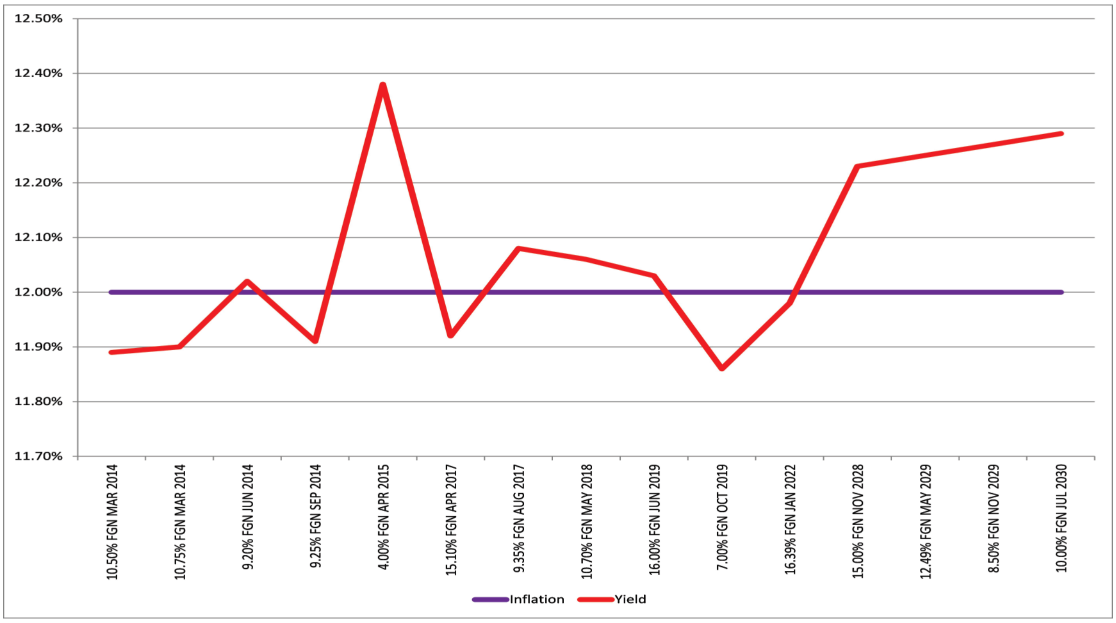
With headline inflation (year-on-year) at 12.0 per cent in December 2012, the real rate of return for some tranches of FGN Bonds was negative (Figure 15). This development might negatively impact the market in the short term as prices adjust. However, given the global appeal of the FGN Bonds, it is expected that the bonds would continue to attract FPIs as yields remained relatively competitive when compared with other sovereign bonds.

Figure 14: FGN Bonds' Yield Curve



Source: Financial Markets Dealers Association

Figure 15: Bond Yields on December 28, 2012 versus December Inflation Rate



Source: Financial Markets Dealers Association and National Bureau of Statistics

2.5.4 The Equity Market

The introduction of a robust information and communications technology has deepened financial integration, enhanced client access to information, and lowered transaction costs. These developments have further boosted investor confidence as evidenced by the sharp rise in FPIs, the rise in market capitalization, the increase in the value of shares traded as a percentage of GDP, an increase in the number of listed domestic companies, the timeliness and reasonable cost of dealings, and efficient trade settlements.

The Nigerian Stock Exchange (NSE) All-Share Index (ASI) closed at 28,078.21 at end-December 2012, representing an increase of 12.40 per cent, from 24,980.20 at end-June. The increase was due to the measures taken to revive the market, which included forbearance of ₦ 22.64 billion by the Federal Government to 84 stockbrokers with margin loans worth ₦ 42.60 billion, backed by underlying assets valued at ₦ 19.96 billion. The forbearance was accompanied with sanctions that would be applied to defaulting stockbrokers going forward. These include:

- Prohibition from providing services to AMCON for a period of not less than 3 years;
- Requirement to reveal to the SEC, dealings in securities valued at a minimum of ₦25 million in single or multiple deals on the same day;
- Limiting of their aggregate indebtedness to 100 per cent of net capital;
- Prohibition from proprietary trading for a period of one year; and
- Imposing the separation of assets and control for brokerage services through the use of custodians.

In addition, the FG waived the 0.075 per cent stamp duties payable on transaction consideration and value added tax (VAT). The NSE also introduced market makers in order to deepen the market and enhance investor confidence. These measures have impacted positively on the market.

2.5.5 The Central Securities Depository

The Bank acquired the Central Securities Depository (CSD) to be integrated with the new Real-Time Gross Settlement (RTGS) System to facilitate Delivery versus Payment (DvP) of government securities. When fully operational, the CSD system would reduce inefficiencies in financial and securities settlements and facilitate effective implementation of monetary policy, improve efficiency of the payments system and, ultimately, enhance stability of the financial system.

2.6 The Insurance Sector

At end-December 2012, 59 insurance companies, two re-insurance companies, 579 brokers, 48 loss adjusters and 2,250 agents were in operation. Significant developments in the industry included the issuance by the National Insurance Commission (NAICOM) of the "No Premium, No Cover" directive, which barred insurance companies from accepting policies on their books except where the premium had been received.

Also, the NSIA of Ivory Coast, the Old Mutual of South Africa, and a private equity fund from Europe took majority stake in various insurers. NAICOM also carried out AML on-site inspection of insurance companies and implemented the local content regulation which resulted in about 48 per cent of oil & gas risk being covered by leading Nigerian insurance companies.

2.7 The Pension Sector

In continuation of efforts to ensure a strong and virile pension industry that can guarantee the sustainability and safety of pension assets, the Nigerian Pension Commission (PENCOM) increased the minimum paid-up capital requirement of Pension Fund Administrators (PFAs) from ₦150 million to ₦ 1 billion. The PFAs were given a maximum period of one year to comply with the new capital requirement. The revised paid-up share capital regime is expected to promote healthy competition in the industry, enhance the presence of the PFAs around the Country, as well as promote the deployment of state-of-the-art information and communications technology. At the expiration of the deadline, 20 out of the 24 PFAs had recapitalized, three were acquired and the operating licence of one was withdrawn.

In order to strengthen the administration of pensions in the public service, the Federal Government inaugurated an Inter-Ministerial Committee (IMC), in 2012, to work out the operational modalities of the Pension Transitional Arrangement Department (PTAD), in accordance with the provisions of Section 30 of the Pension Reform Act 2004. The first phase of the project was concluded by the IMC and a Blueprint forwarded to the Minister of Finance/Coordinating Minister for the Economy.

2.8 Real Sector Intervention Initiatives

In order to promote real sector growth and entrepreneurship development, the Bank sustained the initiatives described in sub-sections 2.8.1 to 2.8.7 during the review period:

2.8.1 The Nigeria Incentive-based Risk Sharing System for Agricultural Lending (NIRSAL)

NIRSAL is designed to promote the provision of affordable financial products to the agricultural value-chain, reduce the risk of financial institutions that grant agricultural loans, build capacity of banks to lend to agriculture, as well as encourage banks to invest in the sector. The initiative is a ₦75 billion programme hinged on five pillars, namely:

- A risk sharing facility (RSF),
- A technical assistance facility (TAF),
- A bank-incentive mechanism (BIM),
- A bank rating system (BRS), and
- An insurance facility (IF).

The notable achievements of the NIRSAL initiative, thus far, include the following:

- Establishment of NIRSAL Plc as a non-bank financial institution;
- Issuance of 8 Credit Risk Guarantees (CRGs) valued ₦5.31 billion; and
- Engagement of 30 state governments to promote aquaculture, the production, processing and marketing of rice, tomato, cotton, and beef.

2.8.2 The Commercial Agriculture Credit Scheme (CACS)

The Commercial Agriculture Credit Scheme (CACS) was established in 2009 to finance large ticket projects along the agricultural value-chain. The cumulative amount disbursed since its inception to 269 projects stood at ₦199.12 billion at end-December 2012. The Scheme recorded the following achievements in the second half of 2012:

- Released the sum of ₦752.00 million to DMBs for 8 projects;
- Created more jobs and increased the capacity utilization of existing projects; and
- Commenced the recycling of ₦16.83 billion repayment proceeds, with the disbursement of ₦3.5 billion to 2 projects.

2.8.3 The Agricultural Credit Guarantee Scheme (ACGS)

A total of 13,869 loans, valued at ₦3.24 billion, were guaranteed in respect of seven (7) DMBs and some Microfinance banks during the review period, compared with 15,910 loans valued at ₦2.43 billion guaranteed during the first half of 2012. Cumulatively from 1978, a total of 803,264 loans amounting to ₦ 62.05 billion were guaranteed. The cumulative number and value of claims paid from its inception to date stood at 14,582 claims, valued ₦450.86 million.

Under the Interest Drawback Programme (IDP) of the ACGS, 10,139 claims, valued at ₦98.85 million, were paid during the review period, bringing the total IDP claims paid from its inception to 181,078, valued at ₦2.78 billion.

2.8.4 The Agricultural Credit Support Scheme (ACSS)

The ACSS was established to finance large ticket agricultural projects, with an interest rebate of 6 per cent, upon the timely repayment of the facility. During the review period, no rebate was paid. However, the total rebate paid from its inception stood at ₦876.89 million to 46 projects.

2.8.5 The SME Credit Guarantee Scheme (SMECGS)

The ₦200 billion SMECGS was established in April 2010 to fast-track the development of the manufacturing sector and SMEs by providing guarantees for bank credits. In the review period, twenty (20) applications, valued ₦877.2 million were guaranteed, bringing the total number of applications guaranteed under the Scheme from its inception to forty six (46), valued ₦2.054 billion.

2.8.6 The Power and Airline Intervention Fund (PAIF)

The ₦300 billion PAIF was approved for investment in power and airline projects. It was designed to address the paucity of long-term credit to the two sectors. In the review period, four (4) applications valued at ₦5.53 billion were approved and disbursed (three power projects received ₦4.757 billion while one airline project received ₦ 776 million). Cumulatively, the sum of ₦181.42 billion for 36 projects had been disbursed by BOI from the inception of the Fund (21 power projects received ₦90.50 billion while 15 airline projects received ₦90.92 billion).

2.8.7 Entrepreneurship Development Centres (EDCs)

The CBN supports capacity building for entrepreneurs in the SME and microfinance sub-sectors. The Entrepreneurship Development Centres (EDCs) were established with the aim of building the entrepreneurial spirit of the country's youth to enable them contribute effectively to the sustainable development of the economy. In pursuit of this initiative, 3 EDCs were established in April, 2008 and located in Onitsha, Kano and Lagos.

In the second half of 2012, the CBN

approved the establishment of 3 new EDCs to be located in Makurdi, Maiduguri and Calabar. In addition to the existing six satellite EDCs located in 6 states, three new satellite centres were approved.

