FINANCIAL STABILITY REPORT

December 2014

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LIST OF ABBREVIATIONS AND ACRONYMS

AIPs	Approvals-in-Principle
AMCON	Asset Management Corporation of Nigeria
AML/CFT	Anti-Money Laundering and Combating the Financing of Terrorism
ASI	All Share Index (Nigerian Stock Exchange Index)
ATMs	Automated Teller Machines
BDCs	Bureaux de Change
BOFIA	Banks and Other Financial Institutions Act 1991 (as amended)
BRICS	Brazil, Russia, India, China, and South Africa
CACS	Commercial Agriculture Credit Scheme
CAR	Capital Adequacy Ratio
CBN	Central Bank of Nigeria
CIBN	Chartered Institute of Bankers of Nigeria
CIFTS	CBN Inter-bank Fund Transfer System
CR6	Concentration Ratio (of the six largest banks)
CRMS	Credit Risk Management System
DFIs	Development Finance Institutions
EBAs	Eligible Bank Assets
EDC	Entrepreneurship Development Centre
FCs	Finance Companies
FGN	Federal Government of Nigeria
FMDQ-OTC	Financial Market Dealers Quotation – Over the Counter Plc
FRACE	Financial Regulation Advisory Council of Experts
FSIs	Financial Soundness Indicators
FSRCC	Financial Services Regulation Co-ordinating Committee
GDP	Gross Domestic Product
HHI	Herfindahl-Hirschman Index
ICFA	Implied Cash Flow Analysis
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
KYC	Know Your Customer
M_1	Narrow Money Supply
M_2	Broad Money Supply
MCP	Microfinance Certification Programme
MENA	Middle East and North African Countries
MFBs	Microfinance Banks
MoUs	Memoranda of Understanding
MPR	Monetary Policy Rate
NDIC	Nigeria Deposit Insurance Corporation
NIBSS	Nigerian Inter-bank Settlement System
NIRSAL	Nigerian Incentive-based Risk Sharing System for Agricultural Lending
NMRC	Nigeria Mortgage Re-finance Company Plc
NPLs	Non-Performing Loans
NSE	Nigerian Stock Exchange

OBB	Open Buy Back
OFIs	Other Financial Institutions
PAIF	Power and Aviation Infrastructure Fund
PCBs	Private Credit Bureaux
PMBs	Primary Mortgage Banks
PoS	Point of Sale
PSV 2020	Payments System Vision 2020
rDAS	Retail Dutch Auction System
ROA	Return on Assets
ROE	Return on Equity
RTGS	Real-Time Gross Settlement System
SEC	Securities and Exchange Commission
SMEs	Small and Medium Enterprises
SMECGS	Small and Medium Enterprises Credit Guarantee Scheme
WAMZ	West African Monetary Zone
wDAS	Wholesale Dutch Auction System
WEO	World Economic Outlook

FOREWORD

The December 2014 edition of the *FSR* reviewed developments in the global and domestic economy and appraised the impact of monetary and financial policies towards the achievement of stability in the Nigerian financial system and the growth of the economy. The period (June – December 2014) was characterized by macroeconomic shocks in the Nigerian economy as a result of heightened political activities and dwindling government revenue occasioned by the rapid decline in the international price of crude oil. The Report highlighted the challenges to financial system stability in general, as well as, the implications for the banking sector soundness in particular. In ensuring financial system stability, the CBN employed not only macro-prudential policy instruments, but also adopted risk based supervision approach to strengthen banking sector resilience.

The Report focused on the resilience of the financial system to withstand unanticipated adverse shocks, while ensuring the continued smooth functioning of the system's financial intermediation processes. A stable financial system should aim at facilitating sustainable economic growth and development necessary for improved standard of living and enhanced economic conditions. The critical role of a stable and sound financial system in the growth and development of the nation, can therefore, not be over emphasized.

This edition of the *FSR* has emphasized the need for financial sector regulatory authorities to identify early warning signals in the sector and recommend appropriate policy tool-kit. This approach, which is in line with international best practice, has been the CBN strategy towards ensuring financial system stability.

The *FSR* is divided into five sections. Section One reviews the global and domestic economic and financial developments, highlighting key stability issues. Section Two chronicles developments in the financial system, while Section Three covers regulatory and supervisory activities. Key developments in the payments system are highlighted in Section Four. Finally, Section Five provides the near-term outlook for financial stability.

May I also acknowledge the contributions of Financial Policy and regulation Department that coordinated the production of this Report as well as other stakeholders whose facilitations were immeasurable.

O. J. Nnanna, Ph. D.
Deputy Governor, Financial System Stability

GOVERNOR'S STATEMENT

During the second half of 2014, which this edition of the Financial Stability Report covers, there were remarkable developments in both the domestic and global economy. On the positive side, we have seen strong GDP growth and declining unemployment in the United States, weakening inflationary pressures in Europe, and rebound of growth in the United Kingdom. On the negative side, many policymakers and governments around the world have been grappling with sustained and significant fall in oil prices, the end of the U.S. Federal Reserve's Quantitative Easing Programme, and the effects of US-led sanctions on Russia for its alleged role in the ongoing Ukrainian conflict.

On the domestic side, we have witnessed direct spillovers into our economy from the negative shocks mentioned above. These spillovers include exchange rate pressures, decline in government revenue, capital reversals, and dwindling accretion to foreign reserves.

It is in this context that I heartily welcome the review and analysis contained in this edition of the FSR. The report provides the basis for implementing appropriate countervailing strategies for stabilizing the financial system. In response to these challenging shocks, we acted calmly to first understand the underlying causes of the problems, and then we debated their policy options and finally acted swiftly to implement decisions that were reached.

Going forward, it is imperative to reiterate that the Bank would continue to formulate policies and implement strategies that will stabilize the financial system and stimulate growth in the real sector. In addition, the CBN will continue to promote financial inclusion and strengthen credit administration processes through the establishment of the National Collateral and Secured Transactions Registry to enhance asset quality. The Bank will also sustain its efforts at strengthening supervision of the financial institutions to ensure financial stability.

I am confident that in spite of the challenges experienced during 2014 and the uncertainties about 2015, the Bank will reinforce its lead role in ensuring the continued coordination and collaboration with stakeholders in the Nigerian financial system to pursue policies that would sustain market confidence. More importantly, it will intensify efforts at achieving greater coordination with the fiscal and other regulatory authorities to ensure financial system stability and effectiveness in macroeconomic management.

It is on this note that I recommend this edition of the *FSR* to all who have a stake in the growth and development of the Nigerian financial system and the economy at large.

Godwin I. Emefiele
Governor, Central Bank of Nigeria

EXECUTIVE SUMMARY

The global economy grew by 3.3 per cent in 2014, the same as in 2013, but growth was lower than the 3.4 and 4.1 per cent in 2012 and 2011, respectively. The US economy, helped by a 55.0 per cent decline in oil prices since September 2014, strengthened the global growth, but was moderated by weaknesses in global investments, inventory overhangs, unfavorable weather conditions, geopolitical tensions and the sluggish recovery in other advanced and the emerging market economies. These factors, alongside others, have resulted in moderate and unbalanced growth in different regions.

Generally, global inflationary pressures eased in 2014, although some advanced economies experienced increased inflation, owing largely to substantial output gaps. In sub-Saharan Africa, inflation rate increased slightly to 6.7 per cent in 2014, but this was generally contained, owing to tightened monetary policies and a decline in oil and food prices.

Developments in both output and inflation in the different regions of the globe produced mixed results in the capital markets during the second half of 2014. In the foreign exchange market, the currencies of most emerging market economies depreciated against the U.S. dollar.

In Nigeria, GDP growth remained robust in the second half of 2014. The tight monetary policy stance of the CBN, which continued into the second half of the year moderated inflationary pressures as the year-on-year headline inflation rate declined marginally to 8.0 per cent. In the second half of 2014, average interest rates remained stable but rose in December in response to further tightening of monetary policy in November. Broad money supply (M_2) grew by 7.29 per cent at the end of the second half of 2014. On the other hand, narrow money (M_1) declined by 10.89 per cent at end-December 2014, compared with the 2.88 per cent decline at the end of the first half of the year.

Credit continued to grow in the second half of 2014, as it recorded 10.97 per cent increase over the end-June 2014 position of ₦15,008.27 billion to close at ₦16,129.49 billion. While credit to the Federal Government declined, credit to the private sector increased by 12.08 per cent in the review period. The structure of credits indicated the continued dominance of short-term maturities. Furthermore, the banking industry remained dominated by a few major banks in terms of both deposits and assets.

During the review period, the CBN strengthened the regulatory framework for financial holding companies by issuing relevant guidelines for their operations and regulation. It also continued to ensure stability of the banking system through effective micro and macro supervision of the system, as well as the conduct of stress tests to evaluate the resilience of the system to shocks. Reform efforts were focused on reviving the mortgage sub-sector through the establishment of the Nigeria Mortgage Refinance Corporation (NMRC).

The Bank sustained its tight monetary policy stance by increasing the Monetary Policy Rate (MPR) from 12.00 to 13.00 per cent and raising the Cash Reserve Requirement (CRR) on private sector deposits by 500 basis points, from 15.00 to 20.00 per cent in the review period. Consequently, rates at the inter-bank funds market, which were relatively stable in the first ten months of 2014, rose in December.During the review period, gross external reserves declined to US$34.25 billion at end-December 2014,owing largely to the fall in oil prices.

Stress tests conducted on the banking industry at end-December 2014 revealed that banks were generally resilient to shocks. They were, however, more sensitive to credit concentration and exchange rate risks than other risks.

Towards enhancing the safety, effectiveness and efficiency of the payments system, the implementation of the cash-less policy was extended to the remaining 30 states of the Federation in the second half of 2014. The registration of bank customers under the Bank Verification Number (BVN) scheme continued. Efforts were also being made to capture customers of microfinance banks under the scheme.

Key risks in the banking system included: risks associated with credit growth; insecurity in some parts of the Country; fluctuation in key prices, arising from external shocks and the uncertainties over the 2015 elections.

1.0 MACROECONOMIC DEVELOPMENTS AND FINANCIAL SYSTEM STABILITY

1.1 Global Economic and Financial Developments

1.1.1 Output

Global output grew by3.3 per cent in 2014 (Table 1.1), the same as in 2013, but was lower than the 3.7 per cent projected for the year, reflecting the slow recovery in the global economy. An expected boost in global output from the strengthening of the US economy and the 55.0 per cent decline in oil prices since September 2014, was offset by weaknesses in global investments and inventory overhangs, unfavorable weather conditions, geopolitical tensions and the sluggish recovery in many advanced and emerging market economies. Other factors included the appreciation of the US dollar, depreciation of the euro and yen, rising interest rates and high risk premia in many emerging market economies. The euro area and Japan continued to grapple with structural bottlenecks and lingering effects of the global financial crisis, while China remained burdened with weak growth. In addition, weak external demand, continued tightening of domestic policies, political uncertainties and supply-side constraints in other developing countries adversely affected the growth in global output across countries in various degrees. Overall, these developments have resulted in moderate and unbalanced growth in global output across regions in 2014.

In the advanced economies, output growth was 1.8 per cent in 2014, compared with the 1.3 and 1.2 per cent recorded in 2013 and 201, respectively. Growth in the US economy rebounded to 2.4 per cent, after the 2.1 per cent contraction in the first quarter of 2014. The growth in the US economy was attributed to the decline in oil prices and unemployment, weakening inflationary pressures, increased household spending and industrial activities, as well as a rise in shale oil production.

In Japan, output growth was 0.1 per cent in 2014, compared with 1.6 per cent in 2013. This reflected a less than expected rebound in domestic spending, owing to an increase in consumption tax during the review period. Canada's output growth was 2.4 per cent in 2014, compared with 2.0 per cent in 2013 owing partly to favourable monetary policy conditions.

Output growth in the euro area was 0.8 per cent in 2014, in contrast to the decline of 0.5 per cent in 2013, reflecting further monetary easing, a more neutral fiscal policy stance, and depreciation of the euro. The growth was offset by weaker investments and declining inflation expectations. In the UK, growth remained relatively strong at 2.6 per cent in 2014 owing to broad-based consumer and business confidence.

In emerging markets and developing economies, output growth declined to 4.4per cent in 2014, compared with 4.7 per cent in 2013 and 5.1 per cent in 2012. Similarly, output growth in China declined to 7.4 per cent in 2014, from 7.8 per cent in 2013, reflecting moderation in domestic demand owing to measures taken to rein in growth in credit and real estate activities. In India, despite the structural challenges and weak demand, output grew by 5.8 per cent in 2014, compared with 5.0 per cent in 2013. Output growth in Russia was 0.6 per cent in 2014, compared with 1.3 per cent in 2013. The decline in growth was linked to low investments, low oil prices, weak demand for exports owing to the economic sanctions and the crisis in Ukraine.

In the Middle East and North Africa (MENA) region, GDP growth was 2.8 per cent in 2014, compared with 2.2 per cent in 2013, despite the decline in oil prices and output as well as political uncertainties. The growth was as a result of stable macroeconomic indicators, such as inflation which declined from 9.0 to 7.6 per cent.

Output growth in sub-Saharan Africa (SSA) was 4.8 per cent in 2014 compared with5.2 per cent in 2013.The growth was attributed, in part, to the adoption of fiscal consolidation in most countries and positive domestic supply-side measures within the region. The slower growth in SSA was attributed to declining oil and commodity prices as well as the outbreak of Ebola Virus Disease (EVD) in the West African sub-region. In Nigeria, output growth rose to 6.2 per cent in 2014, from 5.5per cent in 2013. The South African economy fell short of expectation as output declined to 1.4 per cent in 2014, from 2.2 per cent in 2013.

Table 1. 1: Global Economic Outlook (per cent change)

Region/Country	**Year-on-Year**				
					Forecast
	2011	**2012**	**2013**	**2014**	**2015**
World	4.1	3.4	3.3	3.3	3.5
Advanced Economies	1.7	1.2	1.3	1.8	2.4
United States	1.6	2.3	2.2	2.4	3.6
Euro Area	1.6	-0.7	-0.5	0.8	1.2
Japan	-0.5	1.5	1.6	0.1	0.6
United Kingdom	1.1	0.3	1.7	2.6	2.7
Canada	2.5	1.7	2.0	2.4	2.3
Emerging Markets + Developing Economies	6.2	5.1	4.7	4.4	4.3
China	9.3	7.7	7.8	7.4	6.8
MENA Region	4.5	4.8	2.2	2.8	3.3
Sub-Saharan Africa	5.1	4.4	5.2	4.8	4.9
Nigeria	4.9	4.3	5.4	6.1	4.8

Sources: *i. WEO, October 2014 and WEO Update, January 20,2015;*
ii. Global Economic Prospects, January 2015

1.1.2 Global Inflation

Generally, global inflationary pressures eased in 2014, reflecting contractionary monetary policies and fiscal consolidation measures adopted by most countries.

In advanced economies, inflation increased from 1.4 per cent in 2013 to 1.6 per cent in 2014, largely because many of the economies recorded substantial output gaps, though deflation remained a challenge in some of them. In addition, the low level of inflation, although below most central banks' targets, reflected continued slack in economic activities, reduction in the labour force owing to demographic trends as well as dissatisfied workers leaving the labour market. Inflation in the US, which was 1.5 per cent in 2013, rose to 2.0 per cent in 2014.

In the euro area, inflation moderated to 0.5 per cent in 2014 from 1.3 per cent in 2013 and is expected to rise to 0.9 per cent in 2015, as the region's economy recovers. Similarly, inflation in the United Kingdom moderated to 1.6 per cent in 2014, from 2.6 per cent in 2013 and is projected to increase slightly to 1.8 per cent in 2015.

In Japan, inflation moved from 0.4 per cent in 2013 to 2.7 per cent in 2014 and is estimated to decline to 2.0 per cent in 2015. The rise in inflation in 2014 was attributed to the new fiscal stance and the depreciation of the yen.

Inflation in the emerging and developing economies also moderated to 5.5 per cent in 2014 from 5.9 per cent in 2013. In sub-Saharan Africa, inflation edged slightly up to 6.7 per cent in 2014, from 6.6 per cent in 2013. However, inflation remained within single digit owing to tightened monetary policies and falling oil and food prices.

Table 1. 2: Global Consumer Prices/Inflation (per cent)

Region/Country	**2011**	**2012**	**2013**	**2014**	**2015 Projection**
Advanced Economies	2.7	2.0	1.4	1.6	1.8
United States of America	3.1	2.1	1.5	2.0	2.1
Euro Area	2.7	2.5	1.3	0.5	0.9
Japan	-0.3	0.0	0.4	2.7	2.0
United **Kingdom**	4.5	2.8	2.6	1.6	1.8
Emerging and Developing Economies	7.3	6.1	5.9	5.5	5.6
MENA Region	8.6	9.7	9.0	7.6	8.0
Sub-Saharan Africa	9.5	9.3	6.6	6.7	7.0
Nigeria	10.8	12.2	8.5	8.3	8.7

Source: WEO October, 2014

1.1.3 Global Commodity Prices

The prices of key commodities declined in the second half of 2014, with the highest price decline of 44 per cent in crude oil. The prices of agricultural products, metal and precious metals also witnessed downward trends. In terms of annual average prices, the decline in commodity prices in 2014 relative to 2013 varied from 2.8 per cent for agricultural products to 7.1 per cent for both energy and food, 7.7 per cent for crude oil, 10.3 per cent for gold prices and 12.2 per cent for precious metals (Table 1.3).

Table 1. 3: Average Commodity (Nominal) Price Indices (2010 = 100)

	2010	2011	2012	2013	2014	Change % 2014/ 2013	June 2014	Dec 2014	Change % Dec/ June 2014
Energy	100	129	128	127	118	-7.1	131.4	78.4	-40.3
Non Energy	100	120	110	102	97	-4.9	98.1	91.2	-7.0
Metals	100	113	96	91	85	-6.6	89.2	86.3	-3.3
Agriculture	100	122	114	106	103	-2.8	105.0	96.7	-7.9
Food	100	123	124	116	107	-7.2	109.6	101.2	-7.7
Precious metals	100	136	138	115	101	-12.2	102.9	94.0	-8.6
Memorandum items									
Crude oil ($/bbl)	79	104	105	104	96	-7.7	108.4	60.7	-44.0
Gold ($/toz)	1,225	1,569	1,670	1,411	1,266	-10.3	1,279	1,201	-6.1

Source: Commodity Markets Outlook, January 2015, World Bank Group.

The factors accounting for the decline in commodity prices in the review period included supply increases across most commodity sectors, weak global growth and appreciating US dollar. The fall in oil prices was attributed to an increase in supply combined with a decrease in demand and OPEC's policy shift from supporting prices to maintaining market share.

1.1.3.1 Oil Prices

The Organization of Petroleum Exporting Countries (OPEC) Reference Basket (ORB) was down by 44.0 per cent from the US$108.4pb recorded in June 2014, to US$60.7/bat end-December 2014, the lowest since May 2008, amid imbalances in oil market supply and demand. The oil price drop was the third largest seven-month decline in three decades.

Global oil production rose more rapidly than refining capacity in 2014. Output was 1.7mb/d higher than the88.81mb/d recorded in 2013, and was more than enough to meet growth in demand. In addition, a 0.6mb/d increase in Libya's production at end-October 2014 left the oil market with large inventories, the largest reported crude stocks in more than five and a half years. Also, improvement in shale technology led to higher US production and contributed to the increase in global crude inventories.

Global oil demand was estimated at 93.5mb/d in December 2014, representing an upward revision of 0.02mb/d from the level in the previous month. The adjustment from historical trends mainly reflected better-than-expected oil demand from non-OECD countries. In 2015, world oil demand is expected to rise by 1.15 mb/d, representing an upward revision of 0.30 mb/d owing to expectations of higher oil requirements in non-OECD countries.

1.1.3.2 Food Prices

The Food and Agriculture Organization (FAO)'s Food Price Index (FPI) stood at186.2 points in December 2014, down by 22.7 points (10.9 per cent) from the 208.9 points recorded in June 2014. The index had been on a downward trend since March 2014, closed the year with a monthly average of 186.2 in December 2014, with the sharpest year-on-year decline recorded by cereals

(12.5 per cent), dairy products (7.7 per cent), oils (6.2 per cent) and sugar (3.8 per cent). Only the FAO Meat Price Index recorded an increase (8.1 per cent) compared with 2013.

Table 1. 4: Global Food Price Index

	2010	2011	2012	Yearly Avg. 2013	Yearly Avg. 2014	June 2014	Dec. 2014	Change June – Dec 2014
Food price index	188.0	229.9	213.3	209.8	201.8	208.9	186.2	-22.7
Meat	158.3	183.3	182.0	184.1	198.3	202.8	197.5	-53.0
Dairy	206.6	229.5	193.6	242.7	224.1	236.5	174.0	-62.5
Cereals	179.2	240.9	236.1	219.3	191.9	196.1	183.9	-12.2
Vegetable oil	197.4	254.5	223.9	193.0	181.1	188.8	160.7	-28.1
Sugar	302.0	368.9	305.7	251.0	241.2	258.0	217.5	-40.15

Source: Food and Agriculture Organization of the United Nations

The FAO Cereal Price Index averaged 183.9 points in December, down by 12.2 points from the 196.1 in June 2014, but higher than the 183.2 recorded in December 2014. The decline was driven primarily by a 7.0 per cent fall in the international prices of wheat, owing to abundant supply and large inventories. In terms of annual averages, the FAO Cereal Price Index averaged 192 in 2014, which was down by 12.5 per cent from the 219.3 in 2013.

The FAO Vegetable Oil Price Index averaged 160.7 points in December, down by 28.1 points from 188.8 in June 2014, and 164.9 in December 2014. The December price was its lowest since October 2009. The drop in the index reflected developments in crude oil prices which depressed demand for palm oil and eroded the competiveness of vegetable oil as a biodiesel feedstock.

The FAO Dairy Price Index averaged 174.0 points in December, down by 62.5 points (26.4%) in December 2014.Increased supply and a fall in demand by leading importers, especially China and the Russian Federation, exerted pressure on international prices in December. In 2014, the prices of milk products averaged 224.2 points, down by 7.7 per cent in 2013.

The FAO Meat Price Index averaged 197.5 points in December 2014, which was 5.3 points down from the 202.8 in June 2014 reflecting, mainly, falling currency exchange rates relative to the US dollar and growth in exports. However, the only commodity group within the FAO FPI that registered an increase in 2014 was meat products. On a year-on-year basis, the FAO Meat Price Index increased by 14.2 points, from184.1 in 2013 to 198.3 in 2014.

The FAO Sugar Price Index averaged 217.5 points in December 2014, down by 40.5 points from the 258.0 in June 2014. On an annual basis, sugar prices experienced downward pressure as the index averaged 217.5 points in 2014, compared with the 251.0 in 2013. Ample supplies in major sugar producing countries, especially Brazil, the world's largest producer and exporter, and falling crude oil prices, which reduced the volume of sugar crops being converted into ethanol, impacted on international sugar quotations in December.

1.1.3.3 Gold Prices

The price of gold continued its downward trend during the second half of 2014 as its average spot price settled at US$1,201 per ounce in December 2014, down from the US$1,327.33 per ounce in June 2014 and the US$1,411 per ounce at end-December 2013. Overall, gold lost about 9.5 per cent in price during the second half of 2014, compared with a gain of 10.0 per cent during the first half of the year.

1.1.4 International Financial Markets

1.1.4.1 International Stock Markets

International stock markets recorded mixed developments during the second half of 2014 (Table 1.5). While stock movements in North America and Asia were largely positive, markets in Europe and Africa were mostly negative. In North America, the S&P 500 and Mexican Bolsa increased by 5.0 and 1.0 per cent, between end-June and end-December 2014, respectively, while the Canadian S&P/TSX Composite decreased by 3.4 per cent. In Asia, Japan's Nikkei 225, China's Shanghai Stock Exchange-A and India's BSE Sensex indices increased by 15.1, 58.0 and 8.2 per cent, respectively. In South America, the Argentine Merval increased by 19.8 per cent, while the Brazilian Bovespa decreased by 5.9 per cent. In Europe, FTSE 100, CAC 40, DAX and MICEX indices decreased by 2.6, 3.4, 0.3 and 5.4 per cent, respectively, in the review period.

In the second half of 2014, the global equities market was adversely affected by concerns about slow and fragile economic growth and falling oil prices. This prompted the European Central Bank's (ECB) announcement of its intention to embark on asset purchases to boost the Euro Zone economy. The US stock market, had for the most part, been on a positive path as investors largely ignored the collapse in crude oil prices and focused on strengthening the economy.

In Asia, the Japanese economy went into recession amidst threats of deflation, compelling the Bank of Japan to step up its stimulus programme. However, towards the year-end, its stock market stabilized and the yen strengthened amidst weak oil prices and sluggish global growth. China's economy witnessed slow growth and a rise in non-performing loans which negatively impacted on the stock market.

Stock market indices, in Africa, notably the Nairobi NSE 20 and the Egyptian EGX CASE 30 indices, increased by 4.7 and 9.4 per cent, respectively, while the Nigerian NSE ASI, the South African JSE All-Share and the Ghanaian GSE All Share indices decreased by 18.4, 2.3 and 4.7 per cent, respectively.

Table 1. 5: Selected International Stock Market Indices at end-December 2014

Country	Index	End-Dec.13	End-June-14	End-Dec-14	YTD % Change	% Change June– Dec.2014
AFRICA						
Nigeria	NSE All-Share Index	41,329.10	42,482.49	34,657.15	-16.1	-18.4
South Africa	JSE All-Share Index	46,256.23	50,945.26	49,770.60	7.6	-2.3
Kenya	Nairobi NSE 20 Share index	4,926.97	4,885.04	5,112.65	3.8	4.7
Egypt	EGX CASE 30	6,782.84	8,162.20	8,926.58	31.6	9.4
Ghana	GSE All-Share Index	2,145.20	2,373.38	2,261.02	5.4	-4.7
NORTH AMERICA						
US	S&P 500	1,848.36	1,960.23	2,058.90	11.4	5.0
Canada	S&P/TSX Composite	13,621.55	15,146.01	14,632.44	7.4	-3.4
Mexico	Bolsa	42,727.09	42,737.17	43,145.66	1.0	1.0
SOUTH AMERICA						
Brazil	Bovespa Stock	51,507.16	53,168.22	50,007.41	-2.9	-5.9
Argentina	Merval	4,275.98	6,537.61	7,830.30	83.1	19.8
EUROPE						
UK	FTSE 100	6,749.09	6,743.94	6,566.09	-2.7	-2.6
France	CAC 40	4,295.95	4,422.84	4,272.75	-0.5	-3.4
Germany	DAX	9,552.16	9,833.07	9,805.55	2.7	-0.3
Russia	MICEX	1,503.39	1,476.38	1,396.61	-7.1	-5.4
ASIA						
Japan	NIKKEI 225	16,291.13	15,162.10	17,450.77	7.1	15.1
China	Shanghai SE A	2,214.49	2,144.74	3,389.39	53.1	58.0
India	BSE Sensex	21,170.68	25,413.78	27,499.42	29.9	8.2

Source: *Bloomberg*

1.1.4.2 International Foreign Exchange Markets

During the review period, the currencies of major emerging market economies depreciated against the U.S. dollar, reflecting, largely, the turmoil in many financial markets earlier in the year, the slow economic recovery in advanced economies and the impact of termination of U.S. monetary easing programme. The moderating growth in the advanced countries was weakened by the strengthening U.S. dollar, volatile capital flows and financial system vulnerabilities arising from currency depreciations. Meanwhile, uncertainties in commodity prices which hit Latin American and African markets, and the insurgency and the Ebola epidemic in the West African sub-region exacerbated the pressures on their currencies. The divergent monetary policy stance in China and Japan worsened the fragility of financial markets and currency risks in developing economies.

In North America, the Canadian dollar and Mexican peso depreciated against the US dollar by 7.06 and 12.07 per cent, respectively. Similarly, in Africa, the Nigerian naira, the South African rand and the Kenyan shilling, depreciated against the US dollar by 7.30, 8.04 and3.31per cent, respectively. The Egyptian pound remained unchanged while the Ghanaian cedi appreciated by 3.73 per cent.

In South America, the Brazilian real, the Argentine peso, and the Colombian peso depreciated against the US dollar by 16.92, 4.01, and 21.00 per cent, respectively. Also in Europe, the British pound, the euro and the Russian ruble depreciated against the US dollar by 9.38, 12.05 and 44.06 per cent, respectively.

In the Asian foreign exchange markets, the Japanese yen, the Chinese yuan and the Indian rupee also depreciated against the US dollar by 15.40, 0.16, and 4.52 per cent, respectively.

