

## **BANKING UPDATES: RECENT LANDMARK REGULATIONS, LEGISLATION AND CASE LAW AFFECTING THE BANKING AND FINANCE SECTORS**

Lately, the Nigerian banking landscape has been a beehive of activity. In the wake of crises in the foreign exchange (“FX”) market, liquidity challenges, high incidence of non-performing loans (“NPLs”), poor corporate governance ratings, and increasing competition among banks fueled by cutting edge technologies among others; the banking and loan markets have been characterized by a very dynamic regulatory regime, driven by the Central Bank of Nigeria (“CBN”) and new innovative products and models, introduced by market participants such as banks and other financial institutions (“OFIs”) to keep pace with the changing market environment.

This newsletter brings to readers monthly, a synopsis of regulations, directives, case laws and legislation affecting the banking and loan segments of the Nigerian financial system. In this edition, focus is placed on some of the landmark regulations on credit risk management; FX; and accounting treatment for Micro, Small and Medium Enterprises (“MSME”)’s Development Fund. Also featured in this edition is a market bulletin issued in March by the FMDQ OTC Securities Exchange on how to access its OTC FX Futures through the OTC FX Forwards, as well as a review of the decision of the Court of Appeal in the case of **UBA Plc. v Bakare Wasiu (2017) 4 NWLR (pt. 1555) 318 C.A.** on the scope of the duty of care held by banks to their customers and the liability arising from Personal Identification Number (PIN) misuse. Notably, there are no industry-specific legislative updates for the period under review.

- **GUIDELINES FOR THE OPERATION OF THE REDESIGNED CREDIT RISK MANAGEMENT SYSTEM (CRMS)**

In a bid to strengthen credit appraisal mechanism and curtail the growing rate of defaults among borrowers in the financial services sector, the CBN issued the Regulatory Guidelines for the Operation of the Redesigned Credit Risk Management System (the “**CRMS Guidelines**”) for the banking industry. Introduced by a Circular referenced **FPR/DIR/GEN/CRM/06/012** and addressed to all commercial, merchant and non-interest banks in Nigeria authorized to grant credit facilities or loans to customers, the CRMS Guidelines require banks to make rendition on the Credit Risk Management System (CRMS) before disbursement of loans to customers with effect from February 21, 2017. However, sanctions for any breach of the rendition requirements were to be delayed until April 3, 2017.

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<sup>1</sup> Please note that the period under review is March 2017 and these banking updates reflect guidelines, circulars, and case law issued or otherwise reported in the month of March, 2017.



The following are some of the key provisions of the CRMS Guidelines:

### **Underlying Basis and Objectives**

Following concerns over recurring poor lending practices as captured in bank examination reports, the CRMS Guidelines require rendition on the CRMS before the disbursement of any loan or credit facility. It must be noted that this process of submission does not interfere with any participating bank's decision to extend a loan or credit to its customers as rendition is only required after approval to disburse has been given.

The establishment of the CRMS is generally aimed at identifying and minimizing the activities of serial defaulting borrowers in the financial services industry and assisting in strengthening the credit appraisal processes of participating institutions. Specifically, the aims of the CRMS Guidelines include:

- ensuring that the beneficiary of any loan or credit extended by any regulated financial institution in Nigeria is uniquely identified;
- providing broad guidelines, minimum standards and requirements for the operation of the CRMS database in Nigeria;
- identifying the stakeholders of the CRMS and specifying their roles and responsibilities in their operations of the CRMS;
- providing an enabling environment (business and technological) for the operation of the CRMS and specifying the scope of reporting for the purpose of CRMS return rendition.

### **Roles and Responsibilities of Stakeholders**

The main stakeholders of the CRMS include the CBN, the Nigerian Deposit Insurance Corporation ("NDIC"), Asset Management Corporation of Nigeria ("AMCON"), all licensed commercial and merchant banks, all licensed non-interest banks, and all development finance institutions ("DFI's"). It should be noted that licensed private credit bureaus shall continue to exist and serve their functions, render mandatory returns and comply with all relevant circulars and guidelines on their operations.