Since the inception of the programme, a total of 41,441 individuals have been trained, 106,933 counselled, while 10,895 jobs had been created. In the same period, 1,034 trainees were able to obtain loans valued ₦220.04 million from banks.

2.9 The External Sector

Gross external reserves rose to US$43.83 billion at end-December 2012, from US$35.41 billion at end-June 2012, representing an increase of US$8.42 billion or 23.78 per cent. A breakdown of the total external reserves indicated that 84.33 per cent was held in US Dollars, 5.91 per cent in Euro, 5.87 per cent in IMF SDRs, 1.94 per cent in Renminbi, 1.88 per cent in Pound Sterling, and 0.07 per cent in other currencies at end-December 2012.

Total foreign exchange inflow in the second half of 2012 was US$24.56 billion, compared with US$22.17 billion recorded in the first half of 2012, representing an increase of US$2.39 billion (10.78%).Total outflow in the review period was US$15.85 billion. This was lower by US$3.51 billion (18.13%) than the US$19.36 billion recorded in the first half of 2012. The net inflow in the review period was US$8.71 billion, compared to US$2.82 billion in the first half of the year.

Foreign reserves at end-December 2012 was sufficient to finance 11.3 months of imports, compared with the 9.2 months at end-June 2012 and the internationally-accepted benchmark of three months of import cover. This level could mitigate vulnerabilities to external shocks, thereby increasing confidence in the domestic currency.

3.0 REGULATORY AND SUPERVISORY ACTIVITIES

3.1 Macro-Prudential Supervision

3.1.1 Financial Soundness Indicators[2]

3.1.1.1 Assets-based Indicators

Banking sector soundness improved in the second half of 2012. Aggregate asset quality, measured by the ratio of non-performing loans to total credit, at 3.5 per cent, trended downwards by 0.8 and 1.8 percentage points below the levels at end-June 2012 and end-December 2011, respectively. The ratio of core liquid assets[3] to total assets increased by 1.2 percentage points to 24.7 per cent at end-December 2012, from 23.5 per cent at end-June 2012. Similarly, the ratio of liquid assets to short-term liabilities rose by 0.8 percentage point to 28.9 per cent at end-December 2012 (Figure 17). The improved liquidity level of the sector reflected the increase in holdings of liquid assets, such as short-term government securities, and indicates reduced systemic risk arising from illiquidity.

Figure 16: Banking Industry NPLs to Total Gross Loans (%)

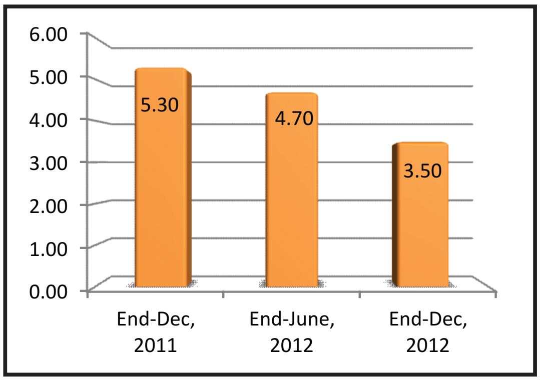


Table 6: Selected Asset-based Indicators

	2008		2009		2010		2011		2012	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)*	(10)**
	End-June	End-Dec	End-June	End-Dec	End-June	End-Dec	End-June	End-Dec	End-June	End-Dec
Asset-based Indicators										
NPL to total gross loans	4.0	6.3	8.5	27.6	28.8	15.7	10.8	5.3	4.7	3.5
Liquid assets (core) to total assets	24.4	17.6	15.6	16.5	17.2	17.2	22.6	25.7	24.3	24.7
Liquid assets (core) to short - term liabilities	33.9	24.2	21.5	22.3	19.4	19.8	25.7	31.2	28.1	28.9
Return on assets (ROA)	2.1	3.7	1.7	-8.9	1.0	3.9	0.9	0.1	1.5	0.8
*Revised, **Provisional,										

[2]Note that the FSIs are computed, based on the IMF Compilation Guide.
[3]Core liquid assets are instruments of not more than 30 days maturity.

3.1.1.2 Capital-based Indicators

The ratio of regulatory capital to risk-weighted assets stood at 18.3 per cent at end-December 2012, indicating an improvement of 0.6 percentage point over its level at end-June 2012. The corresponding ratio of Tier 1 capital to risk-weighted assets also improved by 0.2 percentage point to 18.0 per cent at end-December 2012, from 17.8 per cent at end-June 2012 (Table 7). The regulatory capital to risk-weighted assets ratio was 8.3 percentage points above the prudential requirement of 10.0 per cent.

The ratio of non-performing loans (net of provisions) to capital of the banking system improved to 6.1 per cent at end-December 2012 from 6.8 per cent at end-June.

3.1.1.3 Income and Expense-based Indicators

The ratio of net interest income to gross income declined to 46.0 per cent in the review period, from 48.8 per cent at end-June 2012. Also, the ratio of non-interest expenses to gross income increased by 0.6 percentage point to 51.5 percent from 50.9 per cent at end-June 2012 (Figure 18). Conversely, the ratio of personnel expenses to non-interest expenses decreased by 1.7 percentage point to 37.2 per cent at end-December 2012, from 38.9 percent at end-June 2012 (Table 8).

Figure 17: Banking Industry Liquidity Indicators (%)

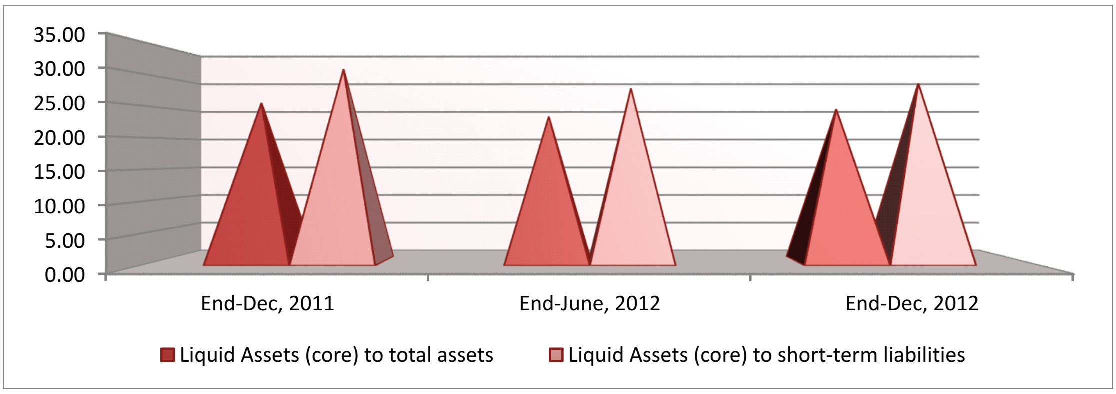


Table 7: Selected Capital-based Indicators

	2008		2009		2010		2011		2012	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)*	(10) **
	End-June	End-Dec	End-June	End-Dec	End-June	End-Dec	End-June	End-Dec	End-June	End-Dec
Capital-based Indicators										
Regulatory capital to risk-weighted assets	23.7	21.9	22.4	4.1	1.5	1.8	4.2	17.9	17.7	18.3
Tier 1 capital to risk - weighted assets	23.2	21.5	21.9	4.9	2.4	2.2	4.5	18.1	17.8	18.0
NPLs net of provision s to capital	3.5	9.1	12.5	106.8	289.8	192.7	74.3	10. 1	6.8	6.1
Return on equity (ROE)	11.5	20.7	8.9	- 222.8	50.2	265.0	29.4	0.5	13.1	7.8

*Revised, **Provisional,

Figure 18: Banking Industry Income and Expense-based Indicators (%)

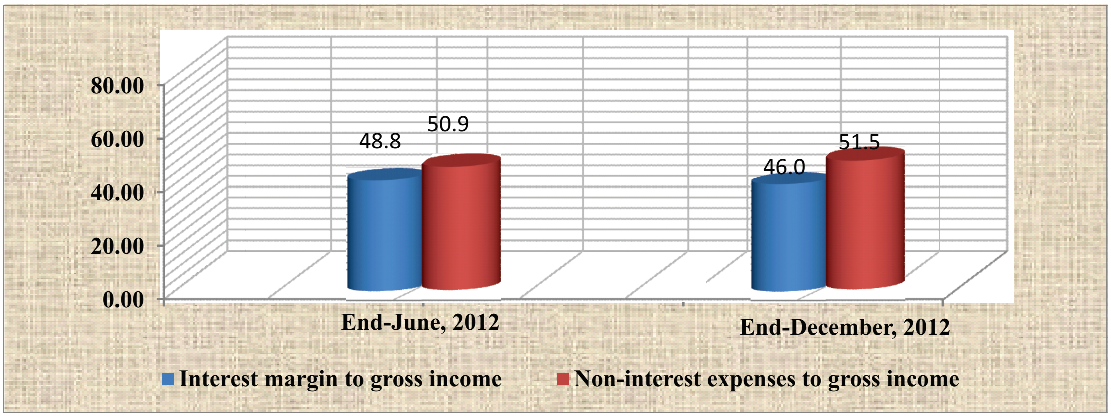


Table 8: Selected Income and Expense-based Indicators

	2008		2009		2010		2011		2012	
	(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*	*(7)*	*(8)*	*(9)**	*(10)***
	End-June	*End-Dec*	*End-June*	*End-Dec*	*End-June*	*End-Dec*	*End-June*	*End-Dec*	*End-June*	*End-Dec*
Income and Expense Based Indicators										
Interest margin to gross income	54.6	58.3	60.1	57.8	54.0	53.7	50.8	42.2	48.8	46.0
Non-interest expenses to gross income	57.8	59.6	64.5	81.2	80.5	66.9	72.9	75.4	50.9	51.5
Personnel expenses to non -interest expenses	45.5	44.8	46.7	47.6	45.5	42.8	44.6	36.1	38.9	37.2
*Revised, **Provisional,										

3.1.2 The Banking Industry Stress Test

The stress test was conducted in terms of liquidity and solvency.

3.1.2.1 The Liquidity Stress Test

The liquidity stress test assessed the resilience of the banking system to substantial withdrawal of deposits, wholesale and long-term funding in a 5-day period and a cumulative 30-day period, with specific assumptions on fire sale of assets to generate liquidity. It also assessed funding maturity mismatch and rollover risk for assets and liabilities in the less than 30-day and 31-90 day buckets, with the assumption of some level of CBN and intra-group funding.

The results showed that industry liquidity ratio declined to 16.1 and 7.8 per cent, after the 5-day and cumulative 30-day shocks, from the pre-shock position of 68.0 per cent (Table 9). Most banks recorded liquidity ratios below the regulatory threshold of 30 per cent for the 5-day and cumulative 30-day run scenarios, respectively. Similarly, five (5) banks recorded negative liquidity ratios following a cumulative 30-day shock. These five banks are categorised as 'large banks', holding 40.3 per cent of the total assets of the banking industry.