Table 1. 6: Exchange Rates of Selected Countries (Value in currency units to US$)

Economy	**Currency**	**31-Dec-13**	**31-Mar-14**	**30-Jun-14**	**30-Sep-14**	**31-Dec-14**	**Appreciation/Depreciation**	
							B/w c & e	**B/w a & e**
AFRICA		**a**	**b**	**c**	**d**	**e**	**F**	**g**
Nigeria	Naira	157.27	157.30	157.29	157.31	169.68	-7.30	-7.31
South Africa	Rand	10.52	10.53	10.64	11.29	11.57	-8.04	-9.08
Kenya	Shilling	86.30	86.30	87.60	89.35	90.60	-3.31	-4.75
Egypt	Pound	6.95	6.97	7.15	7.14	7.15	0.00	-2.80
Ghana	Cedi	2.38	2.66	3.34	3.30	3.22	3.73	-26.09
NORTH AMERICA								
Canada	Dollar	1.06	1.11	1.07	1.12	1.16	-7.76	-8.62
Mexico	Peso	13.10	13.06	12.97	13.43	14.75	-12.07	-11.19
SOUTH AMERICA								
Brazil	Real	2.36	2.27	2.21	2.45	2.66	-16.92	-11.28
Argentina	Peso	6.52	8.00	8.13	8.43	8.47	-4.01	-23.02
Colombia	Peso	1929.51	1971.20	1877.44	2024.85	2376.51	-21.00	-18.81
EUROPE								
UK	Pound	0.60	0.60	0.58	0.62	0.64	-9.38	-6.25
Euro Area	Euro	0.73	0.73	0.73	0.79	0.83	-12.05	-12.05
Russia	Ruble	32.87	35.17	33.98	39.60	60.74	-44.06	-45.88
ASIA								
Japan	Yen	105.26	103.23	101.33	109.65	119.78	-15.40	-12.12
China	Yuan	6.05	6.22	6.20	6.14	6.21	-0.16	-2.58
India	Rupee	61.80	59.89	60.19	61.76	63.04	-4.52	-1.97

Source: Bloomberg

1.1.4.3 International Monetary Policy Rates

Monetary policy rates were generally retained in most advanced economies during the second half of 2014. While the Bank of Japan, the Bank of England, the U.S. Federal Reserve, the Bank of Canada, the Bank of South Korea and the Reserve Bank of Australia maintained rates between

0.25 and 1.00 per cent, the European Central Bank reduced its policy rate, from 0.15 per cent in June to 0.05 per cent in September 2014. The Reserve Bank of New Zealand maintained its rate of 3.25 per cent approved in June to end-December 2014. The Bank of Indonesia also kept its rate at 7.5 per cent during the second half of2014. However, the Bank Negara Malaysia raised its rate, from 3 per cent in the first half of 2014 to 3.25 percent in the second half of 2014.

In the BRICS countries, the monetary policy stance was mixed during the second half of 2014. Russia and India left their rates unchanged; Brazil and South Africa tightened up, and China eased up rates. Mexico maintained its rate at 3.0 per cent throughout the second half of 2014, while Chile cut its rate from 4.0 per cent in June 2014 to 3.75 per cent in July, 3.5 per cent in August, 3.25 in September, and 3.0 per cent in October 2014 and kept it till the year-end. However, Colombia increased its policy rate from 4.25 per cent in June 2014 to 4.5 in July and maintained it till the year-end. Most upward changes were attributed to capital outflows owing to the normalization of monetary policy of the US Federal Reserve Bank and tapering.

Table 1. 7: Summary of Policy Rates Across Selected Countries (Jan – Dec 2014)

Country	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Developed Economies												
Japan	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Europe	0.25	0.25	0.25	0.25	0.25	0.15	0.15	0.15	0.05	0.05	0.05	0.05
UK	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
US	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	1	1	1	1	1	1	1	1	1	1	1
South Korea	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
New Zealand	2.5	2.5	2.75	2.75	2.75	3.25	3.25	3.25	3.25	3.25	3.25	3.25
Australia	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
ASEAN												
Indonesia	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.75	7.75
Malaysia	3	3	3	3	3	3	3.25	3.25	3.25	3.25	3.25	3.25
BRICS												
Brazil	10.5	10.75	10.75	10.75	10.75	11	11	11	11	11	11.25	11.25
Russia	8.25	8.25	8.25	8.25	8.25	8.25	8.25	8.25	8.25	8.25	8.25	8.25
India	7.75	8	8	8	8	8	8	8	8	8	8	8
HK Base	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
South Africa	5	5.5	5.5	5.5	5.5	5.5	5.5	5.5	5.5	5.5	5.75	5.75
Other Emerging Economies & South America												
Mexico	3.5	3.5	3.5	3.5	3.5	3	3	3	3	3	3	3
Chile	4.25	4.25	4	4	4	4	3.75	3.5	3.25	3	3	3
Colombia	3.25	3.25	3.25	3.75	4	4.25	4.5	4.5	4.5	4.5	4.5	4.5
Africa												
Egypt	9.25	9.25	9.25	9.25	9.25	9.25	10.25	10.25	10.25	10.25	10.25	10.25
Ghana	16	18	18	18	18	18	19	19	19	19	21	21

Source: Bloomberg

1.2 Domestic Developments

1.2.1 Output

Provisional data from the National Bureau of Statistics (NBS) indicated that the domestic economy expanded further in the second half of 2014. Gross Domestic Product (GDP) measured in real terms recorded a growth of 13.03 per cent over the level in the preceding half year, in contrast to the 6.14 per cent decline in the first half against end December 2013 performance. It was, however, 0.31 percentage point below the 13.34 per cent recorded in the corresponding period of 2013. Overall, growth in real GDP continued to be buoyed by sustained expansion in the non-oil sector, though it was moderated by the lull in the oil sector, owing to the drastic fall in the international oil prices.

The non-oil sector recorded 15.06per cent growth in real terms in the second half of 2014, compared with the 7.04 per cent decline in the preceding first half. The growth in the non-oil sector was driven mainly by significant expansion in the agriculture sector, particularly, the crop production activities. Correspondingly, the contribution of the non-oil sector stood at 90.31 per cent, indicating an increase of 1.6 and 0.7 percentage points over the 88.71 and 89.57per cent recorded in the preceding half year and corresponding period of 2014, respectively. In real terms, the agriculture sector recorded the highest level of growth at 40.5 per cent, followed by the services sector (10.4%), trade (6.9%), and manufacturing (3.6%). In terms of sectoral contribution, the services sector accounted for the largest share (35.7%) of real GDP. This was followed by agriculture (25.2%), trade (16.1%), crude petroleum, natural gas and solid minerals (10.0%), manufacturing (9.5%),and construction (3.5%).

Activities in the oil sector witnessed challenges, arising from falling oil prices during the second half of 2014.Although average daily production of crude oil rose to 2.18 million barrels per day (mb/d) in the fourth quarter, from 2.15 mb/d in the third quarter, oil as a percentage of GDP declined by 2.9 per cent in contrast to 1.6 per cent growth in the first half. Further analysis also indicated that the oil sector contributed 9.7 per cent to real GDP in the second half, showing 1.59 and 0.73 percentage points decline below the contributions in the preceding half year and the corresponding period of 2013, respectively.

Figure 1. 1: Gross Domestic Product by Sector (₦ billion)

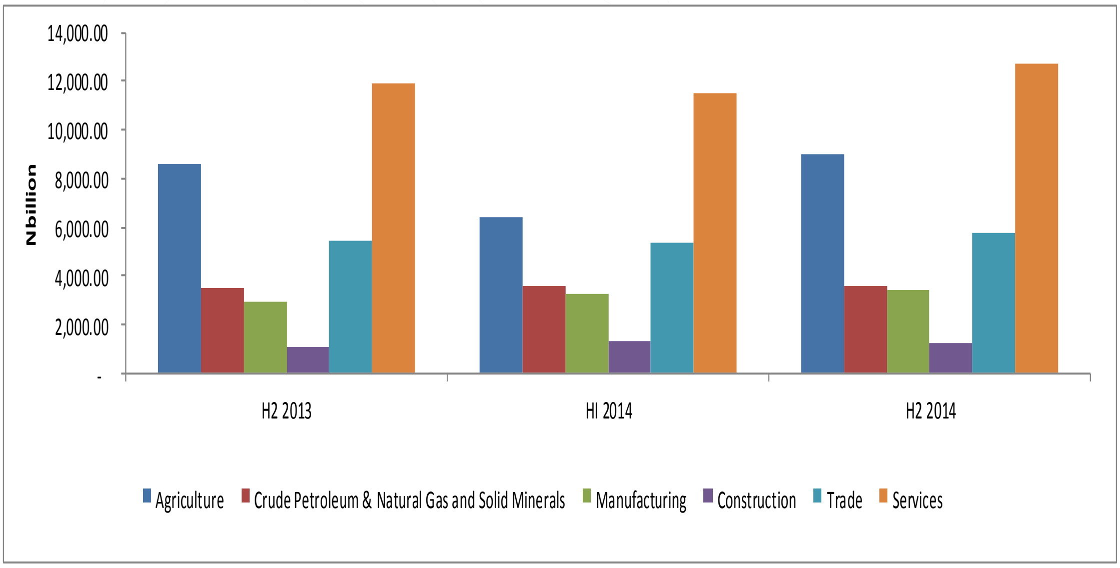


Table 1. 8: Changes (per cent) in Real GDP by Sector over Preceding Half Year

Sector	H2 2013	H1 2014	H2 2014
Manufacturing	3.6	10.8	3.6
Construction	-4.2	19.0	-5.8
Services	10.6	-3.0	10.4
Trade	6.6	-.8	6.9
Agriculture	41.2	-26.0	40.5
Crude Petroleum, Natural Resources and Solid Minerals	-2.8	1.6	-2.9

Figure 1. 2: Share of Oil and Non-oil Sectors in Real GDP (%)

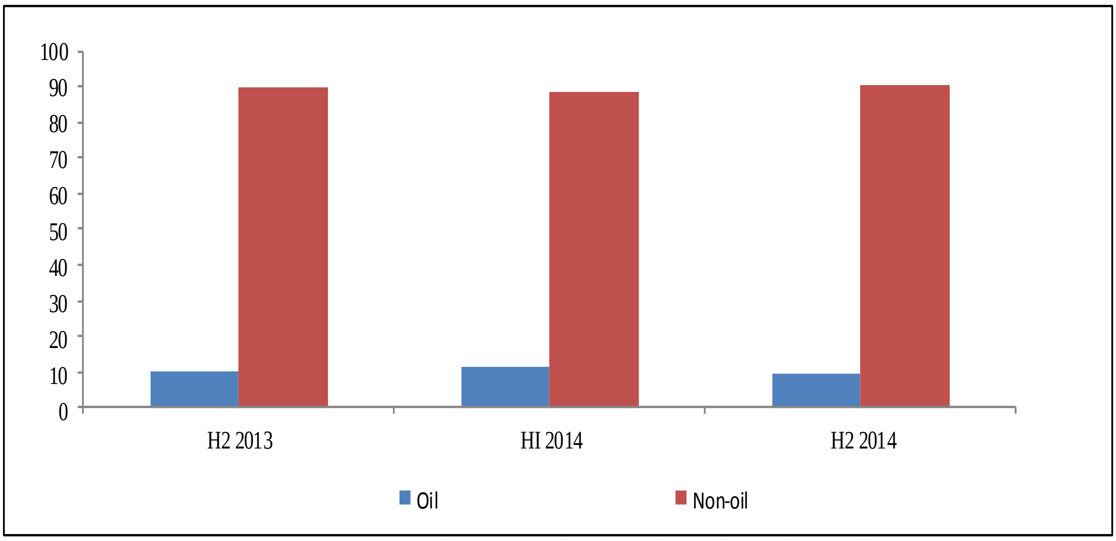
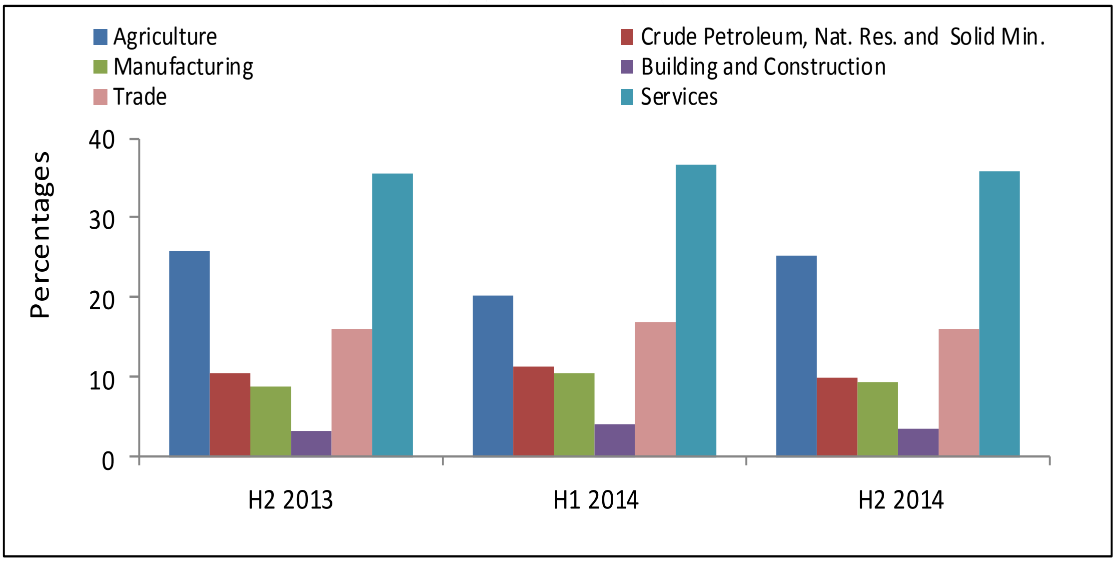


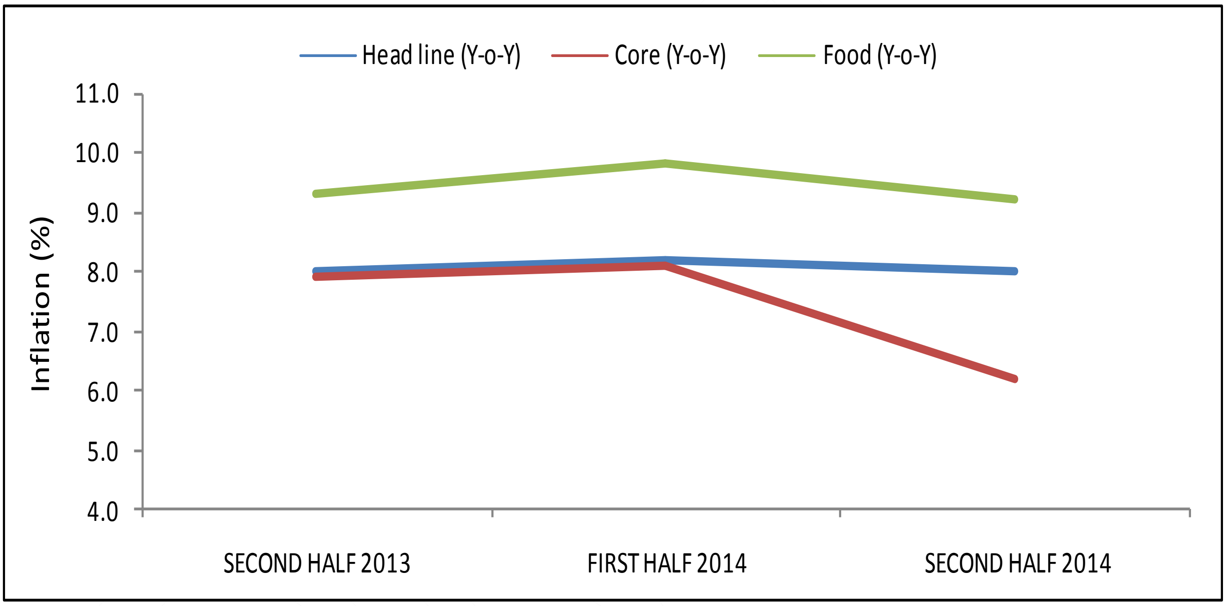
Figure 1. 3: Sectoral Share in Total GDP (%)



1.2.2 Inflation

Domestic inflationary pressure was moderated by the tight monetary policy stance of the CBN as the general price level trended downward during the review period. Data from the National Bureau of Statistics (NBS) showed that the all-items composite Consumer Price Index (CPI) stood at 164.4 in December 2014 (November 2009=100),compared with 158.6 and 152.3 at end-June 2014 and end-December 2013, respectively. Consequently, year-on-year headline inflation, which stood at 8.2 per cent at end-June2014, declined to 8.0 per cent at end-December 2014, the same level as at the end of December 2013. Inflation has, therefore, remained in the single digit range for twenty four (24) consecutive months, indicating relative stability in the general domestic price level. Similarly, in spite of the slight increase in food prices, especially during the festive period, food inflation declined to 9.2 per cent at end-December 2014, compared with 9.8 and 9.3 per cent at end-June 2014 and end-December 2013, respectively. Also, core inflation fell to 6.2 per cent at end-December 2014, from 8.1 and 7.9 per cent at end-June 2014 and end-December 2013, respectively (Figure 1.4).

Figure 1. 4: Inflationary Trend (Year-on-Year)



1.2.3 Interest Rates

Towards the end of the year, interest rates generally increased, however, on the average, interest rates in the second half of 2014were generally lower than their levels in the first half, with the exception of savings and 1- month deposit rates which rose to 3.40 and 8.43 per cent, from their respective levels of 3.35 and 8.31 per cent at end-June 2014.These developments were attributed, largely, to the liquidity surfeit in the system, which had, however, been continually moderated by the monetary tightening stance of the CBN. The average term deposit rate fell from 8.57 per cent in the preceding half year to 8.28 per cent in the second half of 2014.Similarly, deposit rates for other maturities fell from a range of 4.81 –9.98 per cent in the first half of 2014,to 4.43 – 9.78 per cent in the second half of 2014 (Figure 1.5).

The average inter-bank call and open-buy-back (OBB) rates stood at 12.90 and 12.69 per cent in the second half of 2014, up from their respective levels of 10.44 and 10.99 per cent in the preceding half year. The average prime lending rate however, fell by 0.35 percentage point to 16.39 per cent. Average maximum lending rate also fell by 0.04 percentage point to 25.72 per cent in the review period, from 25.76 per cent in the preceding half year. Consequently, the spread between the average maximum lending and the average term deposit rates stood at 17.44 percentage points, indicating a 0.25 percentage point above the level in the first half of 2014. With inflation at 8.0 per cent at end-December 2014, most deposit and all lending rates were positive in real terms, the only exceptions being the average savings and 7- day maturity deposit rates. This positive development is expected to encourage savings, promote capital accumulation and enhance the capacity of banks to expand credit to the real sector.

Figure 1. 5: Lending and Deposit Rates

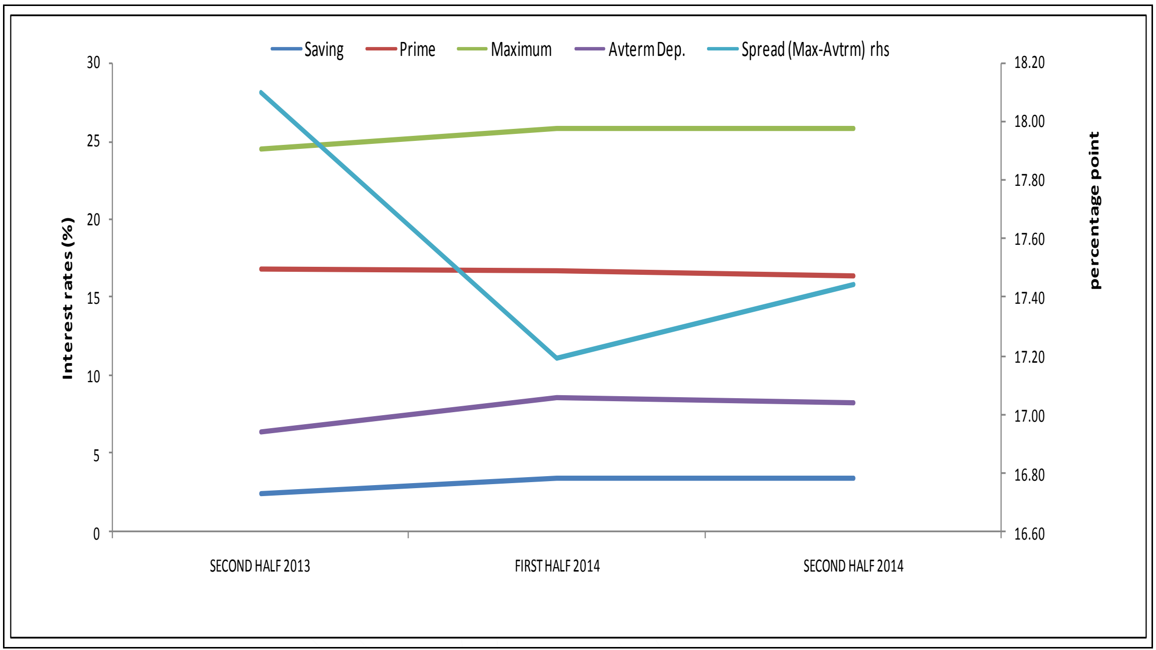
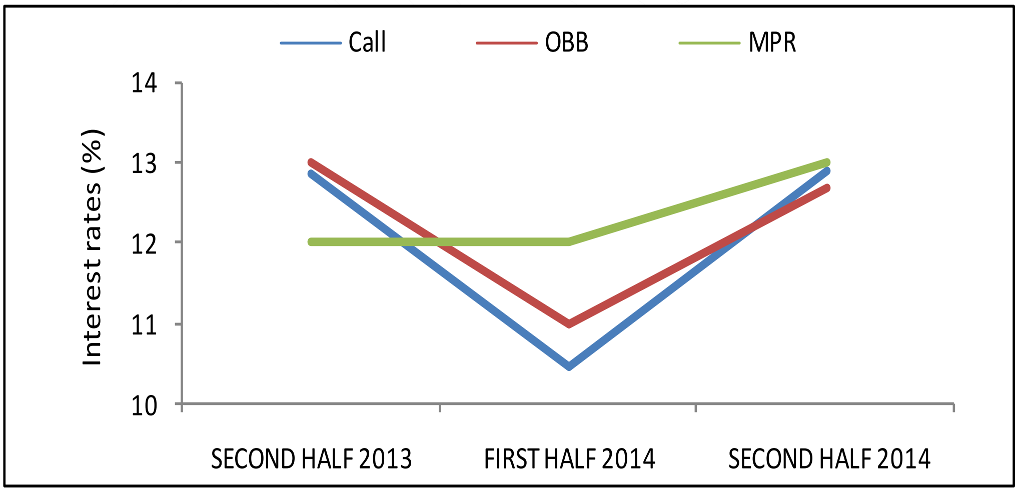


Figure 1. 6: Money Market Interest Rates and MPR

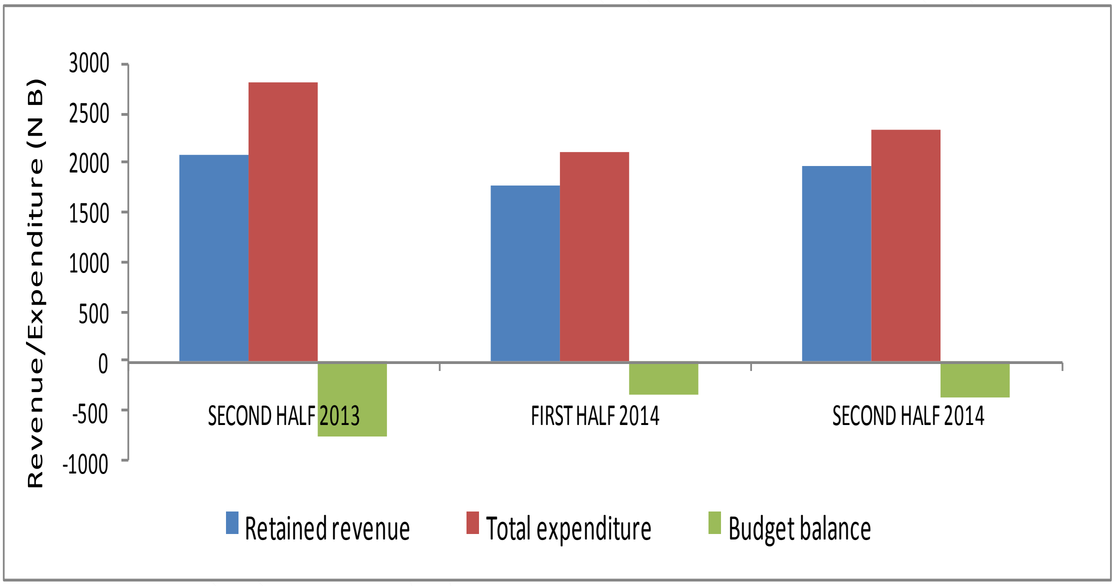


1.2.4 Fiscal Operations

The Federal Government's retained revenue for the second half of 2014 increased to ₦1,951.19 billion, from ₦1,771.27 billion in the first half, but was lower than the budget estimate of ₦2,134.04 billion. Analysis of the retained revenue showed that the Federal Government's share of the Federation Account was ₦1,403.94 billion (71.9%); the VAT Pool Account, ₦55.62 billion (2.9%); the Federal Government Independent Revenue, ₦284.14 billion (14.6%); SURE-P,₦97.76 billion (5.0%); while others (including excess crude and NNPC additional revenue) accounted for the balance of ₦109.73 billion (5.6%).Similarly, Federal Government expenditure grew by 10.5 per cent to ₦2,316.54 billion, from ₦2,096.37 billion in the first half, compared with the budgeted expenditure of₦2,616.14 billion for the second half of 2014. Consequently, the fiscal operations of the Federal Government resulted in an overall deficit of₦365.35 billion or 0.8 per cent of GDP, as against the proportionate budget deficit of ₦482.10 billion for the second half of 2014 and ₦325.10 billion recorded in the preceding half year. The deficit was financed mostly from privatization proceeds (Figure 1.7).

The second half of 2014 also witnessed the commencement of a sustained decline in international oil prices, a development that signalled a decline in government revenue in 2015, given the traditional dominance of oil receipts in its revenue profile.

Figure 1. 7: Federal Government Fiscal Operations



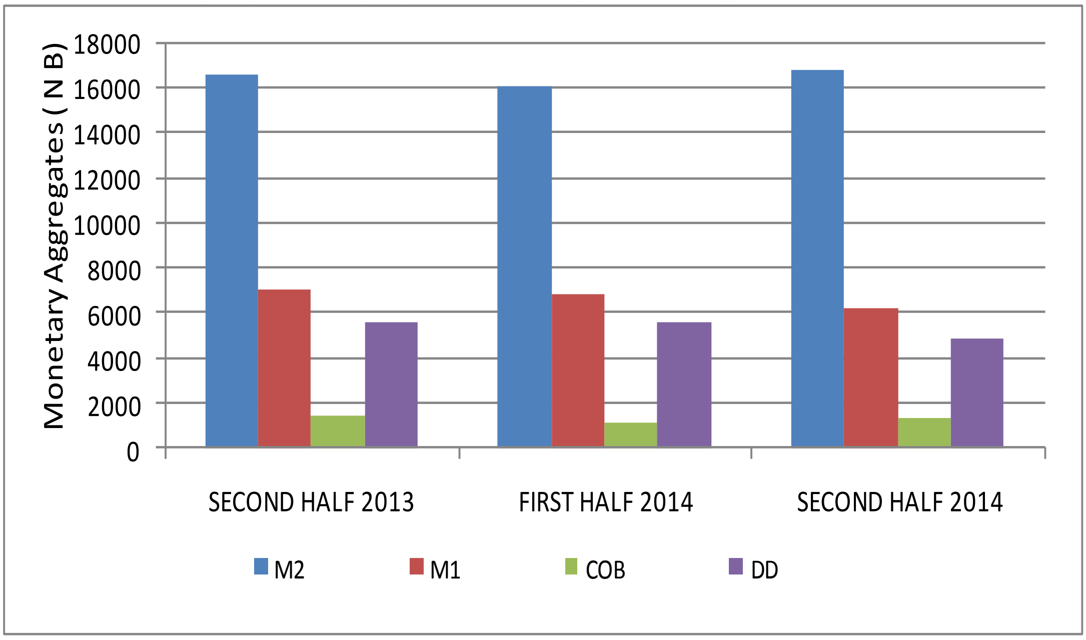
2.0 DEVELOPMENTS IN THE FINANCIAL SYSTEM

2.1 Monetary and Credit Developments1

Broad money (M_2) grew by 7.29 per cent to ₦16,833.24 billion at end-December 2014,compared with the indicative benchmark of 15.02 per cent for fiscal 2014 and the growth of 3.08 per cent at end-June 2014. The development was driven largely by the respective increases of 11.3 and 10.97 per cent in other assets (net) and domestic credit (net), but was moderated by the significant decline of 15.02 per cent in foreign assets (net) of the banking system. Correspondingly, the growth in total monetary liabilities, M_2, was driven by the significant increase in quasi-money which more than offset the decline in narrow money (M_1). Further analysis of the composition of M_2 showed that the distribution became more skewed in favour of the less liquid component (quasi money), as the gap between the two widened, especially in the last quarter of the year.

