CENTRAL BANK OF NIGERIA

PRUDENTIAL GUIDELINES FOR DEPOSIT MONEY BANKS IN NIGERIA

EFFECTIVE: 1 JULY 2010

CONTENTS

1 INTRODUCTION:

Background:

The Nigerian banking sector witnessed dramatic growth post consolidation (2005) and the developments posed a lot of challenges for the industry and regulation. The initial perceptions that the Nigerian banking system was sound and insulated from global financial crisis were misplaced. The factors that led to creation of extremely fragile financial system that was tipped into crisis by the global financial meltdown include:

1. Macro-economic instability caused by large and sudden capital outflows;
2. Major failures in corporate governance at banks;
3. Lack of investor and consumer sophistication;
4. Inadequate disclosure and transparency about financial position of banks;
5. Critical gaps in prudential guidelines (current prudential guidelines was issued in 1990) and
6. Uneven supervision and enforcement

In addressing the above listed challenges, the CBN introduced a Four (4) Pillar Reform Programme in 2010 tailored towards:

- Enhancing the quality of banks;
- Establishing financial stability;
- Enabling healthy financial sector evolution; and
- Ensuring the financial sector contributes to the real economy

As part of the initiative to enhance the quality of the banks, the CBN undertook a review of the prudential guidelines. In this regard, the revised Prudential Guidelines aim to address various aspects of banks' operations, such as risk management, corporate governance, KYC and anti-money laundering/ counter financing of terrorism and loan loss provisioning. The guidelines also aim to address the peculiarities of different loan types and financing to different sectors.

Loan Loss Provisioning Guidelines:

The loan loss provisioning guidelines which form part of the enhanced Prudential Guidelines provide guidance on recognition and measurement of loans, establishment of loan loss allowances, credit risk disclosure and related matters. It sets out CBN's views on sound loan provisioning and disclosure practices for deposit money banks in Nigeria.

The guidelines also serve as a basic framework for evaluation of banks' provisioning policies and practices. The objectives of the enhanced provisioning guidelines are to:

1) Promote enhanced provisioning policies and practices, which are consistent with sound risk management practices for Nigerian Banks;

2) Ensure that provisioning guidelines support the life cycle and gestation periods of the various specialized loans;

3) Provide a framework for ensuring that the current provisioning guidelines are counter-cyclical; and

4) Provide framework for "Haircuts" adjustments for LOST Facilities.

These prudential guidelines should be regarded as minimum requirements and licensed banks are encouraged to implement more stringent policies and practices to enhance mitigation of risks.

SAMUEL A. ONI
DIRECTOR OF BANKING SUPERVISION

2.0 DEFINITIONS

(a) **Commodities Finance** refers to structured short-term lending to finance inventories or receivables of exchange-traded commodities (e.g. crude oil, metals, crops or farm produce), where the exposure will be repaid from the proceeds of the sale of the commodity and the borrower has no independent capacity to repay the exposure.

(b) **Retail financing** means any financing allowed to individuals for meeting their personal, family or household needs. The facilities categorized as retail financing are as follows:

(i) **Credit Cards** mean cards which allow a customer to make payments on credit.

Supplementary credit cards shall be considered part of the principal borrower for the purposes of these guidelines.

(ii) **Auto Loans** mean the loans to purchase the vehicle for personal use.

(iii) **Housing Finance** means loan provided to individuals for the purchase of residential house / apartment / land. The loans availed for the purpose of making improvements in house / apartment / land shall also fall under this category.

(iv) **Personal Loans** mean the loans to individuals for personal needs.

(v) Any other exposure to an individual borrower as may be categorized by the CBN.

(c) **Forced Sale Value (FSV)** means the value which fully reflects the possibility of price fluctuations and can currently be obtained by selling the collateralised assets in a forced / distressed sale conditions.

(d) **Project Finance** is a method of funding in which the lender looks primarily to the revenues generated by a single project, both as a source of repayment and as security for the exposure. This type of financing is usually for large, complex and expensive installations.

It is principally a form of 'Non-recourse' or 'Limited Recourse' financing, where the lenders base their credit decision solely or primarily on the cash flows of the project, with respect to repayment of the project debts. Projects might include:

(i) A road, including toll road, fly over, bridge project;

(ii) A mass transit, urban rail project;

(iii) A rail-bed, stations system, rail freight, passenger services project;

(iv) A telecommunication local services, long distance and value added project;

(v) A power generation project;

(vi) A power transmission or distribution project by laying a network of new transmission or distribution lines;

(vii) A natural gas exploration and distribution project,

(viii) A Liquefied Petroleum Gas extraction, distribution and marketing project;

(ix) An LPG import terminal, distribution and marketing project;

(x) An LNG (Liquefied Natural Gas) terminal, distribution and marketing project;

(xi) A water supply, irrigation, water treatment system, sanitation and sewerage system or solid waste management system project;

(xii) A dam, barrage, canal project;

(xiii) A primary and secondary irrigation, tertiary (on-farm) irrigation project;

(xiv) A port, channel dredging, shipping, inland waterway, container terminals project;

(xv) An airport;

(xvi) A petroleum extraction, refinery, pipeline project;

(xvii) Any other infrastructure project of similar nature, as may be defined from time to time by CBN.

(e) **Specialized loans** include the following:

(1) **Agricultural Finance** which are categorised as Farm Credit and Non-farm credit.

(A) **Farm Credit** includes:

(i) Production Loans for inputs like seeds, fertilizers, pesticides, etc. Production Loans also include working capital finance to meet expenses of various natures attributable to farming.

(ii) Farm Development Finance (including finance for improvement of agricultural land, orchards, nurseries, agro allied industries, bakeries, animal husbandry, horticulture etc.) and construction of storage facilities, etc. for storage of seed, raw agriculture/farm produce.

(iii) Finance for the purchase of agricultural machinery and equipment like tractors, threshers, etc.

(iv) Non-fund based facility (e.g. letters of credit) for procurement/import of agricultural supplies etc by corporate & non corporate farmers.

(B) **Non-farm credit** includes financing for livestock such as dairy, poultry and fisheries etc.

Agriculture Financing shall not include loans to traders and intermediaries engaged in trading/processing of agriculture commodities. Such lending would be covered under Prudential Guidelines for Corporate/ Commercial Banking or SME Financing. However, agricultural financing can be extended to entities (including corporate farms, partnerships and individuals) engaged in farming activity as well as processing, packaging and marketing of mainly their own agricultural produce, provided 75% of the agriculture produce being processed, packaged and marketed should be produced by the above-mentioned entities themselves.

(2) **Mortgage loan** is a loan secured by real property through the use of a document which evidences the existence of the loan and the encumbrance of that realty through the granting of a mortgage which secures the loan

(3) **Margin loan** is a loan that allows the customer to finance against shares. The term margin refers to the difference between the market value of the shares and the cost of shares. The primary and secondary sources of repayment are from the sale of the securities purchased.

(4) **Object Finance** is a method of funding the acquisition of physical assets (e.g. ships, aircraft, satellites, railcars, and fleets etc) where the repayment of the exposure is dependent on the cash flows generated by the specific assets that have been financed and pledged or assigned to the lender.

(5) **Project Finance** is a form of 'Non-recourse' or 'Limited Recourse' financing, where the lenders base their credit decision solely or primarily on the cash flows of the project, with respect to repayment of the project debts.

(6) **Real Estate Loan** also known as **"Income producing real estate"** is a loan provided for funding of real estate (such as, office buildings to let, retail space, multifamily residential buildings, industrial or warehouse space, and hotels) where the prospects for repayment and recovery on the exposure depend primarily on the cash flows generated by the asset. The primary source of these cash flows would generally be lease or rental payments or the sale of the asset.

(7) **Commercial Real Estate** Loan also known as "**High-volatility commercial real estate"** is the financing of commercial real estate that exhibits higher loss rate volatility (i.e. higher asset correlation) compared to other types of specialized lending.

(8) **SME Loan** is a loan provided to a Small and medium enterprise (SME). A small and medium enterprise is defined as any manufacturing enterprise with a maximum turnover of N500 million and assets of N250 million (excluding land and working capital).

3.0 RISK MANAGMENT

3.1 Credit policy to be duly approved by board of directors:

Banks should prepare a comprehensive credit policy duly approved by their Board of Directors. The policy should, inter alia cover loan administration, disbursement and appropriate monitoring mechanism etc. The policy should be reviewed at least every three years.

3.2 Limit on exposure to a single obligor/ connected lending:

(a) The total outstanding exposure by a bank to any single person or a group of related borrowers shall not at any point in time exceeds 20% of the bank's shareholders fund unimpaired by losses.

(b) $33^{1}/_{3}\%$ of a bank's off balance sheet engagements shall be applied in determining the bank's statutory limit to a single obligor as per 3.2(a) above.

(c) The total outstanding exposure (on and off balance sheet) by a bank to all tiers of government and their agencies shall not at any point in time exceed 10% of the total credit portfolio.

(d) 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.

(e) Aggregate large exposures in any bank should not exceed eight times the shareholders fund unimpaired by losses.

3.3 Credit Concentration Policies:

(a) Banks should put in place effective internal policies, systems and controls to identify, measure, monitor, and control their credit risk concentrations. The policies should be approved by the Board of Directors and should cover the different forms of credit risk concentrations to which a bank may be exposed. Such concentrations include:

- (i) Significant exposures to an individual counterparty or group of related counterparties;
- (ii) Credit exposures to counterparties in the same economic sector or geographic region;
- (iii) Credit exposures to counterparties whose financial performance is dependent on the same activity or commodity; and
- (iv) Indirect credit exposures arising from a bank's Credit Risk Mitigation (CRM) activities (e.g. exposure to a single collateral type or to credit protection provided by a single counterparty).