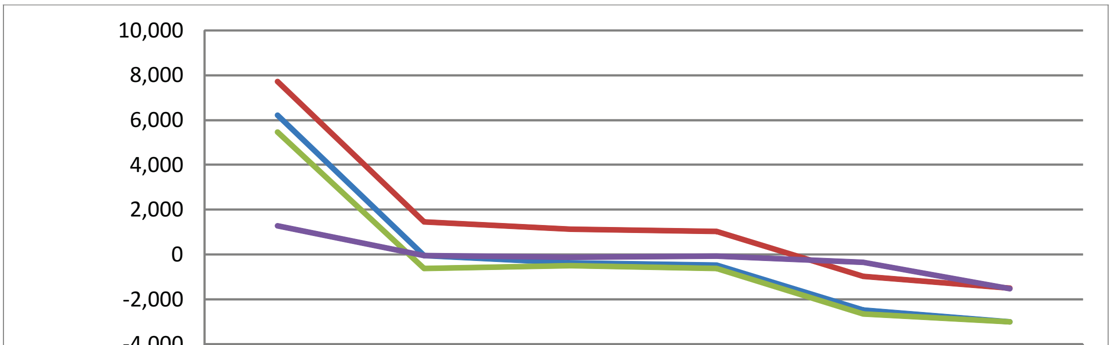
However, under the rollover risk, assets in the 30-day buckets were adequately funded, following the three scenarios used for the test (Figure 19).

Although the test revealed vulnerability in some banks, the overall banking system was not at risk as it was well-positioned to absorb any liquidity pressures that might occur.

Table 9: Implied Cash Flow Analysis, System Level Results

Total Number of Banks tested	Number of Banks with < 30% liquidity ratio				December 2012	
20	Dec. 2012	Sept. 2012	June 2012	March 2012	System LR (%)	Liquidity Shortfall to make 30% LR (₦'billion)
Pre-Shock LR					68.0	
Test 1.1: Implied Cash Flow Test (5 Days)						
Day 1	5	14	7	7	34.4	Nil
Day 2	10	14	14	10	30.4	Nil
Day 3	12	14	15	12	26.1	388.87
Day 4	15	15	15	14	21.4	797.41
Day 5	15	16	15	15	16.1	1,188.85
Test 1.2: Implied Cash Flow Test (30 Days)	17	19	16	17	7.8	1,849.11

Figure 19: Rollover Risk Pre- and Post-Shock



	Less than 30 days (N'billion)	31-90 days (N'billion)	90 -180days (N'billion)	180 360days (N'billion)	1-3 years (N'billion)	above 3 years (N'billion)
Pre-Shock	6,201	-41	-380	-480	-2,470	-3,003
Scenario 1	7,705	1,464	1,125	1,025	-966	-1,499
Scenario 2	5,458	-625	-493	-624	-2,651	-3,004
Scenario 3	1,289	-46	-110	-60	-344	-1,535

Figure 20: Industry and Individual Bank Pre-Shock Positions

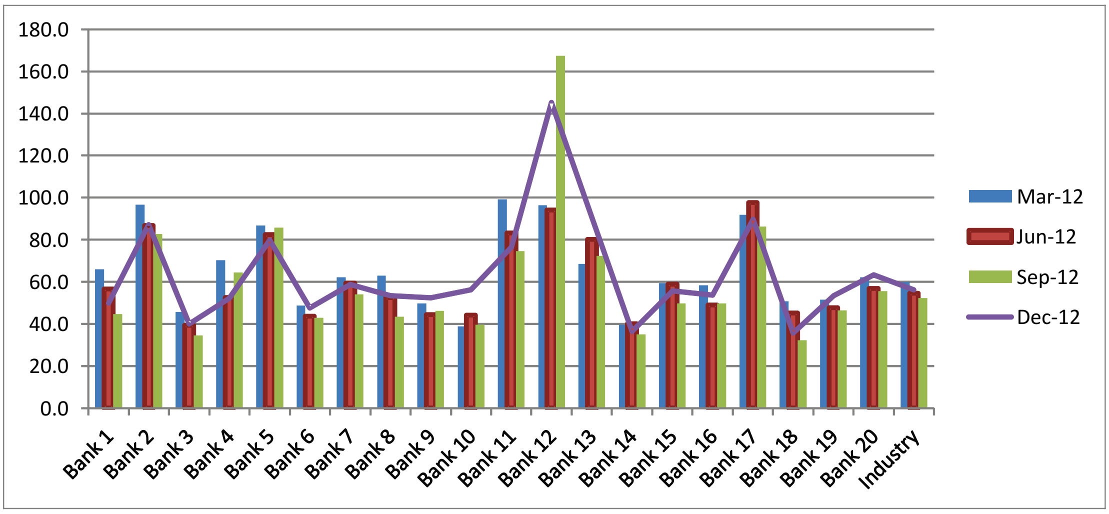


Figure 21: Industry Position After 1-5 Day and Cumulative 30-Day Shocks

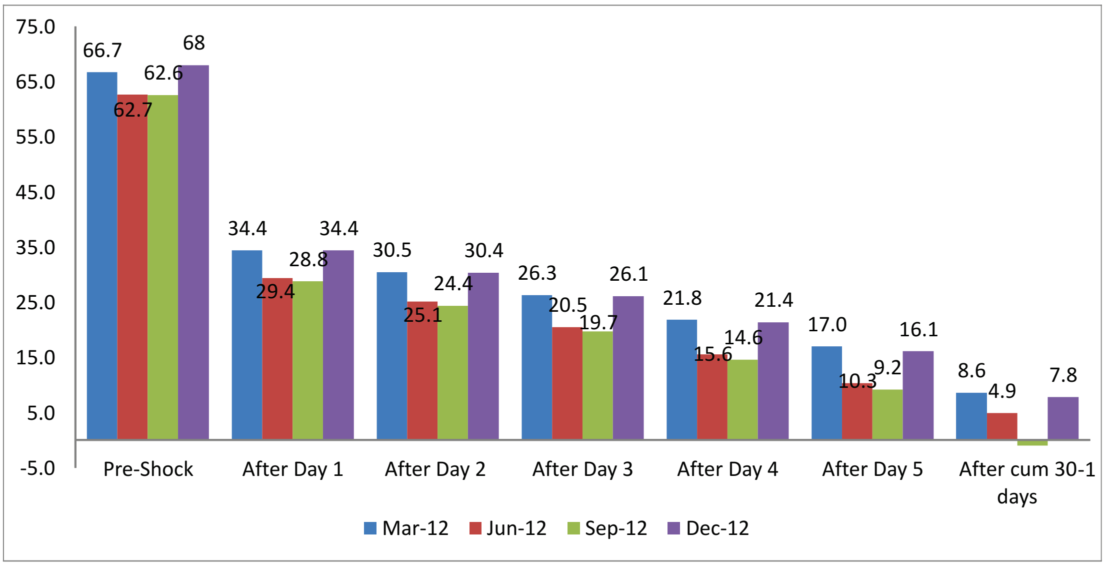
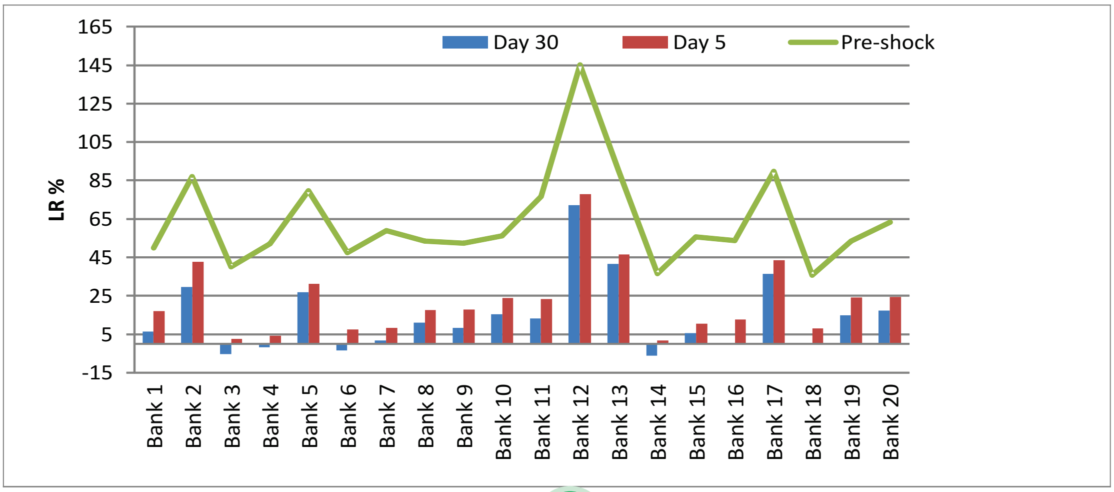


Figure 22: Individual Bank Positions After 5-Day and Cumulative 30-Day Shocks



3.1.2.2 The Solvency Stress Test

The solvency stress test assessed the resilience of the Nigerian banking industry to plausible shock scenarios. The scenarios were based on historical worst case and hypothetically strained macroeconomic situations. The test assessed banks' balance sheet deterioration from the baseline position (steady state), which entailed a static balance sheet approach (assumed no response to the shocks). The assumptions were built around credit, liquidity, exchange and interest rate risks. The resilience of the banks was assessed against a benchmark defined with reference to 10 per cent CAR, 30 per cent liquidity ratio, 5 per cent NPL ratios, as well as trend performance of return on asset (ROA) and return on equity (ROE).

For systemic and peer assessment, the banks were classified into three groups, based on their asset size as follows: large (≥₦1 trillion); medium (<₦1 trillion but ≥ ₦500 billion) and small (<₦500 billion).

The Baseline Positions

The baseline CARs for the banking industry, large, medium and small banks stood at 18.36, 18.06, 20.32, and 16.93 per cent, respectively. These represent 0.05, -0.26, 1.16 and 0.66 percentage points change over the June 2012 positions. Similarly, the pre-shock banking industry, large, medium and small banks liquidity ratios were 68.02, 61.99, 47.22 and 79.77 per cent, respectively, representing 29.24, 28.35, 4.76 and 22.41 percentage points change, respectively.