Available data indicated that M_1 declined by 10.89 per cent at end-December 2014 to ₦6,266.68 billion, compared with the 2.88 and 5.23 per cent decline at end-June 2014 and end-December 2013, respectively. The decline at the end of the second half of 2014 was attributed to the respective 12.28 and 5.53 per cent fall in demand deposit (DD) and currency outside banks (COB). As a ratio of total monetary assets, COB stood at 8.1 per cent, compared with the 7.18 and 9.22 per cent at the end of the first half of 2014 and the corresponding half of 2013, respectively, indicating a marginal improvement over the level in the preceding half year.

Figure 2. 1: Trend in Monetary Aggregates



[1] The analysis is based on the revised *CBN Monetary Survey* as at December 31, 2014.

2.1.1 Aggregate Credit to the Economy

Net domestic credit (NDC) grew by 10.97 per cent to ₦16,129.49 billion at end-December 2014,compared with₦15,008.27 billion at the end of the preceding half year. This reflected a 12.08 per cent growth in claims on the private sector (CP), which more than offset the 21.81 per cent fall in claims on the Federal Government (CG) (Figure 2.2).

Figure 2. 2: Credit to the Economy

2.1.1.1 Claims on the Federal Government

Net claims on the Federal Government declined significantly by 21.81 per cent to negative ₦2,017.53 billion at end-December 2014, compared with the negative ₦1,973.60 billion and a decline of 19.16 per cent at the end of the first half of 2014. The development, relative to the first half, was mainly attributed to the decline in the banking system's holdings of government securities, reflecting the flow of bank credit away from the government sector to the private sector. This movement might be related to the increase in CRR on public sector deposits.

2.1.1.2 Claims on the Private Sector

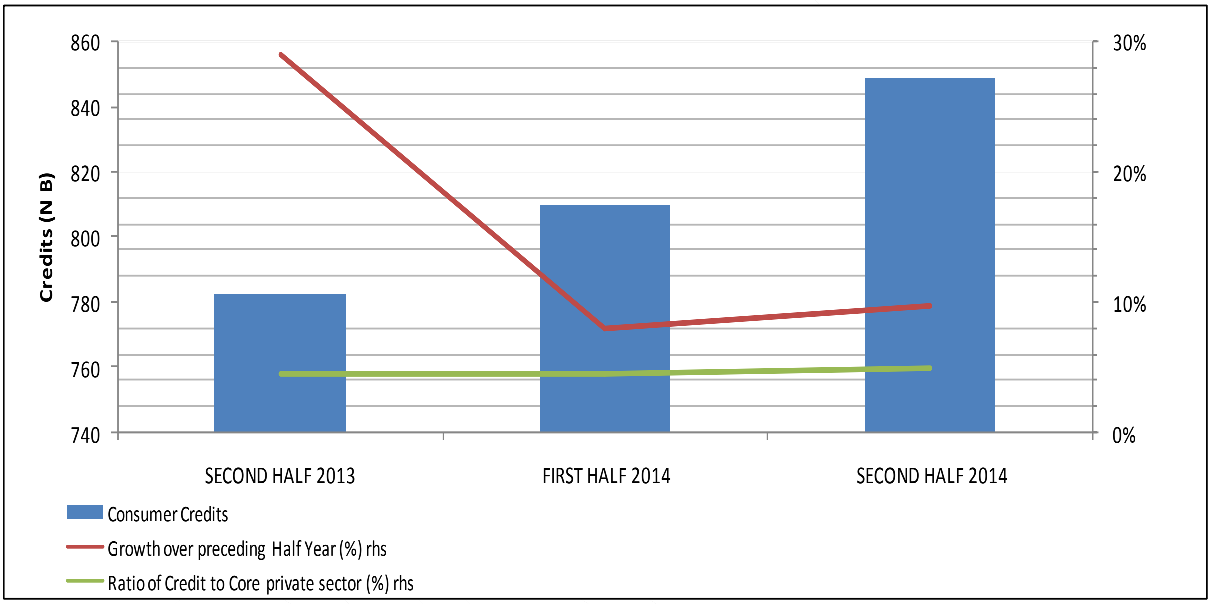
At ₦18,147.03 billion, credit to the private sector(including states, local governments and non-financial public enterprises) increased by 12.08 per cent, compared with the growth of 4.88 per cent recorded at the end of the first half of 2014. The growth in private sector credit reflected, largely, the 13.00 per cent rise in claims on the core private sector[2]. The impressive growth in credit to the private sector (especially the core private sector) reflected the impact of various policies of the Bank to enhance the lending capacity of banks and encourage increased lending to the productive sector *vis-à-vis* the government sector.

[2]Excludes the states and local governments.

2.1.1.3 Consumer Credit

The volume of consumer credit by the banks improved during the second half of 2014. Available data indicated that aggregate outstanding consumer credit stood at ₦848.77 billion at the end of the review period, compared with ₦809.8 billion at end-June 2014. This reflected an increase of 4.81 per cent, compared with 3.49 per cent at the end of the first half of 2014. As a ratio of total credit to the core private sector, consumer credit constituted 4.88 per cent, compared with 4.49 per cent in the first half of 2014 (Figure 2.3). The development could be attributed, largely, to the impact of the recent decision not to remunerate standing deposits facility (SDF) in excess of ₦7.5 billion. The rising consumer credit could enhance the effectiveness of monetary policy transmission.

Figure 2. 3: Consumer Credit



2.1.2 Sectoral Classification of Private Sector Credit

The upward trend in the amount of credit extended to the private sector continued during the second half of 2014. Available data indicated that total credit to the various sectors of the economy grew significantly by 16.62 per cent to ₦12,629.99 billion, compared with 7.86 and 13.88 per cent growth recorded in the preceding half year and the corresponding period of 2013, respectively. The oil and gas sector continued to attract the highest share of total credit as it accounted for 25.70 per cent, compared with 24.33 per cent in the first half of 2014, while the manufacturing sector accounted for 13.15 per cent of the total credit, the same level as in the preceding half year. Agriculture, forestry and fishing category accounted for 3.96 per cent of the total credit, indicating a 0.12 percentage point increase over the 3.84 per cent recorded in the preceding half year (Figure 2.4 and Table 2.1).

Figure 2. 4: Sectoral Distribution of Credit

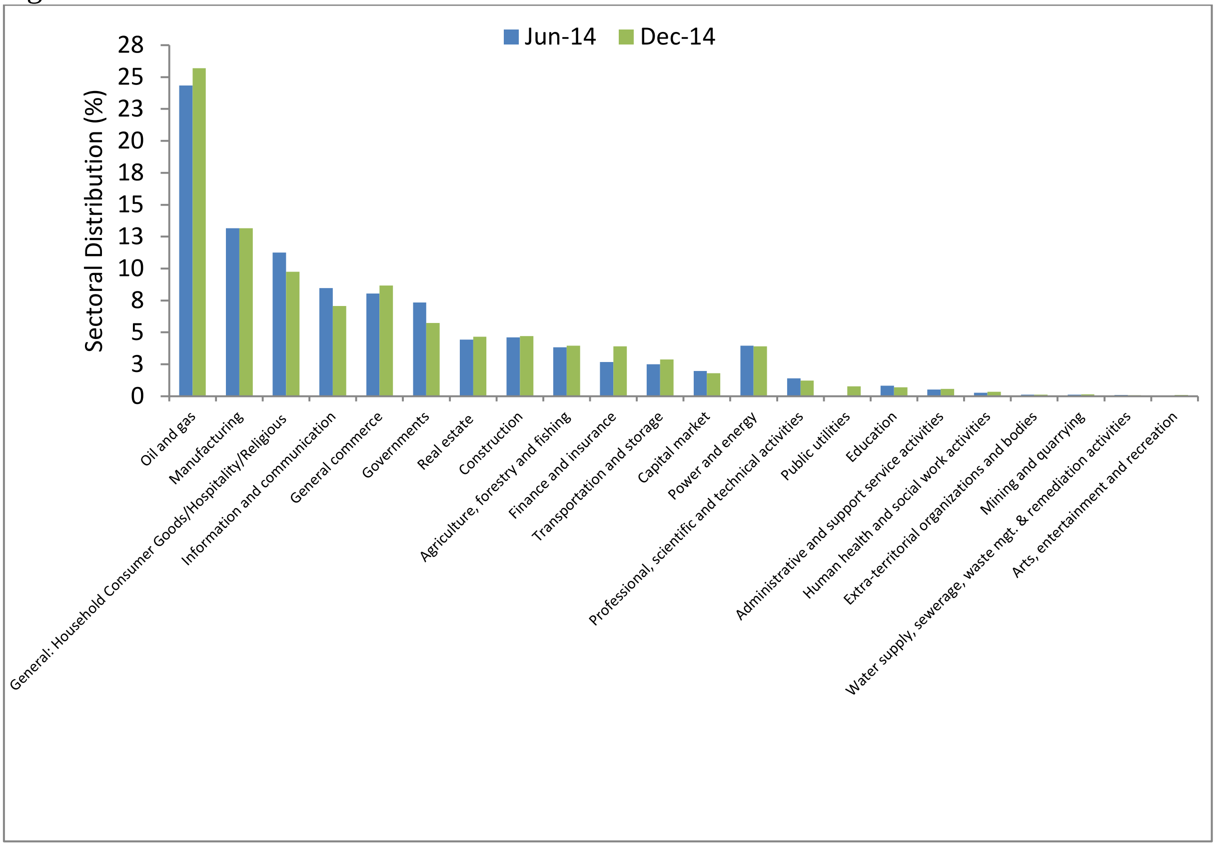


Table 2. 1: Sectoral Distribution of Credit

	June 2014		December 2014	
Sector	₦'Billion	Per cent	₦ 'Billion	Per cent
Oil and gas	2,635.12	24.33	3,246.40	25.70
Manufacturing	1,424.11	13.15	1,661.12	13.15
General: Household Consumer Goods/Hospitality/Religious	1,220.17	11.26	1,232.15	9.75
Information and communication	917.46	8.47	894.70	7.08
General commerce	872.32	8.05	1,093.88	8.66
Governments	795.40	7.34	726.64	5.75
Real estate	479.35	4.43	588.06	4.66
Construction	498.67	4.60	593.65	4.70
Agriculture, forestry and fishing	415.88	3.84	500.26	3.96
Finance and insurance	289.46	2.67	494.66	3.92
Transportation and storage	272.02	2.51	363.17	2.88
Capital market	213.73	1.97	228.46	1.81
Power and energy	427.75	3.95	493.52	3.91
Professional, scientific and technical activities	150.40	1.39	154.52	1.22
Education	89.04	0.82	88.46	0.70
Administrative and support service activities	56.94	0.53	72.36	0.57
Human health and social work activities	30.32	0.28	44.59	0.35

Activities of extra-territorial organizations and bodies	14.53	0.13	15.25	0.12
Mining and quarrying	13.26	0.12	17.27	0.14
Water supply, sewerage, waste mgt. & remediation activities	9.51	0.09	10.33	0.08
Arts, entertainment and recreation	4.53	0.04	12.60	0.10
Public utilities	0.10	0.00	97.94	0.78
Total	**10,830.07**	**100.00**	**12,629.99**	**100.00**

2.1.3 Reserve Money

Reserve money (RM) stood at ₦5,964.75 billion at end-December 2014, indicating an increase of 17.18 per cent, in contrast to a decline of 5.97 per cent at the end of the preceding half year. This was higher than the indicative benchmark of ₦5,106.90 billion. The development reflected the increase in net domestic assets and other assets (net) of the CBN. The corresponding increase in the uses of reserve money was attributed to the rise in both currency-in-circulation and bank deposits with the CBN.

2.1.4 Maturity Structure of Bank Deposits and Credits

The structure of bank credits in the second half of 2014 indicated the continued dominance of loans and advances of short-term maturities, although with a slight improvement over the position in the preceding half year. Credits maturing within one year accounted for 49.59 per cent, compared with 56.6 per cent at the end of the first half of 2014. The medium-term (≥1yr and < 3yrs) and long-term (3yrs and above) maturities stood at 19.50 and 30.91 per cent, compared with 16.80 and 26.60 per cent, respectively, at the end of the first half of 2013 (Figure 2.5). The increase in the proportion of credits with both medium- and long-term maturities may be attributed to the effects of various policies of the Bank to de-risk the real sector and encourage banks to grant loans of medium to long-term maturities.

Similarly, deposits of less than one-year maturity constituted 96.31 per cent (of which 73.69 per cent had maturity of less than 30 days), compared with 95.60 per cent at end-June 2014. Further analysis showed that the medium and long-term deposits constituted 2.69 and 1.00 per cent, compared with 3.40 and 1.00 per cent at end-June 2014, respectively (Figure 2.6).

Notwithstanding the slight improvement in the proportion of credits with medium- and long-term maturities during the second half of 2014, the dominance of short-term maturities in deposits of banks continued to be a major constraint to their capacity to grant long-term credit. There is also the challenge that this development might result in liquidity and re-pricing risks. However, continuous implementation of the various policies by the Bank to de-risk and encourage lending to the real sector, as well as the curtailment of inflationary pressures to ensure sustained general price stability is expected to further improve medium to long-term lending.

Figure 2. 5: Distribution of Bank Loans and Advances by Maturity

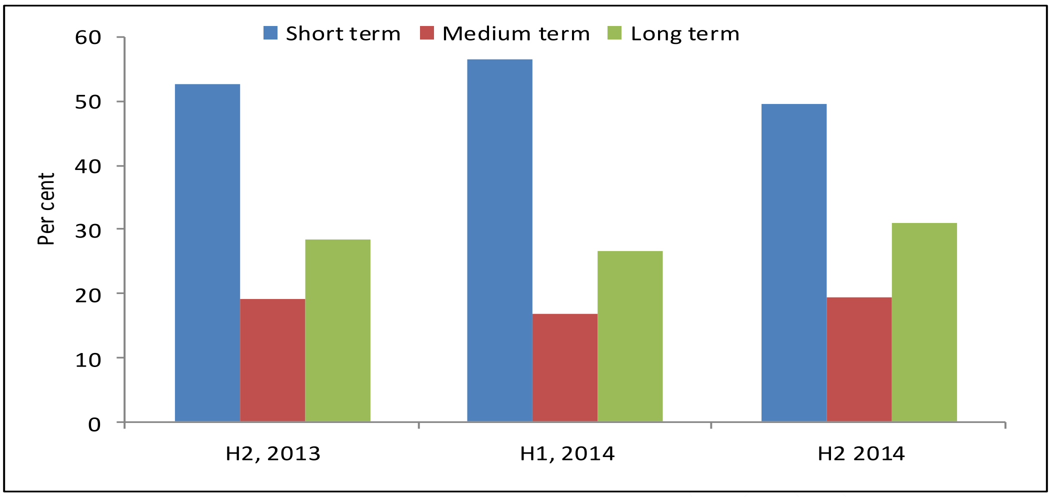
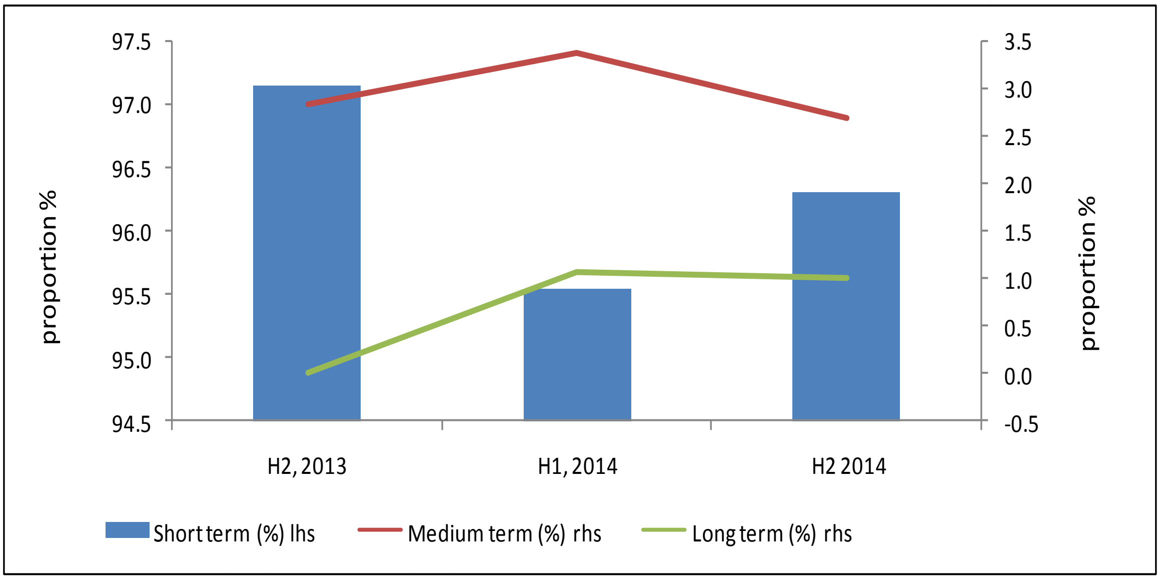


Figure 2. 6: Maturity Structure of Bank Deposits

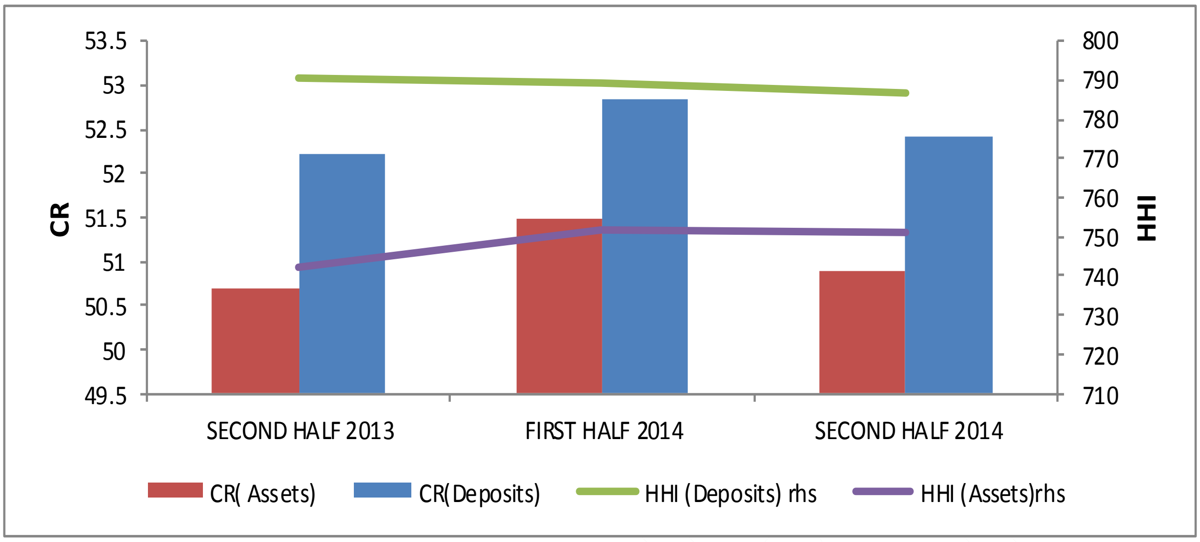


2.1.5 Market Structure of the Banking Industry

During the review period, the average market share of deposits and assets of the five largest banks (concentration ratio–CR_5) decreased to 52.42 and 50.88 per cent, respectively, from 52.85 and 51.48 in the first half of 2014.Similarly, the average market share of the largest bank, in terms of deposits and assets, decreased to 14.61 and 13.68 per cent, respectively, from 14.80 and 13.69 per cent in the first half of 2014.Notwithstanding the marginal improvement recorded relative to the first half of the year, the structure of the banking industry, in the second half of 2014, remained dominated by a few banks.

In terms of competitiveness, the industry remained competitive in both deposits and assets, as indicated by the average Herfindahl-Hirschman Index (HHI) of the industry for deposits and assets which stood at 786.66 and 750.91 (on a scale of 10,000), respectively, for the review period, compared with 789.21 and 752.06 in the first half of 2014 (Figure 2.7).

Figure 2. 7: Market Concentration Ratios of the Banking Industry (Assets and Deposits)



2.2 Banks and Other Financial Institutions

2.2.1 Banking Industry Reforms

The Bank continued to implement its reform initiatives under the 2010 Banking Model. The following milestones achieved at end-December 2014:

i. Eleven (11) banks out of the erstwhile 24 universal banks had fully complied with the *CBN Regulation on the Scope of Banking Activities and Ancillary Matters, No 3, 2010*, while nine (9), including the three (3) bridge banks, were working towards compliance. Four (4) banks had earlier merged with other banks;

ii. The Asset Management Corporation of Nigeria (AMCON) had sold two (2) out of the three (3) bridge banks - Mainstreet and Enterprise Banks - to Skye Bank Plc and Heritage Banking Company Limited, respectively, while Keystone Bank is expected to be sold in 2015; and

iii. Associated and Kakawa Discount Houses that were granted Approvals-In-Principle (AIPs) to convert to merchant banks in the first half of 2014 were in the process of obtaining their final licences.

2.2.2 Regulation of Financial Holding Companies

In order to guide the industry on the implementation of the 2010 Banking Model, the CBN, in August 2014, issued the *Guidelines for Licensing and Regulation of Financial Holding Companies in Nigeria* to complement the *CBN Regulation on the Scope of Banking Activities and Ancillary Matters, No 3, 2010*. The Guideline cover, among others things, the definition and structure of financial holding companies (FHCs), licensing requirements, ownership and corporate governance.

2.2.3 Non-Interest Banks

During the review period, Tijarah Microfinance Bank (MFB) was licensed as a Non-Interest (Islamic) MFB with State Authorization to operate in Bauchi State. The CBN, in conjunction with Islamic Finance Council (IFC), the UK and Enhancing Financial Innovation & Access (EFlnA) organized an interactive session for the Financial Regulation Advisory Council of Experts (FRACE) members and members of the Non-Interest Financial Institutions' (NIFIs') Advisory Committee of Experts (ACE). The session was aimed at building organizational capacity and enhancing financial inclusion.

2.3 Other Financial Institutions

There were 3,538 Other Financial Institutions (OFIs) in Nigeria at end-December 2014, compared with the 4,220 licensed institutions at end-June 2014, representing a decrease of 682 institutions (16.0%). The change was attributed to the net effect of the exit of 733 BDCs owing to their inability to meet the recapitalization requirements, the licensing of 54 new OFIs (51 MFBs and 3 FCs); and the rev0cation of two (2) MFBs licenses during the review period. The total number comprised six (6) Development Finance Institutions (DFIs), 42 Primary Mortgage Banks (PMBs), 903 Microfinance Banks (MFBs), 64 Finance Companies (FCs) and 2,523 Bureaux de Change (BDCs) (Table 2.2).

Table 2. 2: Institutions in the OFI Sub-sector

Institution-Type	Number	
	June 2014	**Dec 2014**
Development Finance Institutions	6	6
Primary Mortgage Banks	40	42
Microfinance Banks	854[3]	903
Finance Companies	64	64
Bureaux de Change	3,256	2,523
Total	**4,220**	**3,538**

The total assets of the sub-sector increased by 23.2 per cent to ₦1,690.8 billion at end-December 2014, from ₦1,372.2 billion at end-June 2014. The total paid-up capital, however, decreased by 0.36 per cent to ₦444.8 billion at end-December 2014, from ₦446.4 billion at end-June 2014, while the total net loans/advances increased by 58.03 per cent to ₦1,048.5 billion at end-December 2014, from ₦663.5 billion at end-June 2014. Total deposits decreased by 22.81 per cent to ₦357.0 billion at end-December 2014, from ₦462.5 billion at end-June 2014.

[3]Revised from 925 to reflect 71 MFB revocations not captured in the June 2014 FSR.

The key developments that occurred in the sub-sector in the second-half of 2014 are outlined below:

2.3.1 Microfinance Banks

The total assets of microfinance banks (MFBs) increased to ₦300.73 billion at end-December 2014, from ₦280.76 billion at end-June 2014, reflecting an increase of 7.11 per cent. Similarly, the paid-up capital and shareholders' funds of MFBs increased by 13.48 and 7.37 per cent to ₦82.44 billion and ₦91.01 billion at end-December 2014, from ₦72.65 billion and ₦84.76 billion, at end-June 2014, respectively. The increase in capital was due largely to the recapitalization of MFBs that upgraded from Unit to State MFBs and State to National MFBs.

Table 2. 3: Key MFB Financial Highlights

	June 2014 (₦' billion)	**Dec. 2014 (₦' billion)**	**% Change**
Total Assets	280.76	300.73	7.11
Paid up Capital	72.65	82.44	13.48
Shareholders Funds	84.76	91.01	7.37
Deposit Liabilities	144.4	145.83	0.99
Loans and Advances	129.5	162.91	25.8

Total deposit liabilities and net loans/advances also increased by 0.99 and 25.80 per cent to ₦145.83 billion and ₦162.91 billion at end-December 2014, compared with ₦144.4 billion and ₦129.5 billion, at end-June 2014, respectively. The relative improvement in the operations of MFBS was attributed to the impact of the CBN initiated Microfinance Certification Programme (MCP) for the boards and management of MFBs and the growing acceptance of the microfinance banking model. Reserves, however, decreased by ₦3.5 billion to ₦8.6 billion at end-December 2014, from ₦12.1 billion at end-June 2014, owing to increased loan provisioning.

2.3.1.1 Unified Application (Core Banking System) for MFBs

The Bank collaborated with development partners and other stakeholders to establish a unified application (Core Banking System) for the MFB sub-sector. The proposed unified platform, together with the Rural Financial Institutions (RUFIN) project for online rendition of electronic returns by MFBs, is expected to facilitate accurate and prompt rendition of statutory returns.

2.3.1.2 Microfinance Certification Programme

In the review period, 289 candidates completed the Microfinance Certification Programme (MCP), bringing the total certified operators to 2,882 at end-December 2014. The certified operators were spread over 632microfinance banks, representing 71.5 per cent of the sub-sector.

Efforts are ongoing to ensure that all the management staff of microfinance banks undergo the certification programme.

2.3.2 Primary Mortgage Banks

The number of primary mortgage banks (PMBs) in operation increased to 42 at end-December 2014, from 40 at end-June 2014, as two (2) dormant PMBs were reactivated following their recapitalization. National PMBs remained at 10 at end-December 2014, while State PMBs increased to 32 from 30 at end-June 2014.

During the review period, the CBN extended the deadline, from June 30, 2014 to December 31, 2014, for some PMBs that had made progress towards recapitalization to conclude the process.

The total assets of PMBs decreased by 5.97 per cent to ₦389.0 billion at end-December 2014, compared with ₦413.7 billion at end-June 2014. However, their paid-up capital, deposit liabilities and loans/advances increased by 51.78, 35.33, and 22.18 per cent to ₦121.69 billion, ₦703.74 billion and ₦133.02 billion, respectively, at end-December 2014. Aggregate reserves declined by 74.53 per cent, from ₦94.61 billion to ₦24.10 billion, while shareholders' funds increased by 35.95 per cent, from ₦107.24 billion to ₦145.79 billion at end-June 2014.

2.3.2.1 Cash Reserve Requirement for PMBs

In September 2014, the CBN extended the cash reserve requirement facility to PMBs. To this end, relevant operating accounts were opened for each PMB by the Bank to ensure effective monetary policy management.

2.3.2.2 The Nigeria Mortgage Re-finance Company Plc

During the second half of 2014, the sum of ₦2.88 billion was called up as the second tranche of investment from both domestic and multilateral investors. This was in addition to the **₦7.**05 billion earlier invested in the Nigeria Mortgage Re-finance Company (NMRC) Plc, which translated to 1.76 billion units of shares for allotment awaiting approval by SEC, bringing the equity capital contribution to ₦9.93 billion.

2.3.2.3 Uniform Underwriting Standards

In the review period, the CBN issued Uniform Underwriting Standards (UUSs) for implementation by PMBs. The standards, which were adapted from the IFC Mortgage Toolkits, are expected to promote uniform underwriting for the mortgage banking industry.

2.3.3 Finance Companies

The number of Finance Companies (FCs) in operation remained at 64 at end-December 2014. The total assets/liabilities of FCs increased to ₦119.60 billion at end-December 2014, from ₦106.61 billion at end-June 2014, reflecting an increase of 12.18 per cent. Similarly, paid-up capital increased by 3.07 per cent to ₦16.12 billion from ₦15.64 billion at end-June, 2014 and reserves increased by 513 per cent to ₦2.34 billion from negative ₦830.03 million at end-June 2014, owing, largely, to the operations of leasing companies which had come under the purview of the Bank. Borrowings also increased by 6.26 per cent to ₦68.42 billion from ₦64.39 billion at end-

June 2014. However, loans/advances decreased by 6.60 per cent to ₦48.81billion at end-December 2014, from ₦52.26 billion at end-June 2014.

