CENTRAL BANK OF NIGERIA
Central Business Area District
P.M.B. 0187
Garki, Abuja

09-61638445
09-61638455 (Fax)

October 28, 2008

BOD/DIR/CIR/2008/GEN/3/17

TO: ALL DEPOSIT MONEY BANKS AND DISCOUNT HOUSES

EXPANDED DISCOUNT WINDOW OPERATIONS

In order to ensure a robust operation of the discount window and in the process provide effective and efficient guidance for the conduct of monetary operations, the Central Bank of Nigeria hereby expands its discount window operations.

The key elements of the Expanded Discount Window operations include:

- The provision of two categories of facilities, namely; the overnight standing facility and the fixed tenor repo;
- The increase in the tenor of borrowing from the window from overnight to 360 days;
- The increase in the number of financial instruments acceptable as collateral in the Window to include non-federal government securities.
- The widening of the base of the financial markets from which the instruments are drawn; and
- The broadening of financial innovations to support the operations of the Discount Window.

Details of the Guidelines on the Expanded Discount Window Operations are as contained in the attached document

All operators in the money market are to be guided by the provisions in the Guidelines, and may wish to contact the undersigned if further clarifications are needed.

JamesKAOlekah

James K. A. Olekah
Director, Banking Operations Department

GUIDELINES ON THE EXPANDED DISCOUNT WINDOW OPERATIONS

CENTRAL BANK OF NIGERIA

OCTOBER, 2008

FOREWORD

This Guideline is issued by the Central Bank of Nigeria (CBN) in exercise of its statutory powers under section 30 of the CBN Act 2007.

Under the Guidelines, the Bank hereby expands its discount window operations in order to allow more robust processes of injection and absorption of excess liquidity in the money market.

The expanded discount window is introduced to admit non-federal government instruments as eligible securities. It is also to ensure that the tenor of liquidity provided under the discount window operations is extended from overnight to maturities of up to 360 days.

For any further clarification on the Guidelines, enquiries can be directed to:

The Director,
Banking Operations Department
Central Bank of Nigeria
Abuja

CENTRAL BANK OF NIGERIA
Central Business Area,
Abuja.
PRIVATE MAIL BAG 0817: Garki Abuja

TELEPHONE: 0961638445

Contents

INTRODUCTION

1. Following the liberalization of the financial markets and the need to deepen the securities market, the Central Bank of Nigeria in exercise of its statutory powers hereby expands the Bank's Discount Window operations. This is through the admittance of non-federal government instruments. It also involves extending the tenor of liquidity provided through the discount window from overnight to maturities of up to 360 days. These additional initiatives are expected to engender a more efficient and effective financial resource flows and intermediation. However, the basic policy thrust in the administration of the Discount Window (DW) would remain that of the Central Bank of Nigeria acting as a lender of last resort in relieving liquidity shortages and absorbing excess liquidity in the banking system.

2. The Central Bank of Nigeria (the Bank) recognizes that open market operations are the primary means of effecting changes in the overall level of bank reserves and the interest rates in the inter-bank market. It will, therefore, continue to employ open market operations in the adjustment of reserves. Nevertheless, the DW is expected to serve as a supplementary adjustment mechanism, especially for the institutions which may be facing liquidity imbalances. It must be realized that access to the DW has the implication of creating reserves, and reserves should be created circumspectly if monetary control objectives are to be constantly placed in adequate perspective.

GENERAL CONDITIONS GOVERNING THE DISCOUNT WINDOW (DW) OPERATIONS

3. DEFINITION OF TERMS

Institutions: Banks and Discount Houses only.

Bank: Central Bank of Nigeria (CBN)

DMB: Deposit Money Banks

DH: Discount Houses

MPR: Monetary Policy Rate

DW (Discount Window): The window through which the CBN grants standing lending facilities and outright advances to the DMBs and DHs.

NDIC (Nigeria Deposit Insurance Corporation): A body established to provide insurance for private sector deposits in the DMBs.

SLF (Standing Lending Facility): An overnight advance available to DMs and DHs.

SDF (Standing Deposit Facility): The deposit facility for institutions to place overnight excess funds with the CBN.

