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EXPOSURE DRAFT ON THE PRUDENTIAL GUIDELINES FOR PRIMARY MORTGAGE 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 Primary Mortgage 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 PRIMARY MORTAGE BANK IN NIGERIA

[AUGUST 2019]

[1ST DRAFT OF PGS FOR PMB – JUNE 2019]

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PRUDENTIAL REQUIREMENTS FOR PRIMARY MORTGAGE BANK

Every Primary Mortgage Bank (PMB) shall comply with the following prudential requirements:

1. RISK MANAGEMENT

1.1. Credit Policy

a) A PMB 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 PMB'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 PMBs 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) PMBs 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) PMBs 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) A PMB shall have a board approved credit concentration policy covering the different form of credit risk concentration to which it may be exposed. The policy shall include an effective system of internal controls to identify, measure, monitor, and control credit risk concentrations.

   Credit risk concentrations to which a PMB 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 a PMB's Credit Risk Mitigation (CRM) activities (e.g. exposure to a single collateral type or to credit protection provided by a single counterparty).

b) Limits should be defined in relation to a PMB's capital, total assets or, other appropriate measures.

c) A PMB'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 result of the test and make adequate plans to respond to plausible adverse changes in market condition

d) A PMBs shall have a credit portfolio plan as part of its Credit policy which shall consider the following amongst others:

   i. The target market and portfolio size;
   ii. Macro-economic condition including fiscal and monetary policy guidelines;
   iii. Minimum risk acceptance criteria;
   iv. Credit concentration policy;
   v. Historical portfolio performance;

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

1.3. Exposures to Directors and their Related Interests

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

1.4. Disclosure of Insider-Related Credits in Financial Statements

(a) PMBs shall full 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 analysed 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.

The requirements of this sections 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 PMB'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. Lending Limits

a) The maximum loan to any individual borrower shall not exceed one percent

[1%] while a loan to group of borrowers, a corporative or corporate bodies, shall not exceed five percent [5%] of the shareholders' funds unimpaired by losses or as may be prescribed by the CBN.

b) The credit as applicable to this section shall include any advance, loan, financial guarantee, credit facility or any other liability; and for the purpose of this section, all advances, loans or credit facilities extended to any person shall be aggregated in the determination of the specified limit and shall include all credits extended to any subsidiaries or associates of a corporate body.
c) A large exposure is any credit to a customer or a group related borrowers that is at least 5% of a PMB's shareholders fund unimpaired by losses.
d) Aggregate large exposures in any PMB shall not exceed five (5) times the shareholders fund unimpaired by losses.

1.6. 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.

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

PMBs shall:

(a) Ensure that every borrower completes the Loan Application Form (LAF) designed by the PMB and that the LAF is approved by relevant officers or organs of the PMB.
(b) Ensure that the LAF contains such information as the PMB may require to evaluate the application.
(c) Not disburse any credit facility (including renewal, enhancement and rescheduling/restructuring) until the Loan Application Form (LAF) designed by PMB is completed by the customer and approved by the relevant officer
(d) Ensure that the LAF contains such information as the PMB may require to evaluate the credit application, which may include recent audited financial statements/management accounts, projected cash flows, records of past bank accounts.

(e) Obtain credit reports within 30 days prior to the disbursement of facilities from at least **two (2) credit bureaus** before granting any facility to their customers. The result of the enquiry shall be documented in the credit file of the customer. In addition, compliance with the CBN circular BSD/DIR/GEN/CIR/04/014 issued on April 30, 2010 is mandatory.

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

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

(h) Obtain the Tax Identification Number (TIN) of corporate borrowers

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

(j) 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 PMB; and
   ii. examiners, as well as the PMB's internal and external auditors, to have immediate and complete factual information from which they can form an objective opinion on the credit facilities.

(k) 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.

1.8. Minimum Information on Credit Print-Outs

PMBs shall 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;
xi. Sector/Industry;
xii. Type and value of security pledged;
xiii. Borrower's BVN or TIN; and
xiv. Evidence of NCR registration

1.9. Management of Market Risk

a) PMBs 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.
c) In addition to any hedging instruments held, a PMB shall be required to match its long-term loans to borrowers with liabilities of similar characteristics and duration so as to maintain minimal risk exposure to fluctuations in market interest rates.
d) A PMB shall employ appropriate risk management tools to assess and report to the CBN each quarter its market risk exposure.

