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To: The General Public

GUIDELINES FOR GRANTING LIQUID ASSET STATUS TO SUKUK INSTRUMENTS ISSUED BY STATE GOVERNMENTS

In view of the need to foster financial system and economic growth and development, as well as complement the efforts of government at various levels, the Central Bank of Nigeria (CBN) has approved “Guidelines for Granting Liquid Asset Status to Sukuk Instruments Issued by State Governments”, to enhance the diversification of sources of funding for development at the sub-national levels.

Consequently, members of the public and relevant stakeholders are requested to note the said Guidelines as contained below for operations in the Nigerian financial markets.

Thank you.

A handwritten signature in blue ink, appearing to be 'A. Sere-Ejembi'.

Dr. (Mrs.) Angela Sere-Ejembi
For: Director, Financial Markets Department

GUIDELINES FOR GRANTING LIQUID ASSET STATUS TO SUKUK INSTRUMENTS ISSUED BY STATE GOVERNMENTS

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Definition of Terms

Irrevocable Standing Payment Order (ISPO) – *A written mandate given by the issuer (state government) of a Sukuk to the Accountant General of the Federation (AGF) authorising the AGF to deduct, at source, predetermined sums of money from the statutory allocation of the issuer*

Issue Date – *The date on which a Sukuk is issued*

Maturity Date – *The date on which a Sukuk becomes due and payable*

Secondary Market – *The market where previously issued instruments are traded*

Sinking Fund – *A fund into which an issuer sets aside money over time, in order to retire its debt instruments*

Sukuk – *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*

GUIDELINES FOR GRANTING LIQUID ASSET STATUS TO SUKUK INSTRUMENTS ISSUED BY STATE GOVERNMENTS

1.0 INTRODUCTION

Financial deepening is gradually gaining ground in the Nigerian financial landscape with the introduction of new financial products, including non-interest financial instruments, to cater for the diverse financial needs of the populace and government at various levels. Hence, the adoption of Sukuk issuance by state governments in Nigeria, as an alternative means of financing public expenditure, will contribute to the deepening of the financial system. In the same light, it is expected that other levels of government as well as interested supra-national financial organisations may get involved in Sukuk structuring at some time in the future.

Thus, to ensure the sustainability of this development, the Central Bank of Nigeria (CBN) has considered the need to enhance the quality of Sukuk instruments, by issuing these guidelines to provide for eligibility for the grant of liquidity status to Sukuk issued by state governments at its discount window as well as for the purpose of liquidity ratio computation. This will further deepen the market and promote investment and secondary market activities.

2.0 ELIGIBILITY CRITERIA

2.1 Enabling Legislation

The Sukuk issuance shall be backed by a law enacted by the relevant State House of Assembly, specifying that a sinking fund to be fully funded from the consolidated revenue fund account of the state be established.

2.2 Fiscal Responsibility Law

The state government shall have in place a fiscal responsibility law, with provisions for public debt management, in order to enhance investor confidence.

2.3 State Debt Management Department

The state government shall establish a debt management department in order to ensure transparency and professional management of debt issues.

2.4 Credit Rating

The Sukuk shall, at inception and throughout its tenor, be of investment grade as determined by a rating agency accredited by the Securities and Exchange Commission (SEC).

2.5 Utilisation of Proceeds

A SEC confirmation that the proceeds have been disbursed in line with the provisions of the prospectus shall be submitted to the Director, Financial Policy and Regulation Department (FPRD) of the CBN at the anniversary of the Sukuk

issuance. Subsequently, SEC confirmation shall be required on amounts that have not been disbursed by the first anniversary.

2.6 Repayment Structure – Sinking Funds

Repayment structure shall be from a funded sinking fund account (supported by a legislated irrevocable standing payment order (ISPO) and/or other legislated sources of repayments disclosed in the offer documents).