Repo (Repurchase Agreement): The sale of securities for immediate payment and the commitment by seller to buy back the securities at a later date under an agreed term.

Bankers Acceptance (BA): A bill of exchange which is drawn on, and accepted by, a DMB.

Guaranteed Commercial Paper (GCP): An unconditional promise by the issuer to pay to the order of a person, a certain sum at a future date.

Guidelines: The Guidelines for the expansion of CBN's Discount Window

Promissory Note: A contract where one party (the maker or issuer) makes an unconditional promise in writing to pay a sum of money to the other (the payee), either at a fixed or determinable future time or on demand of the payee, under specific terms.

4. The operation and functions of the DW will continue to be based on the following broad conditions:

(i) Lender of Last Resort Facility - Institutions seeking to utilize the DW must first fully exhaust all alternative market sources. The DW is to be approached on a Last resort basis only.

(ii) Deposit Money Banks and Discount Houses shall access the DW only on secured basis. Any credit must therefore be fully and adequately collateralized by eligible securities listed in paragraph 6 of this Guideline.

(iii) Deposit Money Banks and Discount Houses may use the DW to obtain liquidity from the Bank via repo or collateralized loans against eligible instruments.

(iv) Repo credit from the DW shall be for a period not exceeding one year.

(v) Collateralized loans shall be on an overnight basis through standing lending facilities.

(vi) Credits at the DW must be with eligible instruments whose tenor shall not exceed one year. In other words, such instruments shall be those qualifying for secondary market operations with the Bank.

(vii) ***Credits by way of an advance or outright borrowing must be fully secured by eligible instruments***.

(viii) The eligible instruments at the DW will be rated appropriately and in line with the prevailing economic conditions and the financial well being of the issuer of the security.

(ix) Advances or outright borrowing at the DW whilst adequately secured shall be priced appropriately and the applicable rate of interest will be governed by the prevailing economic and market conditions. In any event, such advances shall attract a rate of interest at the Bank's MPR plus a margin determined at the discretion of the Bank.

ACCESS TO THE DISCOUNT WINDOW

5. All DMBs and DHs shall have direct access to the DW. The Bank through its ***Banking Operations Department*** shall exercise good judgment and discretion in the administration of the DW in order to ensure that the DW objectives are met. In particular, institutions may be denied access to the DW in the following circumstances:

(i) if the Bank observes an act of undue rate arbitrage in the operations of the institution's dealings;

(ii) if an institution is found to have contravened the provisions of the Bank's monetary and credit policy guidelines;

(iii) if the Bank discovers that the institution is be over-trading or engaged in undue mismatch of its assets and liabilities;

(iv) if there is contravention of the clearing houses rules;

(v) if there is any contravention or non-observance of provisions of the prudential guidelines;

(vi) If a DMB/DH under a holding action fails to comply with the provisions of the holding action.

ELIGIBLE INSTRUMENTS

6. The following instruments shall qualify for eligibility at the DW:

i. Nigerian Treasury Bills

ii. Nigerian Treasury Certificates

iii. FGN Bonds

iv. NDIC Accommodation Bills

v. States Government Bonds

vi. Banker's Acceptances/Guaranteed Commercial Papers/Promissory Notes.

vii. Any other instrument that may be approved by the Bank from time to time.

7. The first three instruments are securities issued by the Federal Government of Nigeria, while the others are the non-federal government securities. It must be noted that not all non-federal government instruments will have automatic eligibility at the DW. The Bank will maintain a list of the eligible instruments for DW operations. DMBs/DHs will be required to satisfy certain prescribed conditions as contained in the Annexure to this paper, in order to have eligibility conferred on their instruments. Consideration for applications from prospective eligible authorized dealers will be open-ended. Such applications should be addressed to the Director of Banking Operations, Central Bank of Nigeria, Abuja or Tinubu Square, Lagos.

NIGERIA TREASURY BILLS (NTBs)

8. NTBs are the obligations of the Nigerian Government. They are short-term securities issued for various tenors up to one year. NTBs are issued by auction in various denominations. Interested investors usually make application for purchase of the bills through any authorized dealer. The bills are issued in bearer form and in book entry, and are therefore negotiable. Because of the zero issuer risk, they are the most liquid and marketable money market instrument in the Nigerian money market today.

