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EXPOSURE DRAFT ON THE PRUDENTIAL GUIDELINES FOR MICROFINANCE BANKS

The Central Bank of Nigeria (CBN), in June 2010, issued the revised Prudential Guidelines to deposit money banks in Nigeria as part of its efforts at enhancing the quality of banks' assets. The need for sector-specific Guidelines has become apparent given developments which had specific impact on different classes of financial institutions over the years.

Accordingly, the CBN hereby issues for observations and comments, the attached draft Prudential Guidelines for Microfinance Banks. The Guidelines may be downloaded from the CBN website, **www.cbn.gov.ng**.

We would be pleased to receive your comments by **Friday, September 20, 2019**. Soft copies of your presentation may be forwarded to **pgofis@cbn.gov.ng**.

Thanks.

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CENTRAL BANK OF NIGERIA

PRUDENTIAL GUIDELINES FOR MICROFINANCE BANKS IN NIGERIA

[August 2019]

TABLE OF CONTENTS

Contents

1.0. RISK MANAGEMENT

1.1. Credit Policy

a) An MFB shall have a comprehensive credit policy duly approved by its Board of Directors.
b) The policy shall include the eligibility requirements for borrowers, the products offered, terms and conditions for granting loans/facilities, procedures for loan administration and disbursement, appropriate monitoring mechanism and set out the standards to be used to manage credit risk.
c) The policy shall indicate the MFB's collateral requirements, including the types of qualifying collateral and the collateral coverage for the different classes/types of facilities.
d) Credit facilities shall be granted at non-preferential terms and conditions that are clearly disclosed and at prices that reflect the credit risk.
e) Investments in Bankers Acceptances (BAs) and Commercial Papers (CPs) shall be treated as part of the loan portfolio.
f) The credit policy shall address lending to directors as part of lending to related parties.
g) All MFBs are required to register all movable collaterals with the National Collateral Registry (NCR). Evidence of the NCR registration is a necessary part of the loan documentation.
h) An MFBs shall have a credit portfolio plan part of its credit policy, which shall consider the following among others:
    i. The target market and portfolio size;
    ii. Macro-economic conditions, including fiscal and monetary policy guidelines;
    iii. Minimum risk acceptance criteria;
    iv. Credit concentration policy;
    v. Historical portfolio performance;
i) An MFB shall review its credit portfolio plan on a quarterly basis to ensure that the plan is still reflective of current market conditions. In the event of adverse changes in the macro-economic environment or particular sectors, industries or regions, appropriate review and mitigation strategies shall be conducted.
j) The policy shall be reviewed at least every three (3) years.

1.2. *Credit Concentration Policy*

a) An MFB shall have a board of directors' approved credit concentration policy covering the different forms of credit risk concentrations to which it may be exposed. The policy shall include an effective system of internal controls to identify, measure, monitor, and control credit risk concentration. Credit concentrations to which an MFB may be exposed include:

i. Significant exposure to an individual, counterparty or group of related counterparties;
ii. Credit exposure to counterparties in the same economic sector or geographic region; and

b) Indirect credit exposure arising from an MFB's Credit Risk Mitigation (CRM) activities (e.g. exposure to a single collateral type or to credit protection provided by a single counterparty). The policy shall specify credit risk concentration limits and the methodology for calculating credit concentration. Limits should be defined in relation to a MFB's capital, credit portfolio, total assets or other appropriate measures.
c) In defining the portfolio concentration limits for industries or sectors, MFBs shall adopt the Standard Industry Classification (SIC) of economic sectors issued by the CBN;
d) An MFB's management shall conduct stress tests of its credit portfolio, at least on a quarterly basis. The test shall also consider the credit concentration risk. The management shall review the results of the tests and make adequate plans to respond to plausible adverse changes in market conditions.
e) In assessing credit risk concentration of an MFB, the CBN will consider the credit concentration policy, the credit portfolio plan and the extent to which the MFB considers credit concentration as part of the subjective factors in making specific provisions. Non-compliance with an MFB's established policy on credit concentration and monitoring shall form a basis for supervisory action which may include additional loan loss provisions.

1.3. *Lending Limits*

a) The maximum loan to any individual borrower shall not exceed 1 per cent while a loan to group of borrowers, a co-operative or a corporate body shall not exceed 5 per cent of the MFB's shareholders' fund unimpaired by losses or as may be prescribed by the CBN.
b) Aggregate insider-related lending shall not exceed 5 per cent of an MFB's shareholders' funds unimpaired by losses. Loans under a staff scheme are excluded, but shall be in accordance with the staff conditions of service.
c) A large exposure is any credit to a customer or a group of related borrowers that is at least 5 per cent of an MFB's shareholders fund unimpaired by losses.
d) Aggregate large exposures in any MFB shall not exceed five (5) times the shareholders fund unimpaired by losses.

1.4. *Disclosure of Insider-related Credits in Financial Statements*

(a) MFBs shall disclose all credit exposures involving insiders. Insider-related credits include credits to shareholders, employees, directors and their related interests. In line with the BOFIA, the term "director" includes director's wife, husband, father, mother, brother, sister, son, daughter and their spouses

(b) The disclosure required to be presented in the financial statements is as follows:

- (i) The aggregate amount of insider-related loans, advances and leases outstanding as at the financial year end shall be separately stated in a note to the accounts and the non-performing component further analyzed by security, maturity, performance, provision, interest-in suspense and name of borrowers.
- (ii) Notes to the accounts on guarantees, commitments and other contingent liabilities shall also give details of those arising from related-party transactions.
- (iii) The external auditors and audit committees shall **include in their report, their opinion** on related-party credits.
- (c) The requirements of this section do not apply to credits extended to employees under their employment scheme of service, or to shareholders whose shareholding and related interests are less than 5 per cent of the MFB's paid up capital as at the date of the financial report or to public limited liability companies in which a director has an interest that is less than 5 per cent.

