



## CENTRAL BANK OF NIGERIA

Financial Policy and Regulation Department  
Central Business District  
P.M.B. 0187  
Garki, Abuja.

Tel: 09-46237401  
E-mail: [fprd@cbn.gov.ng](mailto:fprd@cbn.gov.ng)

**FPR/DIR/GEN/PAR/02/013**

August 23, 2019

### **EXPOSURE DRAFT ON THE PRUDENTIAL GUIDELINES FOR MORTGAGE REFINANCE COMPANIES**

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 Mortgage Refinance Companies. The Guidelines may be downloaded from the CBN website, [www.cbn.gov.ng](http://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](mailto:pgofis@cbn.gov.ng).

Thanks.

A handwritten signature in blue ink, appearing to read 'Kevin N. Amugo'.

**KEVIN N. AMUGO**  
**DIRECTOR, FINANCIAL POLICY AND REGULATION DEPARTMENT**

**CENTRAL BANK OF NIGERIA**

**PRUDENTIAL GUIDELINES FOR MORTGAGE REFINANCE COMPANIES IN NIGERIA**

---

**[AUGUST 2019]**

**[1<sup>ST</sup> DRAFT OF PGS FOR PMB – JUNE 2019]**

## 1.0 Table of Contents

PRUDENTIAL REQUIREMENTS FOR MORTGAGE REFINANCE COMPANIES .....	4
1. RISK MANAGEMENT .....	4
1.1. Credit Policy .....	4
1.2. Credit Concentration Policy.....	5
1.3. Uniform Underwriting Standards .....	5
1.4. Eligible Collaterals.....	6
1.5. Exposures to Directors and their Related Interests .....	6
1.6. Disclosure of Insider-related Credits in Financial Statements.....	6
1.7. Lending Limit .....	7
1.8. Bankers Acceptances and Commercial Papers.....	7
1.9. Basic Information on Borrowers.....	7
1.10. Minimum Information on Credit Print-Outs .....	8
1.11. Management of Interest Rate Risk .....	9
1.12. Revaluation of Fixed Assets.....	9
1.13. Mortgage Refinance Assets to Total Assets Ratio .....	9
1.14. Mortgage Refinance Assets to Loanable Funds Ratio.....	9
1.15. Liquidity Requirements .....	9
1.16. Maintenance of Reserve Fund .....	10
1.17. Capital Adequacy Requirements.....	10
1.18. Restrictions on Declaration of Dividends .....	11
1.19. Credit Ratings.....	11
1.20. Write-Off of Fully Provided Credit Facilities .....	11
1.21. Non-Performing Loans .....	12
1.22. Permissible Investments and Restrictions.....	12

1.23.	Investment in Fixed Assets .....	12
1.24.	Maximum Equity Investment Holding Ratio.....	12
1.25.	Fixed Assets/Long-Term Investments and Branch Expansion .....	12
1.26.	Reconciliation of Inter-Branch Accounts and Treatment Of Suspense Account Entries	13
1.27.	Foreign Currency Borrowing .....	13
1.28.	Other Known Losses .....	13
1.29.	Keeping of Proper Records.....	13
1.30.	Implementation of Examination Report Recommendations .....	14
2.	<i>CODE OF CORPORATE GOVERNANCE</i> .....	14
3.	<i>KNOW-YOUR-CUSTOMER AND ANTI-MONEY LAUNDERING MEASURES</i> .....	14
3.1.	Know Your Customer .....	14
3.2.	Anti-Money Laundering Measures.....	14
3.3.	Records Retention .....	14
4.	<i>LOAN CLASSIFICATION AND LOSS PROVISIONING</i> .....	15
4.1.	Loan classification system .....	15
4.2.	Loan Loss Provisioning other than specialised.....	18
4.3.	Collateral Adjustment for Lost Facilities:.....	18
4.4.	Treatment of IFRS Impairment Charge for Prudential Purposes.....	21
4.5.	Credit Portfolio Disclosure Requirement.....	21
4.6.	Interest Accrual .....	22
4.7.	Classification and Provisioning for Other Assets.....	22
4.8.	Facilities Without Approval.....	23
4.9.	Off- Balance Sheet Engagements.....	23
5.	<i>FINANCIAL SOUNDNESS INDICATORS AND FINANCIAL RATIOS</i> .....	24