During the review period, the Bank issued the *Revised Guidelines for Finance Companies in Nigeria* with an implementation deadline of September 30, 2015. Under the Guidelines:

- Leasing companies outside CBN regulatory purview that engage in finance lease business are required to apply for a finance company licence and be subjected to CBN's prudential/regulatory requirements for finance companies. However, the Bank will not regulate the operations of financial or corporate companies which render only operating lease services.
- Self-regulatory Organisations, such as the Financial Houses Association of Nigeria (FHAN) and the Equipment Leasing Association of Nigeria (ELAN) are expected to collaborate with the CBN in ensuring that all existing leasing companies engaged in finance lease business are brought under the supervisory purview of the CBN.

2.3.4 Bureaux de Change

During the review period, BDCs were required to comply with the new licensing requirements (Table 2.4) by July 31, 2014. As a result, the number of BDCs at end-December 2014 decreased to 2,523, from 3,256 at end-June 2014, reflecting a decrease of 733 or 29.05 per cent.

Table 2. 4: Highlights of the New Licensing Requirements

	Old	**New**
Capital Requirement	₦10 million	₦35 million
Mandatory Cautionary Deposit	US$20,000	₦35 million
Application Fee	₦10,000	₦100,000
Licensing Fee	₦100,000	₦1 million
Annual Renewal Fee	₦10,000	₦250,000
Multiple Ownership	Not prohibited	Prohibited

2.3.5 The Development Finance Institutions

The total assets of the six (6) reporting development finance institutions (DFIs) increased by 53.3 per cent to ₦881.5 billion at end-December 2014, compared with ₦575.1 billion at end-June 2014. The increase was due, largely, to improved operational performance arising from their participation in various intervention funds channelled by the CBN to stimulate economic growth. Furthermore, the net loans/advances of the institutions increased by 103.62 per cent to ₦703.7 billion at end-December 2014, from ₦345.6 billion at end-June 2014.

2.3.5.1 Development Bank of Nigeria

The Development Bank of Nigeria (DBN) established by the Federal Government of Nigeria (FGN) was granted an Approval-in-Principle (AIP) by the CBN in September 2014. DBN is expected to have a paid-up capital of ₦100 billion to be taken up by the FGN in partnership with other potential equity investors and development partners including the World Bank and African Development Bank. A wholesale DFI (WDFI) is envisioned to complement the efforts of other existing development finance institutions towards real sector development and to leverage current players on the SME and agriculture finance value chain, through participating financial institutions.

2.3.5.2 Guidelines for Development Finance Institutions

During the review period, the CBN issued guidelines for the operations of both retail and wholesale DFIs for private investors to operate DFIs. The guidelines provided for the licensing, regulation, supervision, and operations of both WDFIs and Retail DFIs (RDFIs). In particular, the minimum capital requirements for WDFI and RDFI are ₦100.0 billion and ₦10.0 billion, respectively.

2.4 Financial Inclusion

In furtherance of its effort to implement measures aimed at enhancing access to basic banking facilities and financial services, the Bank, in the review period, conducted another on-site verification of the status of compliance of banks and other financial institutions (OFIs) with the provisions of the Tiered KYC Circular and financial inclusion measures in the CBN AML/CFT Regulations.

The verification exercise, which was conducted in 22 commercial banks and 2 microfinance banks revealed that as at end-September 2014, 18 banks and 2 MFBs had commenced the implementation of the Tiered KYC requirements, while 4 banks were yet to commence. Furthermore, only ten (10) banks were fully compliant, eight (8) partially compliant while four (4) banks and two (2) MFBs were non-compliant.

The Bank will continue to monitor the implementation of the measures to enhance financial inclusion in Nigeria.

2.4.1 Financial Literacy

The Bank continued to undertake a series of activities during the review period in pursuit of the implementation of financial literacy framework. The activities conducted were as follows:

- Financial Literacy and Consumer Protection Sensitization and Mass Awareness Programme in five (5) states across the Federation during the period under review, in addition to seven (7) states covered in the first half of 2014;
- Financial Literacy Advocacy/School Mentoring Programme in 14 secondary schools across the six (6) geo-political zones and a financial literacy interactive/advocacy session for junior secondary school students;

- Collaboration with relevant stakeholders[4] to develop an MoU that would support the deployment of an end-to-end digital financial services infrastructure for the realization of the financial inclusion target; and
- National Baseline Survey on Financial Literacy in Nigeria, which involved:
  - ✓ Development of the segmentation model that would be used during data analysis,
  - ✓ Analysis of the data collected from the field during the administration of the survey, and
  - ✓ Commencement of the production of a final report highlighting the findings of the Financial Literacy Survey.

2.5 Financial Markets

2.5.1 The Money Market

At its November 2014 MPC meeting, the Bank further tightened its monetary policy stance by increasing the Monetary Policy Rate (MPR) from 12.00 to 13.00 per cent and the cash reserve ratio (CRR) on private sector deposits from 15.00 to 20.00 per cent. In addition, it retained the CRR on public sector deposits at 75.00 per cent. The net foreign currency trading position limit was reviewed downward from 1.0 to zero per cent on December 17, 2014.

Money market rates moved in response to these developmentsand peaked at 23.46 and 26.15 per cent for OBB and inter-bank, respectively, in December 2014. The monthly weighted average inter-bank call rate ranged from 10.89 to 26.15 per cent, while OBB rates ranged from 10.48 to 23.46 per cent during the review period. The weighted average monthly OBB and inter-bank call rates closed at 23.46 and 26.15 per cent, respectively, at end-December 2014, from 10.57 and 10.50 per cent at end-June 2014.

2.5.1.1 Nigerian Treasury Bills

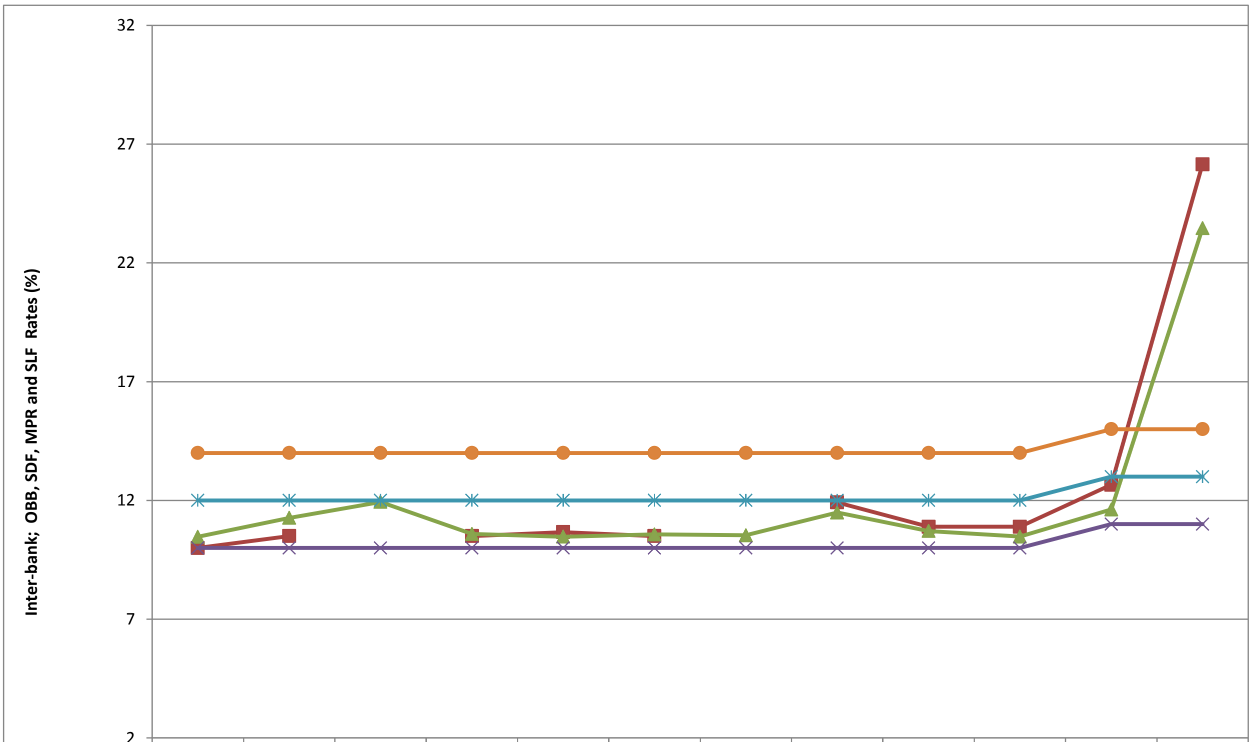
Nigerian Treasury Bills (NTBs) for 91-, 182- and 364-day tenors worth ₦1,649.75 billion were offered and allotted in the review period. This indicated a decrease of 26.01 per cent compared with ₦2,229.72 billion in the first half of 2014. The total public subscription stood at ₦2,434.19 billion in the second half of 2014, compared with ₦5,609.37 billion in the preceding period. This development could be attributable to investors’ response to CBN policies of raising its MPR from 12 to 13 per cent and the consequent higher NTB rates.

The holding structure of investments in NTBs indicated that banks and discount houses took up ₦660.38 billion (40.03%), non-bank investors ₦901.13 billion (54.62%), while the CBN took up the balance of ₦88.24 billion (5.35%). The average marginal rates ranged from 9.58 to 11.25 per cent for the 91-day, 10.10 to 14.48 per cent for the 182-day, and 10.14 to 13.58 per cent for the 364-day tenors.

[4] Key stakeholders included the FMF, DFID, Bill & Melinda Gates Foundation, and EFinA.

At end-December 2014, investment in NTBs by banks and discount houses accounted for 69.94 per cent of the NTBs outstanding, the non-bank investors accounted for 30.00 per cent, while the Bank accounted for the balance of 0.06 per cent.

Figure 2. 8: Money Market Rates Movements, 2014



	January	February	March	April	May	June	July	August	September	October	November	December
Inter-bank	10.00	10.50		10.50	10.67	10.50		11.92	10.89	10.89	12.66	26.15
OBB	10.47	11.27	11.94	10.59	10.47	10.57	10.53	11.49	10.71	10.48	11.62	23.46
SDF	10.00	10.00	10.00	10.00	10.00	10.00	10.00	10.00	10.00	10.00	11.00	11.00
MPR	12.00	12.00	12.00	12.00	12.00	12.00	12.00	12.00	12.00	12.00	13.00	13.00
SLF	14.00	14.00	14.00	14.00	14.00	14.00	14.00	14.00	14.00	14.00	15.00	15.00

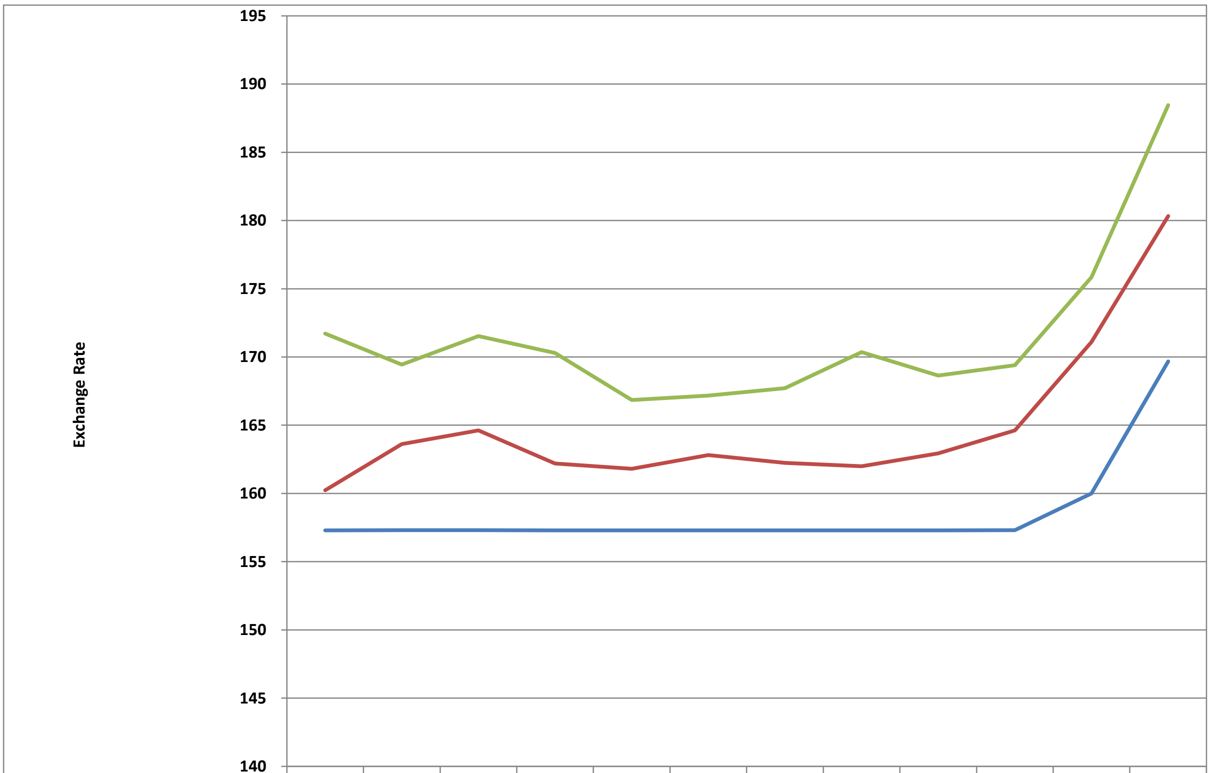
2.5.2 The Foreign Exchange Market

During the review period, the CBN sustained its efforts in maintaining the stability of the foreign exchange rate. However, exchange rates weakened at both the inter-bank and bureaux de change (BDC) market segments. The weakening was due, largely, to the falling oil prices resulting in dwindling external reserves as well as sustained demand pressure.

The CBN continued to conduct the bi-weekly auctions and also intervened regularly in the inter-bank segment of the market. Consequently, exchange rate at the official window remained relatively stable for most part of 2014, thereby sustaining investor confidence. However, the exchange rate rose in November and December 2014, following the adjustment of the midpoint of the official rate from ₦155/US$ to ₦168/US$ and the widening of the band from ±3 to ±5 per cent.

The average foreign exchange rate at the rDAS, inter-bank and BDCs segments depreciated by 7.30, 9.71 and 11.30 per cent to ₦169.6800/US$, ₦180.3286/US$ and ₦188.4524/US$, respectively at end-December 2014.

Figure 2. 9: rDAS, Inter-bank and BDC Rates, 2014



	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
W/DAS-SPT (incl. 1% comm.)	157.29	157.31	157.30	157.29	157.29	157.29	157.29	157.29	157.30	157.31	160.00	169.68
Inter-Bank	160.23	163.62	164.62	162.19	161.81	162.82	162.25	161.99	162.93	164.62	171.10	180.33
BDC	171.71	169.45	171.52	170.30	166.84	167.17	167.71	170.36	168.64	169.40	175.85	188.45

2.5.3 The Capital Market

Activities on the floor of the Nigerian Stock Exchange (NSE) were bearish during the review period as both the All Share Index (ASI) and Market Capitalization (MC) generally trended downwards. The decline was due largely to the profit taking activities of investors and increased net capital outflows, as some foreign investors sold off because of concerns over currency depreciation in the face of the steady decline in external reserves and international crude oil prices.

2.5.3.1 The Bond Market

Total bonds outstanding at end-December 2014 stood at ₦5,695.37 billion, of which FGN, agency, sub-national and corporate bonds constituted ₦4,783.63 billion (83.99%), ₦325.97 billion (5.72%), ₦461.14 billion (8.10%) and ₦124.63 billion (2.19%), respectively. The end –December 2014 figure reflected7.42 per cent increase over the end-June 2014 figures of ₦6,314.33 billion, composed of FGN, agency, sub-national and corporate bonds valued ₦4,370.14 billion (69.21%), ₦1,179.51 (18.68%), ₦572.71 billion (9.07%) and ₦191.96 billion (3.04%), respectively.

Table 2. 5: Outstanding Bonds

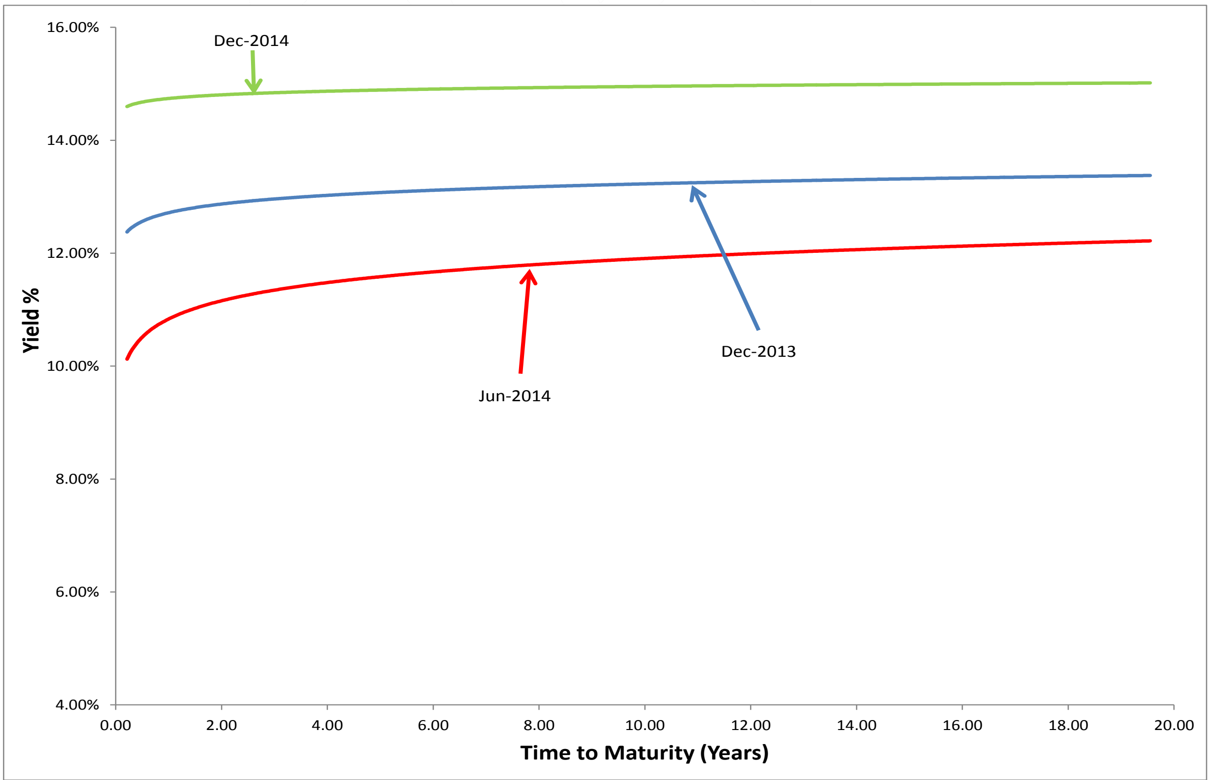
	June 2014 (₦' billion)	December 2014 (₦' billion)	% Change
FGN	4,370.14	4,783.63	9.46
Agency	1,179.51	325.97	-72.36
Sub-National	572.71	461.14	-19.48
Corporate	191.96	124.63	-35.08
Total	**6,314.33**	**5,695.37**	**-9.80**

FGN Bonds

New issues and re-openings of FGN Bonds series 1, 2, and 3 were auctioned in the second half of 2014. The total value of FGN Bonds offered for sale were valued ₦503.61 billion, while public subscriptions and sales stood at ₦1,027.40 billion and ₦493.31 billion, respectively. The over-subscription was attributed to the high level of liquidity in the banking system, investors' preference for long-term instruments and the attractive rates.

Demand for FGN Bonds at the secondary market declined as a result of the Bank's decision to further tighten its monetary policy stance. There were increased yields on the Bonds at end-December 2014, compared with the position at end-June 2014 (Figure 2.10). With headline inflation at 8.00 per cent at end-December 2014, FGN bonds remained attractive to investors.

Figure 2. 10: Yield Curves for Nigeria



Source: Financial Markets Dealers Quotations

Agency Bonds

During the review period, no bond was issued by FGN agencies, while bonds valued at ₦853.44 billion were redeemed by AMCON. Consequently, total outstanding bonds by FGN agencies stood at ₦325.97 billion, comprising FMBN ₦30.56 billion and Local Contractors Receivables Management (LCRM) Limited ₦295.41 billion.

Sub-National Bonds

In the second half of 2014, there was no new issue, compared with the first half of the year when three (3) state governments issued bonds valued ₦15.00 billion. However, two (2) state governments redeemed their bonds valued ₦23.00 billion. The total outstanding bonds held by 15 state governments stood at ₦461.14 billion.

Corporate Bonds

Two (2) corporate bonds valued ₦15.50 billion were issued in the review period, compared with a nil position in the first half of 2014.

Table 2. 6: Corporate Bonds Issued in the second half of 2014

Company	**Description**	**Value (₦ Billion)**	**Issue Date**
Stanbic IBTC	182D T.bills+1.20 Stanbic IA 30-Sep-2024	0.1	Sept. 14
Stanbic IBTC	13.25 Stanbic IB 30-Sep-2024	15.4	Sept. 14
Total		**15.5**	

2.5.3.2 The Equities Market

The NSE ASI closed at 34,657.15 at end-December 2014, from 42,482.49 at end-June 2014. Foreign portfolio investments in the market were valued₦692.39 billion, while divestments amounted to ₦846.53 billion, reflecting a net outflow of ₦154.14 billion at end-December 2014. Although the market witnessed relative stability at the beginning of the year up to the third quarter, there was some volatility in the fourth quarter as a result of declining crude oil prices and foreign exchange reserves.

The market for new equity listings remained relatively flat during the second half of 2014, as only three (3) new equities (one on Alternative Securities Market and two [2] Exchange Trust Fund) were listed. Four companies were delisted as a result of non-compliance with the post-listing rules of the NSE thereby bringing the number of listed companies and equities to 189 and 197, respectively.

In efforts to deepen the capital market, the appropriate authorities took the following initiatives:

- The Securities and Exchange Commission (SEC) conducted a study on the feasibility of derivatives in the capital market and to assess market readiness, the infrastructure requirements, and the sequencing for the launch of risk management products in the Nigerian capital market;

- The NSE signed a capital market agreement with the London Stock Exchange Group (LSEG) to strengthen cooperation and promote mutual development between the two exchanges;

- The NSE, the SEC and the Central Securities Clearing System Plc completed a Transaction Cost Analysis (TCA) of the implicit and explicit costs of trading on the Nigerian Stock Exchange, compared with other regional and global exchanges, with a view to implementing a new pricing structure in 2015;

- The NSE launched direct market access (DMA) facility as a first step to the implementation of the sponsored access facility under the West African Capital Markets Integration (WACMI) programme, thereby giving global investors more control over the final execution of their orders, as well as their ability to exploit price and liquidity opportunities;

- The NSE launched a new, user-friendly website (X-Web) to improve accessibility, for both listed company information and other key data points relating to the business of the Exchange; and

- The NSE, in partnership with the Convention on Business Integrity (CBI), launched the Corporate Governance Rating System (CGRS) designed to rate listed companies, based on their corporate governance practices, thereby enhancing market confidence. Participation by listed companies will become mandatory in 2015.

2.6 Real Sector Interventions

2.6.1 Risk Mitigation and Insurance Schemes

The various risk mitigation and insurance schemes initiated by the Bank are aimed at reducing the risk faced by the banks in providing increased access to financial services to the real sector. In this regard, various risk sharing and guarantee schemes were initiated over the years to encourage increased lending to the sector, while minimizing the risk inherent in the lending. Updates on the activities under the various initiatives are highlighted below:

2.6.1.1 The Nigeria Incentive-based Risk Sharing System for Agricultural Lending Plc

Nigeria Incentive-based Risk Sharing System for Agricultural Lending (NIRSAL) Plc was established in 2010, to de-risk agricultural lending and unlock financial resources for agricultural value chain development. During the review period, NIRSAL issued 14 Credit Risk Guarantees (CRGs) valued at₦4.35 billion, compared with four (4) valued at₦2.06 billion at end-June 2014. The total number and value of CRGs under the scheme at end-December 2014 were 60 and ₦20.627 billion, respectively.

The Growth Enhancement Scheme

Under the Growth Enhancement Scheme (GES), NIRSAL guaranteed ₦7.434 billion accessed by 40 agro-dealers during the period under review, compared with the ₦5.66 billion accessed by 24 agro-dealers in the first half of the year. It also paid ₦149.92 million as interest drawback to borrowers, compared with ₦163.83 million paid in the first half. The aggregate for the guarantee and interest drawback at end-December 2014 stood at ₦32.99 billion and ₦348.82 million, respectively.

Insurance Facility

During the review period, three (3) private insurance companies expanded their insurance portfolio to cover agricultural insurance. NIRSAL Plc is expected to collaborate with them to facilitate the development of innovative customer-friendly agricultural insurance products.

Technical Assistance Facility

On capacity building, a total of 27,142 farmers were trained nationwide. Out of this, 15,000 cocoa farmers were trained in eight (8) states, 1,822 cotton farmers were trained in two (2) states, while 500 rice farmers were trained in one (1) other state.

Bank Rating and Incentive Mechanisms

During the period, the sums of ₦1.5 billion and ₦15 billion were set aside for the Bank Rating and Bank Incentive Mechanisms respectively. Under these mechanisms, banks/counterparties will be rated by reputable, independent organizations on the basis of the projects they finance in the agricultural value chains and the impact of their lending on food security, social life, rural employment, and incomes. Subsequently, banks with higher ratings will be further incentivized to lend more to projects in the agricultural value chains.

2.6.1.2 The Agricultural Credit Guarantee Scheme

A total of 36,909 loans, valued ₦7.068 billion, granted by 8 commercial and 42 microfinance banks were guaranteed during the review period, compared with the 35,413 loans, valued ₦5.93 billion, guaranteed in the first half of 2014. These outcomes reflected increases of 4.22 and 19.19 per cent in the number and value of loans guaranteed, respectively. The enhanced performance was attributed to the increase in the number of participating MFBs and prompt payment of interest drawback claims which encouraged more farmers to patronize the Scheme.

2.6.1.3 The Small and Medium Enterprises Credit Guarantee Scheme

Activities under the Scheme in the second half of 2014 increased as the number of facilities guaranteed increased from four (4) to five (5) and the value from ₦153.23 million to ₦400.00 million, reflecting a 161.05 per cent increase in value, compared with the first half of 2014.

Analysis of the distribution of guaranteed projects showed that the services sector accounted for 62 projects (74.73%), followed by manufacturing with 15 projects (23.37%), agro-allied with3 projects (1.33%) and the health sector with1 project (0.57%).

The total number of fully-repaid project loans during the period under review stood at eleven (11) valued at ₦750.60 million, bringing the cumulative number to thirty four (34) valued ₦2.295 billion, since the inception of the Scheme in 2010.

2.6.1.4 The Movable Collateral Registry (MCR)
The Bank continued to collaborate with the International Finance Corporation/World Bank Group (IFC/WBG) and other key stakeholders to develop a legal and institutional regime to promote the use of movable properties as collateral for loans in Nigeria, known as the Secured Transaction and National Collateral Registry (ST & NCR).

Activities under the MCR during the review period included the following:

- Execution of a two-year cooperative agreement with the IFC;
- Issuance of the Regulation on the National Collateral Registry;
- Advertisement of expression of interest (EOI) by the IFC/WBG for the development of the Collateral Registry IT Software; and
- Commencement of the development of the ST & NCR draft Bill.

2.6.2 Credit Support Schemes

2.6.2.1 The Commercial Agriculture Credit Scheme
During the review period, under the Commercial Agriculture Credit Scheme (CACS), a total of ₦28.74 billion was disbursed to 52 projects through 12 banks, compared with ₦8.18 billion disbursed to 17 projects through 8 banks in the first half of 2014. This indicated increases of 205.88 per cent in number and 251.3 per cent in value, respectively, of the projects financed. An analysis of the total number of projects also showed that production, processing, marketing and input supplies accounted for 59.61, 26.92, 7.69 and 5.78 per cent, respectively. Recoveries on the projects amounted to ₦61.85 billion, compared with ₦6.92 billion in the first half of 2014, reflecting an increase of 793.79 per cent.

The cumulative amount disbursed under the Scheme at end-December 2014 stood at ₦263.025 billion to346 projects, while ₦72.399 billion was repaid by 185 projects.

2.6.2.2 The Power and Airline Intervention Fund
During the review period, ₦3.19 billion was released to the Bank of Industry (BOI) in respect of two (2) power projects, compared with ₦508 million disbursed to one (1) project in the first half of 2014. A total of ₦9.02 billion was also paid back by borrowers under the Scheme, compared with ₦19.77 billion in the first half. The cumulative amount released to BOI from the inception of the Scheme in 2010, stood at ₦236.36 billion disbursed through 14 commercial banks in respect of fifty three (53) projects. These comprised thirty eight (38) power projects valued at ₦118.93 billion and fifteen (15) airline projects valued at ₦117.43 billion.