1.5. Exposures to Directors and their Related Interests

MFBs shall fully disclose their credit exposures to directors, significant shareholders and other insiders in their financial statements and returns prescribed by the CBN.

1.6. *Basic Information on Borrowers and Minimum Contents of Credit files:*

MFBs shall:

(a) Ensures that every borrower completes the Loan Application Form (LAF) designed by the MFB is completed by the customer and approved by the relevant officers.

(b) Ensure that the LAF contains such information as the MFB may require to evaluate the credit application, which may include recent audited financial statements/management accounts, projected cash flows and records of past bank accounts.

(c) Obtain credit reports within 30 days prior to the disbursement of facilities from at least **two (2) credit bureaux** before granting any facility to a customer. The result of the enquiry shall be documented in the credit file of the customer. In addition, compliance with the CBN circular OFI/DIR/CIR/GEN/17/151 issued on May 10, 2017 on Data Exchange Agreement with at least two licensed credit bureaux

(d) Provide evidence that a search has been conducted on the borrower in the CBN's Credit Risk Management System (CRMS) database.

(e) Obtain the Bank Verification Number (BVN) of individual borrowers and directors of corporate borrowers.

(f) Obtain the Tax Identification Number (TIN) of corporate borrowers.

(g) Obtain information on entities related to the borrowers.

(h) Maintain credit files whether in electronic, print or other form, on all its borrowers, which shall contain adequate and timely information on the credit-worthiness of the borrowers to enable:
   i. proper and effective monitoring of credit facilities extended by the bank; and
   ii. examiners, as well as the bank's internal and external auditors, to have immediate and complete factual information from which they can form objective opinion on the credit facilities.

(i) Maintain basic information (including those set out in the **Annexure 1**, where applicable) on the following to enable an objective evaluation of the quality of each facility:
   i. the borrower;
   ii. the credit facility;
   iii. the appraisal of the credit application;
   iv. the conduct and status of the account;
   v. an offer letter showing conditions for draw down; and
   vi. evidence of acceptance of offer by the borrower.

1.7. *Minimum Information on Credit Print-Outs*

MFBs shall provide the following minimum details in their credit printouts:

a) Account number of customer;
b) Name of customer;
c) Type of facility;

d) Date facility was granted;
e) Interest Rate;
f) Authorized limit of facility;
g) Original expiry date;
h) Restructure Date (if any);
i) Balance on account;
j) Date of last lodgment or credit operation by the customer; and
k) Sector/Industry
l) Type and value of security pledged.
m) Bank Verification Number (BVN)
n) Evidence of NCR registration

1.8. *Co-Signers as Borrowers*

Members in a group lending arrangement shall be allowed to co-sign as borrowers or issue cross-guarantees for one another to the same MFB.

1.9. Bankers Acceptances and Commercial Papers

The issuance and treatment of BAs and CPs shall be in line with the CBN's "Guidelines on the issuance and treatment of Bankers Acceptances and Commercial Papers" issued on November 18, 2009 or as may be advised by the CBN.

1.10. *Revaluation of Fixed Assets*

The prior approval of the CBN shall be obtained by an MFB before the recognition of revaluation surplus on fixed assets in its books. The valuation shall be made by qualified professional(s) whose identity and qualifications are stated, with the valuation basis clearly shown. MFBs are to note that revaluation of fixed assets is applicable to own premises only.

1.11. *Compulsory Investment in Treasury Bills*

a) An MFB is required to maintain not less than 5% and not more than 10% of its deposit liabilities in Treasury Bills (T-Bills).
b) An MFB may acquire T-bills from the secondary market via its correspondent bank or in the primary market (directly from the CBN).

1.12. *Limit on Investment in Placements and Fixed Deposits with Other Banks*

The maximum amount an MFB can invest in placements and fixed deposits with deposit money banks shall not exceed 15 per cent of its deposit liabilities.

1.13. *Liquidity Ratio*

An MFB is required to maintain a minimum of 20 per cent of its deposit liabilities in liquid assets.

1.14. *Limit of Investment in Fixed Assets*

An MFB shall not invest more than 20 per cent of its shareholders' funds unimpaired by losses in fixed assets.

1.15. *Maintenance of Reserve Fund*

a) Every MFB shall maintain a Reserve Fund out of its net profit for each year (after adequate provision has been made for taxation and before any dividend is declared), where the amount of the Fund is:
    i. less than 50 per cent of its paid-up capital, an amount which shall not be less than 50 per cent, of the MFB's net profit for the year;
    ii. equal to or in excess of 50 per cent, but less than 100 per cent of its paid-up capital, an amount which shall not be less than 25 per cent of the MFB's net profit for the year; or
    iii. equal to 100 per cent or more of its paid-up capital, an amount equal to 12.5 per cent of the MFB's net profit for the year.
b) An MFB shall not appropriate any sum from its Reserve Fund without the prior written approval of the CBN.
c) The CBN may vary the proportion of net profit transferable to the Reserve Fund;
d) No accretion shall be made to the Reserve Fund until:
    i. All preliminary and pre-operational expenses have been written off;
    ii. Adequate provision has been made for loan loss/assets deterioration; and
    iii. All identifiable losses have been fully provided for.