#### **CBN:**

The CBN is charged with the following responsibilities under the CRMS Guidelines:

- acting as custodian of the CRMS database;
- providing regulatory guidance for the effective and efficient operation of the CRMS;
- providing platform for rendition of the CRMS related data and ensuring availability and accessibility of the platform at all times;



- ensuring full compliance by participating banks on renditions to the CRMS only; and acting as arbiter, through its Consumer Protection Department, in the event of a dispute between a borrower and a participating bank relating to entries on the CRMS only.

#### **NDIC:**

The NDIC shall be responsible for the following:

- updating the status of existing loans granted by financial institutions (in liquidation); and
- acting as arbiter in the event of a dispute between a borrower and entries on the CRMS by financial institutions (in liquidation).

#### **AMCON:**

The AMCON is responsible for updating the credit record status of eligible banks' assets ("EBAs") transferred from financial institutions.

#### **Participating Banks:**

Generally, all participating banks bear among others, the following responsibilities:

- compliance with extant CRMS related regulations;
- data integrity and all liabilities that may arise otherwise;
- submission of valid and complete credit information of their customers before disbursement of credits.

More specifically, participating banks bear responsibilities to the borrower, and the CBN. A participating bank must ensure that it obtains accurate Bank Verification Number ("BVN") or Taxpayer Identification Number ("TIN") details, as well as the email address of the borrower. The participating bank is also required to fill the CRMS with valid and accurate information.

#### **Scope of Reporting:**

***Transactions to be reported on the CRMS*** – The transactions required to be reported on the CRMS are as follows:

- details of all credit by way of loans and advances (with no upper or lower limits) before disbursement;
- all investment securities captured as part of loans and advances shall also be reported using the appropriate reporting templates as specified in the CRMS user manual; and
- any dishonoured/dud cheque issued by a banking customer is required to be reported using the template specified in the CRMS user manual.

***Operational Procedures for the CRMS*** – Participating institutions are required to refer to the updated CRMS user manual and approved Code Book (which are available at the CRMS portal) for detailed CRMS returns rendition procedures, information requirements and respective templates for all CRMS returns.



***Rendition of returns and records maintenance*** – With respect to the operation of the CRMS, the following should be noted:

- rendition on the CRMS is to be done using only recognized and valid unique identifiers – BVN for individuals and TIN for non-individuals;
- participating banks are required to submit necessary information in appropriate templates, and make regular updates and maintenance of records in a timely manner to reflect the true and correct credit position of a borrowing customer at any particular point in time;
- apart from updating borrowers' exposure levels at prescribed intervals, participating banks are expressly prohibited from updating submitted/created credit records where there are no underlying transactions to support same; and
- the CBN cannot amend any information submitted on the CRMS platform by participating institutions.

***Specific requirements for rendition on the CRMS***

***a) Non-individual borrowers (e.g. Companies)***

- The board of directors or promoters of a legal entity, duly registered with appropriate statutory agencies, retain the ultimate responsibility for ensuring that any loan or credit facility contracted on behalf of the legal entity is repaid;
- The board resolution or any other legally recognized basis for authorizing request for a loan or credit facility must expressly authorize the participating bank to obtain and retain on the CRMS:
  - (i) TIN related information such as company name, registration number, address, etc.
  - (ii) BVN related information such as the name, address, date of birth, gender, etc. of directors;
- Where the directors or promoters of the legal entity are individuals, they will be required to provide the valid BVNs to the participating banks for authentication and this will form part of the information on the CRMS.

***b) Individual borrowers***

- A valid BVN must be provided to the participating bank for authentication and will form part of the data on the CRMS;
- The legally recognized document or basis for a loan or credit facility request must expressly authorize the participating bank to obtain and retain BVN related information such as name, address, date of birth, gender, etc.



### c) Guarantees/Guarantors

- no guarantee provided by an individual shall be allowed on the CRMS without BVN;
- where a registered entity in Nigeria provides a guarantee to either an individual or non-individual borrower, its TIN must be provided in the data submission;
- the board resolution or other legally recognized basis for authorizing the entity to serve as a guarantor must include language expressly authorizing the participating bank to obtain and retain on the CRMS, TIN related information such as company name, registration number, address, etc.

