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REVIEW OF UNIVERSAL BANKING MODEL

As part of its strategic initiatives for reforming the Nigerian financial system to enhance the quality of banks, ensure financial system stability and promote the evolution of a healthy financial sector, the Central Bank of Nigeria (CBN) is currently reviewing the Universal Banking Policy

In this regard, a draft "Review of Universal Banking Model" is hereby released as exposure draft to the industry for comments/inputs. A copy of the document which is herewith forwarded to you can also be accessed at:

<http://www.cenbank.org>

Please forward your comments/inputs to the Director of Banking Supervision to reach him not later than April 14, 2010

J. O. AJEWOLE

Ag. Director of Banking Supervision

Note: Please your comments should be sent electronically to this email address: apayuba@cenbank.org while hard copy should be forwarded to the Director, Banking Supervision Department.

Review of Universal Banking Model



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Introduction



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Objective of this Document

The document aims to achieve the following:

- review the current banking model in operation,
- provide a business case for the change in licensing regime,
- define new banking licenses under consideration, and
- define new business rules.



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Introduction

Banks in Nigeria currently carry out a wide range of banking and non-banking services, which include insurance, investment advisory, asset management services, etc., by virtue of the universal banking licence regime.

The regime, however, has exposed banking business to greater risks that challenge the stability of the financial system.

As part of the CBNs blueprint for reforming the Nigerian financial system, which includes the enhancement of the quality of banks, financial system stability and evolution of healthy financial sector, the CBN is implementing strategic imperatives to prevent a reoccurrence of the recent past events in the Nigerian banking industry.

CBNs primary objectives for the current reform exercise include:

- Depositor/consumer protection by ring fencing “banking” from non-banking business
- Ensuring effective regulation of the entire business of “banks” while facilitating a business model that is supportive of their growth aspirations
- Redefining the licensing model of banks and articulating rules/guidelines to guide bank operations going forward
- Facilitating the enhancement of risk management at “Group Enterprise” level to enable management and shareholders fully understand and address risks from a holistic perspective.



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Key Features and Issues of the Current Universal Banking Model

Key Features	Key Issues
Banks have the latitude to undertake a wide scope of financial services activities	Limited skills to cover the entire spectrum of business of the current banking groups
Banks are organized as 'operating holding companies' playing multiple roles as an operating entity (bank); a holding company to the subsidiary entities; and holding direct and indirect investments in other non-financial services entities	Increased risk from affiliate transaction e.g. contagion risk
Banks have grouped assets and function as a consolidated group with marginal distinction between the bank and the subsidiaries in terms of management and operations	Improper allocation of depositors fund to high risk businesses e.g. proprietary trading and investments
Typically, banks are sole or majority shareholders in the subsidiary financial institutions with overwhelming powers at Board and management levels	Limited penetration and specialisation, as a result of the insufficient niches which have not been appropriately served
	Economic/systemic risk i.e. 'too big to fail syndrome'
	Regulatory arbitrage/regulator handshakes
	Weak group corporate governance



While the current model promised to deliver benefits of economies of scale and achieve synergies across complementary financial services business lines, the issues above, some of which have crystallized, have prompted the CBN to review the current banking arrangement. Therefore, the CBN in reviewing this arrangement, will require banks to focus on core banking business.





Reviewing the Universal Banking Regime



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Reviewing the Universal Banking Regime

The universal banking regime was introduced vide the "Guidelines for the Practice of Universal Banking in Nigeria" (UB Guidelines) issued by the CBN in 2000.

In the main, the UB Guidelines expanded the range of financial activities that banks may engage in to include:

- making or managing investment on behalf of any person;
- provision of insurance services;
- establishing insurance subsidiaries; and
- capital market activities (including underwriting and issuing house activities).

In addition, the CBN permitted banks to establish subsidiaries that are not engaged in banking business.



To achieve the objective of having banks focus on their core banking business, the CBN will issue guidelines requiring banks to divest from non-banking business.

The Guidelines will define the new types of licenses and permitted activities. It will also state the modalities for transiting from the existing arrangement to the new licensing regime.

Further, the guidelines will also provide a cut-off date within which banks are to:

- "spin-off" or discontinue operations which are inconsistent with the terms of their new banking license; or
- divest from non banking subsidiaries in which they have equity ownership.