1.16. *Capital Adequacy Ratio*

a) An MFB shall commence operations with, and maintain at all times, a minimum paid-up capital appropriate for its authorization as may be prescribed by the CBN from time to time.
b) The Capital Adequacy Ratio (CAR) of an MFB shall be measured as a percentage of the qualifying capital to its risk weighted assets.
c) MFBs shall maintain minimum CAR of 10 per cent at all times or as may be prescribed by the CBN.
d) An MFB shall maintain a ratio of not more than 1:10 of its shareholders' funds unimpaired by losses to the net credits.

e) The CBN may require an MFB to maintain additional capital as it considers appropriate in respect of specific concentration of risks or market risks or connected lending.
f) MFBs that do not possess adequate capital will be classified and appropriate supervisory actions taken in line with the Supervisory Intervention Framework

1.17. *Restrictions on Declaration of Dividends*

An MFB shall not declare or pay a dividend on its shares until it has:

a) Completely written-off all its preliminary and pre-operational expenses;
b) Made the required provisions for non-performing loans and other erosions in asset values;
c) Satisfied the minimum CAR requirement; and
d) Met all matured obligations.

1.18. *Credit Rating*

a) All MFBs shall have a board approved credit rating policy and model, for rating all counter parties/obligors. The ratings of obligors shall be updated, at least, on a quarterly basis.
b) In measuring credit risk of loans and advances to customers and to banks at a counterparty level, MFBs must ensure that the following components are considered:
    i. The probability of default of the obligor;
    ii. The exposure at default;
    iii. The loss given default;
    iv. Forward looking information; and
    v. The peculiarities of the sector in which the obligor operates.

1.19. *Reconciliation of Inter-Branch Accounts and Treatment of Suspense Account Entries*

(a) All entries outstanding in the Inter-Branch Accounts (by whatever name called) and / or suspense Account must be reconciled / cleared and taken to the appropriate account within **30 days** from the date the entry is made in the above-named accounts.

(b) All outstanding items in the Inter-Branch Accounts/Suspense accounts not reconciled within 30 days shall be treated in line with Sub-section 11.08.

(c) Banks shall institute an effective system of internal controls for the operations of Inter-Branch and Suspense Accounts, which ensures reconciliation/clearing of the entries in the shortest possible time and also clearly assigns responsibilities to the official(s) for timely reconciliation and clearance.

1.20. *Foreign Borrowing for On-Lending by Nigerian Banks*

All MFBs shall be required to comply with the CBN circular OFI/DIR/DOC/GEN/018/271, "Letter to all Other Financial Institutions of Foreign Borrowing", dated November 29, 2001.

1.21. *Policies and Procedures for Write-off of Fully Provided Credit Facilities*

a) The facility must have been fully provided for in line with the loan loss provisioning guidelines and must be in bank's book for at least one (1) year after full provision.
b) There should be evidence of board approval.
c) If the facility is insider or related party credit, the approval of CBN is required.
d) The fully provisioned facility must be appropriately disclosed in the audited financial statement.

1.22. *Keeping of Proper Records*

a) All MFBs shall keep proper records of all transactions as may be required by the CBN. Such documents should be arranged sequentially and be made available to CBN and other regulatory authorities on demand.
b) All MFBs shall refrain from adopting any measures or practices whereby they would either artificially or temporarily show an ostensibly different position of their records and/or financial statements.

1.23. *Loan Portfolio Composition*

The value of the loan portfolio of an MFB shall, at all times, be a minimum of 80% for micro loans and a maximum of 20% for small and medium enterprises (SMEs).

1.24. *Maximum Equity Investment Holding Ratio*

The aggregate value of the equity participation of an MFB in all permissible enterprises shall NOT exceed 7.5% of its shareholders funds unimpaired by losses.

1.25. *Special Prudential Standards*

i. Any unsecured advances, loans or credit facilities of an aggregate amount to an individual in excess of Fifty Thousand Naira [₦50,000] is not permitted.
ii. Notwithstanding the provision of Sub-section (i) above, group guarantees or third party guarantees of an individual acceptable to the MFB shall qualify as collateral for unsecured advances in excess of ₦50,000.

1.26. *Other Known Losses (OKL)*

All assets for which the net realizable value has fallen below the carrying value shall have the difference in value recognized and charged to the income account as "other known losses".

1.27. *Fixed Assets/Long-Term Investments and Branch Expansion*

a) MFBs shall not be allowed to finance any of the following other than from the shareholders' funds unimpaired by losses:
   i. Acquisition of fixed assets;
   ii. Equity investments in permissible activities and investments in long-term debentures subject to CBN's approval in writing; and
   iii. Branch expansion.
b) In consideration of a request for the approval of any or a combination of the above, reference shall be made to the aggregate value of the existing investment(s) and the current request(s) against the shareholders' funds' unimpaired by losses.

1.28. *Implementation of Recommendations in Examination Report*

The Board and management of licensed MFBs shall ensure the implementation of all recommendations contained in the CBN/NDIC Examination Reports.

1.29. *Management of Market Risk*

MFBs are required to institute strategies to manage market risk including the development of risk appetite, appropriate policies, processes, and organization structures to support ongoing management and quantification market risk.

Quantification of market risk capital charge shall be in line with the CBN Guidance Notes on the Calculation of Capital Requirement for Market Risk.

1. CODE OF CORPORATE GOVERNANCE

All MFBs shall comply with the provisions of the Code of Corporate Governance for Microfinance Banks as issued by the CBN Circular FPR/DIR/CIR/GEN/07/017 dated October 26, 2018 or any other relevant circular(s) as issued by the CBN.

2. KNOW-YOUR-CUSTOMER AND ANTI-MONEY LAUNDERING MEASURES

2.1. Know Your Customer

All MFBs shall be required to comply with the principles and procedures of Know Your Customer (KYC) and relevant circulars issued by the CBN.

2.2. Anti-Money Laundering Measures

All banks shall be required to comply with the Money Laundering (Prohibition) 2011 (as amended), the CBN AML/CFT Regulation 2013 and other relevant circulars issued by the CBN from time to time.

2.3. Records Retention

All MFBs shall keep records on all transactions for a minimum period of six (6) years and shall retain such records for a longer period where the transactions relate to litigation or are required by the Court of Law or by any other competent authority.