### Non-compliance (Penalties and Sanctions Regime)

The CBN is vested with the powers to monitor compliance with the CRMS Guidelines through routine onsite examinations of financial institutions, off-site review of returns rendition, and periodic spot checks. In the events of contravention of any of the provisions of the CRGM Guidelines, penalties and sanctions would be levied on both the participating banks and their principal officers.

**CATEGORIES OF NON-COMPLIANCE** – Non-compliance with the CRMS Guidelines can occur in any of the following conditions:

- **failure to submit borrower's details before disbursement** – this refers to a single incident where a participating bank fails to submit details of an approved loan or credit **before** disbursement to the beneficiary;
- **persistent failure to submit the borrower's details before disbursement** – this refers to two or more incidents in any calendar year where a participating bank fails to submit details of an approved loan or credit **before** disbursement to the beneficiary. **It is worth noting that two or more incidents refer to individual loan or credit types regardless of whether one or more borrowers is involved;**
- submission of misleading, incorrect, invalid and/or incomplete information relating to the borrower and the credit details at the time the loan was approved and submitted on the CRMS before disbursement including the borrower's unique identification, purpose of loan or credit, funding sources. **It should be noted that all required information in the CRMS is considered material;**
- any discrepancy between information submitted to the CRMS and the contents of the borrower's credit or the credit file;
- inappropriate handling of the borrowers records on the CRMS, including unauthorized release of a borrower's credit details submitted on the CRMS; failure to update borrower record(s) in a timely manner so as to align with any changes to the terms and conditions of the loan/credit facility; and



- failure to check the CRMS, as part of the credit appraisal process, and retain a copy of a CRMS generated report with date and time stamps of such status check in a borrower's credit file.

### **Accountability for Specific Roles in Participating Banks**

- ***Chief Risk Officer ( "CRO") (directly or through Chief Credit Officer ("CCO"))***

The CRO or CCO, as the case maybe will be required to ensure the following:

- all credits or loans or exposures are reported;
- all details required and submitted must mirror the contents of internal credit files for the borrower; and
- adherence to the minimum maintenance cycle for updating records in the CRMS of at least once a month.

**It should be noted that under the CBN's Revised Assessment Criteria for Approved Persons' Regime for Financial Institutions ("Approved Persons' Regime"), the CRO will be held individually accountable and responsible for regulatory breaches that occur during his or her tenor. This includes discovery of such regulatory breaches after his/her tenor.**

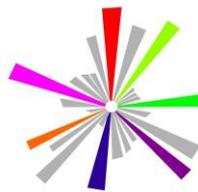
- ***Chief Finance Officer ( "CFO")***

The CFO is required to ensure that total loans, advances or credits reported on the IFRS-compliant financial regulatory application or platform for rendition of prudential regulatory returns (FiNA) or any other regulatory platform for such submissions of returns, must match the total value of credit or exposure reported in the CRMS. **It should be noted that under the Approved Persons' Regime, the CFO will be held individually accountable and responsible for regulatory breaches that occur during his or her tenor.**

- ***Chief Compliance Officer ( "CCO")***

The CCO is required to undertake the following:

- immediately and formally advise both the Director, Banking Supervision Department and Director, Financial Policy & Regulation Department of the CBN where there are personnel changes involving either the CRO or CFO;
- ensure that internal processes required to generate all required information for accurate and timely rendition are institutionalized;
- ensure compliance by the participating bank with the letter and spirit of the CRMS Guidelines and report any breaches to the CBN.