9. An active secondary market is conducted daily at the Bank where two-way quotes in the respective bill bands are made. However, unlike the primary market, the

Bills are sold to buyers in book-entry form in order to facilitate the transactions which are enormous in value and volume. A secondary market amongst money market counter-parties also exists where bills could be traded. NTBs have automatic eligibility at the DW. Holders wishing to repo physical bills at the DW must specially endorse those bills to the Bank. In the case of book-entry holdings, an application duly signed by two authorized signatories is required. All transactions are usually for same-day value and proceeds of discounted bills are credited into the current account of the DMB/DH held at the Bank.

NIGERIAN TREASURY CERTIFICATES (NTCs)

10. Like treasury bills, NTCs are also obligations of the Nigerian Federal Government. NTCs are medium-term money market instruments of one year and two-year maturities. NTCs possess all the attributes of NTBs in the market, in terms of risk and dealings, as well as transferability and negotiability. Therefore, much of the provisions contained in the foregoing paragraphs 9 and 10 relating to NTBs apply to NTCs.

FGN BONDS

11. FGN Bonds are sovereign obligations backed by the "full faith and credit" of the Nigerian Federal Government. They are long-term debt instruments with maturity greater than one year issued on behalf of the Federal Government by the Bank on the authority of the Debt

Management Office (DMO). They are issued at par and at a coupon rate, as interest is paid periodically.

12. Interested applicants and investors usually make application for purchase of the instruments through DMBs/DHs. The instruments are issued in physical certificates or book entry form.

13. The secondary market activities are at present conducted on the floor of the Nigerian Stock Exchange with the expectation of over the counter trading in the Bank. DMBs and DHs wishing to rediscount physical instruments at the DW must specially endorse those instruments to the Bank. In the case of book-entry holdings, an application duly signed by two authorized signatories is required. All transactions are usually for same-day value and proceeds of discounted instruments are credited into the current account of the DMB or DH held at the Bank.

NDIC ACCOMODATION BILLS

14. An Accommodation Bill is a bill to which a person called an accommodation party puts his name to oblige or accommodate another person without receiving any consideration for so doing. The position of such a party is, in fact, that of a surety or guarantor. When a banker discounts an accommodation bill he becomes a holder for value and an accommodation party is liable to a holder for value.

15. In exercise of its statutory obligations to insured banks, the Nigerian Deposit Insurance Corporation (NDIC) is empowered by section 37 (2) (c) of the NDIC Act 2006 to accept an accommodation bill with interest for a period not exceeding 90 days maturity exclusive of days of grace and subject to renewal of not more than four times. An NDIC accommodation bill is an eligible instrument at the DW and such a bill must meet the following requirements:

(i) be drawn by an insured DMB;

(ii) be drawn for a period not exceeding 90 days;

(iii) be signed by two authorized signatories of the bank;

(iv) bear on the face of the bill the acceptance of the NDIC with the authorized signatories of the Corporation;

(v) be endorsed specially to the Bank by the DMB;

(vi) the rate of commission (which should be expressed as a percentage on the face value) payable on the bill should be agreed between the DMB and NDIC while the Bank shall be advised accordingly.

16. Provided the foregoing conditions are fully satisfied, the Bank will proceed to discount the bill at the DW subject to the following:

i) the applicable discount rate, which in any event will not be lower than the MPR will be at the discretion of the Bank;

ii) the proceeds of the bill, net of NDIC commission, will be credited to the current account of the bank at the Bank, under advice;

iii) at the maturity of the bill, the face value shall be debited to the account of the DMB;

iv) in the event that the funds in the current account of the DMB are insufficient to cover the face value of the bill at maturity, the entire amount shall be debited into the account of the NDIC, under advice, but without formal notice; and

v) all parties shall ensure that an accommodation bill once issued is not renewed for more than a four-cycle period.