(b) A bank's framework for managing credit risk concentrations should be clearly documented and should include a definition of the credit risk concentrations relevant to the bank and how these concentrations and their corresponding limits are calculated. Limits should be defined in relation to a bank's capital, total assets or, where adequate measures exist, its overall risk level.

(c) A bank's management should conduct periodic stress tests (on a quarterly) of its major credit risk concentrations and review the results of those tests to identify and respond to potential changes in market conditions that could adversely impact the bank's performance.

(d) All banks should put in place policies on credit Portfolio Plan as part of their credit risk management which should be approved by their respective boards. The plan shall specify the target portfolio size as well as portfolio distribution by industry, economic sectors, Business Units etc. The portfolio plan shall at a minimum consider the following:

(i) Macro-economic climate including fiscal and monetary policy guidelines

(ii) Bank policies on its target market

(iii) Minimum risk acceptance criteria definition for each bank

(iv) Bank's policies on concentration risks by industry, market sector, and obligor

(v) Historical portfolio and experience of each bank, etc.

(e) In defining the portfolio concentration limits for industries or sectors, banks shall adopt the standard industry classification (SIC) definition recently developed and released by the CBN.

(f) Banks should review their credit portfolio plan on a quarterly basis to ensure that the plan is still reflective of current market circumstances. In the event of Material Adverse Changes affecting the macro-economic environment or particular sectors, industries or regions, appropriate review and mitigation strategies should be performed

(g) The CBN will assess the extent of a bank's credit risk concentrations, how they are managed, and the extent to which the bank considers them as part of subjective factors in making specific provisions. Non-compliance with a bank's established policies on credit concentration and monitoring shall form a basis for Supervisory actions which may include additional loan loss provisions under sections 12.1(e) (1) (ii); 12.1(e) (2) (ii) and 12.1(e) (3) (ii). The subjective factors shall also be extended to provisions on specialized loans.

3.4 Exposures to Directors and their related interests:

(a) A significant shareholding is defined as a holding of at least 5% (individually or in aggregate) of a bank's equity.

(b) Director, insider and significant shareholder credit exposure should be fully disclosed by banks in their financial statements and returns prescribed by the Central Bank of Nigeria.

(c) Insiders include directors, significant shareholders and employees. According to BOFIA, the term "director" includes director's wife, husband, father, mother, brother, sister, son, daughter and their spouses.

(d) Banks should ensure that their credit policies specifically address lending to directors as part of related parties or insiders lending policies.

3.5 Disclosure of Insider-related credits in financial statements:

(a) Insider-related credits include transactions involving 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 should be separately stated in a note to the accounts and the non-performing component further analyzed by security, maturity, performance, provision, interest-in suspense and name of borrowers.

(ii) Notes to the accounts on guarantees, commitments and other contingent liabilities should also give details of those arising from related-party transactions.

(iii) The external auditors and audit committees should include in their report, their opinion on related-party credits.

(c) The requirements of Sections 3.4 and 3.5 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% 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%.

3.6 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 from time to time.

3.7 Basic Information on Borrowers:

(a) Banks shall not approve and/or provide any exposure (including renewal, enhancement and rescheduling/restructuring) until and unless the Loan Application Form (LAF) designed by banks is completed.

(b) The Loan Application Form shall contain such information as the bank may require to evaluate the application, which may include recent audited financial statements/management accounts, projected cash flows, records of pas bank accounts.

(c) All banks must show evidence of making enquiries or obtain credit report from at least two (2) credit bureaus before granting any facility to their customers. The result of the enquiry should be documented in the credit file of the customer. In addition, compliance with the CBN circular BSD/DIR/GEN/CIR/04/014 issued on 30 April 2010 is mandatory.

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

3.8 Minimum information on credit print-outs:

All banks should provide the following minimum details in their credit print-outs:

(i) Account number of customer;

(ii) Name of customer;

(iii) Type of facility;

(iv) Date facility was granted;

(v) Authorized limit of facility;

(vi) Original expiry date;

(vii) Balance on account;

(viii) Date of last lodgement or credit operation by the customer; and

(ix) Sector/Industry/Type/ value of security pledged.

3.9 Minimum Contents of Credit files:

(a) Every bank shall 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:

(i) to enable proper and effective monitoring of credit facilities extended by the bank; and
(ii) to enable examiners, as well as the bank's internal and external auditors, to have immediate and complete factual information from which they can form an objective appraisal of the quality of the credit facilities.

(b) A bank shall 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 conditions for draw down; and

(vi) evidence of acceptance of offer by the borrower.

3.10 Margin lending:

All banks involved in margin lending shall comply with the guidelines issued by the CBN/ Securities and Exchange Commission (SEC) on Margin Lending for banks, brokerage firms, asset managers and other financial institutions.

3.11 Revaluation of fixed assets:

Prior approval of the CBN must be obtained by any bank before the recognition of the revaluation surplus on fixed assets in its books, taking into consideration that:

(i) The basis of the underlying fixed assets valuations must be stated, and the valuation made by qualified professionals whose identity and qualifications are stated;

(ii) The difference between the market and historic values of the eligible fixed assets being revalued shall be discounted by 55%;

(iii) The revaluation of fixed assets is applicable to own premises only; and

(iv) The revaluation of fixed assets (owned premises only) is permissible within a minimum period of seven years after the date of the purchase of the asset or the last revaluation.

3.12 Foreign Exchange Risk – Net Open position Limit:

All banks should comply with Net Open Position (NOP) limit as advised by the Central Bank of Nigeria from time to time.

3.13 Liquidity ratios:

(a) The following liquid assets are admissible for computation of liquidity ratio:

(i) Cash;

(ii) Balance held with the CBN;

(iii) Net balances held with banks within Nigeria;

(iv) Nigerian treasury bills;

(v) Nigerian treasury certificates;

(vi) CBN registered certificates;

(vii) Net inter bank placement with other banks;

(viii) Net placement with discount houses;

(ix) Total certificate of deposits;

(x) FGN bonds;

(xi) Stabilization securities;

(xii) Net Certificate of Deposit held under 18 month to maturity; and

(xiii) Any other asset as prescribed by the CBN from time to time.

(b) The CBN shall prescribe the minimum liquidity ratio for banks in Nigeria from time to time in line with its monetary policy's directions.

(c) A bank may be considered illiquid if:

(i) the bank's current account with the CBN is overdrawn and not covered by the next working day consecutively for five working days within a month;

(ii) the bank suffers clearing operation deficits for 5 consecutive days i.e there was adverse clearing settlement position without adequate cover to the extent that recourse had to be made to the clearing collateral;

(iii) the bank is unable to pay maturing obligations for 5 consecutive days;and

(iv) the bank is a net taker of interbank deposit of up to 25% of its total deposits for a consecutive period of 90days

(d) The CBN as part of its regulatory oversight function can take the following actions over a bank considered illiquid:

(i) invite management for a discussion on its plan to improve liquidity;

(ii) request the bank to realize assets that do not qualify for inclusion in liquidity ratio computation;

(iii) conduct spot check to investigate the problem of the bank;

(iv) advise the bank to divest from subsidiaries or related companies;

(v) change management and/or board;

(vi) solicit for short term liquidity support for the bank from Nigeria Deposit Insurance Corporation (NDIC);

(vii) suspend the bank from clearing until it makes good its clearing position;

(viii) provide financial support and other lender of last resort actions

3.14 Statutory reserve:

Every bank shall maintain a reserve fund appropriated out of its net profits for each year (after due provision made for taxation) and before any dividend is declared as follows:

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 30% of the net profits; and

(ii) equal to or in excess of the paid-up share capital, transfer to the reserve fund a sum equal to not less than 15% of the net profit;

Provided that no transfer under this subsection shall be made until all identifiable losses have been made good.

3.15 Cash reserve ratio:

The CBN shall prescribe the minimum cash reserve ratio for banks in Nigeria from time to time in line with its monetary policy's directions.

3.16 Capital adequacy ratio

(a) The minimum ratio of capital to total risk-weighted assets shall remain at 10% as prescribed in the circular BSD/11/2003 issued on August 4, 2003. Furthermore, at least 50% of a bank's capital shall comprise paid-up capital and reserves, while every bank shall maintain a ratio of not less than 1:10 between its adjusted capital funds and total credit net of provisions. However, banks are encouraged to maintain a higher level of capital commensurate with their risk profile.

(b) The existing definition of the constituents of capital, deductions from total qualifying capital and restrictions within and between primary (Tier 1) and supplementary (Tier 2) capital are generally consistent with the Basel Accord.

(c) Tier 2 capital is limited to 100% of Tier 1 capital.

(d) The general provision will be part of Tier 2 Capital where the bank's specific provision for bad and doubtful debts has been made to the satisfaction of the CBN. However, such general provision will be restricted to a maximum of 1.25% of the risk weighted assets.

(e) Deferred tax assets are considered as intangible assets for capital adequacy purposes and should be deducted from total capital and reserves in arriving at total Tier 1 capital.