2.4. Suspicious Transactions

a) MFBs shall pay special attention to all complex, unusually large transactions, and all unusual patterns of transactions, which have no apparent economic or visible lawful purpose. Such suspicious transactions shall be as listed in Schedule 3 of the CBN AML/CFT Regulation, 2013. However, these are not intended to be exhaustive and only provide examples of the most basic ways in which money may be laundered. The background and purpose of such transactions shall, as far as possible, be examined, the findings established in writing, and be available to help the relevant authorities in inspection and investigation.

3. LOAN CLASSIFICATION AND LOSS PROVISIONING

3.1. Credit Portfolio Classification System for Facilities

a) MFBs shall review their credit portfolio continuously (at least monthly) with a view to recognising deterioration in credit quality. Such reviews shall classify an MFB's credit exposures based on the perceived risks of default.

b) In order to facilitate comparability of MFB's' classification of credit portfolios, the assessment of risk of default shall be based on criteria which shall include, but are not limited to, repayment performance, borrower's repayment capacity on the basis of current financial condition.

c) Credit facilities shall be classified as "performing" or "non-performing" as defined below:

   1. Performing facility: A credit facility is deemed to be performing if all due principal and interest have been settled or if past due principal and/or interest is not more than 30 days;

   2. Non-performing facility: A credit facility shall be deemed as non-performing when any of the following conditions exists:

      i. interest or principal is past due for more than 30 days;

      ii. interest for more than 30 days have been capitalised, rescheduled or rolled over into a new loan.

      iii. off-balance sheet engagement crystalizes

d) Non-performing credit facilities shall be classified into four categories namely, pass and watch, sub-standard, doubtful or lost on the basis of the criteria below:

   1. Pass and watch facility: – A facility where past due principal and/or interest is above 30 days but less than 60 days;

   2. Sub-Standard

      The following objective and subjective criteria shall be used to identify sub-standard credit facilities:

      i. Objective Criteria: facilities on which past due principal and/or interest remain outstanding for at least 60 days but not more than 90 days.

      ii. Subjective Criteria:

         a. Credit facilities which display well-defined weaknesses that could affect the ability of borrowers to repay, such as inadequate cash flow to service debt, undercapitalisation or insufficient working capital, absence of adequate financial information or collateral documentation, irregular payment of principal and/or interest, non-performing facilities with other banks and inactive accounts where withdrawals exceed repayments or where repayments can hardly cover interest charges.

b. Significant deterioration in credit rating of the borrower/obligor between initial recognition and the reporting date.

c. Significant financial difficulty of the borrower.

d. Grant of concessions to the borrower/obligor by its lender(s) for economic or contractual reasons relating to the borrower/obligor's financial difficulty, especially where the lender(s) would not ordinarily consider such concession(s).

e. It is probable that the borrower will enter bankruptcy or other financial reorganization.

f. The purchase or origination of a financial asset at a deep discount that reflects credit losses.

(2) **Doubtful**

The following objective and subjective criteria shall be used to identify doubtful credit facilities:

i. Objective Criteria: facilities on which unpaid principal and/or interest remain outstanding for at least 91 days but not more than 180 days.

ii. Subjective Criteria: facilities which, in addition to the weaknesses associated with sub-standard credit facilities, reflect that full repayment of the debt is not certain or that realisable collateral values will be insufficient to cover bank's exposure.

(3) **Lost Credit Facilities**

The following objective and subjective criteria shall be used to identify lost credit facilities:

i. Objective Criteria: facilities on which unpaid principal and/or interest remain outstanding for more than 180 days.

ii. Subjective Criteria: facilities which in addition to the weaknesses associated with doubtful credit facilities, are considered uncollectible and are of such little value that continuation as a bankable asset is unrealistic such as facilities that have been abandoned, facilities secured with unmarketable and unrealizable securities and facilities extended to judgment debtors with no means or foreclosable collateral to settle debts.

e) A restructured or rolled-over facility shall not be treated as a new facility.

f) Where a credit facility already classified as "non-performing" is restructured or rolled-over, that facility shall retain its previous classification as if the renewal, restructuring or roll over did not occur.

g) When a facility rescheduling is agreed with a customer, provisioning shall continue until it is clear that rescheduling is working at a minimum, for a period of 90 days.

h) For a "non-performing" or "Watchlist" facility, to be re-classified as "performing", outstanding and due but unpaid principal interest shall not exceed 30 days. Similarly, before a "non-performing" facility can be reclassified as "watchlist", outstanding interest and due but unpaid principal shall not be more than 60 days.

i) MFBs are required to adopt the criteria specified in paragraphs 3.1(a) to 3.1(h) to classify their credit portfolios in order to reflect the recoverable values of their credit facilities.

j) MFBs shall note that the Central Bank of Nigeria reserves the right to object to the classification of any credit facility and to prescribe the classification it considers appropriate for such credit facility.