STATE GOVERNMENT BONDS

17. State Government Bonds are obligations of State Governments or their agencies. Like FGN Bonds, they are long-term debt instruments with maturity greater than one year. They are also backed by full faith, credit and taxing power of the State Governments issuing them.

18. The instruments will be accorded eligibility at the DW subject to the following:

(i) Must be rated by a recognized rating agency.

(ii) Must have a minimum of “BBB” rating.

(iii) Must be secured by an Irrevocable Standing Payment Order (“ISPO”) of the issuer as a first charge upon, and payable out of the Statutory Allocation of the State Government and must be deductible at source.

(iv) Must provide a Sinking Fund Account to be managed by a registered Trustee.

(v) Must be guaranteed by a DMB/DH.

BANKERS’ ACCEPTANCE (BAs)

19. A Bankers Acceptance is a bill of exchange which is drawn on, and accepted by, a DMB. It usually arises from documentary or acceptance credits which have been opened by a DMB in favour of a customer who is the drawer of the Bill. The customer may require short-

term finance from a DMB to cover the movement of goods in home and overseas trade, or to finance existing stock pending sale or processing. By placing its acceptance on the bill, a DMB is accepting a contingent liability as well as giving an indication that it will honour the draft upon presentation at maturity. Being a three-ways-out paper, BAs may command a low credit risk in the money market.

20. To qualify for eligibility at the DW, an acceptance must be made by a DMB accorded eligibility status by the Bank. The Bank will maintain a list of those institutions whose acceptances are eligible for discount at the DW (the criteria for determining eligibility is contained in the annexure to this Guidelines.) On the other hand, those accepted by a DMB whose acceptances are not accorded eligibility at the DW will be classified as ineligible acceptances. A BA must satisfy the following conditions:

(i) the BA must identify the underlying transaction for which the bill was drawn.

(ii) shall be self-liquidating and must not be for capital purposes;

(iii) shall be drawn for an original tenor not exceeding 180 days

(iv) the bill shall not be payable outside Nigeria

(v) the bill shall not be drawn on, or accepted by connected parties or by a DMB with a share holding link with the drawer. Connected parties will be informed where there exists direct or indirect shareholding relationship as well as common or inter-locking directorship; and

(vi) the bill must have been purchased by DMBs/DHs thus making the bill a two-name paper, namely those of the drawer, the accepting bank/discount house.

21. **The tenor of borrowing shall not exceed that of the underlying BA.**

22. The features of an eligible BA at the DW are contained in the provisions outlined in paragraphs 8 and 9 of the Annexure to this Guideline.

GUARANTEED COMMERCIAL PAPER (GCP)/PROMISSORY NOTES

23. A Guaranteed Commercial Paper is an unconditional promise by the issuer to pay to the order of a person, a certain sum at a future date. The instrument is issued in form of a Note with a maturity of less than one year at a discount from face value and must carry a bank’s guarantee with the bank incurring a contingent liability.

24. A Promissory Note is a contract where one party (the maker or issuer) makes an unconditional promise in writing to pay a sum of money to the other (the payee), either at a fixed or determinable future time or on demand of the payee, under specific terms.

25. To qualify for eligibility at the DW, a GCP must satisfy the provisions contained in the foregoing paragraphs 20 and 21 relating to BAs.

TYPES OF FACILITY

26. There are basically two types of credit which are available to eligible borrowers at the DW. These are:

- Overnight Advance/***Standing Lending Facility (SLF)*** or Outright Borrowing
- Fixed Tenor Repo.

Eligible instruments may be repurchased by the Bank at the DW. Such instruments shall not exceed a maturity period of one year.

While Outright Advances shall be on overnight basis, Repurchase Agreements shall be for such periods as shall be stipulated by the Bank from time to time.

27. ***Standing Lending Facility:***

The CBN Standing Lending Facility (SLF) is an overnight advance available to deposit money banks / discount houses. The facility is fully collateralized with a margin of 10 per cent (for only FGN securities backed facilities) above the face value of the amount applied for. For non-federal government securities, the Bank reserves the right to determine the collateral margin after accessing the dating of the instrument.