1.10. Foreign Currency Borrowing

a. In line with CBN letter OFI/DIR/DOC/GEN/018/271 on foreign borrowing dated February 12, 2018, the aggregate foreign currency borrowing of a PMB 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.
b. In addition, PMBs 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.

1.11. Liquidity Requirements

a) The liquidity ratio shall be the proportion of liquid assets to borrowings due within one (1) year.

b) A PMB shall maintain a minimum liquidity ratio of 20% on specified liquid assets against deposit liabilities. Specified liquid assets shall include Treasury Bills, fund placements, money at call and short-term investments with not more than 90 days maturity or as may be determined by the CBN. A PMB shall adopt and implement sound and prudent liquidity management framework, which shall describe in detail its Asset Liability Management (ALM) Policy and be overseen by its Asset/Liability Management or similar Committee.

c) A PMB'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.

1.12. Maintenance of Statutory Reserves

d) Every PMB shall maintain a reserve fund and shall out of its net profit after taxation and before any dividend is declared, transfer to the statutory reserves as follows:
   i. Where the reserve fund is less than the paid-up share capital, a minimum of 20% of the net profits; or
   ii. Where the reserve fund is equal to or in excess of the paid-up share capital, a minimum of 10% of net profit;
   iii. No transfer to the reserve fund shall be made until all identifiable losses have been made good.

1.13. Capital Adequacy Requirements

a) A PMB 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.

b) The Capital Adequacy Ratio (CAR) of PMBs shall be measured as the ratio of qualifying capital to its risk weighted assets.
c) The minimum CAR for PMBs shall be 10 per cent or as may be prescribed by the CBN from time to time.
d) PMBs shall maintain a ratio of not more than 1:10 of its shareholders' funds unimpaired by losses to its net credits.
e) The CBN may require a PMB to maintain additional capital as it considers appropriate in respect of specific concentration of risks or market risks or connected lending
f) Based on a level of capital adequacy ratio below the acceptable limit, a PMB may be classified as follows:
    i. Under-capitalised;
    ii. Significantly under-capitalised;
    iii. Critically under-capitalised; and
    iv. Insolvent

PMBs that do not possess adequate capital will be classified and appropriated supervisory action taken in line with the Supervisory Intervention Framework.

1.14. Restrictions on Declaration of Dividend

A PMB shall not declare or pay a dividend on its shares until it has:

i. Completely written-off all its preliminary and pre-operational expenses;
ii. Made the required provisions for non-performing loans and other erosions in asset values;
iii. Satisfied the minimum CAR requirement; and
iv. Met all matured obligations.

1.15. Credit Rating

a. PMBs shall have a board-approved credit rating policy and model for rating counterparties/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/or counterparty level, PMBs 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.

1.16. 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.

1.17. Policies and Procedures for Write-Off of Fully Provided Credit Facilities

a) The facility shall have been fully provided for in line with the loan loss provisioning guidelines and shall be in PMB's book for at least one year after full provision.
b) There shall 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 shall be appropriately disclosed in the audited financial statement.

1.18. Keeping of Proper Records

a) All PMBs 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 PMBs 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.

1.19. *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”.

1.20. *Implementation of Examination Report Recommendations*

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

1.21. *Revaluation of Fixed Assets*

The prior approval of the CBN shall be obtained by a PMB 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. PMBs are to note that revaluation of fixed assets is applicable to own premises only

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

No PMB 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.

2. CODE OF CORPORATE GOVERNANCE

All PMBs shall comply with the provisions of the Code of Corporate Governance for Primary Mortgage 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.

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

3.1. Know Your Customer

All DFIs 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

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

3.3. Records Retention

All PMBs shall keep records on all transactions for a minimum period of five (5) 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.

3.4. Suspicious Transactions

PMBs 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.

4. LOAN CLASSIFICATION AND LOSS PROVISIONING

4.1. Credit Portfolio Classification System for Facilities Other Than "Specialized Loans"

a. PMBs shall review their credit portfolio continuously for 30 days with a view to recognising deterioration in credit quality. Such reviews shall classify PMBs' credit exposures based on the risks of default.

b. In order to facilitate comparability of PMBs' 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 PMBSs involved in the syndication. Thus, the worst classification by any of the PMBs in the syndicate 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 payments have been settled or if not past due for more than 30 days.
   2. Watchlist facility: – A facility where principal and/or interest is past due by 31 days 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 obligation crystalizes

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 as on which past due principal and/or interest remain outstanding for more than 90 days but less 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: facilities on which unpaid principal and/or interest remain outstanding for at least 180 days but less than 360 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 PMB'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 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 interest shall not exceed 30 days. Similarly, before a "non-performing" facility to be reclassified as "watchlist", outstanding interest and due but unpaid principal shall not be more than 60 days.

j. Banks 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. PMBs 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.