(f) Based on a level of capital adequacy ratio below the acceptable limit, a bank may be classified as follows:

- (i) Under capitalised
- (ii) Significantly under capitalised;
- (iii) Critically under capitalised; and
- (iv) Insolvent

(g) The conditions and corresponding supervisory actions for banks with the classifications under (c) above are stipulated below:

Condition of a bank	Restriction/supervisory Action
Under capitalised banks (i.e banks with Capital adequacy ratio –CAR- greater than or equal to 5% but less than the prescribed minimum level of 10%	i) Conduct special examination; ii) Restrict dividend distribution; iii) Restrict investment in other subsidiaries/related companies; iv) Restrict investment in fixed assets
Significantly under capitalised banks (i.e. Banks with CAR less than 5% but equal to or greater than 2%)	i) Restrict new lending to recoveries (zero based lending); ii) Request for business plan on how fresh funds are to be injected

Condition of a bank	Restriction/supervisory Action
	into the bank; iii) CBN to review business plan within two weeks and communicate to the bank its acceptability or otherwise; iv) The CBN should make the final capital call on the bank within 4 months from time of acceptance of the business plan; v) Within two months after the final capital call, the CBN may take over management and control of the bank and hand it over to NDIC; vi) The CBN may appoint the NDIC which may consider the following options; (a) Recapitalisation and restructuring by new investors; (b) Create incentives for healthy banks to take over the sick one; (c) Encourage private debt factoring companies to acquire the bad debts of the bank; and (d) Recommend the revocation of licence
Critically undercapitalized (i.e banks with CAR less than 2%) Insolvent banks (i.e banks that have negative CAR)	Take over management and control and/or revoke the licence

3.17 Credit rating of counter party/obligor and sector:

(a) All banks should put in place an internal rating policy/model and conduct internal credit ratings for all counter parties/ obligors and sectors.

(b) In measuring credit risk of loans and advances to customers and to banks at a counterparty level, banks must ensure that the following components are considered:

(i) character and capacity of the obligor to pay or meet contractual obligations;

(ii) current exposures to the counter party/ obligor and its likely future developments;

(iii) credit history of the counter party/ obligor; and

(iv) the likely recovery ratio in case of default obligations – value of collateral and other ways out.

3.18 Credit rating of bank:

(a) It shall be mandatory for all banks to have themselves credit rated by a credit rating agency.

(b) The credit rating should be on a regular basis i.e. credit rating should be updated on a continuous basis from year to year, within six months from the date of close of each financial year and the rating report complete in all respects be submitted to the CBN. Further, banks shall disclose their credit rating prominently in their published annual reports.

3.19 Reconciliation of inter-branch accounts and treatment of suspense account entries:

(a) All entries outstanding in the Inter-Branch Accounts (by whatever name called) and / or suspense Account must be reconciled / cleared and taken to the proper head of account within 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 3 months shall be classified in accordance with section 12.9.

(c) Banks 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.

3.20 Foreign borrowing for on-lending by Nigerian banks:

All banks shall be required to comply with the CBN circular BSD/DO/CIR/VOL.I/2001/22, *"Guidelines for foreign borrowing for on-lending by Nigerian Banks", dated November 29, 2001.*

3.21 Policies and procedures for write-off of fully provided credit facilities:

(a) The facility must have been fully provided for in line with the loan loss provisioning guidelines and must be in bank's book for at least one year after full provision.

(b) There should be evidence of board approval.

(c) If the facility is insider or related party credit, the approval of CBN is required.

(d) The fully provisioned facility must be appropriately disclosed in the audited financial statement.

3.22 Misreporting:

All Banks shall refrain from adopting any measures or practices whereby they would either artificially or temporarily show an ostensibly different position of bank's financial performance or position as given in their financial statements. Particular care shall be taken in showing their deposits, minimum capital requirement, non-performing loans/assets, provisioning, profit, inter-branch and inter-bank accounts, etc.

3.23 Transitional Provisions:

All banks that are currently in breach of the prudential requirements especially provisions of section 3.17 are given up to 24 months from the effective date of these guidelines to regularize.

Detailed plan for regularization should be forwarded to the CBN within 3 months from the effective date of these guidelines and subsequently updated every quarter.

4.0 CORPORATE GOVERNANCE:

As part of the efforts to promote good corporate governance in the Nigerian Banking Industry, the CBN issued Code of Corporate Governance for Banks in Nigeria with effective date of April 3, 2006. Compliance with the provisions of the code is mandatory for all banks.

In furtherance of the on-going banking reforms, the following guidelines will address some corporate governance issues not specifically addressed in the initial code of corporate governance. These include:

(a) Chief Executive Officers, CEO of banks shall serve a maximum tenure of 10 years.

(b) All CEOs who would have served for 10 years by July 31, 2010 shall cease to function in that capacity and shall hand over to their successors.

(c) Where a bank is a product of merger, acquisition, take-over or any other form of combination, the ten years period shall include the pre and post combination service years of a CEO provided that the bank in which he previously served as CEO was part of the new bank that emerged after the combination.

(d) Any person who has served as CEO for the maximum tenure in a bank shall not qualify for appointment in his former bank or subsidiaries in any capacity until after a period of 3 years after the expiration of his tenure as CEO.

(e) The Governor/Deputy Governors of the CBN and the Managing Director/CEO and Executive Directors of the Nigeria Deposit Insurance Corporation, NDIC shall not be eligible for appointment in any capacity in banks until after the expiration of 5 years from the date of their exit from the CBN or NDIC as the case may be.

(f) The Departmental Directors of the CBN and the NDIC shall not be eligible for appointment in any capacity in banks and their subsidiaries under the supervision of the CBN and NDIC until after the expiration of 3 years from the date of their exit from the CBN or NDIC as the case may be.

(g) Henceforth, all banks shall reflect the provisions of these guidelines in the terms of engagement of their CEOs.

4.1 Tenure of Non Executive Directors:

In order to ensure both continuity and injection of fresh ideas, non-executive directors should not remain on the board of a bank continuously for more than 3 terms of 4 years each, i.e. 12 years.

4.2 Tenure of External Auditors:

The tenure of external auditors in a given bank shall be for a maximum period of ten years from date of appointment after which the audit firm shall not be reappointed in the bank until after a period of another 10 years

5.0 KNOW YOUR CUSTOMER AND ANTI-MONEY LAUNDERING MEASURES

5.1 Know your customer:

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

5.2 Anti-money laundering measures:

All banks shall be required to comply with the Anti-money Laundering Act 2004 (or any amendments to this Act)and relevant circulars as issued by the CBN from time to time.

5.3 Record retention:

The records of transactions and identification data etc. maintained by banks occupy critical importance as far as legal proceedings are concerned. Prudence demands that such records may be maintained in systematic manner with exactness of period of preservation to avoid any set back on legal and reputation fronts. Banks shall therefore, maintain, for a minimum period of five years, all necessary records on transactions, both domestic and international. Banks shall, however, retain those records for longer period where transactions relate to litigation or are required by the Court of law or by any other competent authority.

5.4 Correspondent banking:

(a) Banks shall gather sufficient information about their correspondent banks to understand fully the nature of their business. Factors to consider include:

- (i) Know your customer policy (KYC)
- (ii) Information about the correspondent bank's management and ownership
- (iii) Major business activities
- (iv) Their location
- (v) Money laundering prevention and detection measures
- (vi) The purpose of the account
- (vii) The identity of any third party that will use the correspondent banking services (i.e. in case of payable through accounts)
- (viii) Condition of the bank regulation and supervision in the correspondent's country

5.5 Suspicious transactions:

Banks should pay special attention to all complex, unusually large transactions, and all unusual patterns of transactions, which have no apparent economic or visible lawful purpose. Examples of such suspicious transactions are listed at **annexure 7**. However, these are not intended to be exhaustive and only provide examples of the most basic ways in which money may be laundered. The back ground and purpose of such transactions should, as far as possible, be examined, the findings established in writing, and be available to help the relevant authorities in inspection and investigation.

The existing list of examples of suspicious transactions as **annexure 7** is supplemented with the enclosed list of characteristics of financial transactions that may be a cause for increased scrutiny as **annexure 8**.

6.0 PROJECT FINANCING:

6.1 Policy to be duly approved by Board of Directors:

Banks shall prepare a comprehensive project financing policy duly approved by their Board of Directors. The policy may be part of the overall credit policy of a bank and should, interalia cover loan administration, disbursement and appropriate monitoring mechanism etc. The policy should be reviewed at least every three years.

6.2 Credit Appraisal of Projects:

A thorough credit appraisal of projects by banks is of utmost importance in order to identify the project risks, and to ascertain the fact that the project will function as per plans. Assessment of the financial and economic viability of the project should also be carried out to determine adequacy of the project cash flows with respect to repayment capacity of the project debts, as well as ensuring a satisfactory rate of return on the funds proposed to be lent. Banks are, therefore, encouraged to develop the requisite expertise to conduct a thorough appraisal of the proposed project, and may constitute appropriate special Divisions/ Department for project financing or outsource project feasibility assessment.

6.3 Assessment of Projects:

Projects particularly Infrastructure Projects usually go through development, construction, start-up, and operation stages. Banks should, therefore, assess these stages separately for risk mitigation. While some of the guidelines in this regard are provided below, banks may put in place additional safeguards appropriate to their risk assessment:

Development Phase: Keeping in view the higher risk in this phase, the funding needs should be met primarily through capital from the main sponsors only. However, if the lenders decide to provide funding during this phase of the project, they should critically evaluate the possibility of various risks, including those arising from unclear government policies, if any, and their possible impact on the viability of the project.

Construction and Start-up Phase: In this phase, the major risk is that the construction may not be completed on time, or may have large cost overruns. A project may fail to reach its completion for many reasons, ranging from technical design flaws to mismanagement of the project, financial problems, or changes in government regulations. Therefore, the lending banks are advised to adequately safeguard their interests and stress upon the project companies to also hedge such risks by opting for fixed-price, certain-date construction contracts (including turnkey contracts), and built-in provisions for liquidated damages if the contractor fails to perform, along with obtaining insurance cover for certain areas of the project.