Figure 23: Number of Banks in Each Bucket of CAR

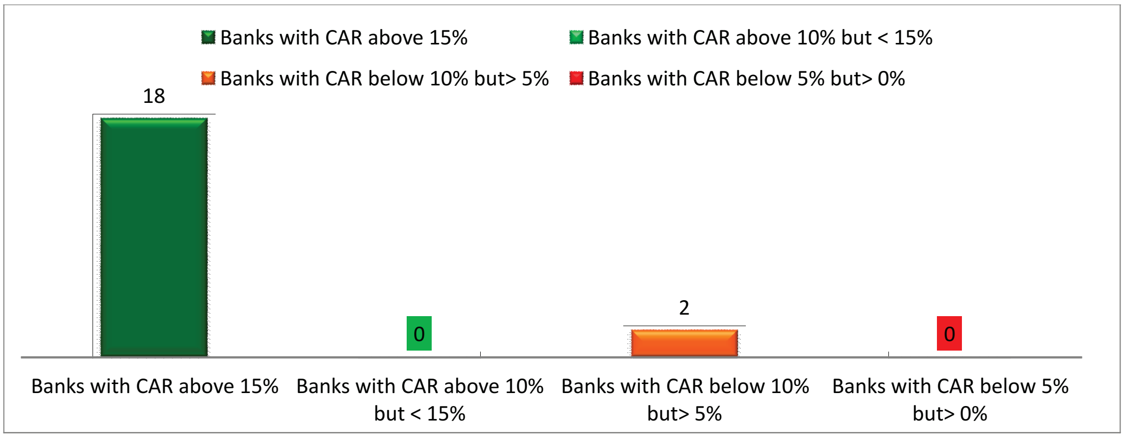


Figure 24: Number of Banks in Each Bucket of LR

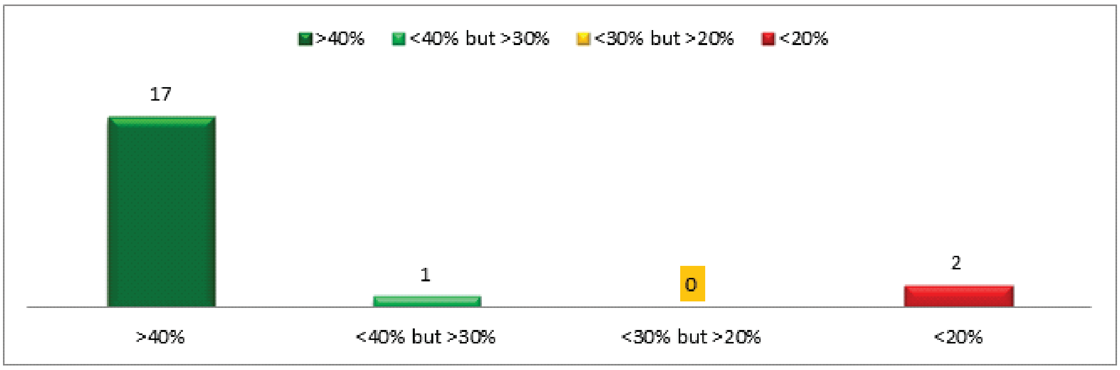


Figure 25: Baseline CAR and Liquidity Ratios (%)

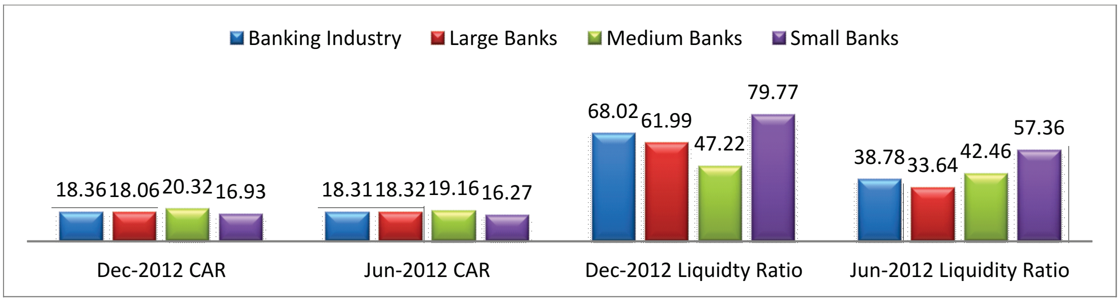
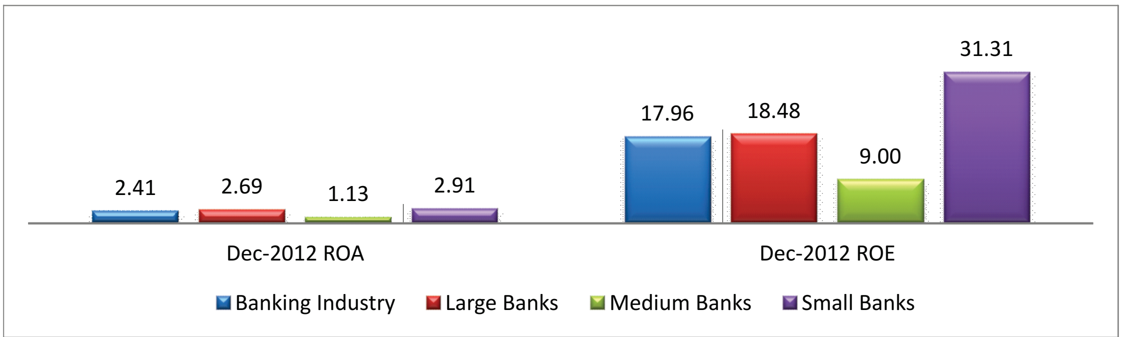


Figure 26: Baseline ROA and ROE (%)



The pre-shock ROAs of the banking industry, large, medium and small banks were 2.41, 2.69, 1.13 and 2.91 per cent, respectively at end-December 2012, while their ROEs stood at 17.96, 18.48, 9.00 and 31.31 per cent, respectively.

3.1.3 Stress Test Results

Credit Risk

The banking industry resilience to credit risk sustained an upward trend. The impact of the most severe shock (200% rise in NPLs) on capital resulted in a CAR of 11.40 per cent. Large and medium banks were less vulnerable to the shock, maintaining CARs of 12.92 and 13.97 per cent, respectively.

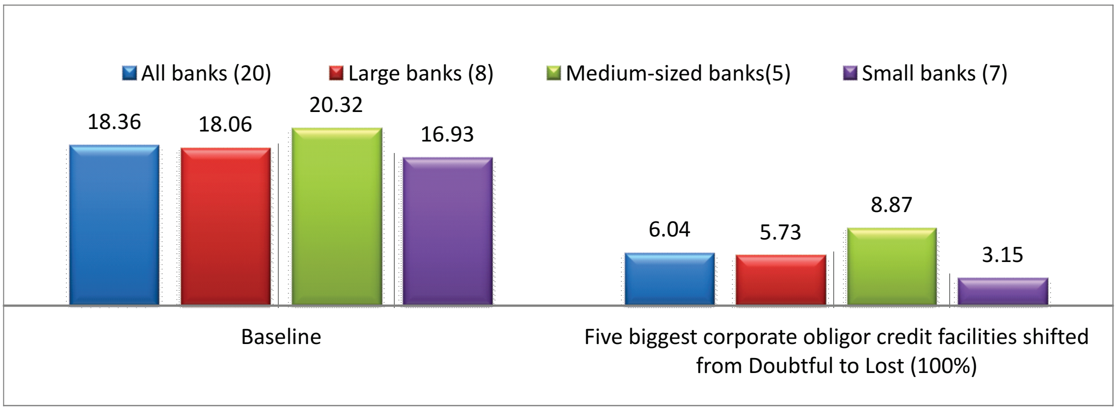
However, the small banks' CAR deteriorated to -5.22 per cent, from 16.93 per cent. Thus, the affected banks would require about ₦30 billion to raise their CARs to the regulatory threshold of 10 per cent. Under this scenario, 12 banks maintained CARs above 10 per cent, while 3, 1 and 4, banks had <0%, <5% but ≥ 0%, and ≤ 10% but ≥ 5%, CARs, respectively.

Table 10: Stress Test Results – Credit Risk

Number of Banks with CAR Under Respective Scenarios	<0%	<5	<10	<15	>15	Total
Shock 1ai -10% NPLs increase	0	0	2	2	16	20
Shock 1aii-15% NPLs increase	0	1	1	2	16	20
Shock 1aiii-20% NPLs increase	0	1	1	2	16	20
Shock 1aiv-30% NPLs increase	0	1	1	2	16	20
Shock 1av-50% NPLs increase	1	1	1	4	13	20
Shock 1avi-100% NPLs increase	3	0	1	7	9	20
Shock 1avii-200% NPLs increase	3	1	4	7	5	20

The banking industry and all the categorised banks showed significant levels of concentration risk as indicated by the speed of capital deterioration resulting from a decline in the quality of assets to the top obligors. If exposure to "top five obligors" were to shift from doubtful to lost, CARs for the industry, large, medium and small banks would deteriorate from 18.36, 18.06, 20.32 and 16.93 per cent to 6.04, 5.73, 8.87 and 3.15 per cent, respectively. Furthermore, only five banks would achieve a CAR greater or equal to 10 per cent, while the remaining 15 banks would have either less than 10 per cent or a negative CAR.

Figure 27: Credit Concentration Risk



Interest Rate Risk

The results of the tests on the net position of interest-sensitive instruments to "returns on assets" and "returns on equity" revealed that the entire banking industry, "categorized banks" and individual banks maintained a less vulnerable position to interest rate risk as their pre-shock positions (in terms of capital impairment, ROA and ROE) declined only marginally, even after severe shocks were applied.

Table 11: Stress Test Results – Interest Rate Risk

Severe Shocks (500bps to 1000bps)	Banking Industry	Large Banks	Medium Banks	Small Banks
Baseline CAR	18.36	18.06	20.32	16.93
Baseline ROA	2.41	2.69	1.13	2.91
Baseline ROE	17.96	18.48	9.00	31.31
Interest Rate Volatility (Impact on CAR)				
Shock 5biii (500bps downward parallel shift in yield curve)	18.08	17.88	19.84	16.37
Shock 5biv (1000bps downward parallel shift in yield curve)	17.80	17.70	19.36	15.80
Impact of Parallel Shift in Yield Curve Shocks on ROA				
Interest Rate Volatility				
Shock 5biii (500bps downward parallel shift in yield curve)	2.20	2.54	0.80	2.58
Shock 5biv (1000bps downward parallel shift in yield curve)	2.00	2.40	0.46	2.25
Impact of Parallel Shift in Yield Curve Shocks on ROE				
Interest Rate Volatility				
Shock 5biii (500bps downward parallel shift in yield curve)	16.42	17.50	6.34	27.74
Shock 5biv (1000bps downward parallel shift in yield curve)	14.87	16.51	3.67	24.17

Exchange Rate Risk

The test results showed that the impact of exchange rate risk on the net foreign assets of banks would bring about deterioration in CAR if a 50 per cent appreciation in exchange rate was applied. Specifically, under this scenario, twelve banks would fail to meet the required 10 per cent minimum regulatory mark. The position was largely due to a high foreign exchange asset level relative to total risk weighted assets.