3.2. Provision for Non-Performing Facilities

a) MFBs are required to make adequate provisions for perceived losses based on the credit portfolio classification system prescribed in paragraph 11.01. Two types of provisions (that is specific and general) are considered adequate to achieve this objective.

b) Specific provisions are made on the basis of risk of default on credit facilities while general provisions are made in recognition of the fact that a performing credit facility may be inherently risky.

c) Consequently, MFBs shall make provisions for credits as specified below:

    i. General Provision - 2 per cent of the outstanding balance of performing facilities or as may be advised by the CBN from time to time.

    ii. Specific provisions shall be applied as follows:

        aa. For facilities classified as, Pass and watch, Sub-Standard, Doubtful, or Lost, interest overdue by more than 60 days shall be fully (100 per cent) provided for and recognized on cash basis only.

ab. For facilities classified as, Pass and Watch, Sub-Standard, Doubtful, or Lost principal repayments that are past due shall be fully (100 per cent) provided for and recognized on cash basis only.

ac. For facilities classified as non-performing, provisions shall be made on the outstanding principal balance as follows:

- Pass and watch: 5 per cent
- Sub-Standard: 20 per cent;
- Doubtful: 50 per cent;
- Lost: 100 per cent.

d) In summary, on-performing credit facilities shall be classified into four categories namely, Pass & Watch, Sub-standard, Doubtful or Lost on the basis of criteria below:

Days at Risk (No. of days missed payment)	**Description**	**Provisioning Requirement or Allowance for Probable Loss (%)**
0 – 30 days	Performing	2
31 – 60 days	Pass and Watch	5
61 – 90 days	Substandard	20
91 – 180 days	Doubtful	50
181 or more days	Lost	100
Interest and principal past due by more than 30 days	Non-performing	100

3.3. Collateral Adjustment for Lost Facilities

To encourage utilization of more credit enhancement and mitigation strategies, collateral adjustments shall be applied in loan provisioning. This process considers the quality and realizability of underlying collaterals pledged against loan facilities.

a) For collateral to be considered for "Haircut Adjustments", it must be:

i. Perfected;

ii. Realizable, with no restrictions on sale; and

iii. Regularly valued with transparent method of valuation;

b) All documentation used in collateralized transactions must be binding on all parties and legally enforceable in all jurisdictions. MFBs must conduct sufficient legal review to verify this and have a well-founded legal basis to reach this conclusion, and undertake such further review as necessary to ensure continuing enforceability.

c) Valuation of residential and commercial properties shall be carried out by an independent professional valuer. The valuer while assigning any values to the mortgaged residential and commercial property shall take into account all relevant factors affecting the saleability of such assets including any difficulty in obtaining their possession, their location, condition and the prevailing economic conditions in the relevant sector, business or industry.

d) The values of residential and commercial properties so determined by the valuer must be a reasonably good estimate of the amount that could currently be obtained by selling such assets in a forced / distressed sale condition. The valuers shall also mention in their reports the assumptions made, the calculations / formulae/ bases used and the method adopted in the determination of the values i.e. the forced sale value (FSV).

e) The following are collateral instruments eligible for collateral adjustments:

    i. Cash (as well as certificates of deposit or comparable instruments issued by the MFB) on deposits with the bank which is incurring the counterparty exposure.
    ii. Treasury bills and other government securities.
    iii. Quoted equities and other traded securities.
    iv. Bank guarantees and receivables of blue chip companies.
    v. Residential legal mortgage
    vi. Commercial legal mortgage
    vii. Other collaterals as defined by the CBN from time to time.

f) The following haircut adjustments shall be applicable on all loan types classified as lost:

Description of Collateral	Haircut adjustments weightings
Cash	0%
Treasury Bills and government securities e.g. bonds	0%
Quoted equities and other traded securities	20%
Bank guarantees and Receivables of blue chip companies	20%
Residential legal mortgage	50%
Commercial legal mortgage	50%

g) The haircuts adjustment weightings shall be taken into consideration in arriving at the adjusted provisions for facilities classified as lost. The adjusted provisions shall be derived as follows:

Required Provision = E – {VC X (1- HW)}

Where,

E = Total Exposure

HW = haircut weightings

VC = Value of Collateral

If {VC X (1-HW)} is greater than E then no provision is required.

The value of collateral for quoted equities and other traded securities shall be market value while for mortgages, it shall be forced sale value (FSV).

h) The CBN will review the list of eligible collaterals and the haircut adjustments applicable from time to time.

3.4. Other Conditions for Haircut Adjustments

a) The non-performing facilities requiring haircut adjustments and the haircut adjustment calculations including valuation of collaterals shall be reviewed by the MFBs' auditors and must be ratified by the CBN.

b) For the purpose of (1) above, review of valuation by external auditors does not fall under appraisal or valuation services prohibited by the code of corporate governance.

c) A maximum of one year is allowed for the haircut adjustments pending which the collaterals shall be realized and shortfall in provision taken.

d) If the facility on which haircut adjustment has been applied remains non-performing after one year, then the haircut adjustment will be disregarded.

3.5. Treatment of IFRS Impairment Charge for Prudential Purposes

MFBs shall compute impairment charge on financial instruments and off-balance sheet engagements as prescribed in the relevant IFRS.

(a) The IFRS impairment charge shall be compared with provisions determined under this Guidelines and the difference shall be treated as follows:

   i. If p**rudential provisions are greater than IFRS impairment charge**, the difference shall be transferred **from the general reserve to a non-distributable regulatory risk reserve**.

   ii. If **prudential provisions are less than IFRS impairment charge**, the difference shall be transferred from the regulatory risk reserve account to the general reserve to the extent of the non-distributable regulatory risk reserve previously recognized.

(c) The non-distributable regulatory risk reserve shall not be recognized as a component of qualifying capital.

3.6. *Credit* Portfolio Disclosure Requirement

a. An MFB is required to provide in its audited financial statements, an analysis of its credit portfolio into “performing” and “non-performing” as defined in this Guidelines

b. The amount of provision for deterioration in credit quality (that is, losses) shall be segregated between principal and interest.

c. A maturity profile of credit facilities based on contracted repayment programme, shall be provided along with the maturity profile of deposit liabilities in the financial statement.

d. An MFB is also to provide a vintage analysis of its portfolios as follows:

	<= 1 year	> 1 year <=3 years	> 3 years	Total
	₦	₦	₦	₦
Performing				
Non-performing Total				

e. Other details as required by the CBN circular on "minimum information to be disclosed in financial statements".

