In August 2015, the Central Bank of Nigeria ("CBN"), as part of its efforts to regulate the Nigerian foreign exchange market, issued a circular referenced BSD/DIR/GEN/LAB/08/037, restricting Nigerian banks from granting foreign currency denominated loans to Nigerian companies who do not generate revenues in foreign currency. In addition, banks are prohibited from re-denominating naira denominated loans into foreign currency denominated loans. Based on this directive, foreign currency loans can only be extended to companies who generate revenues in foreign exchange.

The circular is one of the policy initiatives of the CBN aimed at:

- Facilitating the stability of the foreign exchange market;
- Limiting foreign exchange risk exposure of Nigerian banks;
- Reducing undue pressure on the demand for foreign exchange; and
- Limiting the likelihood of default on repayment of foreign currency denominated loans.

This circular would most certainly affect domestic lending and like any other rule or policy control measure introduced to stabilize any financial system, there are bound to be implications both positive and negative. Below are some of the potential impacts of the CBN directive:

**THE POSITIVE IMPACT**

**A. Reduction of probability of obligor’s default:**

The rise in foreign exchange rates and the consequent scarcity of foreign currency has made obligors of many foreign currency loan facilities default in their loan obligations due to difficulties in accessing foreign currency for the repayment of their loans. The implementation of the circular by the CBN would therefore assist in reducing the demand on foreign currency as the number of loans that would be Naira denominated would increase.

**B. Stability in the Naira value:**

The introduction of the circular would further strengthen the Naira as the prohibition of foreign currency denominated loans to companies that do not generate foreign currency revenues would result in a decrease in the demand for foreign currency; and a rise in demand for Naira in view of the fact that there would be an increase in the number of naira receivable-businesses which would apply for loans in Naira.
C. Increase in Foreign Direct Investment (FDI):

The circular, which allows for foreign currency borrowing from foreign banks, would encourage Foreign Direct Investment (FDI). An increase in FDI would lead to the creation of new employment opportunities by foreign investors, injection of funds into the capital market and increase in revenue for the government through taxation, royalties’ e tc.

D. Availability of loan capital:

As the granting of foreign loans by banks is dependent on their access to foreign currency, the banks may not always have available facilities given exchange rate fluctuations. However, there can hardly be shortage or scarcity of the local currency in Nigerian banks. Thus, any business in need of a loan would be able to access capital at any given time.

THE NEGATIVE IMPACT

A. Difficulty in accessing foreign currency for repayment of foreign currency loan by Naira receivable business:

Consequent upon the implementation of the circular, businesses in Nigeria who solely generate Naira revenues would begin to experience difficulties in accessing foreign currency to service loans granted by foreign institutions as the circular does not make provisions for existing foreign currency loans by naira receivable businesses.

Thus, failure of local investors to access funds at the Autonomous Foreign Exchange Market would lead to shortage in the availability of requisite business capital particularly capital intensive businesses who constantly rely on foreign loans for their operations. This shortcoming may in the long run lead to poor economic output from these businesses.

B. Inability of small and medium scale businesses to access foreign currency for purchases of commodities:

The restriction placed on access to foreign currency would adversely affect small and medium scale enterprises with naira receivable businesses; and are engaged in the commercial trading of foreign commodities. These traders would be left with no choice but to purchase the requisite foreign currency from the parallel market at exorbitant prices. This in the long term would result in a hike in the prices of such commodities thereby affecting the consumers and the society at large.

C. Repayment of Nigerian international students’ loans:

It is pertinent to note that the impact of the CBN circular affects not only businesses but also individuals particularly internationally trained students who need to service loans obtained from foreign countries in the course of their studies abroad.

The circular poses economic difficulties to this class of individuals, as they now either have to pass through the rigor of servicing such loans through the arduous Form A documentation process or are left with the option of seeking foreign currency from the parallel market at exorbitant prices.

D. Difficulty in carrying out online transactions using debit/credit cards:

There would be difficulty in carrying out online international transactions by individual consumers as a result of the high and fluctuating foreign exchange rates particularly because individuals do not have access to foreign currency easily.