2.6.2.3 The Nigeria Electricity Market Stabilization Facility
The Nigeria Electricity Market Stabilization Facility (NEMSF) is a collaborative initiative between the Bank and the Ministries of Petroleum Resources and Power, the Nigerian Electricity Regulatory Commission (NERC), the Nigerian National Petroleum Corporation (NNPC) and Electricity Transmission Company of Nigeria. The objective is to address the challenges of power

and gas sectors in order to fast-track the development of a viable and sustainable energy market in Nigeria.

During the review period, the Bank engaged relevant transaction and legal advisers as well as fund managers towards setting up a special purpose vehicle for the management of the Facility. The Bank also provided the ₦220 billion fund needed to establish the Energy Intervention Facility (EIF) and signed definitive implementation agreements with other key stakeholders, including relevant government ministries, departments and agencies.

2.6.2.4 The SME Restructuring and Refinancing Facility

The SME Restructuring and Refinancing Facility (RRF) was established to fast-track the development of the manufacturing sector of the Nigerian economy by facilitating access to credit by manufacturers, improving the financial position of banks, generating employment and increasing foreign exchange earnings, among others.

The total amount disbursed under the SME Restructuring and Refinancing Facility (RRF)in the second half of 2014 stood at ₦33 billion, as against the ₦17.8 billion disbursed in the first half of 2014.The cumulative disbursements to 601 projects, from the inception of the Scheme to end-December 2014, stood at ₦339.73 billion.

2.6.2.5 The Real Sector Support Facility

In November 2014, the Bank established a ₦300 billion Real Sector Support Facility (RSSF) to replace the RRF, in order to address the funding needs of large ticket SMEs. The RSSF is to be disbursed at 9 per cent with a tenor of 15 years. Having largely achieved the objective for which the RRF was established, the Bank decided to refocus its intervention on new/start-up projects in the real sector (manufacturing and agricultural value chain SMEs) of the economy.

2.6.2.6 The Micro, Small and Medium Enterprises Development Fund (MSMEDF)

In order to improve access to finance by the micro, small and medium enterprises (MSME) sub-sector of the economy, the ₦220 billion MSMEDF was inaugurated at the 8th Annual MSME Finance Conference/Entrepreneurship Awards in August 2014.

Other activities carried out under the auspices of the Fund during the review period included:

- Disbursement of ₦4.629 billion to thirteen (13) Participating Financial Institutions (PFIs) and five (5) state governments for on-lending to eligible beneficiaries;
- Capacity building and sensitization programmes in 33 states; and
- Development and signing of memoranda of understanding with 22 state governments and the FCT.

2.6.2.7 Entrepreneurship Development Centres

A total of 3,260 participants were trained by the new Entrepreneurship Development Centres (EDCs) located in three (3) states, compared with 3,101 in the first half of 2014. This resulted in the creation of 3,659 jobs, compared with 2,703 in the first half of 2014. In addition, 1,170 of the trainees accessed credits from banks for start-ups and expansion of existing businesses compared with 904 in the first half of 2014.

2.7 The External Sector

At end-December 2014, gross external reserves declined to US$34.24 billion (equivalent of 7 months of imports cover)from US$37.33 billion at end-June 2014 (equivalent of 8.7 months of imports cover) due, largely, to the fall in oil prices and demand for Nigerian crude. This created pressure on the external reserves which was exacerbated by high demand for foreign exchange in the rDAS and the inter-bank segments of the foreign exchange market. The high demand was driven mostly by the excess liquidity in the banking system and speculative activities.

Total inflow of foreign exchange was US$23.66 billion, compared with US$22.89 billion recorded in the first half of 2014. This represented an increase of US$0.77 billion or 3.4 per cent which was due, largely, to the proceeds received through inter-bank swaps. Total outflow decreased by US$2.23 billion or 7.8 per cent to US$26.27 billion when compared with US$28.50 billion in the first half of 2014. This development reflected the decline in foreign exchange sales by the Bank in the rDAS and the BDC segments of the market.

The net outflow from the external reserves was US$2.61 billion, compared with US$5.61 billion recorded in the first half of 2014. The net outflow of US$2.61 billion, coupled with the unrealized exchange rate loss of US$0.48 billion, accounted for the US$3.09 billion difference between the level of reserves at end-June 2014 (US$37.33 billion) and at end-December 2014 (US$34.24 billion).

As part of measures to effectively manage the external reserves, the Bank took the following initiatives during the review period:

- Directed banks to utilize, within two (2) working days of delivery, all funds purchased through the CBN interventions in the inter-bank market, failing which such funds would be returned at the original purchase rates;
- Required that funding of the importation of electronics, finished products, information technology, generators, telecommunication equipment and invisible transactions shall be from the inter-bank foreign exchange market only;
- Increased the MPR to 13 from 12 per cent and the CRR on private sector deposits to 20 from 15 per cent; and
- Adjusted the midpoint of the official rate to ₦168/US$ from ₦155/US$, and widened the corridor from ±3 to ±5 per cent.

3.0 REGULATORY AND SUPERVISORY ACTIVITIES

3.1 Macro-Prudential Supervision

3.1.1 Financial Soundness Indicators

3.1.1.1 Asset-based Indicators

Most asset-based indicators revealed improvements in asset quality in the banking sector in the second half of 2014. The ratio of non-performing loans (NPLs) to gross loans declined by 0.62 percentage point to 2.88 per cent at end-December 2014. The improvement in asset quality could be attributable to improved risk management and corporate governance practices as well as the write-off of non-performing loans during the preparation of the end-of-year accounts. The ratio of core liquid assets to short-term liabilities increased marginally by 0.1 percentage point to 16.7 per cent at end-December 2014, compared with 16.6 per cent at end-June 2014. However, the ratio of core liquid assets to total assets decreased by 0.3 percentage point to 11.4 per cent at end-December 2014, from 11.7 per cent at end-June 2014 (Figure 3.1).

Figure 3. 1: Banking Industry NPLs to Gross Loans

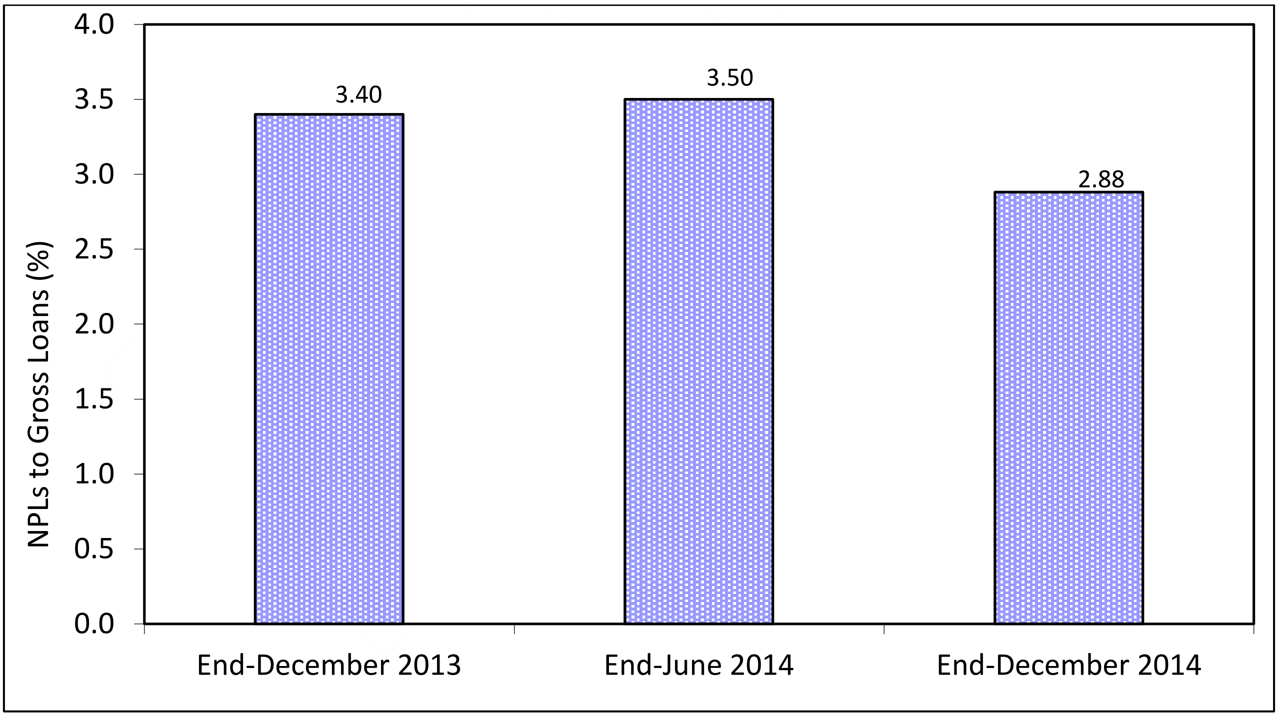
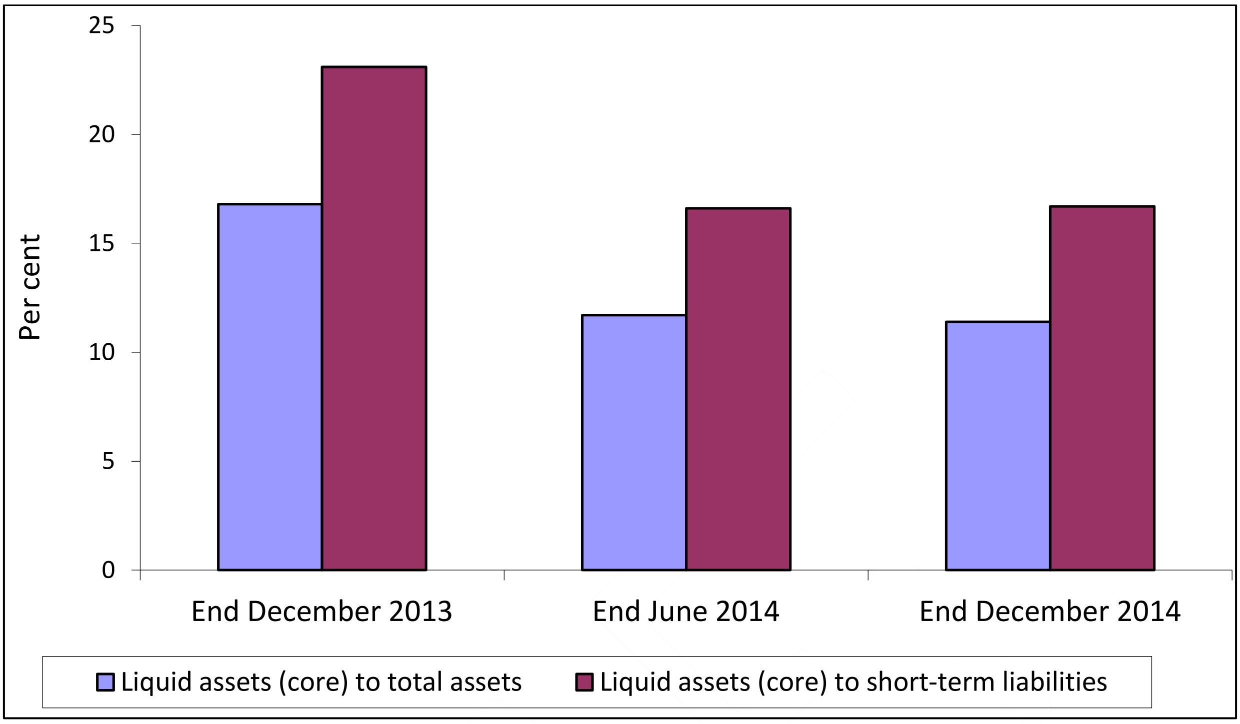


Figure 3. 2: Banking Industry Liquidity Indicators

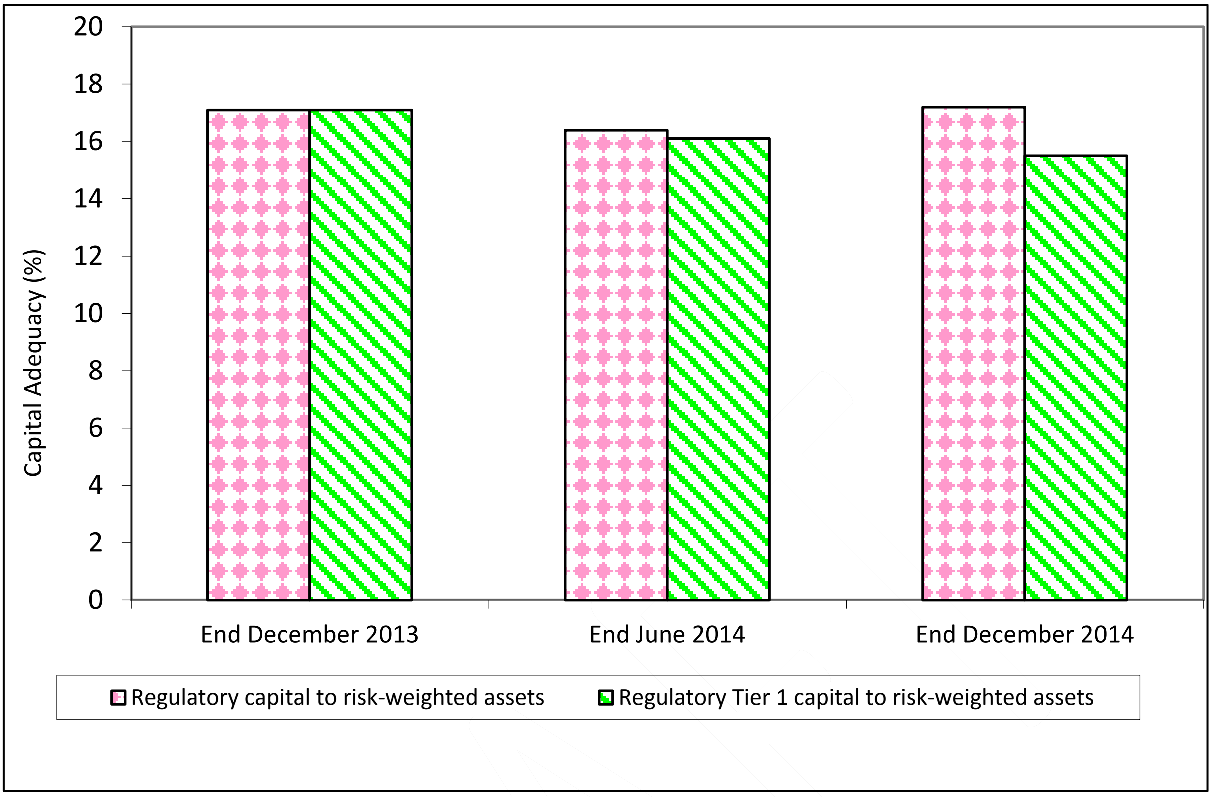


3.1.1.2 Capital-based Indicators

The ratio of regulatory capital to risk weighted assets stood at 17.2 per cent at end-December 2014 showing an increase of 0.8 and 0.1 percentage points above the levels at end-June 2014, and end-December 2013, respectively. However, the ratio of tier 1 capital to risk weighted assets, which stood at 15.5 per cent at end-December 2014, was 0.7 and 1.7 percentage points below the levels at end-June 2014 and end-December 2013, respectively (Figure 3.3).

The industry ratio of non-performing loans (net of provisions) to capital declined from 5.6 per cent at end-June 2014 to 4.1 per cent at end-December 2014, showing an improvement in the banking sector's capacity to absorb losses.

Figure 3. 3: Banking Industry Capital Adequacy Indicators



3.1.1.3 Income and Expense-based Indicators

The ratio of interest margin to gross income declined to 51.2 per cent in the review period, from 62.7 per cent at end-June 2014. The decrease reflected the efforts of the authorities to reduce the high lending rates in the industry. Similarly, the ratio of non-interest expenses to gross income decreased by 8.6 percentage points to 56.9 per cent at end-December 2014, from 65.5 percent at end-June 2014, while personnel expenses as a ratio of non-interest expenses declined by 1.6 percentage points to 36.6 per cent at end-December 2014, from 38.2 per cent at end-June 2014.

Table 3. 1: Selected Financial Soundness Indicators (FSIs) of the Nigerian Banking Industry* (All figures are in percentages, except otherwise indicated)

Indicators	2009		2010		2011		2012		2013		2014**	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
	End-Jun	End-Dec	End-Jun	End-Dec	End-Jun	End-Dec	End-Jun	End-Dec	End-Jun	End-Dec	End-Jun	End-Dec
1. Assets-based Indicators												
Non-performing loans to gross loans *	9.4	37.3	38.3	20.1	11.6	5.8	4.5	3.7	3.9	3.4	3.7	3.0
Liquid assets (core) to total assets*	13.7	11.0	12.9	11.7	11.6	16.0	14.3	16.2	13.7	16.8	11.7	11.4
Liquid assets (core) to	19.9	16.9	16.4	14.9	15.2	21.8	19.4	22.1	19.0	23.1	16.6	16.7

short-term liabilities*												
2. Capital-based Indicators												
Regulatory capital to risk-weighted assets*	22.4	4.1	1.5	1.8	4.2	17.9	17.7	18.3	18.9	17.1	16.4	17.2
Regulatory Tier 1 capital to risk-weighted assets*	21.9	4.9	2.4	2.2	4.5	18.1	17.8	18.0	18.5	17.1	16.1	15.5
Non-performing loans net of provisions to capital *	8.3	148.7	308.4	133.5	40.7	7.1	4.3	3.8	5.9	5.8	5.6	4.1
3. Income and Expense-based Indicators												
Interest margin to gross income*	60.0	59.1	51.9	53.6	49.4	31.0	67.7	62.0	65.2	63.9	62.7	51.2
Non-interest expenses to gross income*	68.0	137.4	65.7	50.2	70.6	24.4	59.2	64.8	62.7	68.1	65.5	56.9
Personnel expenses to non-interest expenses	41.9	47.7	40.1	36.8	41.1	67.8	39.3	42.5	39.5	36.9	38.5	36.6

Note: *FSIs are computed based on IMF guidelines. The indicators for the period End-June 2009 to End-December 2013 are revised.
** Provisional

3.2 Banking Industry Stress Tests

Stress tests were conducted at end-December 2014 with the overall objective of identifying vulnerabilities in the banking industry that could lead to an adverse systemic impact, and taking appropriate policy measures.

The tests captured the idiosyncratic nature of individual bank's balance sheet and macro-prudential concerns, using both the bottom-up and top-down approaches specified in the modified IMF's stress test framework. Assessments of the resilience of the Nigerian banking system were done by applying a series of exceptional but plausible shocks and scenarios, which effectively translated single factor and multifactor shocks into banks' balance sheets.

The exercise covered the 23 banks in the system, using the following risk channels: credit, liquidity, interest rates, foreign exchange rates, and foreign exchange trading risks. The resilience of the banking system was assessed against a defined benchmark of 10 per cent CAR, 30 per cent liquidity ratio, and 5 per cent NPL. They were also assessed on the basis of return on asset (ROA) and return on equity (ROE).For systemic and peer assessments, banks were classified into three groups, based on asset size as follows: Large banks (assets >₦1 trillion); medium (assets ≥₦500 billion<₦1 trillion); and small (assets <₦500 billion).

3.2.1 The Baseline Position

The baseline (pre-shock) capital adequacy ratios (CARs) for the banking industry as well as for large, medium and small banks stood at 17.16, 17.54, 14.55 and 13.77 per cent, respectively at end-December 2014. These reflected 0.73, 0.64, 0.12 and negative 2.29 percentage point change, respectively, from their end-June 2014 positions. Similarly, the pre-shock liquidity ratios for the banking industry and for large, medium and small banks were 45.77, 43.44, 52.86 and 50.51 per cent, respectively. These reflected decreases of 4.14, 3.73, 6.17, and 4.31 percentage points, respectively, from their levels at end-June 2014 (Tables 3.2 and 3.3).

Table 3. 2: Baseline CARs

		Banks		
	Banking Industry	**Large**	**Medium**	**Small**
December 2014 (%)	17.16	17.54	14.55	13.77
June 2014(%)	16.43	16.90	14.43	16.06
Percentage Point Change	0.73	0.64	0.12	-2.29

Table 3. 3: Baseline Liquidity Ratios

		Banks		
	Banking Industry	**Large**	**Medium**	**Small**
December 2014 (%)	45.77	43.44	52.86	50.51
June 2014 (%)	49.91	47.17	59.03	54.82
Percentage Point Change	-4.14	-3.73	-6.17	-4.31

Figure 3. 4: Number of Banks with CARs in Each Bucket

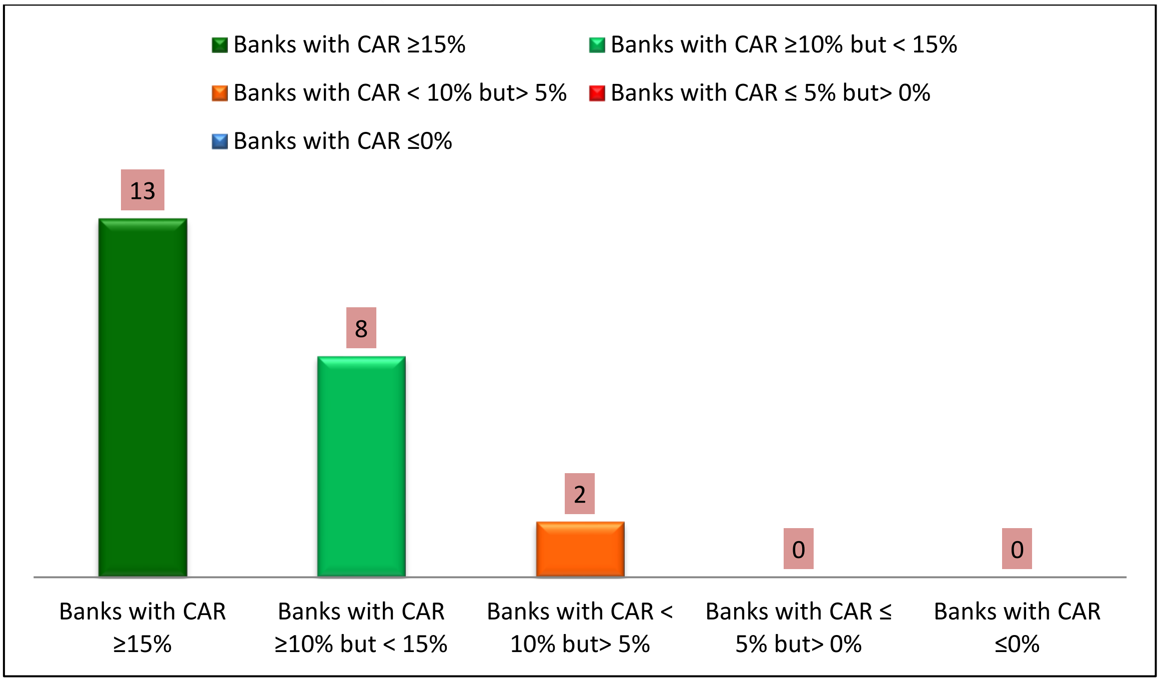


Figure 3. 5: Number of Banks with LRs in Each Bucket

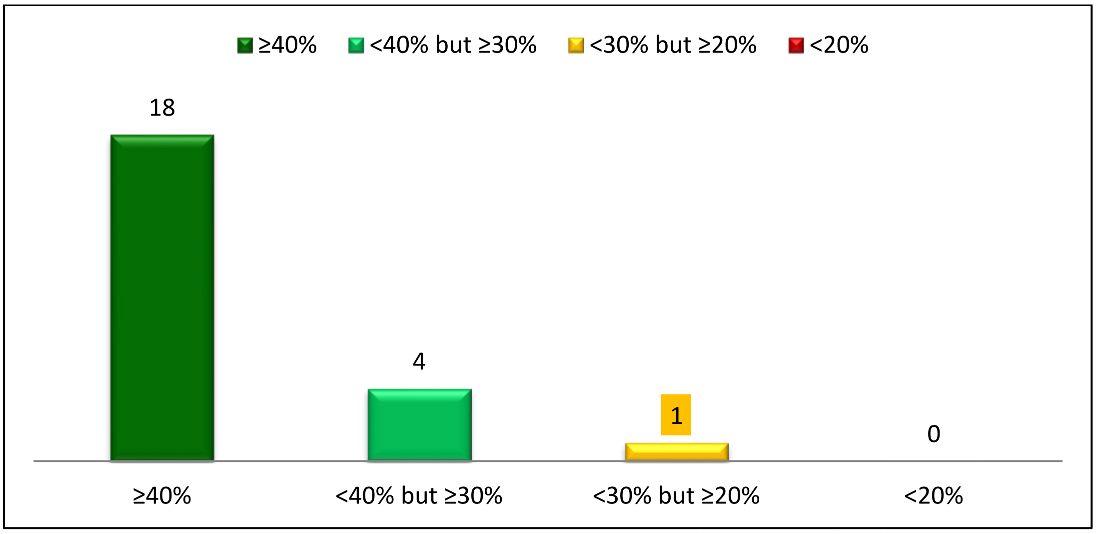
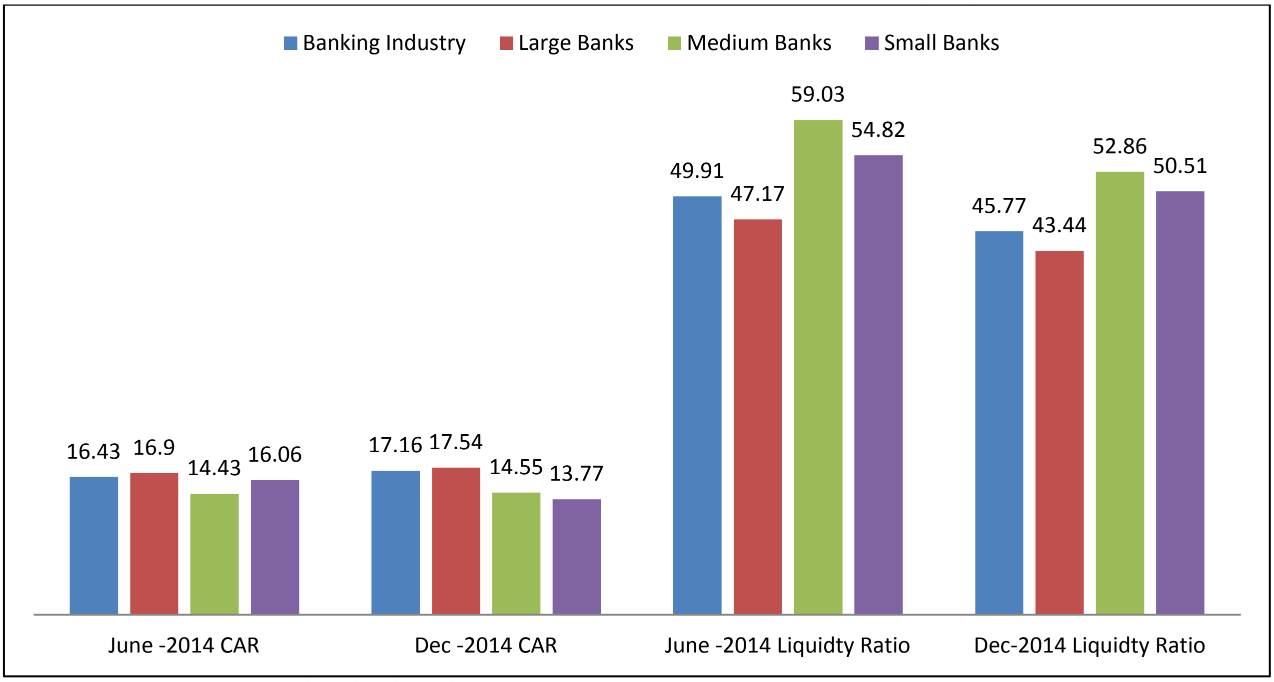
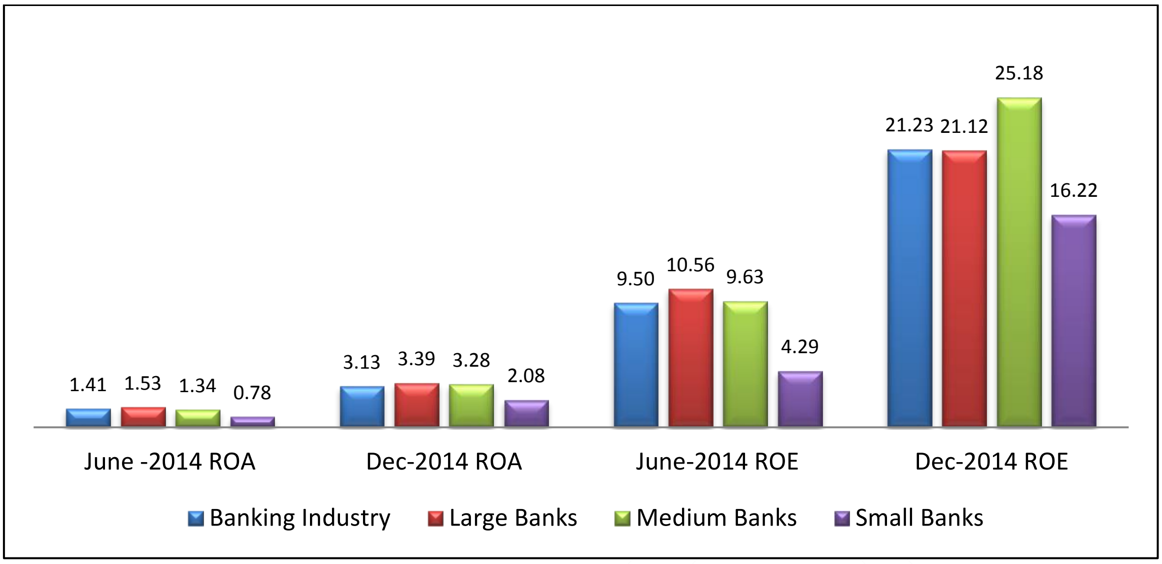


Figure 3. 6: Baseline (Pre-shock) CARs (%)



The pre-shock ROA of the banking industry, large, medium and small banks were 3.13, 3.39, 3.28 and 2.08 per cent, respectively. These reflected increases of 1.78, 1.86, 1.94 and 1.50 percentage points, respectively, over June 2014 positions. On the other hand, the ROE of the banking industry, large, medium and small banks increased to 21.23, 21.12, 25.18 and 16.22 per cent in December 2014, from 9.50, 10.56, 9.63 and 4.29 per cent in June2014, respectively. These indicated increases of 11.73, 10.56, 15.55 and 11.93 percentage points for the banking industry, large, medium and small banks, respectively (Figure 3.7).

