

Introduction

This is G. Elias & Co.'s regulatory update for the month of March 2017. This update summarizes the recent developments in the banking and finance regulation space that are relevant to G. Elias & Co.'s clients operating in the Nigerian banking and finance sector.

Exposure Draft of the Codes of Corporate Governance for Other Financial Institutions in Nigeria

By a circular referenced FPR/DIR/CIR/GEN/06/011 dated February 27, 2017, the Central Bank of Nigeria (the "CBN") released an exposure draft of the Codes of Corporate Governance (the "Codes") for Primary Mortgage Institutions, Micro Finance Banks, Mortgage Refinancing Companies, Development Finance Institutions, Bureaux De Change; and Finance Companies (each called "the Institution" and collectively called "OFIs"). The Codes, if adopted by the CBN, will have wide-reaching impact on the corporate governance systems and structures of OFIs. The Codes, *inter alia*, make provisions on the size and composition of boards of directors of the OFIs, appointment and tenure of directors, remuneration of directors, establishment and functions of committees, shareholders' proceedings and rights of shareholders, transparency and disclosure, and whistleblowing. Suffice it to say that OFIs might be required under the Codes to make changes targeted at ensuring compliance with the relevant codes.

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Board Management

Responsibilities of the Board: the Codes provide that each board of directors (the "Board") of the OFIs shall: (i) have ultimate responsibility for the performance and affairs of its institution; (ii) define the strategic goals of its institution and approve its short-term business strategies; (iii) determine the required skills, knowledge and experience of its members; (iv) ensure that human, material and financial assistance are effectively deployed towards the attainment of set goals of the institution; (v) appoint the MD/CEO as well as top management staff; (vi) ensure that there is a succession plan in place for the roles of the MD/CEO and other Executive Directors; (vii) set limits of authority, specify threshold for large transactions which will require the prior approval of the Board; (viii) be severally and jointly liable for the activities of its institution; and (ix) ensure strict adherence to the relevant Code and other extant laws and regulations. The Codes also specify that every Board shall have a charter and that appointments to the Board and top management positions in an institution shall be approved by the CBN.

Board Size and Composition: the Codes stipulate different board sizes and composition for the OFIs.

The Code of Corporate Governance for Bureaux De Change (the "BDC Code") provides that the size of the Board of any BDC shall be a minimum of three (3) and a maximum of five (5) directors which shall include at least one (1) independent director appointed for a term not more than five (5) years. .

The Code of Corporate Governance for Development Financial Institutions in Nigeria (the "DFI

Code”) stipulates that the number of directors on the Board of a DFI shall be a minimum of seven (7) and a maximum of eleven (11) directors or in accordance with the statute establishing the institution. The Board shall consist of Executive (EDs) and Non-Executive Directors (NEDs) but with more than fifty percent of the Board being NEDs. The DFI Code further provides that the Board of a DFI shall consist of at least one (1) and at most two (2) independent directors as stipulated in the CBN Guidelines on the appointment of Independent Directors.

The Code of Corporate Governance for Finance Companies (the “FC Code”) provides that the size of the Board of any FC shall be a minimum of five (5) and a maximum of nine (9) directors with more than fifty percent of the directors being NEDs. The FC Code further provides that the Board of a FC shall consist of at least one (1) and at most three (3) independent directors. The maximum tenure of an independent director shall be two terms of four (4) years each.

The Code of Corporate Governance for Microfinance Banks (the “MFB Code”) stipulates that the minimum number of directors on the Board of an MFB shall be a minimum of five (5) and a maximum of seven (7), ten (10) and fifteen (15) for Unit, State and National MFBs respectively. At least one (1) and no more than two (2) of the directors shall be independent directors appointed for a maximum tenure of two (2) terms of four (4) years each. The Code also provides that a Unit MFB shall appoint only one ED being the MD/CEO. For a State or National MFB, the maximum number of EDs (MD/CEO) shall be five (5). The MFB Code further provides that the members of the Board of an MFB shall be qualified persons knowledgeable in business and financial matters with at least two (2) members having banking or related financial industry experience. The Board shall consist of EDs and NEDs but majorly of NEDs.

The Code of Corporate Governance for Mortgage Refinance Companies (the “MRC Code”) and the **Code of Corporate Governance for Primary Mortgage Banks in Nigeria** (the “PMB Code”) stipulates that the minimum number of directors on the Board of a MRC and PMB shall be a minimum of seven (7) and a maximum of fifteen (15). The Code further provides that the members of the Board shall be qualified persons knowledgeable in business and financial matters. The Board shall consist of EDs and NEDs with the NEDs being at least twice the number of the EDs at any time. Further, at least one (1) and a maximum of two (2) independent directors shall be appointed to the Board.