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### Penalties and Sanctions Grid

S/N	Nature of Breach	Sanctions <sup>2</sup>
1.	Failure to submit the borrower's details before disbursement, from the effective date of this CRMS Guidelines.	₦1,000,000 per day for each loan from the day it was disbursed till the date it was discovered or reported.
		Individual letter of explanation from the CRO and CCO to the Director, Banking Supervision, and Director Financial Policy & Regulation for each unreported loan.
		Value of each approved loan or disbursed amount (whichever is higher) to be immediately deducted from qualifying capital in the capital adequacy ratio for regulatory capital purposes, and apply same for the next three (3) years.
2.	Persistent failure to submit borrowers' details before disbursements	Where breach occurs 3 or more times in a calendar year, penalty shall be the equivalent of all incomes earned from each loan or credit. In addition, Approved Persons' Regime will require decertification of the CRO and CCO.
3.	Submission of misleading, incorrect or incomplete information/Discrepancy between information submitted on the CRMS and the contents of borrower's credit file/Failure to update existing or live records to reflect status of credit or loan	₦10,000 per day for each incorrect or invalid data from the day it was submitted to the date it was discovered.
		Individual letter of explanation from the CRO and CCO to the Director, Banking Supervision, and Director Financial Policy & Regulation for each reported loan.
		For recurring incidents in more than 3 loans/credits in a calendar year, penalty shall be the equivalent of 50% of all incomes earned from each loan or credit.
4.	Discrepancy between total loans or advances or credits reported on FiNA or any regulatory platform and total value of credit or exposures reported in the CRMS	Where there is a single incident in one calendar year, a letter of explanation from the CFO and CRO to the Director, Banking Supervision, and Director Financial Policy & Regulation on the discrepancy. In connection with two or more incidents in a calendar year, the Approved Persons' Regime will require decertification of the CFO and CRO.

<sup>2</sup> Please note that sanctions highlighted will apply where the borrower is not a related entity to the participating bank. Sanctions will differ based on the participating bank's relationship with the borrower. Generally where the borrower is a related entity to the participating bank, sanctions are more severe.

## **Complaints and Dispute Resolution**

The required rendition on the CRMS database is the sole responsibility of the participating financial institutions and the CBN shall not be liable or joined in any dispute arising from wrong information given in respect of a credit report on a holder or data subject. The dispute resolution process under the CRMS Guidelines is consistent with the CBN's Consumer Protection Framework 2016 and is as follows:

- A borrower who disputes credit record or information on CRMS would be required to formally complain to the reporting participating bank for a resolution;
- If dissatisfied with the response of the reporting participating bank, the complainant may refer the issue to the Director, Consumer Protection Department, CBN; and
- Where any of the parties remains dissatisfied with the outcome of the CBN's mediation process, the issue may be further referred to an arbitration panel or a court of competent jurisdiction for resolution.

### **• IDENTIFICATION OF BORROWERS' RECORDS WITHOUT BVN OR TIN**

As part of its strategies for ensuring the reliability of data submitted by borrowers and to further strengthen credit risk management in the country, the CBN issued a Circular referenced **FPR/DIR/GEN/CRM/06/013** and dated February 28, 2017 which was addressed to all commercial, merchant and non-interest banks on **Identification of some Borrowers' Records without BVN or TIN Migrated from the Stop Gap to the Redesigned Credit Risk Management System (CRMS)** ("Circular on Identification of Borrowers without BVN or TIN"). The Circular was issued further to an earlier one dated June 23, 2015 and referenced FPR/DIR/GEN/05/07 on the same subject.

As stated in the Circular on Identification of Borrowers without BVN or TIN, the new regulation forms part of measures to safeguard the integrity of data entered in the CRMS and to uniformly address instances of any borrower's unwillingness to provide their BVN or TIN during data cleansing phases. Accordingly, all affected banks are henceforth required to prepare and submit a schedule of such borrowers as follows:

#### **For "Migrated records without BVN":**

- Borrower Identification ( Borrower Code, Full Name or Name of Company/Firm, Gender, Date of Birth, Address);
- Borrower's Referees' Identification (Full name, Referee's Bank Details, Gender, Date of Birth, Address); and
- Credit Record(s) Identification (a sub-schedule capturing Credit ID/ CRMS Ref No, Status (closed/life) and Outstanding Amount (if any)



❖ **It should be noted that a similar schedule is required also for “Migrated records without TIN”.**

The above information was required to be submitted to the CBN’s Director, Financial Policy & Regulation Department within four weeks of the issuance of the Circular.