. The following procedure shall apply in the granting of an overnight advance/SLF to a DMB/DH:

i) submission of an application for an overnight advance, addressed to the Director, Banking Operations Department, CBN;

ii) the application shall state:

  - the amount required, which shall not exceed 10% of the applicant's total assets at the time of application;
  - the purpose for which the advance is required;
  - the date it is required;

iii) the application shall be accompanied by :

  - a statement of the applicant's assets as at the close of business the previous day;
  - collateral in form of treasury bills, or other eligible collateral whose face value should not be lower than ***110%*** of the advance;

iv) the interest on overnight advance shall be deducted from the advance and the balance credited to the borrower's current account with the Bank;

v) the applicable interest rate which will be at the discretion of the Bank shall not be lower than the ***Monetary Policy Rate (MPR).***

vi) the over-riding consideration shall be that the window should be accessed only on a last resort basis.

27. Each DMB/DH shall be eligible for an advance only once in any day and at the close of business. Any DMB/DH that accesses the CBN DW too frequently shall be subjected to greater scrutiny by the Bank. The Bank shall not hesitate to impose penalty on any DMB/DH should there be inappropriate utilization of the SLF window. The CBN may suspend or revise the conditions of any one or both of the SLF if it does not meet the overall objectives of the Bank's monetary policy stance.

Repurchase Agreement (Repo)

29. A Repurchase Agreement is a contract involving two simultaneous transactions in a single contract. It is the sale of securities for immediate payment and the commitment by the seller to buy back the securities at a later date, under an agreed term. The Repo could be viewed as a money market instrument in its own right to the extent that it allows an investor the opportunity of suitable asset/liability structuring.

30. Transactions on a Repurchase Agreement could be either a Repo (buy-back) or a reverse (sell-back) depending on whether the transaction is viewed from the standpoint of the lender or the borrower of the funds. For purposes of the DW facility the CBN will view a transaction as a Repo, which is a creation of reserves while a Reverse Repo is withdrawal of reserves.

31. In the conduct of open market operations, the Bank uses outright sales/purchases of securities as well as repurchases transactions to effect either a permanent or temporary action on bank reserves. Generally, central banks use repos at their own initiative for monetary policy purposes and not a means of making a secondary market in an asset. This basic concept will guide discount officers in the administration of the Repo facility at the DW. In other words, a perceived liquidity surplus in the system on any one day or over a period could engender a reverse action. Conversely, a shortage could evoke a repo action. Outside these two scenarios, a repurchase transaction will be viewed strictly as means of making a secondary market trading.

32. Whenever a repo transaction is undertaken as a secondary market trading, the Bank will view such transaction purely as a loan and the following conditions will apply:

(i) The term of a repo shall be as prescribed by the Bank from time to time. The tenor shall not exceed 360 days

(ii) A repo is viewed as a loan, albeit collateralized. The applicable rate shall therefore be market-driven. In any event, such rate shall not be lower than the CBN ***MPR.***

All eligible securities at the DW will be allowed for repo transactions.

(iii) Repo shall not be granted alongside an overnight advance.

(iv) The maximum allowable borrowing under a repo transaction in DW shall not exceed 70% of the face value of the eligible security. This clause is applicable to only the non-treasury securities i.e. commercial bills and state government bonds.

33. ***Deposit money banks and discount house will be eligible for repo only once in any one day at the close of business. The reason for the facility shall be explicitly stated. Therefore, at 3:30 p.m. every day each deposit money bank /discount house shall inform the Director, Banking Operations Department of the Bank of its position in the money market, that is, whether it is short of funds or has surplus funds*.**

34. The ***Bank*** reserves the right to disallow access to the expanded discount window if:

(i) There is a perceived excess in the general level of bank reserves in the system.

(ii) A DMB/DH is suspected to be involved in rate arbitraging

(iii) The supporting collateral is inadequate in terms of value and quality.

(iv) The DMB/DH's access to the DW, on cumulative basis, at any time is more than 50% of the DMB/DH's shareholders' funds unimpaired by losses.

PRICING AT THE DISCOUNT WINDOW

35. The pricing of instruments at the DW will be fully market-based in order to disallow any incidence of undue arbitraging.