Foreign Exchange Trading Risk

The banking industry is less vulnerable as ROA and ROE would only change marginally, even after an induced 100 per cent decline in foreign exchange (FX) trading income. This is due to banks' high level income positions from other sources, relative to the size of their FX trading income.

Table 12: Stress Test Results - Exchange Rate Risk

Number of Banks with CAR Under Specified Scenarios	<0%	<5%	<10%	<15%	>15%	Total
Baseline	0	0	1	2	17	20
Shock 4bi (10% appreciation in favour of the Naira)	0	0	1	5	14	20
Shock 4bii (20% appreciation in favour of the Naira)	0	0	2	10	8	20
Shock 4biii (50% appreciation in favour of the Naira)	1	1	10	1	7	20
Shock 4biv (100% appreciation in favour of the Naira)	5	7	3	3	2	20

Table 13: Foreign Exchange Trading Risk

Number of Banks with ROA and ROE in Respective Buckets	<0%	<1%	<2%	<5%	>5%	Total
Impact of FX Trading Shocks on ROA						
Baseline ROA	2	3	7	6	2	20
FX Trading Income Volatility						
Shock 7ai (10% decline in FX trading Income)	2	4	7	4	3	20
Shock 7aii (20% decline in FX trading Income)	2	4	7	4	3	20
Shock 7aiii (50% decline in FX trading Income)	2	4	7	5	2	20
Shock 7aiv (100% decline in FX trading Income)	4	2	8	5	1	20
Impact of FX Trading Shocks on ROE	<0%	<5%	<10%	<15%	>15%	
Initial ROE	0	0	1	5	14	20
FX Trading Income Volatility	0	0	1	5	14	20
Shock 7ai (10% decline in FX trading Income)	0	0	1	5	14	20
Shock 7aii (20% decline in FX trading Income)	0	0	1	5	14	20
Shock 7aiii (50% decline in FX trading Income)	0	0	1	5	14	20
Shock 7aiv (100% decline in FX trading Income)	0	0	1	5	14	20

3.1.4 Enhancement of the Specific Tools and Framework for Supervision

The CBN engaged a consultant to develop a policy proposal for the enhancement of specific tools and for managing the stability of Nigeria's financial system. During the period covered by this Report, the policy proposal was presented to Management. The policy proposal is built around four modules as follows:

- Macro-prudential Policy Framework
- Micro-prudential Policy Framework
- Crisis Handling and Resolution Framework; and
- Legal Underpinnings.

The Macro-prudential Module addresses the following areas:

- Consideration of fiscal and monetary policy instruments with their potential impact on the resilience of the financial system;
- Policy harmonization and resolution of conflict of objectives between monetary policy and financial policy;
- The role of the CBN and other regulatory authorities in ensuring systemic stability; and
- Quality of data gathering, quality of data, capacity building, and accountability.

The objectives of the Micro-prudential Module are to:

- Review and validate existing banking supervision tools;
- Benchmark the supervisory tools with those of other central banks in terms of mandate, governance, organization and resources; and
- Review the existing risk-based banking supervision mechanism and the operation of holding companies under the new banking model.

The Crisis Handling and Resolution Module is to enhance the existing framework for crisis handling and resolution in the financial system. The scope covers the build up to crisis, transition to crisis, early warning system, contingency planning, prompt corrective action arrangement and coordination with other authorities.

The Legal Underpinning Module is to identify any gaps in existing and pending legislation that might require amendments to enable the implementation of the recommendations.

The implementation of the recommendations will strengthen the existing framework for supervision at the micro- and macro-levels, enhance coordination among regulators in the supervision of the financial system as well as in resolving crisis situations.

3.2 Supervision of Banks and Other Financial Institutions

3.2.1 Banks

3.2.1.1 Commercial Banks

A commercial banking licence with regional authorization was granted to Heritage Banking Company Limited following the restructuring and recapitalisation of the erstwhile Societé Générale Bank, during the review period, bringing the total number of licensed commercial banks to 21.

In the review period, 17 of the 20 commercial banks in operation were examined. The result of the examination showed that three (3) banks had a composite rating of High; eight (8), Above Average; four (4), Moderate, and two (2), Low. This was an improvement over the previous exercise that rated five (5) banks High; six (6), Above Average; four (4), Moderate and one (1), Low. The examination indicated that the direction of risk was stable for most of the banks (Table 14).

Table 14: Composite Risk Rating of Banks

Risk Rating	Number of Banks	
	Dec. 2012	Dec. 2011
High	3	5
Above Average	8	6
Moderate	4	4
Low	2	1
Total	**17**	**16**

Good corporate governance, enhanced internal controls and risk management practices were the major factors that influenced the improvement in the risk rating of banks. The improvement was also a reflection of the impact of the on-going reforms in the sector. The asset quality of banks improved considerably since the previous examination as the average industry NPL ratio was within the maximum prudential threshold of 5 per cent, attributable partly to the sale of NPLs to AMCON and partly to improved credit risk management in banks.

It was also observed that the stringent credit policy reduced the expansion in credit to the economy. Consequently, the credit risk profile of most banks indicated a moderate risk rating, and an improvement in the short-term outlook.

The earnings of most banks improved over the previous period and were generally assessed as "Acceptable". However, the business strategy of most banks to hold huge amounts of bonds and treasury bills, driven by the relatively high interest rate margin, led to increased market risk in the banking industry. This is because changes in monetary policy may result in low treasury bill and bond yields, culminating in a reduction in banks' income margins/earnings.

Banks holdings of bonds, treasury bills, cash and other eligible liquid instruments provided the industry with adequate liquidity, resulting in a low liquidity risk profile, which is unlikely to change in the short to medium term.

3.2.1.2 Examination of Foreign Subsidiaries

During the period under review, on-site examination of eighteen foreign subsidiaries of Nigerian banks was carried out. Eight were jointly conducted with host supervisors, while ten were carried out solely by the CBN. Thirteen of the examination reports were issued in the period. The reports indicated that 4 subsidiaries had a composite risk rating of "high", 5 "above average" and 4 "moderate".

3.2.1.3 Non-Interest Banks

The number of licensed, full-fledged, non-interest banks remained at one, with one other bank offering such services through a window.

3.2.1.4 Merchant Banks

The first two merchant banks, under the new banking model, were licensed during the review period, namely, Rand

Merchant Bank Nigeria Ltd (a subsidiary of First Rand Bank of South Africa) and FSDH Merchant Bank Limited (transformed from its discount house status).

3.2.2 Discount Houses

The number of discount houses dropped to four (4) as one (1) converted to a merchant bank. There was no examination of the discount houses during the review period as the examination cycle had not fallen due.

3.2.3 Other Financial Institutions

3.2.3.1 Microfinance Banks (MFBs)

At end-December 2012, the number of licensed MFBs stood at 882, compared with 870 at end-June, 2012. The increase was attributable to the grant of 12 new licences. There were no revocations of MFB licences during the review period.

The examination of 792 of the MFBs in operation was concluded in the second half of 2012. The examination showed that 68.3 per cent of the institutions met the capital adequacy ratio (CAR) of 10 per cent, while 82.4 per cent complied with the minimum liquidity ratio (LR) of 20 per cent. The average LR of the institutions was 62.3 per cent, which exceeded the prescribed minimum LR of 20 per cent.

Poor asset quality remained the bane of MFBs, as their NPLs represented 61.9 per cent of the total loan portfolio, as against the regulatory benchmark of 5 per cent. This was attributed to the fact that most of the institutions were yet to articulate their risk management frameworks. Consequently the CBN had concluded arrangements for all MFBs to attend an enterprise risk management training in the first half of 2013.

3.2.3.2 Primary Mortgage Banks (PMBs)

The number of licensed PMBs stood at 82 at end-December 2012, compared with 84 at end-June. The reduction was accounted for by the absorption of 2 PMBs by their parent banks, under the new Banking Model.

Seventy five (75) of the 82 licensed PMBs were examined. Of this number, 32 or 43 per cent, met the extant minimum shareholders' funds unimpaired by losses of ₦100 million, while 43 or 57 per cent, were undercapitalized. In contrast, 60.0 per cent of the PMBs met the prescribed minimum capital adequacy ratio of 10 per cent, compared with 64.0 per cent in 2011. Also, 66.7 per cent of the institutions met the minimum Liquidity Ratio of 20 per cent, compared with 69.3 per cent in 2011. The exercise also revealed that one year into the compliance period set for PMBs to meet the new higher minimum capital requirements, 9 had shareholders' funds unimpaired by losses of between ₦2 billion and ₦5 billion, 6 had between ₦1 billion and ₦2 billion, while 17 had between ₦100 million and ₦1 billion. The other 43 had capital bases below ₦ 100 million, with 21 of them posting negative balances.

With respect to the prescribed prudential requirements, including the measure of their focus on the core function of mortgage lending, only 19 met the minimum mortgage to loanable assets ratio of 60 per cent, while only seven (7) met the minimum mortgage to total assets ratio of 50 per cent. In addition, a substantial portion of their investible funds were held as placements and related cash investments with DMBs.

It is expected that the on-going reform of the mortgage/housing finance sector, including the establishment of a mortgage refinancing company and the adoption of uniform underwriting standards, would provide the impetus for PMBs to increase their investment in mortgage lending and housing finance.

3.2.3.3 Finance Companies (FCs)

The number of operating FCs at end-December 2012 was 66, compared with 108 as at end-June. The reduction was as a result of the revocation of the licences of 43 FCs, while one FC was licensed during the period.

Sixty-five FCs were examined in the second half of 2012, and the result showed that 52 of them were active, two inactive, two slated for voluntary liquidation, while nine were undergoing restructuring. Further analysis of the active FCs showed that 44.2 percent of the companies met the prescribed minimum capital adequacy ratio of 12.5 percent; 48.1 per cent met the prescribed minimum capital of ₦ 20 million; while 55.8 percent met the prescribed adjusted capital to net credits ratio of 1:10. Although the non-performing to total loans ratio improved to 44.6 percent, from 53 percent as at the previous examination, it was considered too high to support sound and efficient operations.

3.2.3.4 Development Finance Institutions (DFIs)

The five (5) DFIs were examined during the period under review. The examination revealed that three (3) of the DFIs exhibited weak financial conditions, largely attributable to poor asset quality and corporate governance.

3.2.3.5 Bureaux de Change

There were 2,278 BDCs in operation at end-December 2012, an increase of 11.0 percent over the position as at December 31, 2011. The increase was due to the licensing and commencement of operations of 226 BDCs during the year.

Spot-checks were conducted on 200 BDCs in the review period. The exercise revealed the perpetration of several regulatory infractions, including sales of personal and business travel allowances in excess of the approved limits; non-implementation of anti-money laundering controls; failure to maintain basic accounting records; poor documentation of sales; and rendition of false and inaccurate returns to the CBN.