(1) **Responsibility of Assuming Completion Risk:** As lenders cannot control the construction process, therefore, banks are advised to negotiate that risks during completion phase of the project be the responsibility of the project company, its sponsors, contractors, equipment suppliers, and insurers.

(2) **Physical and Financial Completion of Projects:** In order to protect against the risk of physical and financial non completion of the infrastructure project, banks are advised to closely observe following issues for risk mitigation:

(i) **Project Funds Agreement (PFA):** The most common threat to physical completion of the project is cost overruns, which affects the project's financial rate of return, and if these cost overruns are not financed through additional financing, the same may even lead to abandonment of the project. Therefore, to ensure that unexpected costs do not jeopardize the project's completion, creditors and minority investors may insist on a commitment for standby financing as part of the initial financial package. This may be provided by sponsors through a contractual agreement, i.e. Project Funds Agreement (PFA), which is a standby subordinated loan or equity, wherein sponsors may either provide or arrange the requisite funds.

(ii) **Financial Completion Agreement (FCA):** It is pertinent to emphasize that a new project may reach physical completion but may not become self-sustaining for a number of reasons, such as supply problems or weak market demand. If financial completion is not achieved, profitability will suffer, and the project is likely to encounter debt-service difficulties. Project documentation, therefore, may include a Financial Completion Agreement (FCA), which specifies, in contract form, the initial financial projections of the project against which creditors and investors are willing to invest funds. Under a Financial Completion Agreement, the sponsors typically commit to provide subordinated loans or additional equity to the project until the agreed financial performance is achieved. By requiring sponsors to ensure project financial completion, lenders greatly reduce the default risk of the project. The lenders may, at their own discretion, require the sponsors to arrange suitable insurance cover, if available, for covering such risk.

(iii) **Project Insurance:** To ensure fulfillment of obligations by the sponsors, their obligations under PFA/FCA shall be backed-up by a letter of credit, bond or guarantee from a creditworthy third party. However, for mitigating force majeure that cannot be contractually allocated, banks are advised to call for purchase of insurance, wherever possible, by the sponsors, so as to mitigate both direct and indirect types of force majeure.

6.4 Monitoring of projects:

Banks shall establish a mechanism for continuous monitoring of project implementation to ensure proper utilization of the credit disbursed to the company. For this purpose, proper scrutiny/audit shall be undertaken of the Project Account(s).

6.5 Maximum duration of loan:

Banks shall decide the duration of the loan and this should take into cognizance the gestation period and peculiarities of each project.

6.6 Moratorium:

Where moratorium is available for payment of principal and interest, payment of principal and interest becomes due only after the moratorium period is over.

7.0 OBJECT AND REAL ESTATE FINANCING:

7.1 Policy to be duly approved by board of directors:

Banks shall prepare a comprehensive object financing policy and real estate financing policy duly approved by their Board of Directors. The policy may be part of the overall credit policy and procedures of a bank. The policy should be reviewed at least every three years.

7.2 Purpose of Loans:

Banks shall ensure that the loans have been properly utilized and for the same purposes for which they were acquired / obtained. The banks should develop and implement an appropriate system for monitoring the utilization of loans.

7.3 Monitoring of Real Estate Market:

Banks are encouraged to setup a separate department for real estate loans. The department among other things is responsible for monitoring the real estate market.

7.4 Duration of Loan:

Banks shall decide the duration of the loan and this should take into cognizance the gestation period and peculiarities of the object being financed.

8.0 SMALL AND MEDIUM ENTERPRISES FINANCING:

8.1 Policy to be duly approved by board of directors:

Banks shall prepare a comprehensive policy for SME financing duly approved by their Board of Directors. The policy should be reviewed at least every three years.

8.2 Source and Capacity of Repayment and Cash Flow backed Lending:

Banks shall specifically identify the sources of repayment and assess the repayment capacity of the borrower on the basis of assets conversion cycle and expected future cash flows. In order to add value, the banks are encouraged to assess conditions prevailing in the particular sector / industry they are lending to and its future prospects. The banks should be able to identify the key drivers of their borrowers' businesses, the key risks to their businesses and their risk mitigants.

8.3 Securities:

Banks shall decide on appropriate security for SME facilities.

9.0 AGRICULTURE FINANCING:

9.1 Policy to be duly approved by board of directors:

Banks shall prepare a comprehensive agriculture financing policy duly approved by their Board of Directors. The agricultural policy may be part of the overall credit policy of a bank. The policy should, interalia cover loan administration, disbursement and appropriate monitoring mechanism. The policy should be reviewed at least every three years.

9.2 Repayment capacity of the borrower:

While extending agricultural financing, the banks should take into account the total indebtedness of the borrower and his disposable income.

9.3 Natural Calamities:

(a) Where natural calamities impair the repaying capacity of agricultural borrowers, as a relief measure. Banks may decide on their own to:

   (i) convert the short-term production loan into a term loan or re-schedule the repayment period, and

   (ii) grant fresh short-term loans

(b) In such cases of conversion or re-schedulement, the term loan as well as fresh short-term loan may be treated as current and need not be classified as non performing loan. The asset classification of these loans would, therefore, be governed by the revised terms and conditions and these would be treated as non performing under the extant norms applicable for classifying agricultural advances as non-performing loan.

9.4 Insurance of Agriculture Produce:

Banks may request their agriculture loan borrower to insure their agriculture produce in order to avoid loss in case of natural calamity.

9.5 Proper utilization of loan:

Where the agricultural loans have been extended for specified purposes, the banks are encouraged to ensure that the loans have been utilized for the same purposes for which they were obtained. For this purpose, the banks may consider it prudent to make payments directly to the suppliers wherever appropriate.

9.6 Valuation of Security:

The valuation of security in Agriculture Financing is a complicated and specialized area; therefore experts should be hired for valuation related issues.

9.7 Cash flow based facilities:

Banks are encouraged to extend agriculture financing on the basis of future cash flows instead of relying solely on the collateral.

10.0 MICROFINANCE LOANS:

For microfinance loans, the current microfinance guidelines issued for microfinance banks are applicable. Other finance companies which come under the supervision of Other Financial Institutions Supervision Department (OFISD) shall follow the guidelines applicable to them.

11.0 RETAIL FINANCING

11.1 Minimum conditions for Retail Financing:

(a) Apart from the specific guidelines given under each mode of financing separately, general requirements laid down here should also be followed by banks while undertaking retail financing. It may be noted that these are the minimum requirements and should not in any way be construed to restrict the role of the management of banks to further strengthen the risk management processes through establishing comprehensive credit risk management systems appropriate to their type, scope, sophistication and scale of operations. The Board of Directors of banks are required to establish policies, procedures and practices to define risks, stipulate responsibilities, specify security requirements, design internal controls and then ensure strict compliance with them.

(d) For a facility to be classified as a retail financing it should fulfill the following criteria:

(i) The exposure must be to an individual person or persons; and

(ii) The exposure must take the form of any of the following: revolving credits and lines of credit (including credit cards and overdrafts), personal term loans and leases (e.g. instalment loans, auto loans and leases, student and educational loans, personal finance).

Mortgage loans are excluded to the extent that they qualify for treatment as housing finance.

12.0 LOAN LOSS PROVISIONING

12.1 Credit portfolio classification system for facilities other than "Specialized loans"

(a) Licensed banks should review their credit portfolio continuously (at least once in a quarter) with a view to recognising any deterioration in credit quality. Such reviews should systematically and realistically classify banks' credit exposures based on the perceived risks of default. In order to facilitate comparability of banks' classification of their credit portfolios, the assessment of risk of default should be based on criteria which should include, but are not limited to, repayment performance, borrower's repayment capacity on the basis of current financial condition and net realisable value of collateral.

(b) Credit facilities (which include loans, advances, overdrafts, commercial papers, bankers acceptances, bills discounted, leases, guarantees, and other loss contingencies connected with a bank's credit risks) should be classified as either "performing" or "non-performing" as defined below:

(1) a credit facility is deemed to be performing if payments of both principal and interest are up-to-date in accordance with the agreed terms;

(2) a credit facility should be deemed as non-performing when any of the following conditions exists:

(i) interest or principal is due and unpaid for 90 days or more;

(ii) interest payments equal to 90 days interest or more have been capitalised rescheduled or rolled over into a new loan (except where facilities have been reclassified as specified in 12.1(d) below).

(c) The practice whereby some licensed banks merely renew, reschedule or roll-over non-performing credit facilities without taking into consideration the repayment capacity of the borrower is objectionable and unacceptable. Consequently, before a credit facility already classified as "non-performing" can be reclassified as "performing" the borrower must effect cash payment such that outstanding unpaid interest does not exceed 90 days.

(d) When a loan rescheduling is agreed with a customer, the rescheduling should be treated as a new facility but provisioning should continue until it is clear that rescheduling is working at a minimum, for a period of 90 days. Reversal of interest previously suspended and provision against principal previously made should be recognized on a cash basis.

(e) Non-performing credit facilities should be classified into three categories namely, sub-standard, doubtful or lost on the basis of criteria below:

(1) **Sub-Standard**

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

(i) Objective Criteria: facilities as defined in 12.1(b) on which unpaid principal and/or interest remain outstanding for more than 90 days but less than 180 days.

(ii) Subjective Criteria: 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, and inactive accounts where withdrawals exceed repayments or where repayments can hardly cover interest charges.

