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FINANCE UPDATE

HIGHLIGHTS OF THE CIRCULARS ISSUED IN THE FINANCE INDUSTRY IN SEPTEMBER 2021

Dear Esteemed Client,

Introduction

The Central Bank of Nigeria ("CBN") issued the following Circulars in September 2021. We hope that you find some of the information useful in your operations.

- **TED/FEM/PUB/FPC/01/007 - Observance of Due Diligence in the Processing of Foreign Exchange Transactions**
- **PSM/DIR/PUB/CIR/01/026 - Disaggregation of Bulk Payment**
- **BSD/DIR/PUB/14/063 - BASEL III Implementation by Deposit Money Banks in Nigeria**
- **BSD/DIR/PUB/14/063 - Revised Guidelines on Supervisory Review Process of Internal Capital Adequacy Assessment Process (SRP/ICAAP)**

1. TED/FEM/PUB/FPC/01/007 - OBSERVANCE OF DUE DILIGENCE IN THE PROCESSING OF FOREIGN EXCHANGE TRANSACTIONS

The CBN has reiterated its directive to banks and financial institutions to desist from all Foreign Exchange (FX) malpractices. Apart from Know Your Customer (KYC) requirements, banks are also required to know their customers' business. Banks who are found culpable of FX malpractices will be liable to suspension for a minimum period of one year. This development is part of the CBN's effort at preventing illicit forex flows and graft.

For more information on the circular, please click here.

2. PSM/DIR/PUB/CIR/01/026 - DISAGGREGATION OF BULK PAYMENT

In a bid to resolve the challenges faced by banks and PSPs in processing bulk transfers, the CBN has directed banks and Payment Service Providers (PSBs) to separate all transactions that would ordinarily be categorised as bulk payment before a transfer is processed. Accordingly, banks and PSPs are to ensure that all end-to-end bulk payments or transfers by their customers are processed on their platforms and must contain a detailed breakdown of the accounts that receive the credits retained in the custody of the sender's banks.

This directive by the CBN stems from the fact that originating banks and PSPs usually pass a single debit entry through the initiating customers' account and multiple credits to beneficiaries without adequate records of the credit entries in their system which distorts audit trail and hampers transparency. It is expected that implementation of this directive will address these challenge.

For more information on the circular, please click here.

3. BSD/DIR/PUB/14/063 - BASEL III IMPLEMENTATION BY DEPOSIT MONEY BANKS IN NIGERIA

The CBN has set November 2021 as the deadline for banks to begin implementing Basel III criteria. The Basel III standard is a voluntary global regulatory framework that addresses bank capital adequacy, stress testing, and market liquidity risk.

The CBN issued the following Basel III Guidelines /Reporting Templates for implementation by banks:

- Guidelines on Regulatory Capital
- Guidelines on Leverage Ratio (LeR)
- Guidelines on Liquidity Coverage Ratio (LCR)
- Guidelines on Liquidity Monitoring Tools (LMT)
- Guidelines on Large Exposures (LEX)
- Guidelines on Liquidity Risk Management and Internal Liquidity Adequacy Assessment Process (ILAAP)

Key provisions introduced by the above listed Guidelines include the following:

- Banks are required to maintain a minimum leverage ratio of 4% at all times;
- Banks must calculate the leverage ratio in accordance with the relevant requirements specified to supplement their risk-based capital requirements;
- The LCR shall apply to all commercial and merchant banks (otherwise known as Reporting Entity) operating in the Nigerian Financial System on both entity (stand-alone) and consolidated basis. As a general principle, no excess liquidity should be recognised by a cross-border banking group in its consolidated LCR if there is reasonable doubt about the availability of such liquidity.
- A reporting entity with assets and liabilities denominated in foreign currencies shall report its LCR positions for US dollars, Pound Sterling, Euro, Yuan, and other currencies in Naira equivalent separately, regardless of whether these are significant currencies for the reporting entity and monitor the liquidity needs in significant currencies on an ongoing basis.
- Reporting entities are required to notify the CBN immediately if their LCR has fallen, or is expected to fall, below 100%.
- The calculation of the LeR will be at both the entity and consolidated levels.