Whilst the circular may seem a bitter pill to swallow for most Nigerian businesses, it must be said that those of this school of thought are not alone. This restriction policy on foreign currency borrowing is not peculiar to Nigeria alone as the same policy has been implemented by the Central Banks in other jurisdictions with varying degrees of success.

Prior to 2014, the Ghanaian currency (“cedi”) suffered significant depreciation in value leading to a severe increase in foreign exchange rates; increased foreign debt; and gross downturn in its financial capital markets. Consequently, it became imperative for
some form of financial policy intervention. The Bank of Ghana in intervening introduced a range of measures to ease foreign currency controls.\(^1\)

Of importance amongst the myriad of control introduced by the Apex Bank, was the directive that all banks are to convert all undrawn facilities into local currency and that no bank should grant a foreign currency-denominated loan or foreign currency-linked facility to a customer who does not earn revenues in foreign exchange.\(^2\) It should be noted that unlike its Nigerian counterpart, the Bank of Ghana circular makes provision for existing foreign currency loans by a non-foreign exchange earner by allowing existing fully drawn foreign currency denominated loans to non-foreign exchange earners to run until expiry.\(^3\)

However, rather than assist in reviving the economy and the value of the cedi, the economy of Ghana further faced deteriorating macroeconomic imbalance, severe currency depreciation, as well as rise in inflation and interest rates.\(^4\) These challenges forced a review of the Apex Bank’s policies and a reversal including the relaxation of the restrictions on foreign currency borrowing. Foreign currency loans are now no longer restricted to businesses that earn their revenues only in foreign exchange. The amended policy allows for drawing in foreign currency, the undrawn balances on foreign currency loans; and also permits remittances and other transfers to be kept in foreign exchange without a directive for its conversion as well as retention percentages.

From the Ghanaian experience, it can be concluded that the restriction on foreign currency loan (amongst other foreign currency policies that were introduced) as well as its subsequent reversal had little or no impact in resuscitating the economy. In fact, it was not until the intervention of the International Monetary Fund (‘IMF’) through its assistance program that the economy of Ghana began to experience an improvement and appreciation of its local currency.\(^5\)

In Europe, foreign currency loans to the unhedged non-banking sector (i.e non-foreign currency generating businesses) are not uncommon and introduce a substantial exchange-rate-induced credit risk to European banks.\(^6\) Hungary falls amongst the countries in Europe with financial policies restricting foreign currency denominated loans. In 2008, Hungary suffered major financial crisis as a result of its significant external debt liabilities. One of the major factors that contributed to Hungary’s indebtedness was the extensive borrowing by Hungarian banks from international financial institutions who offered foreign currency denominated loans that attracted significantly lower interest rates in comparison to Hungarian currency denominated loans to households and firms that did not earn their revenues in foreign exchange. This consequently led to a build-up of a large, unhedged foreign liability by the non-foreign exchange earners.\(^7\) These liabilities, which were largely denominated in Swiss francs and, to a lesser extent, in euros resulted in the depreciation of the Hungarian currency.

In view of the foregoing, the Hungarian Government sought to put in place a number of intervention policies to stabilize the economy. Amongst these policies, was a new regulation referred to as Decree 361/2009 which was implemented in 2009\(^8\) to ensure lending practices of financial institutions were more prudent and to substantially restrict and discourage foreign currency denominated lending.\(^9\) The regulation however did not achieve the objective for which it was passed; it merely increased the difficulty in the repayment of the foreign currency loans. As a further mitigating measure, the Hungarian Government in 2011 adopted the recommendation of the European Systemic Risk Board on lending in foreign currencies (ESRB/2011/1). In adopting this recommendation, the Hungarian Financial Supervisory Authority (HFSA) issued additional regulations to the already existing legislation (i.e Decree 361/2009).