3.3 Compliance with International Standards

3.3.1 Anti-Money Laundering/ Combating the Financing of Terrorism

The CBN, in conjunction with other stakeholders, continued to implement the recommendations of the Financial Action Task Force (FATF), the Inter-Governmental Action Group Against Money Laundering in West Africa (GIABA) Mutual Evaluation (2008), and the IMF technical assistance team (2011). To this end, the Bank took the following measures during the review period:

- Amended the AML/CFT Regulation 2009 to align it with the Money Laundering (Prohibition) Act, 2011 and the Terrorism Prohibition Act, 2011;
- Issued and gazetted the AML/CFT Risk-based Supervision (RBS) Framework;
- Approved the use of INEC voters' registration card as an alternative means of identification for the

purpose of account opening;

- Inaugurated the AML/CFT Stakeholders' Consultative Forum; and

- Developed an AML/CFT Training Manual for Bank Examiners and Operators.

The CBN would continue to upgrade and enforce regulations to safeguard the Nigerian financial system from money laundering, terrorism financing and other illicit financial transactions.

3.3.2 International Financial Reporting Standards (IFRS) and Basel II/III

The implementation of the IFRS and Basel II/III gained additional traction during the review period.

On IFRS, the CBN carried out follow-up visits to confirm that the implementation plans by the DMBs were on course. To further streamline the implementation of IFRS, in line with the existing Roadmap, the Financial Reporting Council (FRC) issued guidelines on mandatory exceptions and optional exemptions for first-time adoption of IFRS. (See Box 2 at the end of this Report.)

Basel II/III implementation efforts during the review period focused on the conduct of a Quantitative Impact Study (QIS) to ascertain the impact on the operations of DMBs.

Furthermore, a draft Basel II/III Regulatory Framework for Prudential Supervision of the Nigerian Banking System was issued as an exposure draft to the industry, in December 2012. Comments from the industry were being collated. It is envisaged that the detailed implementation timelines would be issued on the adoption of Basel II/III in the Nigerian banking industry, in consultation with stakeholders, early in 2013.

3.4 The Asset Management Corporation of Nigeria (AMCON)

In the review period, AMCON acquired additional eligible bank assets (EBAs) of ₦ 77.42 billion. The Corporation also restructured EBAs amounting to ₦313.38 billion, while recoveries amounted to ₦23.61 billion. The balance of acquired EBAs was ₦3.92 trillion at end-December 2012, compared with ₦3.28 trillion at end-June of the same year. At end-December 2012, AMCON had issued bonds with a total face value of ₦5.59 trillion, compared with ₦ 5.40 trillion at end-June of the same year. The proceeds of the bonds were used to purchase EBAs, provide financial accommodation to the recapitalized banks, and to acquire the three bridge banks. Meanwhile, AMCON commissioned a due diligence audit of the three bridge banks, preparatory to divestment from them by 2014.

In order to boost the Banking Sector Resolution Cost Sinking Fund, the contribution of banks to the Fund was increased from 30 to 50 basis points of their total assets at the end of each year.

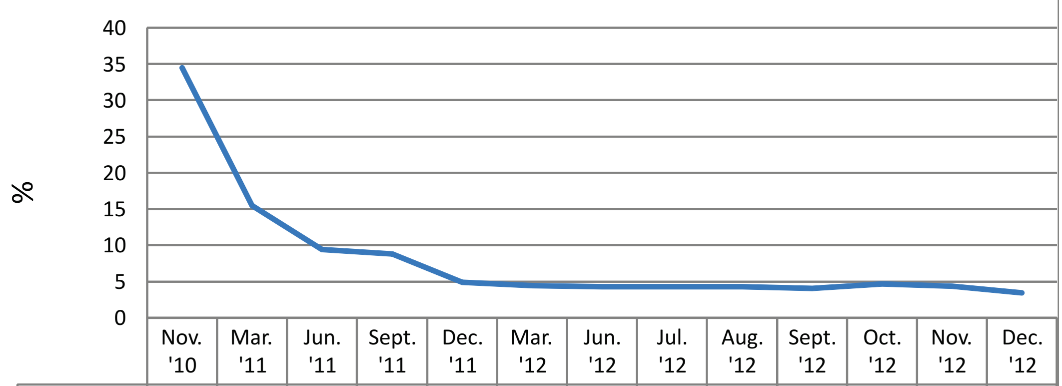
3.5 Key Risks in the Financial System

3.5.1 Credit Risk

The quality of bank assets improved during the review period, as the NPL ratio fell to 3.5 per cent, compared with 4.3 per cent at end-June 2012. The industry NPL ratio remained within the regulatory threshold of 5 per cent, though 6 banks failed to meet the requirement (Figure 28).

At end-December 2012, the NPLs declined by 16.76 per cent to ₦ 282.9 billion, from ₦339.88 billion at end-June

Figure 28: Trend of Banking Industry NPLs



	Nov. '10	Mar. '11	Jun. '11	Sept. '11	Dec. '11	Mar. '12	Jun. '12	Jul. '12	Aug. '12	Sept. '12	Oct. '12	Nov. '12	Dec. '12
NPLs %	34.5	15.5	9.4	8.8	4.9	4.44	4.3	4.31	4.27	4.08	4.68	4.35	3.47

2012.

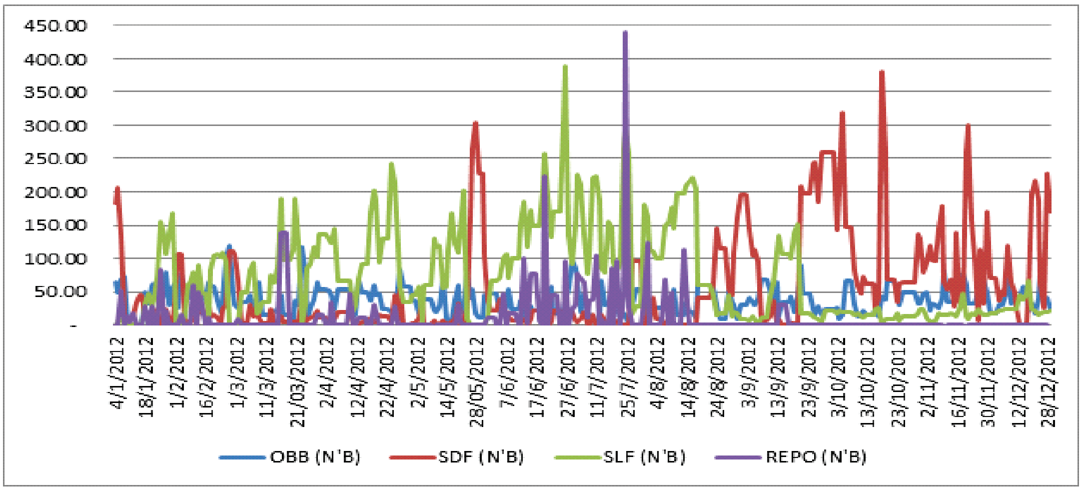
Total credits increased to ₦8.15 trillion at end-December 2012, from ₦7.87 trillion at end-June. The top 50 and 100 obligors accounted for 32.44 and 40.86 per cent, respectively, of the gross credit at end-December 2012, signifying a high level of concentration. This compares with 30.62 and 39.13 per cent respectively, of the gross credit of ₦7.87trillion at end-June 2012.

3.5.2 Liquidity Risk

All the DMBs met the 30 per cent regulatory liquidity ratio during the period under review, although a large portion of their liquid assets were held in government securities with long-term maturities. This development has the potential for crowding out the private sector.

Box 1: SDF/SLF/OBB/REPO Operations by Banks in Nigeria (January - December 2012)

This chart shows significant improvement in financial system liquidity - from the condition of liquidity squeeze in the first half of the year to liquidity surfeit in the second half ended – December 2012. This was clearly depicted by the prevalence of SDF spikes from August 2012 to end-December, 2012. It is noteworthy, that Repo transactions were ceased in the same month, while a circular on "Revised Guideline for Accessing CBN Lending Window and Repurchase Transactions" was concurrently issued to promote greater transparency, fair play and market discipline.



3.5.3 Market Risk

Buoyed by earnings from crude oil sales and FPIs, exchange rates at the inter-bank, BDC and WDAS segments were relatively stable in the review period. Interest rates in the money market recorded mixed results as the average maximum lending rate increased marginally against the consolidated deposit rate which experienced a decrease.

The capital market continued on an inspiring note with positive strides as equity market indicators improved during the review period. The impressive performance of the market was due largely to the growing demand for the stocks of blue-chip companies, especially by portfolio investors, following improvements in earnings and investor-confidence. This trend is expected to continue in light of the positive rating of 'Ba3 with a stable outlook' assigned to the Country by Moody's and the inclusion of Nigeria in the JP Morgan Global Bonds Index – Emerging Markets (GBI – EM) and the Barclays EMLC Index. However, the market remained vulnerable to external shocks that might arise from an unexpected reversal of capital flows and volatility in crude oil prices.

3.5.4 Operational Risk

The reported cases of fraud and forgery decreased by 3.04 per cent to 2,230 involving ₦7.76 billion in the second half of 2012, from 2,300 cases involving ₦7.04 billion in the first half of 2012. Actual losses declined by 25.31 per cent to ₦ 1.83 billion in the second half, from ₦ 2.45 billion, in the first half of 2012.

The security challenge in some parts of the country remained a cause for concern during the period. However, the recent successes by the security agencies in tackling insecurity would create a more conducive environment for businesses to flourish. Frauds, armed robberies, kidnappings and terrorist attacks may continue to be a challenge for businesses and security agencies, thereby posing a significant threat to financial system stability.

The CBN continued to collaborate with banks and other stakeholders to improve operational risk management in order to mitigate these risks.

3.5.5 Reputational Risk

Unethical practices as well as disputes associated with banking operations, including recent interventions in distressed banks by the CBN, continued to be a source of litigation in the second half of 2012.

With regard to petitions by bank customers, the resolution mechanism put in place by the CBN resulted in the refund of a total of ₦2.196 billion by banks to their customers in the second half of 2012, compared to ₦1.41 billion in the first half. Furthermore, the CBN has developed a Financial Literacy Framework aimed at improving the level of awareness and financial literacy in the Nigerian populace.

In July 2012, the Bankers' Committee adopted the Nigerian Sustainable Banking Principles (NSBP), as well as the key sector guidelines, to support environmentally and socially responsive economic development. It is expected that the NSBP principles would encourage banks to practise good ethics in their lending decisions and thereby enhance overall risk management. It would also improve the image and reputation of banks.