Figure 3. 7: Baseline (Pre-shock) ROA and ROE (%)



3.2.2 Solvency Stress Test

Credit Risk

The banking industry, as well as large and medium banks were resilient to credit risk, as the impact of the most severe shock of a 200 per cent NPL increase resulted in their CARs remaining above the 10 per cent required minimum (13.72%, 14.94% and 11.19% for the banking industry, large and medium banks respectively) (Table 3.4). The small banks, however, showed significant vulnerability to the shock of a 200 per cent NPL increase as their CAR fell to 8.85 per cent. Under this scenario, 16 banks maintained CARs above 10%, while 5 had CARs ≤10% but ≥5%. Furthermore, one (1) bank had CAR <5% but ≥0% and one other bank had CAR<0% (Table 3.5).

Table 3. 4 General Credit Shocks

	Solvency Ratios After Shocks			
	All Banks	Large Banks	Medium	Small
Shock 1av-50% NPLs increase	16.32	16.30	13.73	12.55
Shock 1avi-100% NPLs increase	15.32	16.14	12.76	11.07
Shock 1avii-200% NPLs increase	13.72	14.94	11.19	8.85

Table 3. 5: Number of Banks with CARs under Respective General Credit Shocks

	<0%	≥0 &<5	≥5 & ≤10	>10 &<15	≥15	Total
Shock 1av-50% NPLs increase	0	0	3	7	13	23
Shock 1avi-100% NPLs increase	1	0	5	5	12	23
Shock 1avii-200% NPLs increase	1	1	5	4	12	23

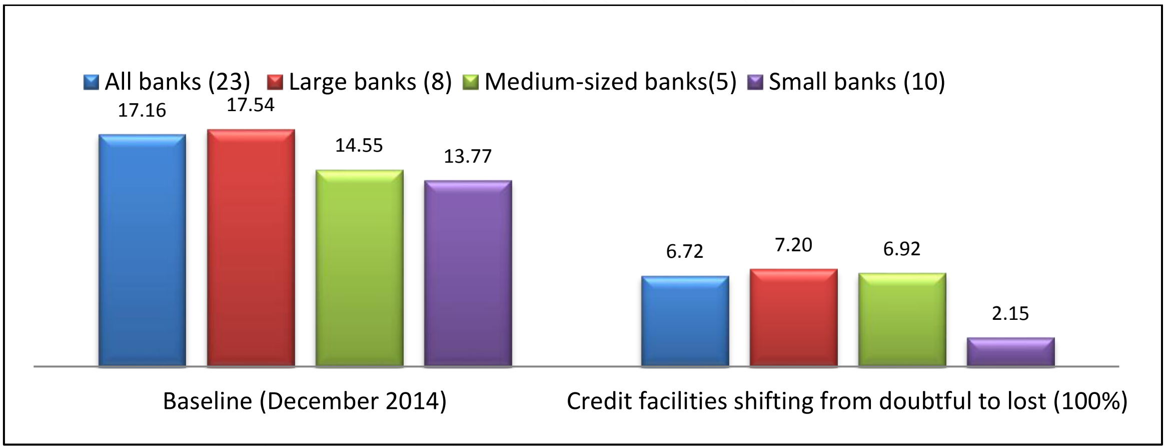
Credit Concentration Risk

Under the scenario of "Five biggest corporate obligors" credit facilities shifting from performing to sub-standard (10% provision)" and "from sub-standard to doubtful (50% provision)", the banking industry and all peered banks showed significant resilience to credit concentration risk as their CARs remained above 10 per cent, except the small banks, whose CAR fell to 8.33 per cent (Table 3.6). However, when their facilities shifted to lost (100% provision), the CARs of the banking industry, large, medium and small banks fell below the regulatory threshold of 10 per cent to 6.72, 7.20, 6.92 and 2.15 per cent, respectively (Table 3.6 and Figure 3.8).

Table 3. 6: Effect of Credit Concentration Risk on CARs

	All Banks	**Large Banks**	**Medium**	**Small**
Baseline CAR	17.16	17.54	14.55	13.77
Credit Concentration Shock on 5 Biggest Corporate Obligors Credit Facilities	**Solvency Ratio After Shocks**			
	All Banks	Large Banks	Medium	Small
Shift from Performing to Sub-standard (10%)	16.22	16.61	13.84	12.74
Shift to Doubtful (50%)	12.25	12.67	10.90	8.33
Shift to Lost (100%)	6.72	7.20	6.92	2.15

Figure 3. 8: Credit Concentration Risk



Liquidity Risk

Liquidity risk in the banking industry was adjudged mild as the impact of the most severe shock, a 15 per cent withdrawal of 20 largest deposits, resulted in the liquidity ratio falling by 2.29 percentage points, from 45.77 to 43.48 per cent. Similarly, under the same shock scenario, large, medium and small banks exhibited the same trajectory as their liquidity ratio dropped to 41.35, 49.53 and 47.10 from 43.44, 52.86 and 50.51 per cent respectively. The banking industry and the peered banks were, therefore, resilient to liquidity risk, indicating relatively diverse sources of funding (Table 3.7).

Table 3. 7: Impact of Runs on Liquidity Ratios

Liquidity Shocks	**Banking Industry (%)**	**Large Banks (%)**	**Medium Banks (%)**	**Small Banks (%)**
Baseline	**45.77**	**43.44**	**52.86**	**50.51**
Shock 6gi (5% Run on 10 largest Deposits)	45.17	42.88	52.02	49.63
Shock 6gii (10% Run on 10 largest Deposits)	44.55	42.32	51.15	48.72
Shock 6giii (15% Run on 10 largest Deposits)	43.92	41.74	50.26	47.78
Shock 6hi (5% Run on 20 largest Deposits)	45.03	42.76	51.80	49.42
Shock 6hii (10% Run on 20 largest Deposits)	44.26	42.06	50.69	48.29
Shock 6hiii (15% Run on 20 largest Deposits)	43.48	41.35	49.53	47.10

Interest Rate Risk

Under the most severe shock of a 1,000bps downward shift in the yield curve, the CARs of the banking industry, medium and small banks slightly deteriorated from the baseline position to 17.02, 13.88 and 13.55 per cent respectively. However, the CAR for large banks marginally increased to 17.55 per cent (Figure 3.9).

Figure 3. 9: Impact of Interest Rate Shock on CARs

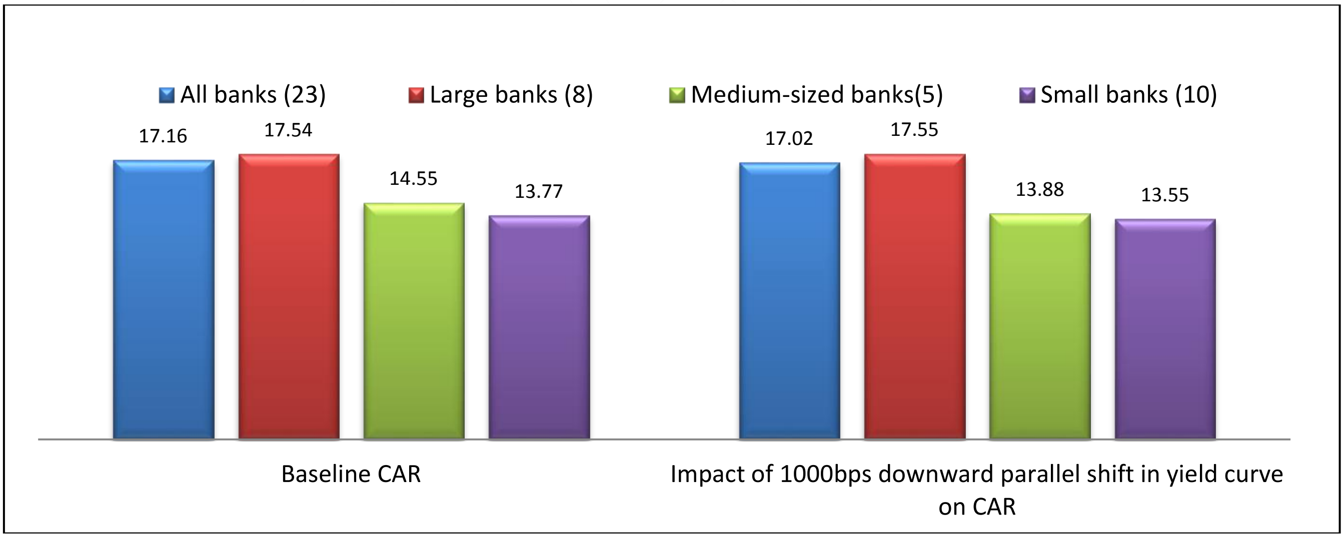
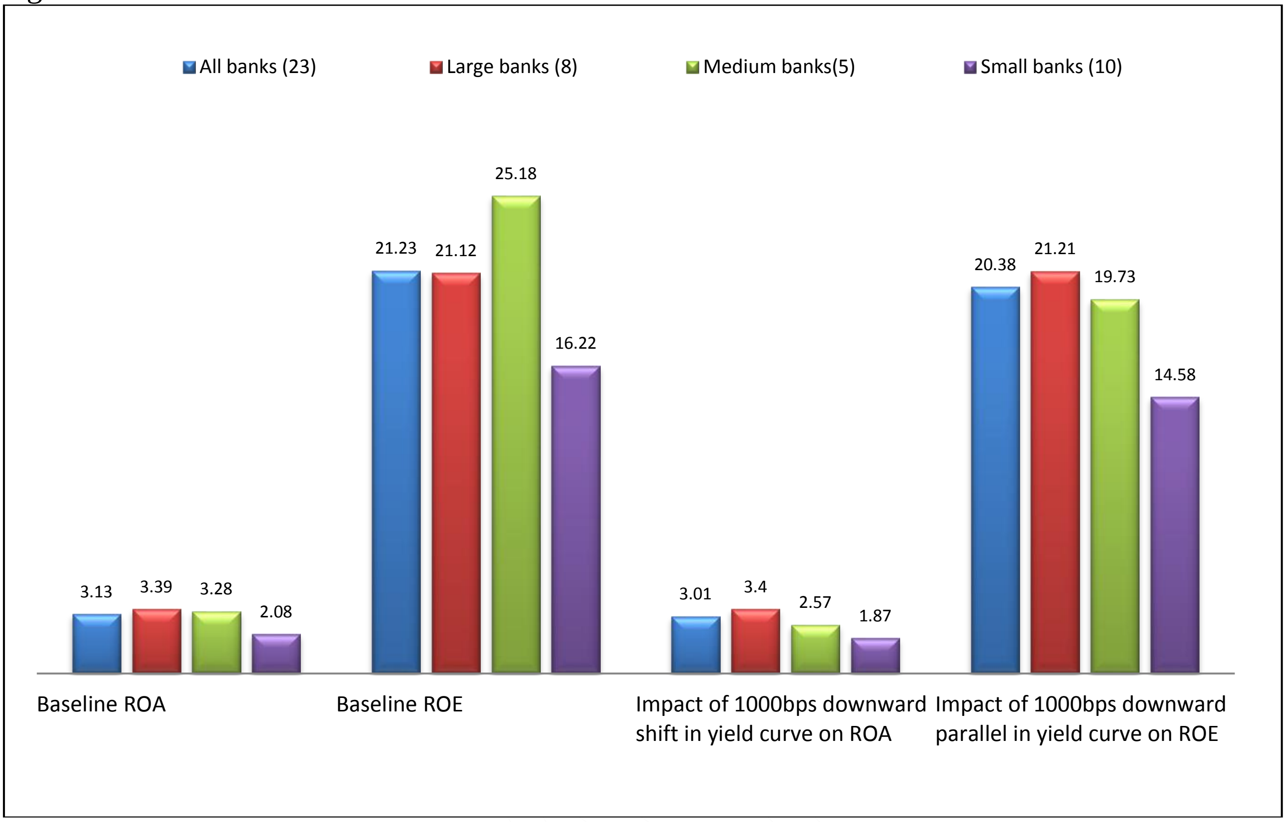


Figure 3. 10: Interest Rate Risk



Under the same shock scenario, the ROA for the banking industry, medium and small banks deteriorated marginally to 3.01, 2.57 and 1.87 per cent respectively, and their respective ROE deteriorated marginally to 20.38, 19.73 and 14.58 per cent. However, the ROA and ROE of the large banks increased marginally to 3.4 and 21.21 per cent, respectively (Figure 3.10).

The industry was adjudged resilient to interest rate risk, given the relative stability of its CAR, ROA and ROE after a severe shock of 1,000 bps parallel downward shift in the yield curve was induced.

Table 3. 8: Impact of Selected Shocks on CARs, ROA AND ROE

Shock Scenarios	**Banking Industry**	**Banks**		
		Large	**Medium**	**Small**
Baseline CARs	17.16	17.54	14.55	13.77
Baseline ROA	3.13	3.39	3.28	2.08
Baseline ROE	21.23	21.12	25.18	16.22
Impact of Interest Rate Volatility on CARs				
Shock 5biii (500bps downward parallel shift in yield curve)	17.09	17.54	14.21	13.66
Shock 5biv (1000bps downward parallel shift in yield curve)	17.02	17.55	13.88	13.55
Impact of Interest Rate Volatility on ROA				
Shock 5biii (500bps downward parallel shift in yield curve)	3.07	3.40	2.93	1.97

Shock 5biv (1000bps downward parallel shift in yield curve)	3.01	3.40	2.57	1.87
Impact of Interest Rate Volatility on ROE				
Shock 5biii (500bps downward parallel shift in yield curve)	20.80	21.16	22.45	15.40
Shock 5biv (1000bps downward parallel shift in yield curve)	20.38	21.21	19.73	14.58

Exchange Rate Risk

In line with the appreciating trend of the US$ against the naira, the impact of exchange rate on the banks' balance sheet was assessed via default on loans granted in foreign currency in respect of whose repayment would be in the same currency. The naira exchange rate depreciation was calibrated to assume a one-to-one percentage default on the exposures.

The banks showed great resilience to foreign exchange risk as their capital only experienced significant deterioration after the impact of "a 50 per cent exchange rate depreciation" shock was induced on their net foreign credit exposure. At this point, four (4) banks with baseline CAR above 10 per cent, slipped below the minimum regulatory threshold (Table 3.9).

Table 3. 9: Number of Banks with CARs Outcomes under Various Shock Scenarios

CAR (%)	<0	≥0 &<5	≥5 &<10	≥10 &<15	≥15
Baseline	0	0	2	8	13
Shock 4bi (10% depreciation in naira exchange rate)	0	0	3	7	13
Shock 4bii (20% depreciation in naira exchange rate)	0	1	2	7	13
Shock 4biii (50% depreciation in naira exchange rate)	1	2	3	6	11

Table 3. 10: CARs of Banks under Various Shock Scenarios

Single Factor Shocks	**CARs After Shocks**			
	Banks			
	All	**Large**	**Medium**	**Small**
Shock 4bi (10% depreciation in naira exchange rate)	16.48	16.97	13.92	13.08
Shock 4bii (20% depreciation in naira exchange rate)	15.80	16.40	13.29	12.38
Shock 4biii (50% depreciation in naira exchange rate)	13.76	14.68	11.40	10.30

Similarly, under the same shock scenarios, the CARs of the industry, large, medium and small banks were above the minimum threshold of 10 per cent, indicating their resilience to foreign exchange risk (Table 3.10).

Foreign Exchange Trading Risk

The results of the stress tests showed that the banking industry was resilient to foreign exchange trading risk. The banks' pre-shock positions, both in terms of the impact on ROA and ROE, changed only marginally, even after an induced 100 per cent decline in foreign exchange trading income. This was mainly due to the high net profit positions of the banks relative to the size of their FX trading income (Table 3.11).

Table 3. 11: CAR of Banks Given Foreign Exchange Trading Shocks on ROA

	Banking Industry	**Large**	**Medium**	**Small**
Impact of FX Trading Shocks on ROA				
Baseline ROA	3.13	3.39	3.28	2.08
FX Trading Income Volatility				
Shock 7ai (10% decline in FX trading Income)	2.97	3.21	3.11	1.97
Shock 7aii (20% decline in FX trading Income)	2.81	3.03	2.93	1.86
Shock 7aiii (50% decline in FX trading Income)	2.32	2.48	2.40	1.55
Shock 7aiv (100% decline in FX trading Income)	1.52	1.57	1.52	1.02

Table 3. 12: Number of Banks Given Foreign Exchange Trading Shocks on ROE

	Banking Industry	Large	Medium	Small
Baseline ROE	21.23	21.12	25.18	16.22
FX Trading Income Volatility				
Shock 7ai (10% decline in FX trading Income)	20.13	19.99	23.83	15.40
Shock 7aii (20% decline in FX trading Income)	19.04	18.85	22.48	14.57
Shock 7aiii (50% decline in FX trading Income)	15.75	15.45	18.43	12.09
Shock 7aiv (100% decline in FX trading Income)	10.27	9.79	11.67	7.95

Overall, although the stress tests result showed that the banking industry is generally resilient to the most severe shocks, there were concerns over credit concentration risk and exchange rate risk.

3.2.3 Liquidity Stress Test

A liquidity stress test was conducted using the Implied Cash Flow Analysis (ICFA) and the Maturity Mismatch/Rollover Risk approaches to assess the resilience of the banking industry and individual banks to liquidity and funding shocks.

The ICFA test assessed the ability of the banking system to withstand unanticipated substantial withdrawal of deposits, as well as short-term wholesale and long-term funding over a 5-day and a cumulative 30-day periods, with specific assumptions on the fire sale of assets.

The test assumed a gradual average outflow of 3.8, 5.0 and 1.5 per cent of total deposits, short-term funding and long-term funding, respectively over a 5-day period (Test 1.1) and a cumulative average outflow of 22.0, 11.0 and 1.5 per cent of total deposits, short-term funding and long term funding, respectively, on a 30-day balance (Test 1.2). It also assumed that the assets listed in Table 3.13 would remain unencumbered after the fire sale:

Table 3. 13: Assets Unencumbered after Fire Sale

S/N	Assets	% Unencumbered
1	Cash and cash equivalent	100
2	Current account with CBN	100
3	Government Bonds & Treasury Bills and other assets with 0% risk-weighting exposure	66.5
4	Certificates of deposit held	66.5
5	Other Short-term investments	49
6	Collateralized placement and money at call	49
7.	CRR	30

The Maturity Mismatch/Rollover Risk approach assessed the funding maturity mismatch and the rollover risk for assets and liabilities in the 0-30 and 31-90 day buckets, with the assumption on the availability of funding from the CBN and intra-group sources, as described below:

i. Test 2a: *Descriptive Maturity Mismatch:* assumed that the baseline mismatch remained, but 5 per cent of total deposit would be made available from the CBN and intra-group funding;

ii. Test 2b: *Static Rollover Risk:* assumed that 80.0 and 72.0 percent of the funding in the 0-30 day and 31-90 day buckets would be rolled over with no possibility to close the funding gap from other buckets. However, 5 per cent of total deposits would still be available from the CBN and intra-group funding; and

iii. Test 2c: *Dynamic Rollover Risk:* the assumption was as in 2b above, but with the option of closing the liquidity gap from other buckets.

Analysis of Liquidity Stress Test Results

The test results revealed that the industry liquidity ratio declined to 10.40 and 7.80 per cent, from 45.77 per cent after the 5-day and cumulative 30-day shocks, respectively (Table 3.14). Most banks' LRs were below the 30.0 per cent threshold under the two scenarios.

Table 3. 14: Implied Cash Flow Analysis

Total Number of Banks tested	Number of Banks with < 30% liquidity ratio				System LR (%)	Liquidity Shortfall to make 30% LR (₦' billion)
23	Dec 2014	Sep 2014	June 2014	Mar 2014	Dec 2014	
Test 1.1: Implied Cash Flow Test (5 Days)						
Day 1	9	9	10	10	33.20	
Day 2	14	13	13	15	28.30	285.15
Day 3	16	16	14	15	23.00	867.47
Day 4	17	16	17	16	17.00	1,423.46
Day 5	19	17	17	16	10.40	1,955.90
Test 1.2: Implied Cash Flow Test (30 Days)	20	18	17	17	7.80	2,137.16

Figure 3. 11: Industry and Individual Bank Pre-shock Liquidity Ratio Positions

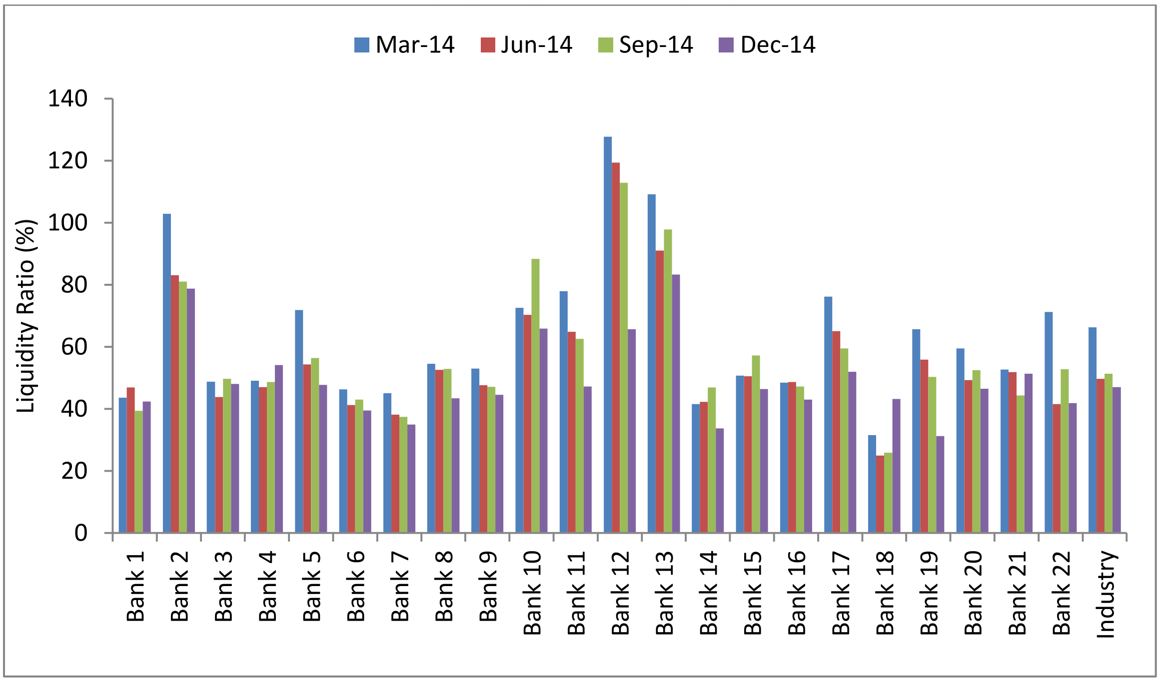


Figure 3. 12: Industry Position after 1-5 day and Cumulative 30-day Shocks

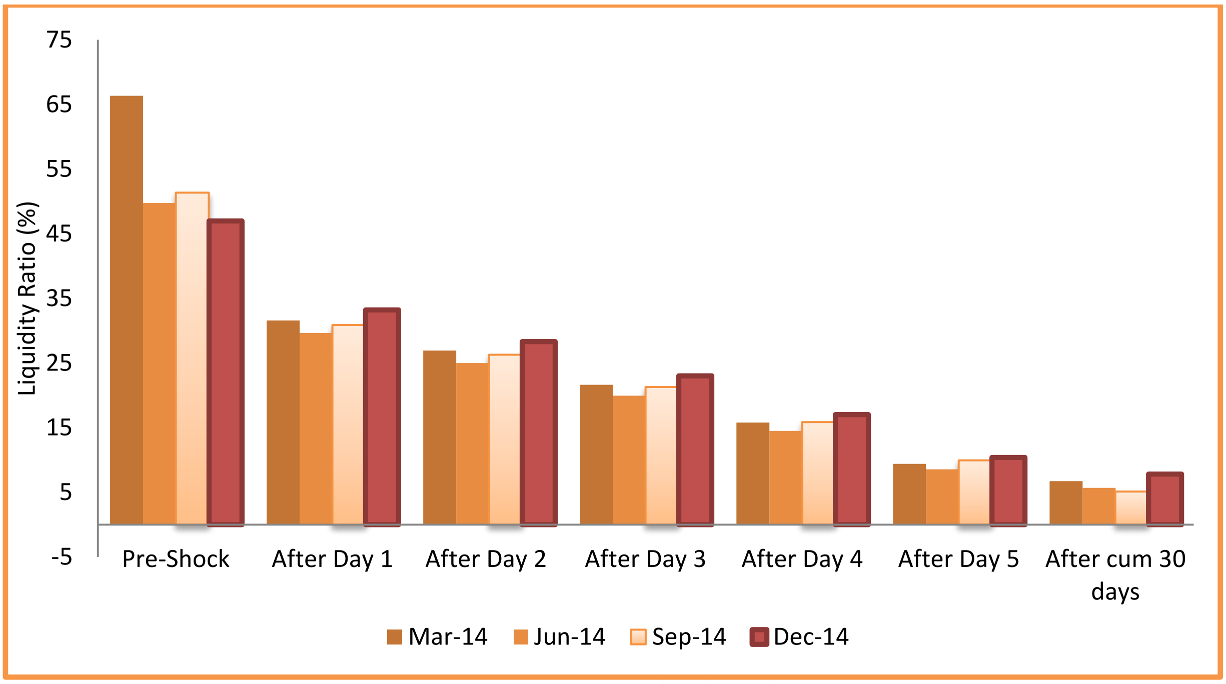
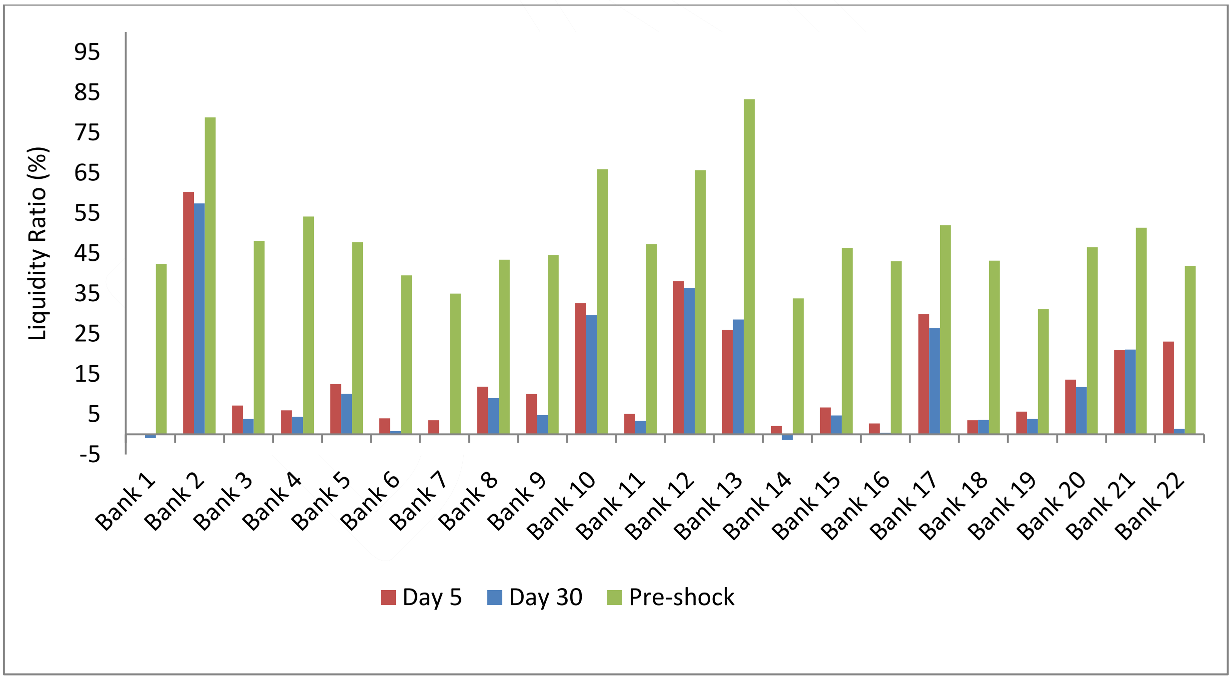


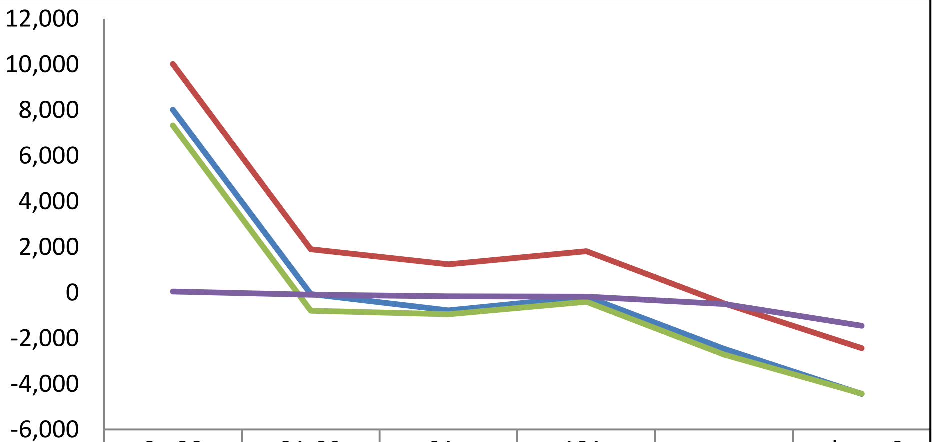
Figure 3. 13: Individual Bank Positions after 5-day and Cumulative 30-day Shocks



N.B: Bank 23 was excluded from Figure 3.13 because of its outlier effect.