6. UPDATE OF THE PRUDENTIAL GUIDELINES.....	25
7. EFFECTIVE DATE.....	25
Annexure 1.....	26
Annexure 2.....	28
Annexure 3.....	33

## **PRUDENTIAL REQUIREMENTS FOR MORTGAGE REFINANCE COMPANIES**

Every Mortgage Refinance Company (MRC) shall comply with the following prudential requirements:

### **1. RISK MANAGEMENT**

#### **1.1. Credit Policy**

- a) An MRC shall put in a place a comprehensive credit policy duly approved by its Board of Directors.
- b) The policy shall include the eligibility requirements for borrowers, terms and conditions for refinancing 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 also indicate the MRC's collateral requirements, including the types of qualifying collateral and the collateral coverage for each type of credit facility, if any, for the different types/classes 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 and commercial papers 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) An MRC shall have a Credit Portfolio Plan as part of its credit concentration 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. The credit concentration policy;
  - v. Historical portfolio performance;
- h) An MRC 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.
- i) The policy shall be reviewed at least every three (3) years.

## **1.2. Credit Concentration Policy**

- a) An MRC shall have a board-approved credit concentration policy, covering the different forms of credit risk concentration to which an MRC may be exposed. The policy shall include an effective system of internal controls to identify, measure, monitor, and control credit risk concentration. Credit concentration to which an MRC may be exposed include:
  - i. Significant exposure to an individual counterparty or group of related counterparties;
  - ii. Credit exposures to counterparties in the same economic sector or geographic region; and
  - iii. Indirect credit exposures arising from an MRC's Credit Risk Mitigation (CRM) activities (e.g. exposure to a single collateral type or to credit protection provided by a single counterparty).
- b) The policy shall specify concentration limits and the methodology for calculating credit concentration. Limits should be defined in relation to an MRC's capital, credit portfolio, total assets or, other appropriate measures.
- c) In defining the portfolio concentration limits for industries or sectors, MRCs shall adopt the Standard Industry Classification of Economic Sectors (SIC) issued by the CBN;
- d) An MRC's management shall conduct stress tests of its credit portfolio at least on a quarterly basis. The tests 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.

In assessing credit risk concentration of an MRC, the CBN will consider the credit concentration policy, the credit portfolio plan and the extent to which the bank considers credit concentration as part of the subjective factors in making specific provisions. Non-compliance with an MRC's established policy on credit concentration and monitoring shall form a basis for supervisory action, which may include additional loan loss provisions.

## **1.3. Uniform Underwriting Standards**

An MRC shall uphold the underwriting standards for mortgages and commercial real estate financing as shall be jointly agreed with the Mortgage Banking Association of Nigeria (MBAN) members, commercial banks, other primary mortgage originators and the CBN.

#### **1.4. Eligible Collaterals**

- a) Eligible collaterals shall be limited to the following assets:
  - (1) First lien mortgages on owner-occupied residential properties that:
    - i. meet the uniform underwriting standards as prescribed by the CBN for all MRCs;
    - ii. are fully insured against common real property perils; and
    - iii. the owner did not record any outstanding obligation to mortgage lender over the past six months.
  - (2) Securities issued, insured or guaranteed by the Federal Republic of Nigeria or any agency thereof.
  - (3) Bank deposits.
  - (4) Other assets as the CBN may specify from time to time.
- b) An MRC shall assess the value of the collateral that is to secure the advances before the advances are made, and at least yearly thereafter for all outstanding advances.
- c) An MRC shall require borrowers to provide additional qualified collateral to compensate for any decline in the value of the pledged collateral securing their outstanding advances.
- d) The MRC shall require borrowers to provide substitute qualified collateral if any security or residential mortgage securing an outstanding advance matures, defaults, or becomes past due by more than 90 days.