3.6 Credit Information Bureaux

3.6.1 The Credit Risk Management System (CRMS)[4]

Registered borrowers in the CRMS database rose by 2.7 per cent to 86,438 at end-December 2012, from 84,090 at end-June 2012. Similarly, the number of borrowers with outstanding facilities of ₦1 million and above increased by 18.4 per cent to 30,929 from 26,119. The number of credits rose by 29.6 per cent to 43,866 at end-December 2012, from 33,833 at end-June. However, the value of outstanding credits declined by 23.7 per cent to ₦3.53 trillion, from ₦4.65 trillion at end-June, 2012.

CRMS-related complaints declined by 27.9 per cent to 31 in the second half of 2012, from 43 in the first half of the year.

3.6.2 Private Credit Bureaux (PCBs)

The number of private credit bureaux remained at three (3) in the review period. The total number of borrowers in their database increased to 19.71 million at end-December 2012, from 18.64 million at end-June 2012. The growing patronage was attributed to increased awareness of their services.

3.7 The Financial Services Regulation Co-ordinating Committee (FSRCC)

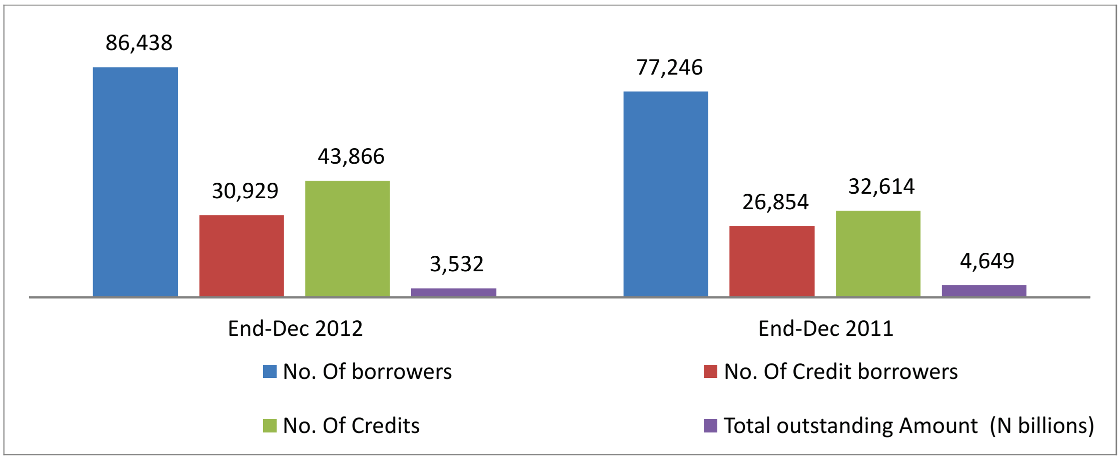
Following the intervention of the FSRCC, the Federal Inland Revenue Service (FIRS) granted tax concessions to banks that adopted the Holding Company (HoldCo) structure to support member agencies' sectoral reforms. The Corporate Affairs Commission (CAC) also granted concessions to the HoldCo banks to spread payments due to the Commission over a period of three years.

The FSRCC web-site was restructured in the review period to improve information sharing among members in order to minimize the risks that could arise in the financial system as a result of inadequate information.

3.8 Consumer Protection

The Bank received a total of 505 petitions from customers against financial

Figure 29: Selected CRMS Statistics for end-December 2012



[4] The CRMS is a depository of credit information on borrowers of ₦1 million and above for individuals, and ₦5 million and above for corporate customers.

institutions during the second half of 2012, compared with 444 received in the first half of the year. The corresponding value of refunds to petitioners amounted to ₦2.196 billion, compared to ₦1.412 billion recorded in the first half of 2012. The complaints were related to ATM issues, excess charges, unauthorised deductions, dishonoured cheques and guarantees, fraudulent withdrawals, non-crediting of accounts and cheque conversion. The Bank also conducted its maiden consumer protection compliance examination to assess the compliance level of the DMBs.

4.0 DEVELOPMENTS IN THE PAYMENTS SYSTEM

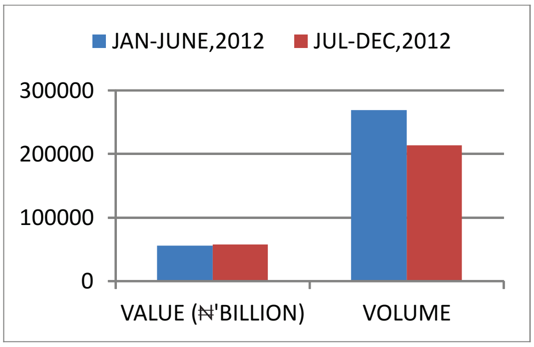
Pursuant to the achievement of the Payments System Vision 2020, the Bank continued to update the guidelines and implement policy measures during the review period, the highlights of which include the following:

- Granting of commercial licences to five (5) mobile payment scheme operators, bringing the total number of operators to 20;
- Commencement of the pilot run of the cheque truncation project in the Lagos Clearing Zone, resulting in a reduction of the clearing cycle from T+2 to T+1 in the Lagos Clearing Zone;
- Removal of ₦100 charge on "not-on-us" ATM cash withdrawals; and
- Review of the guidelines on Stored Value and Prepaid Card Issuance, as well as on Transaction Switching Services.

4.1 The Real-Time Gross Settlement (RTGS) System

The volume and value of inter-bank transfers through CBN's RTGS (CBN Inter-bank Funds Transfer System - CIFTS) decreased to 213,825 and ₦57.29 trillion in the second half of 2012 from 273,105 and ₦58.58 trillion respectively in the first half, reflecting decreases of 21.7 and 2.20 per cent. The increasing use of alternative payment platforms, such as NIBSS Instant Payment and NEFT, accounted for the decline.

Figure 30: CBN RTGS Transactions



4.2 NIBSS Instant Payment (NIP)

The volume and value of NIP transactions increased to 3,293,216 and ₦2.87 trillion in the second half of 2012, from 1,158,882 and ₦1.02 trillion in the first half, reflecting increases of 184.17 and 182.13 per cent, respectively. The increases were attributed largely to the cashless policy which commenced in Lagos in the first half of 2012.

Figure 31: NIP Transactions (Value)

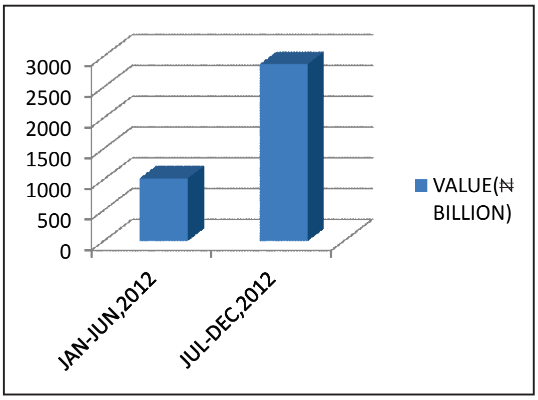
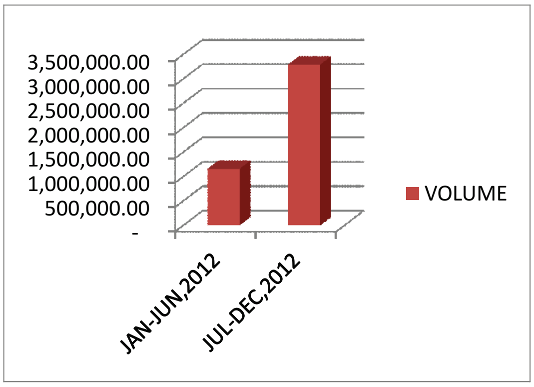


Figure 32: NIP Transactions (Volume)



4.3 NIBSS Electronic Fund Transfer (NEFT)

The volume of NEFT transactions increased to 15,143,752 at end-December 2012, from 13,597,974 at end-June, reflecting an increase of 11.37 per cent, while the value of NEFT transactions decreased from ₦6.85 trillion at end-June 2012 to ₦6.81 trillion, indicating a slight decrease of 0.45 per cent.

Figure 33: NEFT Transactions (Value)

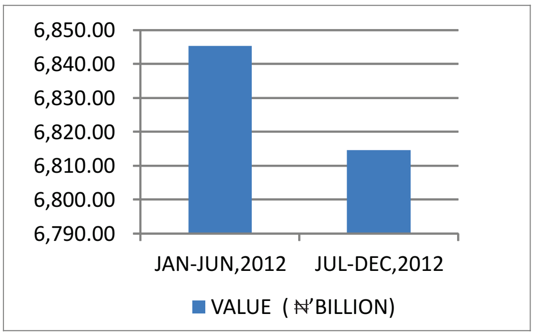
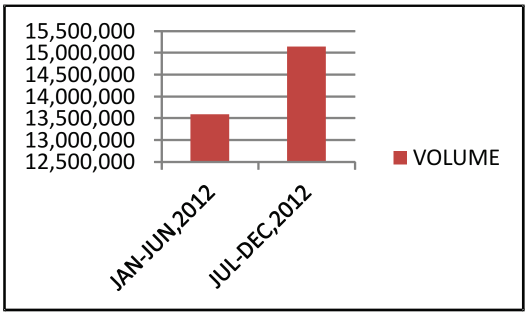


Figure 34: NEFT Transactions (Volume)



4.4 Cheque Clearing

The volume of cheques cleared increased by 4.59 per cent to 18,988,822 at end-December 2012, from 18,154,880 at end-June 2012. However, the value decreased by 4.24 per cent to ₦9.65 billion, from ₦10.08 billion. The increase in volume was attributed to the cashless policy which limits the value of third party cheques that could be cashed across the counter to ₦150,000 and the ceiling of cheques that could be passed through clearing to ₦10 million.

Figure 35: Volume of Cheque Transactions

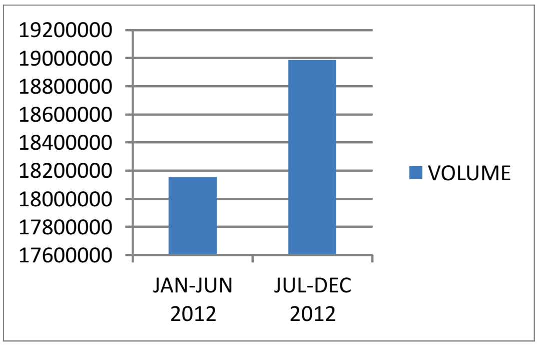
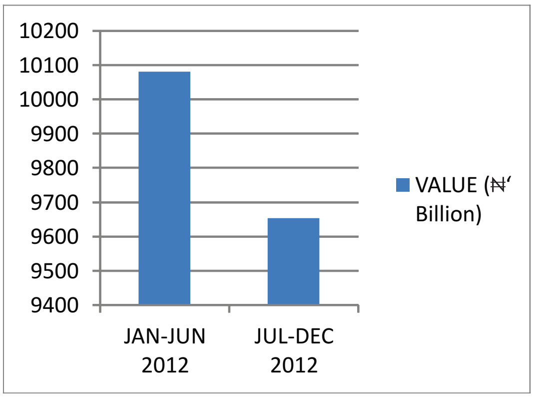


Figure 36: Value of Cheque Transactions



4.5 Electronic Card Payments

The volume and value of electronic card (e-card) transactions rose to 201,793,172 and ₦1.13 trillion in the second half of 2012, from 185,044,221 and ₦1.03 trillion in the first half of 2012, reflecting increases of 9.05 and 9.2 per cent, respectively.