3.7. Interest Accrual

a) It is the responsibility of bank management to recognize revenues when they are earned or realized and make provision for all losses as soon as they can be reasonably estimated.

b) However, interest on non-performing credit facilities overdue by more than 90 days shall be fully (100 per cent) for and recognized on cash basis only.

3.8. Classification and Provisioning for Other Assets

a) The term "Other Assets" relate to those asset items that are not shown separately in the balance sheet of an MFB. These items include Impersonal Accounts (of various descriptions), Suspense Accounts such as frauds and cashiers' shortages, Cheque Purchased, Uncleared Effects and Inter-Branch Items. The accounts usually grouped together as "other assets" contain fictitious or intangible assets. The accounts could contain long outstanding items, the origins of which had been forgotten, untraceable or irreconcilable. In situations like these, the items if not material shall be written off and where material (i.e. at least 10 per cent of aggregate balance of Other Assets) shall be classified as shown below. It shall be noted that items enumerated below are by no means exhaustive:

1. Sub-Standard

Fraud cases of up to 1 month but less than 3 months old and under police investigation regardless of the likely outcome of the cases.

A minimum provision of 20 per cent shall be made for "Other Assets" items classified as sub-standard.

2. Doubtful

Items for doubtful classification shall include, but are not limited to outstanding fraud cases of 3 to 6 months old, with slim chances of full recovery.

A minimum of 50 per cent provision shall be made for "Other Assets" items classified as doubtful.

3. Lost

Items for lost classification shall include, but are not limited to the following:

i. Cheques purchased and uncleared effects over 30 days old and for which values had been given.

ii. Outstanding fraud cases over 6 months old and involving protracted litigations.

iii. Inter-branch items over 30 days old whether or not the origins are known.

iv. All other intangible suspense accounts over 30 days old.

v. Full provision (i.e. 100 per cent) shall be accorded to items classified lost.

3.9. Revolving and Overdraft Facilities

a) Normally the first indication that a revolving or overdraft facility may be non-performing is when the turnover on the account is considerably lower than anticipated when the facility was arranged or when interest is charged which takes the facility above its approved limit.

b) The following conditions shall be observed for a revolving or overdraft facility:

i. There shall be "clean-up period[1]" of at least three (3) working days before a revolving or overdraft facility can be rolled-over.

[1] Period during which the customer does not enjoy an overdraft/revolving facility from the bank, having paid off the last one

ii. There shall be maximum of 90 days "clean-up cycle[2]" on every revolving or overdraft facility.

iii. Except for new customers, the amount of facility shall not exceed 200 per cent of average monthly turnover in the last six months

c) Banks are required to classify revolving or overdraft facilities as specified below:

i. Performing: Where all conditions of the contract are met and repayments are up to date.

ii. Watchlist:

aa. Where any of the conditions listed in (b) above are not specified in the offer/contract; and/or

ab. The turnover over the last 30 days is less than 75 per cent of the turnover specified in the offer/contract.

iii. Non-performing:

a. Sub-standard –

Where:

aa. One (1) clean-up cycle is not observed,

ab. The account is "above limit" for 30 consecutive days, or

ac. Turnover of the last 30 days is less than 50 per cent of the turnover specified in the offer/contract.

b. Doubtful –

Where:

aa. Two clean-up cycles are not observed,

ab. The facility is "above limit" for 60 consecutive days, or

ac. Turnover of the last 30 days is less than 30% of the turnover specified in the offer/contract

c. Lost –

Where:

aa. The facility has been operating "above limit" for 90 days,

ab. More than two clean-up cycles are not observed, or

[2] Period during which outstanding amount must be repaid by the customer

ac. The facility expired but unpaid for more than 14 days

d) MFB's are to make general and specific provisions on revolving/overdraft facilities as follows:

   i. General provisions: 2 per cent on performing facilities

   ii. Specific Provisions:

   Specific provisions shall be made as follows:

   - Watchlist: 5 per cent
   - Sub-Standard: 20 per cent;
   - Doubtful: 50 per cent; and
   - Lost: 100 per cent.

e) In the case of revolving and overdraft facilities, where a facility rescheduling is agreed with a customer, provisioning shall continue until it is clear that the rescheduling is working at a minimum for a period of 30 days.

3.10. Facilities without Approval

MFBs shall not allow accounts to be overdrawn without due approval. For accounts that were inadvertently overdrawn, the account shall be regularized within 30 days or fully provided for.

3.11. Off- Balance Sheet Engagements

a. A proper appraisal of Off-Balance-Sheet engagements shall be undertaken with a view to determining the extent of loss an MFB may likely sustain. Off-Balance-Sheet engagements include stand-by letters of credits, bonds, guarantees, indemnities, acceptances, and pending or protracted litigations (the outcome of which may not be easily determined).

b. The following factors shall be taken into consideration in recognizing losses on Off-Balance-Sheet engagements:

   i. Date the liability was incurred
   ii. Expiry Date
   iii. Security Pledge
   iv. Performance of other facilities being enjoyed by the customer, e.g. loan and advances
   v. Perceived Risk.

c. Non-performing off-balance sheet engagements shall be recognized on the balance sheet, classified lost and provisions made in line with sections 4.1 and 4.2.

d. Off-Balance-Sheet engagements shall not form part of balance sheet totals while their disclosure in note form shall distinguish between:

i. direct credit substitutes, e.g. general guarantees of indebtedness (including standby letters of credit serving as financial guarantees for loans and securities), and acceptances (including endorsements with the character of acceptances);

ii. certain transaction-related contingent items (e.g. performance bonds, bid bonds, warranties and standby letters of credit related to particular transactions;

iii. sale and repurchase agreements and assets sales with recourse, where the credit risk remains with the MFB;

iv. commitments that are unconditionally cancellable, or that effectively provide for automatic cancellation due to deterioration in a borrower's creditworthiness;

v. lending of MFBs' securities or the posting of securities as collateral by an MFB, including instances where these arise out of repo-style transactions (i.e. repurchase/reverse repurchase and securities lending/securities borrowing transactions);

vi. other commitments (e.g. formal standby facilities and credit lines) with an original maturity not more than one year; and

vii. similar commitments with an original maturity of up to one year, or which can be unconditionally cancelled at any time.

e. MFBs shall make a general provision of 1% of the credit equivalents value (CEV) of off-balance-sheet engagements.

f. To compute the CEV, MFBs shall apply a credit conversion factor of 50 per cent to all categories of OBS.