(2) **Doubtful**

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

(i) Objective Criteria: facilities on which unpaid principal and/or interest remain outstanding for at lest 180 days but less than 360 days and are not secured by legal title to leased assets or perfected realisable collateral in the process of collection or realisation.

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

(3) **Lost Credit Facilities**

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

(i) Objective Criteria: facilities on which unpaid principal and/or interest remain outstanding for 360 days or more and are not secured by legal title to leased assets or perfected realizable collateral in the course of collection or realization.

(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) Banks are required to adopt the criteria specified in paragraphs 12.1(a) to 12.1(e) to classify their credit portfolios in order to reflect the true accounting values of their credit facilities. Licensed banks should 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.

12.2 Provision for non-performing facilities other than "Specialized loans" as defined by the guidelines

(a) Licensed banks are required to make adequate provisions for perceived losses based on the credit portfolio classification system prescribed in paragraph 12.1 in order to reflect their true financial condition. Two types of provisions (that is specific and general) are considered adequate to achieve this objective. Specific provisions are made on the basis of perceived risk of default on specific credit facilities while general provisions are made in recognition of the fact that even performing credit facility harbours some risk of loss no matter how small. Consequently, all licensed banks shall be required to make specific provisions for non-performing credits as specified below:

(1) For facilities classified as Sub-Standard, Doubtful, or Lost:

(i) interest overdue by more than 90 days should be suspended and recognized on cash basis only.

(ii) principal repayments that are over due by more than 90 days should be fully provided for and recognized on cash basis only.

(2) For principal repayments not yet due on non-performing credit facilities, provision should be made as follows:

(i) Sub-Standard Credit Facilities: 10% of the outstanding balance;

(ii) Doubtful Credit Facilities: 50% of the outstanding balance;

(iii) Lost Credit Facilities: 100% of the outstanding balance.

(b) For prudential purpose, provisioning as prescribed in 12.2(a) should only take cognizance of realizable tangible security (with perfected legal title) in the course of collection or realization. Consequently, collateral values should be recognized on the following basis:

(1) For credit exposure where the principal repayment is in arrears by more than six months, the outstanding unprovided principal should not exceed 50% of the estimated net realizable value of the collateral security.

(2) For credit exposure where the principal repayment is in arrears by more than one year, there should be no outstanding unprovided portion of the credit facility irrespective of the estimated net realizable value of the security held.

(3) For a credit exposure secured by a floating charge or by an unperfected or equitable charge over tangible security, it should be treated as an unsecured credit and no account should be taken of such security held in determining the provision for loss to be made.

(4) For all credit exposure classified as lost, but with credit enhancement and mitigation strategies such as collateral etc, banks are allowed to make haircut adjustments as defined in section 12.13.

(c) Provisioning and classifications under 12.1 and 12.2 apply to commercial, commodities financing, corporate loans, retail and consumer credits and facilities granted to federal, state and local governments and their parastatals. Other credits or facilities not specifically classified as specialized loans are also subject to provisioning under section 12.1 and 12.2.

12.3 Provision for non-performing facilities under "Specialized loans"

The classifications and provisioning for specialized loans such as Agricultural finance, Project finance, Object finance, Real estate Finance, SME finance and Mortgage finance takes into considerations the cash flows and gestation periods of the different loan types.

For the various types of loans, the basis for classifications and provisioning is presented in **Annexure 2 to 6.**

12.4 Adapting Prudential Guidelines to IFRS

When IFRS is adopted in Nigeria, Banks would be required to make provisions for loans as prescribed in the relevant IFRS Standards.

(a) Provisions for loans recognized in the profit and loss account should be determined based on the requirements of IFRS. However, the IFRS provisions should be compared with provisions determined under prudential guidelines and the expected impact/changes in general reserve should be treated as follows:

  (i) **Prudential Provisions is greater than IFRS provisions**; transfer the difference from the general reserve to a non-distributable regulatory reserve.

  (ii) **Prudential Provisions is less than IFRS provisions**; the excess charges resulting should be transferred from the regulatory reserve account to the general reserve to the extent of the non-distributable reserve previously recognized.

(b) The non distributable reserve should be classified under Tier 1 as part of core capital.

12.5 Credit Portfolio Disclosure Requirement

(a) Each licensed bank is required to provide in its audited financial statements, an analysis of its credit portfolio into "performing" and "non-performing" as defined in paragraphs 12.1(b) and 12.1(e)

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

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

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

12.6 Disclosure Requirement for "Specialized loans"

(a) The banks shall disclose total loans outstanding under each specialized loan as at year end and provision against the loans.

(b) The banks shall disclose non performing loans by loan types in the financial statements and the percentage to total loans along with movement of specific provision under each category.

(c) The non performing loans shall be classified under each classification category i.e. watchlist, substandard, doubtful, very doubtful and lost.

12.7 Interest Accrual

(a) It is the responsibility of bank management to recognize revenues when they are earned or realized and make provision for all losses as soon as they can be reasonably estimated. However, experience revealed a wide diversity amongst licensed banks on income recognition. While a few banks cease accruing interest on non-performing credit facilities after three months, some after six months or a year, some do not appreciate the need to suspend interest on such facilities.

(b) In order to ensure the reliability of published operating results, the following criteria should be adopted by all licensed banks for the treatment of interest on non-performing credit facilities:

   (i) All categories of non-performing credit facilities should automatically be placed on non-accrual status that is, interest due thereon should not be recognized as income.

   (ii) All interest previously accrued and uncollected but taken into revenue should be reversed and credited into suspense account specifically created for this purpose which should be called "interest in suspense account" unless paid in cash by the borrower. Future interest charges should also be credited into same account until such facilities begin to perform.

   (iii) Once the facilities begin to perform, interest previously suspended and provisions previously made against principal debts should be recognized on cash basis only. Before a "non-performing facilities", can be re-classified as "performing", unpaid interest outstanding should not exceed 90 days.

12.8 Classification of Other Assets

(a) The term "Other Assets" relate to those asset items, not shown separately in the balance sheet of a bank. These items include Impersonal Accounts (of various descriptions), Suspense Accounts such as frauds and cashiers' shortages, Cheque Purchased, Uncleared Effects and Inter-branch Items. More often than not, the accounts usually grouped together as "Other Assets" contain fictitious or intangible assets. The accounts could contain many long outstanding items, the origins of which had been long forgotten, untraceable as well as irreconcilable. In situations like these, the items if not material should be written off and where material (i.e. at least

10% of aggregate balance of Other Assets) should be classified as below. It should be noted that items enumerated below are by no means exhaustive:

(1) **Sub-Standard**

(i) Cheques purchased and uncleared effects outstanding after the permissible clearing period.

(ii) Fraud cases of up to 6 months old and under police investigation regardless of the likely outcome of the cases.

(iii) Inter-branch items of 3 months.

(iv) All other intangible suspense accounts existing in the books for up to 3 months.

A minimum provision of 10% should be made for "Other Assets" items classified as sub-standard.

(2) **Doubtful**

The above listed features must have been aggravated and are likely to result in losses higher than recommended for sub-standard items. Items for doubtful classification should include, but are not limited to the following:

(i) Cheques purchased of between 3 to 6 months old but which had been withdrawn or cancelled and substituted with new ones. Similar treatment should be accorded to uncleared effects for which values had been given.

(ii) Outstanding fraud cases of 6 to 12 months old and with slim chances of full recoveries.

(iii) Inter-branch items outstanding for between 3 to 6 months.

(iv) All other intangible suspense accounts outstanding for between 6 months and 12 months. A minimum of 50% provision should be made for "Other Assets" items classified as doubtful.

(3) **Lost**

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

(i) Cheques purchased and uncleared effects over 6 months old and for which values had been given.

(ii) Outstanding fraud cases over 12 months and involving protracted litigations.

(iii) Inter-branch items over 6 months old whether or not the origins are known.

(iv) All other intangible suspense accounts over 12 months old.

Full provision (i.e. 100%) should be accorded to items classified lost.

12.9 Revolving and Overdraft Facilities:

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

(b) In addition, a revolving or overdraft facility may be within limit but will be considered to be non-performing if interest have not been serviced for 90days and above.

In these circumstances:

(i) A revolving facility should be classified as non-performing and unpaid interest suspended once 90 days (or such shorter period as may be specified by regulatory authorities) elapses after the facility limit is exceeded.

(ii) Once a facility is classified as non-performing, provision against principal and unpaid interest should be made in accordance with this prudential guidelines.

In the case of revolving and overdraft facilities, where a loan rescheduling is agreed with a customer, the rescheduling should be treated as a new facility but provisioning should continue until it is clear that the rescheduling is working at a minimum for a period of 90 days. Reversal of interest previously suspended and, provisions against principal previously made, should be recognized on cash basis.

12.10 Facilities Without Approval:

(a) Facilities without approval comprise the following:

(i) Excess over limit on overdrafts and current accounts;

(ii) Matured loans without renewal; and

(iii) Other facilities that do not have an existing contract defining the customers' obligations to repay such facilities.

(b) Facilities without approval that are not regularized within 90 days shall be classified in accordance with section 12.1 and provisions recognized in accordance with section 12.2.

12.11 Off- Balance Sheet Engagements

(a) A proper appraisal of Off-Balance-Sheet engagements should be undertaken with a view to determining the extent of loss a bank may likely sustain. Off-Balance-Sheet items include Letters of Credits, Bonds, Guarantees, Indemnities, Acceptances, and Pending or Protracted Litigations (the outcome of which could not be easily determined).

(b) The following factors should be taken into consideration in recognizing losses on Off-Balance-Sheet engagements:

(i) Date the liability was incurred

(ii) Expiry Date

(iii) Security Pledge

(iv) Performance of other facilities being enjoyed by the customer, e.g. loan and advances

(v) Perceived Risk.