• **GUIDANCE ON ACCOUNTING TREATMENT FOR MICRO, SMALL AND MEDIUM ENTERPRISES DEVELOPMENT FUND (MSMEDF)**

To provide guidance to Other Financial Institutions (OFIs) which benefit from the Micro, Small and Medium Enterprises Development Fund (the “**MSMEDF**”), in accounting for the funds in their books, the CBN issued a Circular referenced **OFI/DIR/CIR/GEN/17/069** and dated March 1, 2017 which was addressed to all Development Finance Institutions (“DFIs”), Microfinance Banks (“MFBs”) and Finance Companies (“FCs”).

The Circular notes that funds are available under the MSMEDF through direct or indirect funding.

**Direct Funding:**

With respect to direct funding, the Circular stipulates that funds received from the CBN for on-lending to borrowers shall be treated as on-balance sheet items as OFIs bear the risk of default. In addition, the OFIs are required to ensure that:

- the assets and liabilities related to the MSMEDF are stated as separate line items on the balance sheet explanatory notes;
- there is a separate credit schedule for the on-lending facility;
- the on-lending facility is administered based on the provisions of the MSMEDF Guidelines/Memorandum of Understanding (MOU) with the CBN (especially the section on rates);
- provisions for loan losses is in line with the Prudential Guidelines;
- the funds due to the CBN as repayment of the facility are segregated into: funds payable within 12 calendar months; and funds repayable after 12 calendar months.

**Indirect Funding:**

For indirect funding, the Circular states that funds received through State Government/FCT for on-lending shall be treated as off-balance sheet items as State Government/FCT act as the primary obligor to the CBN, and bear the risk of credit default. The Circular further notes that the OFIs, being the secondary obligor, also bear some risks which may crystalize where they fail to adhere to the terms and conditions of the MOU with the State Government/FCT. Where this happens, the Circular stipulates that the asset and liability should be reflected on the balance sheet. In instances where State Government/FCT provides a list of beneficiaries of the MSMEDF, in the event of default, funds are required to remain off-



balance sheet items in the books of the OFIs. OFIs with off-balance sheet engagements are therefore required to ensure that:

- the MOU with the State Government/FCT is duly signed by representatives of both the OFI and the State Government/FCT;
- the MOU clearly defines the terms and conditions of the engagement; and
- there is full disclosure of the amounts received, disbursed and recovered, as well as the performance of the loans in the audited financial statements and management accounts.

#### • **UPDATED DIRECTIVES TO AUTHORISED DEALERS ON FOREIGN EXCHANGE**

In order to increase foreign exchange availability to all end users and ensure that a fair and verifiable exchange rate operates in the market, the CBN directed all authorized dealers in a Circular dated March 3, 2017 and referenced FMD/DIR/CIR/GEN/08/006 to do the following:

- open a teller point for retail FX transactions, including and selling all locations in order to ensure access to foreign exchange by their customers and other users, without any hindrance;
- have an electronic display board in all their branches showing rates of all trading currencies (customers must insist on processing FX transactions based on the displayed rates);
- process and meet the demand for Travel Allowances (PTA/BTA) by end-users within 24 hours of such application, as long as the end-users meet basic requirements already outlined in earlier directives; and
- process and meet demands for school fees and medical bills within 48 hours of such application.

**The Circular further states that these directives take effect immediately and that non-compliance would attract sanctions, including but not limited to being barred from all future CBN foreign exchange interventions.**

#### **BULLETIN ON THE USE OF FX FORWARD CONTRACTS FOR ACCESS TO THE OTC FUTURES MARKET**

In a bid to boost foreign currency liquidity in the country whilst promoting flexibility to support client's business strategies in the over-the-counter ("OTC") FX Futures market, the FMDQ OTC Securities Exchange ("FMDQ") issued a market bulletin referenced **FMDQ/MRG/160317-MB-20** to all Dealing Member Banks ("DMBs") on March 16, 2017.



Accordingly, clients of DMBs wishing to import foreign currency into the country for the purpose of executing eligible underlying transactions (“EUTs”), including foreign portfolio investments and foreign currency loans at a future date, are permitted to hedge their future foreign currency exposure using OTC FX Futures contracts.

