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LETTER TO ALL BANKS

PRUDENTIAL REGULATION FOR THE MANAGEMENT OF FOREIGN EXCHANGE RISKS OF BANKS

The Central Bank of Nigeria has noted with concern the growth in foreign currency borrowings of banks through foreign lines of credit and issuance of foreign currency denominated bonds (Eurobonds). The lower interest rate on foreign debt has created an incentive for banks to borrow abroad, and this has the advantage of providing fairly stable and long term funds to extend credit facilities in foreign currency and enhance their capital base. However, this also exposes banks to foreign exchange risks and other risks.

Therefore, to ensure that these risks are well managed and avoid losses that could pose material systemic challenges, the CBN issues the following prudential and hedging requirements:

1. Prudential Requirements

- a. The aggregate foreign currency borrowing of a bank excluding inter-group and inter-bank (Nigerian banks) borrowing should not exceed 75% of its shareholders' funds unimpaired by losses.

The 75% limit supersedes the 200% specified in Section 6 of our Guidelines for Foreign Borrowing for on-Lending by Nigerian Banks issued on November 26, 2001.

- b. The Net Open Position (long or short) of the overall foreign currency assets and liabilities taking into cognizance both those on and off-balance sheet should not exceed 20% of shareholders' funds unimpaired by losses using the Gross Aggregate Method.

Banks whose current NOP exceed 20% of their shareholders' funds are required to bring them to prudential limit within six (6) months.

Banks are required to compute their monthly NOP using the attached template.

- c. The current NOP limit of 1% of shareholders' funds has been renamed as Foreign Currency Trading Position. This will continue to subsist in line with guidelines issued by the CBN.
- d. Banks are required to have adequate stock of high-quality liquid foreign assets i.e cash and government securities in each significant currency to cover their maturing foreign currency obligations. In addition, banks should have in place a foreign exchange contingency funding arrangement with other financial institutions.

2. Hedging and Other Requirements

- a. Banks should borrow and lend in the same currency (natural hedging) to avoid currency mismatch associated with foreign currency risk.
- b. The basis of the interest rate for borrowing should be the same as that of lending i.e. there should be no mismatch in floating and fixed interest rates, to mitigate basis risk associated with foreign borrowing interest rate risk.
- c. With respect to Eurobonds, any clause of early redemption should be at the instance of the issuer and approval obtained from the CBN in this regard, even if the bond does not qualify as tier 2 capital.

Banks are required to adhere to the provisions of this circular with immediate effect.

Yours faithfully,

TOKUNBO MARTINS (MRS.)
DIRECTOR OF BANKING SUPERVISION

Monthly Computation of Net Open Position (Gross Aggregate Method)

| | US Dollars | Euro | Pound | Others | Total |
|--|------------|------|-------|--------|-------|
| FOREIGN ASSETS | | | | | |
| BALANCE SHEET ITEMS: | | | | | |
| Holdings of Foreign Currency | | | | | |
| Balances held with Foreign Banks | | | | | |
| Placement with Foreign Banks | | | | | |
| Balances held with Offices & Branches Abroad | | | | | |
| Treasury Securities of Foreign Governments | | | | | |
| Other financial Instruments in foreign currency | | | | | |
| Loans and Advances in foreign currency | | | | | |
| Other Foreign Assets (not captured above)* | | | | | |
| OFF BALANCE SHEET ITEMS: | | | | | |
| Undelivered spot purchases | | | | | |
| Forward purchases | | | | | |
| Others | | | | | |
| TOTAL FOREIGN ASSETS [A] | | | | | |
| | | | | | |
| FOREIGN LIABILITIES | | | | | |
| BALANCE SHEET ITEMS: | | | | | |
| Balances Held for Foreign Banks | | | | | |
| Takings from Foreign Banks | | | | | |
| Balances Held for Offices and Branches Abroad | | | | | |
| Foreign currency Deposits | | | | | |
| Financial Instruments Issued in foreign currency | | | | | |
| Loan and advances in foreign currency | | | | | |
| Other Foreign Liabilities (not captured above)* | | | | | |
| OFF BALANCE SHEET ITEMS: | | | | | |
| Undelivered spot sales | | | | | |
| Forward sales | | | | | |
| Others | | | | | |
| TOTAL FOREIGN LIABILITIES [B] | | | | | |
| | | | | | |
| NET OPEN POSITION (A-B) | | | | | |
| | | | | | |
| | | | | | |
| AGGREGATE LONG POSITION [C] | | | | | |
| AGGREGATE SHORT POSITION [D] | | | | | |
| GROSS AGGREGATE POSITION | | | | | |

| | | | | | |
|---|--|--|--|--|--|
| (Absolute values) [C+D] | | | | | |
| SHAREHOLDERS' FUNDS UNIMPAIRED BY LOSSES | | | | | |
| GROSS AGGREGATE OPEN POSITION AS PERCENTAGE OF SHAREHOLDERS' FUNDS | | | | | |

*Including derivative contracts

All figures are to be reported in Naira equivalent using mid-market spot rate of the reporting date with the rates presented below:

US dollars

Euro

Pounds

Others