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CENTRAL BANK OF NIGERIA'S REGULATORY MEASURES TO IMPROVE LENDING TO THE REAL SECTOR: IMPACT AND CHALLENGES

ARTICLE SERIES

INTRODUCTION

Nigerian banks have become increasingly reluctant to lend to businesses that operate in the real sector thereby affecting the ability of these businesses to grow. In response, the Central Bank of Nigeria (CBN) released the Circular on 'Regulatory Measures to Improve Lending to the Real Sector of the Nigerian Economy' (the CBN Circular)[1] on 3 July 2019. The CBN Circular is part of CBN's attempt to intervene, on behalf of the affected businesses, and improve lending which is expected to boost the economy. The CBN Circular provides that:

1. All Deposit Money Banks (DMBs) are required to maintain a minimum Loan to Deposit Ratio (LDR) of 60% by September 30, 2019. This ratio shall be subject to quarterly review.

2. To encourage SMEs[2], Retail, Mortgage and Consumer lending, these sectors shall be assigned a weight of 150% in computing the LDR for this purpose.

3. Failure to meet the above minimum LDR by the specified date shall result in a levy of additional Cash Reserve Requirement (CRR) equal to 50% of the lending shortfall of the target LDR.

A bank's LDR is calculated by comparing its total loans to its total deposits for the same period. A high loan to deposit ratio means that the bank is issuing out more of its deposits in loans. In order to ensure that banks comply, the CBN has stated that where banks default in attaining the required LDR), 50% of the lending shortfall of the target LDR should be paid as additional CRR. The rationale behind the CBN Circular is, arguably, to 'force' banks to lend in an economy still recovering from a contraction (in 2016) that caused bad loans to surge.

Subsequently, on 30 September 2019, the CBN released BSD/DIR/GEN/LAB/12/049, a supplement[3] to the CBN Circular. Citing an appreciable growth in lending, the CBN reviewed the LDR target for DMBs upwards from 60% to 65%. The CBN also set a new deadline of 31 December 2019 for the DMBs to comply with the new threshold. The directive also states that the punitive measures set out in the CBN Circular remain the same.

OUR THOUGHTS

Currently, many DMBs in Nigeria, including Guaranty Trust Bank Plc, Zenith Bank Plc, First Bank of Nigeria Holdings Plc, United Bank for Africa Plc and Unity Bank, are falling short of the initial threshold set by the CBN Circular with their LDR at 57.64%, 55.8%, 52.8%, 57.4% and 48% respectively.[4] The Head of Research at FSDH Merchant Bank, Ayo Akinwunmi, had stated when the CBN Circular was released that the banks would have to credit an additional N1.5 trillion credit assets by September 2019 to meet the required minimum specified by the CBN.

[1] The CBN Circular is available at https://www.cbn.gov.ng/Out/2019/CCD/Lending%20to%20Real%20Sector.pdf
[2] Small and Medium Enterprises [3] The supplement is available at https://www.cbn.gov.ng/Out/2019/BSD/CIRCULAR%20ON%20REGULATORY%20MEASURES%20TO%20IMPROVE%20BANK%20LENDING%20-October%202019.pdf
[4] Nwokoji C., 3 Banks Cross New LDR Limit, 10 Record Increase in Loan Book —Analysis, Nov 4 2019. Available at https://tribuneonlineng.com/3-banks-cross-new-ldr-limit-10-record-increase-in-loan-book-analysis/ ; Accessed on 3 Dec 2019

In the intervening period between the release of the CBN Circular and the supplement, the CBN claims that industry gross credit has increased by N829.40 billion or 5.33% from N15,567.66 billion at the end of May 2019 to N16,397.06 billion as at 26 September 2019.[6]

While the numbers released by the CBN represent an impressive surge in lending due to the CBN Circular, it is prudent to put the numbers in context. The CBN's numbers are taken from a small sample size of roughly four months. This is simply not enough time to declare the policy a success or indeed increase targets. Also, there is no guarantee that the lending rate will increase on the current trajectory. Finally, there have been reports that the figures observed by the CBN have been padded by the use of underhanded practices by DMBs. Reportedly, some banks gave loans to customers who in turn bought treasury bills (TBs) and other securities at CBN's open market operations (OMO), thereby earning a margin considered as an arbitrage – taking advantage of rate differentials in the markets.[7] Although the CBN has stated that banks and customers will be punished and blacklisted for arbitrage, it will be very difficult to keep track of such activities especially if a third party is included in the conspiracy.[8]

In a similar vein, the punitive measures stipulated in the CBN Circular could be relatively ineffective. The CBN Circular state that half of any defaulting DMBs' LDR shortfall will be compulsorily remitted to the CBN as part of its CRR.