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Reviewing the Universal Banking Regime

CBN also anticipates that some Banks/Banking Group may wish to retain non-core banking business. For these, it will be a requirement to do the following:

- Evolve into a holding company model where a non-operating HoldCo holds the investments in:
 - The bank; and
 - Each non-core banking operation in a subsidiary arrangement (SubCo).
- Comply with CBN requirements for the establishment of HoldCos which will include a detailed business case for engaging in any non-core banking operation. The business case will include the corporate and risk management frameworks that should be put in place to demonstrate how depositors funds from core banking business will be ring-fenced from non-core banking business

Features of the permitted HoldCo arrangement:

- Subsidiary banks will be licensed and regulated by the CBN
- The operating subcos (non-bank subsidiaries of HoldCO) will be licensed and regulated by the relevant functional regulator
- Holdco will be licensed by the CBN as an Other Financial Institution (OFI) under BOFIA
- HoldCo will be domiciled in Nigeria

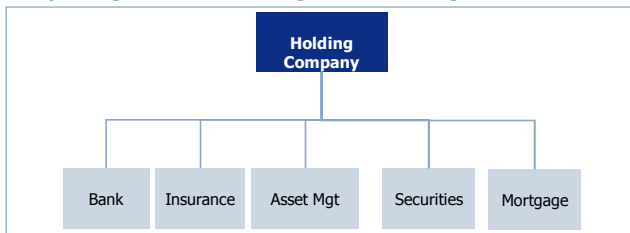


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Resultant Holding Company Structure – An example

1 Non-operating HoldCo with banking and non-banking subsidiaries



Preconditions for Adoption of HoldCo model

Adoption of the HoldCo model becomes necessary when a licensed bank:

- Owns/Decides to expand into other type(s) of banking or other financial services
- Also where a shareholder owns/controls a minimum of 20% of one bank and another financial services entity, it triggers the requirement for a HoldCo structure



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Defining the New Licensing Regime



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Mechanics for exchanging licenses

To implement the new licensing regime, the CBN will replace the existing universal banking license with a new licence which terms will be restricted to the nature of the banks specific activities.

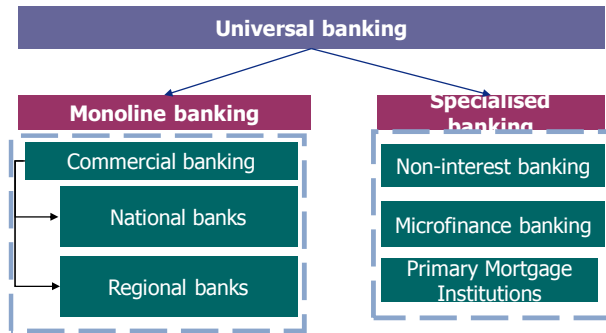


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Available Licenses

The banking licenses available to replace the current universal banking license are detailed in the chart below:



Commercial Banking

Definition: A commercial bank is any bank whose business includes the acceptance of deposits withdrawable by cheque (BOFIA 1991 as amended)

	National banks	Regional banks
Geographic scope	<ul style="list-style-type: none"> National and international 	<ul style="list-style-type: none"> Allowed to operate in a minimum of 5 and a maximum of 10 contiguous states
Other requirements		<ul style="list-style-type: none"> Regional banks must have the word "Regional" in its name
Minimum capital	<ul style="list-style-type: none"> N25 billion for banks operating in Nigeria only N100 billion for banks with operations outside Nigeria 	<ul style="list-style-type: none"> N15 billion
Key prudential requirements	<p>Capital adequacy</p> <ul style="list-style-type: none"> Minimum qualifying capital to risk weighted assets ratio of 10% <p>Regulatory lending limit</p> <ul style="list-style-type: none"> Single obligor limit: Not more than 20% of SHF 	<ul style="list-style-type: none"> Similar to national banks
Permissible activities	<ul style="list-style-type: none"> Take current, savings and term deposits Provision of finance or credit facilities Deal in foreign exchange Act as a Settlement Bank 	<ul style="list-style-type: none"> Similar to national banks except that regional banks cannot act as settlement banks



Commercial Banking (Cont'd)

