



CENTRAL BANK OF NIGERIA

Banking Supervision Department
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December 10, 2014.

LETTER TO ALL BANKS

OIL AND GAS INDUSTRY CREDIT RISK MITIGATION

As you are aware, falling oil prices and the potential for a further decline has been a major concern in recent times. Oil prices have declined from US\$ 107.89/bbl in June 2014 to US\$ 85.06/bbl in October 2014, and currently trading at US\$ 67.33/bbl. The possibility of a further decline should not be underestimated.

Considering the quantum of exposure to the oil & gas sector, combined with risk management deficiencies revealed by the recent Risk Based Supervision exercise, there is a need to proactively guard against a crystallization of these risks. The Central Bank of Nigeria therefore considers it essential to ensure that banks have sufficient capital buffers to mitigate these escalating risk taking activities.

Consequently, as a follow up to our circular of April 2, 2013 referenced BSD/DIR/GEN/LAB/06/017, and titled "RE: REVIEW OF RISK WEIGHTS ON CERTAIN INDUSTRY EXPOSURES IN THE COMPUTATION OF CAPITAL ADEQUACY", the following revision will now apply: -

"Where exposure to the oil & gas sector (as defined by the International Standard Industrial Classification of Economic Sectors as issued by the CBN) is in excess of 20 per cent of total credit facilities of a bank, the risk weight of the entire portfolio in that sector will attract a risk weight of 125% for the purpose of capital adequacy computation".

Banks are to note that these risk weights are dynamic and may be reviewed as economic conditions dictate.

In addition, licensed banks are required to:

1. Prepare and forward to the Central Bank of Nigeria, as at December 8, 2014, the computations and results of a single - factor sensitivity stress test, using the attached template and guidelines, on the impact of volatile and falling crude oil prices on the bank's financial position, performance, liquidity, and prudential ratios.
2. Ensure that:
 - a. The projections for volumes of crude oil sales for upstream obligors are backed by independent and professionally prepared reserves estimation reports.

- b. Adequate technical data is provided by the obligor for the management of obligor credit risk, including a copy of the feasibility study of the project being financed.
- c. Collateral documentations are perfected and copies placed in the obligor's credit file.
- d. There is a documented improvement in their monitoring activities of Oil and Gas Exploration & Production exposures.
- e. Oil and gas customers have a robust and effective enterprise risk management policy and system. Of key importance is a price risk hedging policy.
- f. There is a documented improvement in the mechanisms for continuous gathering, storage, and analyses of information about the state and trends of the oil and gas industry both locally and globally.
- g. A comprehensive review exercise on oil and gas obligors is conducted on a periodic basis.
- h. Adequate training in credit appraisal is provided for the marketing, and credit risk management units.
- i. There is an improvement in the quality of credit file contents, organization and indexing, presentation, maintenance, management, and oversight.

Furthermore, banks are reminded of their responsibility to comply with the sections 3.3 and 3.9 of the Prudential Guidelines 2010.

It should be noted that banks will be assessed for compliance with the above directives as part of the periodic Risk Based Supervision review.

Yours faithfully,



TOKUNBO MARTINS (MRS.)
DIRECTOR OF BANKING SUPERVISION

GUIDELINES AND TEMPLATE FOR PROPOSED SINGLE - FACTOR SENSITIVITY STRESS TEST

The Single – factor sensitivity testing is a form of stress testing that usually involves an incremental change in a risk factor holding other risk factors constant. Shocks can be assumed to occur instantaneously, and it can be used as a simpler technique for assessing the impact of a change in risks when a quick response is needed.

Guidelines

- A. Four (4) price points are to be used for the stress tests as follows: US\$ 50.00/bbl, US\$ 55.00/bbl, US\$ 60.00/bbl, and US\$ 65.00/bbl.
- B. Impact is assumed to be instantaneous, and current credit risk mitigation is not taken into account.
- C. Focus of this sensitivity test is on transmission of crude oil price shock through deteriorating Oil and Gas, and Public sector credit quality (on-and off-balance sheet risk assets), resulting in elevated NPL levels for the aggregate credit portfolio, and a requirement for additional prudential provisioning.
- D. Banks are to use the table below to determine the level of additional provisioning required as a result of the deterioration in the quality of the specified credit portfolios at the various price points. Banks must clearly provide a description of the model used to determine classification category of the increased NPLs, and the additional loan loss provisions, methodologies, and underlying assumptions.