#### **1.5. Exposures to Directors and their Related Interests**

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

- a) MRCs shall disclose all transactions involving shareholders, employees, directors and their related/connected interests. Insider-related credits include credits to shareholders, employees, directors and their related interests.
- 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 commitments and other contingent liabilities shall also provide 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.

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 bank'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.

### **1.7. Lending Limit**

The maximum loan to any borrower or group of related borrowers shall be 20 times the paid-up value of the borrower's shares in the MRC or 25 per cent of the MRC's shareholders' funds unimpaired by losses, whichever is lower.

### **1.8. 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.

### **1.9. Basic Information on Borrowers**

An MRC shall:

- a) Ensure that every borrower completes the Loan Application Form (LAF) designed by the MRC and that the LAF is approved by relevant officers or organs of the MRC.
- b) Ensure that the LAF contains such information as the MRC may require to evaluate the application.
- c) Obtain credit reports within 30 days prior to the disbursement of facilities from at least **two (2) credit bureaus** before granting any facility to the customer being refinanced. 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 is mandatory.

- 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:
  - a. proper and effective monitoring of credit facilities extended by the MRC; and
  - b. examiners, as well as the bank's internal and external auditors, to have immediate and complete factual information from which they can form
  - c. an 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:
  - a. the borrower;
  - b. the credit facility;
  - c. the appraisal of the credit application;
  - d. the conduct and status of the account;
  - e. an offer letter showing conditions for draw down; and
  - f. evidence of acceptance of offer by the borrower.

#### **1.10. Minimum Information on Credit Print-Outs**

All MRCs should provide the following minimum details in their credit printouts:

- i. Account number of customer;
- ii. Name of customer;
- iii. Type of facility;

- iv. Date facility was granted;
- v. Interest Rate;
- vi. Authorized limit of facility;
- vii. Original expiry date;
- viii. Restructure Date (if any);
- ix. Balance on account;
- x. Date of last lodgment or credit operation by the customer; and
- xi. Sector/Industry;
- xii. Type and value of security pledged;
- xiii. Borrower's BVN or TIN.
- xiv. Evidence of NCR registration

### **1.11.Management of Interest Rate Risk**

An MRC shall be required to match-fund its long-term advances to borrowers with obligations of similar characteristics and duration so as to maintain minimal risk exposure to fluctuations in market interest rates.

### **1.12.Revaluation of Fixed Assets**

The prior approval of the CBN shall be obtained by an MRC 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. MRCs are to note that revaluation of fixed assets is applicable to own premises only.

### **1.13.Mortgage Refinance Assets to Total Assets Ratio**

An MRC shall maintain a minimum ratio of 60 per cent of mortgage refinance assets to total assets.

### **1.14.Mortgage Refinance Assets to Loanable Funds Ratio**

A minimum of 90 per cent of loanable funds should be used in the creation of mortgage refinance assets. Loanable funds shall be construed as the proceeds from the bonds issues and long-term borrowings.

### **1.15.Liquidity Requirements**

- a) An MRC shall maintain at all times sufficient liquid assets to meet its maturing obligations in amounts that comply with a minimum liquidity ratio of 10 per cent or as may be prescribed by the CBN.
- b) An MRC shall adopt and implement sound and prudent liquidity

management framework, which shall describe in detail in its Asset Liability Management (ALM) Policy and be overseen by the Asset/Liability Management or similar Committee.

- c) The MRC's liquidity management framework shall include:
- i. Techniques that effectively identify, measure and manage its liquidity risk.
  - ii. Periodic analyses of net funding requirements under alternative scenarios.
  - iii. Contingent liquidity planning.

