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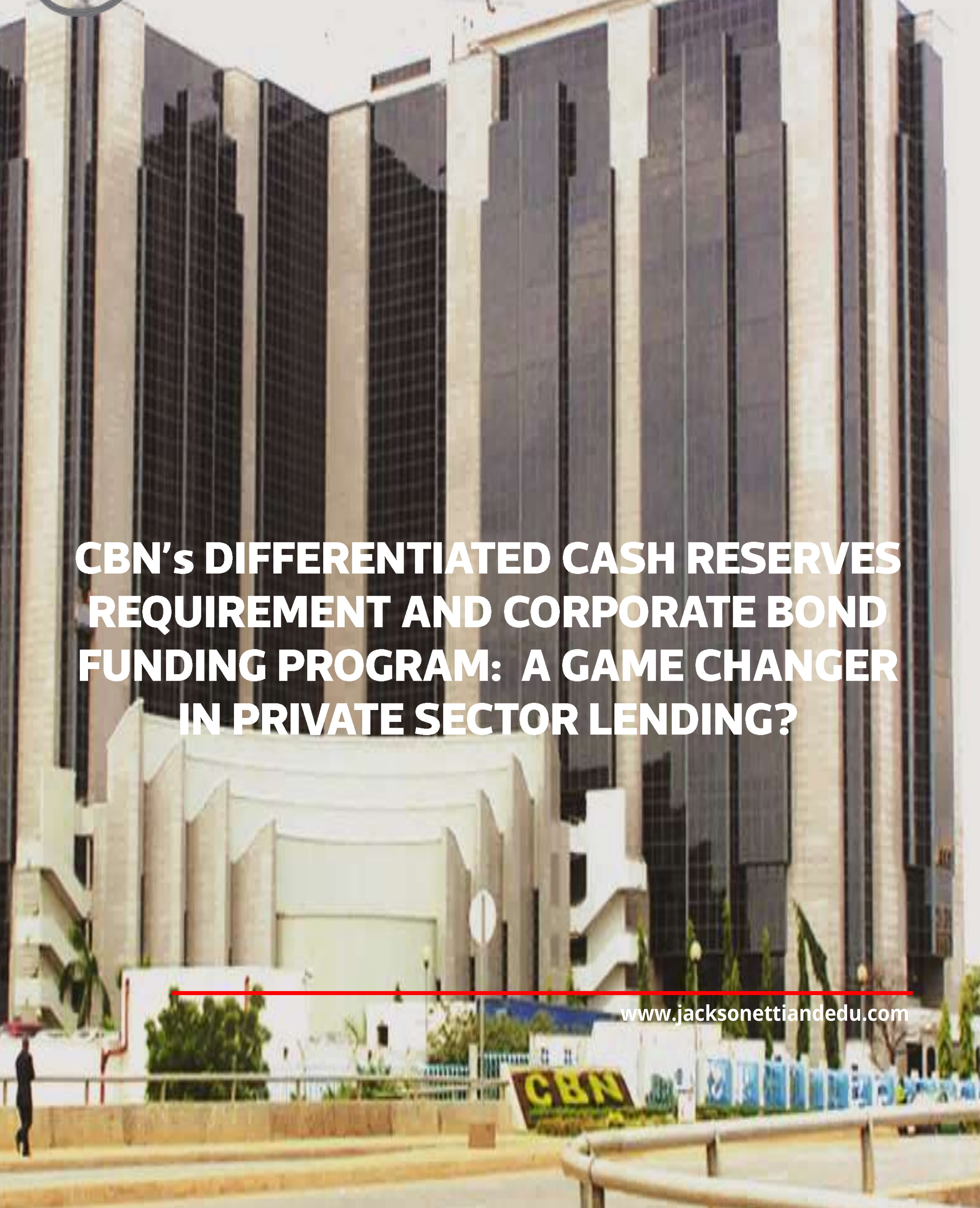

CBN's DIFFERENTIATED CASH RESERVES REQUIREMENT AND CORPORATE BOND FUNDING PROGRAM: A GAME CHANGER IN PRIVATE SECTOR LENDING?