	National banks	Regional banks
Permissible activities (cont'd)	<ul style="list-style-type: none"> ○ Provide treasury management services for clients and itself ○ Custodial services ○ Non-operating equity investments in non-financial firms ○ Provide financial advisory services ○ Invest in the equity of SMEs 	<ul style="list-style-type: none"> • Similar to national banks
Non-permissible activities	<ul style="list-style-type: none"> ○ Insurance underwriting ○ Loss adjusting services ○ Re-insurance services ○ Asset management ○ Broker/dealer ○ Issuing house /underwriting ○ Proprietary trading 	<ul style="list-style-type: none"> • Similar to national banks



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Primary Mortgage Institution

- **Definition**
 - **A primary mortgage institution (PMI) shall be construed as any company that is licensed to carry out mortgage business in Nigeria**
- **Geographical scope**
 - **PMIs are permitted to operate in all the states and the FCT**
- **Minimum Capital**
 - **Minimum shareholders funds of N5 billion**
- **Key Prudential and other requirements**
 - **Capital adequacy ratio: Minimum 10% against risk assets**
 - **Minimum of 50% of mortgage assets to total assets**
 - **Minimum of 60% mortgage assets to loanable funds (total deposits)**
 - **Single obligor limit of 50% of shareholders' funds unimpaired by losses**
 - **Maintenance of statutory reserves of between 10% to 20% of net profit**
 - **Maximum equity investment holding of 25% of shareholders' funds unimpaired by losses**
 - **Minimum of 75% of total mortgage assets should be for residential**



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Primary Mortgage Institution (cont'd)

- Permissible activities
 - Mortgage finance
 - Financial advisory services for mortgage customers
 - Take savings and term deposits
- Non-permissible activities
 - Demand deposits
 - Equity investment in property development
 - Estate agency/facilities management
 - Project management for a real estate development
 - Management of pension funds/ schemes



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Non-Interest Banking

- Overview
 - A non-interest bank is a bank that transacts banking business, engages in trading, investment and commercial activities as well as provide financial products and services in accordance with the principles and rules of Islamic commercial jurisprudence
 - Non-interest banking is based on the prohibition of giving or receiving interest
 - The bank shares in the profit from ventures engaged in using customer

Key features of non-interest banks

Deposits	• In form of quasi-capital
Earnings from financing	• Investment in an underlying asset for onward leasing or sale to customers
Revenue	• Generated from lease rentals or share of profits on disposal of investments
Returns	• Depositors participate in the share of profits and losses of the bank.



- Geographical scope
 - Non-interest banks are permitted to operate in all the states and the FCT
- Minimum Capital

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Non-Interest Banking (cont'd)

- Key prudential requirements
 - Minimum risk weighted asset ratio of 10%.
 - For the capital adequacy ratio, the risk weighted assets shall consist of the sum of the risk weighted asset financed by the non-interest bank's own capital and liabilities plus 50% of the risk-weighted assets financed by the non-interest bank's Profit Share Investment Accounts.

- Non-permissible activities
 - Products and services that are not Shari'ah compliant



Unbundling the Current Banking Structure



Key Transitional Steps and Timelines

The CBNs preference is for banks to focus on banking business only.

The option of unbundling the current banking structure will entail the break up of the activities of banks under the current universal banking regime into distinct and separate financial business lines for which specific licences must be obtained from the relevant regulator.

In this option, banking groups that choose to adopt the HoldCo model must demonstrate a business case for retaining any non-banking, but financial operations.

Transition Guidelines	Time Lines
Evaluation of Portfolio to decide whether to divest or restructure	1 – 3 months
1 Divestiture option	9 months
2 Transition to HoldCo Option	15 months
<hr/>	
Total Duration	12 - 18 months

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Tax and Other Regulatory Issues impacting Transition

In the migration from the current universal banking regime to a regime that focuses on core banking business, the CBN recognises that banks are likely to face certain tax and regulatory challenges that may increase the costs of the transitioning.

Some of these challenges include the possibility of multiple taxes being imposed on same income stream, re-organisation costs being treated as non-allowable deductions for tax purposes, transfer of assets between entities being subjected to VAT, CGT and stamp duties. In addition, the SEC and NSE have costs associated with granting approvals for restructuring, filing and listing, which are significant in amount.

For the benefit of groups that want to retain a HoldCo structure, the CBN is discussing with other regulators to see what forbearances/clarifications (if any) that can be obtained

For Groups that choose to divest, the CBN will be interested in the means/methodology by which divestiture is undertaken to ensure that shareholder value is not eroded or gifted away.