4.2. Non-performing Loans to Total Loans Ratio

No PMB shall permit the non-performing loans in its portfolio to exceed 10% of total loans and advances.

4.3. Provisioning for Non-Performing Credits

The nature and tenor of loans shall be key factors in providing for non-performing facilities. To this end, the loans of a PMB may be categorized into three (3) namely; Mortgage loans, commercial real estate financing and other loans.

a) Mortgage Loans

Category	**Classification**	**Days past due**	**Treatment of Income**	**% of Provision**
1	Watch list	Where mark-up/ interest or principal is overdue (past due) by more than 90 days from the due date	Unrealized mark-up/ interest to be put in Suspense Account and not to be credited to Income Account except when realized in cash.	1% of **total outstanding** principal balance
2	Substandard	Where mark-up/ interest or principal is overdue (past due) by more than 180 days from the due date	As above	10% of **total outstanding** principal balance
3	Doubtful	Where mark-up/ interest or principal	As above	Un-provided balance should not

		is overdue (past due) by more than 1 year from the due date		exceed 50% of the estimated net realizable value of the security (Determine the net realizable value of collateral as objectively as possible, divide this value by two and net off earlier provisions on the same loan. Unprovided balance should then be ≤ 50%. Unprovided balance should then be ≤ 50%)
4	Lost	Where mark-up/ interest or principal is overdue (past due) by more than 2 years from the due date	As above	100% of **total principal** outstanding balance

b) Commercial Real Estate Financing

Category	**Classification**	**Days past due**	**Treatment of Income**	**% of Provision**
1	Watch list	Where the amount recovered during a period is between 60% and 75% of the	Unrealized mark-up/ interest to be put in Suspense Account and not	1% of total outstanding principal balance.

		amount due and/ or any installment thereof is overdue by more than 180 days.	to be credited to Income Account except when realized in cash.	
2	Substandard	Where the amount recovered during a period is less than 60% of the amount due and/or any installment thereof is overdue by 180 days to 1 year.	As above	25% of total outstanding principal balance.
3	Doubtful	Where the amount recovered during a period is less than 60% of the amount due and/or any installment thereof is overdue by 1 year to 2 years.	As above	50% of total outstanding principal balance.
4	Very Doubtful	Where the amount recovered during a period is less than 60% of the amount due and/or any installment thereof is overdue by 2 years to 3 years.	As above	75% of total outstanding principal balance
5	Lost	Where the amount recovered during a period is less than 60% of the amount due and/or any installment thereof is overdue by more than 3 years.	As above	100% of total outstanding principal balance

c) Other Loans (all loans that are neither mortgage nor commercial real estate loans but which are permissible under Section 1.2 of the *Revised Guidelines for Primary Mortgage Banks in Nigeria 2011* or as may be revised by the CBN from time to time). The provisions for loans that meet this criterion shall remain as follows:

Category	**Classification**	**Days past due**	**Treatment of Income**	**% of Provision**
1	Sub-standard	91 – 180 days	Unrealized mark-up/ interest to be put in Suspense Account and not to be credited to Income Account except when realized in cash.	10% on total outstanding principal.
2	Doubtful	181 – 360 days	As above	50% on total outstanding principal.
3	Lost	Above 360 days	As above	100% of total outstanding principal.

NB: Performing loans would still attract 2% general provision

4.4. Collateral Adjustment for lost Facilities

A. To encourage utilisation of more credit enhancement and mitigation strategies, collateral adjustments shall be applied in loan provisioning.

i. For collateral to be considered for "Haircut Adjustments", it must be:
   a. Perfected;
   b. Realisable, with no restrictions on sale; and
   c. Regularly valued with transparent method of valuation;

ii. All documentation used in collateralized transactions must be binding on all parties and legally enforceable in all jurisdictions. PMBs shall 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.

iii. 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.

iv. 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).

v. The following are collateral instruments eligible for collateral adjustment:

   a. Cash
   b. Treasury bills and other government securities.
   c. Quoted equities and other traded securities.
   d. Bank guarantees and receivables of blue chip companies.
   e. Residential legal mortgage.
   f. Commercial legal mortgage
   g. Other collaterals as defined by the CBN from time to time.

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

Description of Collateral	**Haircut**
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%

vii. 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).