Automated Teller Machines (ATMs) remained the most patronised e-channel, accounting for 97.62 per cent during the review period. Patronage of other channels stood at 0.97 and 0.83 per cent for PoS terminal and mobile payments, respectively. The web-based (internet) mode was the least patronized, accounting for only 0.58 per cent of total e-payment transactions (Figure 37).

Similarly, in value terms, ATM accounted for 92.80 per cent, POS, 3.32 per cent, mobile payments, 2.26 per cent, while web-based (internet) payments accounted for 1.62 per cent (Figure 38).

Figure 37: Volume of Electronic Card Transactions, June - December 2012

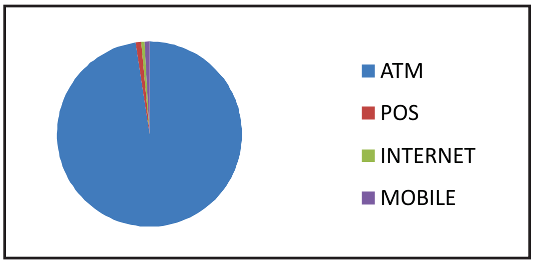
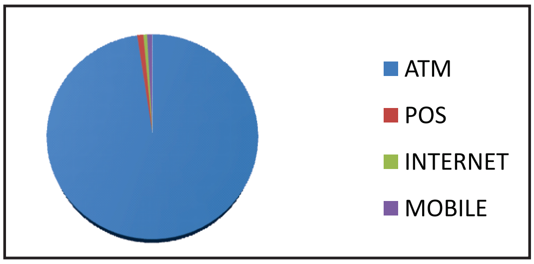


Figure 38: Value of Electronic Card Transactions, June - December 2012



4.5.1 ATM Transactions

The number of ATMs stood at 10,221 as at end-December 2012. The volume and value of ATM transactions increased during the second half of 2012 to 196,995,507 and ₦ 1.05 trillion respectively, from 178,421,958 and ₦937.39 billion in the first half of 2012, representing respective increases of 10.41 and 12.01 per cent.

4.5.2 Mobile Payments

The volume of mobile payments decreased by 30.41 per cent in the review period to 1,668,113, from 2,397,062 in the first half of 2012, while the value increased by 37.76 per cent to ₦25.50 billion, from ₦18.51 billion in the first half of 2012.

The initiatives adopted in the review period led to the positive developments in the payments system recorded above. However, the system continued to experience a number of challenges, such as an inadequate legal framework, infrastructural constraints, and the absence of a unique identifier.

5.0 OUTLOOK

5.1 The Macroeconomic Environment

Debt concerns in the Euro zone, the slow-down in the Chinese economy, and slow recovery in the US could negatively affect demand for oil, with spill-over effects on the domestic financial sector, through the contraction of inflows. Foreign portfolio inflow is expected to remain stable in view of the world output growth projection of the IMF. However, there could be reversals in the event that financial and economic conditions in advanced and emerging economies deteriorate in the months ahead, resulting in adverse impacts on asset prices and exchange rate. Credit lines are likely to reduce as stricter and less favourable terms may be imposed by creditors. It is, however, expected that investment returns would remain stable into the first half of 2013, given that central banks around the world continue their commitment to work towards recovery.

Given that domestic liquidity is primarily driven by oil revenues, the likelihood of lower oil prices would translate into lower receipts and accretion to reserves. As a major importer of oil, the inward-looking stance of the US for its oil needs would dampen oil prices. Indeed, the US in 2012 cut its oil import from Nigeria by 44.6 per cent and projected a further cut to 50 per cent in 2013. Lower oil receipts and reduced accretion to reserves could adversely affect exchange rate, fiscal deficit and FPIs.

5.2 Monetary Policy

Monetary policy stance is expected to remain tight in the first half of 2013, given the 12.00 per cent inflation (year-on-year) in 2012. Consequently, short-term interest rates are likely to remain at their 2012 levels in the first half of 2013. Furthermore, the high inflation rate is not likely to impact negatively on the bond market, as yields in Nigeria continue to be relatively competitive amidst the Euro-zone crisis and declining GDP in developed economies. The equity market is expected to continue to improve following the impact of margin loan forbearance, the waiver of stamp duty and VAT on stock market transactions, and continued in-flow of FPIs, due to strong fundamentals of quoted companies, based on their current share prices.

In its release of November 7, 2012, Moody's Investors Service assigned a 'Ba3 rating, with a stable outlook' to Nigeria. Also, the planned inclusion of Nigeria in the JP Morgan Global Bonds Index – Emerging Markets (GBI – EM) in January 2013 and the inclusion of FGN Bonds in the Barclays EMLC Index, from March 2013, will improve confidence.

5.3 The Payments System

The ongoing implementation of the new RTGS/CSD applications will be completed in the first half of 2013. The improvement in the new RTGS system, being the core settlement infrastructure in the country, is expected to impact positively on the operations of various components of the payments system. Specifically, the new system will interface with the banking applications of all the participants for straight-through-processing of customers' transfers. It will also support the achievement of simultaneous Delivery versus Payment of securities trade to eliminate settlement risk.

The nationwide implementation of a cheque truncation system is expected to commence in the first half of 2013. This will facilitate a reduction of the clearing cycle from T+2 to T+1. Furthermore, the planned nationwide implementation of a ₦150, 000 limit on third party cheque encashment over the counter is expected to reduce fraud associated with paper-based instruments.

In order to benchmark the national Financial Market Infrastructures (FMI) against the BIS Core Principles, a comprehensive assessment is planned for the first half of 2013.

5.4 Banking Sector and Financial Stability

The improved soundness of the banking sector in 2012 is expected to be enhanced with more measures put in place to address current challenges in the sector. The full implementation of the new banking model in 2013 will help to further strengthen the sector and ensure financial system stability as banks focus on their niche areas. The discount houses, MFBs and PMBs, as well as other operators in the financial system, such as pension funds all indicate positive trends in 2013.

Despite some challenges facing the Nigerian financial system, it remained stable over the review period as evidenced by the stress tests on the banking sector. A positive outlook is envisaged over the short and medium terms.

BOX 2
Regulatory Filter Issued by the Financial Reporting Council of Nigeria on the Implementation of IFRS in Nigeria

Pursuant to the adoption of International Financial Reporting Standards (IFRS) in Nigeria, effective January 1, 2012 for listed and Significant Public Interest Entities, as defined by the National Road Map to the Adoption of IFRS, the Financial Reporting Council (FRC) issued the following Regulatory Guidance relating to MANDATORY EXCEPTIONS AND OPTIONAL EXEMPTIONS provisions/requirements of IFRS 1 (First-Time Adoption of IFRS):

1. All entities adopting IFRS must apply IFRS 1 in their first IFRS-based financial statements and make an explicit and unreserved statement of compliance with IFRS; and

2. Apply all mandatory exceptions and consider all optional exemptions in IFRS 1, subject to the following limited applications:

a) Mandatory Exceptions De-recognition of Financial Assets and Liabilities

A first-time adopter is not exempt from SIC-12 (Consolidation-Special Purpose Entities), which requires consolidation of all Special-Purpose Entities (SPEs), including "qualifying special-purpose entities". In other words, SIC-12 contains no specific transitional or first-time adoption provisions. Accordingly, the SIC-12 requirements with regard to the consolidation of SPEs are fully retrospective for first-time adopters. As a result, not all previously derecognised assets and liabilities will remain off-balance sheet upon adoption of IFRS. For example, if under national GAAP an entity derecognised non-derivative financial assets and financial liabilities which has been transferred to an entity treated as an SPE by SIC-12 provisions, those assets and liabilities are required to be recognised on transition to IFRS, and the financial statements of the SPE that is consolidated. However, if the SPE itself has subsequently transferred the asset and achieved de-recognition of the items concerned under the said previous GAAP (other than by transfer to a second SPE or member of the entity's group), then the items remain derecognised on transition.

Accordingly, the financial statements of all the SPEs so identified shall be consolidated and the consolidation procedure shall be followed as provided for in IAS 27 (Consolidated and Separate Financial Statements).

b) Optional Exemptions

i. Business Combinations (Option 1)

IFRS 1 requires first-time adopters to restate only those business combinations occurring on or after the date of transition to IFRS, in line with IFRS 3R (Business Combinations).

For business combinations that occur before the date of transition to IFRS which have been accounted for using national GAAP, IFRS 1 allows the first-time adopter to:

a. Restate all those business combinations retrospectively applying IFRS 3R; or
b. Restate particular business combination(s) retrospectively applying IFRS 3R and thus all other business combinations thereafter up till the date of transition must be restated accordingly; or

c. Elect to retain previous GAAP.

Adopters in Nigeria should note that no restatement is permitted. The treatment under the Nigerian GAAP is retained.

ii. Fair Value or Revaluation as Deemed Cost (Option 2)

This applies to items of Property, Plant and Equipment (PPE), Investment Property (only if cost model is used) and Intangible Assets. The permitted options are:

a. To measure an asset at Fair Value at date of transition and elect to use as deemed cost, or

b. b) Treat a previous GAAP Revaluation of an Asset as deemed cost at date of transition.

However, if Previous GAAP Revaluation value is to be used, such revaluation(s) must be carried out by a duly certified and professionally qualified/registered Valuer (such professional must be a holder of the FRC Registration Certificate in accordance with Section 41 of the FRC Act, 2011).

iii. On Lease: (Option 12)

First-time adopters may use the transitional provisions in IFRIC 4: Determining whether an arrangement contains a Lease and by extension, based on the existing facts and circumstances determine whether IAS 17: Leases, applies.

For the purpose of applying this option, only items of Property, Plant and Equipment (PPE) are to be considered.

iv. Borrowing Costs (Option 15)

The effective date for the application of the transitional provisions of paragraphs 27 and 28 of IAS 23 (Borrowing Costs) as revised in 2007, shall be the date of transition to IFRS, i.e, no retrospective application is allowed.

1. For the purpose of applying mandatory exceptions and considering optional exemptions, effective date of application is the relevant date of transition, in line with the National Road Map on Adoption of IFRS.

2. Further guidance will be issued from time to time by Council.