(c) Non performing off balance sheet items should be recognized on the balance sheet and provisions made in line with sections 12.1 and 12.2.

(d) Full provisions must be made for any loss that may arise from Off-Balance-Sheet transactions.

(e) Off-Balance-Sheet Engagements should not form part of balance sheet totals while their disclosure in note form should 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 bank;

(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;

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

12.12 Provisioning requirements for "Specialized loans":

(a) The banks shall classify and make provisioning for project financings as per provision requirements specified in **Annexure 2.**

(b) The banks shall classify and make provisioning for object finance, income producing real estate and commercial real estate financings as per provision requirements specified in **Annexure 3**.

(c) The banks shall classify and make provisioning for SME financings as per provision requirements specified in **Annexure 4**.

(d) Banks shall classify and make provisioning for agriculture loans as per provision requirements specified in **Annexure 5**.

(e) **Microfinance Loans:**

For microfinance loans, the current microfinance guidelines issued for microfinance banks are applicable. Other finance companies which come under the supervision of Other Financial Institutions Supervision Department (OFISD) shall follow the guidelines applicable to them.

(f) **Mortgage Loans:**

For Mortgage transactions, provisions should take due account of the long-term nature of the loans and the security available. If a repayment becomes overdue for **three months**, no further income should be recognized until regular payments resume.

(i) Provision against principal should be 10% if payment becomes overdue for more than six months.

(ii) Where principal repayment is overdue by more than one year, the outstanding unprovided principal should not exceed 50% of the estimated net realizable value of the security.

(iii) Where principal repayment is overdue by more than two years, there should be no outstanding unprovided portion of the credit facility, irrespective of the estimated net realizable value of security held.

Summary of the provisioning for mortgage loans is specified in **Annexure 6**.

(g) **Margin financing:**

Marked to Market:

(i) All margin facilities shall be marked to market on a daily basis .The excess of loan balance over the market value should be provisioned and charged to the profit and loss account.

(ii) Any increase in the mark to market value from the previous valuation can only be recognized to the extent of previous charge off.

(iii) All margin facilities should be reported in accordance with the rules and regulations issued by the CBN and SEC.

12.13 Collateral Adjustment and Provisioning for Lost Facilities:

(a) In order to encourage banks to utilize more credit enhancement and mitigation strategies, a process for collateral adjustments in loan provisioning is being introduced. This process will put into consideration the quality and realisability of underlying collaterals pledged against loan facilities.

(1) For collaterals to be considered for "Haircut Adjustments", it must be:

(i) Perfected;

(ii) Realizable, with no restrictions on sale; and

(iii) Regularly valued with transparent method of valuation;

(2) All documentation used in collateralized transactions must be binding on all parties and legally enforceable in all jurisdictions. Banks 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 should 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 salability 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.

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. The valuer should 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 sales value (FSV).

(4) The following collateral instruments that are eligible for haircuts include:

(i) Cash (as well as certificates of deposit or comparable instruments issued by the lending bank) on deposits with the bank which is incurring the counterparty exposure.

(ii) Treasury bills and other government securities.

(iii) Quoted equities and other traded securities.

(iv) Bank guarantees and receivables of blue chip companies.

(v) Residential legal mortgage

(vi) Commercial legal mortgage

(vii) Other collaterals as defined by the CBN from time to time.

(5) The following hair cut adjustments shall be applicable on all loan types classified as lost:

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

(6) 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).

(7) 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 adjustments calculations including valuation of collaterals should be reviewed by the banks' auditors and must be ratified by the regulators.

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

(3) A maximum of 1 year is allowed for the haircut adjustments pending which the collaterals should be realized and shortfall in provision taken.

(4) If the facilities on which haircut adjustments have been applied to reduce its provisions remain non-performing after one year, then the haircut adjustments will be disregarded.

12.14 Regulators' Power Over Adequacy of Provisioning

(a) Where CBN believes that based on the bank's portfolio analysis, there is excessive concentrations risks, or has industry knowledge of a delinquent obligor and other subjective factors, the CBN can mandate banks to make additional provision.

(b) Some of the conditions that can make CBN to mandate banks to make additional provision include:

(i) Huge (excessive) concentrations in banks' portfolios.

(ii) High number of watch listed or restructured or rescheduled loans.

(iii) Adverse macro-economic developments affecting the industry to which the bank is exposed.

(iv) Poor board oversights and insider dealings etc.

12.15 Update of loan loss provisioning guidelines:

The CBN shall have powers to amend the loan loss provisioning guidelines as and when they deemed it necessary so that the guidelines reflect the developments in the market and the economic realities of the industry. The review period shall not be later than 5 years.

12.16 Dynamic Provisioning:

(a) The general provisioning guidelines shall be issued by the CBN as a counter cyclical measure from time to time pending its replacement with dynamic provisioning.

(b) The data required for implementation of dynamic provisioning regime shall be gathered by the CBN over a period of five years through quarterly returns. Banks shall be required to submit the quarterly returns as prescribed by the CBN.

13.0 Financial soundness indicators and financial ratios:

(a) Banks are required as part of their risk management framework to institute a process for computing financial ratios and financial soundness indicators for checking financial health of each institution.

(b) Benchmarks should be set and actual results computed and compared to set benchmark 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 for banks are presented in **Annexures 9**.and **10**

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 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

  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

PROVISION REQUIREMENTS

Project Financing

Category	Classification	Days past due	Treatment of Income	% of Provision
1	Watchlist	Where the repayment on outstanding obligations is between 60% and 75% of the amount due and/ or aggregate installments thereof are overdue by more than 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	0% of total outstanding balance
1A	Substandard	Where the repayment on outstanding obligations is less than 60% of the amount due and/ or aggregate installments thereof are overdue by 180 days to 2 years.	As above	25% of total outstanding balance
2	Doubtful	Where the repayment on outstanding obligations is less than 60% of the amount due and/ or aggregate installments thereof are overdue by 2 years to 3 years.	As above	50% of total outstanding balance
3	Very Doubtful	Where the repayment on outstanding obligations is less than 60% of the amount due and/ or aggregate installments thereof are overdue by 3 years to 4 years.	As above	75% of total outstanding balance
4	Lost	Where the repayment on outstanding obligations is less than 60% of the amount due and/ or aggregate installments thereof are overdue by more than 4 years.	As above	100% of total outstanding balance

Annexure 3

PROVISION REQUIREMENTS

Object Financing, Income Producing Real Estate and Commercial Real Estate Financing.

Category	Classification	Days past due	Treatment of Income	% of Provision
1	Watchlist	Where the repayment on outstanding obligations is between 60% and 75% of the amount due and/ or aggregate installments thereof are overdue by more than 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	0% of total outstanding balance
1A	Substandard	Where the repayment on outstanding obligations is less than 60% of the amount due and/ or aggregate installments thereof are overdue by 180 days to 1 year.	As above	25% of total outstanding balance
2	Doubtful	Where the repayment on outstanding obligations is less than 60% of the amount due and/ or aggregate installments thereof are overdue by 1 year to 2 years.	As above	50% of total outstanding balance
3	Very Doubtful	Where the repayment on outstanding obligations is less than 60% of the amount due and/ or aggregate installments thereof are overdue by 2 years to 3 years.	As above	75% of total outstanding balance
4	Lost	Where the repayment on outstanding obligations is less than 60% of the amount due and/ or aggregate installments thereof are overdue by more than 3 years.	As above	100% of total outstanding balance

Annexure 4

PROVISION REQUIREMENTS

SME Short and Long term Loans.

Short term financing facilities:

Short Term Facilities mean facilities with maturities up to one year.

Category	Classification	Days past due	% of Provision
1	Watchlist	Where mark-up/ interest or principal is overdue (past due) by 90 days from the due date	0% of total outstanding balance
1A	Substandard	Where mark-up/ interest or principal is overdue (past due) by 90 days to 1 year from the due date	25% of total outstanding balance
2	Doubtful	Where mark-up/ interest or principal is overdue (past due) by 1 year to 1.5 year from the due date	50% of total outstanding balance
3	Very Doubtful	Where mark-up/ interest or principal is overdue (past due) by 1.5 years to 2 years from the due date	75% of total outstanding balance
4	Loss	Where mark-up/ interest or principal is overdue (past due) by more than 2 years from the due date	100% of total outstanding balance

Long term financing facilities:

Long Term Facilities mean facilities with maturities more than one year.

Category	Classification	Days past due	% of Provision
1	Watchlist	Where mark-up/ interest or principal is overdue (past due) by 90 days from the due date	0% of total outstanding balance
1A	Substandard	Where mark-up/ interest or principal is overdue (past due) by 90 days to 1 years from the due date	25% of total outstanding balance
2	Doubtful	Where mark-up/ interest or principal is overdue (past due) by 1 year to 2 years from the due date	50% of total outstanding balance
3	Very Doubtful	Where mark-up/ interest or principal is overdue (past due) by 2 years to 3 years from the due date	75% of total outstanding balance
4	Loss	Where mark-up/ interest or principal is overdue (past due) by more than 3 years from the due date	100% of total outstanding balance

Annexure 5

PROVISION REQUIREMENTS

Agriculture Financing

Short term financing facilities:

Short Term Facilities includes Purchase for seeds, fertilizers and other inputs and financing for working capital attributable to agriculture.