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HoldCo Framework and Business Rules



HoldCo Framework and Business Rules - Index

Caption	Coverage
Business Definition / Scope of Business	<ul style="list-style-type: none"> ☐ Nature and Definition of HoldCo ☐ Scope of Operations/ Permitted Investments ☐ Business Restrictions ☐ Location/ Domiciliation ☐ Holdco Revenue Streams
Regulator	<ul style="list-style-type: none"> ☐ Regulation ☐ Focus of HoldCo Regulation ☐ Restructuring/ Transactions Requiring Regulator Approval ☐ Reporting Requirements
Group Relationships	<ul style="list-style-type: none"> ☐ HoldCo Relationship with SubCo ☐ HoldCo Ownership (Limits and Criteria) ☐ SubCo Ownership ☐ Intra-group Relations/ Transactions ☐ HoldCo Corporate Governance
Operations	<ul style="list-style-type: none"> ☐ Risk Management ☐ Licensing/Authorisation ☐ Accounting Period



HoldCo Framework and Business Rules

Business Definition/Scope of Business (1/2)

	GENERAL RULES
NATURE AND DEFINITION OF HOLDCO	<ul style="list-style-type: none"> □ The Holding Company (HoldCo) shall own a bank (or banks) and may also engage in other financial services activities closely related to banking but only through non-bank subsidiaries. HoldCo would be permitted to own entities that perform banking, clearing house activities, capital market activities, insurance services or such other services permitted by the CBN. □ The HoldCo shall be an 'Other Financial Institution' (OFI) that owns at least [20%] of the share capital of at least (a) two banks; or (b) one bank and any Other Financial Institution". □ The HoldCo must own adequate voting stock in another company to exercise control (>50%) or significant influence (>20%) of that company's operations. □ HoldCos may be permitted to have intermediate holding companies (a maximum of two layers) subject to regulator approval. □ The HoldCo will be non-operating and will only be allowed to acquire, hold and administer permitted investments (defined under scope of operations/ permitted investments).
SCOPE OF OPERATIONS/ PERMITTED INVESTMENTS	<ul style="list-style-type: none"> □ The Holding Company may own, control or invest in companies involved in the following activities: <ul style="list-style-type: none"> - Banking business - Insurance agency and underwriting - Securities dealing and underwriting



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HoldCo Framework and Business Rules

Business Definition/Scope of Business (2/2)

	GENERAL RULES
SCOPE OF OPERATIONS/ PERMITTED INVESTMENTS (CONT'D)	<ul style="list-style-type: none"> - Microfinance - Pension funds - Primary mortgage institutions - Other financial services (e.g. discount houses,, financial advisory, etc)
BUSINESS RESTRICTIONS	<ul style="list-style-type: none"> □ The Holdco shall assume a non-operating status □ Its activities may include raising capital and allocating capital □ The Holdco will also be prohibited from investments in a non-financial firm. □ The CBN's approval shall be sought before the HoldCo makes an investment in any new business. □ All business activities within HoldCo shall be wholly and clearly separated.
LOCATION/ DOMICILIATION	<ul style="list-style-type: none"> □ The Holding Company will be incorporated and domiciled in Nigeria. □ Intermediate bank holding companies may be allowed subject to the approval of the CBN. □ Intermediate HoldCos may be located in offshore locations. The CBN however retains discretionary powers to reject or decline to approve the location of Intermediate HoldCo, especially if host regulator requirements in proposed Intermediate HoldCo location are not as comprehensive.



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HoldCo Framework and Business Rules Regulator (1/3)

GENERAL RULES	
HOLDCO REGULATION	<ul style="list-style-type: none"> □ The CBN will regulate and supervise HoldCos and issue detailed regulation on licensing, conduct of business and reporting obligations for HoldCos in Nigeria. □ The CBN shall also be responsible for monitoring intra-group transactions and relationships. □ There will be regulatory handshake at the HoldCo level to ensure that all relevant regulators (through the mechanism of the FSRCC) have oversight for the activities of the HoldCo. □ The above is strongly aligned to the FS 2020 vision on consolidated supervision (which is also aligned to the consolidated supervisory regime gaining adoption globally).
FOCUS OF HOLDCO REGULATION	<ul style="list-style-type: none"> □ Regulation of the holding companies shall seek to determine that HoldCos are operated in a safe and sound manner to ensure their financial condition does not threaten the viability of affiliated depository institutions. □ Consolidated supervision of the HoldCo shall cover: <ul style="list-style-type: none"> - Capital adequacy (consolidated) - Consolidated risk management - Corporate governance - Intra group transactions - Large exposures and connected lending - Liquidity mismatches/gaps - Nature and scope of permissible activities - Shareholding structures and spread - Director's appointment - Changes in management and ownership