Board Appointment and Tenure: All the Codes, with the exception of the MFB Code, provide that the existing CBN Guidelines on the appointment of members of the Boards of financial institutions shall continue to apply to the OFIs. Moreover, the Codes state that the track record of intended appointees shall be an eligibility requirement for appointment as director and that the procedure for appointment to the Board shall be transparent and documented in the Board Charter.

The MFB Code on its part provides that members of the Board shall be appointed by shareholders and approved by the CBN. Further, a nominee for the position of NED shall not be an employee of a bank or other financial institution except where the MFB is promoted by a bank.

Board Committees: Apart from the BDC Code which empowers the Board of each BDC to establish those committees considered necessary to support the Board in the discharge of its responsibilities, other Codes dictate that the Boards (except BDC Boards) must have the following Committees: (i) Risk Management and Audit Committee with unrestricted access to the financial records of the institution; (ii) Board Governance and Nominations Committee; and (iii) Board Credit Committee. The Codes further provide that all Board Committees shall have a charter approved by the CBN, the Chairman of the Board shall not be a member of any committee and that all Board Committees shall be headed by NEDs.

The MFB Code differs slightly in its provisions on the Risk Management and Audit Committee

by providing that where the MFB is a National MFB, the Risk Committee must be separate from the Audit Committee. Both committees can be fused in Unit and State MFBs.

Board Meetings: the Codes provide that: (i) the Board shall meet at least once every quarter; (ii) board meetings are mandatory for all directors; (iii) at the very least, a director must attend at least two-thirds of all Board Meetings in the financial year; (iv) the Board shall disclose in the Corporate Governance section of the Annual Report of the institution, the total number of Board and Board Committee Meetings held in the financial year and attendance by each director; and (v) the quorum for Board/Board committee meetings shall be two-thirds of members provided that a majority of NEDs are present.

Tenure: the BDC Code does not have any provision on tenure of office for Board members. However, other Codes stipulate that the tenure of an MD/CEO, except as stipulated in the relevant enabling Act, shall be in accordance with the terms of engagement of the MD/CEO with the institution. Provided that such tenure shall not exceed a maximum period of ten (10) years broken into five (5) years *per* term. After such a ten-year tenure, such MD/CEO shall not be eligible for reappointment as MD/CEO in the institution or its subsidiaries until after a period of three (3) years. The MFB Code differs slightly from the other Codes in that it provides that any person that has served as MD/CEO in a MFB for the maximum tenure of ten (10) years shall not be eligible for reappointment in any capacity until after a period of three (3) years after the expiration of his tenure.

In addition to the foregoing, the DFI Code, FC Code, MFB Code, MRC Code and PMB Code also provide that NEDs of Institutions shall serve for a maximum of three (3) terms of four (4) years each. The DFI Code further provides that in the event of a Board dissolution, a transition period of not more than ninety (90) days shall be permitted for the reconstitution of a new Board.

Separation of Power: the BDC Code does not provide for separation of power. However, other Codes provide that: (i) no one person shall occupy the positions of Board chairman and MD/CEO simultaneously except otherwise prescribed in the enabling Act and (ii) no executive vice chairman shall be recognized in the Board structure. Where an institution is a member of a holding company, not more than two extended family members shall be allowed to serve on the Boards of the institution and the holding company and no two members of the same extended family shall be allowed to occupy the positions of Chairman and MD/CEO or ED of an institution.

Remuneration: the BDC Code only provides that the levels of remuneration shall not be excessive but shall be sufficient to attract, retain and motivate top officers and shall align with the long term interest of the institution and the shareholders. The other Codes, however, further provide that every Board shall establish a remuneration policy for its institution. The committee on NEDs shall determine the remuneration of EDs and the MD/CEO and other EDs shall not receive sitting allowances and directors' fees.

NEDs' remuneration shall be limited to directors' fees, sitting allowances for Board and Board Committee meetings and reimbursable travel and hotel expenses. NEDs shall not receive salaries and benefits whether in cash or in kind. Where stock options are adopted as part of executive remuneration, the Board shall ensure that the stock options are not priced at a discount except with the prior authorization of the relevant agencies and such stock option shall be tied to performance and subject to approval of the shareholders at AGMs.

The other Codes further provide that the share options shall not be exercisable until one year after the expiration of the tenure of the director. Institutions shall disclose in their annual reports, details of the shares held by Directors and related parties and where there is a remuneration committee, it shall consist of NEDs only while the Board Governance and Nomination Committee shall have a combination of EDs and NEDs except where both

committees are combined in which case it shall have only NEDs.