36. In determining the applicable rate, due cognizance will be given to prevailing market rates such as the inter-bank market rates. As had been stated, DMBs/DHs seeking to utilize the DW are expected to have fully exhausted all available alternative market sources of funds.

CONCLUSION:

37. This guideline has been issued to assist money market participants in understanding the facilities which are available at the Central Bank of Nigeria Discount Window and shall be reviewed from time to time as the need arises.

BANKING OPERATIONS DEPARTMENT
CENTRAL BANK OF NIGERIA
ABUJA.

OCTOBER, 2008

ANNEXURE

CRITERIA FOR DETERMINING ELIGIBILITY OF BANKS WHOSE ACCEPTANCES QUALIFY FOR DISCOUNT WINDOW (DW) SUPPORT

This paper describes in general terms the conditions that must be satisfied by an authorized dealer in order to become an eligible institution.

1. The Bank shall maintain a list of those authorized dealers whose acceptances are eligible for discounting at its DW. Any institution may therefore apply at any time to the Bank for inclusion in this list.
2. To acquire an eligible status, an applicant must satisfy the following performance criteria consistently during the six months immediately preceding the receipt of its application:
   - (i) Statutory minimum capital requirement;
   - (ii) Capital adequacy ratio;
   - (iii) Specified liquidity ratio;
   - (iv) Specified cash reserve;
   - (v) Prudential Guidelines; and
   - (vi) Sound management.
3. An assessment of each application will also take cognizance of the following:
   - (i) Track record-whether the applicant already has a demonstrated capacity as well as a substantial existing acceptance business in the Nigeria money market;
   - (ii) Whether the extent to which an applicant has been operating as a market maker or trading in eligible DW instruments is considered adequate; and
   - (iii) Views expressed by other market participants on the usefulness of the role undertaken by the applicant, especially with regard to inter-bank transactions.

4. An important performance criterion on the assessment of an application is that an applicant must have demonstrated active participation in the Nigerian money market. This is meant to encompass an applicant's volume of trading in eligible DW instruments.

5. Institutions are expected to operate their current accounts at the Bank in a consistently regular manner. The overdrawing of its CBN account (without any supportable collateral under the mandate facility) by an institution is an indication of its current or future inability to promptly and fully satisfy its financial obligations. In this regard, applicants for eligibility would be required to have conducted their CBN accounts in a most desirable manner over the prescribed period.

6. The Bank in its dealings in the money market recognizes the need to control the composition and size of its own debt portfolio. The Bank will not impose any direct limit on the volume of acceptance business written by eligible institutions. However, for reasons of prudence, it will exercise internal controls on the proportion of its own portfolio for which an individual acceptor's paper may account. The Bank would therefore ensure that the volume of each institution's acceptances is not disproportionately out of line with its capital resources. Furthermore, the Bank may limit the volume of acceptances, which it may acquire at any time, for purposes of monetary controls.

7. A DMB may apply for eligibility at any time. The eligibility list will be revised from time to time with a view to adding to, or deleting from, the list. An eligible bank, which wishes to renounce its eligibility, is free to do by giving notice to the Bank.

8. For a BA, GCP and Promissory Note to qualify for eligibility at the DW, it must conform to the following:

i) its size should be 24cm by 13cm.
ii) the name and logo of its accepting bank should be clearly stamped and endorsed on the face of the instrument.
iii) "Acceptance" by DMB should be clearly stamped and endorsed on the face of the instrument.
iv) Other endorsements should be clearly indicated on the reverse side of the instrument.
v) Instruments traded in the market should be in the minimum denomination of N5million.

9. The following documents should accompany any DW dealings in Bankers Acceptance (BAs); Guaranteed Commercial Papers (GCPs) and Promissory Notes:

i) Details of contract letters.

ii) Original instruments.

10. Standing Lending Facility:

The CBN Standing Lending Facility (SLF) is an overnight advance available to deposit money banks / discount houses. The facility is fully collateralized with a margin of 10 per cent (minimum) above the face value of the amount applied for.

Banking Operations Department
Central Bank of Nigeria

OCTOBER, 2008