#### **1.16.Maintenance of Reserve Fund**

- a) Every MRC shall maintain a reserve fund appropriated 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 reserve funds is:
- i. Less than the paid-up share capital, transfer to the reserve fund a sum equal to not less than 20 per cent of the net profit; or
  - ii. Equal to or in excess of the paid-up share capital, transfer to the reserve fund a sum equal to not less 10 per cent of net profit;
- b) The CBN may vary the proportion of net profit transferable to the reserve fund.
- c) 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;
  - iii. All identifiable losses have been fully provided for.

#### **1.17.Capital Adequacy Requirements**

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

- e. MRCs that do not possess adequate capital shall be classified in line with the Supervisory Intervention Framework and appropriate actions taken in line with the Framework.

### **1.18.Restrictions on Declaration of Dividends**

No dividend shall be paid until after:

- i. All accumulated losses have been fully absorbed and written off.
- ii. All preliminary and pre-operational expenses have been written off.
- iii. Capital Adequacy ratio has been met.
- iv. All matured obligations have been met.

### **1.19.Credit Ratings**

- a) MRCs shall have a board-approved credit rating policy and model for rating counter parties/ obligors and sectors. 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, MRCs 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.

### **1.20.Write-Off of Fully Provided Credit Facilities**

The following conditions shall apply to the write off of fully provisioned credit facilities:

- a) The facility must have been fully provided for in line with the loan loss provisioning guidelines and must be in MRC's book for at least one year after full provision.
- b) The write-off shall be approved by the MRC's board of directors.
- c) If the facility is insider or related party credit, the prior written approval of CBN is also required.
- d) The write-off shall be appropriately disclosed in the audited financial statements.

### **1.21. Non-Performing Loans**

The maximum ratio of non-performing loans to total gross loans for MRCs shall not at any point in time exceed 10 per cent or such other level as may be prescribed by the CBN from time to time.

### **1.22. Permissible Investments and Restrictions**

The following assets shall be the only permissible MRC's investments:

- (a) Debt obligations issued, insured, or guaranteed by the Federal Republic of Nigeria or any agency thereof.
- (b) Demand deposits, term deposits, or certificates of deposit in banks.
- (c) Deposits and reserves held at the CBN.
- (d) Other investments specifically permitted by the CBN.

At no time, except in the first two (2) years of the MRC's operations, shall its permissible investments exceed 40 per cent of its total assets, unless otherwise stipulated by the CBN in considering the MRC's liquidity needs and its borrowers' demands for loanable funds.

### **1.23. Investment in Fixed Assets**

The maximum amount that an MRC may invest in fixed assets is 20 per cent of its shareholders' funds unimpaired by losses.

### **1.24. Maximum Equity Investment Holding Ratio**

An MRC shall not invest more than 10 per cent of its shareholders' funds unimpaired by losses in the equity of any venture or undertakings without the prior approval of the CBN.

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

No MRC shall be allowed to finance any of the following other than from shareholders' funds unimpaired by losses:

- i. acquisition of fixed assets;
- ii. equity investments and investment in long-term debentures;
- iii. Branch expansion: In consideration of request for any or a combination of the above options, reference shall be made to the aggregate value of the listed items against the shareholders' funds unimpaired by losses.
- iv. For the avoidance of doubt, the eligible shareholders' funds shall be derived only from the most recent audited financial statement approved by CBN.

## **1.26.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 proper head of account within three (3) months from the date the entry is made in the above-named accounts.
- b) All outstanding items in the Inter-Branch Accounts which are not reconciled/ cleared within three (3) months shall be classified in line with the provisioning for licensed commercial banks.
- c) MRCs shall institute an effective internal control system for the operations of Inter-Branch and Suspense Accounts, which ensures reconciliation/clearing of the entries in shortest possible time and also clearly fixes the responsibilities on the official(s) for neglecting the timely reconciliation and clearance.

## **1.27.Foreign Currency Borrowing**

In line with CBN letter OFI/DIR/DOC/GEN/018/271 on foreign borrowing dated February 12, 2018, the aggregate foreign currency borrowing of an MRC shall not exceed 125 per cent of its shareholders' funds unimpaired by losses or such other level as the CBN may specify from time to time. In addition, MRCs shall borrow and lend in the same currency (natural hedging) to avoid currency mismatch associated with foreign currency risk. They shall ensure that the basis of the interest rate for borrowing matches that of lending i.e. floating rate liabilities shall be used to create only floating rate assets and fixed interest rates liabilities used to create only fixed rate assets.

