

FINANCE UPDATE

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ADVOCAT
LAW PRACTICE

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1. FMD/DIR/GEN/CIR/07/006: GUIDELINES FOR GRANTING LIQUID ASSET STATUS TO SUKUK INSTRUMENTS ISSUED BY STATE GOVERNMENTS

The Central Bank of Nigeria's ("CBN"), as part of its efforts in deepening the financial sector and enhancing the quality of Sukuk instruments issued by state governments, has approved the Guidelines for granting liquid asset status to Sukuk instruments issued by State Governments ("the Guidelines").

"Sukuk" for the purposes of the Guidelines is defined as the certificates of equal value representing undivided shares in the ownership of tangible assets, usufructs and services or (in the ownership of) the assets of particular projects or special investment activity.

The Guidelines provide for the eligibility criteria for the grant of liquidity status to Sukuk issued by the state governments, benefits of liquid asset status, investment limits, ceiling on lending to sub-national governments, risk-weights for Sukuk that do not qualify as liquid assets and application procedures and other matters. The Guidelines applies both to previously issued state government Sukuk and subsequent issuance of same.

Sukuk is an alternative means of financing public expenditure; and it is believed that the implementation of the Guidelines would enhance the diversification of sources of funding for the development of Governments at sub-national level.

Some of the salient provisions of the Guidelines are as follows:

a. Eligibility Criteria

For a state government to be eligible to issue Sukuk instruments, the following must be put in place:

- An enabling legislation to be enacted by the State House of Assembly specifying the establishment of a Sinking Fund to be fully funded from the consolidated revenue fund account of the state;

Sinking Fund refers to a fund into which an issuer sets aside money over time, in order to retire its debts instruments.

- A fiscal responsibility law with provisions for debt management to boost investor's confidence;
- A State debt management department to guarantee transparency and professional management of debt issues;
- The credit rating must be of investment grade as determined by the rating agency accredited by the Securities and Exchange Commission ("SEC");
- A confirmation from SEC that proceeds have been disbursed in line with the provisions of the prospectus which has been duly submitted to the Director, Financial Policy and Regulation Department ("FPRD") of the CBN;
- The repayment shall be from the Sinking Fund account supported by a legislative Irrevocable Standing Order ("ISPO") and/or other legislated sources of repayments disclosed in the offer documents;
- Irrevocable letter of authority issued by the Accountant General of the State government to deduct at source from the statutory allowance due to the state and approved by the Federal Minister of Finance in the event of default by or failure of the State to meet its payment obligations;
- The tenor of the Sukuk shall be for a maximum maturity of 10 (ten) years;
- Evidence of approval from SEC and Ministry of Finance for the issuance of Sukuk;

b. Benefits of Liquid Asset Status

- i. State government Sukuk which has attained the liquid asset status shall be assigned a weight of 20 per cent or as may be prescribed by the CBN from time to time.
- ii. Sukuk with liquid asset status will also qualify as a liquid asset for the purpose of computing bank's liquidity ratio.

iii. State government Sukuk which meet the criteria for liquid asset status will be eligible for repurchase transactions at CBN.

c. Investment Limits

- The Guidelines peg the maximum investment a bank can make in any Sukuk issued by the state government or its agencies at 10% of the total amount outstanding of the Sukuk;
- The aggregate portfolio of a bank in a Sukuk issued by State government and their agencies shall not exceed 30% of the bank's total portfolio in Debt Securities.

“Debt Securities” for this purpose include Nigerian Treasury Bills, Federal Government of Nigeria Bonds, State Government and its agencies’ Bonds, corporate bonds and dated preference shares. It should however be noted that this investment limit is per issue and not per issuer.

- Underwritten positions of the State government Sukuk will not be regarded as investment; and thus will not be considered in determining the investment limits.
- The Guidelines also require the rendering of monthly returns on the underwritten positions and the sell-off strategy to the Director, Banking Supervision Department of the CBN.

d. Ceiling on Lending to Sub-National Governments

The Guidelines exclude eligible State governments from the 10% ceiling on lending to all tiers of government as specified in the CBN circular of June 26, 2009 referenced BSD/DIR/GEN/CIR/03/011.

e. Risk-weights for Sukuk that do not qualify as Liquid Assets

For the purpose of computing the capital adequacy ratio of banks, State government Sukuks that do not qualify as liquid assets would be assigned a risk weight of 50% or as may be prescribed by the CBN from time to time.

f. Miscellaneous

The Guidelines also require that state government Sukuks comply with the relevant provisions of the Investment and

Securities Act 2007 together with its amendments and the SEC rules that may be prescribed from time to time.

It is important to note that the CBN regularly publishes on its website, State government Sukuks that qualify for liquid asset status.

In conclusion, the Guidelines will be subject to review from time to time.

2. BPS/DIR/GEN/CIR/03/008: AMENDMENTS TO THE GUIDELINES ON TRANSACTION SWITCHING IN NIGERIA

The CBN, as part of its effort towards strengthening the electronic payment system in Nigeria, released the Guidelines on transaction switching in Nigeria (“the Guidelines”) in April 2016.¹ The Guidelines set out the procedures for the operation of switching services in Nigeria and the rights and responsibilities of the parties to a switching contract.

However, the CBN, in furtherance of its objective in guaranteeing electronic payment efficiency and financial inclusion, issued this circular to amend the provision of Section 2.6.3 of the Guidelines.

Pursuant to Section 2.6.3 of the Guidelines, *“the Nigeria Central Switch (“NCS”) shall not own or promote any card business or retails products and shall be run in accordance with international best practice”*. This provision is now amended to read as *“the NCS shall be run in accordance with international best practice”*.

Prior to this amendment, the NCS has been under-utilized by banks and other payment switch operators for the routing of their e-payment transactions contrary to the CBN directive. With this amendment, the restrictions placed on NCS have been removed to guarantee a more competitive environment and promote shared services and innovation in the electronic payments system in Nigeria.

Consequently, the Nigerian Inter-Bank Settlement System Plc is to immediately communicate the Application Programming Interface (“API”) and other specifications of all its products to all banks and other licensed operators

¹ This was examined extensively in our CBN Regulatory Update for the month of May, 2016

including switches, mobile money operators and payment service providers.

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