4. FINANCIAL SOUNDNESS INDICATORS AND FINANCIAL RATIOS

a) An MFB shall, as part of its risk management framework, institute a process for computing financial ratios and financial soundness indicators for assessing its financial health.

b) Benchmarks shall be set and actual results computed and compared to set benchmark at least on a quarterly basis. The report shall be presented to the

Board of Directors or appropriate Board Committees for deliberation and remedial actions as considered necessary;

c) Illustrative examples of financial soundness indicators and financial ratios for banks are presented in **Annexures 2 and 3.**

5. UPDATE OF THE GUIDELINES

The CBN shall review this Guidelines as and when necessary but not later than five (5) from the effective date set out below

6. COMPLIANCE WITH THE GUIDELINES

Any director or manager of a financial institution who, during his or her tenure, fails to ensure compliance with the prudential guidelines for a period of three (3) consecutive months without satisfactory explanation and evidence of efforts being made to address the contravention shall be appropriately sanctioned in line with extant regulations.

The CBN shall however, inform in writing the Board of every financial institution under its purview, of the observed prudential deficiency and shall request it to forward its corrective action plan.

7. EFFECTIVE DATE

The Guidelines shall take effect from January 1, 2020

Annexure 1

INFORMATION TO BE MAINTAINED IN CREDIT FILES

(a) Information on borrower:

i. Natural Persons – Occupation, Employer, Salary/Income, Financial position/net worth and any other relevant information.

ii. Others – Constitution (proprietorship, partnership, private company, public company, society, club, co-operative, statutory board), business background and history, organization structure, management team/directors, shareholders/proprietor/partners, financial position and performance, and any other relevant information as may be prescribed by the CBN.

(b) Information on credit facility:

iii. Description of facility type

iv. Purpose of facility

v. Terms of facility – limits, interest rates, repayment schedules, expiry dates

vi. Collateral – types, valuation amount, valuation date and where

vii. Applicable, name of the valuer

viii. Guarantors – names, financial position and net worth

(c) Information for appraisal of credit application:

(Certain information would not be applicable for borrowers who are natural persons.)

(1) Assessment and recommendations of account officer/manager

(2) Approval and basis of approval by management/credit committee

(3) Qualitative analyses based on:

- i. borrower Information
- ii. history of relationship with customer
- iii. information on the banking relationship of other related groups of the borrower with the bank

iv. information obtained on the borrower from other institutions and sources, including related offices of the bank

v. analysis of industry and business risk

vi. single customer concentration (if appropriate)

(4) Quantitative analyses based on:

i. Financial position and performance (previous, current and projected)

ii. Business plans, sources and cash flow forecast for meeting repayment requirements

(5) Capital resources

(6) Other commitments

(7) Collateral appraisal and value

(d) Information for periodic credit review

(Certain information would not be applicable for borrowers who are natural persons.)

(1) Assessment and recommendations of credit review officer, including:

i. Credit grading/rating accorded

ii. Provision for losses

iii. Suspension of interest

(2) Approval and basis of approval for renewals; revision in terms and conditions; and changes in credit grading

(3) Latest available information on:

i. Outstanding facilities utilized, including contingent liabilities, commitments and other off-balance sheet transactions

ii. Conduct and servicing of account

iii. Correspondences and call reports from meetings with borrowers and site visits

iv. Current qualitative analyses based on latest updated

v. information on borrower, including review comments from internal and external auditors where available

(4) Current quantitative analyses based on latest updated financial information, appraisals and valuations

(5) Information on the account conduct of other related groups of the borrower

(6) Analysis of industry and business risk

Annexure 2

Financial Soundness Indicators

Indicator	**Indicates**	**Comments and basis of computation**
Regulatory capital to risk- weighted assets	Capital adequacy	Broad measure of capital including items giving less protection against losses, such as subordinated debt, tax credits, unrealized capital gains $\frac{\text{Total qualifying capital}}{\text{Risk weighted assets}} \times 100$
Regulatory Tier 1 capital to risk weighted assets	Capital adequacy	Highest quality capital such as shareholder equity/ retained earnings, relative to risk weighted assets $\frac{\text{Total tier 1 capital}}{\text{Risk weighted assets}} \times 100$
Regulatory Tier 2 capital to risk weighted assets	Capital adequacy	Tier 2 capital relative to risk weighted assets $\frac{\text{Total tier 2 capital}}{\text{Risk weighted assets}} \times 100$

Indicator	Indicates	Comments and basis of computation
Non-performing loans net of provision to capital	Capital adequacy	Indicates potential size of additional provisions that may be needed relative to capital $\frac{\text{NPL – Provision}}{\text{Total qualifying capital}} \times 100$
Capital to assets	Capital adequacy	Broad measure of capital adequacy which is a buffer for losses $\frac{\text{Total qualifying capital}}{\text{Total assets}} \times 100$
Non-performing loans to total gross loans	Asset quality	Indicates the credit quality of banks' loans $\frac{\text{Non-performing loans}}{\text{Gross loans}} \times 100$
Sectoral distribution of loans to total loans	Asset quality	Identifies exposures concentrations to particular sectors $\frac{\text{Loans per Sector}}{\text{Gross loans}} \times 100$
Large exposures to capital	Asset quality	Identifies credit exposure to large borrowers $\frac{\text{Aggregate large exposure}}{\text{Total qualifying capital}} \times 100$ A large exposure is any credit to a customer or a group of related borrowers that is at least 10% of a bank's shareholders fund unimpaired by losses
Geographical distribution of loans to total loans	Asset quality	Identifies credit exposure concentrations to particular countries by the banking system $\underline{\text{Loans per defined geographical area}} \times 100$