## **1.28.Other Known Losses**

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".

## **1.29.Keeping of Proper Records**

MRCs 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.

### **1.30. Implementation of Examination Report Recommendations**

The Board and management of all MRCs shall ensure the implementation of all recommendations contained in the CBN Examination Reports.

### **1.31. Management of Market Risk**

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

## **2. CODE OF CORPORATE GOVERNANCE**

All MRCs shall comply with the provisions of the Code of Corporate Governance for Mortgage Refinance Companies 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.

## **3. KNOW-YOUR-CUSTOMER AND ANTI-MONEY LAUNDERING MEASURES**

### **3.1. Know Your Customer**

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

### **3.2. Anti-Money Laundering Measures**

MRCs shall be required to comply with the Anti-Money Laundering Act 2011, CBN AML/CFT (for Banks and Other Financial Institutions) Regulation 2013 and relevant circulars issued by the CBN.

### **3.3. Records Retention**

MRCs 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.



## **4. LOAN CLASSIFICATION AND LOSS PROVISIONING**

### **4.1. Loan classification system**

- a. MRCs shall review their credit portfolio continuously (at least once in a quarter) with a view to recognising deterioration in credit quality. Such reviews shall classify the credit exposures based on the risk of default.
- b. In order to facilitate comparability of MRCs' classification of their credit portfolios, the assessment of risk of default shall be based on criteria which shall include, but are not limited to repayment performance and borrower's repayment capacity on the basis of current financial condition.
- c. For syndicated facilities, the classification shall be the same across all MRCs involved in the syndication. Thus, the worst classification by any of the MRCs involved in the syndication shall apply across board.
- d. Credit facilities shall be classified as "performing", "watchlist" 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 not past due by more than 30 days.
  2. Watchlist facility: – A facility where principal and/or interest is past due by 31 to 90 days;
  3. 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 90 days;
    - ii. interest past due for 91 days or more have been capitalised, rescheduled or rolled over into a new loan;
    - iii. off balance sheet obligations crystallise.
- e. Non-performing credit facilities shall be classified into three categories namely, sub-standard, doubtful or lost on the basis of the criteria below:

#### **1) Sub-Standard**

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

- i. Objective Criteria: credit facilities on which principal and/or interest past due remain outstanding for at least 91 days but not more than 180 days.
- ii. Subjective Criteria:
  - a. Credit facilities which display well-defined weaknesses, which 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: credit facilities on which unpaid principal and/or interest remain outstanding for at least 181 days but not more than 360 days.
- ii. Subjective Criteria: credit 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 360 days and off-balance sheet engagements that have crystalized.
  - 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.
- f. A restructured or rolled-over facility shall not be treated as a new facility.
  - g. 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.
  - h. When 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 90 days.
  - i. For a “non-performing” or “watchlist” facility to be re-classified as “performing”, outstanding interest and due but unpaid principal shall not exceed 30 days. Similarly, for a “non-performing” facility to be re-classified as “watchlist”, outstanding interest and due but unpaid principal shall not exceed 90 days.
  - j. MRCs are required to adopt the criteria specified in paragraphs 4.1(a) to 4.1(e) to classify their credit portfolios in order to reflect the recoverable values of their credit facilities.
  - k. MRC should note that the CBN reserves the right to object to the classification of any credit facility and to prescribe the classification it considers appropriate for such credit facility.