Board Appraisal: the BDC Code does not provide for Board appraisal. The other Codes however make provision for an annual Board and Director's review/appraisal conducted by an independent consultant covering all aspects of the Board's structure, composition, responsibilities, processes and relationships as may be prescribed by the CBN. The report of the appraisal shall be presented to shareholders at AGMs with a copy forwarded to the CBN.

Shareholders

Rights and Functions of Shareholders: the Codes provides that shareholders shall have the right to: (i) obtain relevant and material information from the Finance Companies ("FCs") in a timely and on a regular basis; and (ii) participate actively and vote in general meetings. Further, the Codes enjoin FCs, in addition to traditional means of communicating with shareholders, to have website, adopt newsletters and regular village meetings, annual general meetings and extraordinary general meeting.

Equity Ownership: the BDC Code provides that no government, ministry, department or agency shall have direct and/or indirect equity holding in any BDC. The DFI Code, MRC Code and PMB Code on the other hand stipulate that, an equity holding of 5% and above by any investor shall be subject to CBN's approval and where such shares are acquired through the capital market, such institution shall apply for a "no-objection" letter from the CBN immediately after the acquisition. The DFI Code however makes an exception for DFIs established by an enabling Act by providing that ownership structures of such DFIs shall be in line with the provisions of their respective enabling Acts or as may be prescribed by the CBN.

The FC Code stipulates that except as approved by the CBN, no individual, group of individuals, their proxies or corporate entities and/or their subsidiaries shall own controlling interest in more than one (1) FC.

The MFB Code provides that except as approved by the CBN, no individual, group of individuals, their proxies or corporate entities and/or their subsidiaries shall own controlling interest in more than one (1) MFB. Further, in order to discourage governments from having majority shareholding in MFBs and PMBs, the MFB and PMB Codes provide that direct or indirect equity holding by government shall be divested to private individuals within a maximum period of five (5) years from the date of licensing/investment. (The MFB Code further provides that government shareholding shall not exceed 10% after such divestment.)

Protection of Shareholder's Rights: except for the BDC Code that has no provision on the protection of shareholders rights, the other Codes provide that: (i) every shareholder shall be treated fairly; (ii) the Board shall ensure that minority shareholders are adequately protected from overbearing influence of controlling shareholders; and (iii) the Board shall ensure that shareholders are promptly provided with evidence of ownership interest in the institutions such as share certificates, dividend warrants and related documents.

General Meetings: the Codes prescribe that: (i) notice of general meetings shall be as prescribed in the Companies and Allied Matters Act, 1990 ("CAMA"); (ii) the venue of the meeting shall be convenient and easily accessible by majority of shareholders; (iii) unrelated issues shall not be lumped together at general meetings, statutory business shall be clearly spelt out and separate resolutions shall be proposed and voted on each issue; and (iv) the Board shall ensure that decisions reached at general meetings are fully implemented.

Shareholders' Association: the Codes, except for the BDC Code, stipulate that the Board shall ensure that dealings of the institutions with shareholders' associations are in strict compliance with the code for shareholders' associations issued by the Securities and Exchange Commission. In addition to the foregoing, the MFB, MRC and PMB Codes provide that where

the MFB, MRC or PMB is not listed, its dealings with the shareholders' association shall be transparent and in line with the relevant governance codes.

Rights of Other Stakeholders: the Codes provide that employees, customers and other stakeholders shall have the right to freely communicate their concerns about illegal and unethical practices to the Board and where the concerns bother on the activities of the Board, such individuals shall have recourse to the CBN. Further, the Codes provide that where such stakeholders' interest are protected by law, stakeholders shall have the opportunity to obtain effective redress for violation of their rights. The Code also enjoins the institutions to demonstrate good corporate social responsibility to their stakeholders and host communities.

Disclosure and Transparency: the Codes provide that Institutions are to make timely, quality and robust disclosures beyond what is stipulated in the Banks and Other Financial Institutions Act, 1991 (as amended), Companies and Allied Matters Act, 1990 and the Monetary Policy Guidelines. For instance, the Codes provide that every OFI shall, in its annual reports, disclose material information on: (a) major items that have been estimated in accordance with applicable accounting and auditing standards; (b) rationale for all material estimates; (c) details of directors- remuneration policy for Board members and executives, total NEDs remuneration including fees, allowances; total executive compensation including bonuses paid/payable, organizational structure, details and reasons for share buy-backs, if any during the period under review, policies for handling related party transaction; Board of Directors' performance evaluation, details of directors, shareholders and their related parties who own 5% and above of the institution's shares as well as other shareholders who, in concert with others, control the institution; (d) corporate governance- governance structure and composition of board committees; (e) risk assets- loan quality, lending/borrowing to/from subsidiaries; (f) risk management; (g) information on strategic modification to the core business; (h) all regulatory/supervisory contraventions during the year under review and infractions uncovered through whistleblowing including regulatory sanctions and penalties; (i) capital structure/ adequacy; (j) opening and closure of branch/cash centre; (k) any service contracts and other contractual relationships with related parties; (l) frauds and forgeries; (m) contingency planning framework; (n) contingency planning framework; and (o) any other matter capable of affecting the financial condition of the company and its status as a going concern.