Category	Classification	Days past due	% of Provision
1	Watchlist	Where mark-up/ interest or principal is overdue (past due) by 90 days from the due date	0% of total outstanding balance
1A	Substandard	Where mark-up/ interest or principal is overdue (past due) by 90 days to 1 year from the due date	25% of total outstanding balance
2	Doubtful	Where mark-up/ interest or principal is overdue (past due) by 1 year to 1.5 year from the due date	50% of total outstanding balance
3	Very Doubtful	Where mark-up/ interest or principal is overdue (past due) by 1.5 years to 2 years from the due date	75% of total outstanding balance
4	Loss	Where mark-up/ interest or principal is overdue (past due) by more than 2 years from the due date	100% of total outstanding balance

Long term financing facilities:

Long Term Facilities includes Farm development finance, purchase of machinery and financing for livestock.

Category	Classification	Days past due	% of Provision
1	Watchlist	Where mark-up/ interest or principal is overdue (past due) by 90 days from the due date	0% of total outstanding balance
1A	Substandard	Where mark-up/ interest or principal is overdue (past due) by 90 days to 1 year from the due date	25% of total outstanding balance
2	Doubtful	Where mark-up/ interest or principal is overdue (past due) by 1 year to 2 years	50% of total outstanding

		from the due date	balance
3	Very Doubtful	Where mark-up/ interest or principal is overdue (past due) by 2 years to 3 years from the due date	75% of total outstanding balance
4	Loss	Where mark-up/ interest or principal is overdue (past due) by more than 3 years from the due date	100% of total outstanding balance

Annexure 6

PROVISION REQUIREMENTS

Mortgage Loans

Category	Classification	Days past due	Treatment of Income	% of Provision
1	Watchlist	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	0% of total outstanding balance
1A	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 balance
2	Doubtful	Where mark-up/ interest or principal is overdue (past due) by more than 1 year from the due date	As above	Un provided balance should not exceed 50% of the estimated net realisable value of the security
3	Lost	Where mark-up/ interest or principal is overdue (past due) by more than 2 years from the date	As above	100% of total outstanding balance

Annexure 7

EXAMPLES OF SUSPICIOUS TRANSACTIONS

1. General Comments

The list of situations given below is intended mainly as a means of highlighting the basic ways in which money may be laundered. While each individual situation may not be sufficient to suggest that money laundering is taking place, a combination of such situations may be indicative of such a transaction. Further, the list is by no means complete, and will require constant updating and adaptation to changing circumstances and new methods of laundering money. The list is intended solely as an aid, and must not be applied as a routine instrument in place of common sense.

A customer's declarations regarding the background of such transactions should be checked for plausibility. Not every explanation offered by the customer can be accepted without scrutiny.

It is justifiable to suspect any customer who is reluctant to provide normal information and documents required routinely by the bank in the course of the business relationship. Banks should pay attention to customers who provide minimal, false or misleading information or, when applying to open an account, provide information that is difficult or expensive for the bank to verify.

2. Transactions Which Do Not Make Economic Sense

(i) A customer-relationship with bank that does not appear to make economic sense, for example, a customer having a large number of accounts with the same bank, frequent transfers between different accounts or exaggeratedly high liquidity;

(ii) Transactions in which assets are withdrawn immediately after being deposited, unless the customer's business activities furnish a plausible reason for immediate withdrawal;

(iii) Transactions that cannot be reconciled with the usual activities of the customer, for example, the use of Letters of Credit and other methods of trade finance to move money between countries where such trade is not consistent with the customer's usual business;

(iv) Transactions which, without plausible reason, result in the intensive use of what was previously a relatively inactive account, such as a customer's account which shows virtually no normal personal or business related activities but is used to receive or disburse unusually large sums which have no obvious purpose or relationship to the customer and/or his business;

(v) Provision of bank guarantees or indemnities as collateral for loans between third parties that are not in conformity with market conditions;

(vi) Unexpected repayment of an overdue credit without any plausible explanation;

(vii) Back-to-back loans without any identifiable and legally admissible purpose.

3. Transactions Involving Large Amounts of Cash

(i) Exchanging an unusually large amount of small-denominated notes for those of higher denomination;

(ii) Purchasing or selling of foreign currencies in substantial amounts by cash settlement despite the customer having an account with the bank;

(iii) Frequent withdrawal of large amounts by means of cheques, including traveller's cheques;

(iv) Frequent withdrawal of large cash amounts that do not appear to be justified by the customer's business activity;

(v) Large cash withdrawals from a previously dormant/inactive account, or from an account which has just received an unexpected large credit from abroad;

(vi) Company transactions, both deposits and withdrawals, that are denominated by unusually large amounts of cash, rather than by way of debits and credits normally associated with the normal commercial operations of the company, e.g. cheques, letters of credit, bills of exchange, etc;

(vii) Depositing cash by means of numerous credit slips by a customer such that the amount of each deposit is not substantial, but the total of which is substantial;

(viii) The deposit of unusually large amounts of cash by a customer to cover requests for bankers' drafts, money transfers or other negotiable and readily marketable money instruments;

(ix) Customers whose deposits contain counterfeit notes or forged instruments;

(x) Large cash deposits using night safe facilities, thereby avoiding direct contact with the bank;

(xi) Customers making large and frequent cash deposits but cheques drawn on the accounts are mostly to individuals and firms not normally associated with their business;

(xii) Customers who together, and simultaneously, use separate tellers to conduct large cash transactions or foreign exchange transactions.

4. Transactions Involving Bank Accounts

(i) Matching of payments out with credits paid in by cash on the same or previous day;

(ii) Paying in large third party cheques endorsed in favour of the customer;

(iii) Substantial increases in deposits of cash or negotiable instruments by a professional firm or company, using client accounts or in-house company or trust accounts, especially if the deposits are promptly transferred between other client company and trust accounts;

(iv) High velocity of funds through an account, i.e., low beginning and ending daily balances, which do not reflect the large volume of funds flowing through an account;

(v) Multiple depositors using a single bank account;

(vi) An account opened in the name of a foreign exchange dealers that receives structured deposits;

(vii) An account operated in the name of an offshore company with structured movement of funds.

5. **Transactions Involving Transfers Abroad**

(i) Transfer of money abroad by an interim customer in the absence of any legitimate reason;

(ii) A customer which appears to have accounts with several banks in the same locality, especially when the bank is aware of a regular consolidated process from such accounts prior to a request for onward transmission of the funds elsewhere;

(iii) Repeated transfers of large amounts of money abroad accompanied by the instruction to pay the beneficiary in cash;

(iv) Large and regular payments that cannot be clearly identified as bona fide transactions, from and to countries associated with (i) the production, processing or marketing of narcotics or other illegal drugs or (ii) criminal conduct;

(v) Substantial increase in cash deposits by a customer without apparent cause, especially if such deposits are subsequently transferred within a short period out of the account and/or to a destination not normally associated with the customer;

(vi) Building up large balances, not consistent with the known turnover of the customer's business, and subsequent transfer to account(s) held overseas;

(vii) Cash payments remitted to a single account by a large number of different persons without an adequate explanation.

6. Investment Related Transactions

(i) Purchasing of securities to be held by the bank in safe custody, where this does not appear appropriate, given the customer's apparent standing;

(ii) Requests by a customer for investment management services where the source of funds is unclear or not consistent with the customer's apparent standing;

(iii) Larger or unusual settlements of securities transactions in cash form;

(iv) Buying and selling of a security with no discernible purpose or in circumstances which appear unusual.

7. Transactions Involving Unidentified Parties

(i) Provision of collateral by way of pledge or guarantee without and discernible plausible reason by third parties unknown to the bank and who have no identifiable close relationship with the customer;

(ii) Transfer of money to another bank without indication of the beneficiary;

(iii) Payment orders with inaccurate information concerning the person placing the orders;

(iv) Use of pseudonyms or numbered accounts for effecting commercial transactions by enterprises active in trade and industry;

(v) Holding in trust of shares in an unlisted company whose activities cannot be ascertained by the bank;

(vi) Customers who wish to maintain a number of trustee or clients' accounts that do not appear consistent with their type of business, including transactions that involve nominee names.

8. Miscellaneous Transactions

(i) Purchase or sale of large amounts of precious metals by an interim customer;

(ii) Purchase of bank cheques on a large scale by an interim customer;

(iii) Extensive or increased use of safe deposit facilities that do not appear to be justified by the customer's personal or business activities.

Annexure 8

CHARACTERISTICS OF FINANCIAL TRANSACTIONS THAT MAY BE A CAUSE FOR INCREASED SCRUTINY

1. Accounts:

(i) Accounts that receive relevant periodical deposits and are dormant at other periods. These accounts are then used in creating a legitimate appearing financial background through which additional fraudulent activities may be carried out.

(ii) A dormant account containing a minimal sum suddenly receives a deposit or series of deposits followed by daily cash withdrawals that continue until the sum so received has been removed.

(iii) When opening an account, the customer refuses to provide information required by the financial institution, attempts to reduce the level of information provided to the minimum or provides information that is misleading or difficult to verify.

(iv) An account for which several persons have signature authority, yet these persons appear to have no relation among each other (either family ties or business relationship).

(v) An account opened by a legal entity or an organization that has the same address as other legal entities or organizations but for which the same person or persons have signature authority, when there is no apparent economic or legal reason for such an arrangement (for example, individuals serving as company directors for multiple companies headquartered at the same location, etc.).

(vi) An account opened in the name of a recently formed legal entity and in which a higher than expected level of deposits are made in comparison with the income of the promoter of the entity.

(vii) The opening by the same person of multiple accounts into which numerous small deposits are made that in aggregate are not commensurate with the expected income of the customer.