The conditions for accessing the OTC FX Futures market are as follows:

- the forward contract to be used for access to the OTC FX Futures market must be a **deliverable forward**;
- the OTC FX Futures contract purchased to hedge the future foreign currency exposure must be **one (1) month longer** than the tenor of the forward contract at the minimum;
- the Futures DMB will be required to execute the OTC FX Futures contract with minimum documentation, such as the Deal Confirmation of the FX forward transaction and an executed forward contract, which must be updated to FMDQ OTC FX Futures Trading & Reporting System (FFTRS) or such other FMDQ-advised medium;
- Subsequently, the Futures DMB shall provide the following documentation within three (3) business days of the maturity of the forward contract:
  - valid Certificate of Capital Importation (CCI).
  - SWIFT confirmation of the inflow.
  - other valid capital importation documentation and such other documentation as may be prescribed by FMDQ from time to time.

## CASE REVIEW

### ***UBA Plc v. Bakare Wasiu (Court of Appeal Decision)***<sup>3</sup>

In this case, the Respondent paid the sum of ₦140,000 into an electronic account with the Ijebu-Ode branch of the appellant bank, which he intended to use in paying his school fees. When he approached the same branch two days later for the transfer of the money to pay his school fees, the Respondent was informed that there was no money in the account. On further enquiry, it was revealed that the money had been transferred to another person's account in another bank (First Bank Plc.). The Respondent made a formal complaint to the CBN on the issue while Respondent's counsel also wrote a letter of complaint on behalf of his client to the Appellant. In its reply to the letter of complaint, the Appellant asked the Respondent to liaise with First Bank Plc. for the refund of the money. The Appellant bank though admitted that the Respondent had deposited money for an ATM cash card it further stated that its internal investigation showed that the money in the Respondent's cash card was transferred into another card issued by First Bank Plc. The Appellant then contended that the Respondent either by himself or through another person (to whom he must have revealed his secret PIN) transferred the funds to First Bank Plc's card.

Consequently, the Respondent filed an action against the Appellant at the High Court of Ogun State, claiming refund of the sum of ₦140,000, special damages and general damages. At the trial of the case, the court found and held the Appellant liable and entered judgment in favour of the Respondent. The Appellant thereafter filed an appeal against the judgment of the trial court.

The Court of Appeal, in a unanimous decision, dismissed the appeal, affirming the judgment of the lower court on the following two (2) grounds:

#### **1. Liability of the bank for fraud arising from counterfeiting and card skimming:**

The Court held that in line with established traditions in the banking industry, the CBN as a regulator of the industry, in accordance with international best practices, issued a policy guideline to regulate the industry called "*Guidelines on Electronic Banking in Nigeria*" (the "Guidelines").

The Guidelines provide that a bank, in relation to automated teller machine, will be held liable for fraud arising from card skimming and counterfeiting, except where it is proven that the merchant is negligent in handling the card. However, where a case of PIN misuse is established, the card holder will be held liable for fraud arising from such misuse.

In the instant case, however, the Court of Appeal held that the onus of proving PIN misuse was on the Appellant bank, and that the onus was not discharged. The rationale behind this decision was that the

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<sup>3</sup> (2017) 4 NWLR (Pt. 1555) 318 C.A



bank was negligent in failing to ensure that the default ATM PIN was substituted for the customer's personalized PIN, thus breaching the duty of care owed by the bank to the customer.

## **2. Operation of the Principle of Tracing:**

The Court of Appeal also justified the liability of the Appellant bank on the strength of the equitable Doctrine of Tracing. On the basis of this doctrine, a beneficiary is allowed to recover his lost property and he may do this by either following the original asset and enforcing his equitable title to it, or tracing it into the substituted assets in the hand of the trustee or other fiduciary and enforcing a proprietary remedy against him. Thus, a bank in possession of a customer's money is in the position of a trustee or other fiduciary and whenever there is a loss of such beneficial customer's funds, the customer and the bank will be entitled to trace such fund to wherever same is.