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Recently, the Central Bank of Nigeria (CBN) issued guidelines (Guideline) for accessing its Real Sector Support Facility (RSSF) comprising the Differentiated Cash Reserves Requirement (DCRR) Regime and the Corporate Bond (CB) Funding Program. This innovative initiative forms part of the macro prudential tools being deployed by CBN under its expansionary monetary policy drive to stimulate affordable long-term credit to critical sectors of the Nigerian economy.

Below, we examine the key drivers for this policy initiative, discuss the features of the DCCR and CB programmes, then identify the eligibility criteria for accessing both programmes, and analyse the potential impact of the policy on macro-economic activities.

Key Drivers Necessitating the Policy Initiative

Access to affordable long-term credit has remained an illusion for most corporates despite the concerted efforts of CBN to reduce the costs of borrowing through different initiatives (including deploying intervention funds, reducing CRR from 25% to 22.5%, maintaining the MPR at 14%). Interestingly, despite inflation rates trending downwards, exchange rate stability seemingly achieved through the convergence of black market rates with official NAFEX rates, and price stability attained; deposit money banks (DMBs) have continued to show considerable reluctance to grow their loan book because of current macro-economic risks and need to reduce their NPL portfolio. This perception of risk has obviously led to interest rates remaining considerably high with Nigerian DMBs having the highest lending rates in sub-Saharan Africa.

Therefore, it had become imperative to stimulate the flow of credit at affordable rates to the private sector but in such a way that would have real impact on the economy and complement the Federal Government's fiscal policy hence focus for the DCCR on the Manufacturing and Agricultural sectors with emphasis on those projects that had potential for job creation , would yield foreign exchange earnings and have a high local content.

Features of DCCR Regime and CB Funding Program

Under the DCCR Regime, DMBs can request for the release of funds held with CBN as part of their Cash Reserve Requirement (which as of today is set at 22.5%) to finance both greenfield and brownfield projects in the Manufacturing and Agricultural sectors. The financing would be structured as an amortizing facility of up to N10billion at an all-in fixed interest rate of 9% over a 7year tenor with a 2year moratorium.

The CB funding program in contradistinction to the DCCR regime would see CBN directly take active investment participation in corporate bond issuance programmes of triple A minus rated companies. The active participation of CBN in the corporate issuance programme would only be limited to those companies that meet its eligibility criteria.

Eligibility Criteria for Accessing DCRR Regime and CB Funding

DCRR Regime: In terms of accessing the facilities available under the DCRR regime, only CRR contributing DMBs are eligible to participate under the programme meaning that this is targeted at DMBs to the exclusion of other financial institutions i.e. Microfinance Banks, Development Finance Institutions, Primary Mortgage Institutions etc. The Facilities are specifically meant for greenfield and brownfield projects in the targeted sectors (which may include other sectors approved by CBN) therefore prohibited for use for trading activities or refinancing purposes neither will they be available to corporates that have a non-performing loan facilities with any DMB.

CB Funding Programme: Though the CB funding programme is not sector specific, CBN's participation in the bond issuance programme would be limited to triple A minus corporates that are subject to intensified transparency requirements provided that the bond issuance has a tenor of at least 7years and is targeted at projects that are employment and growth stimulating.

Impact Analysis

Undoubtedly, significant thought went into the choice of this initiative as the usual approach would have been to reduce the CRR by some basis points and hope that this incentivises DMBs to lend to private sector efforts in the real sector. The genius of the DCRR is that it quantitatively eases liquidity into targeted sectors that have real potential to impact the economy without leading to inflationary pressures. However, that does not make it a silver bullet as issues of transparency, monitoring, proper

credit assessment and due diligence will be paramount in measuring the ability of this option to achieve its lofty objectives. Also, while it is laudable that CBN has given itself opportunity to fund other sectors provided they are 'employment or growth stimulating', it could lead to arbitrariness considering there is no clarity as to what constitutes 'employment or growth stimulating'.

About the CB Funding program, while we understand the sensitivity in not crowding out market investors, it seems its investment scope is too narrow especially as it's limited to corporates that are triple A minus. The question then is how many corporates fall within this category and surely a smaller percentage of them are undertaking projects that are employment or growth stimulating. It would have been better to focus on investment grade companies within a defined ratings band to capture more corporates and consequently make more impact.

Conclusion

CBN deserves accolades for conceiving this innovative scheme but the real work will lie in the implementation framework and transparency mechanism to ensure that the funds are used for the targeted objective.

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