The Trustee(s) to the Sukuk shall submit to Director, FPRD, CBN every six months: (a) a statement of accounts of the sinking funds' investments and (b) a statement of declaration on the sufficiency of the sinking funds' investments and investment income in meeting maturing and redemption obligations.

The Trustees shall advise the Director, FPRD, CBN on the action taken in the event that the Trustees are of the opinion that the sinking fund may be insufficient or there may be the likelihood of default, in line with Sections 255 and 256 of the Investment and Securities Act, 2007 or any amendment thereto.

2.7 Irrevocable Letter of Authority

The Accountant General of the State shall issue an Irrevocable Letter of Authority to deduct at source from the statutory allocation due to the state, approved by the Federal Minister of Finance, in the event of default by or failure of the state to meet its payment obligations.

2.8 Tenor of the Sukuk

The state government Sukuk shall be limited to a maximum maturity of ten (10) years, in order to be considered for liquid asset status.

2.9 Approval

The state government shall provide evidence of approval from both the SEC and the Federal Minister of Finance for the issuance of the Sukuk.

3.0 BENEFITS OF LIQUID ASSET STATUS

3.1 Risk-Weights for Capital Adequacy Ratio

For the purpose of computing the capital adequacy ratio of banks, state government Sukuk with liquid asset status shall be assigned a weight of 20 percent or as may be prescribed by the CBN from time to time.

Sukuk with liquid asset status will also qualify as a liquid asset for the purpose of computing banks' liquidity ratio.

3.2 Repurchase Transactions

State government Sukuk, which meets the criteria for liquid asset status shall be eligible for repurchase (repo) transactions at the CBN. The collateral provided by counterparties towards the repo shall have a "haircut" applied as may be prescribed by the CBN from time to time.

4.0 INVESTMENT LIMITS

The maximum investment a bank shall make in any Sukuk issuance of a state government or its agencies is limited to 10% of the total amount outstanding of that Sukuk. This is an investment limit per issue and not per issuer.

The aggregate portfolio of a bank in Sukuk issued by state governments 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, FGN Bonds, FGN-guaranteed notes, sovereign debt notes, and any other Nigerian sovereign debt securities, CBN bills, bonds collateralised with FGN bonds, state government bonds, state government agency bonds, corporate bonds and dated preference shares.

The underwritten positions of the state government Sukuk shall not be regarded as investments and, therefore, will not be considered in determining these limits. However, a monthly return on the underwritten positions and the sell-off strategy shall be rendered to the Director, Banking Supervision Department (BSD) of the CBN.

5.0 CEILING ON LENDING TO SUB-NATIONAL GOVERNMENTS

Eligible state government Sukuk shall not be included in the computation of the 10 percent ceiling on lending to all tiers of government as specified in the CBN Circular, reference BSD/DIR/GEN/CIR/03/011, dated June 26, 2009.

6.0 RISK-WEIGHTS FOR SUKUK THAT DO NOT QUALIFY AS LIQUID ASSETS

6.1 Capital Adequacy Ratio

For the purpose of computing the capital adequacy ratio of banks, state government Sukuk that do not qualify as liquid assets shall be assigned a risk-weight of 50 percent or as may be prescribed by the CBN from time to time.

6.2 General Issues

The state government Sukuk shall comply with all the relevant provisions of the Investment and Securities Act, 2007, including amendments thereto as well as SEC rules, as may be prescribed from time to time.

7.0 APPLICATION PROCEDURE AND OTHER MATTERS

These guidelines shall apply to both previously issued state government Sukuk and new issues.

State governments seeking liquid asset status for their Sukuk shall apply to the Director, FPRD, CBN through their financial advisers.

The CBN shall regularly publish, on its website, state government Sukuk that qualify for liquid asset status.

8.0 REVIEW OF THE GUIDELINES

These guidelines shall be reviewed from time to time.

Dr. Alvan E. Ikoku
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Central Bank of Nigeria, Abuja
October 6, 2016