## **4.2. Loan Loss Provisioning other than specialized**

- (a) MRCs are required to make adequate provisions for perceived losses based on the credit portfolio classification system prescribed in paragraph 4.1. 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 perceived 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, MRCs 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 non-performing, interest overdue by more than 90 days shall be fully (100 per cent) provided for and recognized on cash basis only.
    - ab. For facilities classified as non-performing, principal repayments that are past due shall be fully (100 per cent) provided for and recognized on cash basis only.
    - ac. For outstanding principal of facilities classified as “watchlist”, 5 per cent provision on the outstanding principal amount.
    - ad. For principal repayments that are not yet due on non-performing credit facilities, provisions shall be made on the outstanding principal balance as follows:
      - Sub-Standard: 20 per cent;
      - Doubtful: 50per cent; and
      - Lost: 100 per cent.

## **4.3. Collateral Adjustment for Lost Facilities:**

- a)** To encourage utilisation of more credit enhancement and mitigation strategies, collateral adjustments shall be applied in loan provisioning.
  - 1. For collateral to be considered for “Haircut Adjustments”, it must be:
    - i. Perfected;

- ii. Realisable, with no restrictions on sale; and
  - iii. Regularly valued with transparent method of valuation;
- 2. All documentation used in collateralized transactions must be binding on all parties and legally enforceable in all jurisdictions. MRCs 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.
- 3. Valuations 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.
- 4. The values of mortgaged 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. Valuers shall also mention in their report 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).
- 5. The following are collateral instruments eligible for collateral adjustment:
  - i. Cash
  - 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.

6. The following hair cut adjustments shall be applicable on all loan types classified as lost:

<b>Description of Collateral</b>	<b>Haircut</b>
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	20%
Residential legal mortgage	50%
Commercial legal mortgage	50%

7. 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).

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

**b) Other Conditions for Haircut Adjustments**

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

2. 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.
3. A maximum of 1 year is allowed for the haircut adjustments pending which the collaterals shall be realized and shortfall in provision taken.
4. If the facility on which haircut adjustment has been applied remains non-performing after one year, then the haircut adjustment will be disregarded.

#### **4.4. Treatment of IFRS Impairment Charge for Prudential Purposes**

MRCs 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 **prudential 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.
- b. The non-distributable regulatory risk reserve shall not be recognised as a component of qualifying capital.

#### **4.5. Credit Portfolio Disclosure Requirement**

- a. An MRC shall provide in its audited financial statements, an analysis of its credit portfolio into “performing”, “watchlist”, 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 funding liabilities in the financial statement.

- d. An MRC is also to provide a vintage analysis of its credit portfolio as follows:

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

#### 4.6. Interest Accrual

- a. It is the responsibility of an MRC's management to recognize interest 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) provided for and recognized on cash basis only.

#### 4.7. Classification and Provisioning for Other Assets

- (a) The term "other assets" relates to those asset items that are not shown separately in the balance sheet of an MRC. These items include impersonal accounts (of various descriptions), suspense accounts such as frauds and cashiers' shortages, cheques purchased, uncleared effects and inter-branch items. 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” 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” 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 litigation.
- 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.

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

#### **4.8. Facilities Without Approval**

MRCs shall not allow credit facilities without due approval. For facilities inadvertently extended without approval, the accounts shall be regularized within 30 days or be fully provided for.

#### **4.9. 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 MRC may likely sustain. Off-balance-sheet engagements include letters of credit, 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 pledged
  - iv. Performance of other facilities being enjoyed by the customer, e.g. loans 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 Section 4.1 and 4.2.
- d. Off-balance sheet engagements shall not form part of balance sheet totals while their disclosure in note form in the financial statements shall be in appropriate classifications
- e. MRCs shall make a general provision of 1 per cent of the credit equivalent value (CEV) of off-balance sheet engagements.
- f. To compute the CEV, MRCs shall apply a credit conversion factor of 50 per cent to all categories of off-balance sheet engagements.

## **5. FINANCIAL SOUNDNESS INDICATORS AND FINANCIAL RATIOS**

- a) An MRC 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 should be set and actual results computed and compared to the benchmarks at least on a quarterly basis. The report should 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 are presented in **Annexures 2** and **3**.

