Central Bank of Nigeria

GUIDELINES FOR GRANTING LIQUID ASSET STATUS TO STATE GOVERNMENT BONDS

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Table of Contents

1.0 INTRODUCTION

State governments as agents of development are saddled with responsibilities that are sometimes beyond their current resources, given the level of economic development in the country. The recourse to the capital market to fund projects, especially of long gestation periods, should therefore be encouraged as this will not only improve the socio-economic well-being of the people but also deepen the capital market.

It is believed that conferring liquidity status on state government bonds would promote investments in these securities, encourage the regular issuance of the bonds by state governments, stimulate primary and secondary market activities and facilitate the development of the Nigerian capital market.

It is in light of the foregoing that the Central Bank of Nigeria (CBN), on March 2, 2010, decided to confer liquid asset status on eligible state government bonds in accordance with the CBN Act (2007). The CBN hereby issues the following Guidelines to operationalise the decision.

2.0 ELIGIBILITY CRITERIA

2.1 Enabling Legislation

The issuance of bonds shall be backed by a law enacted by the State House of Assembly, specifying that Sinking Funds fully funded from the consolidated revenue fund account of the State be established.

2.2 Fiscal Responsibility Law

The State government shall have in place a fiscal responsibility law, with provisions for public debt management, in order to enhance investors' confidence in the issuer.

2.3 State Debt Management Departments

The State Government shall establish a debt management department in order to enhance transparency and the professional management of debt issues.

2.4 Credit Rating

The bond shall, at inception and throughout its tenor, be of investment grade as determined by a rating agency accredited by the Securities and Exchange Commission (SEC).

2.5 Utilisation of Proceeds

A SEC confirmation that the proceeds have been disbursed in line with the provisions of the prospectus shall be submitted to the CBN at the anniversary of the bond issuance. Subsequent SEC confirmations shall be required on amounts that have not been disbursed by the first anniversary.

2.6 Repayment Structure – Sinking Funds

Repayment structure should be from funded sinking funds (i.e. a legislated irrevocable standing payment order (ISPO) and/or other legislated sources of repayments disclosed in the offer documents).

The Trustee(s) to the bond should submit, every six (6) months, (a) a statement of accounts of the sinking funds' investments and (b) statement of declaration on the sufficiency of the sinking funds' investments and investment income in meeting the debt service and redemption obligations to the Financial Policy & Regulation Department in CBN.

The Trustees shall advise the CBN on the action taken in the event that the Trustees are of the opinion that the sinking fund may be inefficient or there is the likelihood of default in line with Sections 255 and 256 of the Investment and Securities Act 2007 or any amendment thereto.

2.7 Irrevocable Letter of Authority (ILoA)

Evidence of an irrevocable letter of authority issued by the Accountant-General of the State to deduct at source from the statutory allocation due to the State in the event of default by or failure of the State to meet its payment obligations or a SEC waiver of the ILoA.

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2.8 Tenor of Bonds

The State government bonds shall be limited to a maximum maturity of seven (7) years in order to be considered for liquid asset status.

3.0 BENEFITS OF LIQUID ASSET STATUS

3.1 Risk-Weights For Capital Adequacy Ratio

3.1.1 For the purpose of computing the capital adequacy ratios of banks and discount houses, state government bonds with liquid asset status shall be assigned a weight of 20 percent or as may be prescribed by the CBN from time to time.

3.2 Repurchase Transactions

3.2.1 State government bonds which meet the criteria for liquid asset status shall be eligible for repurchase or “repo” transactions and the CBN shall open an account with the Central Securities Clearing System (CSCS) Limited to warehouse the securities.

3.2.2 The collateral provided by counterparties towards the repo shall have a “haircut” applied as may be prescribed by the CBN from time to time.

4.0 INVESTMENT LIMITS

The maximum investment a bank shall make in any bond issue of a State government or its agencies is limited to 10% of the total amount outstanding of that bond issue. This is an investment limit per issue and not per issuer.

The portfolio of a bank in bonds of State governments and their agencies shall not exceed 30% of the bank's total portfolio in debt securities. Debt securities for this purpose are - Treasury bills, FGN bonds, FGN-guaranteed notes, Sovereign debt notes, any other Nigerian sovereign debt securities, CBN Bills, Bonds Collateralised with FGN bonds, State government bonds, State government agencies' bonds, Corporate bonds and Dated preference shares.

The underwritten positions of State bonds shall not be regarded as investments and therefore will not be counted in determining these limits. However, a monthly return on the underwritten positions and the sell-off strategy shall be rendered to the Banking Supervision Department of CBN.

Until such time that the Nigerian State bond market presents banks and discount houses with the opportunity of having trading books in State bonds, all State bond holdings shall be classified as investments i.e. Available-For-Sale (AFS) and/or Held-To-Maturity (HTM) for the purpose of CBN reporting.

5.0 CEILING ON LENDING TO SUB-NATIONAL GOVERNMENTS

5.1 State government bonds shall not be included in the computation of the 10 percent ceiling on lending to all tiers of government as specified in the CBN's Circular reference BSD/DIR/GEN/CIR/03/011 dated June 26, 2009.

6.0 RISK-WEIGHTS FOR BONDS THAT DO NOT QUALIFY AS LIQUID ASSETS

6.1 Capital Adequacy Ratio

For the purpose of computing the capital adequacy ratios of banks and discount houses, State government bonds that do not qualify as liquid assets shall be assigned a risk-weight of 50 percent or as may be prescribed by the CBN from time to time.

6.2 General Issues

The State government bonds shall comply with all the relevant provisions of the Investment and Securities Act (ISA 2007) including amendments thereto as well as SEC's rules as may be prescribed from time to time.

7.0 APPLICATION PROCEDURE AND OTHER MATTERS

7.1 These guidelines shall apply to both previously issued state government bonds and new issues of state government bonds.

7.2 State governments seeking liquid asset status for their bonds shall apply to the Director, Financial Policy and Regulation Department, Central Bank of Nigeria, Abuja, through their financial advisers.

7.3 The CBN shall regularly publish, on its website, state government bonds that qualify for liquid asset status.

8.0 REVIEW OF THE GUIDELINES

These guidelines shall be reviewed from time to time.

Glossary of Terms

1. **Bond** – A debt instrument with a maturity greater than one year.
2. **Irrevocable Standing Payment Order (ISPO)** – A written mandate given by the issuer (State government) of a bond to the Accountant-General of the Federation (AGF) authorising the AGF to deduct, at source, predetermined sums of money from the statutory allocation of the issuer.
3. **Issue Date** – The date on which a bond is issued.
4. **Maturity Date** – The date on which a bond becomes due and payable.
5. **Primary Market** – The market for new issues of debt instruments.
6. **Secondary Market** – The market where previously issued instruments are traded.
7. **Sinking Fund** – A fund into which an issuer sets aside money over time, in order to retire its debt instruments.