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LETTER TO ALL BANKS AND DISCOUNT HOUSES

REVIEW OF RISK WEIGHTS ON CERTAIN EXPOSURES IN THE COMPUTATION OF CAPITAL ADEQUACY

The recent crisis in the Nigerian banking industry highlighted several weaknesses in the system, key of which was the excessive concentration of credit in the asset portfolios of banks. Past experience revealed concentrations across products, business lines, and legal entities. The management of concentrations, or pools of exposures, whose collective performance may potentially affect a bank negatively, needs to be properly managed through the establishment of sound risk management processes.

Without prejudice to the risk management control functions put in place by banks and discount houses to mitigate credit concentration risks, the Central Bank of Nigeria, in line with its risk based supervisory review process has reviewed the risk weights assigned to some identified exposures as follows:

i. The risk weight assigned to direct lending to Local Governments, States, Ministries, Departments and Agencies of Governments (MDAs) is increased from 100 per cent to 200 per cent.

ii. Investments in Federal Government of Nigeria Bonds shall continue to attract zero per cent risk weight. However, State Government Bonds, that meet the eligibility criteria set out in the Guidelines for Granting Liquidity Status for State Government Bonds would continue to be risk weighted at 20 per cent.

iii. Where the exposure to any industry economic sector (as defined by the International Standard Industrial Classification of Economic Sector as issued by the CBN) is in excess of 20 per cent of the total credit facilities of a bank, the risk weight of the entire portfolio shall be 150 per cent. Total exposure to a particular industry would include off-balance sheet engagements in which the bank takes the credit risk.

iv. All breaches of single obligor limits without the prior approval of the CBN shall be regarded as impairment to capital.

v. For the purposes of credit transactions, banks' related parties within a holding company structure shall include, among others, the financial holding company (FHC), and other subsidiaries within the group. Credit transactions by the bank within the group would be treated as follows:

   a. FHC lending to a bank within its group – the bank should treat the loan as a liability
   b. Credit by a bank to its FHC – this would be regarded as a return of capital and deducted from the capital of the bank in computing its capital adequacy.
   c. Bank lending to subsidiaries within its group – where the credit is fully secured, it would be assigned a risk weight of 100 per cent, otherwise it would be deducted from the capital when computing capital adequacy.

All banks and discount houses are required to ensure compliance with this directive immediately.

Please, be guided accordingly.

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