Note however that, BDCs are required to include; (i) details of domiciliary accounts owned and maintained by the BDC; and (ii) all customers complaints during the reporting period and actions taken thereon.

Transparency and Integrity in Reporting: the Codes stipulate that institutions shall have a structure (the Board Audit Committee with at least three (3) members which shall consist of at least one NED and two shareholders) to independently verify and safeguard financial reporting. Further, the Code prescribes that the appointment and removal of the chief compliance officer/head of internal audit shall be the responsibility of the Board subject to CBN's ratification. The qualification and experience of the chief compliance officer shall be in accordance with the provisions of the CBN's Competency Framework for the banking industry. The CBN must be notified of any change and reasons thereof within fourteen (14) days of such change. The Codes also provide that the chief compliance officer is to monitor compliance with Anti-Money Laundering and Combating the Financing of Terrorism and the implementation of the corporate governance code.

External Auditor: The Codes stipulate that the appointment of external auditors shall be approved by the CBN and their responsibilities shall include; (i) rendering of reports to the CBN on practices, internal controls and levels of compliance with regulatory directives; (ii) reviewing of the work of internal auditors on key risk elements; (iii) reviewing compliance with policies and internal control procedures put in place by the Board to manage and mitigate risks; (iv) forwarding their report to the CBN along with external auditor's management letter

on the institution's audited financial statements. The Codes prohibit the external auditors from: (a) providing bookkeeping or other services related to the accounting records or financial statements of the audit client; (b) appraisal or valuation services; (c) actuarial services; (d) internal audit outsourcing services; and (e) management of human resource functions including broker or dealer, investment banking services and legal or expert services.

The Codes provide that the tenure of auditors in an institution shall be a maximum of ten (10) cumulative years. The audit firm having served for 10 years shall not be reappointed in the institution until after a period of ten (10) consecutive years.

The MFB and MRC Codes further provide that the MD/CEOs of MFBs are required to certify, in each statutory return submitted to the CBN, that to the best of their knowledge, the returns do not contain any untrue statement because false rendition attract stiff sanction in addition to suspension of the MD/CEO for six months in the first instance and blacklisting subsequently. These Codes further provide that all credit application pertaining to the directors and management staff shall be sent for approval to the Board Committee and no director-related credit facility shall be written off without the prior approval of CBN.

Whistle Blowing: the Codes stipulate that institutions shall have a whistle-blowing policy which shall assure confidentiality of and encourage stakeholders to report any unethical activity to the institution and/or the CBN. Further, the Codes enjoin the institutions to make the whistle blowing policy of the institution known to employees, customers and other stakeholders.

Risk Management: the Codes provide that Boards of the institutions shall put in place adequate systems, policies and procedures for identification, measurement, monitoring and control of the risks inherent in operations. Further, the Codes provide that institutions shall also disclose a summary of risk management policies in their annual financial statements and the composition of an institution's Risk Management Committee shall include at least two (2) NEDs and the ED in charge of risk management but chaired by an NED.

Ethics, Professionalism and Conflict of Interest: institutions are required to establish a code of conduct and to comply with legal obligations, extant laws and regulations while having regard for the expectations of their stakeholders. The Codes also provide that every Institution shall have in place an approved conflict of interest policy and the Board shall be responsible for managing conflicts of interest and enjoin the directors to promptly disclose to the Board any real, potential or perceived conflict of interest.

Sanctions: the Codes stipulate that compliance is mandatory and failure shall attract appropriate sanctions stipulated in s. 60 of BOFIA. Institutions are to render returns on the status of their compliance with the Codes semi-annually or as may be specified by the CBN from time to time.

Regulatory Guidelines for the Operation of the Redesigned Credit Risk Management System (CRMS) For Commercial, Merchant and Non-Interest Banks

By a circular dated February 27, 2017, the Central Bank of Nigeria ("the CBN") released regulatory guidelines for the operation of the redesigned credit risk management system (CRMS) for commercial, merchant and non-interest banks (the "Guidelines"). The Guidelines shall apply to all commercial, merchant and non-interest banks licensed and regulated by the Central Bank of Nigeria and authorized to grant credit facilities or loans to its customers.