Assets in the 0-30 days bucket were adequately funded in the three scenarios used in the maturity mismatch/rollover tests (2a, 2b and 2c). There was deterioration in the 31-90 day bucket in tests 2b and 2c (Figure 3.14).

Figure 3. 14: Rollover Risk, Pre- and Post-shock



	0 - 30 days (N'billion)	31-90 days (N'billion)	91 - 180days (N'billion)	181-360days (N'billion)	1-3 years (N'billion)	above 3 years (N'billion)
Pre-shock	8,011	-65.94	-777.94	-169.18	-2,454	-4,434
Test 2a	10,020.48	1,900.46	1,240.16	1,821.79	-464.37	-2,431.73
Test 2b	7,325.51	-793.29	-949.95	-393.9	-2,714.18	-4,420.11
Test 2c	57.58	-89.89	-159.07	-178.48	-502.17	-1455.59

Overall, the banking industry was resilient, manifesting a low likelihood of deposit runs. The test results indicated a deterioration in the banks' resilience, compared with the position in the first half of 2014. However, compared with the position as at June 2014, the industry was more resilient to liquidity risk arising from deposit runs.

3.2.4 Contagion Risk Analysis through Interbank Exposures

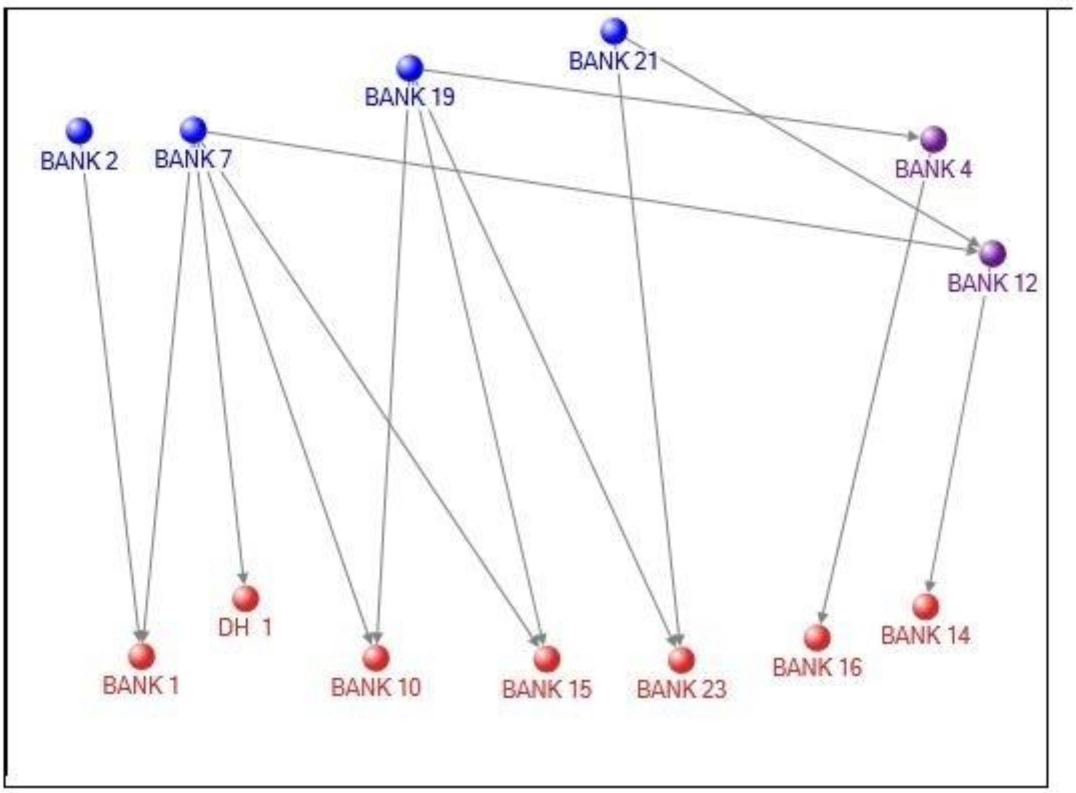
The contagion risk analysis assessed the outcome of the financial interconnectedness of institutions in transmitting shocks to the banking system. An analysis of bilateral links among different banks was conducted using interbank placements, takings, and money-at-call, with emphasis on unsecured exposures. It was assumed that unsecured interbank exposures were lost.

An analysis of banks with unsecured interbank exposures revealed that two (2) banks were central in the network, as they were exposed to three or more counterparties in the system. When secured transactions were considered, seven (7) banks were central in the network as they had three or more bilateral exposures. Also, the contagion risk through unsecured interbank exposure was minimal as only one bank was undercapitalized with a CAR of 8.27per cent. At baseline position, this bank was already undercapitalized (Table 3.15).

Table 3. 15: Result of Net Interbank Uncollateralized Exposure Linkages

Lending Banks	Bank 2	Bank 4	Bank 7	Bank 12	Bank 19	Bank 21	Industry
Pre-Test CAR (%)	14.44	9.42	19.77	28.02	21.02	19.53	17.20
Post-Test CAR(%)	13.76	8.27	18.58	26.88	19.59	10.74	16.71
Net Placement (₦' Billion)	1.83	18.27	27.87	2.5	19	19.7	Nil

Figure 3. 15: Tiered Structure of Unsecured Placements at end-December, 2014



Note: Node colour representation (Blue= Lenders; Red= Borrowers; Purple= Borrowers and Lenders)

3.3 Supervision of the Banking Sector

3.3.1 Routine/Target Examinations

Joint CBN/NDIC examinations were conducted on all the banks in the review period. The examinations, which covered risk assets, corporate governance, among others, provided the opportunity to test their compliance with prudential ratios and the effectiveness of their risk management control functions. At the end of the exercise, some banks with previous Composite Risk Rating of "Above Average" were upgraded to "Low" and "Moderate" composite risk rating.

Risk-based examinations were conducted on two (2) of the three (3) discount houses. The two (2) were rated "Moderate risk", while a compliance examination was conducted on the third in order to review recoveries and evaluate its financial condition.

Maiden examinations of the three (3) licensed financial holding companies were conducted during the review period. The three (3) private credit bureaux were also examined to ascertain their financial conditions and adherence to their operational guidelines.

3.3.2 Examination of Foreign Subsidiaries

Examinations of nine (9) foreign subsidiaries of Nigerian banks were conducted during the review period. The outcomes revealed that one bank was rated "High Risk", two "Above Average Risk" and six "Moderate Risk". The host supervisors of the subsidiaries were duly informed of the outcomes, in line with the MoUs executed with them. Subsidiaries in the West Africa Region were not examined because of the outbreak of the Ebola Virus Disease (EVD), during the review period.

The College of Supervisors

The Committee of Central Bank Governors of the West African Monetary Zone (WAMZ) met in Abuja in July 2014 and agreed, among others, that Nigeria should lead the development of a cross-border crisis resolution framework for the Zone.

Memorandum of Understanding

In the review period, one (1) Memorandum of Understanding (MoU) on information sharing was executed with the Central Bank of Mauritius, bringing the total number of MoUs to 19.

3.3.3 Supervision of Domestic Systemically Important Banks (D-SIBs)

In line with international best practice and the desire to foster financial stability, the Bank, in collaboration with the NDIC, issued the *Framework for Regulation and Supervision of Domestic Systemically Important Banks in Nigeria*. The Framework specifies, among others, the assessment methodology for identifying D-SIBs, higher loss absorbency and additional regulatory requirements such as liquidity, stress testing, disclosure and reporting. The implementation of the Framework is expected to take effect from March 1, 2015.

3.3.4 Combating Money Laundering and Terrorist Financing in Nigeria

In the period under review, the CBN continued to collaborate with both domestic[5] and international[6] stakeholders in fighting the menace of money laundering and the financing of

[5]The Securities & Exchange Commission (SEC), the National Insurance Commission (NAICOM), the Special Control Unit against Money Laundering (SCUML), as well as law enforcement agencies, and Self Regulatory Organizations (SROs).

[6]The Financial Action Task Force (FATF), the Inter-Governmental Action Group Against Money Laundering in West Africa (GIABA), the US Department of State and the US Embassy, and the United Nations Organization

terrorism. In this regard, Government sustained its support in providing political the backing required to enforce AML/CFT regulations.

In the area of combating terrorist financing, the CBN regularly circulated to financial institutions under its regulatory purview the United Nations Consolidated Lists of persons/entities involved with terrorism financing or terrorist activities for appropriate action. The Bank also issued other relevant circulars and notifications in respect of terrorist financing for compliance by financial institutions.

In general, the CBN continued to issue regulations intended to safeguard the Nigerian financial system from the abuses of financial crime, including money laundering, terrorist financing and other illicit financial transactions. These efforts led to the removal of Nigeria from the FATF Grey List in October, 2013 and the FATF's approval for the country to commence FATF membership process in June 2014.

3.3.5 Supervisory Policies for the Stability of the Nigerian Banking System

In the light of the growing foreign currency borrowings by banks and the issuance of Eurobonds, the CBN, issued during the review period, a circular on *Prudential Regulation for the Management of Foreign Exchange Risk of Banks* which required banks to take appropriate measures to hedge their foreign exchange exposures. The circular further adjusted downwards aggregate foreign currency borrowing of banks to 75 per cent, from the previous 200 per cent of shareholders' funds unimpaired by losses. It further pegged banks' Net Open Position at 20 per cent of shareholders' funds unimpaired by losses.

In view of emerging risks in banks and discount houses, another circular on *Internal Capital Generation and Dividend Payout Ratio* was issued in October 2014 to facilitate adequate capital build-up. It required banks and discount houses to adopt more prudent dividend payout policies. Banks and discount houses with a Composite Risk Rating (CRR) of "High", or a non-performing loans (NPLs) ratio higher than 10 per cent, were precluded from paying dividends. Those with ratings of "Above Average" or an NPL ratio of between 5 and 10 per cent were limited to amounts not exceeding 30 per cent of the profit after tax.

Furthermore, a circular on the *Exclusion of Non-distributable Regulatory Reserve and Other Reserves in the Computation of Regulatory Capital of Banks and Discount Houses* was issued to derecognize "Regulatory Risk Reserve" as part of Tier I capital, and "Collective Impairment" as part of Tier II capital. Conversely, it recognized "Other Comprehensive Income Reserve" as Tier II capital, subject to a limit of 33.33 per cent of Tier I capital.

3.4 Supervision of Other Financial Institutions

3.4.1 Microfinance Banks

During the review period, 467 MFBs were examined bringing the total examined in 2014 to 834. This number represented 94 per cent of the existing 884 MFBs. The remaining 50 comprised 30 licensed during the year, which were yet to qualify for maiden examination, and 20 others, which had either closed shop or were undergoing restructuring.

The post-examination monitoring of 340 MFBs was conducted during the second half of the year. The exercise revealed that 71 (20.88%) of the MFBs had implemented at least60 percent of the examiners' recommendations, 92 (27.06%) had implemented between 40 and 59 per cent of the recommendations, while 162 (47.65%) had implemented less than 40 per cent of the recommendations. Thirteen (3.82%) of the remaining MFBs were found to have closed shop, while the reports on two (2) were yet to be finalized. To improve the level of compliance with the examiners' recommendations, appropriate penalties were imposed on the erring institutions.

3.4.2 Finance Companies

An analysis of the call reports of the 64 operating finance companies (FCs) as at end-December 2014, showed that 24 were sound, six (6) marginal,24 technically insolvent, and six (6) unsound. Four (4) were, however, undergoing restructuring. The on-site routine examination of the FCs was on-going at end-December 2014.

3.4.3 Bureaux de Change

During the review period, 322 high end user bureaux de change (BDCs)[7] were examined to assess their compliance with the documentation requirements for foreign exchange utilisation. The reports revealed that most of the BDCs were involved in infractions such as inadequate/improper documents, non-utilisation of funds for eligible transactions and relocation of offices without prior approval, among others. The erring BDCs were appropriately penalised.

3.5 Compliance with International Standards

3.5.1 Basel II Implementation

The implementation of Basel II Capital Adequacy requirements commenced on October 1, 2014, following the completion of the 9-month parallel run of minimum capital adequacy computation, using Basel I and II rules. The analysis of the first call reports submitted by banks and discount houses in October 2014 showed that three (3) out of the ten (10) commercial banks with international authorization and three (3) out of the nine (9) commercial banks with national authorization failed to meet the minimum CAR of 15and 10 per cent, respectively. The affected banks were required to implement capital restoration plans.

All banks and discount houses submitted their first set of Internal Capital Adequacy Assessment Process (ICAAP) reports in the second half of 2014, covering their current and prospective capital requirements as at December 31, 2013. The review of the ICAAPs was done in two phases. Phase 1 covered 12 banks comprising mainly domestic systemically important banks (D-SIBs), the foreign-owned banks and two of the bridge banks, while Phase 2 covered the remaining 14 banks and discount houses.

[7]High-end user BDCs refer to operators that bought a minimum of $250,000 during a specified two-week period.

The reports revealed that thirty (30) risks were identified by the banks as being material to their operations. Of this number, six (6) risk types, the Pillar 1 risks (credit, market, operational) as well as liquidity, reputational and strategic risks, were common to all the banks. However, banks differed in their assessment of the extent to which each of the risks was significant to their operations.

Whereas some banks failed to set aside additional capital for their Pillar 2 risks, resulting in their regulatory capital being the same as the economic capital, others failed to provide sufficient information regarding the data used for the assessment process, the assumptions made and the stress tests carried out.

It was also observed that most banks neither submitted evidence of board approval of their ICAAP, training for board members on ICAAP, risk monitoring reports, nor provided evidence of a review by auditors. It is expected that sustained regulatory dialogue with the banks will improve the implementation of Basel II/III, going forward.

3.6 Competency Framework for the Banking Industry

The CBN commenced the full implementation of the Competency Framework for the Banking Industry in November 2014. Sequel to the gaps observed in the baseline assessment earlier conducted, financial institutions submitted their remedial plans to the CBN. Bank directors and employees with deficiencies in the qualifications required for manning key control functions had been enlisted or required to acquire appropriate certification in accordance with the relevant plans. The implementation of the plans is being monitored.

3.7 The Framework for Managing Stability in the Nigerian Financial System

Following the lessons learned from the 2008 global financial crisis and its impact on the Nigerian financial system, the CBN commissioned the SPP[8]& Oliver Wyman[9] (Consultants) in 2010 to strengthen institutional and legal frameworks to enhance stability in the Nigerian financial system**.**

The programme has the following main objectives:

i. *Macro-prudential policy:* Provide an early warning system to identify, monitor and analyse risks and vulnerabilities in the financial system as a whole;
ii. *Micro-prudential policy:* Strengthen the supervision of individual entities and contribute to the processes of macro-prudential and crisis management policies;
iii. *Crisis management continuum:* Develop a framework for handling financial crises in a cost-effective manner.

The SPP/OW report recommended the following:

- Establishment of a Financial System Stability Committee (FSSC);
- Organisational restructuring of stakeholders involved in macro-prudential regulation;

[8]SPP – Systemic Policy Partnership
[9]Oliver Wyman is a financial stability consulting firm

- Development of a macro-prudential analytical framework and capabilities;
- Enhancement of the micro-prudential function for structural resilience;
- Preparation for early intervention measures, crisis triggers, management and resolution;
- Human capital development;
- Enhancement of the external engagement model;
- Legal preparation and redraft of CBN, BOFIA and other relevant laws/bills; and
- Enhancement of data gathering and storage capabilities.

The Financial Services Regulation Coordinating Committee (FSRCC) approved the recommendations in the review period and also the release of staff from member-agencies for the nine work streams of the project.

3.8 The Asset Management Corporation of Nigeria

The Asset Management Corporation of Nigeria (AMCON), on October 31, 2014, completed the scheduled redemption of its Series 5Bonds with a face value of ₦866.74 billion, including ₦13.295 billion repurchased by the Corporation. This brings the total amount thus far redeemed since its inception to ₦1.8 trillion. With this redemption, the CBN is the only holder of the 6 per cent 2023 AMCON Note with face a value of ₦3.80 trillion. The Notes are expected to be progressively redeemed over its remaining life from contributions to the Banking Sector Resolution Cost Trust Fund[10] and recoveries from AMCON's operations.

Total recoveries stood at ₦506.50 billion or 28.94 per cent of the total Eligible Banking Assets of ₦1.75 trillion. This comprised cash recoveries of ₦201.37 billion (39.76%) and assets forfeiture worth ₦305.13 billion (60.24%). The assets forfeited comprised real estate and other properties valued ₦191.82 billion, as well as securities of ₦113.31 billion.

During the review, the Corporation divested its equity interest in Enterprise and Mainstreet Banks to Heritage Banking Company Ltd and Skye Bank Plc, respectively. The Corporation is expected to divest from Keystone Bank, the last of the three bridge banks, in 2015.

3.9 Key Risks in the Financial System

3.9.1 Credit Risk

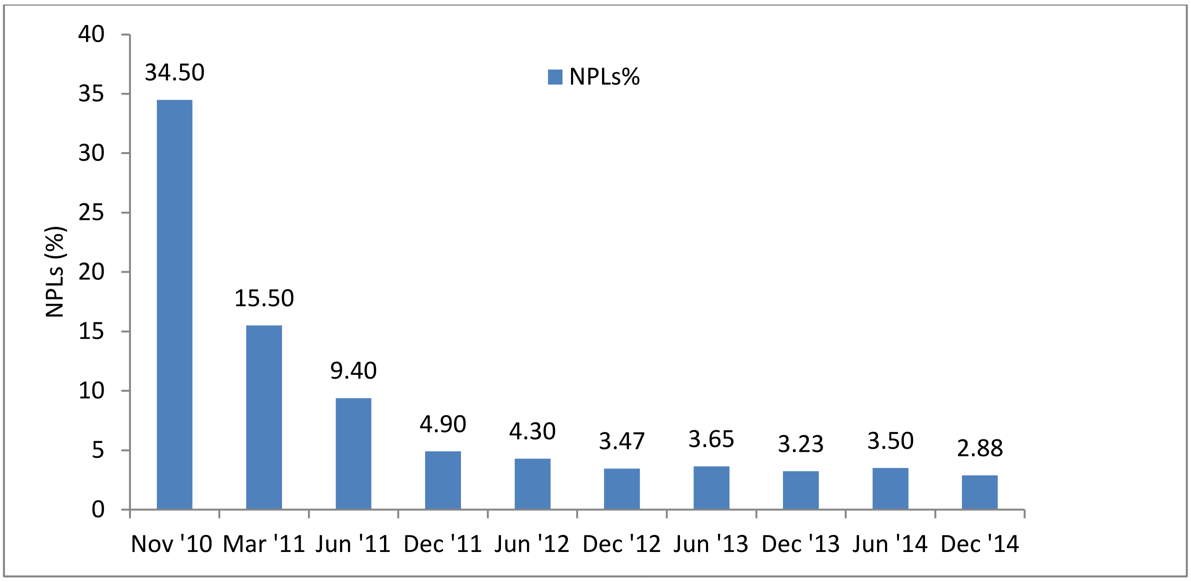
There was a slight improvement in the quality of bank assets as NPLs declined by 4.14 per cent to ₦363.31 billion at end-December 2014, from ₦379.01 billion at end-June 2014. At 2.88 per cent, the NPL ratio remained within the prudential limit of 5.0 per cent (Figure 3.16).

Sustained low oil prices may, however, result in an increase in NPLs, given that the exposure to the oil and gas sector accounted for 25.70 per cent or ₦3.24 trillion of the total credits of ₦12.63 trillion at end-December 2014.

[10]The CBN and banks reached an agreement in 2011 to make yearly contributions to the Banking Sector Resolution Cost Trust Fund (BSRCTF), towards meeting the costs of resolving the 2009 banking crisis in Nigeria.

The Bank will continue to monitor the development while requiring banks to strengthen their contingency plans and to conduct regular stress tests to mitigate the impact of the crash in oil prices on their balance sheets.

Figure 3. 16: Non-Performing Loans



3.9.2 Liquidity Risk

The liquidity ratio for the industry increased by 3.11 percentage points to 45.77 per cent at end-December 2014 from 42.66 per cent at end-June 2014, thus contributing to the high cost of managing liquidity. All banks met the minimum prudential liquidity ratio of 30 per cent during the review period.

3.9.3 Market Risk

There was a mixed trend in the movement of interest rates during the second half of the year. Whilst savings, one month deposit and interbank rates increased, other rates decreased from their levels in the first half of the year. The spread of 22.32 percentage points between the average savings deposit rate of 3.40 per cent and the maximum lending rate of 25.72 per cent was high and indicated persistent inefficiencies in the market, although the spread narrowed marginally from 22.65 per cent at end-June 2014.

Owing to pressures from the fall in oil prices and the consequent low accretion to external reserves, the exchange rates depreciated persistently and became volatile in the interbank and BDC segments of the market during the period under review. Thus, the Bank adjusted the midpoint of its official exchange rate and implemented tighter measures to preserve the value of the naira. Meanwhile, the external reserves declined by US$3.09 billion to US$34.24 billion at end-December 2014, from US$37.33 billion at end-June 2014. Also, a high premium of ₦18.77

(11.06%) and ₦9.88 (6.28%) remained between the rDAS & BDC and rDAS & Interbank segments, respectively, at end-December 2014.

The Bank will continue to monitor market risk and take appropriate actions.

3.9.4 Operational Risk

Some of the key operational risks reported were a high incidence of fraud and forgeries, absence of unique identifiers, and insecurity in some parts of the country. The cases of fraud and forgeries increased to 6,250 at end-December 2014, from 5,197 reported in the first half of the year. The total amount involved in these cases, however, dropped to ₦9.0 billion at end-December 2014 from ₦16.82 billion recorded in the first half of 2014. However, actual losses from these incidents increased to ₦3.04 billion at end-December 2014, from ₦1.72 billion in the first half of 2014. It was observed that some of the reported cases of card fraud were perpetrated in jurisdictions with less secure payment platforms. Banks have been encouraged to adopt global best practices, such as the latest version of the payment card industry data security standard (PCIDSS) certification to mitigate the cyber-threat to their systems.

The CBN in collaboration with the Bankers' Committee introduced the Bank Verification Number (BVN) in February 2014 to improve customer identification with a view to mitigating the risk of money laundering and predatory borrowing in the banking system. All credit customers were required to enroll on the BVN by end-December 2014, while all other customers are expected to obtain their BVN not later than June 2015.

Insecurity in the North-East of the country persisted during the period under review and this affected the operations of some banks in the region.

3.10 Credit Bureaux

3.10.1 CBN's Credit Risk Management System

The Credit Risk Management System (CRMS) continued to complement the process of credit risk management in the banking industry. At end-December 2014, the number of borrowers registered by banks in the CRMS database stood at 125,371. Of this, the total number of credit borrowers was 48,837, while the number of outstanding credits was 78,341.

During the review period, 105 requests/enquiries on customers' credit records in the CRMS were processed as against 84 in the first half of 2014. Most of these were on companies/projects applying for funding under the Commercial Agriculture Credit Scheme (CACS).

3.10.2 Private Credit Bureaux

The number of credit records in the database of the three private credit bureaux declined by 2.67 per cent to 97.69 million at end-December 2014, from 100.37 million in the first half of the year. The decline was attributed to data cleansing carried out by one of the credit bureaux. Similarly, the number of requests for credit information declined by 34.0 per cent, from 238,254 at end-June 2014 to 157,273 at end-December 2014.

3.11 Consumer Protection

During the review period, 782 complaints were received, compared with the 438 received in the first half of 2014. Of this, 504 (64.45%) were resolved or closed compared with 497 in the first half, an increase of 1.41 per cent. The increase in the number of complaints was due to, among others, increased public awareness of the consumer complaints resolution channels available in the CBN. The value of claims by complainants against banks and other financial institutions (OFIs) in the second half of 2014, amounted to ₦15.67 billion and US$1.51 million, while refunds totalled ₦2.38 billion and US$901,864.19 (Table 3.16).

Table 3. 16: Complaints Management Activities from July to December 2014

S/No	Description	July	August	September	Oct	Nov	Dec	Total
1	Number of Complaints received	91	125	142	164	159	101	782
2	Number of Complaints resolved/closed	83	176	65	68	60	52	504
3	Amount claimed (₦ Billion)	0.204	6.74	4,22	0.22	0.056	4.22	15.665
4	Amount refunded (₦Billion)	0.153.72	1.081	0.653	0.115	0.048.75	0.326	2.378
5	Amount claimed (US$)	1,433.79	-	1,503,687.90	-	-	430.4	1,505,552.09
6	Amount refunded (US$)	1,433.79	-	900,000.00	-	-	430.4	901,864.19
7	Mediation meetings held	3	1	2	2	2	3	13

3.11.1 Consumer Complaints Management System

In the second half of 2014, the Consumer Complaints Management System (CCMS) was deployed to improve complaints management in banks, after a user awareness session for their relationship officers. The system is, however, grappling with some IT challenges, resulting in delays by banks in uploading complaints. The Bank will continue to provide technical support for the system and monitor its performance to improve efficiency.

3.11.2 Market Conduct

3.11.2.1Compliance Checks

During the review period, the Bank conducted compliance checks on 20 banks to confirm the accuracy of their monthly returns, ascertain their level of compliance with the Revised Guide to Bank Charges (RGBC), and assess their level of implementation of the regulatory directives.

Erring banks were directed to implement remedial actions, including making refunds amounting to ₦73.02 million to customers who had been over-charged, in violation of the provisions of CBN's *Revised Guide to Bank Charges*.

The maiden compliance check of OFIs was conducted on five (5) PMBs and one (1) MFB. The spot-check was to ascertain the existence and operation of Consumer Complaints Help Desks across the OFIs.

The major findings of the compliance check included the following:

- Two (2) of the OFIs partially complied with the requirement to establish Help Desks at their head offices and branches;
- Only one (1) OFI rendered Monthly Returns on consumer complaints; and
- Only one (1) OFI complied with the requirement to disclose consumer complaints information in its 2013 annual report.

3.11.2.2 Policy on Time Bar on Complaints Management

The Bank exposed a draft policy instrument on time limit for managing complaints against financial institutions to industry stakeholders for their inputs/comments. The proposed policy, which would ensure the availability of supporting documents, is aimed at enhancing timely resolution of complaints as well as promoting efficiency in the complaints management functions of the CBN and the financial institutions. The policy proposed that complaints would be lodged by customers against their financial institutions within a 6-year period from the date of the transaction after which no complaint would be entertained by the CBN. The proposed time limit would not preclude the right of a complainant from seeking redress in the court of law.