S/N	CRUDE OIL PRICE LEVEL	IMPACT OF SHOCK ON OIL AND GAS SECTOR CREDIT PORTFOLIO FROM BASE CASE	IMPACT OF SHOCK ON PUBLIC SECTOR CREDIT PORTFOLIO FROM BASE CASE	ADDITIONAL LOAN LOSS PROVISIONING REQUIRED
1	US\$ 70.00/bbl	25% of portfolio becomes non-performing.	15% of portfolio becomes non-performing.	To be determined by banks loan loss provisioning model
2	US\$ 65.00/bbl	40% of portfolio becomes non-performing.	30% of portfolio becomes non-performing.	To be determined by banks loan loss provisioning model
3	US\$ 60.00/bbl	55% of portfolio becomes non-performing.	45% of portfolio becomes non-performing.	To be determined by banks loan loss provisioning model
4	US\$ 50.00/bbl	65% of portfolio becomes non-performing.	60% of portfolio becomes non-performing.	To be determined by banks loan loss provisioning model

E. The impact of additional loan loss provisioning is to be transmitted into the bank's Statement of Financial Position, Income Statement, Statement of Cash flow, and in the computation of selected ratios using the template below. Note that:

- a) The financial statements and ratios in the template should incorporate all CBN advised additional prudential provisions subsequent to the last Risk Based Supervision examination.
- b) The base case refers to the actual position of the bank as at November 30, 2014. Each stress test shall be referenced to the base case.
- c) The template should be strictly followed. The Statement of Financial Position and Income Statement should be prepared using the Efass line codes as specified.
- d) Ratios should be computed in accordance with Central Bank of Nigeria guidelines, and spread sheets/computations should be provided, if necessary in a concise but clear form.
- e) The completed template with a commentary on the results, description of methodology and loan loss model used, assumptions made with rationale, and a risk mitigation plan should be submitted to the Director, Banking Supervision Department, and soft copies to BSDReturns@cbn.gov.ng within 2 weeks of the date of this letter.

NAME OF BANK :		STRESS DATE:				
RESULTS OF STRESS TEST ON BANKS FINANCIAL HEALTH AT VARIOUS CRUDE OIL PRICES		Base Case (No Stress) November 30, 2014	Shocked Case			
			PRICES - US\$/bbl			
			65.00	60.00	55.00	50.00
		N	N	N	N	N
1	STATEMENT OF FINANCIAL POSITION					
10130	Total Cash					
10370	Total due from CBN, other banks in Nigeria, banks outside Nigeria etc.					
10450	Total Short-Term Investments					
10540	Total Certificates of Deposits Held					
10650	Total Bills Discounted					
10750	Total Other Financial Instruments Held					
10810	Loans and Advances/Leases - Other Banks in Nigeria					

10820	Loans and Advances/Leases - Other Banks outside Nigeria					
10830	Loans and Advances/Leases - Affiliate Companies of bank in Nigeria					
10845	Total Loans & Advances to Govts. In Nigeria					
10850	Other Customers					
10870	Advances Under Leases					
10880	Factored Debts					
10900	Specific Loans/Leases Loss Provision					
10901	General Loans/Leases Loss Provision					
11100	Total Investment					
11230	Other Assets (Net)					
11400	TOTAL ASSETS					
11550	Total Off-Balance Sheet Engagements					
20290	Total Deposits and Takings					
20350	Total Due To Central Bank, other Banks in Nigeria, other Banks Outside Nigeria, offices and Branches of the bank outside Nigeria.					
20440	Total Certificates of Deposits					
20500	Other Liabilities					
20670	Total Loans and Advances From					
20750	Total Debentures/Loans Stock					
20830	Total Capital					
20900	Total Reserves					
20920	Fixed Asset Revaluation Reserve					
20930	Minority Interest					
20950	TOTAL LIABILITIES					
21050	Total Off-Balance Sheet Engagements					
2	INCOME STATEMENT					
30150	Total interest Income					
30240	Total Interest Expense					
30300	Net Interest Income					
30480	Total Non-Interest Income					
30500	Operating Income					
30600	Recoveries					
30700	Total Operating Income					
30860	Total Overhead Expenses					
30881	Provision for Credit Losses - Specific					

30882	Provision for Credit Losses - General					
30883	Provision for Diminution in the value of Investments					
30890	Bad Debt Written Off					
30891	Loss on Sale of Investments					
30900	Other Losses					
30910	Other Expenses					
30920	Total Operating Expenses					
31000	Net Profit/(Loss) Before Tax					
31020	Provision For Income Tax					
31030	Profit/(Loss) After Tax					
31100	Extra - Ordinary Items (Net Of Tax)					
31200	Net Income After Tax And Extraordinary Items					
3	STATEMENT OF CASH FLOW					
	Cash Flow from Operating Activities					
	Operating Cash Flow Changes: Working Capital Changes					
	Net Cash Generated from Operating Activities					
	Cash Flow from Investing Activities					
	Cash Flow from financing Activities					
	Net Increase/Decrease Cash and Cash Equivalent					
	Cash and Cash Equivalent Beginning of the Year					
	Other Adjustments					
	Cash and Cash Equivalent End of the Year					
4	RATIOS					
	Capital Adequacy Ratio					
	Net Interest Margin					
	NPL Ratio					
	Liquidity Ratio					
	Return on Equity					
5	OTHERS					
	Total Non-Performing Loans					