Since the implementation of the CBN Circular, there have been reports that the CBN has debited 12 banks a total of N499 billion for failing to meet the 30 September 2019 deadline.[9] However, the CBN has had to refund some of the affected institutions as the deductions could hamper their operations. On the other end of the spectrum, there are DMBs that would rather cushion the deductions by the CBN than dilute the quality of their loan book. Currently, the non-performing loan (NPL) rate stands at 11% and in view of this, it would be logical for more buoyant banks to prefer parking a higher percentage of their deposits with the CBN than compromise on the profile of the borrowers it lends to. The logic behind the anticipated hesitation on the part of these banks is especially justified when the host of enforcement issues associated with NPLs is factored into the decision to either lend to riskier borrowers or park funds at the CBN.

Furthermore, the CBN Circular does not appear to take the relatively high interest rates in Nigeria into consideration. The interest rate in Nigeria holds steady at 13.5% and, although this is an improvement from past times, it is still prohibitively high for the average borrower in the real sector. This remains a massive stumbling block to lending and the CBN Circular appears to presume that there will be automatic interest from the public once banks are more willing to lend. It is therefore necessary that some mechanisms are put in place to create a favourable landscape for borrowers in order for the CBN Circular to be fully effective.

[5] Ogwu S.M., CBN's new lending directive frees N1.5trn more for real sector, July 5 2019. Available at https://www.dailytrust.com.ng/cbns-new-lending-directive-frees-n1-5trn-more-for-real-sector.html ; Accessed on 2 Dec 2019 [6] Supra 2 [7] Awojulugbe S., Exclusive: CBN goes tough on arbitrage, asks banks to reverse TBs, October 18 2019. Available at https://www.thecable.ng/exclusive-cbn-goes-tough-on-arbitrage-asks-banks-to-reverse-tbs ; Accessed on 2 Dec 2019.
[8] Ibid [9] Loan-to-Deposit Ratio: CBN to Impose Stiffer Sanctions on Banks. Available at https://www.thisdaylive.com/index.php/2019/10/19/loan-to-deposit-ratio-cbn-to-impose-stiffer-sanctions-on-banks/ ; Accessed on 1 Dec 2019

Finally, framework around the implementation of the terms of the CBN Circular is questionable. The CBN has promised to release further guidance as to what entities would fall under the scope of the 'SMEs, Retail, Mortgage and Consumer lending' category and until it does so, the qualifications as to what businesses are specifically protected by the CBN Circular remain unclear.

RECOMMENDATIONS

Having highlighted some of the teething issues and overarching problems with the CBN Circular, we proffer some recommendations that could ease its implementation:

1. The CBN Circular should have been issued on the back of extensive feedback from the relevant stakeholders in the industry as it only appears to address the issue from the perspective of the regulators, and this may hamper the goals the CBN is seeking to achieve. This position is supported by the relatively short compliance dates set by the CBN - less than three months in both instances- to make what is, by any metric, wholesale changes to a lending portfolio, a tall order for even the most sophisticated bank in an ideal market. DMBs in Nigeria cannot lay claim to any of these attributes and most will struggle to meet the deadline set by the CBN as evidenced by the mammoth CRR deductions a number of banks have faced.

2. An extension based on the aforementioned consultation with the relevant stakeholders will enable the CBN to set a workable timetable for implementation and buy immeasurable goodwill from the industry.

CONCLUSION

In conclusion, the introduction of a minimum LDR and the accompanying CBN Circular is a laudable development. However, good regulations have failed due to the lack of effective implementation and ineffective supporting structures. Hence, the CBN should be proactive in creating an enabling environment for the rules to be effective.

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