Update to Foreign Exchange Directives

In view of the CBN's drive to meet FX demand in the market, and in order to further increase FX availability to all end-users and ensure that a fair and verifiable exchange rate operates in the market,

the CBN released a circular on March 3, 2017 directed to all banks in Nigeria. By the circular, Banks are mandated to: (i) open a teller point for retail FX transactions, including buying and selling, in all locations in order to ensure access to foreign exchange by their customers and other users, without any hindrance; (ii) display in electronic boards in all their branches, the rates of all trading currencies, and customers must insist on processing FX transactions based on the displayed rates, (iii) process and meet the demand for PTA and BTA within 24 hours of such application, as long as the end users meet the basic requirements already outlined in earlier directives; and (iv) to process and meet demands for school fees and medical bills within 48 hours of such application.

The directive took effect immediately, and non-compliance would attract sanctions, including but not limited to being excluded from all future CBN foreign exchange interventions.

Immediate Adoption of Examiners' Recommended Provision and Audit Adjustment by Other Financial Institutions

On March 3, 2017, the CBN published the circular directing the immediate adoption of examiners' recommended provision and audit adjustment by other financial institutions (OFIs). By this circular, it is recommended that the Board of an OFI shall, upon receipt of the Routine Examination Report from the Central Bank of Nigeria (CBN) or the Nigeria Deposit Insurance Corporation (NDIC), deliberate on the report and give an undertaking that the recommendations will be implemented. The same consideration is to be given to audit adjustments.

The rationale presented by the CBN for this circular is that most OFIs neither consider the recommended provisions for loan losses and other known losses, nor do they pass on the audit adjustments in their books. This results in discrepancies between the provisions in the examination report, the monthly/quarterly report sent to the CBN, and the audited accounts. The effect is that data is distorted to the effect that shareholders' losses in the returns are higher and different from computed figures in the examination report and the approved audited accounts. Moreover, this presents a distorted picture of the true state of affairs of the OFI, and the unavailability of accurate data inhibits the CBN's ability to formulate adequate policy and decision making for the OFIs.

Although the circular states that non-compliance will attract sanctions, the circular is silent on the exact nature of the sanctions.

Letter to all Development Finance Institutions (DFIs), Microfinance Banks (MFBs) and Finance Companies (FCs)

The letter is dated March 1, 2017 and provides guidance to other financial institutions that benefit from the micro, small and medium enterprises development funds of the CBN ("the Funds") on accounting for the Fund in their books.

Direct funding: the Funds received directly from the CBN for on-lending shall be treated as On-Balance Sheet items as the OFIs bear the risk of default. In addition to adhering to the provisions of the Guidelines for the operation of the Fund, the OFIs shall ensure that:

- (a) the assets and liabilities related to the Funds are stated as separate line items on the balance sheet with explanatory notes;
- (b) there is a separate credit schedule for the on-lending facility;
- (c) the on-lending facility is administered based on the provisions of the Funds guidelines/MOU with the CBN (especially the section on interest rates)'
- (d) provision for loan losses is in line with the prudential guidelines;
- (e) the funds due to the CBN as repayment of the facility are segregated into:

- (i) funds repayable within 12 calendar months (this should form part of current liabilities in calculating liquidity ratio), and
- (ii) funds repayable after 12 calendar months.

Indirect funding: the Funds received through State Governments/FCT ("the Government") for on-lending shall be treated as Off-Balance items where the Government acts as the primary obligor to the CBN, and bears the risk of the credit default. The OFIs, as secondary obligors will assume some risk which may crystalize if they fail to adhere to the terms and conditions of their MOU with the government. Where the risk crystalizes, the assets and liabilities should reflect on the balance sheet. Where the Government provides a list of beneficiaries of the Fund, such that the obligors are not as a result of the OFI's own risk assessment, in the event of default, the funds shall remain as Off-balance sheet item in the books of the OFI.

OFIs having off-balance sheet engagements should ensure that:

- (i) the MOU with the Government is duly signed by a representative of both the OFI and the Government;
- (ii) the MOU should clearly define the terms and conditions of the engagement; and
- (iii) there is full disclosure of the amount received, disbursements recovered, and the performance of the loans in the Audited Financial Statements and Management Accounts.

Contact

For more information, or to seek further clarification on the foregoing, kindly visit www.gelias.com or contact our Managing Partner, Fred Onuobia via e-mail at fred.onuobia@gelias.com

About G. Elias & Co.

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