Indicator	Indicates	Comments and basis of computation
		Gross loans
Return on assets	Earnings/ profitability	Assesses scope for earnings to offset losses relative to capital or loan and asset portfolio PAT x 100 Total assets
Interest margin to gross income	Earnings/ profitability	Indicates importance of net interest income and scope to absorb losses Net interest income Gross Income
Non-interest expenses to gross income	Earnings/ profitability	Indicates extent to which non-interest expenses weaken earnings Non-interest expense Gross Income
Liquid assets to total assets	Liquidity	Assesses the overall liquidity status of the bank Specified liquid assets x 100 Total assets
Liquid assets to short term liabilities	Liquidity	Assesses the vulnerability of the bank to loss of access to market sources of funding or a run on deposits Specified liquid assets x 100 Deposits due within one year
Spread between highest and lowest inter-bank rate	Liquidity	Market indicator of counterparty risks in the inter-bank market Highest interbank rate – Lowest interbank rate

Indicator	Indicates	Comments and basis of computation
Customer deposits to total (non-inter-bank) loans	Liquidity	Assesses the vulnerability to loss of access to customer deposits $\frac{\text{Customer deposits}}{\text{Loans and advances to customers}} \times 100$
Net open position in foreign exchange to capital	Exposure to FX risk	Measures foreign currency mismatch $\frac{\text{Net Open Position}}{\text{Total Capital}}$
Foreign currency-denominated loans to total loans	Exposure to FX risk	Measures risk to loan portfolios from exchange rate movements $\frac{\text{Naira value of FCY loans}}{\text{Loans and advances to customers and banks}} \times 100$
Foreign currency-denominated liabilities to total liabilities	Exposure to FX risk	Measures extent of dollarization $\frac{\text{Naira value of FCY liabilities}}{\text{Total liabilities}} \times 100$
Return on equity	Earnings/ profitability	Indicates extent to which earnings are available to cover losses $\frac{\text{PAT} \times 100}{\text{Shareholders' fund}}$
Trading income to total income	Earnings/ profitability	Indicates dependence on trading income $\frac{\text{Net trading income}}{\text{Gross earnings}} \times 100$

Indicator	Indicates	Comments and basis of computation
Staff costs to non-interest expenses	Earnings/ profitability	Indicates the extent to which high non-interest expenses reduces earnings $\frac{\text{Staff costs}}{\text{Other operating expenses}} \times 100$
Spread between reference lending and deposit rates	Earnings/ profitability	Indicates dependence of earnings on the interest rate spread. (Reference lending rate – deposit rate) %
Total debt to equity	Leverage	Provides indication of credit risk $\frac{\text{Debt securities issued}}{\text{Shareholders fund}} \times 100$
Earnings to interest and principal expenses	Debt service capacity	Indicates extent to which earnings cover losses are reduced by interest and principal payments $\frac{\text{PAT}}{\text{Interest \& principal payments on debt securities}} \times 100$

Annexure 3

Financial Ratios

FINANCIAL RATIO	MEASURES	BASIS OF COMPUTATION
Average cost of depos	Earnings/ profitability	Interest expense Average deposit (i.e opening + closing balances)/2
Basic earnings per share	Earnings/ profitability	Profit attributable to ordinary shareholders (after deduction of debenture int. and tax) Weighted average no of shares in issue
Cost to income ratio (1)	Earnings/ profitability	Total cost (interest expense, operating cost before loan loss expense)/Gross earnings
Cost to income ratio (2)	Earnings/ profitability	Total overhead cost (operating cost including loan loss expense)/Total net revenue
Cost of interest bearing liabilities	Earnings/ profitability	Interest expense Average interest-bearing liabilities (opening + closing balances)/2
Cost of risk	Earnings/ profitability	loan loss expense Average loans (i.e opening + closing balances)/2
Marginal cost of funds	Earnings/ profitability	Increase in int. expense during the month Increase in average deposits during the same month (annualized)

FINANCIAL RATIO	MEASURES	BASIS OF COMPUTATION
Yield on interest earning assets	Earnings/ profitability	$\frac{\text{Interest income}}{\text{Weighted average interest earning assets}}$
Net Interest margin (1)	Earnings/ profitability	$\frac{\text{Net Interest Income}}{\text{Weighted average interest-earning assets}}$
Net Interest margin (2)	Earnings/profitability	$\frac{\text{Net interest income}}{\text{Total interest income}}$
Net revenue from funds	Earnings/ profitability	Interest income - (interest expense + loan expense)
Operating profit	Earnings/ profitability	Profit before taxation (PBT)
Operating profit margin	Earnings/ profitability	$\frac{\text{Operating profit}}{\text{Gross earnings}}$
Liquidity ratio	Liquidity	$\frac{\text{Liquid assets}}{\text{Deposit liabilities (as prescribed by the CBN)}}$
Loan to deposit ratio	Liquidity	$\frac{\text{Total loans}}{\text{Total deposit}}$
Provisioning level	Asset quality	$\frac{\text{Total provision}}{\text{Total NPL}}$
Risk asset ratio	Asset quality	$\frac{\text{Total loans}}{\text{Total assets}}$
Leverage ratio	Capital adequacy	$\frac{\text{Total debt capital}}{\text{Total shareholders' fund}} \times 100$