It is expected that full implementation of the consumer protection initiatives would go a long way in enhancing public confidence in the banking system.

4.0 THE PAYMENTS SYSTEM

4.1 Developments in the Payments System

In furtherance of its efforts in the development of a safe, reliable and efficient payments system, the Bank undertook some major initiatives and implemented new policies during the review period, as highlighted below.

4.1.1 Implementation of the Bank Verification Number Scheme

The implementation of the Bank Verification Number (BVN) scheme, designed to address the absence of a unique identifier across the banking industry was in full swing. The Bank issued circulars guiding the implementation of the BVN scheme by all banks, which stipulated the following:

- All banks are required to enroll at least 40 per cent of their customers by December 31, 2014;
- All customers with new loans must have the BVN as a condition precedent to drawdown, with effect from November 3, 2014;
- All credit customers must have BVNs by December 31, 2014;
- By March 2015, transactions valued ₦100 million or more should only be allowed for customers with BVN; and
- By June 2015, all banks' customers should have their BVNs. Any bank customer without his/her BVN would be deemed not to have met a key component of the KYC requirements.

In addition, the Bank, the Nigeria Inter-bank Settlement System (NIBSS) and other stakeholders collaborated with the National Association of Microfinance Banks (NAMBs) to extend the BVN registration to customers of OFIs, especially the MFBs, with a view to strengthening risk management and KYC processes in the sub-sector.

The collaborative efforts in the implementation of the Scheme have resulted in the enrollment of 2,583,815 customers being enrolled in the BVN central database. The full implementation of the Scheme is expected to increase the effectiveness of the KYC standard as well as the safety and reliability of the payments system.

4.1.2 Review of the Instant and "Next Day Value" Payment Operations

The Bank stipulated minimum required controls for different categories of online funds transfer to strengthen the security of instant payments and next-day-value-funds transfer operations. In addition, banks were directed to comply with the following risk control measures:

- For individual customers, apply daily limits of ₦1million (instant value) and ₦10 million (next day value) to NIBSS Instant Payment (NIP) and NIBSS Electronic Funds

Transfer(NEFT) respectively, and to other electronic payments options with similar features, effective September 1, 2014;

- For corporate customers, apply daily limits of ₦10 million (instant value) and ₦100 million (next day value) to NIP and NEFT respectively, and to other electronic payments options with similar features, with effect from September 1, 2014; and
- Obtain a written indemnity from customers who choose to initiate transactions above the limits specified, subject to a maximum of ₦5 million and ₦100 million for individual and corporate customers, respectively. Transfers above ₦100 million shall be effected through the Real Time Gross Settlement System (RTGS).

4.1.3 The Payment Card Industry Data and Security Standard

All the switches, processors and banks complied with CBN's directive to be Payment Card Industry Data and Security Standard (PCIDSS)-certified latest by November 30, 2014. Operators are required to sustain compliance with the PCIDSS to prevent security breaches, thus increasing public confidence in the system.

4.1.4 The Cashless Policy and e-Payment Incentive Scheme

The implementation of the cashless policy was extended to the remaining 30 states of the Federation in the second half of 2014. However, charging processing fees on withdrawals above the set threshold was deferred till July 1, 2015. To boost the adoption of the cashless initiative, the Bank, in collaboration with the Bankers Committee, introduced incentives to reward usage of electronic payment medium. Notable among the incentives were the following:

- The reduction of a merchant service charge rate from 1.25 per cent or a maximum of ₦2,000, to 0.75 per cent or a maximum of ₦1,200 per transaction;
- Free commission on turnover for all electronic inflows into merchants' account;
- Rewards to merchants through the mystery shopper and recognition campaign;
- A cash refund to customers, based on payment card usage;
- A points-based reward system;
- The offer of promotional gift items to customers, based on their usage of e-payment channels; and
- A tipping point scheme through which sales persons would earn points redeemable through gift items or cash.

4.1.5 Re-introduction of Remote-on-us ATM Fee

As part of the strategy to improve the efficiency of ATM operations in the country, the Bank approved the re-introduction of remote-on-us cash withdrawal transaction fee of ₦65 per transaction, effective September 1, 2014. The fee was to cover the remuneration of the switches, ATM monitoring and fit-notes processing costs by acquiring banks. The fee was applicable as from the 4thremote-on-us withdrawal in a month by a cardholder, thereby making the first three (3) free for the cardholder.

4.1.6 Accreditation of Cheque Printers for 2014

In line with the provisions of the Nigeria Cheque Printers' Accreditation Scheme (NICPAS), the CBN, in collaboration with MICR Technical Implementation Committee, conducted the accreditation of cheque printers in Nigeria for 2014. At the end of the exercise, four (4) cheque printers were accredited to print cheques and other debit paper instruments for the Nigerian financial market.

4.2 The Payments System Vision 2020

In furtherance of the implementation of the Payments System Vision (PSV) 2020, the CBN, during the review period, revised and exposed the draft guidelines and framework on mobile payment services in Nigeria to industry stakeholders for their comments. The objective of the revised Guidelines was to prescribe detailed regulatory and supervisory requirements in line with the current realities in the industry. Furthermore, the CBN approved the adoption of SWIFT sanction screening services by all banks, in line with international best practice.

4.3 Large Value Payments

Significant growth in activity was observed in the inter-bank market as reflected by the quantum leap recorded in the value of inter-bank transfers. The value of inter-bank transfers, through the new Real-Time Gross Settlement (RTGS) system, increased from ₦78,011.68 billion at end-June 2014 to ₦137,498.46 billion at end-December 2014. On the other hand, the volume of inter-bank funds transfer decreased from 323,414 to 251,004 during the same period. This reflected an increase of 76.25 per cent and a decrease of 22.39 per cent in value and volume, respectively. The increase in value was due, largely, to the migration of standing deposit facility operations to the new RTGS system.

4.4 Retail Payments

4.4.1 Cheques Clearing

Activities on the cheque truncation system revealed an increase in the volume of cheques cleared from 7,144,340 at end-June 2014 to 8,221,225 at end-December 2014. On the other hand, the value of cheques cleared decreased to ₦3,558.41 billion in the second half of 2014,from ₦3,710.67 billion in the first half of 2014, a decrease of 4.10 per cent. The decrease in value was attributable to customer preference for electronic channels for high value transactions.

4.4.2 Instant Payments

Instant payments remained attractive to users during the review period. The volume of transactions on NIBSS Instant Payment (NIP) increased to 23,990,206 valued ₦10,783.74 billion in the second half of 2014, from 16,839,648 valued ₦9,137.76 billion in the first half of 2014, indicating an increase of 42.46 and 18.01 per cent, respectively. The increases were due to the a wider adoption of the instant settlement option.

4.4.3 NIBSS Electronic Fund Transfer

The volume of NIBSS Electronic Fund Transfer (NEFT) transactions increased from 14,260,732 at end-June 2014 to 15,556,085 at end-December 2014, while the value decreased by 1.32 per cent to close at ₦7,259.68 billion, at end-December 2014. The decline was due to preference for the NIP platform, being an instant payment channel.

4.4.4 Electronic Card Payments

The volume of electronic card (e-card) transactions rose to 255,820,046 valued at ₦2,446.00 billion in the second half of 2014, from 199,284,309 valued at ₦1,944.56 billion in the first half of 2014, representing an increase of 28.37 and 25.79 per cent, respectively (Table 4.1). This development indicated increased patronage of e-cards by the public.

Table 4. 1: Electronic Card Transactions

Payment Channels	Number of Terminals		Volume of Transactions		% Change (Volume)	Value of Transactions		% Change (Value)
	June 2014	Dec 2014	June 2014	Dec 2014		June 2014 (₦ Billion)	Dec 2014 (₦ Billion)	
ATMs	14,764	15,935	175,506,932	224,595,575	27.97	1,636.41	2,043.47	24.88
PoS	121,886	134,561	8,971,501	11,845,922	32.04	137.72	174.35	26.60
Mobile	-	-	12,575,523	16,041,466	27.56	139.69	184.71	32.23
Internet (Web)	-	-	2,230,353	3,337,083	49.62	30.74	43.47	41.41
Total			**199,284,309**	**255,820,046**	28.37	**1,944.56**	**2,446.00**	25.79

Table 4. 2: Proportion of e-Payment Channels Usage in the Second Half of 2014

Payment Channels	Volume	Volume (%)	Value (₦ Billion)	Value (%)
ATMs	224,595,575	88.07	2,043.47	83.54
PoS	11,845,922	4.50	174.35	7.13
Mobile	16,041,466	6.31	184.71	7.55
Internet (Web)	3,337,083	1.12	43.47	1.78
Total	**255,820,046**	100.00	**2,446.00**	100.00

5.0 OUTLOOK

The global economic activity for 2015 is projected to grow at 3.5 per cent, reflecting a downward revision of 0.3 per cent from the October 2014 WEO forecast. The revised forecast is due to the observed downside risks with the growth prospects in China, Russia, the euro area and Japan, as well as the implications of a weaker activity in major oil exporting countries owing to the sustained decline in oil prices. The United States is the only advanced economy whose growth forecast was raised.

The downside risks include concerns about stagnation and low inflation in the euro area and Japan, as well as shifts and volatility in the financial markets of emerging economies where lower oil prices might lead to external sector and balance sheet vulnerabilities in oil exporting countries. The main upside risk is that of a greater economic boost from lower oil prices.

Output in advanced economies is projected to grow at 2.4 per cent in 2015 up from 1.8 per cent in 2014. In this group, the US, the euro area, Japan and the UK are projected to accelerate while Canada is projected to decelerate in 2015.

China's output growth is projected at 6.8 per cent for 2015, while the emerging and developing economies' growth is forecast at 4.3 per cent. Growth in the MENA countries is estimated at 3.3 per cent, while growth in SSA is projected at 4.9 per cent and that of Nigeria at 4.8 per cent for 2015.

With the exception of Japan, inflationary pressure is expected to persist in 2015 in most advanced economies, as well as in emerging market and developing economies, MENA region and SSA in 2015.

The Nigerian economy is projected to continue to grow, although at a slower rate of 4.8[11] per cent in 2015. Growth is expected to be driven largely by developments in the non-oil sector. Developments in global oil prices are projected to impact negatively on Nigeria's growth.

In terms of price developments, the devaluation of the naira, together with increased electioneering spending would exert inflationary pressures in the first half of 2015. Thus, inflation is projected to rise to 8.78 per cent in 2015. Prices are, however, likely to stabilize in the second half of the year, as the CBN continues to deploy measures to contain inflationary pressure.

Money market rates are expected to remain stable in the first half of 2015. Expectations of increased liquidity surfeit in the system would likely be offset by a tight monetary policy in order to maintain price stability.

[11] The National Bureau of Statistics projects a higher growth rate of 5.54% in its *Economic Review and 2015 – 2017 Outlook.*

Anticipated sources of risk in the financial system in the first half of 2015 would include declining crude oil prices, due to US shale oil and gas production and the resultant pressure on the naira exchange rate. Others include a reversal of capital flows, owing to improvements in the US economy and the adverse implications for the capital market; a possible increase in non-performing loans; security challenges in parts of the country; equity market losses that might linger as a result of low investor confidence; uncertainties associated with the 2015 general elections; and an upward inflationary pressures from election spending and an expected increase in electricity tariffs in the first half of 2015.

In light of the above, the CBN, in collaboration with relevant stakeholders, will continue to take appropriate measures designed to ensure sustained financial system stability.

Box 1: Proposed Secured Transaction and National Collateral Registry for MSMES in Nigeria

Background

Lack of suitably acceptable collateral has been among the top reasons for difficulty in accessing finance by SMEs in Nigeria. A common trend among firms indicates that credit applications are mostly rejected on grounds of collateral, i.e, unacceptable or unsuitable collateral. It is in recognition of this challenge that the CBN started the Secured Transaction and National Collateral Registry (NCR) project in 2013. The Collateral Registry is a central database that records registration charges and collaterals created by borrowers on both movable and immovable properties to secure credit facilities provided by lenders.

Rationale for Secured Transaction and National Collateral Registry Reform in Nigeria

According to National Bureau of Statistics (NBS), the SME sector in Nigeria accounts for close to 50% of GDP. A joint CGAP and the World Bank diagnostic study conducted in January 2009 to assess the **Current State of Access to Finance in Nigeria** established that only 5% of SMEs had access to a loan (despite the fact that 80% of SMEs seek financing). The World Bank's Investment Climate Assessment (ICA) estimated that only about 10% of Nigerian SMEs applied for loans or lines of credit, and about 70% of those who applied were denied financing. An overwhelming 80% of SMEs that do not apply for financing at all would like to have loans/lines of credit. Hence, SMEs would seem to demand credit, but do not apply owing to:

(i) Cumbersome application procedures and high interest rates;

(ii) Inaccessible collateral requirements (in Nigeria a loan requires on average 140% of the value in collateral);

(iii) Loan terms (maturities) that are much shorter than what SMEs require;

(iv) Lack of an adequate framework for the operation of an efficient registry for secured interest on movables assets; and

(v) The absence of an all-inclusive Stakeholders Framework (which would include as donors, DFID, IFC and WBG and other participants such as Corporate Affairs Commission (CAC), Ministry of Finance, MFI, NBFIs and Federal Ministry of Justice, amongst others).

In view of the above, the CBN, set out through the Secured Transaction and National Collateral Registry project, to address the challenge of insufficient access to suitable collateral by SMEs in Nigeria, thereby deepening financial resource flow to the sector.

Steps taken so far by the Bank

(a) Setting up of an Inter-agency Stakeholder Working Committee

The development of a robust collateral registry requires inter-agency collaboration and sustained engagement with key stakeholders. Primary stakeholders in both the public and private sectors were identified and their buy-in solicited. The Stakeholder Working Group (SWG) was inaugurated on September 5, 2013.

The following institutions are represented on the SWG:

Public Sector	Central Bank of Nigeria (CBN)
	International Finance Corporation (IFC)
	Corporate Affairs Commission (CAC)
	Nigeria Investment Promotion Commission (NIPC)
	Small and Medium Enterprises Development Agency (SMEDAN)
	Federal Ministry of Trade and Investments
	Federal Ministry of Justice
	Federal Ministry of Finance
	Securities and Exchange Commission
	Abuja Commodities and Securities Exchange
	Bank of Industry
Private Sector	National Association of Small and Medium Enterprises (NASME)
	National Association of Small Scale Industrialists (NASSI)
	Equipment Leasing Association of Nigeria (ELAN)
	Stanbic IBTC
	Diamond Bank
	Fidelity Bank
	Access Bank

b) The NCR Project Implementation: Where We Are

Project Consultant: International Finance Corporation

Inter-Agency Committee: 16 stakeholder ministries, agencies, institutions and companies

The efforts made or planned by the Bank, between June 2014 and February 2015 towards the completion and commissioning of the Registry in June, 2015 include as follows:

i. Preparation and gazetting of the Regulations for the operations of the Registry - October, 2014;

ii. Draft National Collateral Bill - December, 2014;

iii. Engagement of a software development Vendor – January 2015;

iv. Acquisition of hardware/provision of office space- on-going;

v. Soft launch of the Registry - 31st March, 2015; and

vi. Full commissioning of the Registry - 17th June, 2015.

Box 2: International Money Transfer Services (Out Bound)

In exercise of its powers as conferred by the *Banks and Other Financial Institutions Act (BOFIA), Cap. B3 Laws of the Federation of Nigeria 2004* and the *Central Bank of Nigeria Act, 2007,* the CBN issued on October 3, 2014revised guidelines for the regulation of international money transfer services in Nigeria. The review was carried out to accommodate the recently introduced out-bound money transfer services as an alternative channel of international remittances to serve the needs of small foreign exchange end-users.

The new arrangement provides Nigerians the opportunity of transferring funds for disbursement in foreign currency to beneficiaries and recipients abroad. By the terms of the guidelines, a prospective customer, who wishes to use the service, would pay the naira equivalent to the money transfer operators (MTOs) for the foreign currency payable to the specified beneficiary abroad. The service reduces reliance by small foreign exchange users on bureaux-de-change or banks to source foreign currency before transferring money abroad.

To simplify the process of out-bound remittances and encourage financial inclusion, bank accounts are not required for funds transfer. Also, the service is only applicable to “person-to-person” transfers hence corporate entities are not allowed to use this product.

Other objectives of the revised guidelines include the following:

- Provision of minimum standards and requirements for the operations of international money transfer services in Nigeria;
- Specification of delivery channels for offering international money transfer services (in-bound and out-bound) in a cost-effective manner;
- Provision of an enabling environment for international money transfer services in the Nigerian economy;
- Specification of minimum technical and business requirements for various participants in the international money transfer services industry in Nigeria; and
- Provision of broad guidelines for the implementation of processes and flows of international money transfer services, from initiation to completion.

The allowable limit for the out-bound money transfer per transaction, which was initially pegged at US$2,000 or its equivalent, was revised upward to US$5,000 or its equivalent to promote more transparency and disclosure.

In addition, out-bound transfer services would only be provided by international money transfer service operators, while banks and BDCs that meet the new CBN requirements would serve as agents for money transfer services. MTOs are, however, prohibited from acting as authorized dealers in gold or other precious metals; engaging in deposit taking and/or lending money; maintaining current accounts on behalf of customers; establishing letters of credit; and acting as custodians of funds on behalf of customers.

Other notable highlights in the revised guidelines include the following:

- The allowable cash withdrawal for in-bound transfers shall not be more than US$500, and any amount in excess of $500 shall be disbursed to beneficiaries through bank accounts or mobile money wallets;
- Where the beneficiary does not have a bank account or mobile money wallet, payments shall only be made upon the provision of a satisfactory reference from a current account holder in a bank, confirming that the beneficiary is the *bona fide* owner of the funds;
- The currency to be given to a transfer agent for out-bound money transfers, shall be in naira;
- All outward payment transactions shall be executed in a convertible currency agreed by the parties;
- Where a currency conversion service is offered before initiation of a payment transaction or at the point of payment, the money transfer services operator must disclose all charges, as well as the exchange rate to be used for converting the payment transaction; and
- A money transfer service operator shall not allow or process a transaction that appears to have been deliberately split into small amounts to avoid the reporting requirements under the provisions of the *AML/CFT Act*.

In order to allow for enhanced access by prospective customers, and in line with the objectives of the cashless policy, the CBN plans to engage mobile telephone operators so that customers on the mobile payment platform can transfer money from their accounts via the international money transfer service providers to anybody abroad.

The out-bound money transfer service is expected to simplify the money transfer process in Nigeria, increase convenience and access to money transfer outlets, and reduce reliance on bureaux de change or banks in order to buy foreign currency before transferring money abroad.

Box 3: Framework for the Regulation and Supervision of Domestic Systemically Important Banks

The global financial meltdown, which started in 2007, led to the need for strengthening of regulation of Systemically Important Financial Institutions (SIFIs). The Financial Stability Board described G-SIFIs as "financial institutions whose distress or disorderly failure, because of their size, complexity and systemic interconnectedness, would cause significant disruption to the wider financial system and economic activity"[12]. A SIFI can be a bank, an insurance company, or any other financial institution whose failure might trigger a financial crisis. The BCBS has identified factors for assessing a financial institution as systemically important based on size, interconnectedness, substitutability, cross-jurisdictional activity and complexity.

The failure of such large and complex financial institutions generates severe undesirable externalities that include disruption of the financial system and the real economy. One of the fall-outs of the meltdown is the call for measures to deal with this class of institutions. Consequently, the G20 leaders, at their meeting of November 2011, requested the Basel Committee on Banking Supervision (BCBS) and the Financial Stability Board (FSB) to develop a framework for Domestic Systemically Important Banks (D-SIBs)[13] in addition to the Global Systemically Important Financial Institutions (G-SIFIs).

Thus, regulators in each country have the responsibility for adopting whatever portions of the recommendations they deem appropriate and to set the parameters for defining what a Systemically Important Financial Institution is.

When Systemically Important Banks (SIBs) were in danger of failure in the past, the only one model of rescue adopted was the one which allowed governments to inject capital, provide bailouts and guarantees to keep the financial system stable, while shareholders lost out, as a result of dilution in shareholding. This warranted the need for enhanced supervisory measures for D-SIBs, which the current regulatory policies do not adequately address.

As a result of the financial crises, SIBs have become the target for legislation and regulatory reforms, which have led to an increase in bank capital requirements and the introduction of higher capital surcharges. In response to the challenges posed by such banks, the Central Bank of Nigeria (CBN) and the Nigeria Deposit Insurance Corporation (NDIC), developed a supervisory framework for D-SIBs in Nigeria. This initiative is in tandem with the BCBS and other global initiatives each jurisdiction or country designs a policy framework for the identification and regulation of their D-SIBs so as to limit the economic impact of bank distress and promote financial system stability.

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[13]Neither the Basel Committee nor the Financial Stability Board establishes laws, regulations or rules for any financial institution directly; they are only policy research and development entities. Therefore, they act only in an advisory capacity.

In Nigeria, owing to the dominance of banks in the financial system, this framework shall focus on the enhanced supervision of SIBs.

This framework has adopted similar indicators used in determining G-SIFIs by the BCBS in the identification and supervision of SIBs in Nigeria.

OBJECTIVE

The objective of this framework is to ensure that all SIBs are subjected to an appropriate degree of oversight and regulation. This entails defining the regulatory parameters and calibrating the intensity of oversight by the regulators. The overall goal of this framework is to:

- ✓ Comply with the BCBS Requirements on Supervision of D-SIBs;
- ✓ Ensure a transparent assessment of the basis for their regulation;
- ✓ Create incentives for stronger risk management practices that would reduce the systemic risk which SIBs pose to the system; and
- ✓ Limit the impact of negative externalities on the financial system.

ASSESSMENT METHODOLOGY

The BCBS suggested several methodologies for identifying SIBs, including the indicator-based measurement approach, the bucketing approach, supervisory judgment, periodic review and refinement. However, in this framework, the indicator-based measurement approach, as well as supervisory judgment, were used to determine SIBs in Nigeria.

The Indicator-based measurement approach

The indicator-based measurement approach considers the following factors in the classification of SIBs:

- ✓ Size,
- ✓ Interconnectedness,
- ✓ Substitutability, and
- ✓ Complexity.

<u>Size</u>

The size of a bank is of critical importance to the stability of the financial system and the economy. Since there is no uniform global standard for the assessment of the size of a bank, this framework adopted ‘total assets’ as the principal determinant in the assessment of size.
In Nigeria, when this approach was adopted, the data showed that the eight (8) largest banks accounted for more than 70% of the total industry assets.

<u>Interconnectedness</u>

The more interconnected a bank is to other financial institutions, the greater the potential for the failure of that bank to transmit distress through the financial system and the broader economy. The systemic impact of a bank greatly depends on its degree of interconnectedness with other financial institutions and can be measured by the volume of its intra-financial system assets and liabilities[14] short-term financing by interbank and money market operations. In this framework, the determinant of interconnectedness is net-interbank transactions.

Substitutability

The systemic impact of a bank's distress is greater when it cannot easily be replaced in the short-term period, either as a market participant or financial service provider. Typical determinants of substitutability are: the value of assets under custody, payments cleared and settled through payment systems, values of underwritten transactions in debt and equity markets, and the quantum of lending and deposits of a particular bank. This framework identified total net credits and total deposits of a bank as the determinants of its substitutability.

Complexity

The systemic impact of a bank would be higher if its business model, structure and operations make it difficult or very costly to liquidate by the regulatory authorities. Complexity can be viewed from the bank's network of both domestic and foreign subsidiaries, as well as its affiliation with institutions in other sectors of the financial system, which can complicate the process of liquidating the bank. In tandem with Nigeria's current banking model, the major determinants considered were a bank's branch network and its number of foreign subsidiaries.

Weights

In adopting the indicator-based measurement approach, the weight of 30% each was assigned to size and substitutability, while complexity and interconnectedness were weighted 25% and 15%, respectively. The two determinants within the complexity measure were assigned 12.5% each, whereas determinants under substitutability were each assigned 15% weight.

Supervisory Judgment

The Central Bank of Nigeria applied supervisory judgment in arriving at the results that were derived from the indicator-based measurement approach of the assessment methodology. While the BCBS Indicator-based Measurement Approach assigned equal weights to all factors, this framework has taken cognizance of the domestic environment in assigning different weights to the factors.

IDENTIFIED SIBs

For a bank to be continually classified as being an SIB, the assessment criteria must be met for six (6) consecutive months. Any bank classified as being an SIB would remain as such for a period of 6 months, after which a re-assessment would be carried out by the CBN.

[14] Intra-financial system assets/liabilities is calculated as the sum of lending/deposits to/by financial institutions, holdings of securities issued by the bank or other financial institutions, net mark to market reverse repurchase agreements with other financial institutions, net mark to market securities lending/borrowings to/from financial institutions and net mark to market OTC derivatives with financial institutions.

For a bank to be considered as an SIB, its "cumulative score"[15] should be at least 5%, using the indicator-based measurement approach, subject to review by the Central Bank of Nigeria from time to time. A bank that had total assets of at least 5%, as well as minimum total credits and deposit liabilities of 6% respectively of the industry in the previous six (6) months can be considered as being an SIB.

HIGHER LOSS ABSORBENCY

The capital adequacy ratio (CAR) for banks in Nigeria currently stands at 10% and 15% for national/regional banks and for banks with an international banking licence, respectively. In the computation of CAR recommended by the BCBS, Tier 2 capital should not constitute more than 50% of the qualifying capital, that is, 100% of Tier 1. However, banks designated as being SIBs would be required to maintain a minimum CAR of 15% out of which Tier 2 capital should not constitute more than 25% of the qualifying capital. In other words, Tier 1 capital should be at least 75% of the bank's qualifying capital. In addition, SIBs in Nigeria will be required to set aside a Higher Loss Absorbency[16] (HLA) target or an additional capital surcharge of 1% to their respective minimum required CAR. This should be met with Common Equity Tier 1 (CET1) capital[17]. The aim of the additional loss absorbency requirement is to ensure that an SIB would have a higher share of its balance sheet funded by instruments that reinforce the resilience of the institution as a going concern.

In a situation where the foreign subsidiary of a Nigerian bank is considered systemically important by the host authority, the Central Bank of Nigeria and the host authorities would make arrangements to coordinate and cooperate on the appropriate HLA requirement, within the constraints imposed by the relevant laws in the host jurisdiction.

ADDITIONAL REQUIREMENTS

In addition to the HLA requirement for systemically important banks in Nigeria, the following requirements and policy measures are considered appropriate to address the risks posed by SIBs.

Liquidity Standards

The current liquidity ratio requirement for banks shall be imposed on the SIBs; however, this

[15]Cumulative score represents the aggregate score of the four (4) factors used in identifying an SIB under the indicator- based measurement approach.

[16]The Higher Loss Absorbency (HLA) policy measure is to deal with the cross-border negative externalities created by systemically important banks, which current regulatory policies do not fully address. It will enhance the going concern loss absorbency of SIBs and reduce the probability of their failure.

[17]Common Equity Tier I capital is the highest quality component of a bank's capital as it is capable of fully absorbing losses whilst the bank remains a going concern.

would be subject to change from time to time.

Stress Testing

Stress testing requirements are designed to work in tandem with the capital plan. The results of such tests would be used to make appropriate changes to the bank's capital structure. The CBN and NDIC shall conduct periodic analysis of the capital of each SIB to evaluate its ability to absorb losses in situations of adverse economic and financial conditions.

The SIBs would be required to carry out stress tests of their capital and liquidity on a quarterly basis and the results of the stress test would be reviewed by the Central Bank of Nigeria.

Recovery and Resolution Planning

The SIBs shall be required to develop specific recovery plans which shall be submitted to the Central Bank of Nigeria and the Nigeria Deposit Insurance Corporation by 1st January of every year.

Enhanced Supervision

There shall be greater frequency and intensity of on-site and off-site supervision of SIBs. Monthly monitoring of the key performance indicators of the SIBs shall be carried out by the CBN in order to ensure their safety and soundness, as well as the going concern status of the banks. The SIBs shall be expected to provide high quality data to the regulatory authorities for the purpose of enhanced supervision. In the event that an SIB has a High Composite Risk rating, half-yearly meetings shall be held with the board and management to address issues of supervisory concern.

Disclosure Requirements

The SIBs are to make quarterly disclosures of their financial condition and risk management activities to the regulators as prescribed by the Central Bank of Nigeria. These include, but are not limited to, the following areas:

- ✓ Risk governance and risk strategies/business model,
- ✓ Capital adequacy and risk weighted assets,
- ✓ ICAAP Policy and Computation,
- ✓ Liquidity/Funding,
- ✓ Market risk,
- ✓ Credit risk,
- ✓ Operational risk, and
- ✓ Other identified risks.

SIBs are expected to adopt international bank risk disclosure best practices.

SANCTIONS

Appropriate sanctions shall be imposed for non-compliance with the requirements of this Framework.

ACKNOWLEDGEMENT

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