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

4.5. 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 PMB's auditors and must be ratified by the CBN.
2. For the purpose of (i) 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.

4.6. Treatment of IFRS Impairment Charge for Prudential Purposes

PMBs 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.

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

4.7. Credit Portfolio Disclosure Requirement

a. Each PMB is required to 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 deposit liabilities in the financial statement.

d. PMBs are also to provide a vintage analysis of their portfolios as follows:

	<= 1 year	> 1 year <=3 years	> 3 years	Total
	₦	₦	₦	₦

Performing				
Watchlist				
Non-performing Total				

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

4.8. Interest Accrual

a) It is the responsibility of a PMB'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.

4.9. 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 a PMB. These items include impersonal accounts (of various descriptions), 29 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:

i. Sub-Standard

a. 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.

b. A minimum provision of 20 per cent shall be made for "other assets" classified as sub-standard.

ii. Doubtful

a. 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.

b. A minimum of 50 per cent provision shall be made for "other assets" classified as doubtful.

iii. **Lost**

a. 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.

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

4.10. Facilities without Approval:

PMBs shall not allow credit facilities without due approval. For facilities that were inadvertently extended without approval, the account shall be regularized within 30 days or be fully provided for.

4.11. 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 a PMB 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 Paragraph 27.D.iii and 28.B.iii
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. Short-term self-liquidation trade related contingencies (such as documentary credits collateralized by the underlying shipments);
   iv. Sale and repurchase agreements and assets sales with recourse, where the credit risk remains with the PMB;
   v. Forward assets purchases, forward deposits and partly-paid shares and securities, which represent commitments with certain draw down;
   vi. Note issuance facilities and revolving underwriting facilities;
   vii. Other commitments (e.g. formal standby facilities and credit lines) with an original maturity of over one year; and
   viii. Similar commitments with an original maturity of up to one year, or which can be unconditionally cancelled at any time.

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

x. Lending of PMBs' securities or the posting of securities as collateral, including instances where these arise out of repo-style transactions (i.e. repurchase/reverse repurchase and securities lending/securities borrowing transactions)

e. PMBs 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, PMBs shall apply a credit conversion factor of 50 per cent to all categories of off-balance sheet engagements.

5. OPERATING RATIOS

5.1. Mortgage Assets to Total Assets Ratio

A PMB shall maintain a minimum ratio of 60% of mortgage assets to total assets

5.2. Mortgage Assets to Loanable Funds Ratio

A minimum of 70% of loanable funds should be used in the creation of mortgage assets. Loanable funds shall be construed as the amount of total deposit plus funds from NHF, refinancing entities and other on-lending facilities less funds required to meet cash reserve and liquidity ratios of a PMB.

5.3. Real Estate Construction Finance to Loanable Funds

A PMB shall not exceed a maximum of 30% of real estate construction finance to loanable funds.

5.4. Minimum Mortgage Assets in Residential Mortgage

No PMB shall invest less than 75% of its mortgage assets in residential mortgages.

5.5. Limit of Investment in Fixed Assets

PMBs shall invest not more than 20% of its shareholders' funds unimpaired by losses in fixed assets.

5.6. *Maximum Loan to Value Ratio*

The maximum loan to value ratio (LTV) shall not exceed 80%. Consequently, the equity contribution of the borrower shall not fall below 20%.

5.7. *Maximum Equity Investment Holding Ratio*

No PMB shall invest more than 10% of its shareholders' funds unimpaired by losses in the equity of any venture or undertakings without the prior approval of the CBN.

5.8. *Cash Reserve Ratio (CRR)*

A minimum cash reserve ratio of 2% of adjusted deposit liabilities (i.e. Total deposits plus deposits in suspense and dormant accounts) shall be in its reserve account with the CBN.

6. *FINANCIAL SOUNDNESS INDICATORS AND FINANCIAL RATIOS*

a. A PMB 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.