(viii) An account opened in the name of a legal entity that is involved in the activities of an association or foundation whose aims are related to the claims or demands of a terrorist organization.

(ix) An account opened in the name of a legal entity, a foundation or an association, which may be linked to a terrorist organization and that shows movements of funds above the expected level of income.

2. Deposits and Withdrawals:

(i) Deposits for a business entity in combinations of monetary instruments that are a typical of the activity normally associated with such a business.

(ii) Large cash withdrawals made from a business account not normally associated with cash transactions.

(iii) Large cash deposits made to the account of an individual or legal entity when the apparent business activity of the individual or entity would normally be conducted in cheques or other payment instruments.

(iv) Mixing of cash deposits and monetary instruments in an account in which such transactions do not appear to have any relation to the normal use of the account.

(v) Multiple transactions carried out on the same day at the same branch of a financial institution but with an apparent attempt to use different tellers.

(vi) The structuring of deposits through multiple branches of the same financial institution or by groups of individuals who enter a single branch at the same time.

(vii) The deposit or withdrawal of cash in amounts which fall consistently just below identification or reporting thresholds.

(viii) The presentation of uncounted funds for a transaction. Upon counting, the transaction is reduced to an amount just below that which would trigger reporting or identification requirements.

(ix) The deposit or withdrawal of multiple monetary instruments at amounts which fall consistently just below identification or reporting thresholds, if any, particularly if the instruments are sequentially numbered.

3. Wire Transfers:

(i) Wire transfers ordered in small amounts in an apparent effort to avoid triggering identification or reporting requirements.

(ii) Wire transfers to or for an individual where information on the originator, or the person on whose behalf the transaction is conducted, is not provided with the wire transfer, when the inclusion of such information would be expected.

(iii) Use of multiple personal and business accounts or the accounts of non-profit organizations or charities to collect and then funnel funds immediately or after a short time to a small number of foreign beneficiaries.

(iv) Foreign exchange transactions that are performed on behalf of a customer by a third party followed by wire transfers of the funds to locations having no apparent business connection with the customer or to countries of specific concern.

4. Characteristics of the Customer or His/Her Business Activity:

(i) Funds generated by a business owned by individuals of the same origin or involvement of multiple individuals of the same origin from countries of specific concern acting on behalf of similar business types.

(ii) Shared address for individuals involved in cash transactions, particularly when the address is also a business location and/or does not seem to correspond to the stated occupation (for example student, unemployed, self-employed, etc.).

(iii) Stated occupation of the transactor is not commensurate with the level or type of activity (for example, a student or an unemployed individual who receives or sends large numbers of wire transfers, or who makes daily maximum cash withdrawals at multiple locations over a wide geographic area).

(iv) Regarding non-profit or charitable organizations, financial transactions for which there appears to be no logical economic purpose or in which there appears to be no link between the stated activity of the organization and the other parties in the transaction.

(v) A safe deposit box is opened on behalf of a commercial entity when the business activity of the customer is unknown or such activity does not appear to justify the use of a safe deposit box.

(vi) Unexplained inconsistencies arising from the process of identifying or verifying the customer (for example, regarding previous or current country of residence, country of issue of the passport, countries visited according to the passport, and documents furnished to confirm name, address and date of birth).

5. Transactions Linked to Locations of Concern:

(i) Transactions involving foreign currency exchanges that are followed within a short time by wire transfers to locations of specific concern (for example, countries designated by national authorities, FATF non cooperative countries and territories, etc.).

(ii) Deposits are followed within a short time by wire transfers of funds, particularly to or through a location of specific concern (for example, countries designated by national authorities FATF non cooperative countries and territories, etc.).

(iii) A business account through which a large number of incoming or outgoing wire transfers take place and for which there appears to be no logical business or other economic purpose, particularly when this activity is to, through or from locations of specific concern.

(iv) The use of multiple accounts to collect and then funnel funds to a small number of foreign beneficiaries, both individuals and businesses, particularly when these are in locations of specific concern.

(v) A customer obtains a credit instrument or engages in commercial financial transactions involving movement of funds to or from locations of specific concern when there appears to be no logical business reasons for dealing with those locations.

(vi) The opening of accounts of financial institutions from locations of specific concern.

(vii) Sending or receiving funds by international transfers from and/or to locations of specific concern.

Annexure 9

Financial Soundness Indicators

Indicator	Indicates	Comments and basis of computation
Regulatory capital to risk- weighted assets	Capital adequacy	Broad measure of capital including items giving less protection against losses, such as subordinated debt, tax credits, unrealized capital gains $\frac{\text{Total qualifying capital}}{\text{Risk weighted assets}} \times 100$
Regulatory Tier 1 capital to risk weighted assets	Capital adequacy	Highest quality capital such as shareholder equity/ retained earnings, relative to risk weighted assets $\frac{\text{Total tier 1 capital}}{\text{Risk weighted assets}} \times 100$
Regulatory Tier 2 capital to risk weighted assets	Capital adequacy	Tier 2 capital relative to risk weighted assets $\frac{\text{Total tier 2 capital}}{\text{Risk weighted assets}} \times 100$
Non performing loans net of provision to capital	Capital adequacy	Indicates potential size of additional provisions that may be needed relative to capital $\frac{\text{NPL – Provision}}{\text{Total qualifying capital}} \text{X} \ 100$
Capital to assets	Capital adequacy	Broad measure of capital adequacy which is a buffer for losses $\frac{\text{Total qualifying capital}}{\text{Total assets}} \text{X} \ 100$
Non performing loans to total gross loans	Asset quality	Indicates the credit quality of banks' loans $\frac{\text{Non performing loans}}{\text{Gross loans}} \text{X} \ 100$
Sectoral distribution of loans to total loans	Asset quality	Identifies exposures concentrations to particular sectors $\frac{\text{Loans per Sector}}{\text{Gross loans}} \text{X} \ 100$

Indicator	Indicates	Comments and basis of computation
Large exposures to capital	Asset quality	Identifies credit exposure to large borrowers $$\frac{\text{Aggregate large exposure}}{\text{Total qualifying capital}} \times 100$$ A large exposure is any credit to a customer or a group of related borrowers that is at least 10% of a bank's shareholders fund unimpaired by losses
Geographical distribution of loans to total loans	Asset quality	Identifies credit exposure concentrations to particular countries by the banking system $$\frac{\text{Loans per defined geographical area}}{\text{Gross loans}} \times 100$$
Return on assets	Earnings/ profitability	Assesses scope for earnings to offset losses relative to capital or loan and asset portfolio $$\frac{\text{PAT}}{\text{Total assets}} \times 100$$
Interest margin to gross income	Earnings/ profitability	Indicates importance of net interest income and scope to absorb losses $$\frac{\text{Net interest income}}{\text{Gross Income}}$$
Non interest expenses to gross income	Earnings/ profitability	Indicates extent to which non interest expenses weaken earnings $$\frac{\text{Non interest expense}}{\text{Gross Income}}$$
Liquid assets to total assets	Liquidity	Assesses the vulnerability of the sector to loss of access to market sources of funding or a run on deposits
Liquid assets to short term liabilities	Liquidity	
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)	Liquidity	Assesses the vulnerability to loss of access to customer deposits

Indicator	Indicates	Comments and basis of computation
loans		Customer deposits x 100 Loans and advances to customers
Net open position in foreign exchange to capital	Exposure to FX risk	Measures foreign currency mismatch Net Open Position Total Capital
Foreign currency-denominated loans to total loans	Exposure to FX risk	Measures risk to loan portfolios from exchange rate movements Naira value of FCY loans x 100 Loans and advances to customers and banks
Foreign currency-denominated liabilities to total liabilities	Exposure to FX risk	Measures extent of dollarization Naira value of FCY liabilities x 100 Total liabilities
Return on equity	Earnings/ profitability	Indicates extent too 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)%

Indicator	Indicates	Comments and basis of computation
Total debt to equity	Leverage	Provides indication of credit risk $\frac{\text{Debt securities issued}}{\text{Shareholders fund}} \times 100$
Earnings to interest and principal expenses	Debt service capacity	Indicates extent to which earnings cover losses are reduced by interest and principal payments $\frac{\text{PAT}}{\text{Interest \& principal payments on debt securities}} \times 100$

Annexure 10

Financial Ratios

FINANCIAL RATIO	MEASURES	BASIS OF COMPUTATION
Average cost of deposits	Earnings/ profitability	Interest expense Average deposit (i.e opening + closing balances)/2
Basic earnings per share	Earnings/ profitability	Profit attributable to ordinary shareholders (after deduction of debenture int.and tax) Weighted average no of shares in issue
Cost to income ratio (1)	Earnings/ profitability	Total cost (interest expense, operating cost before loan loss expense)/Gross earning
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)

FINANCIAL RATIO	MEASURES	BASIS OF COMPUTATION
Operating profit	Earnings/ profitability	Profit before taxation (PBT)
Operating profit margin	Earnings/ profitability	$\frac{\text{Operating profit}}{\text{Gross earnings}}$
Liquidity ratio	Liquidity	$\frac{\text{Liquid assets}}{\text{Deposit liabilities(as prescribed by the CBN)}}$
Loan to deposit ratio	Liquidity	$\frac{\text{Total loans}}{\text{Total deposit}}$
Provisioning level	Asset quality	$\frac{\text{Total provision}}{\text{Total NPL}}$
Risk asset ratio	Asset quality	$\frac{\text{Total loans}}{\text{Total assets}}$
Leverage ratio	Capital adequacy	$\frac{\text{Total debt capital}}{\text{Total shareholders' fund}} \times 100$

GLOSSARY

BA	Banker's Acceptance
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