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\(^1\)http://allafrica.com/stories/201406191731.html
\(^3\)http://www.dowuonalaw.com/old-site/legal-updates/Legal-Update-BoG-FX-rules_changes-to-the-Exchange-Control-Rules
\(^5\)Ibid.
\(^6\)https://research.stlouisfed.org/publications/review/1 - Pinar Yesin: Foreign Currency Loans and Systemic Risks in Europe.
\(^8\)Government Decree 361/2009 (XII. 30.) on the conditions of prudent retail lending and the examination of creditworthiness, published in Magyar Közlöny No. 196 of 2009
\(^9\)http://alk.mnb.hu/data/cms2408096/ESRB_guidelines_compliance.pdf
which allowed foreign exchange denominated loans to be repaid at a preferential, fixed exchange rate as well as converting foreign currency denominated loans into loans denominated in Hungarian currency (“HUF”).

Subsequent to the additional regulation on the restrictions on foreign exchange (as established by Decree 361/2009), the Hungarian economy began to improve and witness positive changes.

Succinctly, it is clear that the mere restriction of lending in foreign currency did not stabilize the economy nor stem the depreciation of the Hungarian national currency but rather, it required additional legislation and intervention measures to reduce Hungary’s debt and improve its economy.

Similarly, India places restrictions on the granting of foreign currency denominated loans to its residents. India not only restricts borrowing, it also restricts lending of foreign currency denominated loan. The Foreign Exchange Management Act 1999 (“the FEM Act”) permits any person to sell or draw foreign exchange to or from an authorized person for a capital account transaction. In exercise of this provision and the power conferred on Reserve Bank of India (RBI) by Section 47 of the FEM Act to make regulations, the Foreign Exchange Management (Borrowing or lending in foreign exchange) Regulations, 2000 (“the Regulation”) was introduced. The Regulation makes provisions for borrowing or lending in foreign exchange by a person resident in India. Section 3 of the Regulation provides that “no person resident in India shall borrow or lend in foreign exchange from or to a person resident in or outside India; Provided that the Reserve Bank may, for sufficient reasons, permit a person to borrow or lend in foreign exchange from or to a person resident outside India”.

Section 4 and 5(1) of the Regulation however makes exemptions for authorized dealers and entities in India. To this effect, authorized dealers and its constituents or subsidiaries are allowed to borrow and lend to themselves foreign currency in any foreign jurisdiction in which they reside (i.e. authorized dealers in India can borrow money from its subsidiary (in Japan for example) in that foreign country’s currency).

It is also important to note that individuals are not excluded from the exemptions to the restrictions. Section 6 of the Regulation allows a person resident in India who desires to raise foreign currency loans of the nature or for the purposes specified in the schedule to the Regulation (“the Schedule”) and who satisfies the eligibility and other conditions specified in that Schedule, may apply to the Reserve Bank for approval to raise such loans. The Schedule provides for loans in respect of various schemes; short term scheme; borrowing by exporters or foreign exchange earners; and long term scheme.

For the short term scheme, an overseas supplier of goods may extend foreign currency credit to the importer of its goods in India for financing the import of such goods, provided that the period of maturity of the foreign currency loan credit is more than six (6) months but less than three (3) years. Also, corporate entities in India are allowed to borrow foreign exchange up to US$ 5,000,000 (Five Million Dollars) or its equivalent for general corporate purposes at a simple minimum maturity of three (3) years and up to an amount not exceeding US$10,000,000 (Ten Million Dollars) for the purpose of financing infrastructure projects. Under the long scheme, borrowing for general corporate purposes at the minimum average maturity of eight (8) years is also allowed.

In view of the foregoing, it appears that India’s approach is more of regulating the borrowing and lending of foreign currency denominated loans as opposed to the Nigeria’s approach of an outright prohibition of same.

CONCLUSION

In light of the above, particularly given the experiences and practices of other countries such as India and Ghana, it can be argued that the implementation of the policy by CBN may not achieve the objectives for which it was introduced and may actually cause more harm than good to the economy.

There is need for caution in the formulation of policies to regulate the foreign exchange market. The CBN should consider carving out exceptions for Naira revenue receiving small and medium scale enterprises and individuals as is done in India and to allow them access foreign currency to run their businesses. A consideration may be to place a limit on the amount of foreign currency they can access by based the nature of the transaction in contrast to an outright ban as presently exists.
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