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HoldCo Framework and Business Rules Regulator (2/3)

GENERAL RULES	
RESTRUCTURING / TRANSACTIONS REQUIRING REGULATOR APPROVAL / AWARENESS	<ul style="list-style-type: none"> □ The following structural changes/transactions will require prior CBN approval: <ul style="list-style-type: none"> - Formation of Holding Company (HoldCo). - Changes in Management and ownership structure. - Establishment/acquisition or merger of a bank subsidiary. - Acquisition of control of bank or HoldCo securities through direct or indirect ownership if the acquisition results in the control of more than five percent (5%) of the shares of the bank or HoldCo. - All investments in subsidiaries above 10% of HoldCos equity capital. - Acquisition by a HoldCo or subsidiary (other than a bank) of all or substantial assets of a bank. - Merger or consolidation of HoldCos or subsidiary companies within the HoldCo. - Transactions by a foreign banking organisation involving the acquisition of an interest in a Nigerian bank or in a HoldCo. □ The HoldCo may be compelled by the CBN to divest a subsidiary or other investments where they are at variance with prevailing regulations on subsidiary ownership.
REPORTING REQUIREMENTS	<ul style="list-style-type: none"> □ Consolidated (group) and 'HoldCo Only' financial reports. □ Corporate Governance □ Risk Management structures and risk exposures



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HoldCo Framework and Business Rules Regulator (3/3)

REPORTING REQUIREMENTS (CONT'D)

GENERAL RULES

- Detailed periodic reports covering:
 - Changes in ownership/shareholding structures
 - Top management staff and qualifications
 - Details of directors
 - Board committees
 - Intra-group transactions
 - Details of financial auditors
 - Accounting policies



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HoldCo Framework and Business Rules Group Relationships (1/4)

HOLDCO RELATIONSHIP WITH SUBCO

GENERAL RULES

- HoldCo shall have the following relationships with other entities within the group:
 - **Parent/Subsidiary:**
 - A subsidiary is a company/entity controlled by another entity (Parent). HoldCo must own more than 50% of any subsidiary company.
 - Control of another entity generally evidenced by the following:
 - Ownership : more than 50% ownership.
 - Board of Directors: Power to appoint/remove members of board of directors.
 - Voting Rights: more than 50% voting rights.
 - **Affiliates/Associates:**
 - An affiliate/associate company is an entity in which the HoldCo has significant influence.
 - Significant influence is generally evidenced by the following:
 - Voting Power: 20% or more voting rights.
 - Representation on the Board of Directors.
 - Participation in the policy making process.
- In general, parent-subsidiary relationship will exist between HoldCo and SubCo. Despite the parent-subsidiary relationship, the subsidiary companies shall exist in fact and appearance as separate and independent entities.



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HoldCo Framework and Business Rules

Group Relationships (2/4)

	GENERAL RULES
HOLDCO RELATIONSHIP WITH SUBCO (CONT'D)	<ul style="list-style-type: none"> □ The parent company by virtue of its voting control of the subsidiary company has the power to: <ul style="list-style-type: none"> – Hold the subsidiary accountable for its performance. – Select the subsidiary's directors subject to CAMA (1990) and CBN guidelines on selection of directors. This is a most important aspect of the Holding Company's control of its subsidiary companies.
HOLDCO OWNERSHIP (LIMITS AND CRITERIA)	<ul style="list-style-type: none"> □ No single shareholder shall hold more than 15% of voting shares or 20% of non-voting shares in HoldCo. □ Ownership of 5% or more shares of HoldCo shall be notified to the CBN and the owners unveiled. □ Change in control of the HoldCo shall be subject to the prior consent of the CBN.
SUBCO OWNERSHIP	<ul style="list-style-type: none"> □ No shareholder separate from the HoldCo shall hold more than 15% of voting shares or more than 20% of non-voting shares in the Bank. □ No shareholder who holds more than 10% in HoldCo shall own more than 10% in bank. □ The extant requirement that ownership of 5% or more of the shares of the bank shall be subject to the CBN's approval and full details of the beneficial owners shall be unveiled to CBN.
INTRA-GROUP RELATIONS/ TRANSACTIONS	<ul style="list-style-type: none"> □ A bank affiliate can lend a maximum of 10% of its equity capital to a single affiliate and a maximum of 20% in total to all affiliates under the holding group. □ A bank at any time must not incur any financial liability extended to any person or subsidiary of more than 20% of its shareholders funds. This rule exempts affiliates.