7. *UPDATE OF THE PRUDENTIAL GUIDELINES*

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

8. *EFFECTIVE DATE*

These 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 applicable, name of the valuer

v. 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 PMB

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

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 Total tier 1 capital x 100

Indicator	Indicates	Comments and basis of computation
		Risk weighted assets
Regulatory Tier 2 capital to risk weighted assets	Capital adequacy	Tier 2 capital relative to risk weighted assets Total tier 2 capital x 100 Risk weighted assets
Non-performing loans net of provision to capital	Capital adequacy	Indicates potential size of additional provisions that may be needed relative to capital NPL – Provision X 100 Total qualifying capital
Capital to assets	Capital adequacy	Broad measure of capital adequacy which is a buffer for losses Total qualifying capital X 100 Total assets
Non-performing loans to total gross loans	Asset quality	Indicates the credit quality of banks' loans Non-performing loans X 100 Gross loans
Sectoral distribution of loans to total loans	Asset quality	Identifies exposures concentrations to particular sectors Loans per Sector X 100 Gross loans
Large exposures to capital	Asset quality	Identifies credit exposure to large borrowers Aggregate large exposure X 100 Total qualifying capital

Indicator	Indicates	Comments and basis of computation
		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 Loans per defined geographical area X 100 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

Indicator	Indicates	Comments and basis of computation
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
Customer deposits to total (non-inter-bank) loans	Liquidity	Assesses the vulnerability to loss of access to customer deposits <u>Customer deposits</u> x 100 Loans and advances to customers
Net open position in foreign exchange to capital	Exposure to FX risk	Measures foreign currency mismatch <u>Net Open Position</u> Total Capital
Foreign currency-denominated loans to total loans	Exposure to FX risk	Measures risk to loan portfolios from exchange rate movements <u>Naira value of FCY loans</u> x 100 Loans and advances to customers and banks
Foreign currency-denominated	Exposure to FX risk	Measures extent of dollarization

Indicator	Indicates	Comments and basis of computation
liabilities to total liabilities		Naira value of FCY liabilities x 100 Total liabilities
Return on equity	Earnings/ profitability	Indicates extent to which earnings are available to cover losses PAT x 100 Shareholders' fund
Trading income to total income	Earnings/ profitability	Indicates dependence on trading income Net trading income x 100 Gross earnings
Staff costs to non-interest expenses	Earnings/ profitability	Indicates the extent to which high non-interest expenses reduces earnings Staff costs x 100 Other operating expenses
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 Debt securities issued x 100 Shareholders fund

Indicator	Indicates	Comments and basis of computation
Earnings to interest and principal expenses	Debt service capacity	Indicates extent to which earnings cover losses are reduced by interest and principal payments <u>PAT x 100</u> Interest & principal payments on debt securities

Annexure 3

Financial Ratios

FINANCIAL RATIO	MEASURES	BASIS OF COMPUTATION
Average cost of depo	Earnings/ profitability	<u>Interest expense</u> Average deposit (i.e opening + closing balances)/2
Basic earnings per share	Earnings/ profitability	Profit attributable to ordinary shareholders <u>(after deduction of debenture int. and tax)</u> 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

FINANCIAL RATIO	MEASURES	BASIS OF COMPUTATION
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)
Yield on interest earning assets	Earnings/ profitability	Interest income Weighted average interest earning assets
Net Interest margin (1)	Earnings/ profitability	Net Interest Income Weighted average interest-earning assets
Net Interest margin (2)	Earnings/profitability	Net interest income Total interest income
Net revenue from funds	Earnings/ profitability	Interest income - (interest expense + loan expense)
Operating profit	Earnings/ profitability	Profit before taxation (PBT)

FINANCIAL RATIO	MEASURES	BASIS OF COMPUTATION
Operating profit margin	Earnings/ profitability	Operating profit / Gross earnings
Liquidity ratio	Liquidity	Liquid assets / Deposit liabilities (as prescribed by the CBN)
Loan to deposit ratio	Liquidity	Total loans / Total deposit
Provisioning level	Asset quality	Total provision / Total NPL
Risk asset ratio	Asset quality	Total loans / Total assets
Leverage ratio	Capital adequacy	Total debt capital / Total shareholders' fund x100

GLOSSARY

BA	Banker's Acceptance
BVN	Bank Verification Number
CBN	Central Bank of Nigeria
CEO	Chief Executive Officer
CP	Commercial Papers
CRMS	Credit Risk Management System
FATF	Financial Action Task Force
FCA	Financial Completion Agreement
FSV	Forced Sale Value
IFRS	International Financial Reporting Standards
IRV	Integrated Voice Recording
KYC	Know Your Customer
LAF	Loan Application Form
LNG	Liquefied Natural Gas
LPG	Liquefied Petroleum Gas
NDIC	Nigeria Deposit Insurance Corporation
NPL	Non-Performing Loans
OFISD	Other Financial Institutions Supervision Department
PFA	Project Funds Agreement
PIN	Personal Identification Number
SEC	Securities and Exchange Commission
SME	Small and Medium Enterprise
TIN	Tax Identification Number