**6. UPDATE OF THE PRUDENTIAL GUIDELINES**

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

**7. EFFECTIVE DATE**

This 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:

- i. Description of facility type
- ii. Purpose of facility
- iii. Terms of facility – limits, interest rates, repayment schedules, expiry dates
- iv. Collateral – types, valuation amount, valuation date and where
- v. applicable, name of the valuer
- vi. 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
<b>Regulatory capital to risk- weighted assets</b>	Capital adequacy	Broad measure of capital including items giving less protection against losses, such as subordinated debt, tax credits, unrealized capital gains  $\frac{\text{Total qualifying capital}}{\text{Risk weighted assets}} \times 100$
<b>Regulatory Tier 1 capital to risk weighted assets</b>	Capital adequacy	Highest quality capital such as shareholder equity/ retained earnings, relative to risk weighted assets  $\frac{\text{Total tier 1 capital}}{\text{Risk weighted assets}} \times 100$
<b>Regulatory Tier 2 capital to risk weighted assets</b>	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
<b>Non-performing loans net of provision to capital</b>	Capital adequacy	Indicates potential size of additional provisions that may be needed relative to capital  $\frac{\text{NPL} - \text{Provision}}{\text{Total qualifying capital}} \times 100$
<b>Capital to assets</b>	Capital adequacy	Broad measure of capital adequacy which is a buffer for losses  $\frac{\text{Total qualifying capital}}{\text{Total assets}} \times 100$
<b>Non-performing loans to total gross loans</b>	Asset quality	Indicates the credit quality of banks' loans  $\frac{\text{Non-performing loans}}{\text{Gross loans}} \times 100$
<b>Sectoral distribution of loans to total loans</b>	Asset quality	Identifies exposures concentrations to particular sectors  $\frac{\text{Loans per Sector}}{\text{Gross loans}} \times 100$
<b>Large exposures to capital</b>	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
<b>Geographical distribution of loans to total loans</b>	Asset quality	Identifies credit exposure concentrations to particular countries by the banking system  $\frac{\text{Loans per defined geographical area}}{\text{Total loans}} \times 100$

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



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

Indicator	Indicates	Comments and basis of computation
<b>Staff costs to non-interest expenses</b>	Earnings/ profitability	Indicates the extent to which high non-interest expenses reduces earnings  $\frac{\text{Staff costs}}{\text{Other operating expenses}} \times 100$
<b>Spread between reference lending and deposit rates</b>	Earnings/ profitability	Indicates dependence of earnings on the interest rate spread.  (Reference lending rate – deposit rate) %
<b>Total debt to equity</b>	Leverage	Provides indication of credit risk  $\frac{\text{Debt securities issued}}{\text{Shareholders fund}} \times 100$
<b>Earnings to interest and principal expenses</b>	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
<b>Average cost of deposits</b>	Earnings/ profitability	$\frac{\text{Interest expense}}{\text{Average deposit (i.e opening + closing balances)}/2}$
<b>Basic earnings per share</b>	Earnings/ profitability	$\frac{\text{Profit attributable to ordinary shareholders (after deduction of debenture int. and tax)}}{\text{Weighted average no of shares in issue}}$
<b>Cost to income ratio (1)</b>	Earnings/ profitability	$\frac{\text{Total cost (interest expense, operating cost before loan loss expense)}/\text{Gross earnings}}{\text{Gross earnings}}$
<b>Cost to income ratio (2)</b>	Earnings/ profitability	$\frac{\text{Total overhead cost (operating cost including loan loss expense)}/\text{Total net revenue}}{\text{Total net revenue}}$
<b>Cost of interest bearing liabilities</b>	Earnings/ profitability	$\frac{\text{Interest expense}}{\text{Average interest-bearing liabilities (opening + closing balances)}/2}$
<b>Cost of risk</b>	Earnings/ profitability	$\frac{\text{loan loss expense}}{\text{Average loans (i.e opening + closing balances)}/2}$
<b>Marginal cost of funds</b>	Earnings/ profitability	$\frac{\text{Increase in int. expense during the month}}{\text{Increase in average deposits during the same month (annualized)}}$

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