Consolidated levels will include banking and Holding Company/ group level;

- The leverage ratio exposure measure should generally be based on gross accounting values. Therefore, unless specified otherwise, banks are restricted from utilising physical or financial collateral, guarantees or other credit risk mitigation techniques to reduce the leverage ratio exposure measure, as well as netting assets and liabilities.
- A minimum Pillar 1 regulatory Capital Adequacy Ratio (CAR) of 15% will be applicable to all banks and banking groups with international authorisation and those that have been categorized by the CBN as being Domestic Systemically Important Banks (D-SIBs). A minimum CAR of 10% will be applicable to all other banks.
- Banks are required to disclose and detail to the CBN the sources of material differences between their total balance sheet assets as reported in their Audited Financial Statement (accounting assets) and their on-balance sheet exposures for their leverage ratio exposure measure.

  The LCR is aimed at ensuring that banks hold sufficient unencumbered high-quality liquid assets (HQLA) to survive a 30-day stress period. The CBN has adopted f monitoring tools (metrics); Contractual maturity mismatch; Concentration of funding; Available unencumbered assets; LCR by significant currency; and Market-related monitoring tools specified by Basel Committee on Banking Supervision (BCBS) to monitor bank liquidity rates.

- The Board of Directors of banks are required to provide their assessment of the liquidity adequacy of the bank through a Liquidity Adequacy Statement (LAS) on a quarterly basis. The assessment should be supported by ILAAP outcomes and any other relevant information. Banks' policies should include both quantitative and qualitative targets such as: a) Definition and minimum level of HQLA; b) Reliance on both short- and long-term funding sources, both on an ongoing basis and under contingent liquidity scenarios; c) Limits on the composition of assets and liabilities; d) Level of cash flow mismatches and controls over funding costs; and e) Convertibility of assets into cash to be used as contingent sources of liquidity

In addition to the above, Reporting entities are required to comply with the minimum LCR on a daily basis to help monitor and control their liquidity risk.

We anticipate that strict implementation of the guidelines will strengthen regulation, supervision, and risk management within the banking sector, thereby improving liquidity as well as, make the Nigerian banking system more resilient.

For more information on the circular, please click here.

4. BSD/DIR/PUB/14/063 - REVISED GUIDELINES ON SUPERVISORY REVIEW PROCESS OF INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS (SRP/ICAAP)

This Guidelines provides a Supervisory Review Process (SRP) and is applicable to all Deposit Money Banks (DMBs or Banks) in Nigeria. The SRP is structured along two separate but complementary phases - the Internal Capital Adequacy Assessment Process (ICAAP), and the Supervisory Review and Evaluation process (SREP).

While ICAAP requires Banks to perform an independent and complete forward looking assessment of the risks to which they are exposed, and estimate the internal capital requirement that adequately reflects their risk profile, business strategy and risk acceptance level, the SREP is the process by which the CBN conducts:

a) Reviews and assesses the bank's ICAAP;

b) Analyses the bank's own assessment of its risk profile, the corporate governance, and the internal control system;

c) Verifies overall compliance with prudential requirements and supervisory expectations in relation to the quantification of internal capital and liquidity requirements; and

d) Formulates an overall view on the risk profile of a bank and, where necessary, takes remedial measures.

All Banks are required to develop and document an ICAAP to maintain adequate capital levels consistent with their strategies, business plans, risk profiles and operating environment on a going concern basis. The ICAAP should be based on appropriate risk management systems that require adequate corporate governance mechanisms, an organizational framework with clear lines of responsibility, and effective internal control systems.

In addition, Banks are also required to consider the CBN Guidelines on Stress testing for the Nigerian Banks in the development of their end-to-end stress testing process as well as consider the relevance of the CBN's stress scenarios and the suggested risk drivers in the context of their business and specific risk drivers.

For more information on the circular, please click here.

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