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HoldCo Framework and Business Rules

Group Relationships (3/4)

	GENERAL RULES
INTRA-GROUP RELATIONS/ TRANSACTIONS (CONT'D)	<ul style="list-style-type: none"> □ There are no restriction on regular transactions conducted in the course of normal business as long as the relationships are conducted at "arm's length" and on normal contractual terms. Save and except as prescribed above. Grandfathered transactions shall be an exemption to this rule but must be kept current at all times and are recommended for completion or termination within 12 months of transitioning to the HoldCo arrangement. □ HoldCo shall be obliged to disclose any service contracts and other contractual relationships with SubCos and related parties.
HOLDCO CORPORATE GOVERNANCE	<ul style="list-style-type: none"> □ Adoption of fit and proper test for selecting HoldCo Directors: <ul style="list-style-type: none"> – The HoldCo shall not appoint as CEO/Director any person who is or has at any time been adjudged bankrupt or who is or has been convicted by a court for an offence involving a fraud or dishonesty, or professional misconduct. – Any person that would have served for the maximum allowable period as stipulated by the regulator as a Director (executive or non-executive) in any SubCo, affiliate or related company shall not be eligible for appointment as director in HoldCo until after a minimum period of three (3) years after expiration of the tenure. □ Stipulate minimum number of directors (executive and non executive). □ Stipulate minimum ratio of executive and non-executive directors for the HoldCo □ Limitation on number of Directors that are employees of or affiliated with bank SubCo.



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HoldCo Framework and Business Rules Group Relationships (4/4)

HOLDCO CORPORATE GOVERNANCE (CONT'D)	GENERAL RULES
	<ul style="list-style-type: none"> ▫ Regulator to possess power to withhold approval for nomination of directors and officers and remove from office, based on test of competence and overall fitness. ▫ The HoldCo shall not have as a director any person who is a director of a bank, an affiliate company or companies which are entitled to exercise voting rights in excess of ten per cent of the total voting rights of the HoldCo. ▫ Recent CBN pronouncements of tenure of bank directors shall also apply to HoldCo directors <ul style="list-style-type: none"> ▫ The tenure of the CEO and directors of the HoldCo shall be limited to a maximum of two (2) terms of five (5) years each. ▫ The tenure limit for directors should include the pre and post combination service years of the directors. ▫ Pursuant to the above, CEO and directors of the HoldCo shall not be eligible for reappointment within the HoldCo Group until after a minimum period of three (3) years after expiration of the tenure.



HoldCo Framework and Business Rules Operations (1/1)

RISK MANAGEMENT	GENERAL RULES
	<ul style="list-style-type: none"> ▫ The HoldCo board shall establish policies on risk oversight and management for the group. ▫ Each entity within the HoldCo shall put up a risk management framework specifying policies, procedures and processes for the identification, measurement, monitoring and control of the risk inherent in its operations ▫ The HoldCo shall set up an internal control system to: <ul style="list-style-type: none"> ▫ Support the efficiency of the documentation of financial reports ▫ Enforce the compliance with applicable laws and regulations at all levels ▫ External auditors shall render annual reports to the CBN on the HoldCos risk management practices.
LICENSING AND AUTHORISATION	<ul style="list-style-type: none"> ▫ The HoldCo shall be a duly incorporated entity registered with the Corporate Affairs Commission (CAC). ▫ The HoldCo shall be licensed with the CBN as an 'Other Financial Institution' (OFI). ▫ The license to operate as a HoldCo will be required where: (a) existing Universal Banks seek to unbundle their business activities using the HoldCo structure; or (b) promoters of a company are desirous of operating either (i) at least two banks; or (ii) a bank and any Other Financial Institution".
ACCOUNTING PERIOD	<ul style="list-style-type: none"> ▫ For group reporting purposes, the entities within the HoldCo structure will be required to adopt a uniform year end and financial reporting structure for group reporting purposes.

